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Attorneys' Fees in Shareholder Derivative Suits: The Substantial Benefit Rule Reexamined

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American courts ordinarily apply the rule that a successful plaintiff in a shareholder derivative suit may recover attorneys' fees from the corporation on whose behalf he sues. This rule encourages individual shareholders to undertake the risks of litigation to correct management abuses, even though their personal economic stake in the outcome may be relatively small. However, courts have imposed various conditions on the application of this rule, the most formidable of which is that the action must be successful. Unlike corporate officers, who can obtain reimbursement from the corporation for their attorneys' fees under some circumstances even if they are unsuccessful, shareholder-plaintiffs cannot recover attorneys' fees for unsuccessful suits, regardless of their good faith. The requirement of success can also prevent reimbursement in actions that are settled or that become moot before trial, unless the shareholder can show that the action would have been successful.

In addition to success, many courts require that the plaintiff's action confer a substantial benefit, pecuniary or otherwise, on the corporation. This requirement originated from the class action practice of awarding attorneys' fees to individual plaintiffs whose actions procure a fund for the benefit of the class. In the derivative suit context,
the corporation itself represents a fund against which fees can be assessed when the action does not create a pecuniary benefit. However, many courts believe that an additional limitation is necessary in such cases and require that the action confer a "substantial benefit" on the corporation before they will assess fees against it. The courts that have accepted this substantial benefit rule as a prerequisite to fee awards have often failed to consider its practical effect or its necessity as an effective safeguard against unmeritorious suits. In view of the many other such safeguards, the substantial benefit rule in fact serves only as a rubric under which courts can arbitrarily deny reimbursement for attorneys' fees to shareholder-plaintiffs who fulfill all the conditions for bringing a derivative action and who pursue their actions to successful completion. Moreover, instead of using the class action analogy, with its fund requirement, courts can justify reimbursing a successful shareholder-plaintiff for his attorneys' fees in a derivative action under the theory that a meritorious action on behalf of the corporation should have been brought by the corporation itself.

The United States Supreme Court in Mills v. Electric Auto-Lite Co., moved in the direction of eliminating the benefit requirement in derivative actions brought to enforce federal securities laws, but it did so by purporting to apply the substantial benefit rule. Suing both as representatives of a class of shareholders and derivatively, the plaintiffs in Mills alleged a violation of section 14(a) of the Securities Exchange Act of 1934 and S.E.C. rule 14a-9 in the solicitation of proxies

10. See text accompanying notes 156-67 infra.
11. The theories under which fees can be awarded are discussed in text accompanying notes 29-51 infra.
13. Id. at 396.
14. 15 U.S.C. § 78n(a) (1970). This section provides:
   It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or permit the use of his name to solicit proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78l of this title.
15. 17 C.F.R. § 240.14a-9 (1970). This provides:
   No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary
leading to the merger of Auto-Lite with a corporation having voting
control of Auto-Lite's parent corporation. The Court of Appeals
for the Seventh Circuit reversed the district court's decision sustaining
the plaintiffs' motion for summary judgment. The Supreme Court in
turn reversed and remanded to the district court for a determination of
damages. The Court also granted the plaintiffs an interim award of
attorneys' fees, but denied their request for prospective fees. While
conceding that, if the merger were found to be fair, there would be no
remedy available to the corporation or to its minority shareholders,
and therefore no benefit in the conventional sense, the Court nonethe-
less invoked the substantial benefit rule to assess attorneys' fees against
the survivor corporation. The Court explained:

In many suits under § 14(a), particularly where the violation
does not relate to the terms of the transaction for which proxies are
solicited, it may be impossible to assign monetary value to the
benefit. Nevertheless, the stress placed by Congress on the im-
portance of fair and informed corporate suffrage leads to the con-
cclusion that, in vindicating the statutory policy, petitioners have
rendered a substantial service to the corporation and its share-
holders. . . . [R]egardless of the relief granted, private stock-
holders' actions of this sort "involve corporate therapeutics," and
furnish a benefit to all shareholders by providing an important
means of enforcement of the proxy statute.

By this statement, the Court clearly endorsed the view that a pecuniary
benefit, present or potential, is unnecessary for an award of attorneys'
fees, but it did not so clearly indicate what kind of benefit is required.
Some courts, following Mills, have concluded that attorneys' fees may
be awarded in all suits that "involve corporate therapeutics," at least
when violations of the securities acts are discovered. Some commen-
tators, on the other hand, have observed that it would be inequitable to
make the shareholders of one corporation pay for a benefit conferred on
corporate stockholders generally, suggesting that the substantial bene-

in order to make the statements therein not false or misleading or necessary
to correct any statement in any earlier communication with respect to the
solicitation of a proxy for the same meeting or subject matter which has be-
come false or misleading.

16. 396 U.S. at 378.
17. Id. at 379-80.
18. Id. at 386.
19. Id. at 389, 390 n.13.
20. Id. at 388-89, 392.
21. Id. at 396 (footnotes omitted).
22. See Kahan v. Rosenstiel, 424 F.2d 161 (3d Cir.), cert. denied, 398 U.S. 950
23. Comment, Judicial Encouragement of Private Actions Under Rule 14a-9, 50
B.U.L. REV. 470, 479-80 (1970); Note, Section 14(a): Causation and Attorneys' Fees,
fit rule should be interpreted as requiring some greater service to the shareholders than mere discovery of securities act violations. Part I of this Comment discusses further the evolution and recent applications of the substantial benefit rule, the content of which was cast into such doubt by Mills.

In addition to requiring a benefit to the corporation, lower courts have imposed several other prerequisites to the award of attorneys’ fees: the suit must be brought in a derivative or representative capacity, rather than on behalf of one class of stockholders; it must not be brought under certain statutes that evince a comprehensive scheme of penalties; and the shareholder must show a causal connection between his action and the benefit conferred.24 Like the substantial benefit rule, these requirements have been questioned in recent cases. Part II discusses the kinds of actions in which fees have traditionally been denied and, where the shareholder can recover fees, the capacity in which he must sue, the extent to which his suit must progress, and the standard he must meet to show a causal connection.

Reading Mills as supporting the granting of attorneys’ fees where there is no apparent benefit to the corporation other than therapeutics will remove a substantial barrier to shareholder derivative suits. While some courts deny attorneys’ fees out of the fear that the failure to set certain limits will encourage strike suits,25 other courts hold that allowances for attorneys’ fees “should not be niggardly for appetite for effort in corporate therapeutics should, as in salvage and in bankruptcy cases, be encouraged.”26 The Supreme Court in Mills expressed no fear that derivative actions would be abused, but rather cited the evolution of attorney fee awards in class actions to justify its use of the substantial benefit rule.27 In view of the Court’s strong policy favoring derivative actions,28 and since the effect of its Mills decision is to nullify the requirement of any benefit other than the mere disclosure of securities act violations, the Court should explicitly reject the substantial benefit rule and adopt a different rationale for awarding attorneys’ fees to share-

24. See notes 99-151 infra and accompanying text.
27. 396 U.S. at 391-96.
holder-plaintiffs. Part III of this Comment discusses the competing policy considerations involved in such awards and suggests guidelines for rules governing them.

