STANDING TO APPEAL: SHOULD OBJECTING SHAREHOLDERS BE ALLOWED TO APPEAL ACCEPTANCE OF A SETTLEMENT?

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INTRODUCTION

Derivative actions have long permitted shareholders to exercise some control over wayward management not acting in the best interest of the corporation.[1] Concern developed over abuse of the derivative action by plaintiffs' attorneys through strike suits[2] designed to bilk money out of corporations using the threat of lawsuits to create settlement value.[3] In response to the growing use of strike suits, provisions in the Federal Rules of Civil Procedure were designed to encourage shareholders to raise objections prior to the dismissal or acceptance of a settlement of a derivative action by a district court to help police attorneys not acting in the shareholders' best interest.[4] Recently, the federal circuits have split regarding whether such a shareholder, who appears before the court to object to the proffered settlement, has standing to appeal the acceptance of a settlement.[5]

However, after accepting certiorari on the topic[6] and hearing *California Public Employees Retirement System v. Felzen*,[7] an equally divided U.S. Supreme Court affirmed the Seventh Circuit's decision without opinion, effectively providing no answer for the lower courts.[8] Depending upon the jurisdiction in which a corporation resides, shareholders are currently faced with different standards of involvement in the district courts. If shareholders want to police potentially collusive settlements in derivative actions, intervention is the only

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1. *See* Hawes v. City of Oakland, 104 U.S. 450 (1881). The court gives a history of the development of the doctrine beginning with early English cases. *See id.* at 454-60.

2. Strike suits are defined as "[a] suit (esp[ecially] a derivative action), often based on no valid claim, brought either for nuisance value or as leverage to obtain a favorable or inflated settlement." BLACK'S LAW DICTIONARY 1448 (7th ed. 1999).

3. *See* RALPH C. FERRARA ET AL., SHAREHOLDER DERIVATIVE LITIGATION: BESIEGING THE BOARD § 1.03 (6th ed. 2000). In response to fear of strike suits, states began enacting security-for-expense statutes. As an additional protection for corporations, the Federal Rules of Civil Procedure included provisions requiring notice to shareholders affording an opportunity to object to collusive settlements. *See infra* Part I.

4. *See* FED. R. CIV. P. 23.1.

5. *See* Felzen v. Andreas, 134 F.3d 873, 878 (7th Cir. 1998) (noting the creation of a conflict between the circuits), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999).

6. *See id.*

7. *Cal. Pub. Employees' Ret. Sys.*, 525 U.S. at 315.

8. *See id.*

means to preserve appellate review in the Seventh Circuit; whereas appearance at the settlement hearing to formally object is adequate involvement to supply appellate standing in the Second and Third Circuits.

Part I of this Note will provide a brief overview of the history and development of the derivative action, from its origin as an equitable action through its incorporation into the Federal Rules of Civil Procedure. Part II will discuss the development of the split between the circuits regarding the requirement of intervention (or lack thereof) in order to appeal a settlement of a derivative action. Next, Part III will discuss the advantages and disadvantages of requiring intervention to gain standing to appeal. Part IV of this Note will then discuss the advantages and disadvantages of only requiring involvement as an objector to a settlement to gain standing to appeal acceptance of the settlement. Finally, Part V of this Note will conclude that the U.S. Supreme Court should require intervention to remain consistent with its prior holdings and allow *any* divergence from this rule only through amendment to the Federal Rules of Civil Procedure.

I. HISTORY OF THE DERIVATIVE ACTION

A. Development of the Derivative Action as an Equitable Action

The Supreme Court recognized the derivative suit as an equitable cause of action in *Dodge v. Woolsey* in 1855.[9]

> It is now no longer doubted, either in England or the United States, that courts of equity, in both, have a jurisdiction over corporations, at the instance of one or more of their members . . . to prevent any misapplication of their capitals or profits, which might result in lessening the dividends of stockholders . . . if the acts intended to be done create what is in the law denominated a breach of trust.[10]

The purpose of the derivative action is to give shareholders a means to protect the corporation from the "misfeasance and malfeasance of 'faithless directors and managers.'"[11] A shareholder's derivative suit is an equitable action developed to address an inadequate remedy at law regarding a shareholder's ability to redress a breach of duty owed to the corporation by its managers.[12]

Subsequent to *Dodge*, the Court set forth procedural and substantive requirements a plaintiff shareholder must meet to be entitled to initiate a derivative action in *Hawes v. City of Oakland*.[13] Procedurally, the Court required a shareholder to exhaust all means within the corporation to remedy the

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9. 59 U.S. (18 How.) 331 (1855).

10. *Id.* at 341.

11. Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 95 (1991) (quoting Cohen v. Beneficial Loan Corp., 337 U.S. 541, 548 (1949)).

12. *See* Koster v. (Am.) Lumbermens Mut. Cas. Co., 330 U.S. 518, 522 (1947).

13. Hawes v. City of Oakland, 104 U.S. 450, 460-61 (1881).

grievance.[14] In addition, a shareholder had to address the grievance with other shareholders as a body, time permitting.[15] Substantively, the Court suggested various types of grievances meant to be addressed by a derivative action: (1) an action by the board beyond its authority as conferred by the charter of the corporation, (2) a fraudulent transaction by the acting managers, (3) a board of directors who has acted in their own interests, or (4) a majority of shareholders that are "oppressively and illegally" acting through the corporation "in violation of the rights of other shareholders."[16]

In 1882 the Court adopted Equity Rule 94, which effectively codified the requirements of *Hawes*.[17] Equity Rule 94 was later recodified as Equity Rule 27 and then as Federal Rule of Civil Procedure 23(b) under the class action category.[18] Finally, derivative actions were separated from class actions with the adoption of Federal Rule of Civil Procedure 23.1, which remains substantially in the same form today as when it was enacted in 1966.[19]

Derivative actions have been championed for protecting shareholders' interests in corporations in two ways. First, derivative actions provide shareholders a means to recover monetary or non-monetary benefits for the

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14. *See id.*

15. *See id.* at 461.

16. *Id.* at 460.

17. *See* FERRARA ET AL., *supra* note 3, § 1.03.

18. *See id.*; *see also* 5 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 23.1 app. 100 (3d ed. 2000) (noting that when Rule 23 for class actions was rewritten, Rule 23.1 was added as a separate rule). The 1966 revision was the only substantive change to the rules for derivative actions since their original codification in Rule 23(b) in 1937. *See id.*

19. *See* FED. R. CIV. P. 23.1:

> In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

Id.

corporation.[20] Second, the threat of a derivative suit provides value to a corporation by deterring managers and directors of a corporation from acting against the corporation's best interests.[21] However, the usefulness of derivative suits has been questioned due to increases in accountability of corporate management. Advances have been achieved through: (1) a shift toward independent boards of directors, (2) improvements in corporate governance standards and compliance, and (3) the existence of market forces such as increased activity in mergers and hostile takeovers.[22] Thus, due to increased confidence in the ability of corporations to act in the best interests of shareholders, reliance on derivative actions for the protection of shareholders is lessened.

B. Recognizing Abuses of Derivative Actions by Attorneys

Throughout the history of derivative actions, courts have been concerned with the potential for strike suits, in which a plaintiff's attorney brings an action with the intention of extracting payment from the corporation simply for the nuisance value of the suit.[23] Due to the nature of a derivative action, commentators generally agree with courts that an unusual potential exists for opposing parties to settle on terms that are not in the corporation's best interest.[24] In response to the development of strike suits, states began to enact security-for-expense statutes, which require a plaintiff to post security for a defendant's expenses if the action is deemed to be without merit.[25] Some commentators believed that the security-for-expense statutes would put an end to derivative actions; however, the causes survive as plaintiffs tailor their pleadings to avoid such statutes.[26] As a federal response to the potential for abusive suits, Civil

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20. *See* FERRARA ET AL., *supra* note 3, § 14.05.

