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Constitutional Law—Right to Jury Trial—Stockholders' Right to Jury Trial of Legal Issues In Derivative Suit—*Ross v. Bernhard*

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Constitutional Law—Right to Jury Trial—Stockholders' Right to Jury Trial of Legal Issues in Derivative Suit—*Ross v. Bernhard*.¹—Petitioners, stockholders of the Lehman Corporation, brought a derivative action against the directors of the corporation and against Lehman Brothers, the corporation's brokers. The petitioners alleged that the directors of the corporation had wasted its assets through gross negligence, bad faith, and reckless disregard of their fiduciary duties. The defendant brokers were accused of controlling the corporation through an illegally large representation on its board of directors in violation of the Investment Company Act of 1940.² It was further alleged that this control had been used to obtain excessive brokerage commissions from the corporation, and that the contract between the corporation and its brokers had been breached. The petitioners sought an accounting and a judgment requiring the defendants to pay to the corporation their profits and gains and the corporation's losses resulting from the payment of the brokerage fees. Petitioners also demanded a jury trial upon the issues presented by the corporation's claim.

The district court denied defendants' motion to strike the demand for jury trial and granted an interlocutory appeal on this issue.³ The court of appeals reversed,⁴ holding that a derivative action was equitable in nature and that there was no right to a jury trial. On certiorari,⁵ the United States Supreme Court reversed and HELD: The right to a jury trial attaches to those issues in derivative actions as to which the corporation, if it had been suing in its own right, would have been entitled to a jury.⁶

The *Ross* court was faced with the threshold question of whether it was proper to characterize a derivative suit in terms of the seventh amendment's⁷ preservation of the right to jury trial in "Suits at common law, where the value in controversy shall exceed twenty dollars." This provision has been interpreted as guaranteeing the right of jury trial only as it existed at the time of the enactment of the seventh

¹ 396 U.S. 531 (1970).

² 15 U.S.C. §§ 80a-1 to -52 (1964).

³ *Ross v. Bernhard*, 275 F. Supp. 569 (S.D.N.Y. 1967).

⁴ 403 F.2d 909 (2d Cir. 1968).

⁵ 394 U.S. 917 (1969). The Court granted certiorari to resolve the conflict between the Second Circuit's opinion and the directly opposite opinion reached by the Ninth Circuit Court of Appeals in *DePinto v. Provident Security Life Ins. Co.*, 323 F.2d 826 (9th Cir. 1963), cert. denied, 376 U.S. 950 (1964). For a discussion of the Ninth Circuit opinion see Note, 49 Cornell L.Q. 665 (1964).

⁶ 396 U.S. at 533.

⁷ The seventh amendment provides:

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

U.S. Const. amend. VII.

amendment⁸ on the theory that the passage of the amendment itself "neither enlarged nor abridged the right of trial by jury."⁹ This right, as so preserved, has been recognized as one of paramount importance, any curtailment of which requires scrutiny of the highest degree.¹⁰

Application of the seventh amendment's guaranty requires examination of the nature of the action involved. The derivative suit was created by equity to enable individual stockholders to enforce the right of the corporation when those in control of the corporation refuse to act.¹¹ Historically, because of its derivative nature, this type of action was cognizable only in the equity courts and could not be maintained at law.¹² Because derivative suits have been characterized as being wholly equitable, they have been outside the protection afforded "suits at common law" by the seventh amendment.¹³ The majority in *Ross*, however, departed from this strict historical analysis and viewed the derivative action in a functional context. The majority viewed the derivative suit as being composed of two claims—the right of the petitioning stockholders to maintain the action, and the underlying corporate claim asserted by the stockholders.¹⁴ It is submitted that this functional approach is correct, and is supported by the policy underlying application of the seventh amendment. Furthermore, the functional analysis used by the majority in *Ross* is consistent with the impact of the Federal Rules of Civil Procedure upon the scope of the guaranty of jury trial.

The federal courts have consistently followed a liberal policy in the application of the seventh amendment, that is, courts have been concerned primarily with the substance of that right rather than with procedural details.¹⁵ While the enactment of the seventh amendment preserved existing rights, it was not meant to retain old forms of procedure¹⁶ nor to crystalize the development of the common law.¹⁷ *Ross* follows this basic policy by focusing upon substance rather than form in applying the amendment. The petitioners in *Ross* were procedurally required to present their claim in the form of an equitable derivative action. However, the majority looked beyond the form of the action

⁸ *Shields v. Thomas*, 59 U.S. 253, 262 (1855); 5 J. Moore, *Federal Practice* § 38.08[5], at 81-82 (2d ed. 1969).

