

# CORPORATIONS AND THE NEW FEDERAL DIVERSITY STATUTE: A DENIAL OF JUSTICE

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On July 25, 1958, Public Law 85-554 went into effect.<sup>1</sup> This statute constituted a significant revision of Title 28 United States Code, sections 1331 and 1332, the sections which confer diversity of citizenship jurisdiction upon the federal district courts. Formerly, the federal courts had jurisdiction in controversies between "citizens" of different states, or between citizens of a state and foreign citizens or countries, in any action in which the amount in controversy exceeded the sum of \$3000. A corporation had long been judicially regarded as a "citizen" of the state of its incorporation within the meaning of the

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1. 72 Stat. 415 (1958) which provides:

## AN ACT

Amending the jurisdiction of district courts in civil actions with regard to the amount in controversy and diversity of citizenship.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That section 1331 of title 28 of the United States Code is amended to read as follows:

"§ 1331. Federal question; amount in controversy; costs

"(a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of \$10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States.

"(b) Except when express provision therefor is otherwise made in a statute of the United States, where the plaintiff is finally adjudged to be entitled to recover less than the sum or value of \$10,000, computed without regard to any setoff or counterclaim to which the defendant may be adjudged to be entitled, and exclusive of interests and costs, the district court may deny costs to the plaintiff and, in addition, may impose costs on the plaintiff."

SEC. 2. That section 1332 of title 28 of the United States Code is amended to read as follows:

"§ 1332. Diversity of citizenship; amount in controversy; costs

"(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$10,000, exclusive of interest and costs, and is between—

"(1) citizens of different States;

"(2) citizens of a State, and foreign states or citizens or subjects thereof; and

"(3) citizens of different States and in which foreign states or citizens or subjects thereof are additional parties.

"(b) Except when express provision therefor is otherwise made in a statute of the United States, where the plaintiff who files the case

section,<sup>2</sup> and hence subject to the same diversity jurisdiction as private individuals.

Public Law 85-554 made two significant changes in the traditional diversity of citizenship jurisdiction of the federal courts. In the first place, it raised the jurisdictional amount from \$3000 to \$10,000,<sup>3</sup> and added as a sanction to its new minimum limit a provision allowing the district court to deny costs to a successful plaintiff who recovers less than that amount, or even to award costs to the defendant, if in its discretion, this seems to be merited.<sup>4</sup> In the second place, the statute expressly provided not only that a corporation "shall be deemed a citizen of any state by which it has been incorporated," but also a citizen "of the State where it has its principal place of business."<sup>5</sup>

The purpose of both changes is clear. They are designed to reduce the workload of the federal courts by diminishing the number of

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"(c) For the purposes of this section and section 1441 of this title, a corporation shall be deemed a citizen of any State by which it has been incorporated and of the State where it has its principal place of business.

"(d) The word 'States', as used in this section, includes the Territories, the District of Columbia, and the Commonwealth of Puerto Rico."

SEC. 3. This Act shall apply only in the case of actions commenced after the date of the enactment of this Act.

SEC. 4. The first two items in the chapter analysis of chapter 85, title 28, United States Code are amended to read as follows:

"1331. Federal question; amount in controversy; costs.

"1332. Diversity of citizenship; amount in controversy; costs."

SEC. 5. (a) Section 1445 of title 28 of the United States Code is amended by adding at the end thereof a new paragraph as follows:

"(c) A civil action in any State court arising under the workmen's compensation laws of such State may not be removed to any district court of the United States."

(b) The caption at the beginning of such section, and the reference to such section in the analysis at the beginning of chapter 89 of title 28, are amended by striking out "Carriers; nonremovable actions" and inserting in lieu thereof "Nonremovable actions".

2. *Louisville, C. & C.R.R. v. Letson*, 43 U.S. (2 How.) 497 (1844).

3. 28 U.S.C. § 1332(a), as amended by 72 Stat. 415 (1958).

4. 28 U.S.C. §§ 1331(b), 1332(b), as amended by 72 Stat. 415 (1958).

5. 28 U.S.C. § 1332(c), added by 72 Stat. 415 (1958). It is to be observed that the amendment makes it clearer than under the old statute that a corporation incorporated in more than one state is to be regarded as a citizen of each state from which it has received a charter.

cases which may be originally brought there. Further, since the changes also affect the "removal" jurisdiction<sup>6</sup> of these courts, they are likewise designed to reduce the number of cases which, commenced in state courts, may be transferred for trial to these federal courts. The legislative history of the new amendment makes these ends evident to even the firmest epistemological Missourians.<sup>7</sup>

Congress felt that such a cut in accessibility to the federal courts was necessary because of the "heavy increase"<sup>8</sup> in cases since the end of World War II. As the "Statement" of the Senate Report accompanying the bill puts it:

In the years following World War II the judicial business of the United States district courts increased tremendously. Total civil cases filed are up 75 percent and the private civil business has more than doubled in the districts having exclusively Federal jurisdiction.

Most of the increase has occurred in the diversity of citizenship cases, which have increased from 7,286 in 1941 to 20,524 in 1956. A large portion of this caseload involves corporations. Of the 20,524 diversity of citizenship cases filed in the district courts during fiscal 1956 corporations were parties in 12,732 cases, or 62 percent. This percentage is almost identical with the fiscal years 1951 and 1955.<sup>9</sup>

And, as shown by the statement of Joseph F. Spaniol, Jr., Attorney of the Division of Procedural Studies and Statistics of the Administrative Office of the United States Courts:

One of the principal aims of these proposals is to alleviate the crowded conditions in the district courts which have been prevalent for the last decade by eliminating the filing of cases which concern controversies purely local in nature, though one of the parties may be a corporation chartered in another State, and by curtailing the filing of suits involving lesser values through an increase in the jurisdictional amounts.<sup>10</sup>

As indicated by the Senate Report, Congress adopted this aim as its own. The Report states:

In adopting this legislation, the committee feels that it will bring the minimum amount in controversy up to a reasonable level by contemporary standards and that it will ease the workload of our Federal courts by reducing the number of cases involving corporations which come into Federal district courts on the fictional premise that a diversity of citizenship exists.<sup>11</sup>

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6. 28 U.S.C. § 1332, as amended by 72 Stat. 415 (1958), cross referenced to 28 U.S.C. § 1441 (1958).

7. See S. Rep. No. 1830, 85th Cong., 2d Sess. 2-4, 12-13 (1958).

8. *Id.* at 3, 12.

9. *Id.* at 2-3.

10. *Id.* at 12.

11. *Id.* at 3.

As suggested, the provision making a corporation a citizen not only of its state (or states) of incorporation but also the state in which it has its principal place of business had, as its special target, the corporation formed in one state (usually Delaware) to do business wholly in another. As the Senate Committee<sup>12</sup> pointed out, a corporation has long been regarded as a "citizen" of its state of incorporation regardless of the residence of its shareholders, directors and officers, or of the place where it actually does business. Accordingly, since the district courts have jurisdiction (where the matter in controversy exceeds the jurisdictional minimum) in all civil actions between "citizens of different states," a corporation organized in Delaware, for example, to do business only in Missouri could, if it chose, sue its significant Missouri debtors in the federal court. This privilege was denied to an otherwise identical corporation doing business in Missouri, if it were imprudent enough to have secured its charter from the latter state instead of a foreign one. The Senate Committee considered this to be "neither fair nor proper,"<sup>13</sup> and in fact an "evil,"<sup>14</sup> and the purpose of the new amendment was to "eliminate"<sup>15</sup> all such local corporations as subjects of federal diversity jurisdiction.

It is interesting to note that before passage of the statute as finally enacted, even more stringent curtailment of the jurisdiction of federal district courts was considered. Proposals were studied to raise the jurisdictional limit as high as \$15,000,<sup>16</sup> and to deny completely federal court access to all corporations.<sup>17</sup> The Committee on Jurisdiction and Venue of the Judicial Conference even examined the possibility of abolishing diversity jurisdiction altogether.<sup>18</sup>

In the view of some people, the final enactment was, therefore, not as drastic as it should have been, and at least as to one of its facets, will be of only negligible value in accomplishing the avowed end of litigation reduction which Congress intended. According to the Committee on Jurisdiction and Venue, the increase in jurisdictional minimum to \$10,000 is expected to decrease the amount of

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12. *Id.* at 4. Cf., Comment, 58 Colum. L. Rev. 1287, 1294 n. 48 (1958), stating that prior to the 1958 amendment a corporation was not a citizen at all, but that its shareholders were conclusively presumed to be citizens of the state of incorporation. The distinction seems practically unimportant.

13. Note 7 *supra*, at 4.

14. *Ibid.*

15. Note 7 *supra*, at 5.

16. *Id.* at 32.

17. *Id.* at 11-13. Fears of the unconstitutionality of such a drastically discriminatory measure as H.R. 2516, 85th Cong., 1st Sess. (1957), apparently figured in its rejection. *Id.* at 12.

18. Note 7 *supra*, at 17-20.

civil litigation by only 7.2 per cent, considering both diversity and federal question cases.<sup>19</sup> Restricting "removal" cases by the same dollar limitation will only add 2.2 per cent to that total.<sup>20</sup> Thus the total effect of the higher jurisdictional minimum will be less than a 10 per cent reduction in federal caseload.<sup>21</sup> While some may argue that "every little bit counts," a 10 per cent reduction in a caseload of over 50,000<sup>22</sup> would hardly seem significant, except for those poor litigants whose claims do not total \$10,000, and who therefore are completely denied access to federal courts. Certainly, it is of negligible value if Congress' real purpose is effectively to "ease the workload of our Federal courts."<sup>23</sup>

The result of the amendment making corporations citizens of their states of incorporation and also of the states in which they have their principal place of business looks superficially more significant. As was indicated in the Senate Report, corporations were parties in 62 per cent of the diversity cases in 1956.<sup>24</sup> Of these, almost all (57.9% of all diversity cases) involved a non-resident corporation doing business in the state. In fact, such corporations accounted for 23 per cent of all civil cases.<sup>25</sup> Manifestly, if all of these were eliminated the caseload reduction would be drastic. However, pleadings prior to the 1958 amendments did not have to show the principal place of business of a corporation to establish proper "jurisdictional facts," but only its state of incorporation.<sup>26</sup> Therefore reliable estimates of the number of "spurious" foreign corporations which will be denied access to the federal courts as a result of the new law cannot be made. The Senate Committee reported:

Figures assembled as the result of a recent survey, while showing considerable variation, indicate that from 3.6 to 23.5 percent of such cases will be eliminated.<sup>27</sup>

Mr. Spaniol of the Administrative Office feels that a "small but substantial number of cases will be affected,"<sup>28</sup> As its report indicates,

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19. *Id.* at 30.

20. *Ibid.*

21. This is a maximum figure. Based on the 1956 caseload, the combined reduction will probably only be 8%. See note 7 *supra*, at 15.

22. Note 7 *supra*, at 13-14.

23. *Id.* at 3.

24. *Id.* at 3, 13.

25. *Id.* at 14. This is hardly surprising because of service and venue requirements, and hence is no proof that "spurious" foreign corporations are particularly responsible for the federal court congestion.

26. Note 7 *supra*, at 5.

27. *Id.* at 6, and table at 14.