I

THE SUBSTANTIAL BENEFIT RULE

A. Theories for Counsel Fee Awards

Several theories have been advanced to support the special rule allowing the successful plaintiff in a shareholder derivative action to recover attorneys' fees when no pecuniary fund is brought into court by his action. The Supreme Court in Mills adopted the theory that the action benefits the shareholders as a class and that they can be assessed for the costs of this benefit according to their interests by an award against the corporation. Precedent for this class action theory exists in earlier Supreme Court decisions involving suits by beneficiaries of trust funds. In these cases, the Court recognized that the trust fund itself was a convenient source of attorneys' fees for a suit benefiting all the beneficiaries of the fund. The existence of a fund in which all class members have an interest distinguishes suits by trust fund beneficiaries from class actions by taxpayers or creditors. In class actions involving no preexisting fund, the suit must be successful in order to create a fund from which fees may be assessed against the class members. Although this practical need for success is not present in class actions involving a preexisting fund, the courts have nonetheless required that plaintiffs in such actions be successful before they can recover their attorneys' fees. Similarly, success has been required in derivative suits, even though the corporate assets could be used as a fund for reimbursing unsuccessful shareholder-plaintiffs for their at-

29. 396 U.S. at 396-97. This is essentially the same as the "salvage theory" developed in Hornstein, supra note 7.
31. It is also established by sufficient authority, that where one of many parties having a common interest in a trust fund, at his own expense takes proper proceedings to save it from destruction and to restore it to the purposes of the trust, he is entitled to reimbursement, either out of the fund itself, or by proportional contribution from those who accept the benefit of his efforts. Trustees v. Greenough, 105 U.S. 527, 532-33 (1881).
32. For a detailed analysis of the types of class actions in which the salvage theory has been applied, see Hornstein, supra note 7, at 665-79.
34. See Trustees v. Greenough, 105 U.S. 527, 532 (1881). Even if he is successful, a voluntary trustee of an existing fund, unlike an appointed trustee, cannot recover payment for his own time and efforts expended in the litigation. Id. at 537-38.
The class action view, in fact, logically precludes reimbursement of unsuccessful plaintiffs, because the award is based on a *quantum meruit* theory that all those who benefit from the plaintiff's action should share his costs. When the plaintiff is unsuccessful, there is no benefit and therefore no reimbursement. Even in suits on behalf of a class having a common interest in a preexisting fund, where the practical necessity of pecuniary success is eliminated, the *quantum meruit* rationale dictates that there be some benefit conferred by the suit before the plaintiff can recover attorneys' fees.

Another theory for the award of attorneys' fees in shareholder derivative suits is that the corporation should bear the cost of an action on its behalf because it should have brought the suit itself. This theory overcomes the usual rule against levying attorneys' fees on an adverse party by looking beyond the nominal designation of the corporation as a defendant in derivative suits to recognize that the corporation's interests are actually aligned with the plaintiff. It is also more consistent with the separate entity treatment of corporations than is the class action theory, which treats the assets of the corporation as belonging to the shareholders directly. While this theory might logically permit the award of fees to unsuccessful plaintiffs, the courts have established success as the standard for determining whether the corporation should have brought the suit. The derivative action theory does, however, allow


36. See note 7 supra and accompanying text.


38. A stockholder's derivative suit is brought to enforce a cause of action which the corporation itself possesses against some third party, a suit to recompense the corporation for injuries which it has suffered as a result of the acts of third parties. The management owes to the stockholders a duty to take proper steps to enforce all the claims which the corporation may have. When it fails to perform this duty, the stockholders have a right to do so. Thus, although the corporation is made a defendant in a derivative suit, the corporation nevertheless is the real plaintiff and it alone benefits from the decree; the stockholders derive no benefit therefrom except the indirect benefit resulting from a realization upon the corporation's assets.


40. Hornstein justifies this criterion as follows:

On the other hand, services, which if successful could justify a contract of employment, will not entitle one to compensation if in fact unsuccessful, since the complainant member of the class has no power to retain an attorney for it unless a wrong to the class really must be redressed. A complainant

for the award of fees without the creation of a benefit, since it does not rely on *quantum meruit* to justify reimbursing the plaintiff. This derivative action theory is based squarely on the special characteristics of such actions and is, therefore, logically more easily applicable than are the other theories. Moreover, it does not raise the problem confronted by the Court in *Mills* of how much benefit is necessary to justify a fee award, since the only criterion is success. A third theory under which fee awards in shareholder derivative suits have been justified rests on the general equity power of courts to impose counsel fees on a losing party under special circumstances. Like the class action theory, this view considers the corporation to be a party adverse in interest to the shareholder-plaintiff and is concerned primarily with creating an exception to the rule against levying the cost of attorneys' fees on an adverse party. The special circumstances necessary to justify such an exception include actions "where the taxation of such costs is essential to the doing of justice. . . ." In *Kahan v. Rosenstiel*, for example, the Third Circuit applied this broad rationale to reverse the district court's denial of counsel fees sought from a corpo-

who acts voluntarily on behalf of his class and is unsuccessful is simply an intermeddler and not an instrument for the protection of any class interest. A voluntary "trustee" is reimbursed only if successful, thus differing from a trustee *eo nomine*, who is under a duty to protect the object of his trust and is entitled to reimbursement for his expenses whether he is successful or not. In a stockholder's suit the court's reasoning is that the action having been sustained, it necessarily follows that it should have been brought by the corporation, and it is equitable that the plaintiff be reimbursed for the expenses which the corporation would have incurred had it performed its duty to the stockholders by bringing the action itself.

Hornstein, *supra* note 2, at 790.

41. Even courts that adopt a *quantum meruit* theory for the award of attorneys' fees often do so in reference to benefits conferred on the corporation rather than its shareholders. *E.g.*, Globus, Inc. v. Jaroff, 279 F. Supp. 807, 809 (S.D.N.Y. 1968); Holthuson v. Edward G. Budd Mfg. Co., 55 F. Supp. 945, 947 (E.D. Pa. 1944); Bosch v. Meeker Cooperative Light & Power Ass'n, 257 Minn. 362, 364-65, 101 N.W.2d 423, 426 (1960). This hybrid view is an attempt to recognize the corporation as the real beneficiary of the action, while assessing fees against it under the common law rule for fee awards in class actions. The courts do not expressly state whether they are deliberately modifying the rule to make it applicable to benefits conferred on corporate entities as well as on classes, or whether they regard any benefit conferred on the corporation as benefiting indirectly the shareholders as a class. One court specifically eliminated this distinction between the corporation as an entity and the shareholders as a class by stating that the shareholder's litigation "substantially benefited the class which, in a derivative action, is the corporation." *Chrysler Corp. v. Dann*, 43 Del. Ch. 252, 256, 223 A.2d 384, 386 (Sup. Ct. 1966).

42. The award would, of course, also be subject to the limitations discussed in text accompanying notes 99-151 infra.


45. 424 F.2d 161 (3d Cir. 1970).
poration that had changed the terms of a merger offer after the plaintiff had filed a section 10(b) complaint. Finding this a willful violation of rule 23(e), which requires court approval of the settlement or compromise of class actions, the court said:

In exceptional circumstances . . . where the behavior of a litigant has reflected a willful and persistent "defiance of the law", a court of equity has the power to charge an adverse party with plaintiff's counsel fees as well as court costs.