⁹ *Fitzpatrick v. Sun Life Ins. Co. of Canada*, 1 F.R.D. 713, 716 (D.N.J. 1941).

¹⁰ *Dimick v. Schiedt*, 293 U.S. 474, 486 (1935); *Parsons v. Bedford*, 28 U.S. (3 Pet.) 433, 445-46 (1830).

¹¹ *Dodge v. Woolsey*, 59 U.S. 331 (1855); see Prunty, *The Shareholders' Derivative Suit: Notes on its Derivation*, 32 N.Y.U.L. Rev. 980 (1957).

¹² See Glenn, *The Stockholder's Suit—Corporate and Individual Grievances*, 33 *Yale L.J.* 580, 582 (1924).

¹³ *Richland v. Crandall*, 259 F. Supp. 274, 279 (S.D.N.Y. 1966).

¹⁴ 396 U.S. at 534-35.

¹⁵ *Walker v. Southern Pac. R.R.*, 165 U.S. 593, 596 (1897).

¹⁶ *Gasoline Prods. Co. v. Champlin Co.*, 283 U.S. 494, 498 (1931).

¹⁷ *Galloway v. United States*, 319 U.S. 372, 391 (1943).

and rested its holding upon the legal claim for damages which was the substance of petitioner's suit.¹⁸

While the holding in *Ross* is consistent with the general policy of the application of the seventh amendment, the specific result reached is grounded upon the effect of the Federal Rules of Civil Procedure. With the passage of the Federal Rules, the merger of law and equity became effective in the federal courts.¹⁹ Since the scope of the guaranty of the seventh amendment is in part determined by the equitable or legal nature of a claim, the removal by the Federal Rules of the distinction between legal and equitable actions bears directly upon the initial characterization of the mode of trial. However, the substantive right to trial by jury is expressly left unaffected by the federal merger of law and equity.²⁰ The effect of the Federal Rules upon the seventh amendment is therefore limited to the procedural aspects of that right. While the right itself is not enlarged or abridged by the Federal Rules, the procedural access to that right is controlled by the Rules.

The procedural impact of the merger of law and equity by Federal Rules has been demonstrated in derivative actions prior to *Ross*. In *Fleitmann v. Welsbach Co.*,²¹ a pre-Rules decision, the plaintiff stockholder brought a derivative action to recover treble damages for antitrust violations. The Supreme Court upheld dismissal of the suit, finding that the Sherman Act²² "should not be read as attempting to authorize liability to be enforced otherwise than through the verdict of a jury in a court of common law."²³ Therefore, the action in *Fleitmann* could not be maintained since it was procedurally impossible in pre-merger cases to provide for jury trial of legal issues in an equitable derivative suit.

This same issue was presented after merger in *Fanchon & Marco, Inc. v. Paramount Pictures, Inc.*²⁴ There, the derivative action was allowed, since the procedural impediments found in *Fleitmann* no longer existed "in the merged procedure of the present rules."²⁵ This new procedure permitted the assertion of a claim for treble damages in the derivative suit since

[t]he two major issues of right of the shareholder to sue and of violation of the antitrust laws causing damage to the corporation can be tried side by side or otherwise as may

¹⁸ 396 U.S. at 542.

¹⁹ Fed. R. Civ. P. 2 provides: "There shall be one form of action to be known as 'civil action'."

²⁰ The Rules Enabling Act states that these "rules shall not abridge, enlarge or modify any substantive right" of any litigant. 28 U.S.C. § 2072 (1964).

²¹ 240 U.S. 27 (1916).

²² 15 U.S.C. § 1 et seq. (1964).

²³ 240 U.S. at 29.

²⁴ 202 F.2d 731 (2d Cir. 1953).

²⁵ *Id.* at 735.