21. *See* Reinier Kraakman et al., *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1736 (1994).

22. *See* John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 7 (1985).

23. *See* FERRARA ET AL., *supra* note 3, § 1.03 (noting an infamous plaintiff that had initiated nineteen suits and earned the nickname "Sue and Settle" Venner).

24. *See* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1309 n.8 (3d Cir. 1993) (citing 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, 3 (1991); Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 948 (1993)); *see also* Coffee, *supra* note 22, at 12 (suggesting that the derivative action as it exists today minimizes the possibility of substantial corporate recovery and maintains the likelihood of costly litigation, both factors leading to greater likelihood of settlement without benefit to the corporation); Kraakman et al., *supra* note 21, at 1740-43 (finding that shareholder incentives to bring and maintain a suit are often poorly aligned with the interests of the corporation).

25. *See* FERRARA ET AL., *supra* note 3, § 1.03.

26. *See id.*

Procedure Rule 23.1 was enacted in 1966 (Rule 23.1), which provides two new aspects to derivative actions: (1) plaintiff shareholders who desire to settle or dismiss the action must receive court approval and give notice to the other shareholders, and (2) plaintiff shareholders must represent the interests of the other shareholders fairly and adequately.[27]

Several explanations have been proposed for why a derivative action is such a fertile ground for attorneys to abuse the legal process by extracting fees from a corporation. One aspect of a derivative suit is that if the suit is settled, the corporation pays the legal fees of both parties.[28] The fee structure for a derivative suit has been described as a cross between the American Rule, under which each party is required to pay his own fee, and the English Rule, under which the losing party pays the winning party's fees.[29] This hybrid fee structure exists because the plaintiff can shift his costs to the corporation, while the defendant may be able to shift his costs to the plaintiff only if the jurisdiction requires a security-for-expense bond.[30] That the plaintiff might have to pay the defendant's legal costs increases the plaintiff's risk if the action is litigated to judgment, thereby increasing the plaintiff's incentive to settle.[31] Likewise, the defendant to a derivative action has an incentive to settle because he will be indemnified by the corporation and his insurer(s) will cover a settlement. Whereas, if the action is adjudicated and the defendant is held liable to the corporation, statutes will usually preclude indemnification by the corporation.[32]

Another reason that the settlement of derivative suits presents such a high risk of collusion is that often the plaintiff shareholder is not significantly involved in the litigation and the attorney is usually directing the litigation.[33] Because the plaintiff shareholder may not have much at stake in the litigation, the plaintiff's attorney may not be closely monitored.[34]

> One of the risks flowing from shareholders' difficulty in monitoring derivative litigation is that plaintiffs' counsel and the defendants will structure a settlement such that the plaintiffs' attorneys' fees are disproportionate to any relief obtained for the corporation. Plaintiffs' attorneys and the defendants may settle in a manner adverse to the interests of the plaintiffs by exchanging a low settlement for high fees.[35]

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27. *See* FED. R. CIV. P. 23.1; *see also* 5 MOORE ET AL., *supra* note 18, ¶ 23.1 app. 02, at 6 (illustrating the change from old Rule 23(b) to new Rule 23.1).

28. *See* Coffee, *supra* note 22, at 15-16.

29. *See id.*

30. *See id.*

31. *See id.* at 23.

32. *See id.* at 23-24.

33. *See* FERRARA ET AL., *supra* note 3, § 14.05 ("[D]erivative litigation is unusual in that the party primarily responsible for prosecuting the action is not the real party in interest—the corporation—or even the nominal plaintiff shareholder, but rather is the plaintiff's counsel.").

34. *See id.*

35. Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1310 (3d Cir. 1993).

An additional area of concern is the high rate of settlements compared to the relatively few number of litigated victories by plaintiffs' attorneys.[36] It is generally expected that litigated outcomes should split almost equally between plaintiffs and defendants' victories.[37] However, in the derivative suit arena, federal courts find for the defendant by an overwhelming ratio.[38] The conclusion can be drawn that most derivative actions lack merit and are brought merely for their settlement value.[39] Thus, empirical evidence supports the perceived need to police settlements.

As a method to police collusive actions, nonparty shareholders have used their right to present objections at settlement hearings pursuant to Rule 23.1 to challenge attorneys' fees.[40] One important and necessary aspect of the viability of derivative actions is the ability of the plaintiff's attorney to recover his fees from the corporation.[41] Therefore, a logical way to attack the viability of derivative actions is to attack their funding. If attorneys fear they will not receive compensation, they will be less likely to bring the action at all.

Logically, the best people to police settlements of lawsuits are those who have an investment at stake. Standing to object to the settlement of derivative action is limited. Most jurisdictions agree that a shareholder must own shares in the corporation at the time of the settlement to have standing to present objections, although some jurisdictions require ownership only at the time of the wrongdoing.[42] It is the degree to which a shareholder must become involved in the underlying action that separates the Seventh Circuit from the other circuits that have defined the requirement in the context of the derivative action.

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36. *See* Coffee, *supra* note 22, at 9.

37. *See id.*

38. *See id.*

39. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 742-43 (1975).

> [T]he mere existence of an unresolved lawsuit has settlement value to the plaintiff not only because of the possibility that he may prevail on the merits, . . . but [also] because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event . . . .

Id.

40. *See* Kaplan v. Rand, 192 F.3d 60 (2d Cir. 1999); Felzen v. Andreas, 134 F.3d 873 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzer, 525 U.S. 315 (1999); Rosenbaum v. MacAllister, 64 F.3d 1439 (10th Cir. 1995). In all three cases, an objecting shareholder challenged the fee portion of the settlement.

41. *See* 7C CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE: FEDERAL RULES OF CIVIL PROCEDURE § 1841 (2d ed. 1986) (noting that justifications for reimbursement of attorney fees include the encouragement of bringing the suit by shareholders where monetary interests at stake are small relative to the cost of litigation and the enrichment theory, whereby the corporation whose assets are increased as a result of the suit on its behalf should bear the costs associated with the benefits derived).

42. *See* FERRARA, ET AL., *supra* note 3, § 14.04.

II. DEVELOPMENT OF THE SPLIT OVER LEVEL OF SHAREHOLDER INVOLVEMENT REQUIRED TO GAIN APPELLATE STANDING

Prior to 1998, the circuits had not definitively addressed the different standards applicable to derivative and class action intervention requirements to have standing to appeal.[43] Courts that required intervention to maintain standing to appeal did so in the class action setting, not in the derivative action setting.[44] However, in 1998 the Seventh Circuit issued its decision requiring Federal Civil Procedure Rule 24 intervention[45] specifically in the derivative action context.[46]

A. Requirement of Formal Intervention to Provide Party Status to Appeal Acceptance of Settlement over Shareholder Objections

In 1998 the Seventh Circuit, in *Felzen v. Andreas*,[47] ruled that a shareholder who appeared at a settlement hearing and objected to a proposed settlement of a derivative action, but did not formally intervene, did not have standing to appeal the district court's acceptance of the settlement.[48] The Supreme Court granted certiorari and affirmed the Seventh Circuit's decision in a four-four decision without comment.[49] Thus, the Supreme Court did nothing to clarify the confusion in the lower courts.

