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SHAREHOLDER DERIVATIVE LITIGATION AND CORPORATE GOVERNANCE

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I. INTRODUCTION

In the early part of the last century, the judiciary recognized the shareholder derivative action as a means for shareholders to redress a breach of fiduciary duty by an officer or director.[1] Soon thereafter, courts ruled that the successful plaintiff was entitled to recover attorneys' fees from the

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[1]For early cases recognizing the shareholder derivative action, see Attorney Gen. v. Utica Ins. Co., 2 Johns. Ch. 371, 381-90 (N.Y. Ch. 1817) (commenting in dicta that an action could lie for director accountability and that persons exercising corporate powers may be accountable to the court for a breach of the duty of care); Percy v. Millaudon, 8 Mart. 68, 75-78 (La. 1829) (holding that in an action by shareholders of a banking corporation against three principal directors for fraudulent and unfaithful conduct, the directors are only responsible for errors "of so gross a kind, that a man of common sense, and ordinary attention, would not have fallen into it"); Taylor v. Miami Exporting Co., 5 Ohio 162, 165-68 (Ohio 1831) (holding that "a 'stockholder in an incorporated [b]ank, may sustain [an action] against the corporation, the directors [and] other stockholders [for fraudulent practices], depreciating the value of the stock, suspending banking operations, and withholding dividends") (citing *Attorney General v. Utica Ins. Co.* for the proposition that corporate directors may be held accountable where there is a fraudulent breach of trust); and Robinson v. Smith, 3 Paige Ch. 222, 233 (N.Y. Ch. 1832) (determining that "[g]enerally, where there has been a waste or misapplication of the corporate funds by . . . officers or agents . . . a suit to compel them to account for such waste or misapplication should be in the name of the corporation"). These first American cases postdated, by a few years, the earliest English cases. *See* Charitable Corp. v. Sutton, 2 Atk. 400, 26 Eng. Rep. 642 (1742) (finding the directors of a charitable corporation to have failed to monitor the loan procedures of the corporation in making unsecured loans to fellow directors and, therefore, holding the directors liable for the resulting loan losses on the theory of gross negligence); Adley v. Whitstable Co., 34 Eng. Rep. 122 (Ch. 1810); Hichens v. Congreve, 38 Eng. Rep. 917 (Ch. 1828). The action was further defined in Foss v. Harbottle, 67 Eng. Rep. 189, 202 (Ch. 1843), and Dodge v. Woolsey, 59 U.S. 331 (1 How.) (1855).

corporation on whose behalf the shareholder brought the suit.[2] Early cases seemed to require the creation of a "common fund," that is, a pool of money from which these fees would be paid.[3] In recent years, however, the courts have abandoned this requirement.[4] Instead, in the absence of a common fund, the courts have been willing to award attorneys' fees to the plaintiff if the derivative litigation resulted in a "substantial or common benefit" to the corporation, whether by judgment or settlement.[5] The courts have been quite

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[2]*See* Trustees v. Greenough, 105 U.S. 527 (1881) (collecting cases from both English and American courts permitting the award of attorneys' fees in litigation). The rationale for creating an exception to the normal American rule that parties to litigation bear their own attorneys' fees was that in successful derivative litigation a whole class of people – the shareholders of the corporation – benefits from the successful litigation and, on general equity principles, should be called upon to bear a portion of the expense. Mills v. Electric Auto-Lite Co., 396 U.S. 375, 392 (1970) (recognizing that plaintiffs are entitled to attorneys' fees in derivative litigation because allowing "others to obtain full benefit from the plaintiff's efforts without contributing equally to the litigation expenses would be to enrich the others unjustly at the plaintiff's expense"). In addition, requiring the plaintiff-shareholder to pay his attorney would deter almost all such suits because the benefit to any individual shareholder is likely to be small, while the cost in fees is likely to be relatively large. *See* George D. Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784, 791 (1939) [hereinafter Hornstein, *Counsel Fee*] ("If reimbursement were not permitted to a stockholder successfully prosecuting a suit to redress a wrong to his corporation, the practical effect would be the same as if the suits were prohibited . . . ."). Thus, to encourage meritorious derivative actions, courts order the corporation to reimburse plaintiff for his costs and expenses in bringing the action, including his attorneys' fees. *See* George D. Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658, 663 (1956) ("Every successful suit duly rewarded encourages other suits to redress misconduct and by the same token discourages misconduct which would occasion suit.").

The authority of the federal courts to award attorneys' fees in the absence of an applicable statute rests in their inherent equity authority. Alyeska Pipeline Servs. Co. v. Wilderness Soc'y, 421 U.S. 240, 259 (1975).

[3]The origin of this doctrine can be found in two United States Supreme Court cases: Trustees v. Greenough, 105 U.S. 527 (1881), and Central R.R. & Banking Co. v. Pettus, 113 U.S. 116 (1885). The necessity of a common fund can be traced back to Coleman v. United States, 152 U.S. 96 (1894). *See generally* John P. Dawson, *Lawyers and Involuntary Clients: Attorney Fees from Funds*, 87 HARV. L. REV. 1597, 1603-12 (1974) (discussing the origins of the common fund doctrine).

[4]California first recognized that a successful plaintiff could recover attorneys' fees in the absence of a common fund in 1968. Fletcher v. A.J. Indus., Inc., 72 Cal. Rptr. 146 (Cal. Ct. App. 1968). *See infra* notes 92-99 and accompanying text.

[5]Few courts have defined the term "substantial benefit." One definition, in an oft-cited case, reflects the ambiguity of the term: "[A substantial benefit is] one that accomplishes a result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder's interest." Bosch v. Meeker Coop. Light & Power Ass'n, 101 N.W.2d 423, 425-27 (Minn. 1960). The United States Supreme Court cited this language with approval in *Mills*, 396 U.S. at 395-96 (discussed *infra* at notes 23-40). In *Rosenbaum v. MacAllister*, 64 F.3d 1439, 1444 (10th Cir. 1995), the court used the term "common benefit" to describe what appears to be a "substantial benefit." The court refused to characterize the fund recovered as a "common fund" for purposes of calculating an attorneys' fee based on the fund. *Id.* at 1447. *See infra* text accompanying notes 6-7.

Justice Christian, dissenting in *Fletcher*, 72 Cal. Rptr. at 157, a case in which the California

willing, too willing perhaps, to find a substantial benefit when the derivative action settles, the plaintiff seeks attorneys' fees, and the defendant does not object.[6] In contrast to the judicial deference relative to settlement agreements, courts typically scrutinize fee requests that follow judgments.[7]

This evolution from common fund to substantial benefit, combined with judicial reluctance to scrutinize derivative action settlements, has meant that the value of the "benefit" obtained by "successful" plaintiffs has often been insubstantial, especially when viewed in light of the fees sought by

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Appellate Court first recognized the substantial benefit doctrine, expressed his concern that "[t]he variety of shareholders' actions in which 'substantial benefit' to the corporation may be found is literally boundless." His gloomy prediction was borne out in United Operating Co. v. Karnes, 482 F. Supp. 1029, 1031 (S.D.N.Y. 1980), where the court conceded that "the major benefit to the company is the termination of this expensive and time-consuming litigation." Not all courts have embraced the substantial benefit doctrine. Rhode Island, for example, continues to deny plaintiffs an award of attorneys' fees in derivative actions because of the absence of statutory authority to do so. Kaufman Malchman & Kirby, P.C. v. Hasbro, Inc., 897 F. Supp. 719, 722 (S.D.N.Y. 1995) (stating that "Rhode Island common law incorporates the American rule regarding attorneys' fees [which results in] parties bearing their own costs in the absence of specific statutory or contractual provisions to the contrary"); Eleazar v. Ted Reed Thermal, Inc., 576 A.2d 1217, 1221 (R.I. 1990) (reversing award of attorneys' fees in the absence of statutory authority or contractual liability and restraining judicial construction of implied authority where the statutes are unequivocal and unambiguous). See also *Industrial Distribution Group, Inc. v. Waite*, 485 S.E.2d 792, 795 (Ga. 1997), in which the Georgia Supreme Court reserved judgment on whether it would adopt the substantial benefit rule.

[6]The courts have also awarded attorneys' fees to plaintiff in the absence of a favorable judgment or settlement as long as the corporation "cures" the wrong complained of, and seeks dismissal of the action, provided the plaintiff's actions were the cause of the cure. Mintz v. Bohen, 210 A.2d 569, 570 (Del. Ch. 1965). *But see* Kaufman Malchman & Kirby, 897 F. Supp. at 724 (holding that under New York law, where plaintiff's only action was making a demand on the corporation that resulted in a cure of the wrong complained of, plaintiff is not entitled to attorneys' fees).

The courts have applied the substantial benefit rule to cases in which the plaintiff sues in a representative capacity, such as *Mills*, and where the plaintiff sues individually but confers a substantial benefit on an ascertainable class. Hall v. Cole, 412 U.S. 1, 15 (1973) (stating that union member, in suit vindicating his own right of free speech, conferred a substantial benefit on the union and its members, thereby entitling him to an award of attorneys' fees from the union treasury); Reiser v. Del Monte Properties Co., 605 F.2d 1135, 1140 (9th Cir. 1979) (finding that an individual plaintiff is not precluded from claiming attorneys' fees even though defendant's actions caused the claim to be moot).