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be convenient; that one may go to the jury while the other causes no difficulty.²⁶

The majority in *Ross* also held that the principal effect of merger was that purely procedural impediments based upon the distinction between law and equity were destroyed.²⁷ However, the Federal Rules can be seen as more fundamentally affecting the application of the seventh amendment in that in some instances merger may operate to limit the scope of equitable jurisdiction.²⁸ The basis of equitable jurisdiction is the lack of an adequate remedy at law.²⁹ In the pre-merger scheme, once a court of equity had taken jurisdiction of a case, the equity court could dispose of the entire controversy even though legal remedies later became available.³⁰ The basis for this doctrine of equitable "clean up" was that subsequent legal action, necessarily in a separate suit on the law side, would be inadequate relief for the equity plaintiff because it might not result in orderly settlement of the controversy.³¹ However, under a merged system, there is no need to resort to a separate suit on the law side. The later arising legal issue would be tried to a jury as part of the single unified action. Since this would result in a fair and orderly resolution of the controversy, the initial equity plaintiff would be afforded adequate relief.

This elimination by the Federal Rules of the necessity for the "clean up" doctrine supports the majority holding in *Ross*. Even if the majority's view of the derivative suit as being one of a dual nature is rejected,³² the legal issues contained in the suit cannot be legitimately held for purely equitable disposition. Since the merged system provides an adequate legal determination of these issues in one action, there is no basis to a denial of jury trial on the grounds that the issues are contained in an historically equitable suit.

The adoption of a functional rather than an historical approach by the majority in *Ross* is further supported by recent decisions interpreting the mode of trial by jury under the Federal Rules. In *Beacon Theatres, Inc. v. Westover*,³³ the plaintiff instituted a declaratory judgment action in which the defendant raised a legal counterclaim. The Supreme Court upheld the defendant's request for a jury trial on the legal issues common to both the request for declaratory relief and the defendant's counterclaim.³⁴ In *Dairy Queen, Inc. v. Wood*,³⁵ the

²⁶ *Id.*

²⁷ 396 U.S. at 539, 540.

²⁸ *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 509 (1959).

²⁹ *Dixon v. Northwestern Nat'l Bank*, 297 F. Supp. 485, 488 (D. Minn. 1969).

³⁰ *American Life Ins. Co. v. Stewart*, 300 U.S. 203 (1937); *McGowan v. Parish*, 237 U.S. 285 (1915).

³¹ *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 507.

³² See Comment, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 *Yale L.J.* 725, 729 (1965).

³³ 359 U.S. 500 (1959).

³⁴ *Id.* at 504.

³⁵ 369 U.S. 469 (1962).

plaintiff, alleging trademark infringement, demanded an injunction against further infringement, an accounting, and judgment for damages. The Supreme Court upheld the defendant's demand for a jury trial holding that where a complaint requested both legal damages and equitable relief the legal issues are triable by jury as a matter of right.⁸⁶

The chief significance of *Beacon* and *Dairy Queen* has thus far been seen as the determination of the order of trial of legal and equitable claims. In *Ross*, however, there was no question as to the timing of the trial of separate claims. Determination of the plaintiff's right to sue would not operate to bar further determination of the issues of the defendant's liabilities. The majority in *Ross* relied on *Beacon* and *Dairy Queen* not to establish an order of trial of several claims, but to apply seventh amendment protection to the single issue of damages.⁸⁷ Moreover, as the dissent in *Ross* indicated, both *Beacon* and *Dairy Queen* involved claims which were themselves historically separate actions. The majority in *Ross* therefore extended the effect of *Beacon* and *Dairy Queen* by applying their holdings to a functional issue—the underlying corporate claim—for damages which arose in a single, historically equitable action—the derivative suit. Thus, the impact of the holding in *Ross* was to expand the application of the seventh amendment by focusing upon functional issues as the "unit of treatment"³⁸ to be used in determining the right to jury trial. While the language of the opinion still speaks in terms of the dual nature of a derivative action,³⁹ the reasoning of the holding approaches the question of right to jury trial in terms of the substantive issue of damages underlying the controversy and not the historical form of the action.

This interpretation of the right to jury trial in terms of "issues" rather than "actions" has a basis in decisions prior to *Ross*. In *Beaunit Mills, Inc. v. Eday Fabric Sales Corp.*,⁴⁰ the plaintiffs brought an action requesting a declaratory judgment and injunctive relief relative to a patent owned by the defendants. The defendants then filed a counterclaim for a judgment declaring the patent valid and infringed. The *Beaunit* court held that, although the complaint initially raised only equitable claims, a jury issue might later develop since "there are no longer equity cases and law cases, and it is the issues, not the form of case, which now determine the method of trial."⁴¹ This same type of

⁸⁶ *Id.* at 479.

⁸⁷ 396 U.S. at 542.

