Conflict-of-Interests Statutes and the Need for a Demand on Directors in Derivative Actions

Richard M. Buxbaum†

Where there is no complainant there is no judge.¹ Nowhere is the substantive law so dependent upon the availability of a person entitled to complain of its breach as in the case of litigation on behalf of a corporation. It is a statutory truism that the affairs of a corporation are managed by its board of directors,² and this includes litigation.³ If, however, the directors will not initiate corporate litigation, and if this refusal is dispositive, then whatever harm allegedly was done to the corporation goes unredressed. To remedy this situation a procedure known as the derivative suit is utilized. Its role in triggering corporate litigation against third parties is important, but even more important is its role in triggering suits against those corporate insiders, particularly directors, who by their imprudent or disloyal behavior may have damaged the corporation.⁴

Current developments concerning the prerequisites to allowing a volunteer shareholder to sue on behalf of the corporation are the focus of this Article; in particular, I will examine the so-called demand on directors⁵ as a condition precedent to such derivative actions.⁶

It is the thesis of this Article that many recent cases holding that a prior demand on directors was required, or, if made and rejected, dis-

† Professor of Law, Boalt Hall, University of California, Berkeley. A.B. 1950, LL.B. 1952, Cornell University; LL.M. 1953, University of California, Berkeley.

¹ "Wo kein Klaeger, ist kein Richter," a German folk maxim.

² See the new formulation in ABA COMM. ON CORP. LAWS, MODEL BUS. CORP. ACT § 35 (1974 Revision).

³ The right of a corporate officer to initiate litigation is a separate matter of corporate agency law; it typically does not extend to allow the major actions, particularly those attacking other corporate actors, that are the focus of this discussion. See generally Goebel, The Authority of the President Over Corporate Litigation: A Study in Inherent Agency, 37 St. John's L. Rev. 29 (1962).


⁵ "Demand on directors" is used herein as a shorthand phrase encompassing all postures in which a demand on directors may be involved, e.g., whether a plaintiff's failure to make a demand on the directors to sue will result in dismissal, as well as whether the rejection of demand by the directors will terminate the suit.

⁶ For fuller discussion of the prerequisites to derivative litigation, see R. JENNINOS & R. BUxbAUM, CORPORATIONS—CASES AND MATERIALS 628-83 (5th ed. 1979).
posed of the action were incorrectly decided because such a result undermines the letter and spirit of applicable conflict-of-interests statutes. Standards are then proposed to guide courts in deciding when a refusal to sue should terminate a derivative suit.

Rule 23.1 of the Federal Rules of Civil Procedure and similar state statutory or common law rules have created, in probably all jurisdictions, a substantive requirement that plaintiffs seeking to initiate derivative actions first either demand of the company’s board of directors that it commence the proposed litigation as a direct corporate action, or plead and demonstrate why such a demand was not necessary. Until recently this was little more than a formal requirement. If the underlying corporate complaint alleged impermissible behavior—self-dealing or grossly imprudent acts—by even a few (let alone a majority, or all) of the current members of the board, the demand was excused on the basis that it would be futile to expect “the board” to sue “itself” or some of its members.7

Recently the demand requirement has been promoted to a more important role in several jurisdictions. The details of this evolution have been commented upon extensively.8 For my purposes it is sufficient to note that its most important practical consequence has been to allow a small minority of board members to block derivative actions proposed to be brought against a current sitting majority of that board.9 Depending upon one’s underlying view of derivative litigation, this tentative development can be praised or condemned on the merits. The following partial condemnation is limited to an issue that has been overlooked by courts and commentators involved in this debate, an issue particularly relevant to the mentioned minority-approval situation.

When the challenged conduct involves self-dealing transactions between directors and their corporation—and that remains the important situation in derivative litigation10—statutory or analogous common law rules are involved and must be considered.11 The cases which

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10. See Jones, supra note 4.

