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Imitation or Improvement? The Evolution of Shareholder Derivative Litigation in the United States, United Kingdom, Canada, and Australia

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IMITATION OR IMPROVEMENT? THE EVOLUTION OF SHAREHOLDER DERIVATIVE LITIGATION IN THE UNITED STATES, UNITED KINGDOM, CANADA, AND AUSTRALIA

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I. INTRODUCTION

Within the evolving global economy, corporations must compete to raise capital from investors. Those investors may include individuals, other corporations, banks, governments, and institutional shareholders such as pension funds, mutual funds, insurance companies, and hedge funds. Numerous factors impact an investor's decision to invest money in a particular corporation. For instance, investors in corporations created within the United States may choose to invest in a corporation's shares or bonds depending on their desired level of risk and rate of return.[1] Such investors will also typically invest in a variety of U.S. corporations, as well as perhaps other investment devices such as commodities, to diversify the overall risk to their investment portfolios. Another method for diversification is investing in foreign corporations.

People in the United States have always invested in foreign economies.[2] Investment companies actively encourage U.S. investors to invest in a variety of foreign markets. For instance, E*Trade Financial encourages its customers "to diversify [their] portfolio by trading currencies and stocks in six global markets—Canada, France, Germany, Hong Kong, Japan, and the [United Kingdom]."[3] Noble Trading offers international stock trading in twenty-six countries' stock,

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1. Shares represent an ownership interest, which entitles the owners to a pro rata share of dividends and to vote for the corporation's directors as well as certain other matters. Shares are seen as risky investments because, if the corporation ultimately fails, the shareholders are entitled to their pro rata share of any assets remaining, if any, after all other claims have been paid. On the other hand, bonds are long-term debt securities, which resemble a loan with fixed interest and principal payments over a set number of years. Bondholders would be repaid their investment before any shareholders in the event the corporation fails, but they are entitled only to the amount of their investment plus interest as established by the bond contract. Thus, while shares are riskier investments if the corporation fails, shareholders can achieve exponential returns if the corporation succeeds.

2. J.J. Servan-Schreiber, *The American Challenge*, *in* 7 GOVERNMENTS AND TRANSNATIONAL CORPORATIONS 51, 51–52 (Theodore H. Moran ed., 1993).

3. *Understand E*Trade Global Trading*, E*TRADE FINANCIAL, https://us.etrade.com/e/t/estation/pricing?id=1301300000#__highlight (last visited Dec. 31, 2011).

option, and future exchanges.[4] There are even entire companies devoted to investing in certain international markets. For example, the International Finance Corporation, a part of the World Bank Group, provides debt and equity financing for private enterprises in developing countries,[5] and its investors represent 182 countries.[6] Indeed, in the ever-increasing global economy, investors are now devoting significant amounts of capital to international markets.[7]

An investor seeking to invest in a foreign company, however, must consider numerous factors and risks. In certain countries, the investor must worry whether the country's government will nationalize corporations within its borders or seize corporate assets in some other manner. For example, Zimbabwe announced that all foreign-owned mining companies must dispose a majority of their shares to locals by September 25, 2011, pursuant to a controversial indigenization law.[8] Similarly, Venezuela nationalized its oil industry, and its president has announced plans to nationalize other companies.[9]

In all countries, the investor fears that the government will impose taxes, regulations, or reporting requirements that will detrimentally affect the return on the investment. For example, recent regulatory changes in the United States as well as its corporate tax rates may cause investors in other countries to hesitate before investing in U.S. corporations.[10] Other country-specific considerations

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4. *International Stock Trading*, NOBLE TRADING, http://www.nobletrading.com/worldwide.php (last visited Dec. 31, 2011).

5. INT'L FUNDING CORP., FUNDING OPERATIONS 3 (Sept. 2009), *available at* http://www1.ifc.org/wps/wcm/connect/404fda004851d859b815f9fc046daa89/Fact%2Bsheet_%2Bdiscount%2Bnote%2Bprogram%2B2011.pdf?MOD=AJPERES.

6. *Id.* at 7.

7. P. Krishna Prasanna, *Foreign Institutional Investors: Investment Preference in India*, 3 J. ADMIN. & GOVERNANCE 40, 41 (2008) ("In this age of transnational capitalism, significant amounts of capital are flowing from developed world to emerging economies."). *See also* Todd Moss et al., *Why Doesn't Africa Get More Equity Investment?: Frontier Stock Markets, Firm Size, and Asset Allocation of Global Emerging Market Funds* 1 (Ctr. for Global Dev., Working Paper No. 112, 2007), *available at* http://ssrn.com/abstract=981196 (stating that foreign institutional investors' investments in emerging markets have risen from $25 billion in 1990 to $300 billion in 2005).

8. Devon Maylie & Farai Mutsaka, *Zimbabwe Shuts Out Foreign Minors*, WALL ST. J., Mar. 28, 2011, at A15.

9. Larry B. Pascal, *Developments in the Venezuelan Hydrocarbon Sector*, 5 L. & BUS. REV. AM. 531, 533 (2009) (noting that Venezuela nationalized its oil industry in 1973); Frank Walsh, *Flipping the Act of State Presumption: Protecting America's International Investors from Foreign Nationalization Programs*, 12 TEX. REV. L. & POL. 369, 371 (2008) (noting that on January 8, 2007, Venezuelan President Hugo Chavez announced his plan to nationalize the country's telephone company and its largest electric company, which are both partially owned by U.S. companies).

10. *See* James Gattuso et al., Editorial, *Red Tape Rising: Obama's Torrent of New Regulation*, WALL ST. J., Oct. 29, 2010, at A12, *available at* http://online.wsj.com/article/SB10001424052702303362404575580551313971136.html (quoting a Small Business Administration report calculating regulatory costs at $1.75 trillion annually); Martin Vaughan, *U.S. Business Faces Burden from New IRS Rules –*

include the stability of the government, the stock market, and the monetary currency. The investor should also be concerned about the law governing the corporation's management, such as whether the country has enacted statutes to restrain managers from looting the company and to allow investors to hold managers accountable for their misconduct. Thus, a country's corporate laws constitute an important basis by which corporations compete for investors within the global economy.

This article examines one aspect of corporate law that has recently changed in many countries: shareholder derivative litigation. It would be impractical for one article to compare more than a handful of countries' laws and practices regarding shareholder derivative litigation. When considering investments in foreign countries, numerous methods for categorizing countries come to mind. Countries could be grouped by their approaches to the law such as common law, civil law, and socialist law.[11] More broadly, countries could be divided into developed economies (such as the United States, United Kingdom, Canada, and Australia) and emerging economies (such as India and China). Any categorization of countries is a rough and imperfect divider. Further, in today's global economy, a country's borders do not determine all the relevant concerns for investors in its business entities because one country's economic downturn often affects other countries. For example, the recent debt crisis in Greece has impacted other countries within the European Union.[12] Similarly, the recent housing bubble and mortgage securitization meltdown in the United States has been felt by much of the rest of the world.[13] This article compares the history and recent

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Report, WALL ST. J., July 7, 2010, http://online.wsj.com/article/SB10001424052748703636404575353281768628138.html (discussing concerns expressed by IRS's Office of the Taxpayer Advocate about the health care law's requirement that businesses report any payments to a vendor that exceeds $600 a year); Richard T. Page, *The International and Comparative Tax War: A Strategic Tax Cut Recommendation for the Obama Administration*, 8 TUL. J. INT'L & COMP. L. 287, 290–93 (2009) (noting the United States has the second highest corporate tax rate in the world). *Cf.* Maureen Minehan, *New Administration Could Bring New Challenges for Employers*, 18 WINTER INT'L HR J. 7, 7 (2009) ("In an already volatile market, businesses should immediately prepare for impending changes related to wages, immigration, taxes, health care, executive compensation and benefits, civil rights and . . . an inevitable increase in unionization in the U.S.").

11. LARRY CATA BACKER, COMPARATIVE CORPORATE LAW: UNITED STATES, EUROPEAN UNION, CHINA AND JAPAN 1129 (2002).

12. *See* Simon Nixon, *Don't Bet on an Imminent Euro-Zone Debt Default*, WALL ST. J., April 18, 2011, at C10; *see also* Editorial, *A.I.G., Greece, and Who's Next?*, N.Y. TIMES, Mar. 5, 2010, at A26 (noting "Greece has tottered on the brink of fiscal chaos, threatening to drag much of Europe down with it"); *Bond Sale Lifts Greece*, CHI. TRIB., Mar. 5, 2010, News, at 26 (noting that Greece faces a "disastrous debt default . . . that has shaken the European Union").

13. Mark Landler, *Housing Woes in U.S. Spread Around Globe*, N.Y. TIMES, Apr. 14, 2008, at A1 ("The collapse of the housing bubble in the United States is mutating into a global phenomenon . . . ."); Editorial, *Who's to Blame for Economy?*, USA TODAY, Feb. 17, 2008, at 10A ("[T]he Wall Street firms that created bundles of subprime mortgages and

developments of shareholder derivative litigation within the United States, United Kingdom, Canada, and Australia. These countries are not only all common law countries with developed economies, but their legal systems also are all rooted in English legal traditions.[14]

Part II of this article explains the basic nature of corporations and shareholder derivative litigation in the United States, which has the most recognized and frequent uses of such litigation. Drawing comparisons to the United States, Part III describes the structure of corporations and the evolution of shareholder derivative litigation in the United Kingdom, from which the United States originally imported the derivative device. This article will demonstrate the very different paths that such litigation has taken in these two countries and explain the United Kingdom's recent transition to a statutory shareholder derivative action that partially resembles the statutes of many U.S. states. Parts IV and V then discuss shareholder derivative litigation within Canada and Australia, and demonstrate that these countries have also adopted shareholder derivative statutes comparable in many respects to those of U.S. states. Reflecting upon this comparative analysis of shareholder derivative litigation, Part VI evaluates the criticisms of such litigation in the United States including arguments that it should be abolished or severely limited. This article concludes by examining the statutes of the United Kingdom, Canada, and Australia to determine the influence of U.S. critics advocating for limitations on derivative actions and to assess any potential improvements for U.S. shareholder derivative litigation.

II. THE UNITED STATES

Corporations in the United States are created by state law, not federal law.[15] Each of the fifty states has enacted statutes that govern the creation and operation of the corporations incorporated under its laws.[16] A majority of states have enacted corporation statutes based on the Model Business Corporations Act (MBCA),[17] which was drafted by a committee of the American Bar Association in

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other toxic financial instruments, . . . peddled them as low-risk, high-return investments. These securities . . . fueled the housing bubble and infected the global financial system.").

14. The United States, Canada, and Australia are former English colonies, and England is now part of the United Kingdom.

15. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977) ("Corporations are creatures of state law, and . . . state law will govern the internal affairs of the corporation."); Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1784 (2011) (noting that state law creates corporations as well as determines the rights of shareholders and the powers of directors).

16. STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS § 1.2, at 5 (2002).

17. MODEL BUS. CORP. ACT ANN., preface v. (4th 2008); *see also* Renee M. Jones, *Legitimacy and Corporate Law: The Case for Regulatory Redundancy*, 86 WASH. U. L. REV. 1273, 1294 (2009) ("Although Delaware is the leader among states in fashioning the law and settling disputes on significant corporate matters, the [MBCA] also has a

1950 and was substantially revised in 1984.[18] Although not an adopter of the MBCA, Delaware is the well-recognized leader in corporate law,[19] and courts in other states often look to it when interpreting their own statutes.[20] Despite their different statutory foundations, the laws of Delaware and states adopting the MBCA are substantively similar.[21]

Under statutory law in U.S. states, corporations have a single board of directors, and directors are elected by the shareholders.[22] The directors usually include both executive officers and independent outside directors.[23] Independent directors must comprise at least half the board of directors for publicly traded corporations.[24] However, even with a majority of independent directors on the board, critics question directors' ability to effectively supervise the corporation's officers.[25]

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significant influence on the development of corporate law standards throughout the country.").

18. *See* John E. Mulder, *Foreward* to ABA-ALI MODEL BUS. CORP. ACT, at iii (1959). The text of the Revised Model Act appears in MODEL BUS. CORP. ACT ANN. (4th 2008).

19. Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, U. ILL. L. REV. 661, 678 (2008) ("The corporation leader in the United States is now Delaware."); *see also* Jones, *supra* note 17, at 1287 n.46 (noting that "tiny Delaware [is] the dominant state in setting corporate law rules"); Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law*, 42 U. RICH. L. REV. 1129, 1172 (2008) ("Delaware is viewed as a pioneer and perennial leader in the market for corporate law."); Claire Hill & Brett McDonnell, *Executive Compensation and the Optimal Penumbra of Delaware Corporation Law*, 4 VA. L. & BUS. REV. 333, 354 (2009) (noting Delaware courts' power to define and alter corporate governance).

20. Jones, *supra* note 17, at 1294 (noting that courts in other states often "follow Delaware law as persuasive authority in many decisions under their own statutes and common law").

21. Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1062 (2000) ("[T]here are few substantive differences between Delaware law and that of other states.").

22. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 211(b), 212(b) (2008); MODEL BUS. CORP. ACT [MBCA] §§ 7.29, 8.03(c) (2008).

23. Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 923 (1999) (defining independent directors as outside directors without affiliations to the corporation).

24. Nicola Faith Sharpe, *Rethinking Board Function in the Wake of the 2008 Financial Crisis*, 5 J. BUS. & TECH. L. 99, 109 (2010); DAVID SKEEL, ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM 183 (2005) ("Most large corporations already have a majority of disinterested directors on their boards."); NASDAQ, INC., STOCK MARKET RULES § 5605(b)(1) (2009) (requiring that a majority of the board be composed of independent directors); NYSE, INC., LISTED COMPANY MANUAL § 303A.01 (2009), *available at* http://nysemanual.nyse.com/lcm/ (same).

25. *See, e.g.*, SKEEL, *supra* note 24, at 184 ("All but two of Enron's directors were disinterested, . . . yet the directors simply nodded their heads as [the CEO and CFO] spun their web of magnificent promises and prophecies."); Bhagat & Black, *supra* note 23, at

Under state statutes, the board of directors possesses the authority to manage the corporation.[26] Because shareholders elect the directors, they theoretically may hold those directors accountable for their decisions by electing new directors to the board.[27] Other than electing directors, shareholders possess the power to vote only on dissolution, sales, mergers, and amendments to bylaws and the articles of incorporation.[28] If shareholders believe directors and officers are acting in their self-interest, mismanaging the corporation, or failing to exercise proper oversight, often their only recourse, aside from selling their shares, is to file a shareholder derivative lawsuit.[29]

Section A discusses the roots of shareholder derivative actions in the United States and the current state laws governing them. Despite the availability of shareholder derivative litigation, as Section B explains, U.S. courts typically defer to directors' decisions and thus do not impose liability in such actions. Section C then discusses the fiduciary duties owed by directors pursuant to state law because such duties form the substantive allegations of most shareholder derivative actions.

A. U.S. States Recognize Shareholder Derivative Litigation Under Common Law or Statutes

Courts in the United States have long recognized the shareholder derivative action, allowing shareholders to bring lawsuits on behalf of the

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922 (stating that "[i]ndependent directors often turn out to be lapdogs rather than watchdogs"); Sharpe, *supra* note 24, at 109 ("Most corporations have boards where a majority of directors are outsiders; however, these boards often are composed of individuals who are not qualified to assess the strategic viability of the corporations they direct.").

26. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors."); MBCA § 8.01(b) ("All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors . . . .").

27. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 211(b), 212(b); MBCA §§ 7.29, 8.03(c).

28. Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 105 (2004).

29. *See* Henry G. Manne, *The "Higher Criticism" of the Modern Corporation*, 62 COLUM. L. REV. 399, 409 (1962) (noting that other than voting rights, the only methods of shareholder protection are the sale of shares and the derivative lawsuit); Mary Elizabeth Matthews, *The Shareholder Derivative Suit in Arkansas*, 52 ARK. L. REV. 353, 411 (1999) ("[I]t should be remembered that when a corporation is wronged and the board refuses to remedy that wrong, a derivative suit is the shareholder's only method of redress."); *see also* Brown v. Tenney, 532 N.E.2d 230, 232 (Ill. 1988) ("The derivative suit is a device to protect shareholders against abuses by the corporation, its officers and directors, and is a vehicle to ensure corporate accountability.").

corporation in certain circumstances.[30] This form of representative lawsuit was imported from the English Courts of Chancery.[31] Much of the law regarding shareholder derivative actions was created through common law development by courts.[32] Indeed, all but the procedural aspects of Delaware's shareholder derivative law are still governed by common law.[33] Most U.S. states have now statutorily enacted procedures governing shareholder derivative lawsuits, and many have adopted both the procedures and substantive liability standards of the MBCA.[34] However, even though the MBCA articulates substantive standards of liability, courts must still apply those standards to the facts of each case just as the Delaware courts must apply their common law precedents. Because courts in MBCA states often look to Delaware case law when applying the MBCA's liability standards,[35] the legal results tend not to differ between these states.[36]

Shareholders may file a derivative action on behalf of a corporation for an injury to the corporation,[37] a power that is now recognized by statute in the federal court system and in most states.[38] Typical shareholder derivative lawsuits assert claims for monetary damages based on corporate mismanagement, whereby

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30. *See* Robinson v. Smith, 3 Paige Ch. 222 (N.Y. Ch. 1832) (using trust law as an analogy, the court allowed minority shareholders to pursue a derivative lawsuit asserting that the directors invested the corporation's money without authority and for personal reasons); Taylor v. Miami Exporting Co., 5 Ohio 162 (1831) (using the trust law analogy, the court permitted a shareholder to sue derivatively in an action claiming the directors took corporate assets in violation of their fiduciary duty); *see also* Hawes v. Oakland, 104 U.S. 450, 460 (1881) (stating the requirements for a shareholder to file a derivative action).

31. *See Hawes*, 104 U.S. at 454–57, 460 (discussing the requirements for filing a shareholder derivative action under English case law and adopting them); *see also* Nicholas Calcina Howson, *When "Good" Corporate Governance Makes "Bad" (Financial) Firms: The Global Crisis and the Limits of Private Law*, 108 MICH. L. REV. FIRST IMPRESSIONS (2009), http://www.michiganlawreview.org/first-impressions.

32. *See Hawes*, 104 U.S. at 454–57, 460; *see also* Bert S. Prunty, Jr., *The Shareholders' Derivative Suit: Notes on Its Derivation*, 32 N.Y.U. L. REV. 980, 980–92 (1957) (discussing the case law history of shareholder derivative actions in England and the United States); David A. Skeel, *The Accidental Elegance of* Aronson v. Lewis, 3–6 (U. of Penn., Inst. for Law & Econ., Research Paper No. 07-28, 2007) (same).

33. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 746–51 (Del. Ch. 2005) (referencing case law for the standards governing the business judgment rule defense and directors' fiduciary duties), *aff'd*, 906 A.2d 52 (Del. 2006); DEL. CH. CT. R. 23.1 (stating procedural requirements for filing shareholder derivative actions).

34. BAINBRIDGE, *supra* note 16, at 368–69; MODEL BUS. CORP. ACT ANN., preface at v. (4th 2008) (listing a majority of states as adopting the MBCA). For the procedural requirements for shareholder derivative proceedings filed in MBCA states, see MBCA §§ 7.40–7.46, and for the substantive liability standards, see § 8.31.

35. Jones, *supra* note 17, at 1294; *see also* William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 BUS. LAW. 351 (1992).

36. *See infra* Part II.C.

37. BAINBRIDGE, *supra* note 16, at 362.

38. *See, e.g.*, FED. R. CIV. P. 23.1(a) (2011); MBCA § 7.40(1).

the corporation as a whole has suffered harm as a result.[39] A shareholder may also file a direct shareholder lawsuit when the shareholder has suffered an injury in his or her individual capacity.[40] For example, when the majority shareholders have oppressed or "frozen-out" a minority shareholder, such as by taking all the corporation's profits for themselves, the minority shareholder may file a direct lawsuit.[41]

A shareholder derivative lawsuit faces significant hurdles and disincentives. In order to have the standing required to initiate or maintain a derivative action, federal and state courts require the plaintiff to have been a shareholder at the time of the challenged transaction.[42] In addition, the plaintiff must fairly and adequately represent the interests of the corporation and its shareholders.[43] As a separate hurdle, several states' statutes require shareholders owning less than a prescribed amount of stock, measured either by shares or dollars, to post a bond in an amount sufficient to cover the defendants' reasonable attorneys' fees and expenses.[44] A bond requirement is a tremendous financial disincentive to filing derivative actions.

Even in the absence of a bond requirement, a shareholder often has little financial incentive to initiate derivative litigation because any monetary recovery belongs to the corporation.[45] The shareholder thus benefits only to the extent that the monetary recovery increases the value of his or her percentage shareholding in the corporation. Further, no financial incentive likely exists for a shareholder contemplating a derivative action seeking solely injunctive relief, such as an order requiring the directors to refrain from certain conduct.[46]

Perhaps the largest financial hurdle for a shareholder contemplating a derivative lawsuit is financing the lawsuit. This financial burden, however, can be alleviated if the shareholder can find an attorney willing to take the representation on a contingency basis. Contingency fee agreements are permitted in the United States, unlike most countries.[47] U.S. contingency agreements typically state that

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39. BAINBRIDGE, *supra* note 16, at 363.

40. *Id.* § 8.2, at 362–64.

41. *See, e.g.*, Brodie v. Jordan, 847 N.E.2d 1076 (Mass. 2006).

42. *See, e.g.*, FED. R. CIV. P. 23.1(a), (b)(1); MBCA § 7.41; DEL. CH. CT. R. 23.1(a), (b) (2009).

43. *See, e.g.*, FED. R. CIV. P. 23.1(a), (b)(1); MBCA § 7.41. *Cf.* DEL. CH. CT. R. 23.1(a)–(b) (2009) (requiring an affidavit disclaiming any benefit from serving as the representative of shareholders).

44. WRIGHT ET AL., 7C FED. PRAC. & PROC. CIV. 2d § 1835 (2006) (listing Arizona, California, Colorado, Florida, Nebraska, New Jersey, New York, Pennsylvania, and Wisconsin as states adopting security or bond for expense requirements); *see, e.g.*, COLO. REV. STAT. § 7-107-402(3) (2007) (allowing a court to compel a shareholder who owns less than a prescribed amount of stock to post a bond); NY BUS. CORP. LAW § 627 (same).

45. BAINBRIDGE, *supra* note 16, at 362–63.

46. *See* Christine Hurt, *The Undercivilization of Corporate Law*, 33 J. CORP. L. 361, 381 (2008).

47. *See, e.g.*, John C. Coffee, Jr., *Privatization and Corporate Governance: The Lessons from Securities Market Failure*, 25 J. CORP. L. 1, 6 (1999).

the attorney will receive nothing if the plaintiff loses and that the attorney will receive as much as 40% of the monetary award if the plaintiff wins or settles.[48] If a shareholder derivative lawsuit settles, which most do,[49] the court can approve payment of a sizeable fee for the plaintiff's attorney from the settlement fund.[50] When the rare derivative lawsuit reaches a final verdict, courts have been quite willing to award the plaintiff's attorney his or her fees from the monetary recovery.[51] On the bright side, shareholders who lose their derivative actions must pay only their own attorneys' fees pursuant to the so-called American Rule.[52] Thus, unlike in countries such as the United Kingdom, Canada, and Australia,[53] losing shareholders in the United States do not pay the defendants' attorneys'

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48. Lester Brickman, *Anatomy of an Aggregate Settlement: The Triumph of Temptation Over Ethics*, 79 GEO. WASH. L. REV. 700, 706 (2011) (stating that in nonclass litigation, lawyers typically charge contingency fees ranging from 33% to 40%); Brian T. Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. PA. L. REV. 2043, 2045 n.9 (2010) (citing various sources for the proposition that the typical contingency fee is 33% to 40%).

49. Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 60 (1991) (finding that about 65% of shareholder derivative lawsuits settle); *see also* Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749, 1756 (2010) (finding that nearly all shareholder derivative lawsuits settle); John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 9 (1985) (noting that a majority of shareholder derivative lawsuits are resolved through settlement).

50. *See, e.g.*, FED. R. CIV. P. 23.1(c) ("A derivative action may be settled, voluntarily dismissed, or compromised only with the court's approval."); Mark J. Loewenstein, *Shareholder Derivative Litigation and Corporate Governance*, 24 DEL. J. CORP. L. 1, 25–26 (1999) ("Whether a shareholder derivative suit presents a valid claim or not, the plaintiffs' lawyer may stand to receive a large fee from a settlement, even a settlement that brings little or no benefit to the corporation.").

51. *See, e.g.*, Mills v. Electric Auto-Lite Co., 396 U.S. 375, 392 (1970) (recognizing that plaintiffs are entitled to attorneys' fees in derivative litigation because allowing "others to obtain full benefit from the plaintiff's efforts without contributing equally to the litigation expenses would be to enrich the others unjustly at the plaintiff's expense"); Loewenstein, *supra* note 50, at 2 ("[C]ourts have been willing to award attorneys' fees to the plaintiff if the derivative litigation resulted in a 'substantial or common benefit' to the corporation, whether by judgment or settlement.").

52. Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975); Travelers Cas. & Sur. Co. of Am. v. PG&E, 549 U.S. 443 (2007).

53. Bernard Black et al., *Legal Liability of Directors and Company Officials Part Two: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability (Report to the Russian Securities Agency)*, 2008 COLUM. BUS. L. REV. 1, 14 (2008) (stating that Canada follows the English "loser pays" rule); S. Stuart Clark, *Thinking Locally, Suing Globally: The International Frontiers of Mass Tort Litigation in Australia*, 74 DEF. COUNS. J. 139, 148 (2007) (stating that Australia follows the English rule of loser pays); *see also* Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385, 1406, 1434 (2006) (discussing the U.K.'s loser pays rules).

fees.[54] If the shareholders' attorney was hired on a contingency fee basis, then the shareholders owe nothing to their own attorney.

The demand requirement is another significant procedural hurdle of shareholder derivative litigation in the United States. In federal court and most state courts, a shareholder may file a derivative action only after making demand on the board to rectify the challenged transaction.[55] Indeed, the MBCA's universal demand requirement cannot be avoided.[56] The demand requirement is justified on the basis that the board of directors typically controls the corporation's litigation because it possesses the statutory authority to manage the corporation and its assets, including any cause of action belonging to the corporation.[57] The board may respond to the shareholder's demand by filing the lawsuit itself, resolving the matter internally, or rejecting the demand.[58] The typical board response is to reject the demand,[59] which then requires the shareholder to demonstrate to the court that the demand was wrongfully rejected before a derivative action may proceed.[60] In some states, the shareholder can forgo making demand by pleading that it is excused, which requires a showing that the demand would be futile.[61]

To establish that the demand is futile or that the demand was wrongfully rejected by the board, the plaintiff must show that the business judgment rule defense does not apply to the board's decision.[62] As more fully explained below, this defense presumes that directors acted consistently with their fiduciary duties

54. *Alyeska Pipeline*, 421 U.S. at 247; Franklin Gevurtz, *Disney in a Comparative Light*, 55 AM. J. COMP. L. 453, 488 (2007).

55. *See, e.g.*, FED. R. CIV. P. 23.1; DEL. CH. CT. R. 23.1; MBCA § 7.42.

56. MBCA § 7.42 ("No shareholder may commence a derivative proceeding until: a written demand has been made upon the corporation to take suitable action; and 90 days have expired from the date the demand was made unless the shareholder has earlier been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result by waiting for the expiration of the 90-day period.").

57. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a); MBCA § 8.01(b).

58. *See* Lisa Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 408 (2005).

59. BAINBRIDGE, *supra* note 16, at 395; *see also* Fairfax, *supra* note 58, at 408 (noting that "most boards" decide "not to bring any action").

60. Grimes v. Donald, 673 A.2d 1207, 1219 (Del. 1996); BAINBRIDGE, *supra* note 16, at 395.

61. Aronson v. Lewis, 473 A.2d 805, 814–15 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000). *Cf.* MBCA § 7.42 (2008) (stating a universal demand requirement).

62. Beneville v. York, 769 A.2d 80, 85 n.9 (Del. Ch. 2000); FED. R. CIV. P. 23.1; BAINBRIDGE, *supra* note 16, at 395. Courts often state that plaintiffs already sufficient tools for gathering evidence without discovery. *See, e.g.*, *Grimes*, 673 A.2d at 1216 n.11 (describing shareholders' access to public sources and right to inspect corporate records); *see also* DEL. CODE ANN. tit. 8, § 220(b) (shareholder's inspection right); MBCA § 16.02 (same).

of care, loyalty, and good faith.[63] To rebut this presumption in the demand context, the shareholder typically must prove that a majority of directors were financially interested in the challenged decision or were not independent in making that decision.[64] In other words, a trial court will permit a shareholder derivative lawsuit to proceed only when the board of directors is disabled by some conflict of interest. In such circumstances, the judge may presume the directors would not choose to sue themselves despite the existence of meritorious claims. Courts frequently find that the business judgment rule protects directors' rejection of a demand request.[65]

Even if a shareholder derivative action survives a motion to dismiss based on the demand requirement, the corporation's directors may attempt to stop the litigation through a special litigation committee.[66] The board may appoint a special litigation committee that is composed of independent and disinterested directors.[67] After investigation and consultation with experts, the special litigation committee may seek to terminate the shareholder's action (through a motion to dismiss or motion for summary judgment) based on its recommendation that continuing the litigation is not in the best interests of the corporation.[68] Most courts find that the business judgment rule defense protects the committee's recommendation[69] and therefore grant the motion to dismiss.[70]

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63. *See Aronson*, 473 A.2d at 812; *see also* McMullin v. Beran, 765 A.2d 910, 916–17 (Del. 2000).

64. *See Aronson*, 473 A.2d at 814–15 (Del. 1984); *see also Beneville*, 769 A.2d at 85 n.9. For the MBCA provisions for showing demand was wrongfully rejected, see MBCA § 7.44(c).

65. Fairfax, *supra* note 58, at 408 (noting that courts defer to directors' rejection of a demand request).

66. Douglas M. Branson, *The Rule that Isn't a Rule – the Business Judgment Rule*, 36 VAL. U. L. REV. 631, 647–48 (2002).

67. *Id.* at 648.

68. *Id.*; *see also* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 279 (1985) (noting that a special litigation committee (SLC) may believe dismissal is in the corporation's best interest, because it may raise the stock price).