The derivative suit in *Felzen* was an attempt to recover from the directors of Archer Daniels Midland (ADM) some of a $100 million fine for criminal antitrust charges and payment of a $90 million settlement of antitrust lawsuits filed against ADM for engaging in a price fixing scheme.[50] A settlement was reached in the derivative action, under which the directors agreed to pay $8 million to the corporation, with $3.92 million awarded to plaintiff's counsel.[51] California Public Employees' Retirement System (CalPERS), a substantial shareholder, submitted objections to the district court and appeared at the

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43. *See Rosenbaum*, 64 F.3d at 1439; Bell Atl. Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993).

44. *See* Loran v. Furr's/Bishop's Inc., 988 F.2d 554 (5th Cir. 1993); Croyden Assocs. v. Alleco, Inc., 969 F.2d 675 (8th Cir. 1992); Guthrie v. Evans, 815 F.2d 626 (11th Cir. 1987).

45. FED. R. CIV. P. 24(b) states, in pertinent part,

> [u]pon timely application anyone may be permitted to intervene in an action: . . . (2) when an applicant's claim or defense and the main action have a question of law or fact in common. . . . In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties.

46. *See* Felzen v. Andreas, 134 F.3d 873 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret, Sys. v. Felzer, 525 U.S. 315 (1999).

47. *Id.*

48. *See id.*

49. *See Cal. Pub. Employees' Ret. Sys.*, 525 U.S. at 315.

50. *See* Petitioner's Brief at 2-3, Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999) (per curiam) (No. 97-1732).

51. *See id.* at 8-9.

settlement hearing, but the court approved the settlement over CalPERS objections.[52] CalPERS then appealed the court's approval of the settlement to the Seventh Circuit Court of Appeals.[53]

The Seventh Circuit determined that CalPERS lacked standing to appeal the approval of the settlement.[54] The court rested its opinion largely upon *Marino v. Ortiz*.[55] In *Marino*, the Supreme Court determined that a group of white police officers who were not parties to an agreement settling a class action discrimination lawsuit could not appeal from the consent decree approving the settlement.[56] In issuing its decision, the Court stated that "because petitioners were not parties to the underlying lawsuit, and because they failed to intervene for purposes of appeal, they may not appeal from the consent decree approving that lawsuit's settlement."[57]

In *Felzen*, the court began its opinion by quoting *Marino*, stating that "[t]he rule that only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment, is well settled."[58] The court pointed out that prior to *Felzen* it had determined that a class member who was a nonparty did not have standing to appeal from a summary judgment order.[59] The *Felzen* court based its decision on *Marino*, and in doing so, implicitly overruled circuit precedent.[60] The court noted that although class actions and derivative actions have distinctive characteristics, *Marino* applies to both situations.[61] Therefore, despite the concern that "derivative actions do little to promote sound management and often hurt the firm by diverting the managers' time from running the business while diverting the firm's resources to the plaintiffs' lawyers without providing a corresponding benefit," the court was prevented from hearing this argument on appeal because CalPERS was not a party to the litigation in the district court.[62]

The *Felzen* court also based its decision on the unique status of a shareholder in derivative litigation.[63] According to the court, injury to a shareholder does not create party status for a shareholder because it is not a shareholder's injury that

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52. *See id.* at 8.

53. *See id.* at 9.

54. *See* Felzen v. Andreas, 134 F.3d 873 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999).

55. 484 U.S. 301 (1988) (per curiam), *aff'g per curiam* Hisp. Soc'y of N.Y. City Police Dep't, Inc. v. N.Y. City Police Dep't, 806 F.2d 1147 (2d Cir. 1986).

56. *See id.* at 303-04.

57. *Id.* at 304.

58. *Felzen*, 134 F.3d at 874 (quoting *Marino*, 484 U.S. at 304).

59. *See id.* (citing *In re* Brand Name Prescription Drugs Antitrust Litig., 115 F.3d 456 (7th Cir. 1997)).

60. *See id.* (citing Tryforos v. Icarian Dev. Co., 518 F.2d 1258 (7th Cir. 1975) (suggesting nonparty shareholders could appeal)).

61. *See id.* at 878.

62. *Id.* at 876.

63. *See id.* at 875.

is being litigated.[64] Rather, the corporation's injury is the subject of the litigation.[65] The court reasoned that a shareholder who places his trust in the acting managers of the corporation has no more right to appeal the settlement of a derivative action than a shareholder has to appeal a settlement of antitrust litigation entered into by management on behalf of a corporation.[66]

B. Objection to Settlement Without Intervention Sufficient to Provide Party Status

Two circuits have specifically determined that, in the derivative action context, a shareholder need not formally intervene to have standing to appeal the acceptance of a settlement.[67] *Kaplan v. Rand*,[68] decided after *Felzen*, specifically rejected the *Felzen* court's reasoning.[69] The *Kaplan* court determined that because *Felzen* was affirmed by an equally divided Supreme Court, the Court had not rejected the rule that allows a nonparty to appeal a judgment.[70] As such, the *Kaplan* court determined that the nonparty shareholder objector in this case had standing to appeal the lower court's judgment because the shareholder had an interest that was affected by the judgment.[71]

The appeal in *Kaplan* originated from a derivative suit filed on behalf of Texaco to recover from its directors part of the $115 million in costs paid by the corporation to settle a discrimination claim filed against Texaco.[72] The settlement required inclusion of a statement in Texaco's Annual Report to shareholders notifying them of the right to request certain portions of a task force report prepared pursuant to the discrimination settlement. The settlement also required incorporation of a non-discrimination statement in future contracts entered into with outside vendors.[73] In addition, the plaintiff's attorney requested up to $1.4 million in attorney fees.[74] The district court approved the settlement as "fair and reasonable" and a Special Master, who was appointed to inquire into the appropriateness of the attorney fees, determined that fees of $1 million were appropriate.[75] The district court approved the Special Master's report, and

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64. *See id.* at 876.

65. *See id.*

66. *See id.* at 875.

67. *See* Kaplan v. Rand, 192 F.3d 60 (2d Cir. 1999); Bell Atl. Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993).

68. *Kaplan*, 192 F.3d at 60.

69. *See id.* at 68.

70. *See id.* (finding judgment affirmed by an equally divided court does not have precedential effect) (citing Rutledge v. United States, 517 U.S. 292, 304 (1996)).

71. *See id.* at 67.

72. *See id.* at 61-62.

73. *See id.* at 64.

74. *See id.*

75. *See id.* at 66.

rejected objections raised by nonparty shareholders.[76]

Kaplan is interesting because it was the Second Circuit that issued the opinion that was reviewed by the Supreme Court in *Marino*.[77] The Second Circuit in *Kaplan* interpreted *Marino* much less restrictively than did the Seventh Circuit in *Felzen* regarding the right of a nonparty to appeal. The *Kaplan* court looked favorably upon the following Court statement:

> The rule that only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment, is well settled. The Court of Appeals suggested that there may be exceptions to this general rule, primarily "when the nonparty has an interest that is affected by the trial court's judgment." We think the better practice is for such a nonparty to seek intervention for the purposes of appeal; denials of such motions are, of course, appealable.[78]

The *Kaplan* court noted that by declaring intervention as "the better practice," the Supreme Court did not necessarily require intervention, leaving the door open for exceptions to the general rule, such as the affected-interest exception advanced in *Kaplan*.[79]

When reviewing the affected-interest doctrine's history, the *Kaplan* court referred to a statement by Judge Learned Hand "[i]f not a party, the putative appellant is not concluded by [a judgment], and is not therefore aggrieved by it. But if the decree affects his interests, he is often allowed to appeal."[80] The court determined that because the settlement of the derivative action directed the corporation to pay the attorney fees, the stockholders' interests were affected through the financial well being of the corporation.[81] Even though the corporation's insurance company was to pay the attorney fees and the premiums did not increase upon renewal, the court determined that the possibility that the premiums could have lowered or could rise in the future, along with discouraging future lawsuits, was enough to give the shareholders an affected interest.[82]

The court also advanced the position that allowing appellate review would promote a policy of fairness to shareholders.[83] The adversarial process tests the settlement's fairness, and the court felt "[i]t would make little sense to invite a shareholder to file objections in the manner provided by Rule 23.1 and then deny him the right to challenge the district court's ruling on his objection."[84] When

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76. *See id.*

77. *See* Hispanic Soc'y of N.Y. City Police Dep't, Inc. v. N.Y. City Police Dep't, 806 F.2d 1147 (2d Cir. 1986), *aff'd sub nom.* Marino v. Ortiz, 484 U.S. 301 (1988).