28. *Id.* at 14.

the Senate Committee, relying on the same figures, apparently feels that as many as 23.5 percent of all corporate diversity cases may be eliminated. The impression thus conveyed as to the possible efficacy of the new amendment in cutting down the workload of the federal courts may seem a convincing argument for the wisdom of the legislation. But careful analysis shows that it will only diminish the total number of civil cases by less than 6 percent,<sup>29</sup> *even at this most optimistic assessment of its effect.*

According to the Judicial Conference's Committee on Jurisdiction and Venue even the more radical proposal, ultimately rejected, that a corporation be considered a citizen of every state in which it does business (as opposed to only the state of its incorporation and the place where its principal business is carried on) would only reduce the overall civil caseload by 17 percent.<sup>30</sup> It would seem reasonable, therefore, to assume that the total effect of the change regarding corporations will be considerably less than the above figure of 6 percent, which is concededly a maximum.<sup>31</sup> Thus, the effect of the corporation amendment is of even less importance than that raising the jurisdictional limit, which, according to Mr. Spaniol's summary of the Judicial Conference Committee's conclusion, "would not appreciably lessen the work load on the Federal courts."<sup>32</sup>

The combined effect of both changes can therefore mean no more than a 16 per cent reduction of the total district court caseload, and will probably be considerably less than that.<sup>33</sup> One might well ques-

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29. Since such cases make up only 25% of the civil caseload, *id.* at 13, the total percentage reduction (25% x 23.5%) is 5.9.

30. Note 7 *supra*, at 20.

31. See note 29 *supra*.

32. *Id.* at 15.

33. The accuracy of this prediction seems borne out by the experience for the 1959 fiscal year (ending June 30, 1959). The percentage decrease for all districts in all civil cases filed was only 13.9. For the 86 districts having only federal jurisdiction it was only 16.8%. 1959 Director of the Administrative Office of the United States Courts Ann. Rep. 80 [hereinafter cited as 1959 Ann. Rep.]. These figures of course, reflect decreases from all causes, and not solely from the increase in jurisdictional amount and double corporate citizenship. E.g., the phenomenal decrease (48%) in Texas was due to the amendment to 28 U.S.C. § 1445 (see note 1 *supra*) restricting removal of workman's compensation cases to the federal courts. 1959 Ann. Rep. at 83. Excluding Texas, and thus giving a more accurate picture of the effect of the two changes herein criticized, the overall civil case reduction was 13.6%. *Ibid.* See also, *id.* at 88. The burden of the reduction was of course heavy on diversity cases. In the 82 districts having only federal jurisdiction (excluding the four atypical Texas districts from the total 86), the percentage decrease was 27.1. *Ibid.* It is to be observed that the Administrative Director expects the drop in the overall caseload to be only a temporary one. See *id.* at 93. This would suggest the wisdom of some more satisfactory solution than that undertaken. See also, Comment, 58 Colum. L. Rev. 1287 (1958),

tion the wisdom of the new statute solely on the practical grounds of its inappropriateness to achieve the purported end.

Apart from this, both changes are basically objectionable since they really constitute nothing but an elaborate form of "buck-passing." The volume of litigation throughout the country has increased, just as the population has, and probably for that very reason. Stripped to its bare truth, the curtailment of federal diversity jurisdiction is merely an attempt to shift the burden of that increased litigation onto the states. The amendments are designed simply as a substitute for the appointment of new judges to the federal bench. As pointed out in the Senate Report quoted above, Congress has only increased by 51 the number of federal judges since World War II.<sup>34</sup> This increase is hardly earthshaking.<sup>35</sup>

Any federal legislation which has as its motive *both* the *robbing* of the citizen (here, of his access to the federal courts), and a *refusal* to pay (here, the amount necessary to establish a sufficiently large federal judiciary) is doubly suspect. The means chosen to accomplish this already dubious end compound the felony. Concededly, the increase in jurisdictional amount may be justified on the ground that \$10,000 today is only worth what \$3000 was when that limit was enacted. But there can be no valid justification, even on Congress' own premises, for making the cut through an attack on corporations.

In the first place, even apart from the issue of "buck-passing" to the states, the small savings in judicial time from a curtailment of corporate access to the federal courts, coupled with the fact that the percentage of corporation cases has not increased in the past few

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citing the Director of the Administrative Office of the United States Courts earlier Quarterly Rep. 12 (Nov. 15, 1958), reporting a 25% decline in district court filings in August and September, 1958, but cautioning that the period may not be typical, and even if it is, projected filings in two more years will again exceed dispositions, and hence the relief from congestion afforded by the statute is only temporary.

34. Note 7 *supra*, at 3.

35. State statistics for the comparable period are not readily available. However, the 21st Ann. Rep., N.Y. Judicial Council 30 (1955), indicates that in the period from January 1, 1937 to December 31, 1954, the number of New York State judges increased by 40. When the number of judges in only *one* state (albeit the most populous) in a roughly comparable period has increased almost as much as that of the entire federal judiciary whose function is to serve 50, Congress may well be accused of failing to do its duty to an expanding nation by establishing only 51 new federal judgeships. When, in addition, the \$22,500 cost, 28 U.S.C. § 135, of each new district court judgeship created is compared with total government expenditures (during 1959) of \$150,000 *every minute*, and this relative cost is weighed against the consequences of the complete denial of justice to a number of Americans which will result from the new amendment, the conclusion is inescapable that restricting access to the federal courts is not a proper solution to the problem.

years (and actually may be diminishing) makes highly questionable any special discriminatory treatment of corporations even when they are plaintiffs actively seeking the benefits of federal jurisdiction.

Congress decided to retain diversity jurisdiction of the federal courts, presumably for the reasons given in the Report of the Committee on Jurisdiction and Venue of the Judicial Conference, which was incorporated into the Senate Report.<sup>36</sup> Although the Committee gives a number of reasons, and answers a number of objections to the continuance of the diversity jurisdiction,<sup>37</sup> its reasons boil down to one, i.e., a litigant is more apt to obtain justice in the federal courts than in many state courts. The federal procedure, the Committee feels, is superior. The more careful choice of juries, the greater power given to the judge, the lower expense to litigants, all are features of this superior federal practice. The principal concern of the Committee, however, was the avoidance of local prejudice. 'This, the original reason for diversity jurisdiction, seems clearly the main justification to the Committee for its retention. The Committee Report states:

It has been argued by those who would abolish the Federal diversity jurisdiction that in our modern highly integrated American society there no longer exists the prejudice in the courts of one State against parties who are citizens of other States, which was one of the basic reasons for the establishment of the diversity jurisdiction when the Federal courts were first created. Although, from the nature of the problem, there can be no objective evidence as to the truth of this assertion, there is a great bulk of expert opinion from those who litigate in the courts that local prejudice continues to exist, and that the Federal courts are in truth a strong protection against it.<sup>38</sup>

The Committee cites a Missouri district court decision as proof of its thesis of the necessity for, and the efficacy of, federal jurisdiction in coping with the problem of prejudice. The decision, which was against the New York Central Railroad, was reversed on appeal because of plaintiff counsel's remarks which constituted "an appeal to sectional or local prejudice."<sup>39</sup>

If the real reason for federal diversity jurisdiction is the avoidance of prejudice, as apparently Congress feels it to be, why deny it to corporations, the principal victims of prejudice? If "buck-passing" must be done, should not those excluded from federal jurisdiction be those less needful of its protection?<sup>40</sup> If, as Congress suggests, it is

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36. Note 7 *supra*, at 9.

37. *Id.* at 17-20.

38. *Id.* at 18.

39. *Ibid.*

40. For example, would not a sounder basis of exclusion from federal jurisdiction be all contract cases, since in such cases prejudice is less likely to be

the foreignness of a corporation that creates the prejudice which makes the corrective of federal jurisdiction necessary, it would seem unrealistic to assume that a jury will be less prejudiced against a foreign corporation which does a major portion of its business in a state than against one which does not. On the other hand, if, as is more likely, the cause of prejudice is merely the bigness of the corporation involved, should a corporation be protected from prejudice only in those states where it is least likely to litigate, i.e., those states other than its principal place of business? If Congress is serious in its reasons for preserving diversity jurisdiction, corporations should be singled out for special treatment, but in contradistinction to the present amendment, it should be for special favoritism, rather than discrimination. Corporations, as peculiar objects of prejudice, should, if anything, be given easier access to the federal courts than that formally provided by the old diversity statute.

Ill-advised as the new legislation thus appears (when considered from the point of view of foreign corporations themselves attempting to invoke federal jurisdiction), the new provisions become absolutely insupportable when viewed from the standpoint of an individual attempting to sue as a corporate defendant.

#### THE JURISDICTIONAL PROBLEM AND CORPORATIONS

Just as most laymen regard the Bill of Rights as a direct protection to them from all governmental encroachment, state as well as federal, so do most also regard the jurisdiction of the federal courts as nationwide. Of course, as every lawyer knows, both beliefs are erroneous. Just as the Bill of Rights is only applicable to the states so far as carried over by the fourteenth amendment, so, although Congress *could* make the jurisdiction of every district court nationwide, it has not chosen to do so, except in a few special cases. In general, the jurisdiction of a federal district court is no more extensive, in terms of ability to adjudicate over a particular defendant, than is that of the state courts of the state in which the federal court sits.<sup>41</sup> Some federal courts have even held that they are more limited in territorial sweep than local courts.<sup>42</sup>

Nonetheless, Congress has power which the states lack to allow the jurisdictional hand of federal courts to sweep beyond state

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prevalent than in the typical tort case? One businessman dealing with another, even if it be a foreign corporation, is less likely to exact local sympathy than an innocent victim of a big foreign corporation's tort.

41. See Fed. R. Civ. P. 4(f) restricting service of process, except where otherwise provided by federal statute, to the state in which the district court is located.

42. See 1 Barron & Holtzoff, Federal Practice and Procedure 740 n. 85 (1960).

boundaries. As every law student knows, a court must have jurisdiction over a defendant to render a judgment which will be binding upon him. "Tobago cannot rule the world,"<sup>43</sup> unless Tobago has the defendant somehow within its jurisdictional grasp. Probably the principal virtue of federal jurisdiction is its ability, as yet largely unexplored, to bring different defendants in widely separated parts of the country within the jurisdictional hand of a single court for decision of a single (though multi-party) controversy in one lawsuit.

If jurisdiction is the hand within which a plaintiff must be able to grasp a defendant in order to succeed with his lawsuit, service of process is the essential muscle to cause that desired manual response. Jurisdiction and service are the initial problems facing any lawyer commencing suit. They often prove the *final* problem, in both senses of the word. Federal service of process is generally as limited as that of a state court,<sup>44</sup> and federal courts are also circumscribed by monetary, "diversity," and venue requirements more stringent than those of a state court of general jurisdiction. Therefore no real means of overcoming this initial problem has been given to litigants in federal as opposed to state courts.

If Able who lives in State A desires to sue Baker who lives in State B it is probably not unfair to place the onus on him to go to State B to commence that suit. Normally, he will have to do so even if he wants to avail himself of the federal courts. Able cannot generally use his own state courts, and access to the federal courts in his own state is equally foreclosed.

Where Able desires to sue not only Baker from State B but also Charley from State C, his problems are compounded. Unless both Baker and Charley can be "found" in the same state, Able is almost certain to be unable to sue them both in one action. This would certainly be a desirable area for the intervention of federal jurisdiction. Unfortunately, Congress has declined to make it available in all but a few specialized types of cases. Able is left as remediless under federal procedure as under that of the states which are constitutionally prohibited from exercising jurisdiction over persons unless their "contacts" with the state are such as to render the exercise of that jurisdiction "reasonable."<sup>45</sup> And those contacts must be quite substantial, amounting to at least a simulated actual presence in the state before the exercise of jurisdiction does become "reasonable." Generally, therefore, a foreign corporation must be "doing business"

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43. Paraphrasing Lord Ellenborough, C. J., in *Buchanan v. Rucker*, 9 East. 192, 194, 103 Eng. Rep. 546, 547 (K.B. 1808).