[7]Compare *In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996), discussed *infra* text accompanying notes 9-21, with Thorpe v. CERBCO, Inc., No. 11,713, 1997 Del. Ch. LEXIS 18 (Del. Ch. Feb. 6, 1997), *reprinted in* 22 DEL. J. CORP. L. 1300 (1997) where Chancellor Allen, author of the *Caremark* decision, rejected plaintiff's fee application in the amount of $1,529,867 based on a normal hourly billing rate and, instead, awarded plaintiffs a fee equal to one-third of the common fund of $430,092 generated in the case or $143,364. In reaching this conclusion, Chancellor Allen ruled that the intangible benefits secured in the litigation were insubstantial and speculative. *Id.* at *16. *See also In re* Dunkin' Donuts Shareholders Litig., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,725 (Del. Ch. Nov. 27, 1990), *reprinted in* 16 DEL. J. CORP. L. 1443 (1991) (reducing the fee request in a derivative action, that resulted in more favorable sale of the corporation, from $2,500,000 to $922,000).

plaintiff's counsel. This development has been particularly important in cases alleging a breach of the duty of due care by the directors, because the essence of the plaintiff's complaint is that the defendants' dereliction caused a monetary loss to the corporation. If the plaintiff fails to obtain a monetary recovery, presumably it has failed in the action. A perusal of the settlements in such actions, however, makes clear that, increasingly, the derivative action has been used less to remedy breaches of fiduciary duty and more to alter or affect corporate governance or provide some other kind of intangible relief.[8]

Cases such as *In re Caremark International Inc. Derivative Litigation*[9] typify this trend. *Caremark*, a derivative action claiming the directors breached their duty of care, was filed soon after the corporation settled federal civil and criminal claims alleging improper payments under federal Medicare and Medicaid rules.[10] These settlements, together with related private civil claims, cost the corporation approximately $250 million.[11] The shareholder action alleged that the directors failed to adequately "supervise the conduct of Caremark employees."[12] The

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[8]*E.g.*, Bell Atlantic Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993) (requiring Bell Atlantic to institute internal mechanisms to improve sales and marketing mechanisms, immunizing corporate directors for past conduct, and mandating changes in corporate governance); Granada Invs. Inc. v. DWG Corp., 962 F.2d 1203, 1205 (6th Cir. 1992) (instituting changes in corporate governance requiring addition of three independent directors to the board, creating a special committee to oversee compensation and intercorporate transactions, and requiring annual shareholder meetings); Zimmerman v. Bell, 800 F.2d 386, 391 (4th Cir. 1986) (adopting new procedures to be followed in future tender offers or takeover bids, altering procedures for regrant and termination of stock options, but no monetary relief); *In re* General Tire & Rubber Co. Sec. Litig., 726 F.2d 1075, 1079 (6th Cir. 1984) (implementing remedial action and addition of two independent outside directors for three years to prevent future improprieties); Maher v. Zapata Corp., 714 F.2d 436, 454 (5th Cir. 1983) (removing chairman for breach of fiduciary duty, increasing management emphasis on maximizing current business components, implementing stricter policies on use of company assets, and developing new internal control procedures); Weisberg v. Coastal States Gas Corp., [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,716 (S.D.N.Y. June 16, 1982) (mandating revised corporate policies for shareholder disclosure of commission payments); United Operating Co. v. Karnes, 482 F. Supp. 1029, 1031 (S.D.N.Y. 1980) (resulting in new auditing procedures to control future illegal discounts and conclude the litigation, which were deemed the most significant benefit to the corporation); *In re* Dr. Pepper/Seven Up Cos. Shareholders Litig., No. 13,109, 1996 WL 74214, at *1 (Del. Ch. Feb. 27, 1996) (informing shareholders of the valuation ranges calculated by the company in determining fair share price for impending takeover as sale benefit to corporation supporting $690,000 in attorneys' fees); *In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959, 966 (Del. Ch. 1996) (eliminating monetary component and basing settlement on a requirement that management adopt and implement significant compliance-related programs); Good v. Texaco, Inc., No. 7501, 1985 WL 11536, at *17-18 (Del. Ch. Feb. 19, 1985), *reprinted in* 10 DEL. J. CORP. L. 854 (1985) (stipulating that modification of the repurchase agreement and disclosure to the shareholders of plaintiffs' investigation results supports award of $700,000 in attorneys' fees).

[9]698 A.2d 959 (Del. Ch. 1996).

[10]*Id.* at 960-61.

[11]*Id.* at 961.

[12]*Id.* at 964.

shareholders' claim, however, suffered from at least two noticeable flaws: first, the board *had* put in place structures designed to avoid the problems that occurred; thus, there was a strong defense on the merits.[13] Second, and of greater importance, the corporation's articles of incorporation eliminated the liability of directors for monetary damages for mere breaches of the duty of care, which constituted the gravamen of the plaintiffs' allegations.[14] Therefore, plaintiffs' claim against the directors seemed doomed from the start.

Despite the weakness of their claims, the plaintiffs were able to garner a settlement that consisted of modest reforms in corporate governance[15] and immodest attorneys' fees of $816,000 (plus $53,000 in expenses).[16] In approving the settlement, the Delaware Court of Chancery observed that "there is a very low probability that it would be determined that the directors of Caremark breached any duty to appropriately monitor and supervise the enterprise."[17] Insofar as the court approved the settlement, the case is unremarkable; courts routinely approve settlements even if the plaintiff's case is demonstrably weak.[18] It is somewhat noteworthy, however, that in approving the settlement of the case, the court approved a generous allowance for attorneys' fees despite finding "only a modest substantive benefit"[19] for the corporation, a rare admission that the attorney fee award may be supported by a minimal, as opposed to a substantial, "recovery."

It may be that the Chancellor was imprecise in his use of language in determining that the "modest substantive benefit" in *Caremark* was indeed a "substantial benefit" to the corporation. Nevertheless, one might question whether the approval of attorneys' fees for producing that sort of benefit — a reform in corporate governance — is justified in any amount; and if so, whether the amount should not be grounded primarily on the value of the benefit realized. Quite often, and *Caremark* is an example of this, plaintiff

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[13]*Caremark*, 698 A.2d at 971. Among the steps that Caremark took was the publication of a detailed compliance guide for its employees; the implementation of policy requiring various officers to approve each contractual relationship entered into by Caremark with a physician; the maintenance of an internal audit plan designed to assure compliance with business and ethics policies; the adoption of an internal audit charter requiring a comprehensive review of compliance policies; and the compilation of an employee ethics handbook concerning such policies, etc. *Id.* at 963.

[14]*Id.* at 965.

[15]*Id.* at 966. Caremark agreed that the full board would discuss relevant changes in government health care regulations and that the board would establish a compliance and ethics committee of four directors. This committee would meet at least four times per year, monitor the company's compliance with applicable federal law and report to the board.

[16]*Id.* at 972.

[17]*Caremark*, 698 A.2d at 961.

[18]*See, e.g.*, cases cited *supra* note 5.

[19]*Caremark*, 698 A.2d at 972.

files a case seeking monetary recovery for a monetary loss suffered by the corporation but enters into a settlement devoid of monetary relief for the corporation. In these cases, plaintiff does not set out to reform the governance of the corporation but settles for it because plaintiff knows that such a settlement will support an award of attorneys' fees. This reality has the apparent (although not intended) effect of encouraging the use of derivative actions to reform corporate governance. From the perspective of plaintiff's counsel, this may be a rather circuitous route to corporate governance reform, but it does support a fee, and that is often the motivating force behind the filing of the action. The judiciary's approval of these settlements has made all of this possible.[20]

The result in *Caremark*, and the many other cases that it typifies,[21] may reflect judicial reluctance to reverse an arrangement that disposes of a case to the parties' satisfaction. This judicial timidity, however, comes at a cost: the filing of a marginal and possibly frivolous case is encouraged; the party that was supposed to benefit from a successful derivative action — the corporation — often ends up paying the plaintiff's legal fees and receives little if any benefit from the action; and corporate resources are wasted litigating the action. Most importantly, an abuse of the judicial process occurs because an action designed to remedy breaches of fiduciary duty is used for a different purpose.

In this essay I suggest that the courts reconsider the current policy of approving attorneys' fees in a derivative action settlement unless the settlement (1) generates a common fund out of which such fees may be paid, (2) produces an intangible benefit reasonably susceptible of valuation, or (3) reflects a strong nexus between the relief sought in the complaint and the relief obtained. An analysis of the modern origin of the substantial benefit

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[20]*See* Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 48 (1991) ("Judges rarely reject fee petitions as part of a settlement" on the merits. If the fee settlement is rejected, judges may find themselves wading through a myriad of documents doing fee calculations or risk losing the settlement.). *But see* Schechtman v. Wolfson, 244 F.2d 537, 538 (2d Cir. 1957) (denying counsel fees of $25,000 after finding no benefit to a corporation from a derivative action where the plaintiff could have sought recovery gratuitously from the Federal Trade Commission); *In re* Oracle Sec. Litig., 852 F. Supp. 1437, 1457-58 (N.D. Cal. 1994) (utilizing a competitive bidding approach to class counsel selection thereby capping fees and denying requests for expense overages and interest); Fischer & Porter Co. v. Tolson, 27 Fed. R. Serv. 3d 87, 91-94 (E.D. Pa. 1993) (disapproving settlement and counsel fee award, considering Rule 11 sanctions, and determining that proposed settlement measures were temporary and inadequate and resulted in loss to company); Seinfeld v. Robinson, 656 N.Y.S.2d 707, 714 (N.Y. Sup. Ct. 1997), discussed *infra* notes 40-52 (stating that requiring the court to determine a reasonable fee when an unreasonable one has been requested would only serve to encourage unreasonable demands leading to a fee reduction down to reasonable limits as the only consequence).