Since the defendant in Kahan was the survivor corporation, in which the plaintiff owned no stock, the court may have invoked this special circumstances rule only because both the class action and derivative action theories were inapplicable, the former because the class represented by the plaintiff had no economic interest in the defendant corporation, and the latter because the corporation in which the plaintiff held stock no longer existed. Nonetheless, the court, quoting extensively from Mills, indicated that the plaintiff could not recover fees unless his action had conferred a substantial benefit on the class he represented, which suggests that the court regarded the special circumstances rule by itself as a shaky ground on which to base a counsel fee award. Indeed, due to the increasing applicability of the other theories for awarding counsel fees, courts will probably resort to this amorphous doctrine even less to justify reimbursement of shareholder-plaintiffs in the future.

B. Nature of the Benefit

Though logically distinct, these theories have become more similar in their practical effect due to the evolution of the substantial benefit concept in conjunction with the class action theory. Bosch v. Meeker Cooperative Light & Power Association defined a substantial benefit as

one that accomplishes a result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the cor-

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47. Dismissal or Compromise. A class 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 all members of the class in such manner as the court directs.
Fed. R. Cvt. P. 23(e).
48. 424 F.2d at 167 (footnotes omitted).
49. The district court had denied the award of fees for essentially these reasons.
50. 424 F.2d at 166-67.
51. See notes 52-91 infra and accompanying text.
52. See text accompanying notes 7-14 supra.
53. 257 Minn. 362, 101 N.W.2d 423 (1960).
poration or affect the enjoyment or protection of an essential right to the stockholder's interest.54

Subsequent applications of this rule in both federal and state courts have shown it to be a very uncertain standard for counsel fee awards. Some courts use it to require a potential pecuniary benefit before granting attorneys' fees; others are satisfied with the mere filing of a meritorious claim.55 As the benefit required for a fee award under the class action theory becomes less substantial, this theory increasingly resembles the derivative action theory in its results. A brief survey of some cases wherein the substantial benefit rule has been applied shows the extent to which this evolution has progressed.

Bosch is a case that easily fits the Minnesota supreme court's definition of a nonpecuniary benefit. The plaintiff in Bosch succeeded in having an election of directors and a bylaw amendment declared invalid, which, the court found, could substantially benefit the corporation and its shareholders by correcting and preventing misconduct by the corporation's officers and directors.56 Other state courts, however, have found the rule more troublesome in less clear-cut situations. Chrysler Corp. v. Dann,57 for example, involved a suit against corporate officers for self-dealing and mismanagement. Approving a settlement of the action, the Delaware supreme court awarded attorneys' fees incurred in forcing changes in a compensation plan because the changes would benefit the corporation by "aiding it to acquire and retain highly qualified personnel in a very competitive industry,"58 though the changes would increase the amount of money the corporation would have to spend in the future. At the same time, the court denied attorneys' fees for changes in management personnel, which were part of the settlement, because there was no causal connection between those changes and subsequently increased corporate earnings.59 Such an oblique reversion to the requirement of a pecuniary benefit for counsel fee awards illustrates the substantial benefit rule's potential for overly restrictive application by courts reluctant to find sufficiently beneficial any result that does not create an immediate or future pecuniary benefit.60

54. Id. at 366-67, 101 N.W.2d at 427.
55. See text accompanying notes 57-88 infra.
56. 257 Minn. at 365-67, 101 N.W.2d at 426-27.
57. 43 Del. Ch. 252, 223 A.2d 384 (Sup. Ct. 1966).
58. Id. at 258, 223 A.2d at 388.
59. Id. at 259-60, 223 A.2d at 388-89. The court also adduced the lack of merit of the claim of mismanagement as a ground for denying fees for this part of the settlement. See text accompanying notes 143-44 infra.
60. The Delaware court in the earlier case of Treves v. Servel, Inc., 38 Del. Ch. 483, 154 A.2d 188 (Sup. Ct. 1959), affirmed an award of nominal attorneys' fees for the slight speeding-up of dividend payments, though finding that the suit may have had
In contrast to Dann, a California appellate court in Fletcher v. A.J. Industries, Inc., nonconfronted with nearly identical facts, affirmed the trial court's finding that the submission of the dispute to arbitration and the change of corporate personnel created a benefit sufficient to justify reimbursement of all the plaintiffs' attorneys' fees. This result is more consistent with the Bosch decision, since a change in personnel resulting from a shareholder suit is at least as effective in preventing subsequent misbehavior as the invalidation of an election of directors.

Federal courts as well have invoked the substantial benefit rule in determining whether a plaintiff who succeeds in establishing a violation of federal law, without pecuniary benefit to the corporation, can nevertheless recover attorneys' fees from the corporation. The Second Circuit interpreted the rule somewhat restrictively in Schechtman v. Wolfson, a shareholder suit brought under the Clayton Act to enjoin directors of the plaintiff's corporation from serving as directors of competing corporations. Upon the denial of their motion to dismiss, the directors resigned their competing directorships, thereby rendering the action moot. The court held that attorneys' fees could be awarded even though no final judgment was obtained since "[d]isallowance of counsel fees means that for all practical purposes there will be virtually no derivative suits brought to enforce the antitrust laws under [15 U.S.C. §§ 15, 26]." The court, however, went on to deny counsel fees on the ground that none of the benefits adduced by the plaintiff as justifying the award was "substantial." Had the Bosch rule been applied, the Schechtman court could easily have found sufficient benefit in the correction of the management's violations of a federal statute and the prevention of the resulting deleterious effects. In fact, just this interpretation had already emerged in actions involving violations of federal securities law, as the case of Smolowe v. Delendo demonstrates.

an overall detrimental effect on the corporation by chilling merger negotiations that were pending when the suit was filed. The court thus did not assume an appreciably more liberal attitude in awarding attorneys' fees subsequent to its adoption of the substantial benefit rule than it had manifested previously.

61. 266 Cal. App. 2d 313, 72 Cal. Rptr. 146 (1st Dist. 1968).
62. Id. at 324-25, 72 Cal. Rptr. at 153-54.
63. 244 F.2d 537 (2d Cir. 1957).
64. Id. at 538.
65. Id. at 539.
66. Id.
67. Id.
68. See text accompanying note 56 supra.
69. 136 F.2d 231 (2d Cir. 1943). Since the court in this case adopted the derivative action theory to award attorneys' fees, it did not consider what kind of benefit, if any, would be required for a fee award in cases involving securities act violations,
There, plaintiffs succeeded in procuring funds for the corporation under section 16(b) of the Securities Exchange Act, which allows a corporation to recover short-swing profits made by its officers and 10-percent shareholders trading in its stock. Recognizing that private actions are an important means of enforcing the federal securities law, the court said:

Since in many cases such as this the possibility of recovering attorney's fees will provide the sole stimulus for the enforcement of § 16(b), the allowance must not be too niggardly.