44. See Note 41 *supra*.

45. See Restatement, Conflict of Laws § 74 (Tent. Draft No. 3, 1956).

in a state before *in personam* jurisdiction either state or federal may be exercised over it there.<sup>46</sup>

The plaintiff's jurisdictional problem has been alleviated to some extent in two ways, both, however, on the state level rather than through any expansion of the potentially unlimited federal jurisdiction. The jurisdictional problem was first eased by dispensing with the necessity of suing both Baker and Charley. In other words, Able was allowed to sue only one or the other in many instances in which it would ordinarily seem that both should be defendants and share liability. Clearly if Able could recover his full damage from either Baker or Charley he would not be denied justice. Even though Baker or Charley—whichever one was caught—might feel that he was unfairly treated because he had to pay the full amount of the plaintiff's claim and would often be unable to recover from the other the amount he rightly should have paid, it was apparently felt that this was a better solution to the problem than extending the jurisdictional grasp of any court, even the federal, to enmesh both defendants in the same suit. The legal devices used to accomplish this boil down to easily memorizable rules. Joint tort-feasors are not indispensable nor even conditionally necessary parties; joint obligors under a contract are only conditionally necessary parties, i.e., if one is outside the jurisdiction of the court the action may proceed for the full amount against the other alone, etc.<sup>47</sup> Thus, the jurisdictional problem is by-passed. Since Able *cannot* sue both Baker and Charley, the law will decree that in most instances he *need* not sue both.

The other means to alleviate the jurisdictional problem was the use of fictions; regarding a defendant as though he is physically present

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46. According to *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), a court may constitutionally exercise jurisdiction where there are present "such contacts of the corporation with the state of the forum as make it reasonable, in the context of our federal system of government, to require the corporation to defend the particular suit which is brought there." *Id.* at 317. The same standard is enunciated in the more recent case of *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957). An additional requirement is, of course, the likelihood of adequate notice to the defendant of the pendency of the suit. *Wuchter v. Pizzutti*, 276 U.S. 13 (1928). Even if less definite "contacts" would be constitutionally sufficient to justify the exercise of jurisdiction under this standard, the states have normally required that a corporation be "doing business" within their territory before such jurisdiction would be taken. See, e.g., *Mazzotti v. W. J. Rainey, Inc.*, 31 Del. Ch. 447, 77 A.2d 67 (1950); *Tauza v. Susquehanna Coal Co.*, 220 N.Y. 259, 115 N.E. 915 (1917). And generally, the federal courts are bound by the decisions of the states in which they sit on this matter. See 1 *Barron & Holtzoff*, *op. cit. supra* note 42, at 696 and n. 96. Additionally, for proper venue, a corporation actually must be doing business, or at least be licensed to do so, in the district of suit. 28 U.S.C. § 1391(c) (1958).

47. See Clark, *Code Pleading* 373-74, 376 (2d ed. 1947).

within a state, i.e., within its jurisdictional grasp, even when he is not. Examples, of course, are statutes making out-of-state motorists liable to suit in states they visit, for accidents occurring there;<sup>48</sup> statutes making non-resident businessmen liable to suit in states where they do business on claims arising out of that business;<sup>49</sup> and statutes subjecting domiciliaries to suit in their home states even though they presently reside elsewhere.<sup>50</sup>

For these reasons, state court procedures are normally adequate to secure justice for an injured plaintiff, if not always to all defendants. Therefore, Congress has generally been content to allow federal jurisdiction to mirror that of the state in which the federal court sits, and has not met with severe criticism for so doing.

An ordinary suit against a single corporate defendant will then not prove much more of a burden today than previously. If the plaintiff is from the same state as that in which the corporation does its principal business, access to the federal courts with whatever procedural advantages that may mean will be denied, but there will always be a state court available, often only a few blocks away. Since many states have now patterned their procedure on that of the federal rules<sup>51</sup> the difference will be insignificant. The fact that in the average case there will be no real increase in a plaintiff's burden may well have influenced Congress in its decision to make the change in the law.

Strangely enough the problem of multiple claimants has caused more difficulty than that of multiple wrongdoers. If Able and Baker, each from a different state, both have a share in a single claim against Charley from still another state, or if it is a question of who, Able or Baker, has the one claim against Charley, or even if Able is really suing on Baker's behalf, Charley deserves the assurance that if he is compelled to pay Able the full amount he will not later also have to pay Baker. Baker, too, deserves the assurance that he will be paid that to which he is entitled, no matter who has commenced the lawsuit. The requirement that suits be prosecuted in the name of the real party in interest, the provisions for interpleader, and the rule that joint obligees are indispensable parties are all merely attempts to

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48. See *Hess v. Pawloski*, 274 U.S. 352 (1927), upholding the validity of the Massachusetts statute. See also, N.Y. Vehicle & Traffic Law § 52, a typical statute.

49. See *Doherty & Co. v. Goodman*, 294 U.S. 623 (1935). See also, e.g., the New York and Massachusetts statutes, respectively, N.Y. Civ. Prac. Act § 229-b, and Mass. Gen. Laws c. 227, § 5A (1948).

50. See *Milliken v. Meyer*, 311 U.S. 457 (1940), upholding the validity of a Wyoming statute. See also, e.g., N.Y. Civ. Prac. Act § 235.

51. According to Sunderland, *Cases and Materials on Code Pleading* 16 (3d ed. 1953), Arizona, Colorado, New Jersey, New Mexico and Utah have adopted all or a large proportion of the federal rules, while Iowa, Missouri, South Dakota and Texas have incorporated many of the features of this apotheosis of code pleading.

protect Charley from this danger of having to pay twice, while assuring Baker that he will get whatever is his due even though he has not chosen to start the lawsuit himself.

Able's customary privilege of making Baker a defendant if he does not choose to become a plaintiff<sup>52</sup> is, of course, a means of protecting all the parties involved. This is in accord with the manifest demand of justice that the rights of Able, Baker and Charley, be concluded in the one lawsuit. However, it is often rendered nugatory by the jurisdictional problem. Here, Baker and Charley are both defendants again. But here, quite often, neither of the two aforementioned methods for avoiding the jurisdictional problem is available. Both Baker and Charley, each from a different state, are indispensable to the lawsuit. Ordinarily, only one is within the jurisdictional grasp of any one state. Thus, ironically, the willing plaintiff is absolutely denied justice in the state courts. This situation would seem a much more persuasive reason for the exercise of federal jurisdiction than that of possible local prejudice in a suit which could be brought in either a state or federal court.

Yet Congress has acted to correct this (as international lawyers would undoubtedly correctly characterize it) shocking "denial of justice" resulting from the "unwilling plaintiff" in only three important types of cases; liability under the Securities Exchange Act of 1934,<sup>53</sup> interpleader,<sup>54</sup> and shareholders' derivative suits.<sup>55</sup> Under special statutes the "unwilling plaintiff" can be forced to litigate even though he is outside the normal jurisdiction of the district court in which the action is brought. For example, section 16(b) of the Securities Exchange Act of 1934<sup>56</sup> which is designed to prevent short-swing profits by corporate insiders on the sale of securities, expressly authorizes an owner of securities in the corporation to commence suit "in the name of and in behalf of the issuer" if the issuing corporation refuses to bring the action itself, or fails to diligently prosecute it once brought. Section 27 allows suit in any district wherein any act or transaction constituting a violation of the statute occurred, "or in the district wherein the defendant is found or is an inhabitant or

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52. Clark, *op. cit. supra* note 47, at 358. See also, *id.* at 354.

53. Securities Exchange Act of 1934 § 27, 48 Stat. 902, 15 U.S.C. § 78aa (1958).

54. 28 U.S.C. §§ 1335, 1397, 2361 (1958).

55. 28 U.S.C. §§ 1401, 1695 (1958). There are, of course, other federal statutes which bear on a shareholder's right to bring action in behalf of his corporation which also attempt to alleviate service and venue problems. See, e.g., Investment Company Act of 1940, 54 Stat. 844, 15 U.S.C. § 80a-43 (1958), and the interpetition given to this section in *Schwartz v. Eaton*, 264 F.2d 195 (2d Cir. 1959). However, these statutes are of limited applicability.

56. 48 Stat. 896 (1934), 15 U.S.C. § 78p(b) (1958).

transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found."<sup>57</sup> Thus the unwilling plaintiff, the corporation in whose behalf the action is brought, (an indispensable party for the reasons indicated above)<sup>58</sup> can be caught in the jurisdictional sweep of the same district court which acquires jurisdiction over the real defendant, the wrongdoing insider.

Similarly, the Federal Interpleader Act<sup>59</sup> allows a stakeholder to bring an action against two or more adverse claimants (or potential claimants) for money or property valued at \$500<sup>60</sup> or more, to compel them to litigate to determine which (if any) should be paid by the nominal plaintiff.

Title 28 United States Code, section 1397 allows the action to be brought "in the judicial district in which one or more of the claimants

57. See note 53 supra. This includes the district where a stock exchange on which the securities were sold was located. *Gratz v. Claughton*, 187 F.2d 46 (2d Cir.), cert. denied, 341 U.S. 920 (1951).

58. The indispensability of the corporation would seem to follow from the general principle that the corporate beneficiary of a shareholder's action must be a party to any suit in its behalf. The matter of corporate indispensability does not seem, however, to have been passed upon in section 16(b) suits, perhaps because the ease of serving the corporate defendant has made a "test case" unnecessary.

59. 28 U.S.C. § 1335 (1958), which provides:

(a) The district courts shall have original jurisdiction of any civil action of interpleader or in the nature of interpleader filed by any person, firm, or corporation, association, or society having in his or its custody or possession money or property of the value of \$500 or more, or having issued a note, bond, certificate, policy of insurance, or other instrument of value or amount of \$500 or more, or providing for the delivery or payment or the loan of money or property of such amount or value, or being under any obligation written or unwritten to the amount of \$500 or more, if

(1) Two or more adverse claimants, of diverse citizenship as defined in section 1332 of this title, are claiming or may claim to be entitled to such money or property, or to any one or more of the benefits arising by virtue of any note, bond, certificate, policy or other instrument, or arising by virtue of any such obligation; and if (2) the plaintiff has deposited such money or property or has paid the amount of or the loan or other value of such instrument or the amount due under such obligation into the registry of the court, there to abide the judgment of the court, or has given bond payable to the clerk of the court in such amount and with such surety as the court or judge may deem proper, conditioned upon the compliance by the plaintiff with the future order or judgment of the court with respect to the subject matter of the controversy.

(b) Such an action may be entertained although the titles or claims of the conflicting claimants do not have a common origin, or are not identical, but are adverse to and independent of one another.

60. The low jurisdictional limitation on the amount in controversy, only one-twentieth of that in normal diversity cases, is to be noted.

reside," and Title 28 United States Code, section 2361 allows service of process on claimants in any district. Thus, here again Congress provides a method for solving the problem of the unwilling plaintiff.

The provisions regarding stockholders' derivative actions are also an attempt to meet the problem of the unwilling plaintiff in this special type of lawsuit. Title 28 United States Code, section 1401 allows such an action to be brought in "any judicial district where the corporation might have sued the same defendants," and Title 28 United States Code, section 1695 allows process to be served on the corporation in whose behalf the action is brought "in any district where it is organized or licensed to do business or is doing business."