[21]*See* cases cited *supra* note 5.

doctrine, a review of its application in recent cases and the perverse effects of its use all point to the need for reconsideration. While the origins of this trend can be traced back to at least 1949,[22] the 1970 United States Supreme Court decision in *Mills v. Electric Auto-Lite Co.*[23] gave it a significant boost.

II. *MILLS V. ELECTRIC AUTO-LITE CO.*: NOT THE RIGHT PRECEDENT

Mills was a combined derivative and class action suit. The plaintiffs alleged that the defendants obtained proxies for the approval of a corporate merger by means of false and misleading statements in violation of Securities and Exchange Commission rules and, therefore, in violation of the Securities Exchange Act of 1934.[24] Although the suit was filed just prior to the shareholder vote on the merger, the case did not come to trial until after the merger was consummated.[25] The principal issue in the case related to causation — could the plaintiffs demonstrate a causal relationship between the alleged violation and the injury for which they sought redress.[26]

But more germane to present purposes, the Court went on to consider plaintiff's petition for attorneys' fees for services accrued to that point in the case and held that plaintiffs should be entitled to an award of fees.[27] In so holding, the Court considered, and rejected, the need for a "common fund" from which fees could be awarded.[28] Instead, the Court held that it would be sufficient if the plaintiff's actions resulted in a substantial benefit to the corporation.[29] That occurred in this case, the Court concluded, because the plaintiffs were successful "in vindicating the statutory policy" of fair and informed corporate suffrage and that vindication was a "substantial service" to the corporation and its shareholders.[30]

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[22]See Rosenthal v. Burry Biscuit Corp., 209 A.2d 459 (Del. Ch. 1949), decided by Chancellor Seitz in 1949 but not published until 1965. The court there held that a benefit to the corporation could support an award of attorneys' fees in a derivative action, even in the absence of a common fund. In *Rosenthal*, the plaintiffs alleged that filing the suit caused the defendant to cure the alleged wrong, thereby rendering the case moot. If the action was meritorious, the court held, a fee would be warranted. *Id.* at 461.

[23]396 U.S. 375 (1970). *Mills* is often cited as expanding the common fund doctrine to allow plaintiff's attorneys' fees if plaintiff secures a substantial, albeit intangible, benefit for the class of corporation. *E.g.*, Reiser v. Del Monte Properties Co., 605 F.2d 1135, 1138 (9th Cir. 1979).

[24]*Mills*, 396 U.S. at 377-78.

[25]*Id.*

[26]*Id.* at 377. The Supreme Court concluded that if the proxy solicitation was an "essential link" in the accomplishment of the transaction, plaintiff could satisfy the causation requirement by a showing that there was a "material" violation of the rule in question. *Id.* at 385.

[27]*Id.* at 396-97.

[28]*Mills*, 396 U.S. at 392-97.

[29]*Id.* at 396-97.

[30]*Id.* at 396.

The Court cited a 1940 district court case that employed the term "corporate therapeutics" to characterize the benefit to the shareholders.[31] The Court apparently meant that if the shareholder's action remedies corporate wrongdoing, an award of attorneys' fees is appropriate, even if that remedy did not generate money for the corporation. The attorneys' fee award in *Mills* thus turned on two factors: first, the importance attached by the Court to the plaintiff's success on the merits of the case; and second, the policy of encouraging shareholders to act as private attorneys general in enforcing the federal proxy rules.[32] In light of the latter, the fact that the plaintiff was successful in achieving a judicial determination that the defendants violated the proxy rules was of substantial benefit to the corporation.

State courts deciding whether to approve settlements in derivative actions that include plaintiff's attorneys' fees have cited *Mills* as support for the proposition that plaintiff can recover fees if the suit results in a substantial benefit to the corporation.[33] This often signals a generous application of *Mills*, however, because in the garden variety settlement of a derivative action there is, at best, a tenuous nexus between the wrong complained of and the relief obtained. Using the recent *Caremark* case as an example, the shareholders there complained of a breach of the duty of care by the directors that resulted in substantial monetary loss to the corporation.[34] There was no finding in *Caremark*, as there was in *Mills*, that there was a violation of law, nor was there a payment of money to redress the wrong identified by the shareholders. Of equal importance, no policy under state law encouraged shareholders to act as private attorneys general to assure that directors discharged their fiduciary duties, as opposed to the federal policy that encourages shareholders to enforce the federal proxy rules.[35] Just five

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[31]*Id.* at 396 n.23 (citing Murphy v. North Am. Light & Power Co., 33 F. Supp. 567, 570 (S.D.N.Y. 1940)).

[32]*Mills*, 396 U.S. at 396 n.23.

[33]*E.g.*, James v. Alabama Coalition for Equity, Inc., 713 So. 2d 937 (Ala. 1997) (awarding over $3.5 million to plaintiffs' attorneys in challenge to administration of Alabama public schools); Municipality of Anchorage v. Gentile, 922 P.2d 248, 266-67 (Alaska 1996) (remanding for determination of attorneys' fees in light of *Mills*, holding that no common fund need be created when class members derive substantial benefit); and Gigot v. Cities Serv. Oil, 737 P.2d 18 (Kan. 1987) (affirming award of attorneys' fees in class action to recover the value of helium extracted from natural gas).

[34]*In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959, 960-61 (Del. Ch. 1996).

[35]*Mills* was decided after *J.I. Case Co. v. Borak*, 377 U.S. 426, 430-31 (1964), where the Supreme Court held that a private right of action existed to enforce section 14(a) of the Securities Exchange Act of 1934. In *Borak*, the Court reasoned that the recognition of a private right of action was appropriate because the Securities and Exchange Commission could not review all of the proxy statements filed with it and "the possibility of [private] civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements." *Id.* at 432. It is somewhat ironic that if *Borak* were decided today, the Court would not recognize a private right of action to

years after it decided *Mills*, the Supreme Court rejected the argument that the federal courts had jurisdiction to award attorneys' fees under a private attorney general theory.[36]

State law contains a host of procedural obstacles to shareholder derivative actions against directors,[37] and one potentially devastating substantive obstacle, when the claim rests on breach of the duty of care. The substantive obstacle to plaintiff's success in due care cases is, of course, the statutory provisions enacted in the last ten years allowing a corporation to include in its articles of incorporation a provision limiting director liability. Following the 1985 decision of the Delaware Supreme Court in *Smith v. Van Gorkom*,[38] which held directors liable for breaching the duty of care, Delaware, and then virtually all other states, amended their corporate codes to allow corporations to eliminate director liability for monetary damages for breaches of the duty of care.[39] Thus, a duty of care case can succeed in the face of such a provision only if the plaintiff can prove that the directors acted in bad faith or engaged in intentional misconduct or in a knowing violation of law.

Clearly, then, *Mills* is weak precedent for approving of plaintiff's fee request in shareholder derivative actions when the underlying claim is breach of the duty of care. When a director is alleged to have violated that duty, and the corporation's articles of incorporation contain a state-permitted provision limiting director liability, the state's policy appears to *discourage* such

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enforce section 14(a). In subsequent cases in which parties have sought to persuade the Court to recognize an implied private right of action, the Court has been most reluctant to do so. See, e.g., Central Bank of Denver, N.A. v. First Interstate Bank, N.A., 511 U.S. 164 (1994); Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982); Touche Ross & Co. v. Reddington, 442 U.S. 560 (1979); Cannon v. University of Chicago, 441 U.S. 677 (1979); Piper v. Chris-Craft Indus. Inc., 430 U.S. 1 (1977), demonstrating a different approach to the implication of a private right of action under a federal statute. In short, the Court is loathe to imply a right that Congress failed to express by sanction, leading many to conclude that analytically, at least, *Borak* has been overruled. JAMES D. COX ET AL., SECURITIES REGULATION 650 (1997).

[36]Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240 (1975).

[37]Among other things, many state statutes require the shareholder-plaintiff to post security for expenses and risk liability for attorneys' fees if the action fails. Most states require that the plaintiff make a demand on the board of directors before bringing the suit, and generally the board has broad discretion in dealing with plaintiff's demand. A board decision to dismiss the action is difficult for the plaintiff to overcome. By contrast, a class action alleging that the board of directors violated section 14(a) of the 1934 Act is subject to no such limitations.

[38]488 A.2d 858 (Del. 1985).

[39]*See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (1994); MODEL BUS. CORP. ACT § 2.02(b)(4). Delaware provides an exception that precludes eliminating or limiting director personal liability for acts or omissions not in "good faith," for those involving intentional misconduct or knowing violation of the law, or those from which the director personally benefitted. DEL. CODE ANN. tit. 8, § 102(b)(7) (1994).

actions. Moreover, the relief typically provided in the settlement (corporate governance reform) is obtainable by other, more direct means. Finally, even if the corporation has not amended its articles to take advantage of the liability limitation, the mere presence of such a provision in the statute undercuts the notion of a state policy favoring the cause of action. An obscure case from the New York Supreme Court, *Seinfeld v. Robinson*,[40] stands in stark contrast to the line of cases typified by *Caremark*.