⁸⁸ James, *Trial by Jury and the New Federal Rules of Procedure*, 45 *Yale L.J.* 1022 (1936).

⁸⁹ 396 U.S. at 540.

⁴⁰ 124 F.2d 563 (2d Cir. 1942).

⁴¹ *Id.* at 565-66. The Supreme Court, in 1830, touched on this issue in dictum when it said:

By common law, [the framers of the seventh amendment] meant what the constitution denominated in the third article "law;" not merely suits, which the common law recognized among its old and settled proceedings, but suits in

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functional analysis has been applied to declaratory judgment actions, with the right to jury trial being accorded "common-law issues,"⁴² despite the fact that the form of the action was itself historically equitable.⁴³ Perhaps the strongest indication of this gradual development of a functional application of the seventh amendment is found in *Dairy Queen*, wherein the Court stated that in determining the right to jury trial, "[t]here being no question of the timeliness or correctness of the demand involved here, the sole question which we must decide is whether the action now pending before the District Court contains legal issues."⁴⁴

As has been mentioned,⁴⁵ this re-evaluation of the right to jury trial is consistent with the general policy of the liberal interpretation of the seventh amendment. The adoption of this functional approach would also be consistent with the policies of the Federal Rules themselves. The Rules emphasize simplification of pleading.⁴⁶ Particularly with respect to the right to jury trial, consideration should be focused upon the fundamental issues in dispute and "cannot be made to depend upon the choice of words used in the pleadings."⁴⁷ The functional analysis of the issues presented in a controversy rather than analysis of the historical method of presentation of the controversy follows this federal policy of simplification.

The Federal Rules also adopt the policy of attempting to settle all the claims arising between two litigants in one action.⁴⁸ Clearly, a rule providing for permissive joinder of claims⁴⁹ cannot be expected to function properly if litigants face the possibility of losing their right to jury trial as to issues raised in an historically equitable form of action. By focusing upon the issues themselves, the functional approach furthers this policy of permissive joinder by respecting the right to jury trial for each legal issue.

Once the determination has been made that the issue rather than the form of action is to be considered in questions of the right to jury trial, the issues must be characterized as either legal or equitable. The

which legal rights were to be ascertained and determined, in contradistinction to those where equitable rights alone were recognized, and equitable remedies were administered

Parsons v. Bedford, 28 U.S. (3 Pet.) 432, 446 (1830) (Story, J.).

⁴² *Simler v. Conner*, 372 U.S. 221, 223 (1963).

⁴³ E. Borchard, *Declaratory Judgments* 399 (2d ed. 1941).

⁴⁴ 369 U.S. at 473. The effect of this language has been interpreted as leading away from the strict historical analysis of the seventh amendment, but stopping short of the adoption of a completely functional analysis. *Gefen v. United States*, 400 F.2d 476, 479 n.5 (5th Cir. 1968).

⁴⁵ See p. 1017 *supra*.

⁴⁶ *Conley v. Gibson*, 355 U.S. 41, 47 (1957).

⁴⁷ *Dairy Queen, Inc. v. Wood*, 369 U.S. 477, 478 (1962).

⁴⁸ 2B W. Barron & A. Holtzoff, *Federal Practical and Procedure* § 873, at 31-32 (Wright ed. 1961).

⁴⁹ Fed. R. Civ. P. 18(a) provides in part that "a party asserting a claim to relief . . . may join . . . as many claims, legal, equitable, or maritime, as he has against an opposing party."

language of the Rules Enabling Act⁵⁰ requires that the distinction between law and equity abolished by the Federal Rules is a distinction in procedure and not in remedies.⁵¹ Use of the remedy requested as the main indicia of the nature of the issues is a practicable method of equitable characterization of issues.⁵²

The majority in *Ross* adopted this approach, holding that the issues of breach of the contract with the corporation's brokers and negligence by the corporate directors were legal issues, since the relief sought was money damages.⁵³ The substantive seventh amendment right is therefore procedurally extended to those issues involving common law relief. This functional characterization of issues leaves the traditionally equitable modes of relief such as injunction and specific performance within the control of the court. Thus, fears that a liberal interpretation of *Dairy Queen*, as was made in *Ross*, would eradicate a large area of properly equitable jurisdiction⁵⁴ are unfounded. The practical effect of allowing legal issues to be tried to a jury and equitable issues to the court, regardless of the form of the action, would not significantly change the distinction between types of relief actually administered.