All three of these statutes have been enacted with provisions to meet the plaintiff's problem in securing jurisdiction over a party who should properly be a plaintiff but does not wish to be. The Securities Exchange Act and the Interpleader Act also, incidentally, make it easier for the plaintiff at his option, to join additional parties as defendants besides the unwilling plaintiff. This added advantage is, it will be observed, not available under the provisions designed for the benefit of shareholder-plaintiffs in derivative actions.<sup>61</sup> Clearly, corporations may be involved in all three of these types of actions, and, of course, at least one will always be a party in the last. Unfortunately, at least in suits of the latter two kinds, the beneficial purpose of enabling suit despite an unwilling corporate plaintiff may be frustrated to a large extent. The reason for this unfortunate result is, of course, the very reason for the new amendment; the diversity of citizenship requirement of federal jurisdiction as that requirement has been interpreted by the courts.<sup>62</sup> Congress apparently only considered the effect of its legislation on corporations seeking the benefits of federal jurisdiction as real plaintiffs.<sup>63</sup> It failed to consider the

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61. Compare 28 U.S.C. § 1695 (1958), which only allows extraordinary service upon the corporate beneficiary, with the provisions for nationwide service on *all* defendants found in 28 U.S.C. § 2361 (1958) (as to interpleader), and 48 Stat. 896 (1934), 15 U.S.C. § 78aa (1958) (as to Securities Exchange Act violations).

62. No defendant may have the same citizenship as any plaintiff in an ordinary diversity action since the decision in *Strawbridge v. Curtiss*, 7 U.S. (3 Cranch) 267 (1806). It is to be observed that such a strict interpretation is not necessarily required of the Court's constitutional power over "all cases . . . between citizens of different States." U.S. Const. art. III, § 2. The *Strawbridge* case has, however, been uniformly adhered to for over 150 years.

63. S. Rep. No. 1830, 85th Cong., 2d Sess. 4 (1958) makes it abundantly clear that Congress really considered the problem only of a foreign corporation seeking the jurisdiction of the federal courts as a plaintiff. The Report justifies the new legislation as follows:

This fiction of stamping a corporation a citizen of the State of its incorporation has given rise to the evil whereby a local institution, engaged in a local business and in many cases locally owned, is enabled to bring its

disastrous effect which its legislation will probably have on individual plaintiffs who must make corporations parties or fail completely in the vindication of their rights.

The new amendment will not affect federal jurisdiction in Securities Exchange Act cases, since these do not require diversity of citizenship. The new amendments may, however, result in an effective denial of justice in both interpleader and derivative actions, since both of these do require diversity of citizenship. Fortunately, the diversity requirement has not been as stringently interpreted in interpleader cases by all courts as it has in other types of cases, including shareholders' actions.

Traditionally, where an action is brought under the statutory implementation of article III, section 2 of the Constitution which provides that the judicial power shall extend to all cases "between citizens of different States" the courts have required "complete diversity," i.e., that no plaintiff be a citizen of the same state as any defendant. Thus Able from State A could sue Baker from State B, and Charley from State C, but could not join Abigail from State A as a third defendant.

Fortunately, the diversity requirements in interpleader actions under Title 28 United States Code, section 1335 are not so stringent. The Supreme Court, in *Treinin v. Sunshine Mining Co.*,<sup>64</sup> has allowed a suit in just such a situation as that outlined above, even though under normal diversity rules it would be impossible, at least where the plaintiff Able is a disinterested stakeholder, i.e., the action is one denominated "strict interpleader." A more recent case from the Fifth Circuit has allowed suit in even a more radical departure from the normal diversity requirement. *Haynes v. Felder*<sup>65</sup> allowed a suit by a Texas plaintiff against five defendant claimants only one of which was from a state other than that of the plaintiff. This was allowed even though that one (a citizen of Tennessee) got whatever rights he might have had jointly with three of the Texas defendants and hence

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litigation into the Federal courts simply because it has obtained a corporate charter from another State. (See *Black and White Taxicab and Transfer Company v. Brown and Yellow Taxicab and Transfer Co.*, 276 U.S. 518, 48 S.Ct. 404, 72 L.Ed. 681 (1928). This circumstance can hardly be considered fair because it gives the privilege of a choice of courts to a local corporation simply because it has a charter from another State, an advantage which another local corporation that obtained its charter in the home State does not have. . . . It appears neither fair nor proper for such a corporation to avoid trial in the state where it has its principal place of business by resorting to a legal device not available to the individual citizen. *Ibid.*

64. 308 U.S. 66 (1939).

65. 239 F.2d 868 (5th Cir. 1957).

was not adverse to them. The court held that such "minimal diversity" was sufficient under the interpleader statute.

Thus it would seem that even if Able in the above illustration were to sue Baker, Charley and Abigail, he might join Betty also from State B (Baker's state) without defeating jurisdiction. As Moore summarizes the rule:

It has been rather definitely settled that if there is diversity of citizenship between two adverse claimants the co-citizenship of another rival claimant will not defeat jurisdiction under the Act.<sup>66</sup>

Unfortunately, the Supreme Court has not yet spoken on the subject of "minimal diversity," such as was present in the *Haynes* case. It has also not spoken on the subject of the propriety of jurisdiction where Able, rather than being a mere stakeholder, himself asserts an interest in the subject-matter of the suit, in such a situation as that in the *Haynes* case. In other words there is still doubt about whether a plaintiff may bring an action under the statute where he is both interested in the result, and not diverse from all the defendants.<sup>67</sup>

In the *Treinies* case the Supreme Court expressly reserved decision on the propriety of a suit under the statute where Able from State A was suing Baker from State B and also Betty from State B. Such a suit, however, would seem to be clearly precluded by the statute, which only allows a suit against "two or more adverse claimants, of diverse citizenship as defined in section 1332."<sup>68</sup>

If the Supreme Court supports such holdings as that in the *Haynes* case, the addition of any claimant from another state will save federal jurisdiction. Nonetheless, there will undoubtedly be an unfortunate diminution in access to federal courts as a result of the new amendment to the diversity statute. In the above situation, among others, not only will jurisdiction under the interpleader statute be precluded where Baker and Betty are both corporations incorporated under the laws of State B, but also, even if one is not a State B corporation, but merely does its principal business in that state.

Fortunately, where the new jurisdictional amount is met, suit in such a case will probably still be possible under non-statutory interpleader.<sup>69</sup> Also, fortunately, interpleader often involves a fund or res, and hence states are constitutionally competent to adjudicate the rights of all the unwilling plaintiffs to the subject of the action even

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66. 3 Moore, Federal Practice ¶ 22.09, at 3033 (2d ed. 1948).

67. *Id.* at 3029.

68. *Ibid.*

69. See Fed. R. Civ. P. 22(2); 1 Barron & Holtzoff, *op. cit. supra* note 42, § 48. The amount in controversy will, however, have to be the prohibitive \$10,000, rather than the \$500 permitted for statutory interpleader.

though not all of these parties are personally within the jurisdictional grasp of the court.<sup>70</sup> No such "out" is available in the case of stockholders' derivative suits. It is, therefore, in this area that the worst effect of the new legislation will be felt.

#### SHAREHOLDERS' DERIVATIVE SUITS AND THE NEW AMENDMENT

Shareholders' derivative actions, suits against disloyal directors and officers of a corporation to hold them accountable to the corporation for the benefits of their breach of trust, despite the fact that the corporation, naturally enough, refuses to sue, have long posed both a policy and a procedural problem. The latter at least is in part compounded by what were considered necessary concessions to the former.

Regulation of such suits is, like most legal problems, a task of balance between two possible abuses. The "strike suit," the suit brought merely to harass or more probably to be "bought off" at a healthy profit, is too despicable to be characterized as less than blackmail. On the other hand, the prospect of a shareholder whose corporation is completely at the mercy of a corrupt, self-dealing management is equally unattractive. It is no mean task to devise a law which will give adequate protection to minority shareholders while at the same time preventing the unscrupulous from commencing "strike suits."

Unfortunately, many jurisdictions seem to be more afraid of "strike suits" than of the exploited shareholder. The problems of a shareholder desiring to bring such a suit in a state court are considerable. Certain formal conditions precedent must be met—for instance, prior demand on the directors,<sup>71</sup> and sometimes the shareholders;<sup>72</sup> or excuses given for failure to observe the technicalities. Further, under statutes in many states, and even under the common law of many others, the plaintiff must have been a shareholder at the time of the

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70. See *Standard Oil Co. v. New Jersey*, 341 U.S. 428 (1951); *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950); *Pennington v. Fourth Nat'l Bank*, 243 U.S. 269 (1917); *Harris v. Balk*, 198 U.S. 215 (1905). See also *Restatement, Conflict of Laws* §§ 98, 102, 103 (Tent. Draft No. 4, 1957); *Restatement, Judgments* § 32 (1942). Compare *New York Life Ins. Co. v. Dunlevy*, 241 U.S. 518 (1916).

71. See *Hawes v. Oakland*, 104 U.S. 450 (1881); *Bartlett v. New York, N.H. & H. R.R.*, 221 Mass. 530, 109 N.E. 452 (1915); *Baker & Cary, Cases and Materials on Corporations* 619 (3d ed. 1959); *Ballantine, Corporations* 345-46 (rev. ed. 1946); *Lattin, Corporations* 352-55 (1959); *Stevens, Corporations* 800-03 (2d ed. 1949).

72. See, e.g., *Claman v. Robertson*, 164 Ohio St. 61, 128 N.E.2d 429 (1955); *Baker & Cary, op. cit. supra* note 71, at 619. The prohibitive expense to the plaintiff shareholder where such a demand on the body of shareholders is required is obvious.

alleged wrongs complained of,<sup>73</sup> or as the New York statute (and also the federal rule) puts it, his shares must "have devolved on him by operation of law" thereafter.<sup>74</sup> Needless to say, such a requirement may effectively bar not only the blackmailer, but also the good faith purchaser who discovers too late that management has been "milking" the corporation.

An even more onerous requirement is that of "security for expenses," pioneered by New York, and copied by a number of other states.<sup>75</sup> The New York statute is typical.<sup>76</sup> It provides that the plaintiff (or plaintiffs) must post "security for the reasonable expenses, including attorney's fees," which may be incurred by the corporation and *also* by the defendant directors, officers and employees of the corporation.<sup>77</sup> The plaintiffs may avoid posting this security only if they hold a total of 5% of the outstanding shares of some class of the corporation's stock, or if the value of the stock they hold is over \$50,000.

Needless to say, the likely costs of the corporation and the defendants in defending the suit will probably be quite significant.<sup>78</sup> The

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73. The leading case denying a subsequent shareholder's right to sue even in the absence of a statute is *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024 (1903). See Ballantine, *op. cit. supra* note 71, at 350-51, 352. As to statutes requiring contemporaneous ownership, see *Baker & Cary, op. cit. supra* note 71, at 632-33; Ballantine, *op. cit. supra* note 71, at 357-59; Stevens, *op. cit. supra* note 71 at 810-15.

74. Fed. R. Civ. P. 23(b); N.Y. Gen. Corp. Law § 61. For other states having similar statutes, see *Baker & Cary, op. cit. supra* note 71, at 632; Lattin, *op. cit. supra* note 71, at 356 n. 35.

75. See generally, *Baker & Cary, op. cit. supra* note 71, at 638-42; Ballantine, *op. cit. supra* note 71, at 374; Lattin, *op. cit. supra* note 71, at 384-88; Stevens, *op. cit. supra* note 71, at 810, 815-18.

76. N.Y. Gen. Corp. Law §61-b. For other such statutes, see Lattin & Jennings, *Cases and Materials on Corporations* 773 (3d ed. 1959). Such state statutes are applicable to diversity actions brought in the federal courts. *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949).