78. *Kaplan*, 192 F.3d at 68 (quoting *Marino*, 484 U.S. at 304 (internal citations omitted)).

79. *See id.*

80. *Id.* at 66-67 (quoting West v. Radio-Keith-Orpheum Corp., 70 F.2d 621, 624 (2d Cir. 1934)).

81. *See id.* at 67.

82. *See id.* at 68.

83. *See id.* at 67.

84. *Id.*

discussing the fairness of the settlement, the court noted the concern that when the interests of the plaintiff's attorney and the defendants become aligned toward settlement, the district court may overlook their "mutual indulgence."[85]

When addressing this concern over collusive settlements, the court looked to the Third Circuit's decision in *Bell Atlantic Corp. v. Bolger*.[86] In that case, the Third Circuit acknowledged the general rule stated in *Marino*,[87] but determined that whether an objector in derivative and class action settings may appeal remained unsettled despite *Marino*.[88] The court noted the "agency costs" associated with derivative suits, where shareholders often "lack the incentive and information to police settlements—the costs of policing typically outweigh any pro rata benefits to the shareholder."[89] The court stressed the potential for plaintiffs' attorneys and defendants to exchange a low settlement for high fees due to lack of proper monitoring by shareholders.[90] Finally, the court concluded that "[a]ssuring fair and adequate settlements outweighs concerns that non-intervening objectors will render the representative litigation 'unwieldy.'"[91]

III. ADVANTAGES AND DISADVANTAGES OF AN INTERVENTION REQUIREMENT TO GAIN PARTY STATUS FOR THE OBJECTOR

A. Advantages of an Intervention Requirement

The Seventh Circuit's view has generally been regarded as an approach that places too much emphasis on efficiency in litigation, while placing too little emphasis on policing collusive settlements between the plaintiff's attorney and defendants.[92] Perhaps the most advantageous aspect of requiring intervention is

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85. *Id.* (citation omitted).

86. 2 F.3d 1304, 1307 (3d Cir. 1993).

87. *See id.*

88. *See id.* The court noted, "[a] member of the class who appears in response to the court's notices given to pursuant to the Rule [23.1], and objects to the dismissal or compromise has a right to appeal from an adverse final judgment although he did not become a formal party of record." *Id.* (quoting 3B JAMES W. MOORE, MOORE'S FEDERAL PRACTICE ¶ 23.1.24[3] (1993)). *See* 7C WRIGHT ET AL., *supra* note 41, § 1839, at 182 ("An objector to the settlement may appeal the court's approval of the compromise."). *But see* 15A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE: JURISDICTION AND RELATED MATTERS, § 3902.1, at 105-06 (2d ed. 1992) ("[I]t has been ruled that an individual class member who has not been recognized as a class representative and who has not intervened lacks standing to appeal a judgment on the merits. Similar rules may apply to corporate shareholders affected by the judgment in a derivative action.").

89. *Bell Atl. Corp.*, 2 F.3d at 1309.

90. *See id.* at 1310 n.10 (citing RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 21.9, at 570 (4th ed. 1992)).

91. *Id.* at 1310.

92. *See generally* Susanna M. Kim, *Conflicting Ideologies of Group Litigation: Who May Challenge Settlements in Class Actions and Derivative Suits?*, 66 TENN. L. REV. 81 (1998); Rory Zack Fazendeiro, Comment, Felzen v. Andreas: *The Seventh Circuit Shuts Its Doors to Derivative-*

the ability of the parties to better control and contain the costs of an already complex and costly form of litigation.[93] Allowing the extension of a suit that would have otherwise terminated were it not for an appeal by a nonparty would inevitably add to the cost of the underlying litigation.

Moreover, settlements are highly favored in the law as a way of clearing crowded court dockets and ending costly litigation.[94] Extending the lawsuit increases the litigation costs of the corporation, which ultimately pays for both the plaintiff and defendant's legal fees. The derivative suit context is unique in that often the party defending the suit has its legal fees indemnified by the corporation through directors and officers' liability insurance purchased and maintained by the corporation.[95] In addition to the monetary costs incurred by the corporation, the corporation also incurs substantial costs in the time and effort that management devotes to the litigation.[96] Finally, allowing the nonparty to drag the corporation into an unwanted appellate process creates additional cost concerns due to the difficult standard that must be overcome to overturn the settlement and to thus justify the costs of appeal.[97]

Requiring intervention to gain appellate standing is also more true to the nature of a derivative action.[98] A derivative action is designed to make the

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Suit Appeals by Unnamed Shareholders, 4 ROGER WILLIAMS U. L. REV. 533 (1999); Cecilia Lacey O'Connell, Comment, *The Role of the Objector and the Current Circuit Court Confusion Regarding Federal Rule of Civil Procedure 23.1: Should Non-Named Shareholders Be Permitted to Appeal Adverse Judgments?*, 48 CATH. U. L. REV. 939 (1999).

93. *See* Kraakman et al., *supra* note 21, at 1738.

94. *See* United Airlines, Inc. v. McDonald, 432 U.S. 385, 401 (1977) (Powell, J., dissenting). "The Court . . . ignores the important 'principle that [s]ettlement agreements are highly favored in the law and will be upheld whenever possible because they are a means of amicably resolving doubts . . . and preventing lawsuits.'" *Id.* (quoting Pearson v. Ecological Science Corp., 522 F.2d 171, 176 (5th Cir. 1975) (citation omitted)).

95. *See* Coffee, *supra* note 22, at 16. The defendants in a derivative action can shift their litigation costs to the corporation when the suit is settled. *See id.* However, if the suit goes to trial and judgment, the losing party may not have its litigation costs reimbursed by the corporation. *See id.*

96. *See id.* at 17 (asserting that the financial burden falls more heavily on the defendant in a derivative action due to a greater commitment of resources to the discovery process, the need to engage multiple counsel and a difference in the fees and preparation usually involved by defendant's counsel).

97. The standard for review of a settlement and award of attorneys' fees is an abuse of discretion by the trial court. *See* Bell Atl. Corp. v. Bolger, 2 F3d 1304, 1305 (3d Cir. 1993). This is one of the more difficult standards to overcome, which decreases the likelihood that the settlement will be overturned. Affirmance of the settlement by an appellate court would add additional unwanted cost to the corporation, which is being pulled into the appellate process by another unsatisfied shareholder.