III. THE JUDICIARY TAKES A STAND: *SEINFELD V. ROBINSON*

Seinfeld arose from two unrelated alleged breaches of the fiduciary duty of care by directors of American Express Company (Amex). The first of these allegations related to an incident in which a former Amex officer settled a defamation claim against Amex, resulting in the payment of $8 million by Amex to various charities designated by this former officer.[41] The details of the incident are somewhat murky in the judicial report of the case. Apparently, an Amex employee had retained an investigator whose methods of operation were at least partly responsible for the statements that gave rise to the defamation action.[42] The plaintiffs in the derivative action alleged that Amex should have had adequate systems of internal control to protect against the conduct that gave rise to the defamation action and should have pursued claims against Amex employees who bore some responsibility for the incident.[43] After a careful review, an independent committee of Amex directors determined that pursuing such an action was not in the best interests of the corporation.[44]

The second alleged breach was rather conventional — that the Amex directors failed to monitor adequately the company's substantial investment in Shearson, Lehman, Hutton, Inc., an investment that resulted in substantial financial losses to Amex.[45] The opinion gives no details on this claim, except to say that it was released in the settlement.

These two claims were disposed of in a settlement that required Amex to adopt two corporate resolutions, each of which was to be effective for a period of only four years.[46] The first was designed to avoid a repeat of the incident that gave rise to the defamation by requiring the involvement of the corporate general counsel and the audit committee whenever senior

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[40] 656 N.Y.S.2d 707 (N.Y. Sup. Ct. 1997).
[41] *Id.* at 708.
[42] *Id.*
[43] *Id.* at 709.
[44] *Seinfeld*, 656 N.Y.S.2d at 709.
[45] *Id.*
[46] *Id.* at 709, 711.

management seeks to retain investigators of special projects.[47] The second resolution required independent outside directors to exercise business judgment in any major acquisitions of investment banking companies.[48] On their face, these corporate actions seemed to be of limited value. The first was narrowly tailored to avoid a situation highly unlikely to recur, and the second imposed on directors little beyond what the law already required. The New York Supreme Court expressed its skepticism of the value of the changes in corporate governance, and denied the request of plaintiffs' attorneys for $3.5 million in fees and expenses.[49]

The court analyzed the corporate governance changes from two perspectives: first, the value of these changes to the company going forward; and second, the relationship between these changes and the relief originally sought in the complaint. The court found the resolutions deficient in both respects. As to the value of the corporate governance changes, the court observed that the "[a]doption of 'cosmetic' and 'ephemeral' guidelines do not constitute a tangible nonmonetary benefit for which [the] stockholders' attorneys merit compensation by the company."[50] As to the relationship between the relief obtained and the relief sought, the court simply said that the "[s]ettlement does not achieve the relief sought in the complaint."[51] In this regard, the court compared other decisions, observing that "fee awards are warranted where the result directly impacts upon the complained of conduct."[52] As an abstract proposition, this seems intuitively correct, and the court cited several cases to support its conclusion. In practice, however, distinguishing between a settlement that has a direct nexus to the alleged breach and one that does not is often difficult. Moreover, even if the nexus is present, it does not necessarily follow that the court should approve the settlement, including generous attorneys' fees. The next section discusses this problem: is there a readily available means to identify settlements with an adequate nexus, and should the presence of such a nexus justify an award of attorneys' fees?

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[47] *Id.* at 710.

[48] *Seinfeld*, 656 N.Y.S.2d at 710.

[49] *Id.* at 714 & n.4.

[50] *Id.* at 712 (citing Mokhiber v. Cohn, 608 F. Supp. 616, 628 (S.D.N.Y. 1985), *aff'd*, 783 F.2d 26 (2d Cir. 1986)).

[51] *Id.* at 711. Presumably, the court reached the same conclusion on the second claim, which related to investment banking investment, but the court did not make a separate finding on the claim.

[52] *Seinfield*, 656 N.Y.S.2d at 712 (citing Elite of N.Y. Cars, Ltd. v. Zarbhanelian, 626 N.Y.S.2d 258 (N.Y. 1995); Mencher v. Sachs, 164 A.2d 320 (Del. 1960); Kopet v. Esquire Realty Co., 523 F.2d 1005 (2d Cir. 1975); Ramey v. Cincinnati Enquirer, 508 F.2d 1188 (6th Cir. 1974)).

IV. THE PRESENCE OF A NEXUS BETWEEN THE COMPLAINT AND SETTLEMENT

The most compelling case for approving attorneys' fees in the absence of a common fund is where the relief obtained bears a strong nexus to the perceived wrong. For instance, if the complaint alleges that the directors failed to adequately consider a merger proposal before submitting it to the shareholders for a vote, and the parties settle the action with the defendant-directors agreeing to reconsider the matter and resubmit it to the shareholders, then the award of attorneys' fees is an easy case based on the strong nexus between the complaint and the relief.[53] Indeed, the settlement vindicates the filing of the action. Conversely, if the parties settle the action with the corporation agreeing to create a new committee to review fundamental corporate changes before a board vote, an award of attorneys' fees seems far less justified, as the nexus between the complaint and the relief obtained is weak at best.[54] The salient difference between these hypothetical settlements is whether the relief obtained corrects the alleged wrong (the first example) or merely provides some prophylactic protection against its recurrence (the second example). The latter ought to be carefully scrutinized by the courts.

For instance, in *Bell Atlantic Corp. v. Bolger*,[55] plaintiff filed a derivative action on the heels of a settlement between a Bell Atlantic subsidiary, Bell of Pennsylvania, and the Pennsylvania Attorney General in which the Attorney General alleged that Bell of Pennsylvania violated state

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[53]*See, e.g.*, O'Neill v. Church's Fried Chicken, Inc., 910 F.2d 263, 266 (5th Cir. 1990) (affirming the district court's decision that plaintiff-shareholder was entitled to attorneys' fees where her prosecution of the action affected the decision of the directors to approve a revised tender offer, that increased the corporation's stock value and thereby "conferred a substantial benefit" on the corporation); Globus, Inc. v. Jaroff, 279 F. Supp. 807, 810 (S.D.N.Y. 1968) (concluding that defendants' cancellation of objectionable stock option plan when shareholder's suit was on the "brink of success" formed the basis for an inference that cancellation was caused by the shareholder's suit, but reserving judgment on whether the suit "caused or substantially contributed" to cancellation of the plan); Joy Mfg. Corp. v. Pullman-Peabody Co., 729 F. Supp. 449, 457 (W.D. Pa. 1989) (approving attorneys' fees and finding a benefit to the corporation where derivative action challenged validity of antitakeover measures that thwarted hostile takeover, causing the corporation to put itself up for auction); Cohan v. Loucks, No. 12,323, 1993 Del. Ch. LEXIS 99 (Del. Ch. June 11, 1993), *reprinted in* 19 DEL. J. CORP. L. 697 (1994) (involving a derivative action that complained of corporate adherence to Arab boycott, where relief included corporate undertaking to reinvest in Israel, and attorneys' fees of $700,000 awarded).

[54]For a contrary view, arguing that the substantial benefit rule creates too much of an obstacle to the recovery of attorneys' fees, see Carol G. Hammett, Note, *Attorneys' Fees in Shareholder Derivative Suits: The Substantial Benefit Rule Reexamined*, 60 CAL. L. REV. 164, 165, 167, 185-88 (1972).

[55]2 F.3d 1304 (3d Cir. 1993).

unfair practices and consumer protection laws.[56] As a result of the settlement, Bell Atlantic agreed to pay over $40 million in refunds to customers, make contributions to a consumer education trust and reimburse the Attorney General for its legal costs.[57] The derivative action alleged, *inter alia*, that the Bell Atlantic directors breached their duty of care in allowing this improper activity to occur.[58] The action was settled with an agreement by Bell Atlantic to: (1) disclose to its shareholders the information regarding the Bell Atlantic settlement and related litigation, (2) establish new procedures to monitor sales and marketing programs, and (3) pay plaintiffs' attorneys' fees and expenses up to $450,000.[59] Three shareholder-objectors questioned whether the new monitoring procedures justified the award of attorneys' fees and appealed the district court's approval of the settlement to the Third Circuit.[60]

While the shareholder-objectors were unsuccessful in their appeal,[61] their arguments were not without merit. The settlement of the derivative action simply created a mechanism to assure that Bell Atlantic and its subsidiaries would comply with the law.[62] This does nothing, of course, to remedy the wrong complained of; the remedy looks only to the future. Plaintiff, of course, could respond that avoiding similar future losses is of value. But is this outcome of sufficient value to justify protracted and expensive litigation, not to mention the shifting of attorneys' fees to the corporation? Put differently, if plaintiff had sought this relief in its complaint, to the exclusion of all other relief, including monetary damages, is it not likely that defendants would have settled immediately? Assuming the answer is "yes," then perhaps the corporate defendant should only have to pay for the value of the benefit, largely ignoring the litigation costs of the plaintiff.[63]

One might respond that, in litigation, the defendant frequently ends up settling a claim for an amount that it would have immediately agreed to pay if proposed. That is the nature of any dispute resolution mechanism. Moreover, the assurance that the settlement will be upheld (or immune from

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[56] *Id.* at 1306 & n.2.

[57] *Id.* at 1306.

[58] *Id.*

[59] *Bell Atlantic*, 2 F.3d at 1306-07.

[60] *Id.* at 1307.

[61] *Id.* at 1318.

[62] *Id.* at 1306-07.