77. N.Y. Gen. Corp. Law §61-b expressly provides that security must be given "for the reasonable expenses, including attorney's fees, which may be incurred . . . by the other parties defendant . . ." for which the corporation "may become subject pursuant to section sixty-four of this chapter. . . ." N.Y. Gen. Corp. Law § 64 provides for indemnification of directors, officers and employees made defendants in such shareholders' actions, "except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such officer, director or employee is liable for negligence or misconduct in the performance of his duties." But, even though a completely successful plaintiff will thus get the security deposit back, there is no provision for gauging the size of deposit by the plaintiff's likelihood of success. This defect has been corrected in the California Act. *Cal. Corp. Code Ann. § 834 (Deering Supp. 1959)*. See Lattin, *op. cit. supra* note 71, at 885-86.

78. Thus security in the sum of \$50,000 was required under the New York statute in *Donovan v. Queensboro Corp.*, 75 F. Supp. 131 (E.D.N.Y. 1947).

expenses of defense will probably increase in direct proportion to the plaintiff's likelihood of success. Thus, it would be quite logical under such statutes to require the highest amount of security where the defendants are the most crooked.<sup>79</sup> The greatest protection is thereby offered to the greatest wrongdoers. Thus, not only "strike suits," but perhaps even more so, legitimate shareholder attempts to vindicate corporate rights against corporate wrongdoers are discouraged by being made economically impossible.

There is a further problem, which may discourage the bringing of legitimate stockholder suits even more. A serious question arises as to whether those shareholders necessary to meet the 5% or \$50,000 requirement to avoid the security posting must also meet the requirement of being shareholders at the time of the alleged wrongdoing. The issue is as yet unsettled. A New York case<sup>80</sup> has held that suit might be maintained, without security, by one plaintiff who held his stock contemporaneously with the transaction complained of where he was joined by a group of other plaintiffs and the combined shareholdings were sufficient to make up the 5% or \$50,000 necessary, even though the latter were not shareholders at the time of the alleged wrongdoing. On the other hand, in what is clearly an erroneous decision but may nonetheless be the law, a federal court has held that where a state has such a security requirement all shareholders necessary to make up the minimum required to avoid it must also have been shareholders at the time of the illegal transaction.<sup>81</sup> Thus, the possibility of shareholders' suits may be even further reduced in jurisdictions which have both conditions, and choose to make the security requirement doubly burdensome by adding the contemporaneous ownership requirement to it.

It can hardly be disputed that there are significant obstacles confronting a shareholder trying to bring a derivative action. But difficult as these are to overcome, they are minor when compared with that of securing jurisdiction over all the indispensable defendants. As usual, the problem of the "unwilling plaintiff," securing jurisdic-

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79. Compare, however, Cal. Corp. Code Ann. § 834 (Deering Supp. 1959); note 77 *supra*.

80. *Noel Associates v. Merrill*, 184 Misc. 646, 53 N.Y.S.2d 143 (Sup. Ct. 1944). See also, *Baker v. McFadden Publications*, 300 N.Y. 325, 90 N.E.2d 876 (1950). *Contra*, *Richman v. Felmus*, 3 App. Div. 2d 985, 190 N.Y.S.2d 920 (1959), criticized in 34 N.Y.U.L. Rev. 1427 (1959).

81. *Kaufman v. Wolfson*, 136 F. Supp. 939 (S.D.N.Y. 1955). The decision seems clearly incorrect in that it violates the policy of *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), which dictates that the result in the federal court must be the same as it would be in the appropriate state court. However, a later New York intermediate appellate court case agrees with the Kaufman decision. See note 80 *supra*.

tion over the corporation for whose benefit the action is brought, is the most difficult.

The case of *Dean v. Kellogg*<sup>82</sup> is typical of the jurisdictional problem facing shareholders who bring such an action in the state courts. The plaintiffs were shareholders in a Nevada corporation. They brought suit in Michigan in behalf of their corporation and a Delaware corporation against the Kellogg Company, a Delaware corporation doing business in Michigan, and two individuals, John L. Kellogg, an Illinois resident, and W. K. Kellogg of Michigan.

Needless to say, only the defendant W. K. Kellogg and the Kellogg Company, the two parties which could be found in the state of suit, were served. The Supreme Court of Michigan affirmed a dismissal of the complaint by the lower court on the ground of lack of jurisdiction over "essential parties." The court held that both the Nevada and Delaware corporations in whose behalf the suit was brought were indispensable parties, and since neither had been personally served in Michigan, even though neither could be, the suit had to be dismissed. By the time the appeal had terminated it was too late for the plaintiffs to bring the action elsewhere,<sup>83</sup> and hence the plaintiffs, and the other shareholders of the corporation were forever barred from questioning the propriety of the real defendants' conduct on the merits.

The court felt restrained by constitutional limitations from proceeding without *in personam* jurisdiction (i.e., personal service within the state), and hence rejected the plaintiffs' argument that the cause of action constituted a sufficient "res" to allow an adjudication of the corporations' rights, without having the corporations personally before the court. The court held that personal jurisdiction was necessary for two reasons, those suggested above on a more general policy level: (1) recovery must run in favor of the corporation, (2) the defendants must be protected from later suit by the corporation on the same cause of action.<sup>84</sup>

It could be argued that neither of these grounds is sufficient from a constitutional law point of view to insist upon *in personam* jurisdiction. The corporation can be protected (the first ground) by simply providing by statute that the judgment will run to the corporate beneficiary, whether or not it is a party. The defendants can be protected (the second ground) without personal service on the cor-

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82. 294 Mich. 200, 292 N.W. 704 (1940).

83. *Dean v. Kellogg*, 394 Ill. 495, 68 N.E.2d 898 (1946). As to the federal courts, see *Geer v. Mathieson Alkali Works*, 190 U.S. 428 (1903).

84. These grounds are the ones traditionally asserted for considering the beneficiary corporation an "indispensable" party, as it is almost universally held to be. See *Baker v. Cary*, op. cit. supra note 71, at 690; *Ballantine*, op. cit. supra note 71, at 366-67; *Lattin*, op. cit. supra note 71, at 359-60; *Stevens*, op. cit. supra note 71, at 803-10.

poration, by a procedure analogous to "vouching to warranty," or the notice to the title disputer in early ejectment, notifying the corporation to appear or be barred from any future action on the same cause of action.<sup>85</sup> However, such amelioration on the state level, would undoubtedly require the passage of express statutes on the subject, something which to date has not been done. The Michigan court was, therefore, correct in its conclusion that, under present law, adequate protection of all parties (symbolized by the requirement of indispensability of the unwilling corporate party) required that a suit in which the beneficiary corporations were not personally bound parties had to be dismissed. *Dean v. Kellogg*, of course, represents the prevailing view that the corporation, even though an unwilling beneficiary (plaintiff), is an indispensable party. It must be personally served before jurisdiction to decide the real issue—culpability of corporate officers and directors to the total body of shareholders—may be determined.<sup>86</sup>

As a result, just as in the *Dean* case, many shareholder suits are impossible in state courts, since often not even one of the guilty parties resides in the same state as that in which the necessary corporate parties are incorporated or do business sufficient to make them amenable to service.<sup>87</sup> Also, the greater the number of "real" defendants, and the more corporate beneficiaries, the less likely is the plaintiff to find any state court which will have adequate jurisdiction over all those who should be made parties to the suit.<sup>88</sup>

It should be noted that the problem, although less likely to be

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85. See Winer, *Jurisdiction over the Beneficiary Corporation in Stockholders' Suits*, 22 Va. L. Rev. 153 (1935); N.Y. Law Revision Comm'n Rep. 233-36 (1941); Baker & Cary, op. cit. supra note 71, at 650. See also, *Cohen v. Dana*, 287 N.Y. 405, 40 N.E.2d 227 (1942), providing a possible solution to the problem of the non-resident corporation. But see the unfortunate ultimate result, *Cohen v. Dana*, 83 N.Y.S.2d 414 (Sup. Ct. 1948), aff'd 275 App. Div. 723, 87 N.Y.S.2d 614 (1949).

86. Baker & Cary, op. cit. supra note 71, at 690; Ballantine, op. cit. supra note 71, at 366-67; Lattin, op. cit. supra 71, at 359-60; Stevens, op. cit. supra note 71, at 803-10.

87. As to the necessity of a corporation's doing business in a state before that state can exercise in personam jurisdiction over it, see note 46 supra.

88. It should also be noted that another practical difficulty, in addition to the unwilling plaintiff problem, also presents itself as a result of the jurisdictional limitations on state courts. As indicated above, all "real" defendants are not as necessary as one might offhand suppose in most lawsuits, and this is true also in shareholders' suits. E.g., in the *Dean* case the suit was not dismissed because real defendant, John L. Kellogg, was not served, since the other real defendants, The Kellogg Company and W. K. Kellogg, were. Where the wrongdoing director and the beneficiary corporation are in two different states, as in the *Dean* case, the plaintiff is stymied. However, where there are two or more wrongdoing directors, he may be equally stymied as a practical matter if only a "judgment-proof" one is in the same state as that in which the corporation may be found.

troublesome in the case of "local corporations" organized in one state to do business only in one other "foreign" state, may be present even here. The offending director, the real defendant, may still not be amenable to service in the one state where the corporation actually does business, thus making suit impossible.

Although a few states have made ingenious attempts to solve the jurisdiction problem,<sup>89</sup> the disadvantages, including cost and uncertainty of result, are enough, without considering such standard burdens as the contemporaneous share ownership and security deposit requirements, to discourage even the most hardy from bringing derivative actions.

Federal jurisdiction, therefore, by and large represents the only effective safeguard to shareholders from negligence and breach of trust on the part of corporate management. Even before the present amendments, however, a suit in the federal courts was no panacea to shareholders desirous of protecting their corporations from looting. In the first place, a shareholder is met by the contemporaneous ownership requirement of Rule 23(b) (1).<sup>90</sup> Requirements of state law, including security deposit statutes of the state of the forum, are also carried over,<sup>91</sup> and as indicated, have been interpreted in a more heavy-handed fashion than by the enacting states.<sup>92</sup>

There are then the three customary barriers to an action in the federal courts, failure to hurdle any one of which will prove fatal to the action. They are, of course, the problem of jurisdiction, in the

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89. See Baker & Cary, *op. cit. supra* note 71, at 650-51.

90. Fed. R. Civ. P. 23(b) (1) provides:

Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

The rule thus expressly requires contemporaneous ownership of stock at the time of the alleged wrongdoing (or devolution on the plaintiff by operation of law), *plus* a demand on the directors or a showing that such demand would be futile, *plus* a demand on the stockholders (or some adequate excuse) where state law requires such a demand. See 2 Barron & Holtzoff, *op. cit. supra* note 42, at § 565 and cases there cited.

91. Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949).

92. Kaufman v. Wolfson, *supra* note 81.

case of shareholders' suits the peculiar problem of "diversity jurisdiction," the problem of venue, and the problem of service of process.

In 1936 an amendment to the Judicial Code was enacted<sup>93</sup> which was designed to make the plaintiff's task easier. It combined a provision allowing the venue to be that of any district "where the corporation might have sued the same defendants," with an authorization that process might be served on the corporation "in any district where it is organized or licensed to do business or is doing business." The effect was, of course, to obviate the service problem.<sup>94</sup> Although the wrongdoing party could still be served only in the state where he was found, the corporation need not be found (i.e., incorporated in, or doing business)<sup>95</sup> in the same state. This, of course, over-

93. 49 Stat. 1213 (1936) which provided:

AN ACT

To amend section 51 of the Judicial Code of the United States (U.S.C., title 28, sec. 112).