69. In some states, the plaintiff bears the burden of rebutting the business judgment rule presumption with respect to the SLC's decision, and judicial inquiry is limited to the disinterestedness and independence of the SLC members and the adequacy of their investigation. *See, e.g.*, Auerbach v. Bennett, 393 N.E.2d 994, 1001–02 (N.Y. 1979); Finley v. Super. Ct., 96 Cal. Rptr. 2d 128, 132 (Cal. Ct. App. 2000); Cutshall v. Barker, 733 N.E.2d 973, 978 (Ind. Ct. App. 2000); Janssen v. Best & Flanagan, 662 N.W.2d 876, 889–90 (Minn. 2003). Other states also give business judgment rule protection to a SLC's recommendation but put the burden of proof on the defendants. *See, e.g.*, Lewis v. Boyd, 838 S.W.2d 215, 224 (Tenn. Ct. App. 1992). In Delaware, the defendant also bears the burden of proving the independence and good faith of the SLC, but the court may apply its own business judgment in deciding whether to dismiss. Zapata Corp. v. Maldonado, 430 A.2d 779, 787–89 (Del. 1981).

70. Fairfax, *supra* note 58, at 409 (noting that "in the vast majority of cases courts grant the motion based on the [SLC's] recommendation"~~)~~ (citing Carol B. Swanson,

B. U.S. States Judicially or Statutorily Defer to Directors' Business Judgment

Assuming plaintiffs survive these initial motions to dismiss, the directors can again assert the business judgment rule defense in a motion for summary judgment or at trial.[71] The business judgment rule defense was created by common law, and U.S. courts have recognized the defense for almost 200 years.[72] A frequently stated rationale for the business judgment rule defense is that it provides the protection directors need to fulfill their responsibility to manage the corporation without fear of shareholders second-guessing their decisions through derivative lawsuits.[73] Thus, the rule allows directors to take calculated business risks[74] by protecting them from liability "for honest mistakes of judgment or unpopular business decisions."[75] Other justifications include that directors are "better-suited than courts to make business decisions" and that "judges are not business experts."[76]

The Delaware Supreme Court articulates the business judgment rule defense as a presumption that directors have acted consistently with their fiduciary duties in making decisions for the corporation.[77] To rebut that presumption,

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Juggling Shareholder Rights and Strike Suits in Derivative Litigation: The ALI Drops the Ball, 77 MINN. L. REV. 1339, 1356–57 (1993)).

71. *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 697 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

72. S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 93 (1979–1980).

73. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 927–28 (Del. 2003); A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 cmt. d (1994).

74. *See* Bainbridge, *supra* note 28, at 110; *see also* Branson, *supra* note 66, at 637 (stating the business judgment rule is necessary to encourage directors to engage in "informed risk taking that is essential to business success"); Len Costa, *Boss of the Bosses: Delaware's Most Important Judge Takes on Greedy Executives, Congress, and the History of Corporate Law*, LEGAL AFFAIRS, July/Aug. 2005, at 43, 46 (stating that Delaware courts do not "second-guess decisions made by informed, disinterested boards, for fear of chilling commerce and innovation").

75. Arsht, *supra* note 72, at 96; *see also* Bainbridge, *supra* note 28, at 113–14 ("Business decisions . . . typically involve prudential judgments among a number of plausible alternatives. Given the vagaries of business, moreover, even carefully made choices among such alternatives may turn out badly.").

76. *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919); Branson, *supra* note 66, at 637 (stating that "courts are ill-equipped to review business decisions" because they "often involve intangibles, intuitive insights or surmises as to business matters such as competitive outlook, cost structure, and economic and industry trends"). This judicial deference for business decisions is difficult to justify when courts will review decisions of physicians and engineers. *See* Bainbridge, *supra* note 28, at 120; FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 94 (1991).

77. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006). To invoke the business judgment rule defense, the board must make a decision, which includes a decision to act or a conscious decision not to act. Aronson v. Lewis, 473 A.2d

plaintiffs must show a breach of fiduciary duty[78] or demonstrate fraud, illegality, or waste.[79] If the plaintiff cannot rebut the presumption, the business judgment rule defense protects the directors from liability for their decision.[80] On the other hand, if the plaintiff can rebut the presumption, the directors must prove that the challenged transaction was fair to the corporation.[81]

The MBCA also contains the principal elements of the Delaware business judgment rule defense, although it does not codify it as a whole.[82] MBCA section 8.31 sets forth the standards of liability for directors. Similar to the Delaware business judgment rule defense, the MBCA begins with a presumption that a director is not liable "for any decision to take or not to take action, or any failure to take any action."[83] The MBCA then states that a plaintiff may rebut that presumption by showing that the director breached the fiduciary duties of good faith, care, or loyalty.[84] Only the duty of loyalty portion of the MBCA regarding a director's independence, however, shifts the burden of proof to the director.[85] Even then the director must show only that the "challenged conduct was reasonably believed by the director to be in the best interests of the corporation," not that the transaction was fair to the corporation as required by Delaware law.[86]

Thus, like Delaware's business judgment rule defense, the MBCA starts with a presumption against liability that the plaintiff must rebut by showing that the director breached a fiduciary duty. Regardless of whether a state follows the MBCA or the common law formulation of the business judgment rule defense,

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805, 813 (Del. 1984) *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

78. *See Aronson*, 473 A.2d at 812; *see also* McMullin v. Beran, 765 A.2d 910, 916–17 (Del. 2000) (stating that to rebut the business judgment rule presumption, the shareholder must "provide evidence that the defendant board of directors, in reaching its challenged decision, breached any one of its 'triad of fiduciary duties'").

79. *See, e.g.*, Paglin v. Saztec Int'l, Inc., 834 F. Supp. 1184, 1200 (W.D. Mo. 1993) (illegality and fraud); Shlensky v. Wrigley, 237 N.E.2d 776, 779 (Ill. App. Ct. 1968) (fraud); *In re Walt Disney*, 906 A.2d at 73–74 (waste); Lewis v. Vogelstein, 699 A.2d 327, 335–36 (Del. Ch. 1997) (same; defining waste as "a transfer of corporate assets that serves no corporate purpose" or "for which no consideration at all is received").

80. *McMullin*, 765 A.2d at 916–17; Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989).

81. Emerald Partners v. Berlin, 787 A.2d 85, 90–91 (Del. 2001); *see also In re Walt Disney*, 906 A.2d at 52.

82. MBCA § 8.31 cmt. (noting that the MBCA "does not codify the business judgment rule as a whole" but that "its principal elements . . . are embedded in" § 8.31(a)(2)).

83. *Id.* § 8.31(a).

84. *Id.* § 8.31(a)(2); *see infra* Part II.C.

85. *See id.* § 8.31(a)(2)(iii)(B).

86. *Compare id.* § 8.31(a)(2)(iii)(B), *with In re Walt Disney*, 906 A.2d at 52.

judges invoke the defense to protect boards of directors from legal liability in the vast majority of shareholder derivative actions.[87]

C. U.S. States Impose Fiduciary Duties on Directors Through Common Law or Statutes

In the United States, directors are often said to owe a triad of fiduciary duties: a duty of care, a duty of loyalty, and a duty of good faith.[88] In Delaware, directors' fiduciary duties were created by the courts and are still embodied solely within the common law.[89] In states adopting the MBCA, these fiduciary duties are imposed by statute.[90] As demonstrated below, Delaware common law and the MBCA formulate the fiduciary duties of care, loyalty, and good faith using different language, but they share many similarities. Although directors theoretically face personal liability for breaches of fiduciary duties under both Delaware common law and the MBCA, directors' financial liability for breaching their fiduciary obligations is effectively eliminated through the combined use of indemnification agreements and insurance.[91]

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87. *See* Fairfax, *supra* note 58, at 409 (arguing that "the tremendous deference courts grant to board decisions means that courts hold directors liable for only the most egregious examples of director misconduct"); *see also* TAMAR FRANKEL, TRUST AND HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD 183–84 (2006) (noting "the historical strong protection of corporate boards"); Coffee, *supra* note 49, at 9 (noting that the rare shareholder derivative lawsuits in which judges reach the merits are overwhelmingly decided in the defendant's favor).

88. *See, e.g.*, McMullin v. Beran, 765 A.2d 910, 916–17 (Del. 2000); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

89. *See, e.g.*, *In re Walt Disney*, 907 A.2d at 746–48, 749–51 (referencing case law for the standards governing directors' fiduciary duties); Jennifer O'Hare, *Director Communications and the Uneasy Relationship Between the Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Federal Securities Law*, 70 U. CIN. L. REV. 475, 510 (2002) ("The common law of fiduciary duty is the primary means used to ensure that directors of a state-created entity are acting with 'due care, good faith, and loyalty.'").

90. MBCA §§ 8.30–8.31.

91. Fairfax, *supra* note 58, at 412; Kelli A. Alces, *Beyond the Board of Directors*, 46 WAKE FOREST L. REV. 783, 784 (2011) (noting that "directors are shielded from personal liability"); Bernard Black et al., *Outside Director Liability*, 58 STAN. L. REV. 1055, 1055, 1070–74 (2006) (noting that in a comprehensive study of outside director liability, only thirteen cases imposed personal liability on directors of public companies in the course of twenty-five years of Securities Exchange Commission enforcement actions, securities class action lawsuits, and shareholder derivative lawsuits; only three of the thirteen cases involved fiduciary duty breaches); Eric J. Pan, *Rethinking the Board's Duty to Monitor: A Critical Assessment of the Delaware Doctrine*, 38 FLA. ST. U. L. REV. 209, 246 (2011) (noting that directors avoid personal liability, while corporations must pay the costs of litigation, settlements, and insurance).

1. The Fiduciary Duty of Care

Delaware courts have stated that the duty of care requires directors to "use that amount of care which ordinarily careful and prudent men would use in similar circumstances."[92] In analyzing alleged duty of care breaches, however, Delaware courts focus only on procedural due care, meaning they review alleged duty of care breaches based on the process by which the board made its decision and not the decision's merits.[93] Directors thus breach their duty of care by failing "to act in an informed and deliberate manner" when they make decisions on behalf of their corporation.[94] The effect of this process-oriented focus is that courts "insulate directors from liability whenever they make even a modest attempt to follow the appropriate formalities."[95]

Delaware courts further minimize the duty of care by requiring that "deficiencies in the directors' process are actionable only if the directors' actions are grossly negligent."[96] Gross negligence is defined as a "'reckless indifference to or a deliberate disregard of the whole body of stockholders' or actions which are 'without the bounds of reason.'"[97] The combined effect of the focus on procedural due care and the gross negligence standard is that Delaware courts rarely hold directors liable for breaching their duty of care.[98]

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92. *In re Walt Disney*, 907 A.2d at 749; *Aronson*, 473 A.2d at 812 (stating, "[D]irectors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them"); *see also* Briggs v. Spaulding, 141 U.S. 132, 147 (1891) (stating that directors have a duty to "supervise the business with attention").

93. Smith v. Van Gorkom, 488 A.2d 858, 874–88 (Del. 1985); *see also In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996)("[W]hether a judge . . . believes a decision substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational,' provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in *a good faith* effort to advance corporate interests.").

94. *Van Gorkom*, 488 A.2d at 873.

95. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1790 (2001); Branson, *supra* note 66, at 639–40 ("[C]ritics of the modern business judgment rule say that insistence on formal decisions places a premium on play acting and on paper trails. It does not improve the quality of decisions that are made.").

96. *In re Walt Disney*, 907 A.2d at 749.

97. Tomczak v. Morton Thiokol, Inc., Civ. A. No. 7861, 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990) (quoting Allaun v. Consol. Oil Co., 147 A. 257, 261 (Del. Ch. 1929)).

98. *In re Walt Disney*, 907 A.2d at 750 ("[D]uty of care violations are rarely found"); J. Robert Brown, Jr. & Sandeep Gopalan, *Opting Only In: Contractarians, Waiver of Liability Provisions, and the Race to the Bottom*, 42 IND. L. REV. 285, 298 (2009) ("Delaware courts simply did not find violations of the duty of care. Directors confronted little or no risk of liability for ordinary business decisions. Only suits alleging conflicts of interest had any realistic hope of success."). *Cf.* Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business*

The rare example is *Smith v. Van Gorkom*, in which the Delaware Supreme Court held that the directors violated the duty of care by not adequately investigating a merger offer.[99] In *Van Gorkom*, the court held that the business judgment rule defense does not protect an uninformed decision and that directors may be held to have breached the duty of care if the plaintiff shows that they were grossly negligent in failing to inform themselves of all material and reasonably available information.[100] The impact of *Van Gorkom* was minimized by the Delaware Legislature's subsequent enactment of section 102(b)(7), which permits corporations to limit or entirely eliminate directors' monetary liability for duty of care breaches.[101] All states have now enacted statutes allowing corporations to limit or eliminate directors' liability for duty of care breaches.[102]

In Delaware, directors' duty of care also traditionally included an obligation to oversee the corporation,[103] and courts could impose liability for "a sustained or systematic failure of the board to exercise oversight."[104] For example, in the seminal case of *In re Caremark International Derivative Litigation*, the plaintiffs asserted that the board of directors breached its fiduciary duty of care by failing to monitor the conduct of its employees for compliance with federal law.[105] The plaintiffs claimed that this oversight failure led to a government investigation and federal indictment for multiple felonies against Caremark, as well as Caremark subsequently paying civil and criminal fines totaling $250 million.[106] The court stated that directors are responsible for ensuring "that information and reporting systems exist . . . that are reasonably designed to provide . . . accurate information sufficient to allow . . . informed judgments concerning both the corporation's compliance with law and its business performance."[107] In 2006, however, the Delaware Supreme Court appears to have

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Judgment Rule, 62 TEX. L. REV. 591, 591 nn.1–2 (1983) (noting only seven cases holding directors liable for all breaches of fiduciary duty other than self-interested transactions).

99. *Van Gorkom*, 488 A.2d at 874.

100. *Id.* at 872.

101. DEL. CODE ANN. tit. 8, § 102(b)(7) (2008); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1166 n.18 (Del. 1995) (noting that § 102(b)(7) was enacted in response to *Van Gorkom*); Mark J. Loewenstein, *The Quiet Transformation of Corporate Law*, 57 SMU L. REV. 353, 369 (2004) (*Van Gorkom* "motivated the Delaware legislature . . . to enact legislation that allowed Delaware corporations to exempt directors from monetary damages for breaches of the duty of care.").

102. Fairfax, *supra* note 58, at 412; Brown & Gopalan, *supra* note 98, at 288 (noting that all states allow companies to eliminate monetary damages for breach of the duty of care); *id.* at 310 (describing the different provisions adopted by states).

103. *See* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125 (Del. 1963); *see also In re* Caremark Int'l Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996).

104. *In re Caremark*, 698 A.2d at 971.

105. *Id.* at 964.

106. *Id.* at 960–61.

107. *Id.* at 970.

reclassified oversight claims as a breach of the duty of loyalty.[108] In *Stone v. Ritter*,[109] the Delaware Supreme Court stated that a showing of bad-faith conduct "is essential to establish director oversight liability" and then held that "the fiduciary duty violated by that conduct is the duty of loyalty."[110] Thus, Delaware still recognizes oversight claims as a breach of fiduciary duty, but that fiduciary duty is now loyalty rather than care.[111]

Similar to Delaware common law, the MBCA's standards of conduct state that directors "shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances."[112] Like Delaware courts, the MBCA also focuses on the process a director used in making a decision, rather than the merits of the decision; it does so by examining whether the director was reasonably informed.[113] However, the MBCA imposes liability only if the plaintiff proves that the director "did not reasonably believe" the challenged decision was in the corporation's best interests or "was not informed to an extent the director reasonably believed appropriate in the circumstances."[114] The MBCA thus focuses on what the particular director reasonably believed, rather than what a reasonable person in the director's position would believe. The wording of this MBCA provision seems intended to insulate directors from liability.