The New York district court in Globus, Inc. v. Jaroff closely followed Smolowe in holding that fees could be awarded when no pecuniary benefit was created in an action under section 10(b) of the Securities Exchange Act, but that the action had to confer "an actual, practical benefit in the business sense." In Globus, the shareholder-plaintiff sued the board of directors, alleging proxy solicitation violations relating to the approval of a stock option plan. When the court denied the board's motion to dismiss, they cancelled the plan and rendered the action moot. The court rejected the defendants' argument that the benefits of the plan would have outweighed its detriments, holding that such a judgment could be made only by shareholder approval lawfully obtained. However, the court stopped short of holding that the mere discovery of a violation of section 10(b) would justify fee recovery, requiring instead that the plaintiff show that his action had caused the directors to rescind the plan and had thus conferred a benefit on the corporation.

The United States Supreme Court in Mills took the step that Smolowe and Globus refused to take and found a substantial benefit to the corporation and its shareholders in the mere establishment of a Securities Exchange Act violation. The Court's use of the term "corporate therapeutics" suggests a view similar to that of Bosch: that the corporation was benefited by the correction and prevention of management misconduct. However, this term could also imply that the benefit need only inure to the corporate system generally, in which case the Court went far beyond the class action theory of counsel fee awards and

but the substantial benefit rule would have been inapplicable anyway, since a pecuniary benefit was conferred on the corporation. Id. at 241.

71. 136 F.2d at 241.
73. Id. at 809.
74. Id. at 810.
75. Id. at 808-10.
76. 396 U.S. at 396. For a fuller discussion of the facts in Mills, see text accompanying notes 16-22 supra.
77. See text accompanying note 56 supra.
effectively created an automatic rule for attorneys' fees in actions disclosing violations of federal securities law.

The case of Kahan v. Rosenstiel, where the shareholder-plaintiff's suit caused the revision of a proposed merger, is a good example of the practical effect of Mills. The Delaware district court, ruling on a petition for counsel fees prior to the Mills decision, held that fees could not be awarded for several reasons: First, the plaintiff had not sold his stock and thus would have had no standing to sue under section 10(b) of the Securities Exchange Act. The action, therefore, could not have withstood a motion to dismiss on the pleadings, which is in itself grounds for denying attorneys' fees. Second, the plaintiff represented a class of stockholders who had not yet sold their stock, so his action did not create a fund for the class. When they sold under the revised merger plan, they would get more money than under the original plan, but at the time the plaintiff's petition for counsel fees was presented, his class had not yet realized any benefit. Third, he sought fees not from his own corporation, but from the corporation that had proposed the merger and was the actual defendant in the suit. The Third Circuit, which reached its decision after Mills, reversed the district court's holding and granted attorneys' fees. In refuting the district court's first reason for denying fees, that the plaintiff lacked standing since he had not yet sold his stock, the court said:

Neither the language of § 10(b) and Rule 10b-5 nor the policy they were designed to effectuate mandate adherence to a strict purchaser-seller requirement so as to preclude suits for relief if a plaintiff can establish a causal connection between the violations alleged and plaintiff's loss.

The court still required that the plaintiff prove a meritorious claim, but nothing beyond this was necessary to prove that his action had created a substantial benefit. The court also rejected the district court's second reason—that no fund had yet been created—since the defendants themselves had prevented the creation of a fund by changing the terms of the merger before the action could be tried. As discussed above, the court rejected the district court's third reason for denying

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79. 300 F. Supp. at 450.
80. This rule is discussed in text accompanying notes 135-51 infra.
81. 300 F. Supp. at 452.
82. Id.
83. 424 F.2d at 161.
84. Id. at 173.
85. Id. at 167.
86. Id.
87. See text accompanying notes 45-51 supra.
fees—that fees were sought from the actual defendant rather than the
plaintiff's own corporation—by invoking the equitable rule allowing fee
assessments against defendants guilty of misconduct. The influence
of Mills on this decision is unmistakable. As in Mills, the circuit court
rejected technical arguments the district court had found convincing
and sought instead to promote "corporate therapeutics" by allowing
fees based solely on the plaintiff's discovery of a securities act viola-
tion.

Shortly after being reversed in Kahan, Judge Wright issued an-
other opinion dealing with counsel fee awards in Fischman v. Wexler.88
There, shareholders of a bankrupt corporation filed suit against its par-
et under section 10(b) of the Securities Exchange Act for omissions in
a proxy statement leading to the subsidiary's adoption of a plan of com-
plete liquidation. The parties to the action subsequently entered into
an agreement whereby the parent would pay the subsidiary's liquidation
expenses, attorneys' fees, accountants' fees, and other expenses of liti-
gation if the settlement were $35,000 or less. In approving the settle-
ment, the district court noted that the suit could not possibly have con-
ferred any benefit on the plaintiff's corporation or its shareholders since
the parent, as its principal creditor, would ultimately receive any funds
acquired by the subsidiary.89 The only parties benefited, in the court's
view, were the attorneys, who had set the $35,000 settlement figure in
order to ensure that they would get their fees.90 The court nonetheless
followed the rationale of Mills and Kahan in holding that corporate
therapeutics justified a fee award even under these circumstances, due
to "the need to avoid discouraging counsel from undertaking the risk
of derivative suits such as this one, which happens to have run
aground."91 Disclaiming any effort to evaluate the benefit conferred
by the suit,92 the court noted that it was going beyond Mills, which had
been a more appropriate case for the application of the "salvage the-
ory"93 because it involved both an adjudication of liability and a plain-
tiff who was a stockholder in the corporation against which fees were
assessed.94 The Fischman court would possibly have been more reluc-

89. Id. at 977-79.
90. See id. at 979. While conceding that the plaintiffs' attorneys were "highly
    reputable," the court noted that without the settlement agreement they could not
    have recovered any fees, since even a successful suit would confer no benefit on which
    they could base a claim for fees.
91. Id.
92. Id. ("In considering counsel's application for fees, therefore, no effort has
    been made to evaluate the benefit, if any, conferred on [plaintiff's corporation] or its
    stockholders").
93. See note 29 supra and accompanying text.
94. 309 F. Supp. at 978.
tant to extend the Mills decision had it been assessing fees itself rather than approving the parties' agreed assessment. However, its reliance on the corporate therapeutics doctrine, as set forth in Mills, suggests that it was trying to follow the spirit, if not the letter, of that decision, just as the circuit court did in Kahan. Both of these post-Mills decisions demonstrate an unwillingness to let technical objections, such as the creation of a benefit or the alignment of parties, prevent counsel fee awards in cases involving securities act violations.

In general, the practical significance of the substantial benefit rule has been greatly exaggerated. While its purpose was to allow the award of attorneys' fees in actions that do not create a pecuniary benefit, many courts had already reached this result under other theories. Moreover, the substantial benefit rule provides a rubric under which courts can deny attorneys' fees to plaintiffs whose claims are meritorious and who have conferred some degree of benefit on the corporation. While the Court in Mills purported to apply the substantial benefit rule, the effect of its decision was to create a conclusive presumption in securities act cases that the rule is satisfied when a securities act violation is discovered. Courts finding a violation in this area cannot deny attorneys' fees for want of a sufficient benefit. In other areas, however, courts can continue to use their absolute discretion to determine whether a substantial benefit has been created and can use this rule to deny attorneys' fees to successful shareholder-plaintiffs.