98. *See* Felzen v. Andreas, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999) ("If in the course of managing or settling derivative litigation investors receive new injury, they do so only

corporation whole for its injuries rather than to redress the injuries sustained by the shareholders.[99] Therefore, a shareholder gains standing to sue through his status as representative of the corporation, not through his own injury.[100] Increasingly, however, courts have allowed derivative actions to go forward despite a lack of direct harm to the corporation, raising the concern that derivative actions are being used to avoid the limits placed on class actions by the Private Securities Litigation Reform Act.[101]

In addition, requiring intervention also avoids an improper challenge to the representative capacity of the plaintiff shareholder. Rule 23.1 requires that the plaintiff adequately represent the interests of the corporation.[102] Allowing a shareholder to challenge a settlement effectively permits the nonparty shareholder to challenge the representative capacity of the plaintiff shareholder without going through the normal steps required to both discredit the plaintiff shareholder and establish the representative capacity of the nonparty shareholder.[103] While the nonparty shareholder was allowed party status simply by objecting to a settlement, the original plaintiff shareholder is required to go through the pleading requirements such as the demand requirement and proof of adequacy of representation. Furthermore, the nonparty shareholder often only objects to the award of attorneys' fees, which are part of the settlement.[104] When the only objection is regarding the grant of attorneys' fees, the objector is allowed to accept the benefits of the settlement and attack the fees of the plaintiff's attorney who procured the benefits for the corporation.

The intervention requirement also seems more consistent with the direction

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because the corporation becomes worse off . . . .").

99. *See id.*

100. *See* Kaplan v. Rand, 192 F.3d 60, 66-67 (2d Cir. 1999); *see also Bell Atl. Corp.*, 2 F.3d at 1310 (noting that involvement as an objector at the settlement hearing was sufficient to provide standing).

101. *See* Michael A. Collora & David M. Osborne, *Class-Action Reforms Spur Derivative Claims: Shareholders Are Taking a Fresh Look at Derivative Suits to Pursue Investor Fraud Cases*, NAT'L L.J., Feb. 15, 1999, at B8 (citing Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.)).

102. *See* FED. R. CIV. P. 23.1 ("The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association.").

103. *See* 7C WRIGHT ET AL., *supra* note 41, § 1916 (stating that in a class action setting a prospective intervenor should make a motion to intervene as soon as it is apparent that the interests of the unnamed class members are not adequately represented).

104. *See* Rosenbaum v. MacAllister, 64 F.3d 1439, 1442-43 (10th Cir. 1995). The court determined that, although allowing a nonintervening class member to appeal a settlement would be disruptive to the litigation process, allowing appeal of just the attorney fee would not disrupt the benefits gained by the class and would only serve to increase the amount of benefit available to the class. *See id.* The court applied its analysis to the derivative action context and determined that "[t]he same considerations apply even more clearly . . . [when] the nonparty shareholder wishes to appeal only the fee allowed the party shareholder's attorney in a settlement." *Id.* at 1443.

provided by the Supreme Court in *Marino v. Ortiz*.[105] Appellate courts have often cited the decision in *Marino* when debating the forcefulness intended by the Court.[106]

> The rule that only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment, is well settled. The Court of Appeals suggested that there may be exceptions to this general rule, primarily "when the nonparty has an interest that is affected by the trial court's judgment." We think the better practice is for such a nonparty to seek intervention for purposes of appeal; denials of such motions are, of course, appealable.[107]

Although the Court's language does not provide a resounding rejection of the affected interest doctrine, it does state quite plainly that the "better practice" is intervention.[108] As the Court stated: "[W]e hold that because petitioners were not parties to the underlying lawsuit, and because they failed to intervene for purposes of appeal, they may not appeal from the consent decree approving that lawsuit's settlement . . . ."[109] Although *Marino* clearly implies that intervention should be required to have standing to appeal, the issue has not been foreclosed, as shown by its affirmation of *Felzen v. Andreas* by an equally divided court.[110]

Finally, intervention need not be as great a burden on the objecting shareholder as is often claimed by those advancing the nonintervention position.[111] First, the objecting shareholder need not intervene in order to make objections to the district court. The shareholder's right to present objections is provided by Rule 23.1. Therefore, the objecting shareholder desiring to avoid getting entangled in the litigation through intervention still has the ability to be heard albeit just not in the appellate courts. Shareholders who are willing to commit the time and resources needed to appeal should be willing to commit those same resources toward intervention to preserve the ability to appeal. An

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105. 484 U.S. 301 (1988) (per curiam).

106. *See* Kaplan v. Rand, 192 F.3d 60, 68 (2d Cir. 1999); Felzen v. Andreas, 134 F.3d 873, 874 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzer, 525 U.S. 316 (1999); Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1307 (3d Cir. 1993).

107. *Marino*, 484 U.S. at 304 (citations omitted).

108. *Id.*

109. *Id.*

110. *See Cal. Pub. Employees' Ret. Sys.*, 525 U.S. at 315.

111. *See* Petitioner's Brief at 34, *Cal. Pub. Employees' Ret. Sys.* (No. 97-1732) (arguing that "requiring intervention would sharply curtail, if not eliminate, shareholder appeals and correspondingly impair the public functions they serve"); *see also* Brief of Amicus Curiae Council of Institutional Investors in Support of Petitioners at 16, *Cal. Pub. Employees' Ret. Sys.* (No. 97-1732) (arguing that requiring "shareholder objectors [to] intervene to secure the right to appeal a derivative settlement would erect an unnecessary and costly barrier to shareholder participation and undermine the fairness and integrity of derivative settlements without providing any offsetting benefit").

intervention requirement can facilitate the selection of objectors willing to commit resources to pursue their objections beyond the district court.

B. Disadvantages of the Intervention Position

Although there are several benefits to requiring intervention to gain status to appeal, many disadvantages are also present. Promoting efficiency, perhaps the main goal of the intervention requirement, has its costs. First, some commentators have suggested that a court may be inclined to accept a settlement in an effort to clear its docket of a complex piece of litigation.[112] Second, it is possible that engaging the corporation in extended litigation is likely to add additional legal costs to the action. However, the purpose of the appeal is to assert that the corporation should have received a better settlement from the defendants or should pay a lesser fee to the plaintiff's attorney. In either situation, the objecting shareholder is seeking appellate review in an attempt to either procure a better settlement for the corporation or to save the corporation from paying exorbitant attorneys' fees.

The argument that it is the corporation that has suffered harm, and not the shareholders, may be adhering to form over substance. "The proposition that an injury to the corporation is not an injury to its shareholders is dubious, 'since every injury to a corporation [necessarily has] an impact, however slight, on the shareholders as well.'"[113] When a corporation suffers injury that decreases its market value, the shareholders, as owners of the corporation, experience the loss.

However, the argument that shareholders are the injured parties was compellingly rejected in *Felzen*.[114] That court pointed out that shareholders "have no more right to speak for the firm or control its litigation decisions than bondholders or banks or landlords, all of whom have contractual interests that may be affected by litigation."[115] The court stated that simply having an affected interest is not adequate to develop standing to be considered a party to the lawsuit without formally becoming a party. Every shareholder of a corporation potentially has an affected interest, but the purpose of the derivative action is to allow a representative of the corporation to sue on behalf of the corporation, not to create a cause of action for all shareholders.[116]

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112. *See* Coffee, *supra* note 22, at 27 ("[T]he court may have incentives of its own not necessarily consistent with the public interest—namely, to clear a potentially messy and burdensome case from its docket."); *see also* Kim, *supra* note 92, at 120 ("With crowded dockets, courts may look unfavorably upon the specter of a complicated, time-consuming trial involving derivative claims.").