This intent to insulate directors from liability for alleged duty of care breaches is affirmed by the different language chosen to describe the standard for a duty of care claim alleging lack of oversight. For an oversight claim, the MBCA adopted the reasonable director standard by requiring the plaintiff to establish that:

> [T]he challenged conduct consisted or was the result of . . . a sustained failure of the director to devote attention to ongoing oversight of the business and affairs of the corporation, or a failure to devote timely attention, by making (or causing to be made) appropriate inquiry, when particular facts and circumstances of significant concern materialize that would alert a reasonably attentive director to the need therefor . . . .[115]

The MBCA's use of "a reasonably attentive director" standard for oversight claims contrasts with its focus on the particular director's belief in customary duty

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108. Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006); Martin Petrin, *Assessing Delaware's Oversight Jurisprudence: A Policy and Theory Perspective*, 5 VA. L. & BUS. REV. 433, 444–47 (2011).

109. *Stone*, 911 A.2d at 362.

110. *Id.* at 370.

111. *But see* Petrin, *supra* note 108, at 447–50 (noting that *Stone v. Ritter* created many doctrinal uncertainties that have not yet been resolved).

112. MBCA § 8.30(b).

113. *Id.* § 8.31(a)(2)(ii)(B).

114. *Id.* § 8.31(a)(2)(ii).

115. *Id.* § 8.31(a)(2)(iv).

of care cases and supports the proposition that directors are likely insulated from liability for an alleged breach of the duty of care.

Therefore, the MBCA's emphasis on the challenged director's beliefs likely produces the same effective result as Delaware law: no liability imposed on directors for alleged breaches of the duty of care. However, the MBCA utilizes a different path to do so. It avoids the confusing gross negligence standard of Delaware law, but uses a potentially malleable standard that asks what the challenged director reasonably believed. The similarity in effect between Delaware law and the MBCA is also evidenced by the rarity of courts finding a breach of the duty of care.[116]

2. The Fiduciary Duty of Loyalty

Delaware courts broadly state the duty of loyalty as "mandat[ing] that the best interest of the corporation and its shareholders take[] precedence over any interest possessed by a director . . . and not shared by the stockholders generally."[117] In determining whether directors have breached their duty of loyalty, Delaware courts examine whether the directors made decisions independently based on the merits of the transaction and whether the directors were disinterested in the transaction's outcome.[118]

According to Delaware law, directors are "interested" in the outcome of a transaction when they will receive a personal benefit from it that is not equally shared by the shareholders.[119] Such benefit includes any "substantial benefit from supporting a transaction" and thus need not be monetary.[120] Examples of interestedness include self-dealing, insider trading, payment of excessive compensation, usurpation of corporate opportunities, and competition with the corporation.[121]

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116. *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 750 (Del. 2006) ("[D]uty of care violations are rarely found."); Fairfax, *supra* note 58, at 407–08 ("Over the last twenty years, a variety of mechanisms have contributed to a virtual elimination of legal liability for directors who breach their duty of care under state law."). *Cf.* Cohn, *supra* note 98, at 591 nn.1–2 (noting only seven cases holding directors liable for all breaches of fiduciary duty other than self-interested transactions).

117. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

118. *See Cede & Co.*, 634 A.2d at 362; *see also* Orman v. Cullman, 794 A.2d 5, 22 (Del. Ch. 2002) (stating that the business judgment rule is rebutted where a majority of the directors either were "interested in the outcome of the transaction or lacked the independence to consider objectively whether the transaction was in the best interest of its company and all of its shareholders").

119. Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993).

120. *Cede & Co*., 634 A.2d at 362.

121. *See* BAINBRIDGE, *supra* note 16, at 306–07, 321–23.

Independence requires that directors base their decisions "entirely on the corporate merits of the transaction" and not on personal considerations.[122] Delaware's common law definition of "independence" focuses primarily on family relationships,[123] meaning courts assume that a director cannot act independently if a family member stands on the other side of the proposed corporate transaction. A director also is not independent if he or she is "controlled" by an interested director who has the "unilateral power to decide whether the director continues to receive a benefit upon which the director is so dependent or is of such subjective material importance that its threatened loss" creates doubt as to whether the director can objectively consider the corporate merits of the transaction.[124] Delaware courts, however, rarely find one director to be controlled by another[125] and have never found nonfamilial relationships to be bias producing.[126] As the Delaware Supreme Court has stated, "Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director's independence."[127]

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122. *Id.*; *see also* Telxon Corp. v. Meyerson, 802 A.2d 257, 264 (Del. 2002) ("Directors must not only be independent, but must act independently."); Rales v. Blasband, 634 A.2d 927, 935 (Del. 1993) ("[T]he board must be able to act free of personal financial interest and improper extraneous influences.").

123. *Telxon*, 802 A.2d at 264–65.

124. *Id.* at 264; *see also* Beam *ex rel.* v. Stewart, 845 A.2d 1040, 1050 (Del. 2004); *Rales*, 634 A.2d at 936.

125. Branson, *supra* note 66, at 640 ("Courts are loathe to find that an otherwise reputable business person is not his or her own person."); *see also Beam*, 845 A.2d at 1052 ("To create a reasonable doubt about an outside director's independence, a plaintiff must plead facts that would support the inference that because of the nature of a relationship or additional circumstances other than the interested director's stock ownership or voting power, the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director.").

126. *Beam*, 845 A.2d at 1040.

127. *See id.*; *see also* Crescent/Mach I Partners, L.P. v. Turner, 846 A.2d 963, 980–81 (Del. Ch. 2000) (finding that an allegation that a director was controlled by another director based on their fifteen-year professional and personal relationship was insufficient to raise a reasonable doubt as to independence). Scholars have criticized Delaware's definition of director independence and proposed alternative approaches. *See, e.g.*, Larry Cata Backer, *Director Independence and the Duty of Loyalty: Race, Gender, Class, and the Disney-Ovitz Litigation*, 79 ST. JOHN'S L. REV. 1011, 1023 (2005) (suggesting an alternative approach to assessing director independence that focuses on subordination, including all hierarchical and affective relationships between people, and would defeat any claim of independence); J. Robert Brown, Jr., *Disloyalty Without Limits: "Independent" Directors and the Elimination of the Duty of Loyalty*, 95 KY. L.J. 53, 55–56 (2006–2007) (arguing that "Delaware courts do not adequately ensure that directors defined as independent are in fact independent" and suggesting changes "to ensure that limits on disloyalty remain in place and that fairness continues to matter"); Anthony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237, 293–94 (2009) (analyzing biases that directors can neither identify nor control, such as biases in favor of one's friends, and evaluating potential responses to these unconscious biases).

Similar to Delaware common law, but using slightly different language, the MBCA imposes liability for a breach of the duty of loyalty when the plaintiff establishes that the director was not independent. Under the MBCA, the plaintiff must establish "a lack of objectivity due to the director's familial, financial or business relationship with . . . another person having a material interest in the challenged conduct" or the director lacked "independence due to the director's domination or control by" such a person.[128] Further, the plaintiff must establish that such relationship or domination "could reasonably be expected to have affected the director's judgment respecting the challenged conduct in a manner adverse to the corporation."[129] If the plaintiff succeeds in establishing a reasonable expectation that the relationship or domination affected the director's judgment, then the director bears the burden of proving "that the challenged conduct was reasonably believed by the director to be in the best interests of the corporation."[130] This burden shifting is similar to Delaware law, which requires such a director to prove that the challenged transaction was entirely fair to the corporation.[131] Although the MBCA's express inclusion of financial or business relationships affecting objectivity is a departure from Delaware law's focus on familial relationships, no court opinion has yet applied the MBCA definition to find a director is not independent on the basis of such a relationship.

The MBCA also has numerous provisions requiring a director to be disinterested. For instance, the MBCA states that a director may be held liable when the plaintiff establishes that the director received "financial benefit to which the director was not entitled" or failed "to deal fairly with the corporation and its shareholders."[132] The MBCA specifically defines when a director has a conflicting interest in a corporate transaction and the conditions for when the directors or the shareholders may ratify such transactions.[133] It also has a separate provision that prohibits directors from usurping the corporation's business opportunities.[134] Thus, these provisions largely track Delaware law regarding disinterestedness. In addition to the MBCA, the rules adopted by the NYSE and NASDAQ pursuant to the Sarbanes-Oxley Act of 2002 largely follow Delaware law in defining when directors of publicly traded corporations are not independent and disinterested.[135]

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128. MBCA § 8.31(a)(2)(iii).

129. *Id.* § 8.31(a)(2)(iii)(A).

130. *Id.* § 8.31(a)(2)(iii)(B).

131. Emerald Partners v. Berlin, 787 A.2d 85, 90–91 (Del. 2001); *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006).

132. MBCA § 8.31(a)(2)(v).

133. *Id.* §§ 8.60–8.63.

134. *Id.* § 8.70.

135. Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j–1(m) (2008); NYSE LISTED COMPANY MANUAL § 303A.02 (2009), *available at* http://nysemanual.nyse.com/lcm/ (stating that a director is not independent if, among other things, the director has a material relationship with the listed company, has been an employee of the listed company within the last three years, or has an immediate family member who has been an executive officer

3. The Fiduciary Duty of Good Faith

The duty of good faith is the weakest of the three fiduciary duties. Although the term "good faith" appears in early shareholder derivative cases, it has never served as a basis for any reported court decision finding directors breached a fiduciary duty.[136] In 2006, the Delaware Supreme Court addressed the meaning of the duty of good faith by identifying two categories of bad faith fiduciary conduct: 1) "subjective bad faith," meaning "fiduciary conduct motivated by an actual intent to do harm,"[137] and 2) "intentional dereliction of duty [or] a conscious disregard for one's responsibilities."[138] The Delaware Supreme Court again addressed the duty of good faith a year later in a case alleging that the directors failed to exercise proper oversight.[139] In *Stone v. Ritter*, the court stated that an oversight claim invokes the second category of bad faith conduct, but held "the fiduciary duty violated by that conduct is the duty of loyalty."[140] Consistent with this interpretation, the court explained that "a failure to act in good faith is not conduct that results, ipso facto, in the direct imposition of fiduciary liability" but that a "failure to act in good faith may result in liability because the requirement to act in good faith 'is a subsidiary element' . . . 'of the fundamental duty of loyalty.'"[141] It concluded by stating that the duty of "good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty."[142] Thus, although Delaware recognizes a duty of good faith, it is now subsumed within the duty of loyalty.

Although Delaware common law does not recognize the duty of good faith as an independent fiduciary duty, the MBCA may. The MBCA states that liability may be imposed on directors for "action not in good faith."[143] However, the MBCA provides no definition of good faith or bad faith conduct, and its duty of good faith has not been tested through litigation.

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of the listed company within the last three years); NASDAQ MARKETPLACE RULE 4200(a)(15) (2004) (similar definition).

136. *See* Arsht, *supra* note 72, at 99.

137. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 63–64 (Del. 2006).

138. *Id.* at 66–67 (describing this second category as proscribing fiduciary conduct that does not involve disloyalty but yet is more culpable than gross negligence).

139. Stone v. Ritter, 911 A.2d 362, 364–66 (Del. 2006) (alleging that the directors of AmSouth Bancorporation failed to ensure that a reasonable compliance system existed for the corporation and its subsidiary bank, because both entities had to pay millions of dollars in fines and civil penalties to resolve government investigations into the bank's failure to file federally required Suspicious Activity Reports).

140. *Id.* at 369–70.

141. *Id.* (quoting Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)).

142. *Id.* at 370.

143. MBCA § 8.31(a)(2)(iii) ("A director shall not be liable to the corporation or its shareholders . . . unless the party asserting liability in a proceeding establishes that . . . the challenged conduct consisted or was the result of . . . action not in good faith . . . .").

III. THE UNITED KINGDOM

The United Kingdom encompasses four countries: England, Wales, Scotland, and Northern Ireland.[144] Although the United Kingdom is part of the European Union, the European Union has yet to pass any legislation specifically tailored for shareholder derivative lawsuits or fiduciary duties. Thus, the laws of the United Kingdom still govern its corporations and shareholder derivative litigation.

Corporate laws in the United Kingdom were originally created through common law development by the courts of England.[145] England's first codification of its corporate law occurred in 1862[146] and was supplemented by common law decisions.[147] In 2006, the United Kingdom completely revised its corporate law and adopted the Companies Act of 2006.[148] The current Companies Act is the longest statute in the British Parliament's history at over 700 pages[149] and was implemented in sections over the course of two years.[150] The U.K. Department for Business Enterprise and Regulatory Reform explained the rationale for the overhaul:

> The United Kingdom was one of the first nations to establish rules for the operation of companies. Today our system of company law and corporate governance, setting out the legal basis on which companies are formed and run, is a vital part of the legal framework within which business is conducted. As the business environment evolves, there is a risk that the legal framework can become gradually divorced from the needs of companies, in particular the needs of smaller private businesses, creating obstacles to ways that companies want and need to operate.[151]

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144. Bernard Black et al., *Legal Liability of Directors and Company Officials Part 1: Substantive Grounds for Liability (Report to the Russian Securities Agency)*, 2007 COLUM. BUS. L. REV. 614, 641.

145. Katharine Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791, 798 (2002); Black et al., *supra* note 144, at 641; 1 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 467–84 (1827).

146. Pistor et al., *supra* note 145, at 798 (citing Companies Act, 25 & 26 Vict., c. 89 (1862) (Eng.)).

147. Black et al., *supra* note 144, at 641.

148. Explanatory Note, Background to Companies Act, 2006, c. 46 (U.K.), ¶ 3, *available at* http://www.legislation.gov.uk/ukpga/2006/46/notes/division/2.

149. *Id.*; Andrew Keay, *Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach,"* 29 SYDNEY L. REV. 577, 589 (2007) ("The legislation is the longest in UK parliamentary history.").

150. *See* Department for Business Enterprise & Regulatory Reform, Explanatory Notes, Background ¶ 3, *available at* http://www.legislation.gov.uk/ukpga/2006/46/notes/division/2.

151. *Id*.

The Companies Act covers all aspects of corporate law, including formation of companies, rights of shareholders (called "members" in U.K. companies), appointment and duties of directors, derivative actions, audit requirements, and almost every other element of corporate law that one can imagine.[152] The prior Companies Act included provisions giving minority shareholders a limited ability to bring lawsuits for "unfair prejudice,"[153] which is similar to direct suits for oppression in the United States. However, it was the Companies Act of 2006 that first recognized shareholder derivative lawsuits[154] and first codified the directors' fiduciary duties that had been developed at common law.[155]

In many respects, U.K. companies are similar to U.S. corporations. U.K. companies have a single board, and shareholders appoint directors to the board.[156] The board then chooses the managers, and the CEO is usually a key figure on the board.[157] Although the Companies Act contains very few provisions concerning board structure,[158] the regulations governing publicly listed companies provide standards for companies to use in creating their boards of directors.[159] One such standard requires that half the board be independent nonexecutives, also called outside directors.[160]

Notwithstanding these similarities, there are key distinctions between U.S. corporations and U.K. companies. For example, U.S. corporations are created and governed by state law, rather than federal law.[161] Companies in the United Kingdom are controlled by federal laws, including the Companies Act. In addition, the Companies Act does not expressly confer managerial power on the board in the same way that statutes of U.S. states do. Under the Companies Act, a company's constitution (or articles of association) specifies the directors'

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152. Companies Act, 2006, c. 46 (U.K.).