11. For a listing and analysis of these conflict-of-interests statutes, see Bulbulia & Pinto, Statutory Responses to Interested Directors’ Transactions: A Watering Down of Fiduciary Standards?, 53 NOTRE DAME L. REV. 201 (1977). The role of common law rules, including their
require a demand on directors and those which block further action if the demand is rejected rest on two justifications, one substantive, one technical. Substantively they rest on the \textit{Burks v. Lasker}\textsuperscript{12} dicta that directors can be trusted fairly and impartially to scrutinize the conduct of their implicated fellow directors, and thus to respond appropriately to the demand. Technically they rest on a purported distinction between the authorization of a transaction and the decision not to proceed against even a regretted transaction.

Both justifications, however, must square with any relevant statutory or common law conflict-of-interests rules, a complication which has not been acknowledged or addressed by courts choosing to enforce the demand requirement.\textsuperscript{13} The newer statutory and common law rules governing potential conflict of interests created when directors are engaged in transactions with their corporation are curative rules. They relax earlier, more stringent sanctions against such transactions, sanctions that permitted the avoidance of the transactions without concern for their fairness and utility to the corporation, or that permitted avoidance unless a majority of the board of directors themselves were disinterested.\textsuperscript{14} The new rules relax the avoidance sanction, however, under strict limiting conditions. Only if these are honored is it possible for less than a majority of the board of directors effectively to adopt or to ratify such transactions.

Simplified for present purposes, the curative rules prescribe some level of conduct ("fair," "just and reasonable") understood to be stricter than the business judgment standard applied to arm's-length transactions.\textsuperscript{15} As to some, and perhaps all, of the formal curative decisionmaking procedures permitted by the new rules, the burden of proving compliance with this higher standard may be imposed upon the proponents of the transactions.\textsuperscript{16} These curative procedures are three-fold: either those disinterested members of the board having full

\textsuperscript{12} 441 U.S. 471, 481-82, 485 (1979).

\textsuperscript{13} Statutory and common law considerations have been addressed in a general way in Maldonado v. Flynn, 413 A.2d 1251, 1259-60, 1263 (Del. Ch. 1980) (appeal pending). \textit{See also} Abella v. Universal Leaf Tobacco Co., [1979-1980 Transfer Binder] SEC. REG. REP. (CCH) ¶ 97,649 (E.D. Va., filed Aug. 6, 1980).

\textsuperscript{14} \textit{See} Marsh, \textit{Are Directors Trustees?}, 22 Bus. Law, 35 (1966); authorities cited note 11 supra.

\textsuperscript{15} While not necessarily based upon the statutes, the following opinions illuminate this distinction: Cohen v. Ayers, 596 F.2d 733 (7th Cir. 1979); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. Sup. Ct. 1971); Schreiber v. Bryan, 396 A.2d 512 (Del. Ch. 1978); \textit{cf.} also the reorganization "fairness" cases exemplified by Singer v. Magnavox Co., 380 A.2d 969 (Del. Sup. Ct. 1977).

\textsuperscript{16} The statutory effort to eliminate the fairness requirement in the event of shareholder ratification, for example, has not worked. \textit{See, e.g.,} Remillard Brick Co. v. Remillard-Dandini
knowledge of their fellow directors' self-interest may approve the transaction; or the shareholders may approve it; or the transaction may be proved to be fair or just.

What is important about the combination of standard and procedure is that the first two of these three methods are prospective in nature. What is granted to a minority\(^7\) of the board of directors,\(^8\) in other words, is only the right to enter into a contract or transaction, not the right to ratify a fait accompli which, though it may in theory be one they can repudiate, presents entirely different and greater constraints upon the decisionmaker than does a prospective decision. This limiting condition is to be contrasted with the third curative approach, the proof of fairness. This by definition is retrospective: a decision not properly made initially can yet be rehabilitated, but in an adversary context, before a judge and jury, not by one or some members of the board making an ex parte decision.

The interplay between substantive standards and standards for judicial review in the context of the derivative action may be illustrated by analysis of a typical statute, section 144 of the Delaware General Corporation Law. No transaction is void or voidable solely because of a conflict of interests if, material facts known, “the board . . . in good faith authorizes the . . . transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum . . . .”\(^9\) In contrast, section 144(a)(3) cures voidable transactions if they were fair as of the time they were authorized or ratified by the board.\(^20\) This procedure contemplates a later, post-authorization or ratification test, one specifically charged to avoid the use of hindsight.