The expansion of procedural access to the right of jury trial that is provided in *Ross* is grounded upon the policy issue of the desirability of the use of the mode of trial by jury. The wisdom of the jury system has been both upheld and attacked by various commentators.⁵⁵ A principal argument for the curtailment of trial by jury is that its effectiveness as a fact-finder is severely limited in complicated cases. Derivative suits in particular have been described as involving such voluminous proof and complicated financial data as to be unwieldy for jury trial.⁵⁶ The dissent in *Ross* voiced this basic dissatisfaction with the use of a jury in derivative actions by describing the result reached in the majority opinion as "a reflection of an unarticulated but apparently overpowering bias in favor of jury trials in civil actions."⁵⁷

Fair evaluation of all the objective merits or disadvantages of

⁵⁰ 28 U.S.C. § 2072 (1964).

⁵¹ *Bellavance v. Plastic-Craft Novelty Co.*, 30 F. Supp. 37, 39 (D. Mass. 1939).

⁵² *Harkless v. Sweeny Independent School Dist.*, 278 F. Supp. 632, 635 (S.D. Tex. 1968).

⁵³ 396 U.S. at 542. The Court, in a footnote, indicated that the approach to take in determining whether an issue is legal or equitable is to consider "first, the pre-merger custom with reference to such questions; second, the *remedy sought*; and third, the practical abilities and limitations of juries." [Emphasis added] *Id.* at 535 n.5. However, in its holding, the Court characterized the claim as legal solely because the "relief sought [was] money damages." *Id.* at 542.

⁵⁴ Comment, *supra* note 32, 736.

⁵⁵ For arguments in favor of the use of jury trial, see 1 W. Holdsworth, *A History of English Law* 347 (6th ed. 1938); for arguments to the contrary, see J. Frank, *Courts on Trial* 110-11 (1949).

⁵⁶ *Richland v. Crandall*, 259 F. Supp. 274, 281 (S.D.N.Y. 1966).

⁵⁷ 396 U.S. at 551 (dissenting opinion).

the jury system in general is beyond the scope of this note.⁵⁸ Certainly no attempt is made by the majority in *Ross* to dispel all doubts as to the practical efficiency of the use of a jury in derivative suits. However, the majority holding is clearly in line with the announced federal policy in favor of granting demands for jury trial in any but the "most imperative circumstances."⁵⁹ Such circumstances are unlikely to arise under the liberal procedures for factual findings provided in the Federal Rules.⁶⁰ Complicated fact situations, as often arise in derivative actions, can be efficiently handled through the appointment of special masters⁶¹ to aid the jury. In the final analysis, despite any practical shortcomings of trial by jury, the policy expressed by the seventh amendment requires that the right to jury trial be affirmatively supported and accepted with its "mixed blessings."⁶² The majority decision in *Ross* lies squarely within this tradition which acknowledges the fact that if resort must be had to policy, the policy to be derived from the seventh amendment is in favor of a jury trial.⁶³

In conclusion, the effect of the holding in *Ross* is to move further from a strict historical analysis of the right to jury trial toward the more functional analysis begun in *Beacon Theatres* and re-emphasized in *Dairy Queen*. By focusing upon the underlying legal issues in an historically equitable derivative action, *Ross* extends the application of the right to jury trial. However, the *Ross* decision deals only with procedural access to seventh amendment rights, in that it points towards the use of "issues" rather than "actions" as the unit for determination of the right to jury trial. The real significance of the decision rests not in its strained interpretation of a derivative action as having a dual nature, but in its apparent disapproval of the historical form of action as the basis for interpretation of the right to jury trial. However, the retention of the distinction between legal and equitable issues, preserves the courts' control of issues demanding equitable relief. *Ross* thus maintains the functional distinction between law and equity in terms of the seventh amendment while following the established trend toward procedural expansion of the availability of the right to jury trial.

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⁵⁸ The general effectiveness of the jury system is discussed in J. Moore, *supra* note 8, § 38.02, at 8.

⁵⁹ *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 511 (1959).

⁶⁰ *Dairy Queen, Inc. v. Wood*, 369 U.S. 469, 478 (1962).

⁶¹ Fed. R. Civ. P. 53.

⁶² See J. Moore, *supra* note 8, § 38.02[1], at 17.

⁶³ C. Wright, *Federal Courts* § 92, at 353 (1963).