153. Companies Act, 1985, c. 46, § 461(2)(c) (U.K.); *see also* XIAONING LI, A COMPARATIVE STUDY OF SHAREHOLDERS' DERIVATIVE ACTIONS 19 (2007).

154. *See infra* Part III.A.

155. Black et al., *supra* note 144, at 661.

156. Rita Esen, *Internal Control Within the Legal Structure of United Kingdom and German Companies: Prospects for Change*, 1 J. CORP. L. STUD. 91, 94 (2001); Cheffins & Black, *supra* note 53, at 1400.

157. Esen, *supra* note 156, at 94.

158. Companies Act, 2006, c. 46, §§ 154–56 (requiring private companies to have at least one director and public companies to have at least two directors). *Cf.* Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe – Recent Development of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy*, 1 ECFR 135, 149 (2004) (discussing the lack of detailed provisions on board structure in the 1985 Companies Act).

159. *See* FINANCIAL REPORTING COUNCIL, CORPORATE GOVERNANCE CODE (2010), *available at* http://www.frc.org.uk/documents/pagemanager/Corporate_Governance/UK%20Corp% 20Gov%20Code%20June%202010.pdf. For discussion of such provisions, see Hopt & Leyens, *supra* note 158, at 149.

160. *See* FINANCIAL REPORTING COUNCIL, *supra* note 159, § A.3.2; Cheffins & Black, *supra* note 53, at 1400; Companies Act, 2006, c. 46, § 31.

161. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a); MBCA § 8.01(b).

authority,[162] and directors have a statutory duty to "act in accordance with the company's constitution."[163] In practice, company constitutions usually grant unlimited management authority to the directors, and unlimited authority is the default provision under the Companies Act.[164]

The United Kingdom also has a Corporate Governance Code for every publicly listed company that "sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders."[165] The original code in 2000 was an initiative of the private sector, and it was incorporated into the U.K. Listing Rules.[166] Subsequent revisions are the product of the Financial Reporting Council, a private organization funded by the United Kingdom's accounting and legal professions, financial and commerce communities, and government.[167] Enforcement of the Corporate Governance Code is the responsibility of the United Kingdom Listing Authority, which is a government agency charged with regulating the London Stock Exchange.[168] The Listing Authority sets the Listing Rules, which a company, as a matter of contract and statutory law, must abide by in order to be traded on the London Stock Exchange.[169] In these respects, the U.K. Listing Authority is similar to the U.S. Securities Exchange Commission (SEC).[170] The Listing Rules require that a listed company either comply or explain why it does not comply with the Corporate Governance Code.[171] Although both the creation and enforcement of the Corporate Governance Code are "complex mixtures of private and public action" in the United Kingdom, the trend is toward greater government involvement.[172]

Section A explains the United Kingdom's traditionally limited recognition of shareholder derivative actions under common law and its 2006 expansion of such actions in the Companies Act. It demonstrates the similarities

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162. Companies Act, 2006, c. 46, pt. 3, § 31. A company's constitution includes its articles of association, which must be registered with the registrar of companies. *Id.* §§ 17, 9(6).

163. *Id*. pt. 10, § 171.

164. Black et al., *supra* note 144, at 643.

165. FINANCIAL REPORTING COUNCIL, *supra* note 159.

166. Richard C. Nolan, *The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report*, 6 THEORETICAL INQUIRES L. 413, 417 (2005).

167. *Id.* at 417–18. See information about the Financial Reporting Council at http://www.frc.org.uk/about/ (last visited Dec. 31, 2011).

168. Nolan, *supra* note 166, at 418; John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 239 n.20 (2007).

169. Nolan, *supra* note 166, at 418.

170. *See* Securities Act of 1933, 15 U.S.C. § 77a *et seq*. (2012); Securities Exchange Act of 1934, codified at 15 U.S.C. § 78a *et seq.* (2012).

171. Nolan, *supra* note 166, at 418; Tihir Sarkar et al., *An Analysis of the Walker Review of Corporate Governance in U.K. Banks and Other Financial Institutions*, 127 BANKING L.J. 242, 249 n.4 (2010).

172. Nolan, *supra* note 166, at 418; Sarkar et al., *supra* note 171, at 249 n.4.

between the Companies Act and provisions of state law in the United States. Section B then discusses the United Kingdom's lack of a business judgment rule defense similar to that recognized by U.S. states. Finally, Section C examines the fiduciary duties owed by directors at common law and under the current Companies Act.

A. The United Kingdom Recognized Shareholder Derivative Actions at Common Law and Now by Statute

Although both the United States and England recognized a shareholder derivative action at common law, English common law restricted such actions to very narrow circumstances. Under English common law, shareholder derivative actions were permitted as a limited exception to the basic proper plaintiff rule.[173] Under the proper plaintiff rule, the company was the proper party to bring a lawsuit for director misconduct because directors owed duties to the company alone.[174] However, because the board decided when a company would sue,[175] it was not likely to bring a lawsuit against directors, although occasionally new directors would bring proceedings when the former directors departed.[176] Common law did permit a shareholder to bring a direct action for a personal injury, but the relief could not include any diminution in value resulting from the company's losses.[177]

Recognizing these likely obstacles to remedying corporate wrongdoing, courts used their equity power to create a limited exception to the proper plaintiff rule that permitted a shareholder to bring a suit on behalf of the company.[178] Shareholder derivative actions were permitted only for acts not ratifiable by a simple majority of shareholders, such as where the alleged conduct was illegal, ultra vires, fraudulent, or in breach of a special majority requirement.[179] In other words, this majority rule principle meant that an English court would not intervene in routine business matters unless the plaintiff established that the action involved nonratifiable conduct. Further, under English common law, a shareholder could initiate a suit only when she owned enough shares to dictate

173. LI, *supra* note 153, at 19–22 (citing Foss v Harbottle (1843), 67 Eng. Rep. 189, 2 Hare 461).

174. *Id.*

175. Cheffins & Black, *supra* note 53, at 1404 (citing Mitchell & Hobbs (UK) Ltd v. Mill, (1996) 2 B.C.L.C. 102 (Q.B.); Breckland Group Holdings Ltd. v. London & Suffolk Props. Ltd., [1989] B.C.L.C. 100 (Ch.)).

176. *Id.* (discussing the *Equitable Life* case, in which, after the company became insolvent and the directors were accused of wrongful trading, the post-crisis board initiated proceedings against the directors allegedly responsible for the debt).

177. LI, *supra* note 153, at 19–22.

178. *Id.*; Cheffins & Black, *supra* note 53, at 1404.

179. LI, *supra* note 153, at 19–22; *see also* Cheffins & Black, *supra* note 53, at 1404 (stating that the exceptions included fraud on the minority shareholders, ultra vires conduct, and acts requiring a vote by a special majority of the shareholders).

voting outcomes[180] and only after the board declined to sue.[181] This latter requirement is similar to the demand requirement in U.S. states.[182] In addition, the English majority rule principle is similar to the U.S. business judgment rule defense because both start with a presumption against review of directors' decisions. It is also similar in that both operate as a substantive restriction on shareholder derivative actions and a procedural standing restriction.

Under English common law, minority shareholders had essentially no "effective mechanism to protect themselves or the company, or to discipline corporate management."[183] The English common law on shareholder derivative actions was "regarded as obscure, complex and inaccessible save to lawyers specializing in this field."[184] Another commentator stated that "[t]he circumstances in which this [derivative suit] can be done under present English law are so obscure and difficult to establish that the derivative action is virtually non-existent in England."[185] These criticisms helped spur the 2006 reforms of the Companies Act.

There were, and arguably still are, many financial disincentives to bringing a shareholder derivative suit in the United Kingdom. While the United Kingdom does not have a contingency fee system, plaintiffs may enter into a conditional fee agreement where an attorney can agree to a "no win, no fee" arrangement.[186] Under such agreements, the lawyer may receive up to 100% of his or her hourly fees if the case wins.[187] If the plaintiff loses, this conditional fee arrangement is similar to U.S. contingency fees because the attorney receives nothing. The conditional fee system, however, "compares poorly with the contingency fees that American lawyers receive in the event of a successful outcome."[188] Attorneys receive up to 100% of their hourly fees under U.K. conditional fee agreements; whereas attorneys receive as much as 40% of plaintiffs' total monetary awards under U.S. contingency fee agreements,[189] which can exceed the attorneys' hourly fees. The limited upside potential of U.K. conditional fee agreements means that "a U.S.-style shareholder plaintiffs' bar" has not developed in the United Kingdom.[190]

The U.K. "loser pays" rule poses another financial disincentive to bringing shareholder derivative lawsuits.[191] If the derivative claim fails, the

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180. Cheffins & Black, *supra* note 53, at 1404.
181. Black et al., *supra* note 53, at 26.
182. *Id.*
183. *Id.*
184. LI, *supra* note 153, at 31.
185. Black et al., *supra* note 53, at 26.
186. Cheffins & Black, *supra* note 53, at 1405.
187. *Id.* at 1405–06.
188. *Id*.
189. *See* Brickman, *supra* note 48, at 706; Fitzpatrick, *supra* note 48, at 2045 n.9.
190. Cheffins & Black, *supra* note 53, at 1405.
191. *Id.* at 1406. For the cost structure of bringing suit in the United Kingdom, see Civil Procedure Rules [CPR], 1998, S.I. 1998/3231, pts. 43–49 (Eng.).

shareholder must pay the defendant's costs unless the court grants a protective-costs order requiring the company to reimburse the directors.[192] *Equitable Life Assurance Society v. Bowley*[193] provides an example of the high financial burden that unsuccessful shareholders may bear under the loser pays rule. *Bowley* involved an insurance company that nearly went bankrupt, and the new directors sued the old directors to recover the losses.[194] Even though the new directors dropped the case mid-trial, the estimated legal expenses were £35 million for Equitable Life and £10 million for the defendant directors[195] (about $57 million and $16 million in U.S. dollars).[196] As an additional disincentive, even if the shareholder is successful, a court has the discretion not to order defendants to pay the shareholder's legal fees.[197] Further, like in the United States, any recovery in a successful derivative action will be paid to the company and not to the shareholder who initiated the action.[198]

In addition to financial disincentives, another reason shareholder derivative lawsuits have been uncommon in the United Kingdom is the judiciary's reluctance to hear such cases. Prior to enactment of the current Companies Act, the last derivative suit was the 1981 case of *Prudential Assurance Co. Ltd. v. Newman Indus. Ltd*.[199] In that case, a major institutional investor pursued derivative litigation against two inside directors who allegedly engaged in a self-serving transaction.[200] The company itself ultimately sued the directors, rendering the derivative suit moot.[201] Nevertheless, noting that the plaintiffs were "pioneering a method of controlling companies," the Court of Appeals stated that the "voluntary regulation of companies is a matter for the [financial district]," and the "compulsory regulation of companies is a matter for Parliament."[202] Thus, the court was not willing to allow shareholders to use the judicial system as a method of regulating companies' conduct, stating that such regulation was a matter for the markets and the legislature.

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192. CPR, pt. 44.3(2).

193. Equitable Life Assurance Soc'y v. Bowley¸ [2003] EWHC (Comm) 263, [35]–[41], (2004) 1 B.C.L.C. 180, 188–89.

194. Cheffins & Black, *supra* note 53, at 1399–1400.

195. *Id.* at 1407.

196. For current and historical exchange rates, see http://www.x-rates.com/cgi-bin/hlookup.cgi (showing that the exchange rate in the late 1990s and early 2000s was approximately the same as current exchange rates).

197. Cheffins & Black, *supra* note 53, at 1406.

198. *Id.* at 1407 n.105 (citing Spokes v. The Grosvenor & W. End Ry. Terminus Hotel Co. Ltd., (1897) 2 Q.B. 124, 128)).

199. Prudential Assurance Co. v. Newman Indus. Ltd. (No. 2), (1982) 1 All E.R. 354 (Ch.).

200. Cheffins & Black, *supra* note 53, at 1406–07.

201. Prudential Assurance Co. v. Newman Indus. Ltd. (No. 2), (1982) 1 All E.R. 354 (Ch.).

202. *Id.*

In 2006, the Companies Act statutorily altered the common law basis for bringing a shareholder derivative suit.[203] A derivative claim is defined as a proceeding by a member of a company "in respect of a cause of action vested in the company, and seeking relief on behalf of the company."[204] Such a claim "may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company."[205] To this extent, the Companies Act tracks U.S. derivative law. However, it does not adopt the standing requirement of U.S. law, which requires the shareholder to have owned shares at the time of the challenged transaction. The U.K. law states that "[i]t is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company."[206]

The Companies Act also differs with respect to the U.S. demand requirement. It requires a shareholder filing a derivative claim only to "apply to the court for permission . . . to continue it."[207] Correspondingly, the U.K. Civil Procedure Rules have been amended to require that a shareholder filing a derivative claim seek permission of the court to continue and, until the court grants permission, to prohibit the shareholder from taking any further action in the case except to make an urgent application for interim relief.[208] The Companies Act then states that the court determines whether the shareholder's application and evidence constitute a prima facie case, and thus whether the case may continue.[209] The court may choose to: dismiss the application; give permission to continue the claim on limited terms; or give permission to continue the claim while also directing the evidence to be provided by the company and adjourning the proceedings to enable the shareholder to obtain evidence.[210] Unlike U.S. law, the Companies Act permits a shareholder to seek permission to continue a claim originally brought by the company when that claim could be pursued derivatively.[211] It also permits a shareholder to apply to continue a claim originally brought by another shareholder.[212]

In determining whether to give permission to continue a derivative claim, the Companies Act lists specific factors that the court must consider.[213] Those

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203. This article discusses the provisions of the Companies Act of 2006 applicable to England, Wales, and Northern Ireland. For the provisions for derivative actions in Scotland, which vary slightly, see Companies Act, 2006, c. 46, § 265 (U.K.).

204. *Id*. § 260(1).

205. *Id.* § 260(3).

206. *Id.* § 260(4).

207. *Id.* § 261(1); *see also* Kurt A. Goehre, *Is the Demand Requirement Obsolete? How the United Kingdom Modernized Its Shareholder Derivative Procedure and What the United States Can Learn from It*, 28 WIS. INT'L L.J. 140, 142–43 (2010).

208. CPR 19.9.

209. Companies Act, 2006, c. 46, § 261(2).

210. *Id.* § 261(3–4).

211. *Id.* § 262.

212. *Id.* § 264.

