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# Separate Recovery in Stockholder's Derivative Suit

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two different ways.<sup>12</sup> No decision has hinted that the presence of both terms might supplement the force and effect of one of them standing alone. Thus a covenant to remove all "minable and merchantable" coal would have no greater legal significance than a covenant merely to remove all "minable" coal, or all "merchantable" coal. The operator expects to remove, and should be bound to remove under leases providing for a tonnage royalty, all coal minable at a profit (to avoid incidental argument, say profit under "normal conditions"), and use of the term minable or merchantable, or both, is but a means whereby the goal of fair and reasonable production may be better secured. Both terms qualify the operator's expected profit but can it be said that the influence of one is greater than that of the other? It is believed not.

G. S. B.

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### SEPARATE RECOVERY IN STOCKHOLDER'S DERIVATIVE SUIT

The nature of the stockholder's derivative suit has already been discussed at length in an earlier issue of the *Law Quarterly*.<sup>1</sup> The problem now arises as to whether there can properly be a separate or partial recovery in the derivative suit, and on this controversial issue the authorities are divided. On the one side, the courts are persuasive in their argument that to permit separate recovery is to defeat the rights of creditors of the corporation and to disregard the fiction of corporate entity.<sup>2</sup> "Otherwise than in name the action is by the corporation, and if relief be obtained it belongs, not to the stockholder bringing the action but to the corporation."<sup>3</sup> However, on the other side, the proponents of a separate recovery claim that there are instances where substantially all other stockholders are defendants *pari delicto* with the wrongdoers, and it would be unjust to grant a judgment for the benefit of the corporation. And similarly where the wrongdoers are still in control, circuity of action and multiplied litiga-

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<sup>12</sup> For example, *Tressler Coal Min. Co. v. Klefeld*, 24 S. E. (2d) 98, 101 (W. Va. 1943).

<sup>1</sup> Note (1938) 44 W. VA. L. Q. 129.

<sup>2</sup> *Eshleman v. Keenan*, 22 Del. Ch. 82, 187 Atl. 25 (1938); *Dawkins v. Mitchell*, 149 La. 1038, 90 So. 396 (1922); *Harris v. Pearsall*, 116 Misc. 366, 190 N. Y. Supp. 61 (1921); STEVENS, CORPORATIONS (1936) 659-660.

<sup>3</sup> 13 FLETCHER, PRIVATE CORPORATIONS (Perm. ed. 1931) § 5953.

tion would thus be avoided.<sup>4</sup> After a study of these contrary views, one is disposed to conclude that in the so-called "modern cases" the trend is to permit partial recovery under very special and exceptional circumstances.

In a recent West Virginia case, *Channis v. Laing*, the court granted a separate recovery.<sup>5</sup> The corporate wrongs in that instance amounted to a diversion or appropriation of the assets of the defendant corporation by its officers and directors, and secondly, the failure to offer to the corporation a corporate advantage, *i. e.*, the opportunity to establish a sales department. It is well settled that the first mentioned wrong is *ultra vires*.<sup>6</sup> The authority of directors and officers is normally limited to *intra vires* business and consequently directors may not bind the corporation by authorizing *ultra vires* transactions. The failure to offer to the corporation a corporate advantage is in fact a breach of the fiduciary relationship of the directors to the shareholders. The dispersion of stock ownership in the modern corporation and the effective control of corporate affairs being placed in the hands of a few strategically situated officers has led more and more to an increased amount of such directorate malfeasance. Because of this everwidening breach between ownership on one hand and control and management on the other, the extent to which corporate officials may benefit personally from their positions has become a serious legal problem.<sup>7</sup> Where the corporate property is misused by directors and such property can be traced, many authorities recommend that a trust be imposed for the benefit of the corporation.<sup>8</sup> But whether a trust or an accounting of the profits is ordered, there will in every instance be relief for the nonassenting shareholder. The policy underlying this "corporate-shareholder" remedy appears to be quite sound, the essence being to take away from directors the temptation to compete with the corporation for advantageous contracts and business opportunities. The courts speak loosely of "ratification" of the *ultra vires* acts by the majority shareholders. But it is well settled that

<sup>4</sup> *Equitable Trust Co. of Columbia v. Columbia National Bank*, 145 S. C. 91, 142 S. E. 811 (1928); *Arnim v. American Tubeworks*, 188 Mass. 515, 74 N. E. 680 (1905); *Brown v. DeYoung*, 167 Ill. 549, 47 N. E. 863 (1897); *Eaton v. Robinson*, 19 R. I. 146, 32 Atl. 339 (1895); Note (1937) 51 HARV. L. REV. 164.

<sup>5</sup> *Channis v. Laing*, 23 S. E. (2d) 628 (W. Va. 1943).

<sup>6</sup> STEVENS, CORPORATIONS 254-255; 7 FLETCHER, PRIVATE CORPORATIONS § 3401.

<sup>7</sup> Note (1936) 84 U. OF PA. L. REV. 1008.

<sup>8</sup> *Gilmore v. Gilmore Drug Co.*, 279 Pa. 193, 123 Atl. 730 (1924).

there can be no corporate ratification of such acts,<sup>9</sup> and what the majority shareholders did in the instant case was to "waive" their rights of recourse against the director-wrongdoers. It is also settled that a so-called "ratification" or "acquiescence" by a majority of the stockholders of a misappropriation of corporate funds does not bind a dissenting minority stockholder.<sup>10</sup>

The minority shareholders may require directors and other officers to account for profits made by the use of the company's assets and for any money made by a breach of trust. Setting aside the transaction and requiring that an accounting of profits be made is the common form of relief. Here the majority shareholders were active defendants or "ratifiers" and as such were not entitled to any recovery; therefore the court awarded a separate personal judgment in favor of the minority shareholder. Relief in the form of a separate dividend recovery or a constructive trust was not discussed.

The problem of the present case is not that of *Young v. Columbia Oil Co.*,<sup>11</sup> since here there is a complete corporate cause of action, nor is the issue of *Eshleman v. Keenan* apparently argued. However, the result reached in *Chauns v. Laing*<sup>12</sup> is a desirable one and adds substantially to West Virginia corporation law. Partial recovery is, in effect, an equitable short-cut and is commendable in exceptional cases where the corporation is solvent and creditors' rights will not be defeated. Legal writers have in many instances despaired of ever formulating a set of legal rules to protect the collective interests of shareholders and creditors. The alternative is the evolution of a code of ethics fostered by business men themselves. Whether such would be advisable is a debatable issue and for the present the most favorable solution is to make the best possible use of the now available legal machinery.<sup>13</sup>

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<sup>9</sup> 7 FLETCHER, CORPORATIONS § 3401; STEVENS, CORPORATIONS 608.

<sup>10</sup> 3 FLETCHER, PRIVATE CORPORATIONS § 1104; STEVENS, CORPORATIONS 274.

<sup>11</sup> *Young v. Columbia Oil Co.*, 110 W. Va. 364, 158 S. E. 678 (1931). Note (1932) 38 W. VA. L. Q. 158 (not a complete corporate cause of action, and director must offer advantage to shareholder as well as to the corporation).

<sup>12</sup> *Eshleman v. Keenan*, 22 Del. Ch. 82, 187 Atl. 25 (1938) (issue of partial recovery not apparently argued by counsel).

<sup>13</sup> Note (1936) 84 U. OF PA. L. REV. at 1017.