II

OTHER LIMITATIONS ON COUNSEL FEE AWARDS

In addition to the requirement of a substantial benefit, courts have raised other barriers to the shareholder-plaintiff's recovery of counsel fees, and these barriers apply whether the class action or the derivative action theory is followed. These include the denial of fees in suits brought under certain statutes, in suits benefiting principally one class of shareholders, in suits brought by a shareholder serving as his own attorney, and in suits that have no causal connection to the benefit con-
ferred. As the inadequacy of the substantial benefit rule becomes more apparent,99 these limitations should become increasingly important in determining whether plaintiffs can be reimbursed for attorneys' fees in derivative actions.

A. Certain Statutory Causes of Action

The denial of attorneys' fees in Fleischman Distilling Corp. v. Maier Brewing Co.,100 which involved a trademark infringement in violation of the Lanham Act, was based on the theory that this suit was one of the "statutory causes of action for which the legislature had prescribed intricate remedies."101 The court noted that the patent laws specifically provide for the recovery of attorneys' fees, while attempts to include such provisions in the Lanham Act had failed.102 Defendants in derivative actions brought under the Securities Exchange Act have been unsuccessful in attempting to invoke this same rationale to deny fees under the Act, arguing that the specific provisions for attorneys' fees in sections 9(e) and 18(a) imply that such fees cannot be awarded under other sections of the Act.103 In rejecting this argument in Mills, the Court stated that, unlike the Lanham Act, the Securities Exchange Act manifested no "purpose to circumscribe the courts' power to grant appropriate remedies."104 The Court also cited its own role in determining whether a private right of action should be implied under section 14(a) of the Act to justify a further role for the courts in deciding whether attorneys' fees should be awarded in such actions.105

The Second Circuit in Schechtman v. Wolfson106 reasoned similarly in deciding that attorneys' fees could be awarded in shareholder derivative actions under the Clayton Act. Both Mills and Schechtman involved court-created rights of action under federal statutes, in contrast with Fleischman, which involved a statutory right of action for which definite statutory remedies were prescribed. Thus, this limitation precludes an award of attorneys' fees only in cases where a statute exhibits a comprehensive plan of enforcement, and this is not a formidable limitation on the recovery of fees in shareholder derivative suits, which are nonstatutory in nature.

99. See text accompanying notes 88-91 supra.
100. 386 U.S. 714 (1967).
101. Id. at 719.
102. Id. at 720-21.
104. 396 U.S. at 391.
105. Id.
106. 244 F.2d 537, 539-40 (2d Cir. 1957).
B. Actions Primarily Benefiting One Class of Shareholders

A more restrictive limitation is the requirement that the action benefit the corporation or its shareholders generally, rather than benefiting only a particular group.\textsuperscript{107} Although by definition a derivative action is brought only to redress a wrong to the corporation,\textsuperscript{108} courts are willing to look through this formalism to determine what parties are actually benefited by the result.\textsuperscript{109} It is not even necessary for awarding fees that the action be derivative in form, as long as it benefits the corporation generally or all of the shareholders.\textsuperscript{110}

Courts have taken different positions on this limitation. The Eighth Circuit applied this general benefit requirement in \textit{Missouri Pacific Railroad v. Slayton}\textsuperscript{111} to deny attorneys' fees to a plaintiff who won a declaration that holders of the corporation's two classes of stock, \textit{A} and \textit{B}, were entitled to vote separately on a proposed merger.\textsuperscript{112} Because of this declaration, the \textit{B} stockholders were able to defeat the merger and thereby prevent $200 million from going to the \textit{A} stockholders.\textsuperscript{113} Rejecting the plaintiff's argument that the corporation had benefited from having the class voting rights adjudicated, the court stated that any such benefit to the corporation was far outweighed by the benefit to the \textit{B} stockholders.\textsuperscript{114} Apparently, the court's view was that the benefit to the corporation must outweigh the benefit to any one class in order for the plaintiff to recover his attorneys' fees.

Other courts have given the rule a less restrictive interpretation. For example, in \textit{Murphy v. North American Light & Power Co.},\textsuperscript{115} plaintiffs who held shares in a subsidiary won an action to compel its parent to surrender the subsidiary's notes that it held, and to accept instead shares of the subsidiary's common stock. This exchange benefited the preferred shareholders by restoring their priority, but it also

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{107} See Mann v. Superior Court, 53 Cal. App. 2d 272, 283, 127 P.2d 970, 976 (2d Dist. 1942); 13 FLETCHER § 6045, at 561; Hornstein, \textit{supra} note 2, at 800.
\item \textsuperscript{108} See note \textsuperscript{38} \textit{supra}.
\item \textsuperscript{112} 407 F.2d at 1083.
\item \textsuperscript{113} \textit{Id.} at 1081. When the declaratory judgment was announced, the market value of \textit{B} stock rose from $1530 to $1875 per share. \textit{Id.}
\item \textsuperscript{114} \textit{Id.} The adjudication of voting rights could be considered an "essential right to the stockholder's interest," within the \textit{Bosch} court's definition of a substantial benefit. See note \textsuperscript{54} \textit{supra} and accompanying text.
\item \textsuperscript{115} 33 F. Supp. 567 (S.D.N.Y. 1940).
\end{itemize}
\end{footnotesize}
benefited the corporation by recapturing interest the corporation had paid on the notes and precluding the payment of further interest. The court, however, did not try to balance the benefits created, but merely held that since the corporation was benefited, and since corporate therapeutics were involved, fees should be allowed.

Neither Slayton (a class action) nor Murphy (a derivative suit) attached any importance to the form of the action. That form is not determinative is more clearly illustrated by cases in which fees have been awarded both to plaintiffs who sued as representatives of the shareholders and to plaintiffs who sued in a representative as well as a derivative capacity. In Mills, for example, the plaintiff sued on behalf of both the corporation and the minority shareholders. Had the Court followed the Slayton rationale, it could have held that since the parent corporation that sent out the proxies owned the majority of stock, only the minority shareholders could have been misled by the proxies; therefore, they were the real beneficiaries of the action, and any benefit to the corporation, which no longer existed, was merely incidental. Indeed, the observation of some commentators that section 14(a) is actually intended to protect the shareholders, and not the corporation, lends some support to this view. The Mills Court, however, made no attempt to weigh the interests served but rather allowed the fee award because, as in Murphy, the filing of such suits performs corporate therapeutics that benefit the affected corporation in particular and the corporate system in general.

Kahan v. Rosenstiel, which was brought by the plaintiff as an individual and on behalf of the minority shareholders, would have been an even stronger case for the application of the Slayton doctrine. The crux of the complaint there was that since the majority shareholder had demanded a premium price for his shares, the minority shareholders had not been offered what their shares were really worth. It was the minority shareholders who benefited financially from the subsequent increase in the price offered them, and the only benefit to the corporation

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116. Id. at 568-70.
117. Id. at 570. See text accompanying note 26 supra.
120. 396 U.S. at 378.
122. See text accompanying notes 76-77 supra.
123. 424 F.2d 161 (3d Cir. 1970).
124. Id. at 164-65.
was the general therapeutic value of enforcing the Securities Exchange Act. The court held, however, that this benefit would justify a fee award if the section 10(b) claim were meritorious.\textsuperscript{125} Had the court weighed the benefits conferred, the pecuniary benefit to the minority shareholders would probably have been found far greater than the abstract therapeutic value to the corporation, and attorneys' fees might have been denied.