113. Kim, *supra* note 92, at 114 (quoting WILLIAM L. CARY & MELVIN ARON EISENBERG, CASES AND MATERIALS ON CORPORATIONS 1014 (7th ed. 1995)).

114. *See* Felzen v. Andreas, 134 F.3d 873, 874 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzer, 525 U.S. 316 (1999).

115. *Id.*

116. *See* Papilsky v. Berndt, 466 F.2d 251, 255 (2d Cir. 1972). "The alleged injury inflicted upon the corporation is regarded as affecting only the corporation. The fact that the injury may

Essentially, allowing nonparty shareholders to appeal gives them the opportunity to challenge the representative status of the plaintiff shareholder. Yet, it often is not the representation of the corporation that is being challenged, but rather the fees that are paid to the attorney.[117] However, this viewpoint ignores the premise that an attorney is not a party to an action, but rather is the mouthpiece of the plaintiff shareholder. Although much of the distaste for derivative actions centers on the belief that the attorney is the real party driving the action in search of fees, this discounts the possibility that the plaintiff is involved and interested in the litigation.[118]

Critics of the *Felzen* opinion have generally argued that the court read too much into the holding of *Marino*.[119] *Felzen* can be distinguished from *Marino* simply on a factual basis—*Felzen* involved a derivative action, whereas *Marino* involved a class action.[120] However, nowhere in its opinion did the Court restrict its holding to class actions. Rather, the Court used broad language, simply stating that "only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment."[121]

Another concern with reliance on *Marino* is the brevity of the opinion and its reliance on authority that recognized exceptions that allow nonparties to appeal. "The result is clearly right; the brief statement that better practice demands intervention should not be taken to establish a requirement applicable to all circumstances."[122] One example of such a circumstance is *Kaplan*, in

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indirectly harm a stockholder by diminishing the value of his corporate shares does not bestow upon him a right to sue on his own behalf to recover damages." *Id.* The court then quoted Justice Frankfurter:

> The contrasting difference between a stockholder's suit for his corporation and a suit by him against it, is crucial. In the former, he has no claim of his own; he merely has a personal controversy with his corporation, . . . not a fraction of it to the stockholder. When such a suit is entertained, the stockholder is in effect allowed to conscript the corporation as a complainant on a claim that the corporation, in the exercise of what it asserts to be its uncoerced discretion, is unwilling to initiate.

Id. (quoting Smith v. Sperling, 354 U.S. 91, 99 (1957) (Frankfurter, J., dissenting)).

117. *See* Kaplan v. Rand, 192 F.3d 60 (2d Cir. 1999); *Felzen*, 134 F.3d at 873; Rosenbaum v. MacAllister, 64 F.3d 1439 (10th Cir. 1995).

118. The fact that the plaintiff's attorney is the actual force driving the lawsuit in search of fees is discussed in Part IV, *infra*. This is the foundation for relaxing standards to allow challenges to settlements, including the position that courts should make appellate review available to nonparty shareholders.

119. *See* Kim, *supra* note 92, at 112.

120. The distinction between a class action seeking monetary damages under Federal Rules of Civil Procedure 23(b)(3) and a derivative action is important to critics of the *Felzen* opinion because much reliance is placed on the argument that members of a class action have the ability to opt out of the litigation to avoid preclusion, whereas shareholders do not have an ability to opt out in a derivative action. *See* Kim, *supra* note 92, at 117-18; Fazendeiro, *supra* note 92, at 581.

121. Marino v. Ortiz, 484 U.S. 301, 304 (1988) (per curiam).

122. 15A WRIGHT ET AL., *supra* note 88, § 3902.1, at 130 n.52.

which the court determined that the requirement for intervention had not been established despite the nonparty having an interest affected by the litigation.[123] Admittedly, *Marino* took a rather soft position in finding that "the better practice" is intervention. Impliedly, the Court recognized that situations exist in which intervention is not required.[124]

IV. ALLOWING NON-INTERVENING, OBJECTING SHAREHOLDERS STANDING TO APPEAL ACCEPTANCE OF A SETTLEMENT

A. Advantages of Allowing Appeal Without Intervention

Proponents of allowing objecting shareholders to appeal approval of the settlement without requiring intervention by shareholders rest their arguments primarily on the need to police collusive settlements. Several arguments have been advanced by the nonintervention camp. Minimizing the burden on objecting shareholders will encourage involvement in the settlement process, which is beneficial due to the inherent dangers of collusion and the need for the settlement process to be policed by independent shareholders. Inviting a shareholder to participate in the settlement hearing but refusing to hear him on appeal seems unfair. Shareholders have an affected interest in the settlement and, therefore, should be considered de facto parties for purposes of appeal. Shareholders do not have an ability to opt out of the settlement; thus, they are bound by the outcome. Finally, placing the plaintiff's attorney on notice that his fees can easily be challenged will encourage his pursuit of a real benefit for the corporation.

Furthermore, requiring intervention by objecting shareholders to secure appellate review may discourage some interested shareholders from becoming involved in the settlement process. Objectors play an important role in evaluating the settlement of derivative actions because as soon as the plaintiff and defendant have reached a possible settlement they will join forces to convince the trial court that the settlement is fair.[125] There seems to be a fear that the cost and time commitment of intervention will deter a shareholder with

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123. *See* discussion *supra* Part II.

124. *See Marino*, 484 U.S. at 304. "[T]he better practice is for such a nonparty to seek intervention for purposes of appeal . . . ." *Id.* Obviously, this is not the same as saying a nonparty must intervene. Thus, the door has been left open for debate about the forcefulness of the statement.

125. *See* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1310 (3d Cir. 1993). The court stated:

> In assessing settlements of representative actions, judges no longer have the full benefit of the adversarial process. In seeking court approval of their settlement proposal, plaintiffs' attorneys' and defendants' interests coalesce and mutual interest may result in mutual indulgence. The parties can be expected to spotlight the proposal's strengths and slight its defects. In such circumstances, objectors play an important role by giving courts access to information on the settlement's merits.

Id. (citations omitted).

insufficient financial incentive to deal with the implications of becoming a party.[126] Institutional investors, as shareholders, probably have the greatest financial incentive to intervene, and with the most knowledgeable staff, they can offer valuable input into settlement analysis. However, institutional investors appear to have taken the position that requiring intervention may be too burdensome.[127]

An additional basis for the claim that objecting shareholders should have appellate standing is the affected interest rationale advanced in *Kaplan v. Rand*.[128] The shareholder has a direct interest in the litigation because a shareholder's interest is necessarily implicated by the actions of a corporation. Under the de facto party doctrine, a person may be entitled to appeal if, (1) he participated in the trial court proceedings as if he had intervened, and (2) equity weighs in favor of permitting appellate status.[129] Because of the concern for collusion in the derivative action setting, a good argument can be made that equity favors permitting appeal.

Another argument in support of appellate standing for objectors is that it makes little sense to invite shareholders to participate in the settlement process and then allow the trial court to reject the objections without recourse via appellate review. The procedural processes and recognition of nonparty shareholders under Rule 23.1 acknowledge the reality that a shareholder is affected by the judgment. This reality is evidenced by the fact that Rule 23.1 provides for proper notice to avoid severing the shareholder's rights through

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126. *See* O'Connell, *supra* note 92, at 969 (referencing the "procedural complexities, timing concerns, and litigation costs" associated with intervention); *see also* Petitioner's Brief at 34, 36, Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (per curiam) (No. 97-1732).