The New York statute, section 713 of the Business Corporation Law, reveals the same distinction. Approval of a pending, not-yet-affected transaction is authorized by section 713(a)(1) under similar disclosure conditions, “by a vote sufficient for such purpose without counting the vote of such interested director or, if the votes of the disinterested directors are insufficient to constitute an act of the board . . . , by unanimous vote of the disinterested directors . . . .”\(^21\) If, however, there is no prospective approval, or no approval that is adequate, subdivision (b) provides for avoidance of the transaction “unless the [pro-

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\(^7\) Sometimes a minority of one arguably suffices. See, e.g., N.Y. BUS. CORP. LAW § 713(a)(1) (McKinney 1971 & 1979 Supp.).

\(^8\) The point holds true of shareholder ratification as well.


\(^10\) Id. § 144(a)(3) (1975).

\(^21\) N.Y. BUS. CORP. LAW § 713(a)(1) (McKinney 1971 & 1979 Supp.).
ponent] shall establish affirmatively that the contract or transaction was fair and reasonable as to the corporation at the time it was approved . . . ." 22 Again, the statute contemplates a retrospective decision, without the use of hindsight, by a decisionmaker outside the corporate decisional structure.

The third major statutory form of the curative statute, section 310 of the California Corporations Code, also requires the transaction to meet a fairness standard and, additionally, requires an autonomous verification. Section 310(a) makes transactions nonvoidable despite the material financial self-interest of one or more directors if, after appropriate disclosure, "(2) . . . the board . . . authorizes, approves or ratifies the contract or transaction in good faith by a [sufficient independent vote] and the contract or transaction is just and reasonable as to the corporation as of the time it is authorized, approved or ratified . . . ." 23 Section 310(a)(3) provides the typical alternate curative mode as to transactions not so approved, validating the transaction or contract: if "the person asserting [its] validity . . . sustains the burden of proving that [it] was just and reasonable as to the corporation at the time it was authorized, approved or ratified." 24

The 310(a)(2) "fairness" requirement, despite the fact that it appears in combination with a requirement of approval by "independent directors" rather than only separately as an independent curative option, does not differentiate the California statute fundamentally from those of other jurisdictions; indeed, it confirms the conclusion that for retrospective curative efforts an independent judge is required in case of attack. Marsh points out that the relevance of the separate fairness proviso lies in the difference between the burden of proof of fairness required in the case of challenge to a director-approved transaction as contrasted with a challenged transaction defended on the ground of "fairness" alone. 25 Even a transaction prospectively approved by an appropriate number of independent directors is subject to challenge; in that case, however, the complainant must carry the burden of proving that it was not "just and reasonable" at the time of its approval. The

22. Id. § 713(b). See Lewis v. S.L. & E., Inc., 629 F.2d 764 (2d Cir. 1980).
23. CAL. CORP. CODE § 310(a) (West 1977 & 1980 Supp.).
24. Id. § 310(a)(3). The addition of "ratification" to the board's right of "authorization" and "approval" of course has no bearing on the present problem. It completes a more detailed listing of the various modes by which decisions may be effected. Some may be entered into by subordinate decisionmakers without adequate authority and need to be adopted or ratified by the appropriate plenary management body—hence ratification. Occasionally this mode may legitimate a transaction within the subordinate officer's authority but tainted by a conflict of interests at that level. That too is subject to the text discussion of the "doubled" fairness screen imposed upon board action by the statute.
determination of that challenge, however, also takes place before an independent arbiter—the judge—in the usual adversary context. A fortiori, then, a challenge to a transaction entered into without prior director approval, as to which the proponents are to carry the burden of proving the transaction just and reasonable, can take place only before a court.