The application of the \textit{Slayton} limitation is potentially very broad, since many actions involving a breach of fiduciary duty or violation of the securities laws by a majority shareholder will probably benefit minority shareholders more than the corporation generally.\textsuperscript{126} However, the balancing-of-interests approach adopted by the \textit{Slayton} court is not widely followed, and its application has until now been limited to suits involving the determination of rights of different classes of stock.\textsuperscript{127}

\textbf{C. Suits by Shareholder-Attorneys}

Some courts have placed another limitation on attorneys' fee awards, denying them to shareholder-attorneys who sue in their own name.\textsuperscript{128} The rationale for this limitation is that attorneys who would benefit personally from the fee are more likely than other shareholders to bring unmeritorious suits.\textsuperscript{129} However, even in suits brought by shareholder-attorneys, courts consider other factors, such as the benefits derived from the suit and the extent of the plaintiff's interest in the corporation, to determine whether a fee award is justified. For example, in \textit{Eisenberg v. Central Zone Property Corp.},\textsuperscript{130} a shareholder-attorney, in order to avoid a double corporate tax, brought a derivative action to enjoin the corporation's proposed plan to sell its assets. Although this action conferred a financial benefit on the corporation and its shareholders in the form of a tax saving, the plaintiff, who owned only five of the corporation's 21,000 shares, was denied a fee award. The court said:

\begin{quote}
In such case, the interest of the stockholder being as limited as that of the plaintiff, considerable doubt is cast upon his good faith in instituting a stockholder's derivative action . . . . There is a serious question in our mind, as a matter of public policy, whether
\end{quote}

\begin{footnotes}
\item[125] See text accompanying notes 85-88 \textit{supra}.
\item[126] \textit{See generally} cases cited note 109 \textit{supra}.
\item[127] \textit{See} \textit{BALLANTINE} § 156, at 369-70. \textit{See also} authorities cited note 107 \textit{supra}.
\item[128] \textit{See} 13 \textit{FLETCHER} § 6045, at 565, and cases cited at 574 n.52.
\item[130] 1 App. Div. 2d 353, 149 N.Y.S.2d 840 (1956).
\end{footnotes}
a stockholder instituting a derivative action against a corporation should be allowed compensation as an attorney in the litigation.\textsuperscript{131} Other courts, however, have reached opposite results when the equities so warranted.\textsuperscript{132} The Iowa supreme court awarded fees to an attorney who had a $10,000 equity in the corporation and whose successful suit had recovered over $100,000 for it, stating:

It is also contended that to allow [the shareholder-attorney] an attorney's fee would encourage a lawyer who is a stockholder to commence litigation for the primary purpose of gaining attorney's fees. We do not so interpret the record. . . . [T]o recover fees at all it must be shown, in actions such as this, that the action is well grounded; the corporation must have refused to act; the action must be prosecuted to a successful conclusion, and then only a reasonable attorney's fee can be allowed; the allowance is made by the court and is commensurate with the benefit received by the corporation.\textsuperscript{133}

This reasoning is even more persuasive in view of the fact that many attorneys for shareholder-plaintiffs work on a contingent fee basis,\textsuperscript{134} and the attorney's desire to be recompensed for his time is therefore the main deterrent to the filing of unmeritorious actions whether the suit is brought on behalf of a client or in the attorney's own name. The per se denial of fees to shareholder-attorneys is also unfair; when the shareholder-attorney has a real interest in the corporation, there is no reason to distinguish his action that benefits the corporation from that of a shareholder who hires an attorney to accomplish the same result.

\section{D. The Causal Connection Rule}

The requirement of a causal connection between the shareholder's action and the benefit conferred is perhaps the most reasonable of the limitations on counsel fee awards. When a shareholder's action comes to judgment with a result favorable to the corporation, the shareholder's effort is obviously responsible for whatever benefit is conferred on the corporation. However, if the dispute is settled before final judgment, the question arises whether the beneficial result would have ensued even without the shareholder's interference. If the shareholder does not cause the benefit, he cannot recover under either the class ac-

\begin{thebibliography}{9}
\bibitem{131} Id. at 355, 149 N.Y.S.2d at 842.
\bibitem{132} E.g., Ontjes v. MacNider, 234 Iowa 208, 12 N.W.2d 284 (1943).
\bibitem{133} Id. at 217-18, 12 N.W.2d at 290.
\bibitem{134} Contingent fee arrangements are common in shareholder derivative actions. Steinberg v. Hardy, 93 F. Supp. 873, 873-74 (D. Conn. 1950); Hornstein, supra note 2, at 793.
\end{thebibliography}
tion theory\(^{135}\) or the derivative action theory\(^{136}\) since he has performed no service on behalf of the class of shareholders or the corporation.

Courts generally hold that attorneys' fees may be awarded even though an action ends in a settlement\(^{137}\) or is rendered moot by the defendant's unilateral acts,\(^{138}\) but they differ as to the appropriate standard for demonstrating the causal connection. One theory, applied by the district court in *Kahan*,\(^{139}\) is that if the complaint could have withstood a motion to dismiss, the plaintiff is entitled to recover his attorneys' fees.\(^{140}\) In *Kahan*, the district court dismissed the plaintiff's petition for fees in a section 10(b) action rendered moot by the defendants' acts.\(^{141}\) Since the plaintiff had failed to allege that he was a defrauded purchaser or seller, his complaint could not have withstood a motion to dismiss, and therefore he could not recover his attorneys' fees. The circuit court reversed the district court's finding that the complaint was legally deficient, but in remanding applied another rule of causal connection: whether the claim was meritorious.\(^{142}\) Though the circuit court's rule in *Kahan* worked to allow fees where they had been denied under the district court's test, requiring a plaintiff to prove the merit of his claim is usually a stricter standard than merely requiring that he state a good cause of action.

The Delaware supreme court in *Chrysler Corp. v. Dann*\(^{143}\) imposed a requirement similar to that of the circuit court in *Kahan*. It stated that, in order to recover counsel fees, the plaintiff must possess "knowledge of provable facts which hold out some reasonable likelihood of ultimate success."\(^{144}\) In effect, this view requires that the plaintiff produce sufficient evidence to withstand a motion for summary judgment, which is considerably more demanding than requiring merely an ability to withstand a motion to dismiss on the pleadings.\(^{145}\)