213. *Id.* § 263(3).

factors include the applicant's good faith and the company's decision not to pursue the claim.[214] The court also must consider "the importance that a person [with a duty to promote the company's success] would attach to continuing [the claim]."[215] Similarly, the Companies Act requires that the court give "particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter."[216] In addition, if the alleged act or omission has not yet occurred, the court must consider whether the company could, and likely would, authorize it before it occurs or ratify it after it occurs.[217] If the act or omission has already occurred, the court must consider whether it could be, and likely would be, ratified by the company.[218] Finally, the court is directed to consider whether the claim could be pursued as a direct claim rather than a derivative claim.[219]

For several of those factors, the Companies Act expressly states that permission to continue a derivative claim "must be refused" if that factor is satisfied.[220] So, if a person with a duty to promote the company's success "would not seek to continue the claim," the court must refuse permission to continue it.[221] Similarly, the court must refuse permission to continue the claim if the company has authorized or ratified the challenged act or omission.[222] Thus, to receive permission to continue the case, the shareholder essentially must establish at a preliminary stage that the challenged conduct has not been authorized or ratified by the company and that a director or officer would pursue the claim.[223] If the court grants leave to continue the derivative claim, a trial on the merits may follow.[224]

The statutory authorization of shareholder derivative actions in the Companies Act has produced mixed reactions. Some companies, particularly those operating within politically sensitive areas, have expressed concern that the new law strengthens the rights of those who acquire shares to bring derivative actions for the purpose of harassing companies.[225] In a 2006 survey of directors of public companies, 54% said they were "very concerned" or "quite concerned" that the new law would increase the number of claims against directors.[226] However, no wave of derivative litigation has materialized since the Act was implemented

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214. Companies Act, 2006, c. 46, § 263(3)(a), (e).
215. *Id.* § 263(3)(b).
216. *Id.* § 263(4).
217. *Id.* § 263(3)(c).
218. *Id.* § 263(3)(d).
219. Companies Act, 2006, c. 46, § 263(3)(f).
220. *Id.* § 263(2).
221. *Id.* § 263(2)(a).
222. *Id.* § 263(2)(b), (c).
223. Cheffins & Black, *supra* note 53, at 1405.
224. *Id.*
225. *Id*.
226. *Id*. (quoting HERBERT SMITH, SURVEY RELATED TO DIRECTORS DUTIES AND INSURANCE: SUMMARY REPORT (2006)).

on October 1, 2007.[227] One reason for the paucity of derivative litigation may be the new statute's failure to address the continuing financial disincentives for shareholders to bring such lawsuits.[228]

Similar to U.S. law, shareholders in the United Kingdom are not limited to shareholder derivative suits as the sole means of attempting to control directors' behavior. Shareholders may bring direct suits when they have experienced "unfair prejudice" by the conduct of a company's affairs,[229] which are similar to direct suits for oppression by minority shareholders under U.S. law.[230] A breach of duty by a company's directors perhaps could be deemed unfair prejudice, but most unfair prejudice cases involve the improper diversion of assets or other self-serving conduct for which the customary remedy is a buy-out at fair value.[231] Shareholders may also bring a suit in their own name under U.K. securities law to recover losses caused by false or misleading disclosures for listed companies,[232] which is also similar to U.S. law.[233]

The United Kingdom has also sought to increase shareholder power in other ways. It limits the extent to which directors, in the company's constitution, may have the power to validate self-interested transactions.[234] For example, shareholders must approve payments to directors, loans to directors, and substantial property transactions between a company and a director.[235] The Companies Act also allows the Secretary of State to find that a criminal case may be brought against the directors, but such suits are "virtually never prosecuted."[236] Additionally, a breach of a fiduciary or statutory duty by a director is ground for disqualification from future service as a director.[237] Finally, the Companies Act allows shareholders to remove directors by ordinary resolution at any meeting of the company.[238] One commentator concludes that these additional mechanisms for controlling director conduct mean "that corporate governance in the United Kingdom does not so much rely on enforcing managerial care by directors' personal liability, but rather on the danger of removal by ordinary shareholder resolution, and in particular as a consequence of a change of corporate control."[239] Thus, the United Kingdom has sought to strengthen shareholders' rights through these mechanisms as well as through the explicit recognition of shareholder

227. Goehre, *supra* note 207, at 156.
228. Black et al., *supra* note 53, at 28.
229. Companies Act, 2006, c. 46, § 994.
230. *See supra* notes 40–41 and accompanying text.
231. Cheffins & Black, *supra* note 53, at 1409.
232. *Id.*
233. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (2012).
234. Companies Act, 2006, c. 46, § 41.
235. *Id.* §§ 188–226; *see also* Nolan, *supra* note 166, at 427.
236. Nolan, *supra* note 166, at 430–31.
237. Company Directors Disqualification Act, 1986, c. 46, § 6 (U.K.); *see also* Nolan, *supra* note 166, at 432.
238. Companies Act, 2006, c. 46, § 168.
239. Hopt & Leyen, *supra* note 158, at 152.

derivative actions. It will take years to assess whether these reforms truly produce more effective corporate governance.

B. The United Kingdom Lacks a Business Judgment Rule Defense

Although the United Kingdom has never explicitly recognized a business judgment rule defense, the 1985 version of the Companies Act contained a provision with language loosely resembling such a defense.[240] This provision allowed a court to excuse company officials for a breach of duty if the court found that they acted "honestly and reasonably" and "ought fairly to be excused."[241] The current Companies Act, however, does not contain a similar provision. It also expressly states that provisions protecting directors from liability are void: "Any provision that purports to exempt a director of a company (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void."[242] The current Companies Act thus does not appear to recognize any business judgment rule defense.

Indeed, the United Kingdom does not articulate a statutory or judicially created business judgment rule defense similar to the robust defense created by U.S. law.[243] While U.K. courts presume company officials have acted in good faith and require the plaintiff to prove bad faith, this only partially resembles U.S. law.[244] Nevertheless, English judges have shown that they are reluctant to second-guess corporate decision-making by directors and have refrained from holding directors liable for errors of judgment.[245]

C. The United Kingdom Imposes Fiduciary Duties on Directors at Common Law and Now by Statute

The fiduciary duties of directors have both common law and statutory bases in the United Kingdom.

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240. Companies Act, 1985, c. 6, § 727; *see also* Cheffins & Black, *supra* note 53, at 1414.

241. Companies Act, 1985, c. 6, § 727.

242. Companies Act, 2006, c. 46, § 232(1).

243. Cheffins & Black, *supra* note 53, at 1401; Black et al., *supra* note 144, at 681–82.

244. Black et al., *supra* note 144, at 681–82 ("In England, there is a general assumption that persons have acted in good faith. Anyone who alleges bad faith must state and prove this claim and do both clearly. . . . The effect of these rules is that bad faith must be specifically pleaded, and at trial the claim of bad faith must be supported by evidence: it is not to be assumed.").

245. Cheffins & Black, *supra* note 53, at 1401; Black et al., *supra* note 144, at 681–82.

1. Fiduciary Duties Under English Common Law

At common law, United Kingdom directors owed several "core" duties to their companies.[246] These duties were developed from trust law principles "that persons who hold assets or exercise functions in a representative capacity for the benefit of other people act in good faith and conscientiously protect the interests of those they represent."[247] During the early nineteenth century, the Chancery Court extended the fiduciary duties imposed on trustees to agents, promoters, and directors of companies.[248]

In summarizing the director's common law duty of care, one court stated that a director "undertakes the responsibility of ensuring that he or she understands the nature of the duty a director is called upon to perform," but noted "[t]hat duty will vary according to the size and business of the particular company and the experience that the director held himself or herself out to have in support of appointment to the office."[249] In *In re D'Jan of London Ltd.*, the court more broadly defined a director's duty of care as requiring both "the general knowledge, skill and experience that may reasonably be expected of a person" in the director's position and "the general knowledge, skill and experience that that director has."[250] Regardless of the exact definition, the United Kingdom's common law duty of care consistently emphasized context as well as director knowledge and diligence. Although the duty of care definition is similar to U.S. law, the United Kingdom culpability standard is negligence rather than the Delaware gross negligence standard.[251]

The duty of loyalty under English common law also developed from the law of trusts.[252] It focused on a director's obligation to act in the corporation's best interests and to avoid conflicts of interests with the corporation.[253] Although English courts refrained from exhaustively defining a conflict of interest, the cases reflect that a conflict of interest exists when a financial factor may tempt a director

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246. ROBERT R. PENNINGTON, DIRECTORS' PERSONAL LIABILITY 34 (1987).

247. *Id.*

248. *Id.*; L.C.B. GOWER ET AL., GOWER'S PRINCIPLES OF MODERN COMPANY LAW 572 (4th ed., 1979).

249. In re Barings plc (No. 5), [1999] 1 B.C.L.C. 433, 488b ("The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company."); Black et al., *supra* note 144, at 661 n.50.

250. In re D'Jan of London Ltd., [1993] BCLC 646, 648; Black et al., *supra* note 144, at 662.

251. Cheffins & Black, *supra* note 53, at 1401.

252. Rebecca Lee, *Fiduciary Duty Without Equity: "Fiduciary Duties" of Directors Under the Revised Company Law of the PRC* , 47 VA. J. INT'L L. 897, 911 (2007); PAUL L. DAVIES ET AL., PRINCIPLES OF MODERN COMPANY LAW 16–63, 557–74 (8th ed. 2008).

253. DAVIES ET AL., *supra* note 252, at 16–63, 557–74; Brian Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459, 469 (2001) ("With respect to a duty of loyalty, English courts obliged directors to act in a company's best interests and to avoid conflicts of interest.").

to favor that interest at the company's expense.[254] A court could find a breach of the duty of loyalty even if the challenged transaction was fair and reasonable.[255] However, under common law, companies could avoid liability by adopting exculpatory clauses in the corporate constitution or by having shareholders ratify a conflict-of-interest transaction.[256]

While there were judicially created duties of care and loyalty, some commentators argue that there was not a common law duty of good faith; rather, plaintiffs had to prove bad faith.[257] In *In Re Smith & Fawcett*, the court found that bad faith involves the director's conscious intention to deviate from the duty to act in the company's best interests.[258] However, a duty of good faith has long been assumed to apply to directors once they take their appointment, because they are fiduciaries and must display the utmost good faith toward the company in their dealings with it or on its behalf.[259] In this sense, good faith is tested on a common-sense standard with the "court asking itself whether it is proved that the directors have not done what they honestly believe to be right, and normally accepting that they have unless satisfied that they have not behaved as honest men of business might be expected to act."[260]

In addition, the United Kingdom did not traditionally make a formal legal distinction between the duties of executive and nonexecutive directors. The role of nonexecutive directors, however, may have been judicially altered.[261] In 2001, the court in *In Re Continental Assurance Co. of London plc* stated that while directors have a responsibility to oversee the company's activities, those responsibilities do not "require the non-executive directors to overrule the specialist directors, like the finance director, in their specialist fields."[262] Two years later, the court in *Equitable Life Assurance Society v. Bowley* held that "the duty owed in law by a non-executive director to a company . . . does not differ from the duty owed by an executive director but in application it may and usually will do so."[263] The Companies Act was revised subsequent to these cases, but it also draws no formal distinction between executive and nonexecutive directors.

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254. Black et al., *supra* note 144, at 705.

255. Cheffins, *supra* note 253, at 469–70.

256. *Id.*; *see also* Nolan, *supra* note 166, at 424 ("English law allows a company's constitution to modify directors' fiduciary obligations so that they can be waived *ex ante* by the company's board, usually provided that the interested director takes no part in that decision and always provided that the decision is made *bone fide* in the best interests of the company—something that may be hard to disprove.").

257. Black et al., *supra* note 144, at 664.

258. *Id*.

259. GOWER, *supra* note 248, at 575; Black et al., *supra* note 144, at 663.

260. DAVIES ET AL., *supra* note 252, at 601.

261. Cheffins & Black, *supra* note 53, at 1400.

262. *Id.* (quoting Re Cont'l Assurance Co. of London plc, [2001] B.P.I.R. 733, 850 (Ch.)).

263. *Id*. at 1400 n.51 (quoting Equitable Life Assurance Soc'y v. Bowley¸ [2003] EWHC (Comm) 263, [35]–[41], (2004) 1 B.C.L.C. 180, 188–89).

2. Fiduciary Duties Under the Companies Act of 2006

The Companies Act mandates that directors of U.K. companies comply with numerous new provisions regulating directors' conduct.[264] For example, directors must "act in accordance with the company's constitution."[265] It also clarified the fiduciary duties traditionally owed by directors. These U.K. fiduciary obligations are analogous to corporate statutes in U.S. states, as discussed below.

The Companies Act requires directors to "exercise reasonable care, skill and diligence."[266] The statute then defines this term as meaning "the care, skill and diligence that would be exercised by a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person" in the director's position, and "(b) the general knowledge, skill and experience that that director has."[267] This definition incorporates almost verbatim the definition stated by the court in *In re D'Jan of London Ltd.*[268] It also closely resembles the definition of the duty of care under U.S. law, including Delaware common law and the MBCA provision adopted by a majority of U.S. states.

The Companies Act also obligates a director to "act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole."[269] The director must consider the likely long-term consequences of the decision; the interests of employees; the business relationships with suppliers, customers, and others; the impact on the community and the environment; the desirability of "maintaining a reputation for high standards of business conduct"; and the need to treat members fairly.[270] This duty is subject to any law "requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."[271]

The current Companies Act states a duty of loyalty that resembles the MBCA provisions enacted by a majority of U.S. states in that it requires directors to act independently and disinterestedly. However, while it requires directors to "exercise independent judgment," it fails to offer any definition of independent judgment.[272] In section 175, the Companies Act more clearly outlines a director's duty to avoid both direct and indirect interests that conflict or may conflict with the company's interests, including the "exploitation of any property, information or opportunity."[273] However, section 175 lessens the duty to avoid conflicts of

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264. Cheffins & Black, *supra* note 53, at 1402. For the duties of company directors, see Companies Act, 2006, c. 46, §§ 154–259.

265. Companies Act, 2006, c. 46, § 171.

266. *Id.* § 174(1).

267. *Id.* § 174(2).

268. In Re D'Jan of London Ltd., [1993] BCLC 646, 648; Black et al., *supra* note 144, at 662.

269. Companies Act, 2006, c. 46, § 172(1).

270. *Id.*

271. *Id.* § 172(3).

272. *Id.* § 173.

273. *Id.* § 175(1), (2).

interest by stating that the duty is not infringed if "the situation cannot reasonably be regarded as likely to give rise to a conflict of interest."[274] It also states that the duty is not infringed if the directors have properly authorized the conflict.[275] Section 176 of the Companies Act also clearly states that directors owe a duty not to accept benefits from third parties on account of their position or actions as directors.[276] However, like section 175, it then lessens this duty by stating that it "is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest."[277]

Similar to the MBCA, section 177 of the Companies Act requires a director to declare to the other directors any direct or indirect interest in a proposed transaction with the company "before the company enters into the transaction."[278] The declaration must include the nature and extent of the director's interest,[279] and it must be updated if the declaration of interest later becomes inaccurate or incomplete.[280] Although section 177 excuses a director from declaring an interest of which the director is not aware, it states that "a director is treated as being aware of matters of which he ought reasonably to be aware."[281] Similar to sections 175 and 176, however, section 177 lessens this duty by stating that a director need not declare an interest "if it cannot reasonably be regarded as likely to give rise to a conflict of interest" or if the "other directors are already aware of it."[282] The Companies Act thus makes it fairly simple for directors to avoid a breach of the duty of loyalty.

To enforce these general fiduciary duties, the Companies Act added provisions expressly allowing civil lawsuits for breaches of these duties.[283] Like the MBCA, the Companies Act states that where a director has complied with the duty to avoid conflicts of interest or the duty to declare any interest in a proposed transaction by authorization of the directors, then the transaction "is not liable to be set aside by virtue of any common law rule or equitable principle requiring the consent or approval of the members of the company."[284] A separate chapter of the Companies Act requires the consent or approval of the corporation's members in certain circumstances; compliance with the general duties does not remove the

274. Companies Act, 2006, c. 46, § 175(4).

275. *Id.* § 175(4); *see also id.* § 175(5) (stating that a private company's directors may authorize a conflict where "nothing in the company's constitution invalidates such authorization" and that a public company's directors may do so where the company's constitution enables directors to authorize the matter); *id.* § 175(6) (stating that the directors' authorization is effective only if the "director in question or any other interested director" cannot be counted to satisfy the quorum and voting requirements).

276. *Id.* § 176.