[63] *See* Lewis v. Great W. United Corp., No. 5397, 1978 Del. Ch. LEXIS 723, at *11-12 (Del. Ch. Mar. 28, 1978), *reprinted in* 4 DEL. J. CORP. L. 248, 256 (1979) (recognizing that where a fund is created or preserved, the Delaware courts have said that time and hourly rates are not the most significant elements in a judicial determination of attorneys' fees).

subsequent re-opening) is precisely what encourages parties to negotiate and settle.[64] Derivative litigation is, however, distinctive. In derivative litigation, plaintiff's attorney traditionally has had a strong incentive to prolong the litigation, since the fee that he or she might obtain is often linked to the hours expended and only loosely connected to the value of the benefit obtained, especially when the settlement consists of intangible relief.[65] In fact, when a settlement or judgment generates a common fund, the attorneys' fees are generally a percent of that fund, usually varying between twenty and thirty percent.[66] When the suit results in a settlement consisting of intangible

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[64]*See* Rome v. Archer, 197 A.2d 49, 58 (Del. 1964).

[65]The two methods used to calculate attorneys' fees in derivative litigation are the percent method, applicable when the case generates a common fund, and the lodestar method, which may be used whether or not a common fund is generated. *See In re* Oracle Sec. Litig., 852 F. Supp. 1437, 1449 (N.D. Cal. 1994). Under the lodestar method, attorneys' fees are calculated on the basis of the number of hours reasonably expended by the attorney multiplied by the applicable market hourly rate. *See generally* ALAN HIRSCH & DIANE SHEEHEY, AWARDING ATTORNEYS' FEES AND MANAGING FEE LITIGATION 19 (Federal Judicial Center 1994) (citing Hensley v. Eckerhart, 461 U.S. 424, 433 (1983)). The court may then adjust the lodestar upward or downward, depending on a number of factors, such as incomplete success, novelty or complexity of issues, exceptional success or quality of representation, risk, etc. *Hensley*, 461 U.S. at 434-36. *See generally* HIRSCH & SHEEHEY, *supra*, at 17-40 (discussing the factors relied upon by the courts in calculating the appropriate award of attorneys' fees). By contrast, the percent method simply awards plaintiff attorney a percent of the fund generated by the litigation. Where there is a common fund, the federal courts prefer to use the percent method. *Id.* at 63-66. In the absence of a common fund, the courts must resort to the lodestar method. *Id.* at 63-69. *See also* Southerland v. International Longshoremen's Union, 845 F.2d 796, 800-01 (9th Cir. 1987) (noting that the appropriate starting point in computing attorneys' fees is to multiply the number of hours reasonably spent by a reasonable hourly rate); Levenson v. Overseas Shipholding Group, Inc., 84 F.R.D. 354, 360 (S.D.N.Y. 1979) (determining that the baseline or "lodestar" figure for awarding attorneys' fees is calculated by multiplying the number of hours counsel worked by a reasonable hourly rate).

The Delaware courts have stated that they will award fees as a "matter of discretion," and that "the results achieved through the litigation are generally the primary consideration." Cohan v. Loucks, No. 12,323, 1993 Del. Ch. LEXIS 99, at *10 (Del. Ch. June 11, 1993), *reprinted in* 19 DEL. J. CORP. L. 697, 703 (1994). "Other factors include the time and effort expended by counsel, the complexity of the litigation, the standing and ability of counsel and the contingent nature of the fee arrangement." *Id. See also* Good v. Texaco, Inc., No. 7501, 1985 WL 11536, at *17 (Del. Ch. Feb. 19, 1985), *reprinted in* 10 DEL. J. CORP. L. 854, 880 (1995) (considering "the magnitude of the case, the obstacles facing the plaintiffs at the outset... the expertise of counsel, the contingent nature of the fee prospects facing [plaintiff's counsel] at the outset, [and] the effort put forth and the result achieved"); Sugarland Indus., Inc. v. Thomas, 420 A.2d 142, 149-50 (Del. 1980) (considering, the amount of time and effort expended by counsel, the complex nature of the litigation, and the expertise of counsel). In practice, however, in the absence of a fund, the Delaware courts rely heavily on what amounts to the lodestar method. *See infra* note 66.

[66]*In re* Oracle Sec. Litig., 852 F. Supp. at 1452 (awarding derivative counsel 30% of common fund); Thorpe v. CERBCO, Inc., No. 11,713, 1997 Del. Ch. LEXIS 18, at *17-18 (Del. Ch. Feb. 6, 1997), *reprinted in* 22 DEL. J. CORP. L. 1300, 1311 (1997) (concluding that unusual circumstances justified award of one-third of the common fund as attorneys' fees); Thomas v. Kempner, 398 A.2d 320, 331 (Del. Ch 1979) (determining that plaintiffs' counsel should be awarded 20% of common fund as attorneys' fees). Delaware courts have often demonstrated a willingness to exercise independent judgment in common fund cases if the attorneys' fee, based on a percent

relief, however, attorneys' fees are based primarily on the hours expended by counsel.[67] If, in such instances, the fee were based instead on the value of the benefit obtained, the incentive to prolong litigation would be reduced. Thus, the courts should use, as a paradigm, a fee calculation stratagem appropriate to the value of the benefit as if it were of paramount importance.

This approach has considerable appeal in cases such as *Bolger*, because the corporation had in its articles of incorporation a provision limiting the liability of directors for breach of fiduciary duty.[68] Thus, from the outset of the case, the only probable relief that the plaintiff could obtain was corporate governance reform. It therefore seems wasteful to compensate the plaintiff for time spent seeking relief that was unobtainable, while obtaining relief of questionable value. Moreover, providing generous attorneys' fees in such a case runs contrary to the policy reflected in the statutory provision that permits corporations to limit their director liability.[69] The legislature intended these provisions to deter litigation such as that in *Bolger*, while the actual decision in the case tends to encourage suits against directors.

Another objection to the concept of limiting fees is that defendants need not agree to the settlement; they can always opt to litigate the case to final judgment. Here again, the unique aspects of derivative litigation must be considered. In cases such as *Bolger*, the corporation has an obligation to indemnify the director-defendants, unless they are adjudged liable; and even if liable, the corporation may still be vulnerable for payment of their

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of the fund, would be unreasonable (either too high or too low). In those instances, the courts look to such factors as the number of hours spent on the matter, its complexity, the risk involved, and the expertise of the attorneys in determining the fee. *See, e.g.*, Fox v. Chase Manhattan Corp., No. 8192-85, 1986 Del. Ch. LEXIS 356, at *14 (Del. Ch. Jan. 9, 1986) (reducing the fee request of 17.5% of settlement to approximately 9%); Goldstone v. Texas Int'l Co., Nos. 6651, 6652, 6655 (Consolidated), & 7607, 1985 Del. Ch. LEXIS 493, at *10 (Del. Ch. July 10, 1985), *reprinted in* 11 DEL. J. CORP. L. 658, 663 (1986) (holding that fees limited to 1% of $30 million benefit were reasonable). *See generally* ROBERT CHARLES CLARK, CORPORATE LAW 661-62 (1986) (noting that fees "cluster" around 20% of the common fund); Douglas G. Cole, *Counsel Fees in Stockholders' Derivative and Class Actions — Hornstein Revisited*, 5 U. RICH. L. REV. 259, 283-85 (1970); Robert T. Mowrey, *Attorney Fees in Securities Class Action and Derivative Suits*, 3 J. CORP. L. 267, 297-334 (1977).

[67]*E.g.*, *In re* American Real Estate Partners, L.P., No. 13,687, 1997 Del. Ch. LEXIS 171, at *21 (Del. Ch. Dec. 3, 1997), *reprinted in* 23 DEL. J. CORP. L. 1243, 1253 (1998) (rejecting a fee request of $500,000 based on purported value achieved in litigation, in favor of fee based in part on hours expended); *In re* Dunkin' Donuts Shareholders Litig., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,725, at 98,414-98,415 (Del. Ch. Nov. 27, 1990), *reprinted in* 16 DEL. J. CORP. L. 1443, 1457 (1991) ("When an unquantifiable benefit is involved, the *quantum meruit* approach gives the Court a more equitable means of determining a reasonable fee.").

[68]Bell Atlantic v. Bolger, 2 F.3d 1304, 1306 n.3 (3d Cir. 1993).

[69]DEL. CODE ANN. tit. 8, § 145(b) (1996).

attorneys' fees.[70] Notwithstanding that considerable expense, the corporation has its own costs and expenses to consider, including the cost to its operations of continuing the litigation. When weighing these amounts against the benefits of disposing of the litigation at relatively little cost, the choice is obvious in most instances. In a footnote to the *Bolger* opinion, the court quoted from a statement made by defense counsel at the settlement hearing explaining their rationale for agreeing to the settlement:

> We settled because the relief proposed made sense. It fairly met the issue that had created the problem with Bell of Pennsylvania, and [also] because an award of counsel fees ranging anywhere from zero to four hundred and fifty thousand dollars was not far outside the range of what we thought it would take to try this case to a jury . . . .[71]

The court's assessment of the settlement was characterized as follows:

> Even if plaintiffs hoped to secure a large damage award, this would have to be drastically discounted by the improbability of their success on the merits given the individual defendants' strong defenses. Thus, even if we attach a small figure to the value of the corporate governance changes . . ., this small value may be fair consideration for and accurately reflect the expected payout at trial net of the costs of trial.[72]

While the court is correct that the small likelihood of success at trial justifies a minimal recovery, that same minimal recovery should operate to limit the plaintiff's attorneys' fees because, almost by definition, the benefit is not substantial. The principal benefit to the corporation was simply the

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[70]Under the Delaware Code, for instance, the court of chancery has the authority to order indemnification for the expenses of a director "adjudged . . . liable to the corporation" in a derivative action if the court determines that "despite the adjudication of liability but in view of all of the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery . . . shall deem proper." *Id.* Other states are even more permissive. *See, e.g.*, WIS. STAT. ANN. §§ 180.0851, 180.0852 (West 1992) (requiring indemnification unless the breach of duty was one in which the director (1) willfully failed to deal fairly with the corporation in a conflict of interest situation, (2) committed a crime, (3) received an improper personal benefit, and (4) engaged in wilful misconduct).