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138. *E.g.*, Kahan v. Rosenstiel, 424 F.2d 161 (3d Cir. 1970); Schechtman v. Wolfson, 244 F.2d 537 (2d Cir. 1957).
140. This theory was also applied in Globus, Inc. v. Jaroff, 279 F. Supp. 807, 810 (S.D.N.Y. 1968).
141. 300 F. Supp. at 450.
142. Kahan v. Rosenstiel, 424 F.2d 161, 167, 174 (3d Cir. 1970). In order to establish that the claim was meritorious, the plaintiff would have to prove that the alleged misrepresentation was material. *Id.*
143. 43 Del. Ch. 252, 223 A.2d 384 (Sup. Ct. 1966).
144. *Id.* at 257, 223 A.2d at 387.
145. In federal courts, the motion to dismiss for failure to state a cause of action and the motion for judgment on the pleadings look only to the face of the plead-
Which rule a court will adopt seems to depend largely on the stage to which the litigation has progressed. When a defendant takes actions that render the claim moot after his motion to dismiss is denied, the courts rarely require further proof that the claim was meritorious. However, if mootness or settlement occurs before this stage, the court is more likely to look beyond the face of the pleadings to determine whether the claim was meritorious. Some courts, by applying this standard, have even awarded attorneys’ fees when no complaint was filed at all. However, in the post-Mills case of *Fischman v. Wexler*, which involved an action settled before any complaint was filed, the court awarded attorneys’ fees without making any attempt to evaluate the plaintiff’s section 14(a) claim. When the parties to such a settlement are hostile in interest, the court might be justified in finding an implied admission of the claim’s merit in the defendant’s willingness to settle, but such an inference was highly questionable in *Fischman* since neither the shareholder-plaintiff nor his corporation had a financial interest in the outcome. No shareholders appeared at the hearing to contest the settlement, and the court itself found that the only party actually benefited by the settlement was the plaintiff’s attorney. Such an uncontested action would be a natural opportunity for the court to apply the causal connection test to determine whether the therapeutic benefit of disclosing a securities act violation actually was conferred by the plaintiff’s efforts. The *Fischman* court’s failure to apply such a test may have resulted from a reading of the doctrine of corporate therapeutics to preclude any limitations on counsel fee awards in derivative suits involving securities act violations. But such a conclusion is not

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146. Thus, the ability to withstand a motion to dismiss was considered sufficient in *Schechtman v. Wolfson*, 234 F.2d 537 (2d Cir. 1957), and *Globus, Inc. v. Jaroff*, 279 F. Supp. 809 (S.D.N.Y. 1968).


150. *Id.* at 979.

151. The court did distinguish *Mills* on the ground that it had been fully litigated, but awarded fees anyway due to the need to encourage derivative suits. See text accompanying note 83 supra. Possibly the award of $20,000 rather than the $35,000 requested was due to the questionable causal connection as well as the insubstantial benefit.
justified by *Mills* since there the plaintiff had succeeded in procuring a summary judgment, which established the defendant's liability and automatically met the causal-connection test. This is probably why the *Kahan* court did not question the applicability of the causal-connection test after *Mills*, even though it recognized the strong encouragement that *Mills* gave to derivative actions.

III

**EVALUATION AND SUGGESTIONS FOR CHANGE**

The requirement that a shareholder's suit produce a benefit stems from the fear that plaintiffs would otherwise be able to bring unmeritorious suits merely to harass the management at the corporation's expense.\(^{152}\) Granted that such suits are undesirable, the denial of attorneys' fees for this reason is unjustifiable both because of the other safeguards available against strike suits and because of the detrimental effect the denial of attorneys' fees has on private actions to promote management responsibility.\(^{153}\) Since the creation of a benefit is not required by either practical or theoretical considerations,\(^{154}\) it should be eliminated as a requirement for the award of counsel fees. The desirable ends can be achieved by the requirement that the shareholder be successful or that his claim be meritorious and by the power of a court of equity to fix the amount of the fee according to the magnitude of the attorneys' efforts and the result obtained.\(^{155}\)

**A. Eliminating the Requirement of a Benefit**

The fear that derivative actions will be used to harass management rather than to benefit the corporation has plagued many courts and legislatures. But present safeguards have proven effective in controlling such strike suits. The contemporaneous ownership rule, for example, which prohibits an action by a shareholder who acquired his shares subsequent to the wrong complained of, originated in federal courts as a response to the practice of having a few shares transferred to a nonresident in order to confer jurisdiction on a federal court.\(^{156}\) Many states have adopted the contemporaneous ownership rule by statute or decisional law.\(^{157}\) The rule's main function in state


\(^{153}\) See text accompanying notes 156-79 infra.

\(^{154}\) See text accompanying notes 37-42 supra.

\(^{155}\) See text accompanying notes 180-89 infra.

\(^{156}\) 13 FLETCHER § 5981, at 421. In the federal courts this rule is codified as FED. R. CIV. P. 23.1.

\(^{157}\) The states that have adopted the rule by statute include Arizona, California, Colorado, Delaware, Florida, Georgia, Illinois, Iowa, Kentucky, Massachusetts, Minne-
courts—where collusive jurisdiction is not a problem—is to prevent individuals with knowledge of a wrong to the corporation from acquiring shares for the sole purpose of bringing suit. While this is a valid function, the rule also prevents suits by innocent purchasers, who suffer the same injury as do other shareholders from a prior wrong to the corporation which diminishes the corporation's assets or affects the value of its shares. The contemporaneous ownership rule is especially unnecessary in state courts in view of the common law rule barring suits by transferees who purchase their shares with knowledge of a prior wrong consented to by their transferor. The states could merely have extended this rule to bar actions by subsequent purchasers with knowledge of the wrong, rather than adopting the contemporaneous ownership rule's sweeping prohibition against any actions by subsequent purchasers.

In addition, many states have adopted security-for-expenses statutes requiring a shareholder-plaintiff, on the defendant's motion, to furnish security for the defendant's reasonable costs, including attorneys' fees. Although originally aimed at discouraging plaintiffs from bringing derivative actions and profiting from secret settlements, these statutes are much broader in scope and have decreased the number of derivative actions in some states applying them. In federal courts, the danger of secret settlements is obviated by the less drastic rule requiring court approval of all settlements in class and derivative actions. Some states have rules against secret settlements or modi-
fied security-for-expenses statutes. While not eliminating derivative actions altogether, they at least make it difficult for plaintiffs to bring actions merely for harassment or for their own benefit.

Most of these rules limiting derivative actions are intended to discourage suits that lack merit or that would allow the plaintiff personal economic gain, but the benefit requirement for counsel fee awards does neither, since it applies only to successful actions, and the recovery is only to reimburse the shareholder for the expense of bringing suit. The substantial benefit rule's main effect is thus to discourage shareholders from bringing meritorious actions if there is any doubt that a court would find the benefit adequate to justify the anticipated fee. In view of the many rules available to prevent derivative actions intended for harassment, a rule that acts to discourage the filing of meritorious claims is of dubious value.

Balanced against this danger of unmeritorious suits is the desirability of derivative actions as a means of ensuring management responsibility. Shareholder actions to correct management breaches of fiduciary duty resulting in harm to the corporation have long been recognized as an effective means of detecting and redressing such wrongs. More recently, the federal courts have assigned to shareholder derivative actions an important role in enforcing the federal securities laws. The vital function of counsel fee awards in promoting derivative actions has also been recognized by the courts, for reasons well summarized by Professor Ballantine:

The liberal allowance of counsel fees to the champion of the rights of a group is the dynamic factor giving the necessary impetus and incentive to the volunteer method of representation in class and derivative suits. Otherwise no one individual shareholder could afford to begin a suit of such size and difficulty or undertake to resist an unfair settlement.