> The legal hurdles to intervention by objecting shareholders . . . are daunting. . . .
>
> . . . Shareholders wishing to preserve a right to appeal would face the added financial burden of drafting a pleading the equivalent of a complaint (expressly required by Rule 24) and litigating the timeliness of their motion and the adequacy of existing representation. They would also face all the costs and burdens associated with party status, including wide–ranging Rule 26(a)(1) automatic disclosure duties and the obligation to respond to interrogatories, appear for depositions, and answer virtually unlimited demands for documents.

Id.

127. *See* Brief of Amicus Curiae Council of Institutional Investors in Support of Petitioners at 3, 16, *Cal. Pub. Employees' Ret. Sys.* (No. 97-1732).

128. 192 F.3d 60 (2d Cir. 1999). *See also* discussion *supra* Part II.B.

129. *See* 15A WRIGHT ET AL., *supra* note 88, § 3892.1, at 122 ("Appeals have been permitted on showings that range from easy cases in which a nonparty is formally addressed by a court order through less clear cases in which a nonparty is significantly affected."); *see also* O'Connell, *supra* note 92, at 984-86 (suggesting that courts treat objecting shareholders as de facto parties for purposes of appeal). *But cf.* 15A WRIGHT ET AL., *supra* note 88, at 122 ("As the effect on the nonparty becomes more attenuated, however, a formal intervention procedure should be required as a means of ensuring control over appeals that carry a high potential for delay and abuse.").

representative litigation.[130] Further, the adversarial process justifies allowing the fairness of a settlement to be tested by appellate review.[131] Because the named plaintiff and the defendant have reached an agreement and cannot be expected to present any weaknesses in the settlement arrangement, objecting shareholders become the adversarial tool used to expose any such weaknesses.

Unlike members of some class actions, the shareholder does not have the ability to opt out of a derivative action.[132] The shareholder cannot separate himself from the litigation and pursue his own course of action. The shareholder's inability to opt out makes sense because the corporation can only litigate and recover for the cause of action once under the rules of claim preclusion. However, the effect in a derivative action is that the shareholders are basically bound by the results achieved by the representative plaintiff who first stepped forward.[133] Because the representative shareholder may not always be interested in the litigation, nonparty shareholders should be afforded more deference when challenging the settlement procured by the representative plaintiff.

Finally, appellate standing could, and probably would, be used to police what many believe to be the true weakness of a derivative action—the search for attorneys' fees. The benefit of allowing an appeal of only the attorneys' fees is that it would not implicate several of the concerns of efficiency in representative litigation.[134]

> To allow an individual dissident class member who did not intervene to appeal an attorney's fee award would not be nearly as disruptive. It would not affect the defendant who has paid into court or made other concessions necessary to settle the case. In the usual case, in which the settlement creates a fund to be shared by the plaintiff class, all of the assets the court would have ordered distributed to the class members could be distributed despite the appeal. The only result of allowing the appeal would be to delay the payment of fees and expenses to the attorneys for the plaintiff class. Should the dissident's appeal succeed

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130. *See* FED. R. CIV. P. 23.1 ("The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.").

131. *See Kaplan*, 192 F.3d at 67.

132. *See* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1308 n.4 (3d Cir. 1993). The court noted "that one of the rationales offered in support of an intervention requirement [in class action suits] cannot apply to derivative actions. That is, unlike members of a class certified under Rule 23(b)(3), 'shareholders normally cannot opt out of the class and pursue their own individual action.'" *Id.* (quoting AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.02, at 635 (Proposed Final Draft, Mar. 31, 1992)).

133. *See* Kraakman et al., *supra* note 21, at 1737 ("Under the American regime, they [shareholder plaintiffs] are more likely to be attorneys (with nominal shareholders in tow) in search of legal fees.").

134. *See* Rosenbaum v. MacAllister, 64 F.3d 1439, 1442 (10th Cir. 1995).

> in reducing those fees, there would be additional funds for later distribution to the class members.[135]

This rationale applies equally to the derivative suit, where any reduction of attorneys' fees would accrue to the corporation, thus increasing the settlement value to the corporation.

Attacking the plaintiff's attorneys' fees serves two purposes: (1) attorneys will be less willing to accept a reduced settlement amount in exchange for increased attorneys' fees, and (2) attorneys will be less inclined to bring actions that have a low likelihood of success. This also addresses the concern that even if a named shareholder is monitoring the derivative action, he is less likely to present opposition to fees requested by his attorney from the corporation than he is to object to a paltry settlement amount. Finally, because notice of a settlement usually only establishes a range on possible attorneys' fees, it is more difficult to object to the fees because they are not known until later in the process.[136]

B. Disadvantages of Allowing Appeal Without Intervention

Many of the arguments against the intervention requirement center upon the burden intervention places on the objecting shareholder. Often the objecting shareholder does not learn of the proposed settlement until quite late, with little time until the settlement hearing.[137] Timeliness can be a concern when intervention is sought. However, permissive intervention will likely be granted to the objecting shareholder should he desire intervention.[138] It is quite unlikely that the objecting shareholder who desires intervention would be denied intervention by the district court when objecting to a settlement.[139] However, even if intervention is denied, that denial would be appealable.[140] In addition, intervention can be granted for limited purposes, including appeal.[141] Therefore,

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135. *Id.*

136. *See id.* at 1442-43.

137. *See* Petitioner's Brief at 8, Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999) (per curiam) (No. 97-1732). Petitioner had less than four weeks from receipt of the settlement notice to prepare objections. *See id.*

138. *See* 7C WRIGHT ET AL., *supra* note 41, § 1916, at 422. "The requirement of timeliness must have accommodating flexibility toward both the court and the litigants if it is to be successfully employed to regulate intervention in the interest of justice." *Id.*

139. Allowing intervention by the objecting shareholder seems to be a foregone conclusion. *See* United Airlines, Inc. v. McDonald, 432 U.S. 385, 386, 394-96 (1997) (permitting post-judgment intervention to a non-party member of a class action certification denial). "The critical inquiry in every such case is whether in view of all the circumstances the intervenor acted promptly after the entry of final judgment." *Id.* at 395-96.

140. *See* Marino v. Ortiz, 484 U.S. 301, 304 (1988) (per curiam).

141. *See* 15A WRIGHT ET AL., *supra* note 88, § 3902.1, at 113-14. "Intervention may be granted for specified purposes rather than for full participation in the litigation. If the limitation is not appealed, or is affirmed on appeal, the limited intervenor's standing on appeal is apt to be limited by the scope of the intervention." *Id.* at 113. Further, intervention can be sought solely for

courts may be willing to allow the shareholder to intervene for the sole purpose of ensuring appeal without requiring any additional involvement not otherwise contemplated by presentation of a meaningful objection.[142]

The argument that a shareholder should be considered a de facto party because his interest is being affected has several weaknesses. First, as the court pointed out in *Felzen*, it is the corporation that has suffered the harm and holds the cause of action.[143] Second, the Supreme Court has cast doubt on the viability of a doctrine conferring appellate status without intervention under the affected interest theory.[144] Additionally, under the de facto party doctrine, a person's involvement in a case usually must be substantial in order to be considered a de facto party.[145] Since objecting shareholders generally have not been involved in the case except for reviewing the proposed settlement, it does not appear that they meet the substantial involvement test. The objecting shareholders' involvement in the litigation is more akin to that of amicus curiae. Amicus curiae do not have standing to bring an appeal, but may gain standing through intervention in some instances.[146]

Is it logical to invite shareholders to present objections and not treat them as parties? One purpose for inviting shareholders to present objections is to ensure that the court receives a full presentation of the benefits and deficiencies associated with the proposed settlement, acknowledging that the adversarial process breaks down once the plaintiff and defendant have agreed to a proposed settlement.[147] Thus, the courts look to objecting shareholders to provide valuable information rather than to become parties to the underlying litigation. The former does not necessarily require the latter, as is clear when considering the

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the purposes of appeal. *See id.* at 114. "Intervention can support a nonparty appeal not only when intervention is sought to participate in the trial but also when intervention is sought *for the sole purpose of appeal*." *Id.* (emphasis added).

