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CORPORATIONS - STOCKHOLDERS' SUITS - EFFECT OF *Erie Railroad v. Tompkins* ON FEDERAL EQUITY RULE 27

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CORPORATIONS — STOCKHOLDERS' SUITS — EFFECT OF *Erie Railroad v. Tompkins* ON FEDERAL EQUITY RULE 27 — Plaintiffs filed a stockholders' bill in federal equity court to enforce certain rights of Hearst Consolidated Publications, Inc., a Delaware corporation. The individual defendants, directors of the corporation, were charged with having effected a plan to sell various Hearst properties to the corporation at excessive prices. Defendants moved to strike from the bill of complaint paragraphs referring to transactions which occurred prior to the date when plaintiffs acquired their stock. The motion was based on equity rule 27.¹ The contention of counsel for plaintiffs was that rule 27 is based on the federal general law, which on this point conflicts with the local general law of both New York and Delaware; and that under *Erie Railroad v. Tompkins*,² the court should apply the local general law. In the opinion of the court, it was bound to apply rule 27, so long as the Supreme Court of the United States left the rule in force. *Held*, defendants' motion denied, not because equity rule 27 did not apply, but because its application in the particular situation would be inequitable. *Summers v. Hearst*, (D. C. N. Y. 1938) 23 F. Supp. 986.

The inferior federal courts are bound by the rules promulgated by the Supreme Court of the United States, so long as the rules remain in force.³ Equity rule 27 is based on the principles announced in *Hawes v. Oakland*.⁴ The question is whether the decision in the *Tompkins* case changes the application of equity rule 27.⁵ A recent case⁶ indicates the extension of the rule of the *Tompkins* case to cases arising in equity. On the other hand, federal power over procedure in the federal courts is left undisturbed by the *Tompkins* case.⁷ The issue is raised whether the requirement of equity rule 27 as to stock ownership

¹ Federal Equity Rules of 1912, Rule 27: "Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted against the corporation, must be verified on oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance." This was Rule 94 of the old rules, promulgated in 1882; in the New Rules of Civil Procedure for the District Courts of the United States, it is Rule 23(b). A few verbal changes have been made.

² 304 U. S. 64, 58 S. Ct. 817 (1938), noted in 36 MICH. L. REV. 1312 (1938).

³ *Rio Grande Irrigation & Colonization Co. v. Gildersleeve*, 174 U. S. 603, 19 S. Ct. 761 (1898); *Barber Asphalt Paving Co. v. Standard Asphalt & Rubber Co.*, 275 U. S. 372, 48 S. Ct. 183 (1927).

⁴ 104 U. S. 450 (1881).

⁵ In the principal case, Judge Leibel stated, 23 F. Supp. 986 at 992, "If the principles announced in *Hawes v. Oakland*, supra, had not been embodied in an equity rule promulgated by the Supreme Court, I might feel compelled in obedience to the new doctrine of *Erie Railroad Co. v. Tompkins* to follow the New York decision. . . ."

⁶ *Ruhlin v. New York Life Ins. Co.*, 304 U. S. 202, 58 S. Ct. 860 (1938), holds that a federal court sitting in equity will follow the highest state decisions on a matter which previously would have been considered a question of general law.

⁷ 47 YALE L. J. 1336 at 1351 (1938).

falls on the side of procedural law, or on the side of substantive law. There is no hard and fast distinction between that which is procedural, and that which is substantive.⁸ It has been held that the principle promulgated in rule 27 is one of substantive law.⁹ Dicta in other cases tend to show that the requirement in stockholders' suits brought in federal courts, that plaintiff shall have owned the stock at the time the transactions of which he complains occurred,¹⁰ is a basic principle of equity.¹¹ It would seem that this portion of rule 27 falls on the side of substantive law, and that the rule should be changed by the Supreme Court. State court decisions to the effect that plaintiff need not have owned his stock at the time of the transactions of which he complains should be controlling.¹² The suggestions of Judge Leibell in the instant case indicate that the first step in fulfilling a recent prediction has been made: "The *Erie* case will bring into prominence the issue of procedure versus substance and a greater number of cases will be fought out on that basis."¹³

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⁸ Cook, "Substance' and 'Procedure' in the Conflict of Laws," 42 YALE L. J. 333 (1932).

⁹ Pascual v. Del Saz Orozco, 19 Philippine 82 (1911).

¹⁰ Or that his share had devolved on him since by operation of law.

¹¹ Venner v. Great Northern Ry., 209 U. S. 24, 28 S. Ct. 328 (1907); Dimpfell v. Ohio & M. Ry., 110 U. S. 209, 3 S. Ct. 573 (1883); Taylor v. Holmes, 127 U. S. 489, 8 S. Ct. 1192 (1887).

¹² 38 L. R. A. (N. S.) 988 (1912) lists those jurisdictions whose decisions follow the federal rule, and those contra.

¹³ McCormick and Hewins, "The Collapse of 'General' Law in the Federal Courts," 33 ILL. L. REV. 126 at 137 (1938).