

Corporations—Stockholders' Vote Not to Institute Suit as a Bar to a Derivative Action Based on Alleged Violations of Antitrust Legislation.—*Rogers v. American Can Co.*¹—Rogers brings derivative suit on behalf of Metal and Thermit Corp. (hereinafter called M. and T.) against American Can Co. (holding a substantial minority stock interest in M. and T.), eight of twelve directors of M. and T., and M. and T. (named as nominal defendant) for treble damages and injunctive relief under the antitrust laws.² M. and T. is engaged in the detinning of tin plate scrap, the sale of such detinned steel scrap to steel manufacturers and the sale or use of the tin recovered in the detinning process. American Can Co. is the principal supplier of tin plate scrap to M. and T. In order to comply with Fed.R.Civ.P. 23(b),³ plaintiff engaged in a proxy battle in which the facts upon which this suit is based were submitted to the shareholders. A majority of the shareholders, exclusive of the shares owned by American Can Co. and the directors named as parties defendant, re-elected the same directors and voted not to institute the suit. Defendants moved for dismissal of the complaint and for summary judgment. HELD: The shareholders' vote will not bar the derivative suit, as it was an attempted ratification of past violations of the antitrust laws and an implied authorization of future violations.

The shareholders' power to determine whether or not to sue has long been recognized.⁴ This power is in conformity with the generally accepted view that a corporation is designed to function under "majority rule."⁵ "To permit a minority shareholder to interfere with the corporation's choice of a course of action, in the exercise of its sound discretion in view of all the peculiar circumstances, is a serious invasion of the right of majority control."⁶ The derivative action is an extraordinary remedy conceived to protect the corporation and its shareholders by permitting a shareholder to enforce a corporate cause of action on behalf of the corporation. The right to maintain a derivative suit, consequently, meets head on with the concept of "majority rule."

In determining whether the stockholders' vote would bar the derivative suit, the court distinguished past cases on the basis of whether the vote represented a "business judgment" of a majority of well informed and disinterested shareholders not to sue, or was an attempted "ratification" of an illegal act. If the vote represented a "business judgment," there would be circumstances under which the vote would bar a derivative suit, but if

¹ *Rogers v. American Can Co.*, 187 F. Supp. 532 (D.N.J. 1960).

² Clayton Act §§ 4, 7, 8, 16, 38 Stat. 730 (1914), 15 U.S.C. §§ 15, 18, 19, 26 (1958); Sherman Act §§ 1, 2, as amended, 69 Stat. 282 (1955), 15 U.S.C. §§ 1, 2 (1958).

³ Requiring exhaustion of intra-corporate remedies.

⁴ *United Copper Securities Co. v. Amalgamated Copper Co.*, 344 U.S. 261 (1950); *Hawes v. Oakland*, 104 U.S. 450 (1882).

⁵ Lattin, *Corporations* 355 (1959): "Furthermore, where the question of whether suit should or should not be brought is submitted to the shareholders for affirmation by an inquiring board and the majority shareholders decide, in good faith, that suit ought not be brought, that should end the matter."

⁶ Notes and Legislation, 53 Harv. L. Rev. 1368, 1374 (1940).

found to be an attempted "ratification," the vote would be considered a nullity, not effecting a bar to the action.⁷

This test is a concise and convenient method for obtaining a desired result. But its application brings into focus difficulties stemming from the necessary inquiry into the elusive nature of the shareholders' intent. Though the test admits of precise definition, the criteria for its application are not set forth. The difficulties arise from the failure of the negative vote to reflect whether the shareholders were motivated by an intent to "ratify" or impliedly authorize an illegal act, or to exercise "business judgment." The opinion states that "... if the vote stated specifically that the stockholders in such vote in nowise intended to ratify the past violations of the antitrust laws or to authorize such a violation in the future, but only expressed the judgment of the stockholders that it would not be the exercise of good business judgment to sue for the past damages, now that they were assured that no future violations would occur, under such circumstances the vote would not constitute a ratification of such antitrust violations."⁸ Could then, a board of directors avoid a derivative suit by merely insuring that the minutes of shareholders' meetings and literature sent to shareholders include statements to the effect that "the forthcoming vote not to sue is an exercise of business judgment and is in nowise intended to ratify the illegal act"? If so, what criteria would be employed to resolve the question presented when both motives are set forth: one shareholder requesting a vote not to sue in order to "ratify the illegal act," while another calls for the exercise of sound "business judgment"?

The opinion summarily concludes that the continuing nature of the act, coupled with re-election of the directors charged with illegal conduct demonstrates the shareholders' acquiescence in the carrying on of the allegedly unlawful conduct. This view omits from consideration a host of possible motivating factors which could also logically result in a stockholders' vote not to sue and the re-election of the directors. It has been suggested that "... unlike ratification—a common act, likely to be done with uniform inattention, often by a blanket vote or even by acquiescence—a decision not to sue would generally be the result of directed attention to the specific problem of the advisability of the suit."⁹ The determination not to enforce a corporate cause of action would undoubtedly involve other considerations.¹⁰

⁷ As a bar:

Solomont & Sons Trust v. New England Theatre Operators, 326 Mass. 99, 93 N.E.2d 241 (1950); United Copper Securities Co. v. Amalgamated Copper Co., *supra* note 4.

Not a bar:

Gottesman v. General Motors Corp., 268 F.2d 194 (2d Cir. 1959); Seigman v. Electric Vehicle Co., 72 N.J. Eq. 403, 65 Atl. 910 (1907).

⁸ *Supra* note 1, at 537.

⁹ *Supra* note 6, at 1374.