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That section 51 of the Judicial Code (U.S.C., title 28, sec. 112) is amended to read as follows:

SEC. 51. CIVIL SUITS; WHERE TO BE BROUGHT.—Except as provided in the five succeeding sections, no person shall be arrested in one district for trial in another, in any civil action before a district court; and, except as provided in the six succeeding sections, no civil suit shall be brought in any district court against any person by an original process or proceeding in any other district than that whereof he is an inhabitant; but where the jurisdiction is founded only on the fact that the action is between citizens of different States, suit shall be brought only in the district of the residence of either the plaintiff or the defendant; except that suit by a stockholder on behalf of a corporation may be brought in any district in which suit against the defendant or defendants in said stockholders' action, other than said corporation, might have been brought by such corporation and process in such cases may be served upon such corporation in any district wherein such corporation resides or may be found.

94. Fed. R. Civ. P. 4(f) provides:

TERRITORIAL LIMITS OF EFFECTIVE SERVICE. All process other than a subpoena may be served anywhere within the territorial limits of the state in which the district court is held and, when a statute of the United States so provides, beyond the territorial limits of that state. A subpoena may be served within the territorial limits provided in Rule 45.

The law in effect prior to the promulgation of Fed. R. Civ. P. 4(f) in 1937 was no less restrictive. See 2 Moore, Federal Practice ¶ 4.42 n. 2 (2d ed. (1948)). Thus, in the normal case a defendant is no more amenable to service in a federal court than he would be in the courts of his own state. Where a corporation was not incorporated or doing business in the same state as that in which the real defendants could be served suit was, therefore, effectively foreclosed. The 1936 Amendment corrected this situation.

95. A corporation may of course be served in the state of its incorporation since even if it does not do business there, state corporation laws universally

comes the principal difficulty encountered when the action is brought in a state court. The plaintiff need only go to the district court in the district where he can get hold of the real defendant, and effective service can be made on both the real defendant and the "unwilling plaintiff," the corporation.

The problem of "complete diversity" remained, since Congress had done nothing to alter the judicially created requirement that no one on the plaintiffs' side of the suit could be a citizen of the same state as any one on the defendants' side.<sup>96</sup> Thus, Able from State A could sue Baker from State B and Charley Corporation from State C. Abigail from State A could also be a plaintiff, but if she were made a defendant the jurisdiction would be lost.

Often, of course, the corporation will be incorporated in either the same state as that of the plaintiff (or one of the plaintiffs), or that

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require either (a) the maintenance of a "registered agent" empowered to accept such service, see, e.g., Del. Code Ann. tit. 8, § 131 (1953); D.C. Code §§ 29-907, 29-907b (Supp. 1960); Md. Ann. Code art. 23, §§ 8, 96 (1957); N.C. Gen. Stat. §§ 55-13, 55-15 (Supp. 1957); Ohio Rev. Code Ann. §§ 1701.07, 1701.88 (Baldwin (1958)); Tex. Bus. Corp. Act arts. 2.09, 2.11 (1956); Va. Code Ann. §§ 13.1-9, 13-11 (1956), or (b) a state official similarly empowered to validly receive process in behalf of the corporation, see, e.g., N.Y. Stock Corp. Law §§ 24, 25 (in such states, required agents for service of process are, of course, available for service in an action commenced in the federal courts. Fed. R. Civ. P. 4(d) (3)), or (c) at least a principal office, at which the plaintiff will presumably be able to find (or at least find the whereabouts of) some corporate agent capable of accepting valid service, see, e.g., Cal. Corp. Code § 301 (Deering Supp. 1959); Mass. Ann. Laws c. 156, § 6 (1948); Pa. Stat. Ann. tit. 15, § 2852-306 (1958).

Fed. R. Civ. P. 4(d) (3) provides that service may be made:

Upon a domestic or foreign corporation or upon a partnership or other unincorporated association which is subject to suit under a common name, by delivering a copy of the summons and of the complaint to an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant.

Therefore, generally, all persons available for service in state actions are also available for service in federal cases, together with such other persons who can qualify for the rank of "managing or general agent."

96. The requirement of complete diversity entered with *Strawbridge v. Curtiss*, 7 U.S. (3 Cranch) 267 (1806), and has been uniformly adhered to since that decision. It is to be noted that this decision was not an interpretation of the Constitutional provision, U.S. Const. art. III, § 2, but rather of the federal statute in force at the time. Suggestions have been made that the Supreme Court make this fact clear. See *Ancillary Jurisdiction in Third Party Practice—Rule 14*, 51 Nw. U.L. Rev. 354 (1956). Such a clarification might pave the way for an overruling of this decision, and a consequent release of federal jurisdiction from its present strait-jacket, which manifestly is not a demand of the simple and permissive constitutional provision granting the federal courts jurisdiction in cases "between citizens of different states."

of the defendant (or one of them). If shareholder Able from State A is suing Baker from State B, in behalf of the Bubble Corporation, incorporated under the laws of State B, it thus becomes important to determine whether the Bubble Corporation, although technically a defendant (because an unwilling plaintiff), will be aligned as a defendant or a plaintiff for testing to see if diversity exists. If the Bubble Corporation is considered a defendant the suit may proceed, but, if a plaintiff, suit will be impossible.

Prior to 1957, the accepted criterion for deciding on which side of the fence a corporation belonged, was factually which side had its (or rather its management's) sympathies. If there was "antagonism" to the plaintiff, then the corporation was properly a defendant, and suit in the hypothetical posed above was proper. Like most legal words "antagonism" is a very imprecise term, and hence, until 1957, an initial trial on the issue of antagonism had to be held. Obviously, this requirement proved to be another in the Promethean pains of a complaining shareholder. After a prolonged hearing on this issue,<sup>97</sup> he might be told that the requisite antagonism did not exist (and this might be the decision even though the corporation would not itself sue), the corporation would be realigned as a plaintiff, and the plaintiff's entire efforts would have been for naught.<sup>98</sup> Even if this preliminary issue were decided in his favor, he would still be faced with a trial on the merits in which he would have to introduce much of the same evidence again, and might still ultimately lose on the final issue of liability.

In 1957, the Supreme Court decided *Smith v. Sperling*.<sup>99</sup> The suit was brought in a California district court by a New York stockholder of Warner Bros. Pictures, a Delaware corporation, against California citizens charging a wastage of the Warner Bros.' assets, for the benefit of one of the California defendants and United States Pictures, also a Delaware corporation. The district court had found after a protracted hearing that since there was no fraud on the part of the Warner directors in making the questioned contracts, but only an exercise of independent business judgment, the management was not really antagonistic to the financial interests of the corporation. It

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97. E.g., the hearing on "antagonism" in *Smith v. Sperling*, 354 U.S. 91 (1957), lasted 15 days, and the case was in the courts for over eight years solely on the issue of jurisdiction.

98. It is to be noted that state court jurisdiction even if not originally foreclosed due to the service problem, would often be impossible due to the bar of the statute of limitations after such protracted federal proceedings. See *Baker & Cary*, op. cit. supra note 71, at 643-46. See also, *Dean v. Kellogg*, 394 Ill. 495, 68 N.E.2d 898 (1946) as to this ever-present danger after any prolonged litigation on jurisdiction.

99. Note 97 supra.

therefore realigned Warner Bros. as a plaintiff. Since there was then a Delaware corporation as a plaintiff, and a Delaware corporation (United) as defendant, the suit had to be dismissed for failure of the requisite diversity.

The Supreme Court reversed, disapproving the procedure of separate trial of the issue of antagonism with its necessary and repetitious examination of the merits. It held that the issue of antagonism should be determined on the pleadings, and that sufficient antagonism is present whenever the management refuses to sue to undo a transaction, or "so solidly approves it that any demand to rescind would be futile . . . ." <sup>100</sup> The dissent argued, probably overpessimistically, that the rule laid down by the majority would greatly expand the diversity jurisdiction. <sup>101</sup> The result, however, was to make some shareholders' suits possible, where, under the strictures of state jurisdictional limitations and previous federal decisions, no forum whatsoever would have been available to vindicate corporate rights. If this is an evil it would not seem inconsistent with the obvious purpose of Congress in enacting the 1936 amendment discussed above, and a later provision <sup>102</sup> in the general venue statute <sup>103</sup> making a corporation suable in any district in which it is doing business rather than its place of incorporation only. <sup>104</sup> Both provisions must have been passed to make corporations more amenable to suit in federal courts, and, at least in the case of the 1936 amendment, in precisely this type of action. <sup>105</sup>

In any event, the relaxation of the law with regard to antagonism only helps those plaintiffs who need to have the corporation as a defendant to preserve diversity. If anything, it makes more difficult the task of the plaintiff who must, in order to succeed, have the corporation aligned as a plaintiff, since it makes more doubtful any such realignment. In short, the decision probably does nothing to disturb the earlier court of appeals decision in *Lavin v. Lavin*. <sup>106</sup> If Able from State A sues Baker from State B, in behalf of the Abigail Corporation, incorporated under the laws of State A, and Abigail Corporation

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100. Id. at 97.

101. Id. at 98 (dissenting opinion).

102. 28 U.S.C. § 1391(c) (1958).

103. 28 U.S.C. §§ 1391-406 (1958).

104. 28 U.S.C. § 1391(c) (1958) provides:

A corporation may be sued in any judicial district in which it is incorporated or licensed to do business or is doing business, and such judicial district shall be regarded as the residence of such corporation for venue purposes.

105. H.R. Rep. No. 2257, *infra* note 110.

106. 182 F.2d 870 (2d Cir. 1950). See also, 2 Barron & Holtzoff, Federal Practice and Procedure § 569 (Supp. 1959). See Annot., 18 A.L.R.2d 1022 (1951).

is treated as a defendant, the action manifestly cannot proceed, since diversity is not present. Obviously the action cannot proceed in any state court either unless both the defendant Baker and the Abigail Corporation can be "found" in one state (i.e., the Abigail Corporation must be "doing business"<sup>107</sup> in the same state as the real defendant). The plaintiff, and his corporation, therefore, may be totally without remedy unless federal jurisdiction is possible. The *Lavin* case refused to realign a New York corporation as a plaintiff in a suit by a New York shareholder against real defendants all of whom were from other states. The *Sperling* case, by holding that a corporation is properly a defendant where its directors refuse to sue the real defendants, has in effect decreed that the unwilling plaintiff corporation must always be a defendant, since if its board of directors chose to sue there would never be occasion for a shareholder's suit in the first place. Therefore, the refusal of the Second Circuit in the *Lavin* case to realign the corporation as plaintiff is reinforced by the *Sperling* decision, and thus what is gained by way of access to the federal courts in one instance is counteracted by losses through inability to bring suit in others.

The last obstacle which had to be hurdled even under the previous law, and one which has proved in some courts a greater burden than the others, has been, surprisingly enough, that of proper venue. As was stated above, there is a "special" venue provision for shareholders' suits.<sup>108</sup> In 1948, the 1936 amendment regarding stockholders' derivative actions was split into two parts.<sup>109</sup> The provision for service of process on the corporation became Title 28 United States Code, section 1695, while the venue clause became Title 28 United States Code, section 1401. Its exact wording is:

Any civil action by a stockholder on behalf of his corporation may be prosecuted in any judicial district where the corporation might have sued the same defendants.