142. For an example of involvement in settlement hearings as an objector, see Petitioners' Brief at 8, Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999) (per curiam) (No. 97-1732). The petitioners had to "review the Settlement notice, hire counsel, obtain and review copies of pleadings in the case, weigh the fairness of the Settlement, draft a brief, and appear in court in Decatur, Illinois." *Id.*

143. *See* Felzen v. Andreas, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999).

144. *See Marino*, 484 U.S. at 304.

145. *See* 15A WRIGHT ET AL., *supra* note 88, § 3902.1, at 106.

> Appeals by those who participated as if parties are frequently entertained despite a failure to achieve formal status as a party. Most of these appeals involve persons who participate in trial court proceedings as if they had intervened, and who seem to have been treated on all sides as de facto parties.

Id.

146. *See id.* at 106 n.12.

147. *See* FERRARA ET AL., *supra* note 3, § 14.05 ("Courts also consider both the relative number of objectors and the nature of their objections in considering whether a proposed settlement is entitled to a presumption of fairness.").

status of amicus curiae.

One reason advanced for treating shareholders differently than class members is their inability to opt out of the litigation.[148] However, the reason shareholders cannot opt out of derivative litigation is because they do not have an injury recognized by the courts.[149] Only one entity can recover in a derivative action: the corporation. In a class action, multiple injuries are consolidated into one action.[150] An analysis based upon a lack of an opt out provision concentrates on the wrong entity's injury when considering a derivative action.[151] The reason a shareholder cannot opt out of a derivative action is because the suit could not be controlled if multiple shareholders were pursuing parallel actions. The same concern arises in the appellate courts. One representative of the corporation is entitled to pursue the claim for the corporation, and if his representation is deemed inadequate, the proper method is to challenge the representative's status and replace him in the litigation, not to make collateral attacks once the suit has been concluded.

Finally, allowing shareholders to attack just the attorneys' fees after settlement of the action could have a chilling effect on bringing suit in the first place. Of course, the purpose of this viewpoint is to discourage frivolous suits, not meritorious ones. Derivative actions do provide a useful means to protect shareholders, and going too far in the interest of preventing attorney fee abuses could prevent useful actions from being litigated. However, possible settlement attacks are not likely to deter attorneys from bringing meritorious suits. The ability to attack an attorney's fees can result in a strike suit of its own. Assuming the basis for a strike suit is that avoidance of litigation costs has a settlement value of its own, suits could be filed to reduce an attorney's fees simply to force the attorney to reduce some of her fees to avoid protracted litigation. Although the recovery of fees would accrue to the corporation, under the derivative action rules, the objecting attorney would be entitled to a portion of the savings intended for the corporation.[152] If one assumes that some attorneys are in the business of bringing harassing lawsuits for their settlement value, that assumption can be applied to the foregoing situation. However, it is unlikely that unmeritorious attacks on an attorney's fees will meet little resistance from the attorney like it does from the corporation. Unlike a defendant in a derivative action, the attorney pays his own litigation costs.[153]

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148. *See* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1308 n.4 (3d Cir. 1993).

149. *See* Felzen v. Andreas, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd per curiam sub nom. by an equally divided Court* Cal. Pub. Employees' Ret. Sys. v. Felzen, 525 U.S. 315 (1999).

150. *See* FED. R. CIV. P. 23. Under Rule 23(c) class members may elect to opt out of the class action upon receipt of notice of the action. If the class member fails to opt out, his interest will be litigated by the class representative.

151. *See Felzen*, 134 F.3d at 875.

152. Attorneys are entitled to payment of their fees by the corporation when they provide benefits to the corporation. Those benefits can be monetary or therapeutic in nature. *See* FERRARA ET AL., *supra* note 3, § 14.05.

153. Normal hindrances against bringing such a suit would exist, such as Rule 11 sanctions.

V. RECOMMENDATIONS

Two main concerns must be addressed when determining whether intervention should be required to appeal a settlement of a derivative action. One concern is how to avoid the agency costs inherent in a system in which an attorney usually directs the litigation efforts of a named shareholder who may not be monitoring the litigation. The countervailing concern is how to minimize the complexity and costs of extending a lawsuit that costs a corporation both human and monetary resources.

In confronting the agency problems, an overriding mistrust of plaintiffs' attorneys has developed because of the numerous examples of derivative settlements that seemingly benefit only the attorney.[154] Some believe that requiring intervention will help address the agency problem by encouraging more shareholders to get involved in presenting objections, knowing that their denial will be automatically appealable.[155] However, this view places too much reliance on the contention that intervention places an added burden on shareholders, which they are unwilling to bear. First, the requirement of intervention to gain appellate standing does not place any additional burden on shareholders who have no intention to pursue appeal but who, instead, wish to make their objections known to the trial court. Second, intervention may be granted for limited purposes. For those shareholders willing to commit substantial resources to present objections to the district court, intervening for the limited purpose of appealing an award of attorneys' fees may do little to add to the cost but do more to convince the settling parties of the shareholder's seriousness. Therefore, requiring intervention may actually convince the court and litigating parties that an objecting shareholder is serious enough to continue his efforts on appeal, and, at the same time, do little to affect those shareholders only willing to make an appearance to present objections.

Requiring intervention would serve the purpose of allowing the corporation to control and anticipate its litigation costs. Without requiring intervention, the courts face the problem that every objecting shareholder has standing to bring an appeal. This problem can undermine the purpose behind representative litigation,

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Attorneys would probably be more aggressive at fending off unmeritorious litigation than corporations have been, since their own money is at stake as opposed to directors of a corporation who may be willing to settle because they are indemnified by the corporation. *See* Coffee, *supra* note 22, at 13-14 (suggesting that defendants to derivative actions have failed to take aggressive positions to discourage future lawsuits that may lack merit because it is often cheaper to settle the current suit even though in the long run it encourages future suits brought for their settlement value).

154. *See id.* at 28-31 (giving examples of two cases that appear to have provided no tangible benefit to anyone except the plaintiff's attorneys).

155. *See* Kim, *supra* note 92, at 134, Fazendeiro, *supra* note 92, at 589-90; O'Connell, *supra* note 92, at 987-88 (all determining that intervention was unnecessary and would result in less shareholder involvement in presenting objections and keeping plaintiff attorneys in check).

which is to simplify an action in which numerous possible parties desire to bring the same claim by placing that action in the hands of a qualified representative. Without this consolidation of claims, the litigation becomes unmanageable and extremely costly to both the corporation and the already overburdened court system.

CONCLUSION

Derivative actions have likely fallen out of favor with most groups except the plaintiff attorneys who initiate them. Allowing any shareholder with an affected interest to appeal just because the corporation may be entering into a bad bargain could serve to complicate and further protract litigation that the corporation desires to end. An intervention requirement allows both the courts and the corporation to better control the litigation process, and does not place so great a burden on objecting shareholders that they will not be able to present their objections. The Supreme Court should follow the Seventh Circuit's lead and require intervention before an objecting shareholder is allowed to appeal a settlement.