277. Companies Act, 2006, c. 46, § 176(4).

278. *Id.* § 177(1), (4).

279. *Id.* § 177(1).

280. *Id.* § 177(3).

281. *Id.* § 177(5).

282. Companies Act, 2006, c. 46, § 177(6)(a), (b).

283. *Id.* § 178.

284. *Id.* § 180(1).

need for such approval.[285] It further states that these general duties are subject to any rule of law enabling the company to alter the duties owed by directors.[286] Unlike the statutes of U.S. states, however, the Companies Act does not allow a company's constitution to exempt directors from liability for breach of duty.[287] U.K. shareholders may only excuse, on a case-by-case basis, a breach that does not involve misappropriation of corporate assets or fraud.[288] Because the key provisions in the Companies Act regarding directors' fiduciary duties and civil remedies for breaches of those duties were fully implemented only in October 2007, there is no case law concerning derivative lawsuits under these new provisions.

IV. CANADA

Canada has a federal legal system in which each province has authority to determine its laws as specified in the Canadian Constitution. The federal government enacted the Canada Business Corporations Act (CBCA) in 1975, but this is an optional law.[289] Each province is free to enact its own corporate law, and firms may choose to be governed by the laws of a province or the CBCA.[290] Most Canadian provinces have either copied or closely imitated the CBCA in their corporate governance laws.[291]

Like the United States and the United Kingdom, corporations in Canada have a single board of directors,[292] and directors are elected by the shareholders.[293] Canada previously recognized shareholder derivative lawsuits at common law, which followed the English common law rules.[294] In the 1970s, Canada experienced significant corporate law reform leading to the CBCA.[295] Today,

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285. *Id.* § 180(3).

286. *Id.* § 180(4).

287. Cheffins & Black, *supra* note 53, at 1402–03.

288. *Id.*

289. Black et al., *supra* note 144, at 631; Cheffins & Black, *supra* note 53, at 1442.

290. Black et al., *supra* note 144, at 631; Cheffins & Black, *supra* note 53, at 1442.

291. Black et al., *supra* note 144, at 631; Cheffins & Black, *supra* note 53, at 1442.

292. Black et al., *supra* note 144, at 768.

293. *Doing Business in Canada – Establishing a Canadian Subsidiary*, INT-CONT-M § 49.61 (2011).

294. For an analysis of common law shareholder derivative litigation in Canada, see William Kaplan & Bruce Elwood, *The Derivative Action: A Shareholders "Bleak House"?*, 36 U. BRIT. COLUM. L. REV. 443, 445 (2003). For a discussion of English common law rules on shareholder derivative actions, see *supra* Part III.A.

295. Poonam Puri, *Legal Origins, Investor Protection, and Canada*, 2009 B.Y.U. L. REV. 1671, 1694–95 (2009). Much of the corporate law reform in the 1970s was inspired by the recommendations of the Dickerson Report. ROBERT W.V. DICKERSON ET AL., 1 PROPOSALS FOR A NEW BUSINESS CORPORATIONS LAW FOR CANADA (1971); *see also* Martha O'Brien, *The Director's Duty of Care in Tax and Corporate Law*, 36 U. BRIT. COLUM. L. REV. 673, 679 (2003).

Canada authorizes shareholder derivative actions in the CBCA, which is described in Section A. Section B explains that Canada recognizes a business judgment rule defense that is more limited than that of U.S. states. Section C then discusses Canada's evolution of directors' duties from common law to the current statutory rules, which are also similar to those recognized by U.S. states.

A. Canada Statutorily Authorizes Shareholder Derivative Litigation

Similar to the U.K. Companies Act, the CBCA requires a shareholder to apply to the court for leave to bring an action on behalf of the corporation.[296] It also permits a shareholder, upon application, to intervene in an action to which the corporation is a party.[297] For the court to grant leave for a shareholder derivative action, the following conditions must be met: a) the shareholder gave notice to the company fourteen days before making the application if the company did "not bring, diligently prosecute or defend or discontinue the action"; b) the shareholder "is acting in good faith"; and c) the action is in the company's interests.[298] This procedure resembles that of the U.K. Companies Act. While also similar to the U.S. demand requirement in that the shareholder must give notice to the board, under the CBCA, the court decides whether the action may continue.

Also, like the U.K. Companies Act, the CBCA gives the court broad authority to make any order, at any time, in a shareholder derivative action that it thinks fit.[299] These orders may: authorize the shareholder or another person to control the action; give directions for the action's conduct; direct a defendant to pay any judgment directly to former and present shareholders, instead of to the corporation; and require the corporation to pay the shareholder's reasonable legal fees.[300] Commentators have found that "this statutory derivative action procedure has been sporadic, however, particularly when self-serving conduct has been lacking and a public company has been involved."[301]

Although Canada permits shareholder derivative lawsuits, several financial disincentives may deter shareholders from bringing derivative lawsuits. At least one of these disincentives has been alleviated. Canada historically prohibited contingency fees by common law and statute, but such fees are now permitted in most jurisdictions in Canada just as they are in the United States.[302]

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296. Canada Business Corporations Act [CBCA], R.S.C. 1985, c. C-44, § 239 (Can.), *available at* http://laws.justice.gc.ca/en/C-44/index.html.

297. *Id*.

298. *Id.*

299. *Id.* § 240.

300. *Id.*

301. Cheffins & Black, *supra* note 53, at 1443.

302. Poonam Puri, *Taking Stock of Taking Stock*, 87 CORNELL L. REV. 99, 122 (2001); Caroline Davidson, *Tort Au Canadien: A Proposal for Canadian Tort Legislation on Gross Violations of International Human Rights & Humanitarian Law*, 38 VAND. J. TRANSNAT'L L. 1403, 1443 (2005).

However, various financial disincentives remain. First, any recovery in a successful derivative action will be paid to the company just as it is in the United States and United Kingdom.[303] Second, Canada follows the English "loser pays" rule, which requires the losing party to pay at least some of the successful party's legal costs.[304] Thus, a shareholder who applies for leave to pursue a derivative action and fails or who goes to trial and loses may be ordered by the court to pay the other side's legal costs. Even if ultimately successful, the shareholder must initially pay the costs because courts are reluctant to order companies to pay expenses until after final disposition.[305] Third, unlike in the United States where a settlement may provide for attorney's fees, Canada does not authorize settlements for payment directly from the company to the shareholders' lawyers.[306] The court may make an order requiring the corporation to pay the legal fees incurred by a shareholder in a derivative suit.[307] The parties, however, cannot privately agree to a settlement because court approval is required to discontinue a derivative suit,[308] and the court is unlikely to approve a settlement where the company agrees to pay fees unless the court has previously made a specific order.[309]

In addition, like the direct shareholder lawsuits for oppression under the laws of the United States and those for unfair prejudice in the United Kingdom, Canada permits shareholders to bring a direct lawsuit for relief on the grounds of unfair prejudice.[310] These suits, however, are not common for Canadian public companies because the "equitable rights" that usually underlie a successful direct claim are less likely to arise in a public company than a private company.[311]

B. Canada Recognizes Limited Defenses for Directors by Statute and at Common Law

In 2001, Canada amended the CBCA to expressly include limited defenses for directors. The CBCA provides that a director is not liable for an alleged breach of the duty of care if the director has "exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances."[312] Although limited to the duty of care, this provision is comparable to the business judgment rule recognized by Delaware and the MBCA adopted by many U.S. states. The CBCA further provides that a director is not liable for a breach of the duty of care or good faith if the director relied in good

303. Kaplan & Elwood, *supra* note 294, at 457.
304. Black et al., *supra* note 53, at 14.
305. Cheffins & Black, *supra* note 53, at 1444.
306. *See* Black et al., *supra* note 53, at 14.
307. CBCA, R.S.C. 1985, c. C-44, § 240(d).
308. *Id.* § 242(2).
309. Black et al., *supra* note 53, at 14.
310. CBCA, R.S.C. 1985, c. C-44, § 241.
311. Cheffins & Black, *supra* note 53, at 1444.
312. CBCA, R.S.C. 1985, c. C-44, §§ 123(4).

faith on a) financial statements by a corporate officer or a written report of the corporation's auditor represented "fairly to reflect the financial condition of the corporation," or b) a report of a professional "whose profession lends credibility" to it.[313] This narrow provision, excusing liability for good faith reliance on the corporation's financial statements or reports by professionals, correlates to provisions contained in Delaware's statutes and the MBCA.[314]

While these statutory defenses amount to a limited formulation of the business judgment rule, several Canadian courts had previously recognized a form of judicial deference to directors' business decisions similar to it. For example, in duty of care cases, Canadian courts have stated that they are reluctant to find a breach of fiduciary duty "simply because a business decision went badly wrong."[315] In a 1998 case, *Maple Leaf Foods v. Schneider Corp.*, the Ontario Court of Appeals stated that it reviews whether "the directors made a *reasonable* decision *not a perfect* decision."[316] If the decision falls "within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination."[317] Similarly, in *CW Shareholdings Inc. v. WIC Western International Communications Ltd.*, that same court stated a deferential judicial standard for business decisions: "[T]he court should be reluctant to substitute its own opinion for that of the directors where the business decision was made in reasonable and informed reliance on the advice of financial and legal advisors appropriately retained and consulted in the circumstances."[318] Thus, even without the statutory defense, Canadian courts commonly gave deference to directors' business decisions when the shareholders alleged a breach of the duty of care.

To the extent these courts recognized a limited business judgment rule defense, they did so without expressly adopting the U.S. formulation of it.[319] After the CBCA was amended, however, the Supreme Court of Canada expressly adopted a business judgment rule defense for the duty of care that closely mimics the U.S. rule.[320] In *People's Department Stores v. Wise*, a bankruptcy action in

313. *Id.* §§ 123(4–5).

314. DEL. CODE ANN. tit. 8, § 141(e); MBCA § 8.30(e), (f).

315. *See* Black et al., *supra* note 144, at 675–77.

316. Maple Leaf Foods Inc. v. Schneider Corp., [1998] 42 O.R. 3d 177 (Can. Ont. C.A.).

317. *Id.*

318. CW Shareholdings Inc. v. WIC Western International Communications Ltd., [1998] 39 O.R. 3d 755 (Ont. Ct. Gen. Div.); O'Brien, *supra* note 295, at n.20.

319. Black et al., *supra* note 144, at 676–77 ("Canadian courts, like their English counterparts, traditionally refrained from articulating or applying a specific business judgment rule."). *Cf.* Kenneth G. Ottenbreit & John E. Walker, *Learning from the Delaware Experience: A Comparison of the Canada Business Corporations Act and the Delaware General Corporation Law*, 29 CAN. BUS. L.J. 364, 370 (1998) (noting that Canada, unlike Delaware, lacked a "broad base of judicial decisions" upon which to base a business judgment rule defense).

320. *See* Pamela L.J. Huff & Russell C. Silbergleid, *From Production Resources to People's Department Stores: A Similar Response by Delaware and Canadian Courts on the*

which the directors were alleged to have breached a duty of care, the court stated a business judgment rule type of defense:[321]

> Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.[322]

The court noted that the risk of hindsight bias had led lower Canadian courts to develop "a rule of deference to business decisions."[323] Thus, after *Wise*, directors must "act prudently and on a reasonably informed basis," and their decisions need not be perfect but "must be reasonable business decisions in light of all the circumstances about which the directors . . . knew or ought to have known."[324]

The Canadian business judgment rule differs from the U.S. rule because it applies only to cases in which the court is deciding "whether the directors have met their duty of care, diligence, and skill."[325] It does not apply when a plaintiff is alleging that directors breached their duty to act in the company's best interests[326] or when a transaction involves a conflict of interest.[327] In addition, the Canadian business judgment rule differs from the U.S. rule in that Canadian courts will analyze both the process leading to the business decision and the decision itself in deciding whether the directors made a reasonable choice.[328] If the court finds that the decision falls within the range of reasonableness, it will not substitute its

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Fiduciary Duties of Directors to Creditors of Insolvent Companies, 1 J. BUS. & TECH. L. 455 (2007) (noting the similarity between the Canadian decision in *Wise* and a later U.S. court decision).

321. People's Dep't Stores v. Wise, [2004] 3 S.C.R. 461 (Can.); *see also* Gevurtz, *supra* note 54, at 468.

322. People's Dep't Stores v. Wise, [2004] 3 S.C.R. 461 (Can.).

323. *Id.*; *see also* Huff & Silbergleid, *supra* note 320, at 492; O'Brien, *supra* note 295, at n.20 (stating that "directors' actions are not to be judged against the perfect vision of hindsight" and "should be measured against the facts as they existed at the time the impugned decision was made" (citing CW Shareholdings Inc. v. WIC W. Int'l Commc'ns Ltd., [1998] 39 O.R. 3d 755 (Ont. Ct. Gen. Div.)).

324. People's Dep't Stores v. Wise, [2004] 3 S.C.R. 461 (Can.).

325. *Id.*; Maple Leaf Foods Inc. v. Schneider Corp., [1998] 42 O.R.3d 177 (Can. Ont. C.A.).

326. *See* People's Dep't Stores, 3 S.C.R. 461; CW Shareholdings Inc. v. WIC W. Int'l Commc'ns Ltd., [1998], 39 O.R. 3d 755 (Ont. Ct. Gen. Div.); *see also* Black et al., *supra* note 144, at 677.

327. Black et al., *supra* note 144, at 677–78.

328. *Id.*

opinion for that of the directors.[329] Thus, this limited Canadian business judgment rule defense replicates only the portion of the U.S. rule concerning alleged breaches of the duty of care, for which U.S. states permit corporations to eliminate any liability.

C. Canada Imposes Fiduciary Duties on Directors at Common Law and Now by Statute

Directors' fiduciary duties originated in common law cases in the late nineteenth and early twentieth centuries. As stated by the Canadian Supreme Court, a fiduciary relationship requires "loyalty, good faith and avoidance of a conflict of duty and self-interests."[330] Courts imposed a limited and subjective standard of competence on directors, requiring them "to act with only the skill and care that could be expected of the particular director, given that individual's knowledge and experience."[331] Under common law, directors were not liable for errors of judgment and were not obligated to continuously pay attention to the company's affairs or attend directors' meetings.

The CBCA provides the current basis for directors' fiduciary duties. Similar to U.S. law, the CBCA articulates a standard for the duty of care that requires directors to "exercise the care, diligence and skill" of a "reasonably prudent person."[332] Contrary to the objective standard recognized by U.S. law, however, the standard articulated in the CBCA is "a reasonably prudent person in comparable circumstances."[333] The addition of the "in comparable circumstances" phrase has been interpreted as maintaining the common law subjective standard of diligence, care, and skill. For example, in *Neil Soper v. Her Majesty the Queen*, the Court of Appeals for Ottawa analyzed the Income Tax Act's section 227.1(3) requiring a director to exercise "due diligence" in complying with tax laws, which the court found to be similar to the CBCA's duty of care standard.[334] The court held that the duties of diligence, skill, and care stated in the CBCA are subjective.[335] It explained that the "[u]se of 'in comparable circumstances' indicates that a reasonably prudent person in comparable circumstances may be an unskilled person. The subjective element of the common law standard of skill has not been altered by federal statute."[336]

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329. Maple Leaf Foods Inc. v. Schneider Corp., [1998] 42 O.R. 3d 177 (Can. Ont. C.A.).

330. Canadian Aero Services Ltd. v. O'Malley, [1974] S.C.R. 592 (Can.); *see also* Black et al., *supra* note 144, at 653.

