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## Right of a Subsequent Stockholder to Redress Corporate Wrongs Consummated Prior to His Acquisition of the Stock

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### RIGHT OF A SUBSEQUENT STOCKHOLDER TO RE- DRESS CORPORATE WRONGS CONSUMMATED PRIOR TO HIS ACQUISITION OF THE STOCK

This question of rights presents a matter of very great interest and growing importance in the Federal and State courts of the United States. With the vast and increasing proportion of the active business of modern life which is done

by corporations, it is neither to be wondered at or to be regretted, that the courts of equity should be sought to settle controversies growing out of the relations between stockholders and the corporation of which they are members. That the policy of the law is not set, but is being formulated gradually by adjudications based on experience, necessity and reason, will be realized from an exhaustive search among the authorities.

There is a direct split of authorities on this question. One line of decisions follows the lead of *Pollitz v. Gould*, 202 N. Y. 11, 94 N. E. 1088, holding that "a stockholder may, in the absence of special circumstances, maintain an action on behalf of the corporation for the benefit of himself and all other stockholders, to set aside an improper transaction consummated at the expense of the corporation, although it was completed before he acquired his stock." In support are *Rafferty v. Donnelly*, 197 Pa. 423, 47 Atl. 202; *Appleton v. American Malting Co.*, 65 N. J. Eq. 375, 54 Atl. 454; *Ramsey v. Gould*, 57 Barb, 398. The special circumstances which these courts admit will defeat the subsequent stockholder's right to recover are:

(1) When the suitor is not a bona fide stockholder. *Forrest v. Manchester Ry. Co.*, 4 De G. F. & J. 126.

(2) When the suitor is guilty of acquiescence in the wrong. *Past v. Beacon Co.*, 84 Fed. 371.

(3) When the suitor is guilty of laches. *Peabody v. Flint*, 6 Allen (Mass.) 52.

(4) In cases where the transferee derives his stocks from one who would have been barred from bringing suit because of laches or acquiescence. *Venner v. A. T. & S. F. R. Co.*, 28 Fed. 581; *Frooks v. Southwestern Ry. Co.*, 1 Smale & G. 142.

The other line of decisions, though in the minority, are to be found in the Federal courts and a number of the state courts. The Federal equity rule promulgated by the U. S. Supreme Court in 1882 and numbered 94 (now 27) is in sub-

stance, "that to entitle one to attack a fraudulent transaction or wrong on the part of the corporation, it must appear that one was a stockholder at the time of the commission of the act complained of, or that his shares have devolved on him by operation of law." The court in deciding *Hawes v. Oakland*, 104 U. S. 450, one year before the Federal rule was promulgated, assumed this position, and never, in a single instance has the decision of *Hawes v. Oakland* been deviated from in the Federal court. There are numerous cases where it has been sustained. *United Electric Sec. Co. v. La. Elec. L. Co.*, 68 Fed. 673; *Church v. Citizen's Street R. Co.*, 78 Fed. 526; *Dimpfell v. Ohio M. R. Co.*, 110 U. S. 209; *Taylor v. Holmes*, 127 U. S. 489. It is argued by the proponents of *Pollitz v. Gould supra*, that the Federal rule is a matter of procedure and not of substantive law, and in *Just v. Idaho Canal Co.*, 16 Ida. 639, 102 Pac. 381, it was said: "It is a rule that has been adopted for the purpose of preventing a transfer of stock to a non-resident, in order to enable him to bring the case in the Federal court. It is a rule of practice instead of a principle of law, and is not applicable in state courts." But the Federal courts and some state courts have denied that this is a rule of procedure and have accepted the reasoning of Pardee, C. J., in *United Elec. Sec. Co. v. La. Elec. L. Co.*, *supra*, that "as a general proposition, the purchaser of stocks in a corporation is not allowed to attack the acts and management of the corporation prior to the acquisition of his stocks; otherwise we might have a case where the stock duly represented in a corporation consented to and participated in bad management and waste, and after reaping the benefits from such a transaction could easily be passed into the hands of a subsequent purchaser, who could make his harvest by appearing and contesting the very acts and conduct which his vendor had consented to." The rule must be accepted as something more than a rule of practice to prevent fraud and collusion to invoke the jurisdiction of the Federal court.

Passing from the Federal authorities sustaining this

proposition we come to the state courts which are in accord. Perhaps the leading case on this question is *Home Fire Ins. Co. v. Barber*, 67 Neb., 644, 93 N. W. 1024, which was decided in 1903 by Commissioner Pound, who is at the present time Dean of the Harvard Law School. The case is one in which the present stockholders who are maintaining an action in the name of the corporation are all subsequent purchasers, having obtained their stocks through the defendant, whom they are now suing for fraud on the corporation prior to their acquisition of the stocks. Pound, C., in holding that a present stockholder should not be allowed to sue for mismanagement prior to his purchase unless its effects are of a continuing nature and injurious to the purchaser, says of the particular case, "the present stockholders are contesting acts through which they got title to a large portion of their stocks, and acts which those through whom they derived the greater part of the remainder could not have challenged because they participated therein, and by contesting these acts which did not injure any of the present stockholders in the least, are seeking to recover back a large portion of the purchase price of the stock which was admittedly worth all they paid for it." It would appear from this case and others in accord, that the transferee of stocks acquires no greater rights by his purchase than his vendor had; *Babcock v. Farwell*, 245 Ill. 14, holding that the assignee of shares of stock in a corporation acquires no greater rights than his assignor's, as he holds by the same title and is subject to the same liabilities." Accord *McCampbell v. Railroad*, 111 Tenn. 55; *Matter of Appl'n of Syn. C & N. Y. R. R. Co.*, 91 N. Y. 1; *Graham v. Railroad Co.*, 102 U. S. 148; *Prosser v. Edmonds*, 1 Y. & C. 481; *Upton v. Basset*, *Eliz.*, 445; and *Schilling & Schneider Brewing Co. v. Schneider*, 110 Mo. 83, where the stocks devolved upon the complainant by operation of law.

As to the subsequent stockholder's right to sue when the wrong is of a continuing nature, see *Hymans v. Old Dominion Co.* 1 Me. 294, L. R. A. 1915 D 1128.

But there are a number of cases in different jurisdictions

that follow the Federal rule and are of the opinion that the transferee's inability to sue for mismanagement is not dependent entirely upon the fact that his vendor could not have sued for mismanagement because of participation in such acts, but that the transferee has received all he bargained and paid for and that it would be inequitable to allow him to set aside former transaction and thereby increase the value of his stocks. *Clark v. American Coal Co.*, 86 Iowa 436: "What he paid for and what he received was based on a portion not affected by the fraud consummated prior to his acquisition of the stock." *Alexander Trus. v. Searcy*, 81 Ga., 536-550: "The weight of authority seems to be that a person who did not own stock at the time of transaction complained of cannot complain or bring suit to have them declared illegal." Cited and approved in *Hawes v. Oakland*, *supra*, and *Dimpfell v. Ohio & Miss. R. Co.*, *supra*. To the same effect *Boldenweck v. Bullis*, 40 Colo, 253-259.

That the law on this subject is unsettled appears from the conflict of opinions and authorities and it is difficult to predict which line of cases will ultimately be accepted as authority.

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