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107. See Restatement, Conflict of Laws § 74 (Tent. Draft No. 3 1956), which requires that the defendant's relationship to the state "is such as to make the exercise of judicial jurisdiction reasonable." In a shareholder's derivative suit, since *in personam* jurisdiction over the corporation is required, this will normally mean that the corporation must be doing business in the state where service is to be made, and have some agent present there of such importance that notice is likely to reach the corporation as a result of service upon him. See *Insull v. New York World-Telegram Corp.*, 172 F. Supp. 615 (N.D. Ill.), *aff'd*, 273 F.2 166 (7th Cir. 1959); 1 *Barron & Holtzoff*, *op. cit. supra* note 42, § 179. See also note 46 *supra*.

108. Note 93 *supra*.

109. 62 Stat. 936 (1948).

Although the exact intended scope of the 1936 amendment as originally enacted is not perfectly clear,<sup>110</sup> it is certain that it was *not* intended to make matters more difficult for plaintiffs in derivative actions. Some courts have interpreted it in conformity with this

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110. H.R. Rep. No. 2257, 74th Cong., 2d Sess. 1 (1936) states:

As amended by your committee this proposed legislation relates solely to venue in that class of stockholders' suits brought under the diversity of citizenship jurisdiction of the Federal Courts wherein a stockholder of one corporation brings the suit on behalf of the corporation against another corporation incorporated in another State.

Its purpose is to plug a loophole in judicial procedure through which holding companies and parent corporations are enabled to strip a subsidiary corporation of all its assets to the loss of minority stockholders of the subsidiary corporation without possibility of being brought to account in any court, either Federal or State. Under the existing law with regard to venue, if a holding company and its subsidiary corporation are incorporated in different States, no Federal court can entertain a stockholders' suit without the consent of both corporations. The State courts are powerless in this situation because their process does not run beyond State boundaries. . . .

The right of a stockholder to sue on behalf of a corporation which refuses to bring suit in its own behalf is well recognized, and the conditions under which such a suit may be brought are prescribed by equity rule 27 of the United States Supreme Court.

In a stockholders' suit to enforce rights of the subsidiary corporation as against the parent corporation, both subsidiary and parent corporation are indispensable parties to the suit. Both corporations appear in the case as parties defendant. The presence of both corporations is essential to any judicial determination of the respective rights and liabilities, and in the absence of jurisdiction over either party the suit must be dismissed. . . .

Under section 51 of the Judicial Code, where jurisdiction is founded on diversity of citizenship, suit can be brought only in the district of the residence of either the plaintiff or defendant. A corporation within the meaning of this section is a resident of, and only of, the state of its incorporation. . . .

In the case here under discussion, if suit is to be brought at all in the Federal court, it must be brought either in the district of one of the defendants, or of the plaintiff. If either of the corporations are residents of the same state as the plaintiff, the complete diversity of citizenship requisite to Federal jurisdiction is lacking. The right of the stockholder to bring the suit in the district of which he is a resident cannot be availed of unless both corporations are nonresidents and both do business in that district.

Should suit be brought in the state in which the parent corporation is incorporated, the subsidiary corporation may procure its own dismissal from the suit on the grounds that it is being sued in a State other than that of its incorporation, such State not being the State of residence of the plaintiff, and this is true even though the corporation is regularly

beneficial purpose. For example, in *Montro Corp. v. Prindle*,<sup>111</sup> the court allowed the plaintiff, a New Jersey corporation, to bring suit in the Southern District of New York against a New York corporation in which the New Jersey corporation was a shareholder, and eight individual directors, four of whom were residents of New York, two of Connecticut, and one each of Kentucky and Indiana. To use the *dramatis personae* of previous examples, the suit is basically one by Able from State A against Baker from State B, Charley from State C, and Bubble Corporation from State B, being brought in the district court for State B.

Another federal court has not been so generous.<sup>112</sup> It has, erro-

doing business in the State in which the suit is brought. . . . The suit then fails for want of an indispensable party.

On the other hand, if the suit is brought in the State in which the subsidiary corporation is incorporated, the parent corporation is entitled to raise the objection that it is not being sued in the State of its incorporation nor in the State in which the plaintiff resides, and when such objection is necessarily sustained, the suit again fails for want of an indispensable party.

In either instance the plaintiff is denied access to any Federal court.

Under the amendment to section 51 of the Judicial Code proposed by this bill, the suit would be brought in any district in which the corporation in whose behalf the suit is brought could have itself brought the suit, and process could be served on such corporation wherever it resides or may be found. For example, if the parent corporation were incorporated in State A, the subsidiary corporation in State B, and the plaintiff a resident of State C, the suit could be brought in State A, and process served on the subsidiary corporation in State B.

The power of the Federal courts to maintain a suit cognizable under the judicial power of the United States in any district, and to insure process for service anywhere in the United States is a matter of legislative discretion, controlled by Acts of Congress based upon considerations of convenience to litigants, expense, and promotion of justice . . . . [citations omitted.]

The court in *Schoen v. Mountain Producers Corp.*, 170 F.2d 707 (3d Cir. 1948), found this legislative history to "show quite clearly" that its interpretation of the statute was correct. The court in *Montro Corp. v. Prindle*, 105 F. Supp. 460 (S.D.N.Y. 1952), disagrees.

111. 105 F. Supp. 460 (S.D.N.Y. 1952).

112. *Schoen v. Mountain Producers Corp.*, 170 F.2d 707 (3d Cir. 1948). It is interesting to note that prior to 1887 there were no venue requirements. See *Kibler v. Transcontinental Western Air Inc.*, 63 F. Supp. 724 (E.D.N.Y. 1945). In the face of such interpretations as that in the *Schoen* case it seems desirable to enact a venue statute which will make it clear that it is a venue statute and nothing more, and will also accord with the real purpose of such statutes, the convenience of all parties, including the plaintiff. In an age of modern transportation, venue rules which compel a corporation to litigate in any district of a state in which it does business, but under which an individual cannot be compelled to take a 5 minute subway ride from Brooklyn to Manhattan (Eastern

neously it is submitted, since the section is a venue not a jurisdiction provision, taken Title 28 United States Code, section 1401 to create what is called a "double diversity" requirement, and has forbidden suit in State B since both Baker and the Bubble Corporation are from the same state.<sup>113</sup> The argument preventing suit in State B uses the "special venue" statute as a sword, rather than a shareholder shield, and, in effect takes it as an additional qualification on the diversity jurisdiction. The argument runs that since the statute authorizes suit where the corporation might bring it, it forbids suit, where as here, the corporation could not bring it. Clearly, the corporation could not itself bring suit in the federal court for B, since then diversity would be lacking (real defendant Baker being a citizen of B). Hence the plaintiff Able may not do so either.

Such reasoning is as valid as arguing that we may hate our friends because we only read in the Bible that we must love our enemies.<sup>114</sup> Although Congress allows suit in any district where the corporation might bring it, it does not necessarily intend to preclude suit in a district where the corporation could not bring it because of diversity requirements. Judge Murphy in the *Montro* case<sup>115</sup> correctly suggests that the decision in *Schoen v. Mountain Producers Corp.*<sup>116</sup> is based on a confusion between the separate jurisdictional and venue requirements of federal law. Nonetheless, since the Supreme Court has not yet spoken, a shareholder in certain districts will find an insurmount-

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District of New York to Southern District), but may, for instance, have to travel 300 miles without complaint from southern to northern Utah if he is a citizen of that State, certainly seem to need overhauling.

113. 170 F.2d at 713, where the court stated:

We conclude that in the case of stockholders' derivative suits Section 51, as amended by the Act of 1936 and modified by Section 52, authorized suit to be brought (a) in the district in which the plaintiff stockholder resided, (b) in a district in the State, if any, in which all the defendants including the injured corporation resided, and also, if there was diversity of citizenship between the injured corporation and all the other defendants (c) in the district in which the injured corporation resided or (d) in a district in the State, if any, in which all the other defendants resided. It follows that the district court was right in holding that since diversity of citizenship was lacking between Mountain Producers and all the other defendants the final clause of Section 51 did not authorize the plaintiff to bring this suit in Delaware, the district of Mountain Producers' residence. [Footnotes omitted.]

114. "Cosmus, Duke of Florence, was wont to say of perfidious friends, that, 'We read that we ought to forgive our enemies; but we do not read that we ought to forgive our friends.'" Bacon, *Apothegms* No. 206.

115. 105 F. Supp. 460, 463 (S.D.N.Y. 1952).

116. 170 F.2d 707 (3d Cir. 1948).

able obstruction to bringing suit thanks to the "double diversity" venue requirement.<sup>117</sup>

There is also a serious question under the same statute, without considering the 1958 amendments, whether the venue could ever be successfully laid in the district of the plaintiff's residence if the plaintiff's corporation was not doing business, or licensed to do so, in the same district. The problem exists even if the plaintiff were fortunate enough to "catch" the real defendants in his own state, thus satisfying the requirement of service within the state despite the fact that they were all citizens of some other state.<sup>118</sup> In such a situation venue would in effect be laid under the general venue statute<sup>119</sup> rather than under the "special venue" section,<sup>120</sup> since the corporation could not sue in that district because it would not be the district of the real defendants' residence. If, as Professor Moore suggests,<sup>121</sup> service may only be had on the corporation out-of-state<sup>122</sup> where the venue is laid under section 1401, the latter section would effectively bar the suit where venue was laid in the plaintiff's district, by making it impos-

117. It is to be noted that the Schoen case was decided by the U. S. Court of Appeals for the Third Circuit. Thus the "double diversity" requirement is a binding rule in the federal courts of such important corporation states as Delaware, New Jersey and Pennsylvania.

118. If any of the real defendants were citizens of the same state as that of plaintiff's domicile, or if the corporation were incorporated in that state, lack of diversity would, of course, prevent suit. See note 96 supra.

119. 28 U.S.C. 1391 (1958) which provides:

#### VENUE GENERALLY

(a) A civil action wherein jurisdiction is founded only on diversity of citizenship may, except as otherwise provided by law, be brought only in the judicial district where all plaintiffs or all defendants reside.

(b) A civil action wherein jurisdiction is not founded solely on diversity of citizenship may be brought only in the judicial district where all defendants reside, except as otherwise provided by law.

(c) A corporation may be sued in any judicial district in which it is incorporated or licensed to do business or is doing business, and such judicial district shall be regarded as the residence of such corporation for venue purposes.

(d) An alien may be sued in any district. (June 25, 1948, ch. 646, 62 Stat. 935.)

120. 28 U.S.C. § 1401 (1958).

121. 3 Moore, Federal Practice ¶ 23.21 (2d ed. 1948).

122. See 28 U.S.C. § 1695 (1958) which provides:

#### STOCKHOLDER'S DERIVATIVE ACTION.

Process in a stockholder's action in behalf of his corporation may be served upon such corporation in any district where it is organized or licensed to do business or is doing business. (June 25, 1948, ch. 646, 62 Stat. 945.)

sible to bring in the indispensable corporate party, through making service upon it under section 1695 unavailable.

From this maze of requirements which the plaintiff had to meet even under the federal law prior to the 1958 amendment, at least one thing should be clear; there was very little hope of a shareholder's derivative suit ever reaching a trial on the merits. Unfortunately, the amendment making a corporation a citizen not only of its state of incorporation but also of the state in which it has its principal place of business can only make that dim prospect even less likely. The service hurdle has fortunately not been directly elevated by the new amendment. On the other hand, not only the jurisdictional but also the venue hurdles have been raised to an even more insurmountable height than was true under previous law.