¹⁰ "On principal, we perceive no reason why the usual rule recognizing that it is for the corporation to decide questions of business policy should be subject to an exception limiting the corporate power where a charge is made against an officer or director but where an independent, disinterested majority of the stockholders acting reasonably and in good faith have voted that in their judgment it is not in the best interest of the corporation to sue. We do not believe that

"A corporation may wish to avoid the unfavorable publicity engendered by a trial involving the fraud of its officers. It may wish to retain the good will and the benefits of a generally profitable administration of the accused directors."¹¹ It is not unlikely that the shareholders considered the possible effects of such an action upon the supply of tin plate scrap received from American Can Co. The profitable history of the corporation while American Can was principal supplier of tin plate scrap must certainly have been a significant consideration, as the entire operation of M. and T. revolves around the processing of tin plate scrap. Can the concept of ratification or implied authorization be equated with the business judgment confronting a shareholder in the face of such facts?¹²

The absence of criteria to guide the application of the above test sets one in search of justification for empowering a minority shareholder to take unilateral action to bring suit contrary to the expressed wishes of a majority of shareholders. Such a right must find its source either in law or in public policy. Examination of the applicable statutes reveals the former not to be the case.¹³ The opinion suggests that public policy is a consideration preventing a negative, disinterested shareholders' vote from barring a derivative suit when the action is based solely on federal antitrust law.¹⁴ This is contrary to the *United Copper* case holding which states: "The fact that the cause of action is based on the Sherman Act does not limit . . . the power of the body of stockholders, nor does it give to the individual shareholders the right to interfere with the internal management of the corporation."¹⁵ What is the end served by the "public policy" which denies validity to a reasonable bona fide decision by a disinterested majority that more is to be gained by acquiescence than by suit?

It has been suggested that the sole end served by such a policy is the possible deterrent effect it would have on dishonest directors.¹⁶ This view, which would create among shareholders little Attorneys General, overlooks the fact that Congress has provided for inhibiting dishonest conduct by impressing upon public officials the *duty* of enforcing the antitrust laws,¹⁷

in such a case the power of effective decision shifts from a majority to a minority of the stockholders. *We know of no principal requiring that a corporation once wronged cannot exercise an honest judgment to refrain from doing that which may wrong it again.*" (Emphasis supplied.) Solomont & Sons Trust, supra note, 7, at 114, 93 N.E.2d at 249.

¹¹ 64 Harv. L. Rev. 334, 335 (1950).

¹² "The question whether it is good judgment to sue is quite apart from the question of ratification. This is a distinction of substance and not of form." Solomont & Sons, supra note 7, at 111, 93 N.E.2d at 247.

¹³ Though 15 U.S.C. §§ 16 and 26 provide that a person injured by a violation of the antitrust laws *may* sue and *shall be entitled* to maintain a suit for injunctive relief, if the violation is continuing in nature, under 15 U.S.C. §§ 4 and 9, the U.S. District Attorneys have a *duty* to institute actions for an injunction against antitrust violations.

¹⁴ Supra note 1, at 537.

¹⁵ *United Copper Securities Co. v. Amalgamated Copper Co.*, supra note 3, at 264.

¹⁶ Supra note 8, at 335. Accord, *Kessler v. Ensley Co.*, 123 Fed. 546 (N.D. Ala. 1903).

¹⁷ Supra note 10.

regardless of whether the shareholders vote to sue or not. It is beneficial to distinguish between violations of statutes and violations of the fundamental "corporate compact" or in fraud of the rights of stockholders. The need to grant minority stockholders the power unilaterally to institute suit contrary to a negative stockholders' vote would not be so great when violation of a statute is the subject of the action, as it would be when there is a breach or violation of the "corporate compact" or a fraud on the rights of stockholders. Thus, a situation where a board of directors surcharges the corporation would call for greater protection of the minority stockholder than where the directors violate a federal statute, if public policy is to be invoked in the interest of inhibiting dishonest conduct.

The court referred to *Seigman v. Electrical Vehicle Co.* as a leading case representing the concept that a negative shareholders' vote will not bar a derivative suit, adopting the view that a vote not to sue is in reality an attempted ratification of an illegal act and is therefore unlawful. However, that case can be reconciled by application of the above distinction between violations of statutes and violations of the "corporate compact" or in fraud on the stockholders' rights. There the stockholders attempted to "ratify the illegal act" by voting not to sue former directors who allegedly declared dividends out of capital assets and not surplus assets. Such action struck to the core of the corporate organization, denying the shareholders their interest guaranteed by the corporate structure. Clearly, an illegal alteration of the basic corporate structure calls for greater protection of the minority shareholder than the decision not to exercise the corporation's right to bring suit under a Federal statute.¹⁸ A derivative suit based on alleged violations of antitrust legislation need not be granted in the interest of "public policy" to inhibit dishonest conduct by directors, as statutory provisions for enforcement of those statutes serve that end.

KENNETH H. ZIMBLE

Fair Trade Laws—Requirement of Fair and Open Competition—Admission by Defendant in His Answer is Insufficient to Prove Fair and Open Competition in the Gasoline Market.—*Gulf Oil Corp. v. Mays*.¹—Gulf Oil Corporation brought a bill in equity against a gasoline retailer seeking to enjoin him from selling Gulf gasoline below the minimum price established in contracts between Gulf and other retailers pursuant to the Pennsylvania

¹⁸ "The fact that the bill calls for an inquiry into the illegality of the transaction does not overcome the obstacle that ordinarily stockholders have no standing to interfere with the management. Mere belief that the corporate action, taken or contemplated, is illegal gives the stockholder no great right to interfere than is possessed by any other citizen. Stockholders are not guardians of the public. The function of guarding the public from acts deemed illegal rests with public officials." *Ashwander v. Tenn. Valley Authority*, 297 U.S. 288, 343 (1936) (Brandeis, J.).

¹ 164 A.2d 656 (Penn. 1960).