In short, the price which the modern validating rules exact for their rejection of automatic avoidance of self-interested transactions is either prospective approval under specified conditions or retrospective approval under adversary conditions and by an autonomous decisionmaker. This distinction intuitively makes sense. One need not totally accept Judge Friendly's comments about the difficult position of nominally independent directors who are expected coolly to judge their fellow directors' behavior to embrace the narrower proposition implicit in these statutes: that however difficult it may be to restrain fellow directors from a proposed course of conduct, it is excessively difficult to repudiate a transaction already effected by one's fellow directors, thereby subjecting them, among other things, to financial sanctions. Indeed, this is so clear to the courts that in the leading case of Bennett v. Propp it led the Delaware Supreme Court to absolve those directors who reluctantly acquiesced in a fait accompli from liability to the corporation, although such liability was visited upon the directors who had initiated the transaction.

Whether a transaction initially was properly approved by the requisite number of independent directors, and thus cured of any "taint," often is a difficult question that is not answered uniformly among the jurisdictions. In some jurisdictions a majority of the board may be necessary; in others only enough to constitute a quorum (typically one-third of the board); in others perhaps only a number sufficient to constitute a majority of the relevant quorum; in others only all or a majority of the independent directors though all together are less than a quorum; and finally in yet others perhaps only the sole independent director if there be only one. In some of the cases that adopt the new, still debatable position that a nominally independent director's refusal to sue precludes a derivative suit, the original transaction was in fact authorized by a sufficient number of independent directors to meet the

29. For a review of the entire gamut of possibilities see Marsh, supra note 14, at 46-48 (1966). For recent examples of the variations the newer statutes may generate, see R. Jennings & R. Buxbaum, supra note 6, at 459.
requirements of the statute or analogous common law rule.\textsuperscript{30} In some, however, there was not a sufficient number or, when there was, the authorizing process simply was not utilized.\textsuperscript{31}

In this latter situation, assuming that the statutory analysis presented here is correct, the transaction has not been cured of its self-dealing taint, and at best can be cured only by submitting it to retrospective judicial scrutiny. If this is to be thwarted by a dispositive refusal to sue upon demand, it must be through the resurrection of the old and discredited distinction between approval of a transaction and a later unwillingness to go to court for redress of harm done the corporation by reason of the transaction.\textsuperscript{32} That distinction, in the procedural context here at issue, is neither logically sound nor sound as a matter of policy. Moreover, it was repudiated long ago by most American jurisdictions.\textsuperscript{33}

Known as the Massachusetts rule after \textit{S. Solomont & Sons Trust, Inc. v. New England Theatres Operating Corp.},\textsuperscript{34} the distinction was there developed to force plaintiffs in a pending derivative action, who were not required to make what clearly would have been a futile demand on the directors, nevertheless to make a demand on shareholders who were disinterested and therefore might appropriately decide on the proper corporate course of action. The court's effort to overcome the undisputed substantive law proposition that fraudulent managerial behavior could not be ratified by less than all of the shareholders consisted of the following statement: "We shall not rest our decision upon the power to ratify. The question whether it is good judgment to sue is quite apart from the question of ratification. This is a distinction of

\textsuperscript{30} That was the case in \textit{Burks v. Lasker}, 441 U.S. 471 (1979) (Delaware law), \textit{Abbey v. Control Data Corp.}, 603 F.2d 724 (8th Cir. 1979), \textit{cert. denied}, 444 U.S. 1017 (1980) (Delaware law), and \textit{Auerbach v. Bennett}, 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994 (1979) (New York law).

\textsuperscript{31} Thus the number was inadequate in \textit{Lewis v. Anderson}, 615 F.2d 778 (9th Cir. 1979), a diversity case purporting to apply, but, if the analysis in text is correct, in reality ignoring the California statutory requirement that validation of a challenged action requires the approval of a number of disinterested directors large enough to constitute a normal quorum. \textit{See} note 29 supra.

The reliance in both \textit{Lewis} and \textit{Abbey} on a statutorily authorized delegation of management power to committees of the board as a way of finessing the requirement of an adequate number of disinterested directors seems to be a particularly pernicious case of bootstrapping. I therefore classify such cases as belonging to the group in which the substantive requirements of the statutory curative mode were not met.