The adverse effect on a shareholder through making the diversity requirement more onerous is obvious. To take the simplest situation, Able sues Baker in behalf of Corporation Charley. Even under the old law, suit would be impossible were Charley to be incorporated in Able's state, since Charley Corporation would be a defendant, and the courts have not shown a tendency to realign Charley as a plaintiff except where to do so would defeat rather than sustain jurisdiction. Under the new statute, jurisdiction cannot be sustained even though Charley is not incorporated in Able's state, if it nonetheless has its principal place of business in that state. The result, of course, is to throw Able back into the state courts, which, because of the service requirements of state law, will have to be Baker's state, in which Able may well be unable to secure jurisdiction over Charley Corporation. No matter how heinous his offense Baker will thus go free.

Often a shareholder's suit will involve not only the beneficiary corporation but also another corporation, the recipient of an allegedly improvident contract (as in the *Sperling* case).<sup>123</sup> In such a case, the prospects of shareholder emasculation are multiplied, since each corporation involved is "schizophrenized" into two citizens, that of its state of incorporation plus that of its principal place of business. The *Sperling* case, for example, involved a New Yorker against two Delaware citizens (the two corporations) and a citizen of California. If either one of the Delaware corporations had had its principal place of business in New York, federal jurisdiction would not have been possible. The more corporate parties, the more certain diversity is to be defeated, even assuming that the fission of a corporation into two citizens will be merely binary.

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123. 354 U.S. 91 (1957). Of course, a greater number will often be involved. See, e.g., *Schoen v. Mountain Producers Corp.*, 170 F.2d 707 (3d Cir. 1948), in which four corporations other than the beneficiary were involved.

Unfortunately, there is no assurance that such bifurcation will be merely binary. "Principal place of business" is not an inflexible term. Congress felt that adequate criteria for its resolution were available in bankruptcy precedents which rely on the same test for jurisdiction.<sup>124</sup> If anything, these cases show that the test, like all questions of fact, is hardly certain. A hotel room has been held to be a principal place of business under the latter test,<sup>125</sup> while the district from which the corporation derived its sole income has been held not to be.<sup>126</sup> There would seem to be no cogent reason why two courts could not hold two distinct states each to be the principal place of business of the same corporation, and with equal validity. Even if an appellate court were to pick only one of two or more competing places as the *real* principal place of business, by the time it did so, if suit were still jurisdictionally possible, the time limitation for bringing it might well have elapsed, or the wrongdoers have escaped to Tobago.<sup>127</sup> At the very least, of course, Congress has reinstated the necessity for the same protracted jurisdictional hearing which the Supreme Court only recently tried to eliminate in the *Sperling* case. The resultant impediment to plaintiff shareholders is manifest. Thus, germ-like, the menace to diversity multiplies itself, as a result of the new statute, and with the same insidiousness destroys shareholder rights.

As was stated above, the shareholder's race to the merits may be lost by failure to hurdle any one of the three obstacles to federal jurisdiction (even granting that he qualifies for the race by meeting the contemporaneous ownership requirements and, where applicable, security for costs requirements). Therefore, even if he is not defeated by the new jurisdictional requirement, there is still, in those courts which require "double diversity," a doubly increased bar in the form of the added venue problem. The "double diversity" requirement, it will be recalled, forbids suit against Baker and Charley in Baker's district, of which the Bubble Corporation, the unwilling plaintiff, is also a citizen, since the Bubble Corporation could not bring suit there. In other words, under this theory the requirement is "Diversity of citizenship between the corporate defendant and defendant directors,

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124. S. Rep. No. 1830, 85th Cong., 2d Sess. 5 (1958).

125. *In re Carnera*, 6 F. Supp. 267 (S.D.N.Y. 1933).

126. *Shearin v. Cortez Oil Co.*, 92 F.2d 855 (5th Cir. 1937).

127. See note 98 *supra*. It is also to be observed that under the bankruptcy law, the principal place of business test is not so important. It is basically a venue requirement, and hence the action may be transferred to the proper principal place of business. See *In re Marine Aircraft Corp.*, 118 F. Supp. 844 (S.D.N.Y. 1954), interpreting 66 Stat. 424 (1952), 11 U.S.C. § 55(b) (1958). Here, since it is jurisdictional, it may altogether defeat the plaintiff's right to bring the action.

in addition to such diversity between plaintiff shareholder and defendants . . . ."<sup>128</sup> Under the new amendment, even if the Bubble Corporation were incorporated under the laws of State D, rather than State B, in the above example, the suit could still not proceed where such double diversity is required, if the Bubble Corporation has its principal place of business in the same state as that of any one of the real defendants. For example, in a suit by Able from State A, in behalf of Bubble Corporation, incorporated under the laws of State D, but with its principal place of business in State B, suit in the federal courts of State B would be precluded if there were any real defendant from that state, while suit in State D's federal courts would be precluded if there were any real defendant from that state. And, of course, it is quite likely that at least one offending director will come from either the corporation's state of incorporation or from its principal place of business. It will also often be essential to join a corporation as one of the real defendants, as, for example, in an action where rescission of an improvident contract is sought.<sup>129</sup> Since, as indicated above, every corporation is now potentially two, each from a different state, the dangers of having one of the real defendants of the same citizenship as the beneficiary corporation are still further multiplied, with a result similar to issuance of a statutory Writ of Prohibition against bringing a shareholder suit in any federal court.

The combined effect of the new jurisdictional requirement and its bearing on the double diversity requirement is to preclude suit whenever the beneficiary corporation is incorporated in or has its principal place of business in the state of any one of the plaintiffs or defendants. Suit is further restricted if any of the real defendants are corporations, in the state in which any one of them is incorporated or has its principal place of business. Thus, the new statute provides a quaintly Malthusian geometric formula for the destruction of shareholder rights.

Of course, shareholders of corporations incorporated in more than one state will be very hard hit. So also will shareholders attempting to bring "double" or "multiple" derivative suits.<sup>130</sup> According to Barron and Holtzoff,<sup>131</sup> "A 'double derivative' action is one in which the beneficiary is in his turn a fiduciary and as such refuses to enforce the right which is his as beneficiary of the first fiduciary." A "mul-

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128. *Montro Corp. v. Prindle*, 105 F. Supp. 460, 462 (S.D.N.Y. 1952), summarizing the rule of the Schoen case which it rejects.

129. *Ward v. Deavers*, 203 F.2d 72 (D.C. Cir. 1953). See also, *Smith v. Sperling*, 354 U.S. 91 (1957). See 2 Barron & Holtzoff, *Federal Practice and Procedure* 61 (1950); 3 Moore, *Federal Practice* § 19.10 (2d ed. 1948).

130. See Lattin, *op. cit. supra* note 71, at 366-68.

131. 2 Barron & Holtzoff, *op. cit. supra* note 129, at 160.

tiple" derivative action, of course, is merely one in which there are even more fiduciary-beneficiary relationships in the chain.

In the simplest case, shareholder Able sues in behalf of his corporation, Baker, which is itself a shareholder in Charley Corporation for injuries done to Baker as a shareholder, through the wrongdoing of the individuals who manage Charley. Manifestly, if either of the corporations when bifurcated into dual citizenship, as required by the new statute, becomes a citizen of the same state as the plaintiff, the suit must be dismissed for lack of diversity. In any circuit where "double diversity" is required the same result will also follow if either of the bifurcated corporations becomes a citizen of the same state as the other, or of any of the real defendants. And, of course, the mathematical probabilities of such a result are greater with every additional corporation which becomes involved.

Since the probabilities of state jurisdiction in a case involving multi-defendants are always poor, and with multi-corporate defendants are even poorer (since they must all be "doing business" in the state to be served), the result will often be that no double, much less a multiple, derivative suit can be brought anywhere.<sup>132</sup>

Ironically, Congress, by its new legislation, has recreated the very "loophole" which it was the express purpose of the special venue and service amendment of 1936<sup>133</sup> to "plug." As the House Committee Report to the special venue and service amendment stated:

As amended by your committee this proposed legislation relates solely to venue in that class of stockholders' suits brought under the diversity of citizenship jurisdiction of the Federal courts wherein a stockholder of one corporation brings the suit on behalf of the corporation against another corporation incorporated in another state.

Its purpose is to plug a loophole in judicial procedure through which holding companies and parent corporations are enabled to strip a subsidiary corporation of all its assets to the loss of minority stockholders of the subsidiary corporation without possibility of being brought to account in any court, either Federal or State.<sup>134</sup>

For the reasons given above, the new amendment is even more likely than was the law prior to 1936 to make suit impossible in most such double and almost all multiple derivative actions. The multiplication of indispensable corporate parties, coupled with what, *even in the*

132. Provisions for change of venue are of little value, since transfer will not be ordered to a district where suit could not properly have been brought originally. 1 Barron & Holtzoff, *op. cit. supra* note 42, at 412-413.

133. This amendment is now found in 28 U.S.C. §§ 1401, 1695 (1958).

134. See note 110 *supra*.

*simplest action*, will require at least 6 different state citizenships,<sup>135</sup> will undoubtedly allow most parent corporations "to strip a subsidiary corporation of all its assets to the loss of minority shareholders of the subsidiary corporation without possibility of being brought to account in any court, either Federal or State."<sup>136</sup>

### CONCLUSION

All legislation should be a "balancing of interests"—a weighing of the advantages of a statute against its harmful effects. The new diversity legislation, when weighed in the balance, is found wanting.

Certainly, there is nothing evil about a congressional attempt to save money. Likewise, the new law is not made *per se* evil even though the motive is not that the economic burden be really reduced, but instead merely that it be shifted to the states. However, not all of that burden can be shifted. The result of the new statute will, in many instances, be to deny to many litigants access to any court, state or federal, in other words, to deny justice to a number of our citizens.

The new statute will hit hard in the one area in which state courts are particularly unable to afford redress, the problem of the unwilling, but indispensable, plaintiff. This unwilling plaintiff is often a corporation. Yet, the new legislation especially singles out corporations for discriminatory treatment. Persons attempting to bring interpleader actions will be harmed. The harm to shareholders attempting to bring derivative suits will be even greater.

The new legislation has thus cut down access to the federal courts in just those areas where a plaintiff must have federal jurisdiction. The number of persons injured may not numerically be too large. However, the injury done to each is great. A denial of justice to even one American would not seem worth the few—by budgetary comparison—dollars needed for a few extra federal judges. Even if the higher jurisdictional amount is justified by the continuing inflation, the provision making corporations citizens of two states is not. As shown above it will not primarily harm corporations, but rather those individuals who seek to make corporations defendants.

If federal diversity jurisdiction must be diminished, and realistically it need not be, it should be cut in other areas where the harm

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135. One for the plaintiff, two for each corporate beneficiary (equalling four), and a different one for each real defendant (always a different one from the plaintiff, and where double diversity is required, different from each corporate defendant's possibly dual citizenship). Thus, as is unlikely in such suits, where there is only one real defendant, and double diversity is required, the very minimum is the very unlikely six state diversity.

136. H.R. Rep. No. 2257, 74th Cong., 2d Sess. 1 (1936).

done is not so mortal. Title 28 United States Code, section 1332(c) should be repealed, or at the very least, exceptions should be made which will insure that no American is denied justice from his courts.<sup>137</sup>

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137. At least the statute should be amended to impose the dual citizenship only when the corporation is itself a plaintiff, or at the very least, an exception should be made for shareholder's suits. Even a statute which made federal jurisdiction available only where a state suit was impossible would be preferable to the present law, since it would cut down the federal workload while avoiding the complete denial of justice possible under the present statute.

# WASHINGTON UNIVERSITY LAW QUARTERLY

Member, National Conference of Law Reviews

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Volume 1960

June, 1960

Number 3

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Edited by the Undergraduates of Washington University School of Law, St. Louis.  
Published in February, April, June, and December at  
Washington University, St. Louis, Mo.

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