165. E.g., CAL. CORP. CODE § 834(b) (West Supp. 1966). While New York's prototype statute bases the requirement of security on the plaintiff's stock ownership, California's statute provides for a preliminary hearing on the merits of the plaintiff's claim before security can be required. California's statute is thus logically more relevant to the professed aim of preventing strike suits.

166. See Ballantine, Abuses of Shareholders Derivative Suits, 37 CALIF. L. REV. 399 (1949).

167. The principle that the plaintiff cannot recover payment for his own efforts was established in Trustees v. Greenough, 105 U.S. 527 (1881).

168. Ballantine, supra note 166, at 416 ("The derivative action is practically the only remedy for calling the management to account for its wrongs against the corporation and to obtain restitution").


170. See notes 69-88 supra and accompanying text.

171. Ballantine § 156, at 369.
Because the possibility of recovering counsel fees removes a substantial barrier to shareholder derivative suits, which serve such an important role in the corporate system, rules that limit such recovery should be imposed with caution.

The Mills Court unequivocally endorsed the award of counsel fees to encourage derivative suits as a means of enforcing the federal securities laws, but in doing so it used substantial benefit terminology, which suggests adherence to this rule's limitations. Some commentators have criticized this decision as an improper application of the substantial benefit rule, because fees were imposed on one corporation for a benefit conferred on shareholders generally. While this is a valid criticism of the Court's use of the rule, it suggests only that the Court should have adopted a different rationale for the award, not that fees should be denied to plaintiffs whose actions benefit all shareholders and the corporate system generally. In view of the Court's announced policy of favoring derivative actions and of the questionable value of the benefit requirement for counsel fee awards, the Court should have eliminated it altogether and held instead that fee awards in successful shareholder derivative suits are theoretically justifiable since the corporation should have brought the suit itself and are pragmatically desirable because of the benefit conferred on the corporate system by the private enforcement of the federal securities acts.

These same considerations should also lead state courts to reject the benefit requirement, and some state courts have, in fact, taken this view for many years. As early as 1949, a New York court, in holding that no benefit was required to award counsel fees to a shareholder-plaintiff suing to enjoin an ultra vires act, stated, "The law cannot refuse to recognize as beneficial full observance of the law. The law cannot hold that corporate interests are better served by action outside rather than within the law." It is only because of their continued adherence to the class action theory of fee awards and their preoccupation with preventing unmeritorious suits that more state courts have not simi-

172. 396 U.S. at 396. See notes 20-24 supra and accompanying text.
173. See authorities cited note 24 supra.
174. See text accompanying notes 156-66 supra.
175. That the Mills decision has been interpreted in two subsequent cases as eliminating the requirement of a benefit beyond the disclosure of securities act violations does not preclude the possibility that other courts will interpret it more restrictively. See notes 78-88 supra and accompanying text.
178. See notes 29-36 supra and accompanying text.
179. See text accompanying notes 156-66 supra.
larly rejected the benefit requirement. Its rejection in federal securities cases will perhaps pave the way for changes in the state courts.

B. Preserving Other Limitations

Though the benefit requirement should be eliminated, the preservation of some limitations on counsel fee awards would not be inconsistent with the policy of promoting shareholder derivative suits to encourage management responsibility. The requirement that the action be successful, for example, is desirable to discourage the filing of unmeritorious claims\(^{180}\) and is consistent with the corresponding rule against reimbursing officers and directors who are unsuccessful in defending against claims rising out of their alleged negligence or misconduct.\(^{181}\) The requirement of success also provides a convenient means of determining that the action should have been brought by the corporation itself, which justifies a fee award against it.\(^{182}\)

Some limitations should be reworked. The methods currently used to determine whether there is a causal connection between the plaintiff's action and the benefit conferred are aimed at determining the action's merit,\(^{183}\) but they should be made more explicit as standards for counsel fee awards. The application of different tests of merit when the action terminates at different stages of litigation, and for different reasons, seems very practical. Where the action is rendered moot by the defendants' unilateral acts, the claim's ability to withstand a motion to dismiss should be a sufficient test of its merit, unless the defendants can produce evidence that their acts were contemplated before the plaintiff's claim was known to them and that they were in no way motivated by their knowledge of his claim. The ability to withstand a motion to dismiss should also be the standard for determining merit if the claim is settled after the motion is denied, since this is some indication that the plaintiff would have been able to prove the facts alleged in his pleadings. However, if an action is settled before a claim is filed or before it has been in any way contested by the defendant, the plaintiff should have to show that the claim could have withstood a motion for summary judgment in order to recover counsel fees. The rationale for this higher standard for determining the merits of uncontested claims is

\(^{180}\) However, the threat of not being reimbursed for attorneys' fees does not pose nearly as formidable a deterrent to the filing of unmeritorious claims as the threat of having to pay all of the defendant's litigation expenses, including attorneys' fees, under the state security-for-expenses statutes or under the Securities Act of 1933, § 11 (e), 15 U.S.C. § 77(k) (1970).

\(^{181}\) E.g., CAL. CORP. CODE § 830(a) (West 1967); N.Y. BUS. CORP. LAW § 722 (McKinney 1963); DEL. CORP. LAW § 145(b) (Supp. 1968).

\(^{182}\) See note 40 supra and accompanying text.

\(^{183}\) See notes 135-51 supra and accompanying text.
that the defendant's willingness to settle without contesting the action is sufficiently suggestive of collusion that the plaintiff should have to establish some factual foundation for his claim in order to prove that it should have been brought by the corporation. On the other hand, if the settlement results from the submission of the claim to arbitration, no further test of merit should be imposed. After the merit of the claim is established, there should be no distinction between prelitigation and postlitigation expenses, since all expenses would have been borne by the corporation had it brought the action itself.

Once the threshold of success or merit is crossed, the major limitation on counsel fee awards is the court's power to fix the amount of the fee. Courts consider fee requests from litigants, but they also take into account such factors as the effort expended by the attorney, the pecuniary benefit conferred on the corporation and its shareholders, and other factors that may affect the action's value to the corporation. Courts should, of course, consider that the policy of encouraging derivative actions requires a generally liberal approach to the award of attorneys' fees in such actions, but beyond this the power to fix fees can be used to reward actions that greatly benefit the corporation or the corporate system and to discourage those that do not. The elimination of the benefit requirement will assure at least a minimal reimbursement for the attorneys' efforts in bringing a meritorious action, and the possibility of recovering a higher fee commensurate with the benefit conferred will provide added incentive to shareholders and their attorneys to bring actions that encourage responsible and responsive corporate management.

Carol G. Hammett

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184. The facts in Fischman v. Wexler should have been measured by this standard. See notes 149-51 supra and accompanying text.
187. Even if the parties agree on the amount of the fee, the court may review and redetermine the amount as it sees fit. E.g., Fischman v. Wexler, 309 F. Supp. 976, 979 (D. Del. 1970) (parties' agreed-on figure of $35,000 reduced to $20,000). The amount of the fee is almost entirely in the trial court's discretion, subject only to appellate review to assure that it is "fair and reasonable." Hornstein, supra note 7, at 681.
189. See text accompanying note 26 supra, and authorities cited therein.