[71]*Bell Atlantic*, 2 F.3d at 1313 n.14.

[72]*Id.* at 1313.

dismissal of the litigation. Something must be amiss when dismissing a suit is the basis for awarding fees to the plaintiff.[73]

A final objection might be that parsimonious awards of attorneys' fees would overly deter what might otherwise be meritorious suits, and that other procedures serve as a sorting mechanism for frivolous cases. These other procedures include the contemporaneous ownership requirement,[74] security-for-expense statutes,[75] high pleading standards,[76] the demand requirement,[77] the use of summary proceedings,[78] Rule 11 sanctions,[79] etc. If the plaintiff clears all of these hurdles, and settles the case, it arguably deserves a generous fee award. However, the reality is that plaintiffs often settle cases — particularly the weakest ones — before facing many of these hurdles. In *Caremark*, for instance, a motion to dismiss was pending at the time of settlement.[80]

In *Bolger*, the plaintiff barely survived defendants' motion for summary judgment, which, in turn, was based on the decision of the Bell Atlantic board to dismiss the litigation as not being in the corporation's best interest.[81] The district court agreed that the board had acted in good faith when it sought dismissal, but the court was unconvinced that the board had acted in an informed manner and with due care.[82] While this is a success of sorts, the district court also held that the Bell Atlantic charter provision absolved the defendants of monetary liability.[83] Thus, the Court told the plaintiff that it could go to trial, but it could obtain no monetary relief from the defendants. At this point, the plaintiff had a strong incentive to settle for anything that would support an award of attorneys' fees. Accordingly, the defendants seized the opportunity to dispose of a distracting action, with attendant public relations problems, at a relatively small price.[84] Had the rule been that the settlement, including a fee award, will not be approved

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[73]*See* John P. Dawson, *Lawyers and Involuntary Clients in Public Interest Litigation*, 88 HARV. L. REV. 849, 870 (1975) ("There must be something wrong with a method of analysis that leads to the conclusion: though the start of suit had no effect other than providing an opportunity to stop it, stopping it is enough to warrant awarding a fee.") *See, e.g.*, United Operating Co. v. Karnes, 482 F. Supp. 1029, 1031 (S.D.N.Y. 1980).

[74]CLARK, *supra* note 66, at 650.

[75]*Id.* at 652.

[76]FED. R. CIV. P. 23.1.

[77]*See* CLARK, *supra* note 66, at 640-49.

[78]FED. R. CIV. P. 56.

[79]FED. R. CIV. P. 11.

[80]*In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959, 964-65 (Del. Ch. 1996).

[81]Bell Atlantic Corp. v. Bolger, 2 F.3d 1304, 1306 (3d Cir. 1993).

[82]*Id.*

[83]*Id.*

[84]*See supra* notes 55-63 and accompanying text.

unless the fees are measured in relation to the benefit obtained, the case may never have been brought, as it clearly should not have been.

Tying the award of attorneys' fees to the value of the benefit obtained comports well with traditional notions of restitution, which are, after all, a basis on which the fees are awarded.[85] The Restatement of Restitution, for instance, states this general rule: "Where a person is entitled to restitution from another because the other . . . has received a benefit, the measure of recovery for the benefit thus received is the value of what was received . . . ."[86] Courts departed from this notion in cases in which successful lawyers sought fees from a common fund produced by their efforts. The courts apparently felt comfortable awarding fees from such a fund on the theory that, otherwise, the nonparty beneficiaries of the fund would be unjustly enriched.[87] It has seldom been noted that, in this regard, lawyers receive special treatment by the courts; other such "intermeddlers" generally remain uncompensated altogether, much less entitled to generous compensation.[88] The transition from the common fund doctrine to the

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[85]Trustees v. Greenough, 105 U.S. 527, 532-33 (1881) (concluding that plaintiff-bondholder was entitled to attorneys' fee in successful action that benefited fellow bondholders to avoid injustice). The late Professor John Dawson stated it well:

> In the case supposed [where litigation results in a benefit to nonparty strangers] a claim to recover unjust enrichment could be framed as a claim of the enterprising litigant to enforce contribution to costs that he had necessarily incurred in bringing gains to himself and necessarily, without any element of altruism, to others.

Dawson, *supra* note 3, at 1601.

[86]RESTATEMENT RESTITUTION § 155 (1937). This section of the *Restatement* deals generally with measuring the amount that the recipient of a service has to pay the provider, assuming there is no contract between the parties and assuming that the other criteria justifying restitution are present. *Id.* Comment d makes clear that the cost to the service provider is not the measure: "[T]he limit of restitution is the amount by which the recipient or his property has benefited, although the value of the services or the amount which was expended therefore may be greater." *Id.* Assuming that the "value" of a lawyer's service is the product of his hourly rate times the number of hours expended, the *Restatement* makes clear that, were it to apply to attorneys' fees, the product thus obtained would not measure the defendant's liability.

[87]In *Central R.R. & Banking Co. v. Pettus*, 113 U.S. 116, 122 (1885), the Supreme Court extended an earlier precedent, *Trustees v. Greenough*, 105 U.S. 527 (1881), that recognized the right of a party to seek contribution from a common fund for the legal expenses of that party in generating the fund. *Central R.R.*, 113 U.S. at 123. In *Pettus* the Court held that the lawyer had a right against the fund. *Id.* at 127. Commenting on these two cases, the late Professor Dawson wrote: "The case law that has grown out of *Greenough* and *Pettus* expresses a conviction, widely held among judges and lawyers, at least, that lawyers have a right that is denied to all the rest of the population, to share the wealth of strangers their services have produced." Dawson, *supra* note 3, at 1608.

[88]Dawson, *supra* note 3, at 1608. In the conclusion of his article Professor Dawson sought to explain this anomaly:

> [T]he reception given the *Pettus* case can only be explained by the strong fellow-feeling of judges for brothers in the guild. Similar bounty sought by other kinds of professionals or indeed by anyone else in the population is uniformly denied, so abruptly as a rule that the claim seems to be thought not worthy of discussion.

substantial benefit rule, which allows attorneys' fees in the absence of a common fund provided the corporation receives a substantial benefit from the efforts of the plaintiff and plaintiff's counsel, seems logical enough.[89] On closer examination, however, the transition is troublesome.

In a typical derivative action seeking and obtaining monetary recovery that flows to the corporation, each shareholder has been indirectly benefited by the successful action; presumably, the value of the shareholder's shares is increased, *pro rata*, by the recovery. Thus, any reduction attributable to the payment of the attorneys' fee would still leave the shareholder better off than before the action.[90] This is true regardless of the formula used to compensate the successful attorney so long as the fee is less than the recovery.

Where there is no common fund, however, the mathematics are different. In that case, the "substantial benefit" to the shareholders would seem to justify an award of attorneys' fees only if the benefit somehow enhanced the value of the corporate stock. If, for instance, the market for a publicly traded company took notice of a derivative action settlement that imposed some corporate governance reform, and, as a result, bid up the price of the stock of the corporation, then by analogy to the common fund doctrine, the stockholders should disgorge a portion of this gain to the lawyers who secured it for them. But if there is no bump in the stock price, that is, if the intangible benefit of the settlement is not viewed by the market as enhancing the value of the corporation, or the benefit cannot otherwise be quantified, then there seems little reason to award fees to the attorney who secured this nebulous victory.[91]

Moreover, it seems almost perverse to award attorneys' fees from the corporate coffers in such instances, because such an award *diminishes* the

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Id. at 1653.

[89]*See* Hammett, *supra* note 54, and accompanying text.

[90]This assumes that the costs of the litigation to the corporation, both direct and indirect, are less than the net benefit to it (after plaintiff's attorneys' fees).

[91]For an example of a case in which the court attempted to quantify an intangible benefit, see Baupost Limited Partnership 1983 A-1 v. Providential Corp., No. 12,978, 1993 WL 401866, at *3 (Del. Ch. Sept. 3, 1993) (settlement resulted in the elimination of certain stock options, which the court valued at over $2.5 million, approving a fee of $326,000 or 13% of the benefit obtained). A review of cases decided earlier this century suggests that the courts routinely quantified the relief obtained, *See* Hornstein, *Counsel Fee*, *supra* note 2, at 812-15. A follow-up study done by the author about eight years later confirmed this practice. George D. Hornstein, *New Aspects of Stockholders Derivative Suits*, 47 COLUM. L. REV. 1, 24 (1947) ("In rewarding successful complainants, the court must first determine the value of the benefits derived by the corporation from the judgment or settlement of the suit.") The rule in Delaware appears to be that "the benefit need not be measurable in economic terms." Tandycrafts, Inc. v. Initio Partners, 562 A.2d 1162, 1165 (Del. 1989).

pro rata value of each shareholder's interest in the corporation.[92] Courts do not consider this circumstance when approving fee settlements in derivative actions where no common fund results. Interestingly, I have been unable to find any cases approving fees, solely on the basis of a common fund, where the fee award exceeded the amount of the common fund.[93] Yet the courts willingly approve such fees in the absence of any common fund, despite the fact that those fee awards may have the same economic effect on the shareholders as an award of fees that exceeds the common fund.[94]

It is not insignificant in this regard that within substantial benefit cases the fee payer is invariably the corporation itself. This seems unobjectionable since the balance of the fund (net of the attorneys' fee award), in the common fund cases, becomes part of the corporate treasury. Moreover, in theory, when the common fund represents amounts paid by defendants, it could include amounts to cover all or a portion of the plaintiff's attorneys' fee, so that, in effect, the shareholders do not pay the fee themselves. This possibility, however, evaporates when no fund is created, no enhancement of shareholder wealth is realized, and the corporation itself pays the fees. In such instances, if the courts are to continue to award fees to the plaintiff, they should require that the fees be paid by the defendants, without reimbursement by the corporation.[95] If this is impossible, because

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[92]*See* Fletcher v. A.J. Indus., Inc., 72 Cal. Rptr. 146, 156 (Cal. Ct. App. 1968) (Christian, J., dissenting in part).