\textsuperscript{33} The prevalent rule is stated in \textit{Mayer v. Adams}, 37 Del. Ch. 298, 311-12, 141 A.2d 458, 462 (Sup. C.t. 1958).

A major argument against this view, which applies with equal force to directors' as well as to shareholders' efforts to reject a demand to sue, involves a basic principle of substantive law: "It seems clear . . . that the substantive law which holds certain wrongs to be incapable of ratification by a majority of the shareholders manifests a policy that these wrongs may be redressed by a minority shareholder after he has exhausted his intracorporate remedies." To accept the nominally procedural Massachusetts distinction would be to repudiate the general substantive rule by indirection.

What courts resting on this specious distinction wish to achieve is understandable, and in some cases worth accommodating, but not in this way. Their goal is to save corporations from futile but expensive litigation; abuse of the demand requirement, however, overshoots that goal. This can be illuminated by examining those cases in which the original transaction in fact was authorized by a number of directors sufficient to meet the applicable substantive conflict-of-interests curative rules. First of all, a complaint charging that the transaction was "unfair," yet admitting that its authorization fit the curative requirements (or at least not rebutting an answer so pleading) is demurrable. There simply is no cause of action on that ground. The use of a stringent demand-on-directors requirement in this situation is no more than the functional equivalent of the grant of a demurrer. Therefore a court should enforce such a requirement.

A different problem arises, however, if the complainant now seeks to escape this bar by suing the independent directors as well; either those still in office who, sufficient in number to meet the curative statute's conditions, authorized the transaction originally, or those now in office who with knowledge of the transaction nevertheless refuse to undo its consequences. Consider the first of these two possibilities, that of suing both the originally interested and disinterested directors, all of

35. 326 Mass. at 111; 93 N.E.2d at 247.
36. A second argument, more relevant to shareholder than to director ratification, concerns the problem of how to assure adequate communication of relevant evidence bearing on the transaction to the shareholders, particularly via the proxy solicitation mechanism. See Mayer v. Adams, 37 Del. Ch. 298, 141 A.2d 458 (Sup. Ct. 1958); Leavell, The Shareholders as Judges of Alleged Wrongs by Directors, 35 Tul. L. Rev. 331, 354-55 (1961).
39. Because of the phrasing of Fed. R. Civ. P. 23.1, the pleadings as to the demand issue require greater specificity than do normal pleadings; see the full discussion of this distinction in In re Kaufman Mutual Fund Actions, 479 F.2d 257 (1st Cir.), cert. denied, 414 U.S. 857 (1973); cf. Heit v. Baird, 567 F.2d 1157 (1st Cir. 1977); Vernars v. Young, 539 F.2d 966 (3d Cir. 1976).
whom continue in office. The proper allegation in that case is "waste of assets"; i.e., actionable imprudence in authorizing the transaction. This, typically, is a difficult pleading to sustain. The effort of some courts to avoid a potentially futile yet expensive proceeding by blocking its continuation through the demand-on-directors requirement is in many cases quite understandable.

Yet on this pleading, demand would be futile and thus should be excused, since the directors being sued, although only for actionable imprudence, are the ones who would control the response to the demand. In this situation trial—or at least embarking on the road to trial—is required, since to impose the absolute bar of the demand requirement is illegitimately to create a demurrer remedy to a fact dispute. Why of all defendants only corporate directors should be spared the pain of responding to properly pleaded but in the proof eventually deficient complaints is not apparent. That the innocent corporation and its shareholders thereby are subjected to inconvenience and expense seems irrelevant. Third-party complaints against corporate agents and employees are not similarly disfavored. Nor is the distinction between a third party's and an owner's complaint against an agent relevant. So long as the substantive law of actionable negligence permits an owner to sue an agent, and so long as in a joint-owner case it excuses the agent's behavior only upon the unanimous consent of all owners, then such a complaint deserves the same kind of procedural regularity as one that charges the bishop of Boston with bastardy.

