

# LAW AND CONTEMPORARY PROBLEMS

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## FOREWORD

Litigation brought by shareholders against corporate managements has always been controversial. In particular, derivative suits brought by shareholders on behalf of the corporations in which they own stock are unusual in several respects. Derivative litigation is subject to a number of unique procedural regulations; it frequently becomes a multiparty, multiforum phenomenon of lengthy duration. The plaintiff in such litigation typically owns a relatively small number of shares; indeed, the motivating force behind the suit often appears to be the plaintiff's attorney rather than the named plaintiff. Stockholders' derivative actions are also settled with much greater frequency than civil actions generally, while the value conferred on the corporation by the terms of some settlements has been questioned. Finally, these suits constitute a privately controlled vehicle to challenge the decisions of corporation managers and controlling stockholders, a fact that in itself assures a fair degree of controversy.

Recent events warrant a reexamination of derivative litigation. During the past decade the practice has developed of using litigation committees, composed of nominally independent directors, to evaluate the merits of a derivative suit brought against a corporation. The judicial response to litigation committees' recommendations that suits be terminated as contrary to the corporations' interests has varied considerably through this period. Experience with the litigation committee is now sufficiently well developed to permit a reflective evaluation of the institution's strengths and drawbacks and of the relative virtues of judicial reactions to committee recommendations.

Of more general significance, the Supreme Court's interpretations of the federal securities laws over the same decade have made clear that most, although certainly not all, questions regarding internal relationships within corporations are to be answered by reference to state law. The Court's unwillingness to expand the reach of the federal securities laws to embrace these questions is of special significance to derivative litigation because such suits focus upon questions of internal relationships within corporations,

namely, alleged breaches of fiduciary obligations owed to corporations by directors, officers, and controlling shareholders.

Some current interest in these topics has no doubt been piqued by the American Law Institute's project on corporate governance which, even in its early stages, stimulated considerable debate within the scholarly and business communities about both the proposals to be made to the Institute and, more broadly, the questions of internal corporate governance the Institute was to address. To date, the Institute's membership has been occupied with other of the project's proposals and has not considered those dealing specifically with shareholder litigation. Given their significance, however, consideration of the underlying merits of the proposals for derivative litigation is by no means premature.

The articles in this symposium deal with different facets of derivative litigation, many of them interrelated. In his article, John C. Coffee, Jr. examines the consequences of the widely acknowledged fact that the plaintiff's attorney is an actor of independent and substantial significance in derivative litigation. His article, positing the view that such an attorney is a rational, utility-maximizing decisionmaker, examines why, in some instances, plaintiffs' attorneys' interests diverge from those of their clients and those of society generally. Among other matters, the article analyzes the survival of the phenomenon of the "strike suit" despite a variety of well-intentioned controls and considers whether a judicial tendency to accede in litigation committees' recommendations to terminate derivative suits has a positive or negative impact on the quality of suits brought by the plaintiffs' bar. The article concludes with recommendations for settlement procedures and calculation of plaintiffs' attorney fees designed to align better the economic incentives of the plaintiff's attorney with the interests of the corporation.

James D. Cox and Harry L. Munsinger consider a more general question about litigation committees: whether it is reasonable to believe that a corporation's independent directors, when appointed to a litigation committee, will be able to make an unbiased assessment of the suit's merits and the corporation's interests. Their article describes several social-psychological mechanisms that affect decisions made by groups sharing strong affiliations and concludes that these mechanisms strongly suggest the presence of biasing factors favoring corporate defendants and disfavoring derivative suit plaintiffs. Against this background, the article then evaluates judicial responses to recommendations made by litigation committees, finding many of them to be insufficiently sensitive to the possibility of bias. The proposals made to the American Law Institute concerning litigation committees are also evaluated within the same framework.

Arguing that the debate on many issues concerning derivative litigation would be better informed by a sounder empirical foundation, Bryant Garth, Ilene Nagel, and Sheldon Plager review the extant empirical research on derivative suits and stockholder litigation and assess the limitations of each of the prior studies. Their article then discusses a range of models and

strategies for further empirical research, suggesting how each of these might be implemented to generate information useful to some key aspects of the debate over derivative litigation. Nonetheless, the article concludes with an evaluation of the limitations of empirical research designed to answer several of the most pressing questions raised by shareholder litigation.

My own article explores the significant choice to treat the law of the state of incorporation as the body of state law that in most instances defines internal relationships within corporations. This choice of law question is of significance for derivative litigation as well as for other occasions when the need arises to determine the law applicable to the corporation's relationships with, and the relationships among, its officers, directors, and stockholders. After examining a number of alternatives to the choice of the state of incorporation for these purposes, the article finds them somewhat lacking in feasibility and constitutional acceptability.

The symposium concludes with two student notes. The first evaluates the exception to the attorney-client privilege which is available in derivative litigation. It concludes that the availability of the exception is inappropriately unpredictable and rests on insufficient justifications. The second student note is a study of the weaknesses of rules that attempt to control abuses in the settlement of derivative actions. It also examines the cases dealing with plaintiffs' attorney fees and recommends some reforms in this area.

The contributions to this symposium examine many current issues affecting derivative suit litigation. Although the pieces present, for the most part, valid criticisms of the development of the law in this area, they also provide suggestions and alternatives aimed at making this type of litigation more responsive to the legitimate needs and interests it should promote.

Most of the articles in this symposium were presented and discussed at an editorial conference held at the Duke University School of Law on March 16, 1984. In addition to the authors of the articles, participants at the conference included: Professor Victor Brudney of the Harvard Law School, Cambridge, Massachusetts; Mr. Benjamin S. DuVal of the American Bar Foundation, Chicago, Illinois; Mr. Simon M. Lorne, Esq., of Munger, Tolles & Rickershauser, Los Angeles, California; Professor Richard C. Maxwell of the Duke University School of Law; Mr. T. William Porter, Esq., of Porter & Clements, Houston, Texas; and Mr. Melvyn I. Weiss, Esq., of Milberg Weiss Bershad Spechthrie & Lerach, New York, New York.

*Deborah A. DeMott*