> [I]f the existence of a "common fund" . . . is not prerequisite to the allowance of fees the officers and directors might well be faced with a liquidation of assets to pay fees, even though [the] resulting harm to the corporation might be disproportionate to the "substantial benefits" derived from the lawsuit.

Id. See also Fischer & Porter Co. v. Tolson, 27 Fed. R. Serv. 3d 87, 92-93 (E.D. Pa. 1993) (refusing to approve the settlement including plaintiff's attorneys' fees because the corporate governance changes were "only marginally valuable" to the corporation and "the proposed settlement accomplishe[d] little more than to handsomely reward plaintiff's attorneys").

[93]*See* Thorpe v. CERBCO, Inc., No. 11,713, 1997 Del. Ch. LEXIS 18, at *17-18 (Del. Ch. Feb. 6, 1997), *reprinted in* 22 DEL. J. CORP. L. 1300, 1311 (1997) (rejecting fee request of $1,529,867 because common fund was only $430,092 and plaintiff's attorney would be awarded one-third of that fund); Roth v. Robertson, 118 N.Y. Supp. 351, 354 (N.Y. Sup. Ct. 1909) (holding that where defendant "prevail[s] as to the major portion of the claims asserted against him," costs will not be assessed). Of course, where the suit results in both monetary and direct nonmonetary relief, such as cancellation of claims against the corporation, the fee award may exceed the cash recovery. *See, e.g.*, Colley v. Sapp, 142 P. 1193, 1193-95 (Okl. 1914).

[94]*See supra* note 66 and accompanying text.

[95]This appears to have been the case in *Good v. Texaco, Inc.*, No. 7501, 1985 WL 11536, at *17 (Del. Ch. Feb. 19, 1985), *reprinted in* 10 DEL. J. CORP. L. 854, 878-80 (1985), in which the Delaware Court of Chancery approved the settlement in a combined class and derivative action where no money changed hands other than the payment of plaintiff's attorneys' fees. Technically, however, this may be objectionable, since it amounts to fee shifting to the defendants. *See* cases cited *infra* note 96 for examples.

of prohibitions on fee shifting,[96] or because the corporation is required to indemnify the defendants,[97] or because the corporate charter immunizes the defendants from personal liability,[98] then it seems that an award of attorneys' fees should be precluded, unless the "substantial benefit" can somehow be quantified.[99]

This approach is consistent with the Private Securities Litigation Reform Act of 1995 (PSLRA)[100] and the Bankruptcy Reform Act of 1978,[101] each of which limits attorneys' fees. Under the PSLRA, the court may award fees in securities class actions equal to a "reasonable percentage of the amount of any damages [and] prejudgment interest actually paid."[102] This provision suggests that if the settlement of a class action under the PSLRA results solely in nonpecuniary relief, attorneys' fees may not be awarded.[103] Thus, unlike fees in derivative actions, fees under the PSLRA are calculated solely with reference to the result obtained. Similarly, under the Bankruptcy Act, an attorney retained by the bankruptcy trustee is entitled only to

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[96]*See, e.g.*, Jones v. Uris Sales Corp., 373 F.2d 644, 648 (2d Cir. 1967) (holding that it was error to direct that the individual defendant, rather than the defendant corporation, pay fees of plaintiff's attorney); Fistal v. Christman, 133 F. Supp. 300, 304-05 (S.D.N.Y. 1975) (finding that dismissal conditioned solely on payment of fees to plaintiff's attorney by the "insider," with the corporation receiving nothing, would be contrary to the purpose of the statute).

[97]*See, e.g.*, Waltuch v. Conticommodity Servs., Inc., 88 F.3d 87, 97 (2d Cir. 1996) (finding employee entitled to reimbursement for legal expenses under section of Delaware statute allowing for indemnification for success on the merits in defense of suit involving corporation); Raychem Corp. v. Federal Ins. Co., 853 F. Supp. 1170, 1179 (N.D. Cal. 1994) (holding that indemnification of officers and directors for settlement payments and defense costs in securities fraud action met the criteria under their insurance clause for reimbursement where "permitted or required" by law).

[98]*See, e.g.*, Von Feldt v. Stifel Fin. Corp., 714 A.2d 79, 85 (Del. 1998) (granting director legal costs and expenses pursuant to parent company's bylaws); Heffernan v. Pacific Dunlop GNB Corp., 965 F.2d 369, 376 (7th Cir. 1992) (remanding for determination of whether plaintiff met corporate bylaw prerequisites for indemnification). *But see* Mayer v. Executive Telecard, Ltd., 705 A.2d 220, 223 (Del. Ch. 1997) (holding that attorneys' fees were not recoverable in plaintiff's successful action to enforce corporation's obligation to indemnify officers and directors under the corporate bylaws, entitling this a "fees for fees" action).

[99]*See, e.g.*, Schechtman v. Wolfson, 244 F.2d 537 (2d Cir. 1957). Here, the plaintiff brought a derivative action alleging that the director-defendants were in violation of the Clayton Act because they held interlocking directorships. When the defendants resigned from the other directorship, the suit was dismissed and the plaintiff sought attorneys' fees. The court denied the petition because the "success" was an insufficient benefit to the corporation to justify the fee request. *Id.* at 540. *But see* Ridder v. CityFed Fin. Corp., 47 F.3d 85, 88 (3d Cir. 1995) (advancing plaintiffs' costs of pending litigation because defendants' bylaws required indemnification of employees sued by reason of their employment).

[100]15 U.S.C.A. §§ 77z-1a(6), 78u-4a(6) (West 1997).

[101]15 U.S.C.A. § 330(a)(1)(A) (West Supp. 1998).

[102]15 U.S.C.A. §§ 77z-1a(6), 78u-4a(6) (West 1997).

[103]*See* James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497, 518 (1997).

"reasonable compensation for actual, necessary services."[104] The attorney's fiduciary duty to the estate requires him to make a careful judgment at the outset of the case, "whether the number of billable hours that he [will] be investing [is] commensurate with the expected gain."[105] If the attorney miscalculates, the recoverable fee is directly affected.[106]

A final objection to the current practice of awarding fees for the achievement of corporate governance reform is that such reforms are achievable in a more efficient way. Shareholders dissatisfied with some aspect of the governance structure can alter that structure through bylaw or charter amendments utilizing Rule 14a-8 of the Securities Exchange Act of 1934,[107] or by replacing the board of directors. While this latter remedy is generally expensive, if feasible at all, the former is both inexpensive and available. Rule 14a-8 provides an easy means to affect corporate governance, as long as the shareholders generally favor such reform.[108]

V. THE LIBERALIZATION OF RULE 14a-8

The federal proxy rules have long provided a means by which shareholders can include in their company's proxy statement a proposal for action by the shareholders. This mechanism frequently has been used by shareholders to suggest reforms in corporate governance.[109] For instance, it is not uncommon for shareholders to propose that the bylaws of the corporation be amended to eliminate a requirement for a staggered or classified board.[110] With the increasing activism of institutional shareholders, such proposals have garnered significant support in many instances, with an occasional success.[111]

Under current rules, shareholders desiring to include a proposal in the corporation's proxy statement must first submit the proposal to the corporation.[112] The corporation must include the proposal in its proxy statement for shareholder approval, unless the corporation has certain

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[104]11 U.S.C.A. § 330(a)(1)(A).

[105]*In re* Taxman Clothing Co., 49 F.3d 310, 314 (7th Cir. 1995).

[106]*Id.* at 316.

[107]17 C.F.R. § 240.14a-8(a) (1998).

[108]*See generally* 17 C.F.R. § 240.14a-8 (1998) (specifying mechanics for proposing changes in corporate governance).

[109]*See, e.g.*, Bell Atlantic Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993); Granada Invs. Inc. v. DWG Corp., 962 F.2d 1203 (6th Cir. 1992); Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877 (S.D.N.Y. 1993), *aff'd*, 54 F.3d 69 (2d Cir. 1995).

[110]*See, e.g.*, Corporate Governance Bulletin (Investor Responsibility Research Center, May/June 1993).

[111]*Id.*

[112]17 C.F.R. § 240.14a-8.

grounds under the rule for omitting the proposal.[113] Two grounds are particularly pertinent to proposals related to corporate governance: one that permits the corporation to exclude a shareholder proposal that relates to "ordinary business operations,"[114] and another that permits exclusion of proposals that are "not a proper subject for action"[115] under the law of the corporation's state of incorporation. Using either rationale, companies have sought to omit various proposals related to corporate governance.[116] If a corporation determines to omit a proposal, the Commission's rules require the company to so inform it, and the Commission will then advise the company as to whether or not it agrees with such a determination.[117] If either the company or the shareholder-proposer is dissatisfied with the Commission's decision, the aggrieved party may bring the matter to the federal courts for adjudication. In any event, the possibility of company rejection, SEC review and judicial action add cost and uncertainty to the process, thereby deterring some shareholders from making proposals in the first instance, or from pursuing the steps required for ultimate inclusion. So while Rule 14a-8 provides a means by which shareholders can implement a change in corporate governance, it is less than perfect.[118]

The viability of Rule 14a-8 as a means to corporate governance reform is also enhanced by the availability of attorneys' fees for parties who are successful in getting a proposal into the corporation's proxy statement. In *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc.*,[119] the Second Circuit affirmed an award of attorneys' fees in the amount of $54,140 for shareholders who succeeded in obtaining a judgment that

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[113]In addition, the shareholder must satisfy certain procedural requirements, such as owning at least one percent or $1,000 in market value of the registrant's stock, submitting the proposal not less than 120 days before the date of the release of the previous year's proxy statement, etc. *See* 17 C.F.R. § 240.14a-8(a).