Only in the second situation,—when new directors now in office refuse to undo an earlier transaction, itself properly authorized under curative rules and therefore challengeable only as a waste of assets rather than as "unfair"—does the demand on directors play its full role. Only the earlier ex-directors are being sued: for actionable imprudence in the case of the authorizing, if not also of the benefitted group. The new directors cannot be implicated in the original allegedly imprudent decision and under this assumption have not been sued. In this case they can respond properly to a demand, and a demand on them should be required.

41. See In re Kauffman Mutual Fund Actions, 479 F.2d at 267.
42. Even if only the disinterested directors respond to the demand, it should be excused.
46. It is a separate question whether rejection of a demand automatically bars the proposed action. Compare Swanson v. Traer, 249 F.2d 854 (7th Cir. 1957) (following remand of same, 354
Even then the logical consequence should be drawn. The disappointed claimant now may sue these current directors, derivatively, on the ground that their present refusal to pursue the earlier cause of action is so egregious as itself to amount to actionable imprudence.\footnote{See R. JENNINGS & R. BUFXBAUM, supra note 6, at 662.} That too is a well-pleaded cause of action, not subject to the masked demurrer of the demand requirement. If a court wishes to expedite the resolution of well-pleaded complaints that nevertheless stand little chance of success it can already in the first action examine the new directors' refusal to respond to the demand made upon them. If their refusal seems indefensible, the court has the discretion to permit the suit to proceed against the old director-defendants at once. This is the old but sound rule of \textit{Groel v. United Electric Co. of New Jersey},\footnote{70 N.J. Eq. 616, 61 A. 1061 (Ch. 1905).} and finds its modern form in the rule of some courts that would require demand but would not automatically bar the derivative action simply because the demand was rejected.\footnote{See note 42 supra.} The other side of the coin, of course, is that if the court finds the rejection rational enough not to constitute an actionable waste of assets, that second suit thereby is precluded in advance.\footnote{Note, however, that the review would not be under as deferential a standard as that applicable to original charges of actionable imprudence by a disinterested board, but would and should require a decent level of explanation as to why a prima facie appropriate effort to recoup a corporate asset nevertheless was not appropriate. This is clearly articulated in Tannenbaum v. Zeller, 552 F.2d 402, 418 (2d Cir.), cert. denied, 434 U.S. 934 (1977); see Note, \textit{Mutual Fund Independent Directors: Putting a Leash on the Watchdogs}, 47 FORDHAM L. REV. 568, 581 (1979), and, for a similar approach, Note, 1980 UTAH L. REV. 601. This is already recognized not only in \textit{Groel}, but also in Findlay v. Garrett, 109 Cal. App. 2d 166, 240 P.2d 421 (2d Dist. 1952).} This perception, which recognizes the demand-on-directors requirement as a species of demurrer, suitable only where demurrers are suitable, is both proper and inevitable once one recognizes the distinction between the substantive law governing the various aspects of corporate transactions and the procedure for launching complaints based on that law.

A final and separate question is suggested by the \textit{Groel}\footnote{See text accompanying notes 48-49 supra.} approach, and its modern variation in the recent Second Circuit decision in \textit{Galef v. Alexander}.$^{52}$ Under this approach the plaintiff's case is telescoped insofar as the court makes an expedited pretrial finding of fact as to the rationality of the independent new directors' refusal to sue, and in effect grants the director-defendants summary judgment if that refusal is found rational. Whether this much compression of a plain-

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\footnote{\textit{CONFLICT-OF-INTERESTS STATUTES} 1131}
tiff's right to a full trial, and particularly to full pretrial discovery pro-
ceedings, is appropriate is a question of policy beyond the scope of this
discussion.

One aspect of the problem of the desirability of such compression,
however, bears on my focus on the role of the substantive law of loyalty
in understanding derivative suit requirements—the fact that often the
plaintiffs are only nominal parties in interest.