[114]17 C.F.R. § 240.14a-8(c)(7).

[115]17 C.F.R. § 240.14a-8(c)(1).

[116]*See generally* Daniel E. Lazaroff, *Promoting Corporate Democracy and Social Responsibility: The Need to Reform the Federal Proxy Rules on Shareholder Proposals*, 50 RUTGERS L. REV. 33 (1997) (criticizing the rules permitting corporations to exclude proposals).

[117]17 C.F.R. § 240.14a-8(d). *See also* Lazaroff, *supra* note 116, at 44 (discussing the requirements for omitting a proposal).

[118]In October 1997, the SEC proposed amendments to these rules that, in one respect, would have made the shareholder proposal rules more attractive for those seeking changes in corporate governance.

The SEC's proposal included a provision that would have permitted shareholders owning a certain percentage of the corporation's outstanding stock to override the determination that a proposal is excludable because it relates to the corporation's ordinary business or because the proposal is insignificant in relation to the company's business. Exchange Act Rel. No. 39093, 62 Fed. Reg. 50682 (Sept. 26, 1997). In its final rules, however, the SEC declined to adopt this amendment. 17 C.F.R. § 240.14a-8 (1998).

[119]54 F.3d 69 (2d Cir. 1995).

their proposal – related to Wal-Mart's affirmative action policies – was improperly excluded by Wal-Mart from its proxy statement.[120] Significantly, the court found that the fees were justified despite the fact that Wal-Mart had received a no-action letter from the SEC supporting the omission of the proposal, and over ninety percent of Wal-Mart's shareholders subsequently voted against the proposal.[121] Rather, the court held that promoting "corporate suffrage regarding a significant policy issue confers a substantial benefit regardless of the percentage of votes cast for or against the proposal at issue."[122] Similarly, while current precedent suggests otherwise, attorneys' fees could be awarded in cases in which the proposal was included without the benefit of litigation, and the amount of the fee can reflect a premium because litigation was avoided.[123]

By contrast, suppose the shareholder-proposers in Wal-Mart had, instead of proceeding under Rule 14a-8, filed a derivative action claiming that the Wal-Mart directors violated their fiduciary duty of care by failing to implement measures to assure compliance with federal civil rights statutes. Even assuming that such a claim might lack merit, it is not inconceivable that the corporation would settle this action by agreeing to include in its

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[120] *Id.* at 72.

[121] *Id.*

[122] *Id.*

[123] In *Foley v. Santa Fe Pacific Corp.*, 641 N.E.2d 992, 996 (Ill. App. 1994), the court held that "[a]bsent the filing of an underlying meritorious lawsuit, there can be no suit for the recovery of fees under the 'corporate benefit' rule." The suit was filed following plaintiff's successful proxy fight to achieve the removal of a poison pill. Plaintiff sought reimbursement for his fees and costs in connection with the contest on the theory that his efforts created a substantial benefit for the shareholders. *Id.* at 993. The court refused to extend the substantial benefit rule to a nonlitigation context. *Id.* at 996. This was an unfortunate result, at least for those instances in which plaintiff forewent a litigation option. *See also* Wyser-Pratte v. Van Dorn Co., B.T.Z., Inc., 49 F.3d 213, 218-19 (6th Cir. 1995) (denying attorneys' fees to shareholder who was successful in proxy solicitation where litigation was not required).

By comparison, in *Neese v. Richer*, 428 N.E.2d 36 (Ind. App. 1981), the plaintiff was unsuccessful in a derivative action alleging fraud and mismanagement. *Id.* at 37. In dismissing the derivative action, however, the trial court noted that the corporation had not maintained proper books and records, as required by the Indiana corporate statute, and ordered an audit of the corporate books. *Id.* Plaintiff then requested fees based on this audit, arguing that it benefited the shareholders. *Id.* at 38. The court agreed and awarded fees to the plaintiff, even though the plaintiff probably could not have brought a derivative action to require the corporation to comply with the statute. *Id.* at 42-43. Arguably, if the court was willing to award fees for an incidental benefit generated by an unsuccessful derivative action, it should be willing to award fees for the same benefit obtained directly without the benefit of litigation.

The Delaware courts have indicated a willingness to award attorneys' fees if a pre-litigation demand caused the board to act in a way that benefited the shareholders, provided that the underlying claim was otherwise meritorious. Bird v. Lida, 681 A.2d 399, 407 (Del. Ch. 1996). *See also* Lansky v. NWA, Inc., 471 N.W.2d 713, 714 (Minn. Ct. App. 1991) (determining that attorneys' fees may be awarded if board action moots a derivative action, if there is a substantial benefit to the shareholders caused by the filing of the suit).

proxy statement a proposal to implement a more aggressive affirmative action proposal, such as that which was the subject of the actual Wal-Mart litigation. Under these circumstances, is it appropriate to award attorneys' fees to plaintiffs on the basis of the time spent to achieve this result, even if such fees are vastly more than what it would have cost to obtain the same result under Rule 14a-8? Stated differently, if a relatively inexpensive mechanism is in place to obtain the relief that plaintiff obtained, why not limit the fee award to the less expensive means? *Weisberg v. Coastal States Gas Corp.*[124] provides a paradigm fact situation for application of this approach.

In *Weisberg*, the plaintiffs alleged that the defendant-directors were responsible for illegal payments made by the corporation.[125] After literally thousands of billable hours, plaintiffs "concluded that they lack evidence to support an allegation of a kickback" and, therefore, settled the case for "revised corporate policies requiring disclosure to shareholders concerning commission payments."[126] Under a traditional unjust enrichment evaluation, this would appear to be of minimal value. Yet the court could not ignore the hours expended by the two lawyers representing the plaintiffs: 1,428.75 hours by one counsel and 1,043 by the other, before adjustment for what the court characterized as "unproductive" time.[127] After adjustments, the court awarded the two lawyers a total of approximately $220,000.[128] The court was clearly more concerned with the number of hours spent than with the value of the benefit generated for the corporation. Had the court considered the latter as the paramount concern, the award may have been close to zero. Some award may have been justified by reference to Rule 14a-8. Inasmuch as plaintiff could have accomplished the same objective through that mechanism, the award of attorneys' fees should be limited to the fees that might have been obtained there.

VI. WOULD A LIMITATION ON ATTORNEYS' FEES OVERLY DETER MERITORIOUS LITIGATION OR INHIBIT SETTLEMENTS?

Arguments against a further limitation on attorneys' fees in derivative actions may be that such limitations might deter meritorious litigation. This is, of course, an empirical problem. A few observations, however, seem

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[124][1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,716 (S.D.N.Y. 1982).

[125]*Id.*

[126]*Id.*

[127]*Id.*

[128]Weisberg v. Coastal States Gas Corp., [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,716 (S.D.N.Y. 1982).

appropriate. First, limiting fees on the basis of the value of the result achieved would alter current rules in relatively narrow circumstances; that is, when plaintiff alleges a breach of fiduciary duty and settles for corporate governance reform or some similar intangible relief. This will generally be the case when the plaintiff's claim is weak and/or the defendants have the protection of a charter provision that limits their liability for monetary damages. In each such instance, the deterrence seems appropriate.

Second, attorneys' fees would still be available, but would be limited to the value of the benefit obtained, as measured by the least expensive means of obtaining that benefit. This comports with traditional notions of restitution that are well grounded in equitable principles. Third, it is apparent from cases like *Caremark*, *Bolger*, *Weisberg*, and *Seinfeld*[129] that marginal, if not frivolous, cases garner settlements of dubious value to the plaintiff shareholders and impose considerable cost and expense upon the corporation. This proposal is narrowly tailored to deal with such cases. Perhaps the burden should fall on those who would object to it to demonstrate the merit of such cases and of those that would, in fact, be deterred by the proposal.

VII. CONCLUSION

Attorneys' fees recoverable in the settlement of a derivative action presents somewhat of an anomaly in the law. The plaintiff's attorney brings the action as an intermeddler of sorts, and under general common law principles, would not be entitled to a reward for his actions. Even accepting the rationale for approving fees in some derivative actions, it is difficult to accept the fees awarded in many cases. In parallel situations, under the bankruptcy laws and the Private Securities Litigation Reform Act, both the availability and amount of attorneys' fees are limited in comparison to the situation in derivative actions. The reasons for this anomaly seem to be historically and prudentially based, but nevertheless ripe for reconsideration. I have argued here that, in approving a settlement that includes attorneys' fees, courts should take seriously their own occasional pronouncements that the settlement must substantially benefit the corporation, and the fee must relate to the value of that benefit. In so acting, shareholders will bring fewer cases of questionable merit, and their attorneys will recover only fair compensation in the cases that are brought.

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[129] *See supra* notes 8, 51, & 124 and accompanying text.