In one important sense, derivative suits are a subset of contingent
fee litigation. It is often claimed that such litigation is inappropriately
expensive because the risk propensity of plaintiff's attorneys, both as to
their time and as to their potentially unrecoupable monetary expendi-
tures, bears no relation to the "true" value of the case. By subjecting
defendants to comparable expenses incommensurate with an objective
perception of the lawsuit's value, plaintiffs therefore may force settle-
ments in which defendants' saved future expenditures, transferred to
the plaintiffs' side, become the principal measure of case value.

This nuisance variation of the old and overwhelmingly discredited
strike suit characterization has been challenged both on general theo-
retical and—at least as to derivative suits—on empirical grounds.
Moreover, this approach overlooks one important characteristic pecu-
liar to the derivative suit variant of contingent fee litigation—the power
of the directors to settle the action unilaterally.

So long as the independent directors in office suffice to take pro-

53. See the discussion in Comment, The Demand and Standing Requirements in Stockholder
54. See the conflict between the studies and analyses made by Wood and Hornstein, and the
analysis of that conflict, in Dykstra, The Revival of the Derivative Suit, 116 U. PA. L. REV. 74, 76,
88 (1967). See also the discussion in R. JENNINGS & R. BUXBAUM, supra note 6, at 677-83.
55. See Posner, An Economic Approach to Legal Procedure and Judicial Administration, 2 J.
LEG. STUD. 399, 433 (1973); cf. Dam, Class Actions: Efficiency, Compensation, Deterrence and
Conflict of Interest, 4 J. LEG. STUD. 47 (1975).

A separate problem concerns the inherent conflict of interests between the attorney represent-
ing the derivative plaintiff and the corporate client. See generally Schwartz & Mitchell, An Eco-
nomic Analysis of the Contingent Fee in Personal Injury Litigation, 22 STAN. L. REV. 1125 (1970),
and specifically as to class actions Rosenfield, An Empirical Test of Class Action Settlement, 5 J.
LEG. STUD. 113 (1976). That, however, is a problem concerning the optimal efficiency of contin-
gent fee litigation settlement, but even an inadequate settlement is more efficient than no action on
a meritorious complaint.

Finally, it is important to distinguish the argument that the marketplace for shares provides
the most efficient mechanism for policing conflict-of-interests situations. That is an argument
against any given substantive conflict-of-interests rule, not against the derivative suit as a means
of enforcing that given norm. For a recent, wide-ranging presentation of that argument, see Hether-
ington, When the Sleeper Wakes: Reflection on Corporate Governance and Shareholder Rights,
56. See Jones, An Empirical Examination of the Resolution of Shareholder Derivative and
57. See Wolf v. Barkes, 348 F.2d 994 (2d Cir. 1965).
spective action under the described substantive rules\textsuperscript{58} (and that by definition is the case in this discussion of expedited procedures), they may settle the underlying action with the implicated defendant-directors without court approval, thus undercutting the ongoing action. This step converts a charge that the imprudence of the independent directors and, if applicable, the self-dealing of the implicated ones caused a corporate loss of $X$, to one that the imprudence of the independent directors in causing the corporation to settle its claim against the implicated directors for only $Y$ caused a corporate loss of $(X - Y)$. This is not a nice step to take and in fact seems infrequent in practice,\textsuperscript{59} but it does provide a suitable check against the often imaginary horrible of plaintiffs' attorneys abusing their bargaining position to the point of refusing all reasonable settlement offers. A reasonable settlement under such circumstances, instigated by the appropriate number of independent directors, undoubtedly would prevail against the plaintiff's second-ditch argument that, although independently decided on, the settlement decision was actionably imprudent.

With this concession to the often asserted but seldom proved argument that much derivative litigation is illegitimate and thus deserves forestalling, the demonstrated need to fit derivative suit procedures, including the demand on directors, within the governing substantive fiduciary rules can be confirmed as sound policy.

\textsuperscript{58} This is the critical issue in Clark v. Lomas & Nettleton Fin. Corp., 625 F.2d 49 (5th Cir. 1980).

\textsuperscript{59} See the treatment in Herbst v. ITT, 72 F.R.D. 85 (D. Conn. 1976).