331. O'Brien, *supra* note 295, at ¶ 6.

332. CBCA, R.S.C. 1985, c. C-44, § 122(2).

333. *Id.* § 122(2)(b).

334. Soper v. Her Majesty the Queen, [1998] 1 F.C. 124 (Can. C.A.).

335. *Id.*

336. *Id.*

The CBCA also states that directors owe a duty to "act honestly and in good faith with a view to the best interests of the corporation."[337] This formulation invokes a duty of good faith similar to the MBCA's imposition of liability for "action not in good faith"[338] and perhaps to the more limited duty recognized by Delaware courts.[339] This CBCA provision may even encompass part of the duty of loyalty as recognized in U.S. law in that it requires directors to act in the best interests of the corporation. Nonetheless, this language is less specific than an articulation of a duty of loyalty that requires disinterestedness and independence by directors in making decisions on behalf of the corporation, as appears in U.S. law and U.K. law.

In *Wise*, the Supreme Court of Canada again confirmed that the fiduciary duties imposed upon directors are subjective and that, in considering the best interests of the corporation, directors may also consider the interests of shareholders, employees, suppliers, creditors, consumers, governments, and the environment.[340] This formulation of interests differs from that of U.S. courts, which typically state that directors must consider only the best interests of the corporation and its shareholders. Several years after *Wise*, the Canadian Supreme Court made it mandatory for the board to consider the interests of all stakeholders when making decisions for the corporation.[341] It also expressly rejected the idea that shareholders' interests should prevail.[342] Thus, directors' statutory duties in Canada are owed to the corporation and not to the shareholders.[343]

Contrary to U.S. law but similar to U.K. law, the CBCA prohibits any exculpation of the directors' fiduciary duties.[344] It states that "no provision in a contract, the articles, the by-laws or a resolution relieves a director or officer from the duty to act in accordance with this Act or the regulations or relieves them from liability for a breach thereof."[345] In 2001, however, Canada amended the CBCA to replace joint and several liability with proportionate liability, meaning that "every defendant or third party who has been found responsible for a financial loss is liable to the plaintiff only for the portion of the damages that corresponds to their degree of responsibility for the loss."[346] While not exculpating directors' liability, proportionate liability reduces the potential liability exposure of directors.

337. CBCA, R.S.C. 1985, c. C-44, § 122(1).

338. MBCA § 8.31(a)(2)(i)–(iii) (2008).

339. *See* Stone v. Ritter, 911 A.2d 362, 364–65 (Del. 2006); *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 63–64 (Del. 2006).

340. People's Dep't Stores v. Wise, [2004] 3 S.C.R. 461 (Can.); *see also* Catherine Francis, *People's Department Stores Inc. v. Wise: The Expanded Scope of Directors' and Officers' Fiduciary Duties and Duties of Care*, 41 CAN. BUS. L.J. 175 (2004–2005).

341. BCE v. 1967 Debenture Holders, [2008] 3 S.C.R. 560 (Can.).

342. *Id.*

343. Alvi v. Misir, [2004] Carswell 5302, 57–58 (Ont.).

344. CBCA, R.S.C. 1985, c. C-44, § 122(3).

345. *Id.*

346. *Id.* § 237(3); *see also* Cheffins & Black, *supra* note 53, at 1442.

V. AUSTRALIA

Australia's corporate laws are established by the national government,[347] and its laws followed English law for many years.[348] Since 1981, Australia has been engaged in an ongoing process of corporate law reform.[349] Australia enacted a comprehensive statutory scheme for corporate governance in 2001.[350] Its Corporations Act of 2001 has provisions that closely resemble those of the U.K. Companies Act.[351] Like the United States, the United Kingdom, and Canada, Australia's corporate law requires a single board of directors,[352] and directors are elected by shareholders.[353] A national agency, the Australian Securities and Investments Commission (ASIC), oversees all incorporations and is responsible for regulating corporations, stock markets, and financial services.[354] ASIC administers Australia's Corporations Act and can commence civil penalty proceedings, criminal proceedings, or administrative proceedings for violations of the statute.[355] For instance, the ASIC may disqualify directors from continued service through an administrative ban or a civil penalty proceeding.[356] ASIC's

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347. *See* Paul von Nessen, *Australian Effort to Promote Corporate Social Responsibility: Can Disclosure Alone Suffice?*, 27 UCLA PAC. BASIN L.J. 1 (2009). Once a company registers under the Corporations Act of 2001, it is automatically registered as an Australian company and can conduct business throughout Australia without the need to register in state or territorial jurisdictions. *Starting a Company*, AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION, http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Starting%20a%20company%20or%business (last visited Dec. 31, 2011).

348. Paul von Nessen, *The Americanization of Australian Corporate Law*, 26 SYRACUSE J. INT'L L. & COM. 239, 239–40 (1999).

349. Cheffins & Black, *supra* note 53, at 1435.

350. *Corporations Act 2001* (Cth) s 236(1) (Austl.).

351. Cheffins & Black, *supra* note 53, at 1435.

352. Elizabeth Shi, *Board Structure and Board Composition in Australia and Germany: A Comparison in the Context of Corporate Governance*, 2007 MACQUARIE J. BUS. L. 10 (2007); Peter Surgeon, *Corporate Governance and Directors' Duties in Australia*, *in* GLOBAL COUNSEL CORPORATE GOVERNANCE AND DIRECTORS' DUTIES HANDBOOK (2003).

353. *See* Jennifer G. Hill, *Subverting Shareholder Rights: Lessons from News Corp.'s Migration to Delaware*, 63 VAND. L. REV. 1, 22 (2010) (noting that Australia's Corporations Act § 203D grants "shareholders of public companies an absolute right to remove directors from office, with or without cause, by majority vote").

354. *Australian Securities and Investments Commission Act 2001* (Cth) s 1; *see also* von Nessen, *supra* note 348, at 249.

355. *Corporations Act 2001* (Cth) pt. 5B; *see* von Nessen, *supra* note 348, at 262–63; Michelle Welsh, *Civil Penalties and Responsive Regulation: The Gap Between Theory and Practice*, 33 MELB. U. L. REV. 908, 922 (2009) (noting that the ASIC issued 17 non-criminal civil penalty applications alleging contravention of the duty of care between July 1, 2001, and June 30, 2009); *id.* at 932 (noting that the ASIC commenced 88 court enforcement actions alleging contravention of directors' duties, of which 85 were criminal prosecutions and three were civil penalty applications).

356. Welsh, *supra* note 355, at 928–29 (citing *Corporations Act 2001* (Cth) s 206).

active role in enforcing directors' fiduciary duties distinguishes Australia's corporate system from the other countries discussed in this article.[357]

Until 2000, Australia allowed shareholder derivative actions pursuant to common law, which followed similarly narrow rules as U.K. common law.[358] In 2001, Australia enacted explicit rules for shareholder derivative actions in its Corporations Act. The statute empowers a shareholder (called a member in Australia) to bring an action on behalf of the company or to intervene in any proceeding to which the company is a party if the shareholder receives leave of court.[359] Contrary to U.S. law, Australia's Corporations Act also permits a former shareholder to bring a derivative action or to intervene in an action to which the company is a party[360] and gives the same authority to an officer or former officer of the company.[361] Thus, like in the United Kingdom and Canada, to bring a shareholder derivative action or to intervene in an action to which an Australian company is a party, the current or former shareholder must first apply for leave of court.[362]

Once a derivative action is initiated, the court is required to grant the shareholder leave to continue the case if it is satisfied that: a) the company will not bring or take responsibility for the case; b) the shareholder is acting in good faith; c) it is in the company's best interests; d) "there is a serious question to be tried"; and e) either the applicant notified the company fourteen days before making the application or leave should be granted without such notice.[363] These preconditions for leave to continue a shareholder derivative action are virtually identical to Canada's statute.[364] They are also similar to the U.K. Companies Act in that granting leave requires a good faith applicant and requires the company to have decided not to bring the lawsuit. In addition, these preconditions are similar to the U.S. demand requirement in that the shareholder must have notified the company or show why such notice should not be required.

Australia's Corporations Act further creates "[a] rebuttable presumption that granting leave is not in the best interests of the company" if certain conditions are met.[365] First, the proceedings must be by or against a third party.[366] Second, the company must have decided not to bring or defend the proceedings or have decided to discontinue or settle the case.[367] Third, all directors who participated in the challenged decision must have: 1) "acted in good faith for a proper purpose"; 2) had no "material personal interest in the decision"; 3) "informed themselves

357. *Id.*
358. Cheffins & Black, *supra* note 53, at 1435; von Nessen, *supra* note 348, at 262.
359. *Corporations Act 2001* (Cth) s 236(1).
360. *Id.* s 236(1)(a).
361. *Id.* s 236(1)(b).
362. *Id.* s 237(1).
363. *Id.* s 237(2).
364. *See* CBCA, R.S.C. 1985, c. C-44, § 239 (Can.).
365. *Corporations Act 2001* (Cth) s 237(3).
366. *Id.* s 237(3)(a).
367. *Id.* s 237(3)(b).

about the subject matter of the decision to the extent they reasonably believed to be appropriate"; and 4) "rationally believed that the decision was in the best interests of the company."[368] The statute also states that a "director's belief that the decision was in the best interests of the company is a rational one unless the belief is one that no reasonable person in their position would hold."[369] While Australia's preconditions for granting leave are nearly identical to those under Canada's statute, the CBCA does not include a rebuttable presumption that granting leave is not in the best interests of the company.

This rebuttable presumption within the Australian Corporations Act, however, resembles U.S. law in several ways. The third condition of the rebuttable presumption is similar to that of the business judgment rule recognized by U.S. states in that directors are presumed to have complied with their fiduciary duties of good faith, loyalty, and care. Thus, like in the United States, the directors must have breached one of these fiduciary duties for the presumption to be rebutted. However, this third condition appears to place the burden on the defendant directors to establish that they complied with their fiduciary duties, which is a burden borne by the plaintiff shareholders in the United States. In addition, the second condition of Australia's rebuttable presumption vaguely correlates to the U.S. demand requirement. The first condition, however, differs from U.S. law. It limits Australia's rebuttable presumption to cases by or against a third party, which may exclude cases directly against directors. Thus, no rebuttable presumption would apply when the shareholder brings suit against the directors, which differs greatly from the U.S. business judgment rule that protects directors from liability.

Australian courts historically were deferential to directors' business decisions, but they did not develop a U.S.-style business judgment rule defense that presumes directors complied with their fiduciary duties.[370] Australia's Corporations Act now recognizes a business judgment defense, which is popular among Australian directors.[371] Indeed, Australia's business judgment defense is identical to the third condition of the statute's rebuttable presumption that granting leave is not in the company's best interests. Like U.S. law, Australia's Corporation Act defines "business judgment" as encompassing a decision for the corporation to take or not to take action.[372] The statute states that directors' business judgment meets the statutory requirements and their equivalent common law duties if four criteria are satisfied.[373] First, the directors "make the judgment in good faith for a proper purpose."[374] Second, they "do not have a material personal interest in the subject matter of the judgment."[375] Third, they "inform

368. *Id.* s 237(3)(c).
369. *Id.* s 237(3).
370. *See* von Nessen, *supra* note 348, at 264.
371. *Id.*
372. *Corporations Act 2001* (Cth) s 180(3).
373. *Id.* s 180(2).
374. *Id.* s 180(2)(a).
375. *Id.* s 180(2)(b).

themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate."[376] This subjective standard replicates U.K. law, rather than the objective standard of U.S. law. Fourth, they "rationally believe that the judgment is in the best interests of the corporation."[377] The statute defines the directors' belief as rational "unless the belief is one that no reasonable person in their position would hold."[378] Thus, similar to U.S. law, the directors' business judgment is protected if they acted consistent with their duties of good faith, loyalty, and care. Unlike U.S. law, however, Australia's Corporations Act places the burden on the directors to establish these four criteria, meaning the directors must prove that they complied with their fiduciary duties.

Australia's Corporations Act also imposes fiduciary duties on directors. Indeed, a recurring theme of Australia's corporate law reform has been the creation of legal obligations for directors.[379] Core fiduciary duties originally created through case law are now contained within Australia's Corporations Act.[380] It creates a duty of care quite similar to U.S. law, requiring directors to "exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise."[381] Similar to Canada, however, Australia limits the reasonable person standard to "a director . . . of a corporation in the corporation's circumstances" and with the same responsibilities as the director.[382] Within the statement of its business judgment rule and the rebuttable presumption that granting leave is not in the company's best interests, Australia's Corporations Act imposes duties of good faith and loyalty that are similar to U.S. law. It requires that directors make decisions in good faith and that directors not have material personal interests when making decisions for the company.[383]

Even though Australia's Corporations Act allows for shareholder derivative actions, there are numerous disincentives under Australian law for bringing such actions. Like the United Kingdom and Canada, Australia has a "loser pays" litigation rule.[384] Further, even if ultimately successful, a shareholder will have his or her legal fees paid only if the court orders this payment, and any monetary recovery goes to the company.[385] In addition, like the United Kingdom, Australian law does not typically allow contingency fees for lawyers.[386]

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376. *Id.* s 180(2)(c).

377. *Corporations Act 2001* (Cth) s 180(2)(d).

378. *Id.* s 180(2).

379. Cheffins & Black, *supra* note 53, at 1433–34.

380. *Id.*

381. *Corporations Act 2001* (Cth) s 180(1).

382. *Id.*

383. *Id.* ss 180, 273(3)(c).

384. Clark, *supra* note 53, at 148; Cheffins & Black, *supra* note 53, at 1434.

385. Cheffins & Black, *supra* note 53, at 1434.

386. Paul von Nessen, *Australian Shareholders Rejoice: Current Developments in Australian Corporate Litigation*, 31 HASTINGS INT'L & COMP. L. REV. 647, 668, 683 (2008); von Nessen, *supra* note 348, at 263.

Finally, a shareholder in an Australian corporation may be able to pursue a direct action and avoid the restrictions imposed on a derivative action. Australia's Corporations Act permits shareholders to pursue a direct shareholder action on the ground of unfair prejudice,[387] which is identical to the direct actions permitted in the United Kingdom and Canada as well as similar to direct actions for oppression under U.S. law. Thus, Australia does not limit shareholders to pursing derivative actions. The need for direct shareholder actions, however, may be less in Australia than in the United States because its statute imposes less onerous burdens on shareholders pursuing derivative actions. In particular, Australia's Corporations Act places the burden on the defendant directors to show that they have satisfied their fiduciary duties.[388]

VI. CRITICISM OF SHAREHOLDER DERIVATIVE LITIGATION IN THE UNITED STATES AND ITS INFLUENCE ON THE UNITED KINGDOM, CANADA, AND AUSTRALIA

The United States originally imported the shareholder derivative device and other aspects of its legal system from England. Like the United States, Canada and Australia are former English colonies, and their legal systems are rooted in English legal traditions. The most recognized and frequent uses of shareholder derivative actions occur in the United States. By contrast, such actions have traditionally been rare in the United Kingdom, Canada, and Australia. After many years of limited recognition under common law in the United Kingdom, Canada, and Australia, shareholder derivative actions have now been statutorily authorized in these countries. Despite the intense criticism of derivative litigation in the United States, described in Section A below, these countries have expanded the availability of shareholder derivative actions, and their statutes are comparable in many respects to those of U.S. states. Section B examines the influence of U.S. critics, if any, on the shareholder derivative statutes enacted by these countries.

A. Criticism of U.S. Shareholder Derivative Litigation

Shareholder derivative litigation is frequently criticized within the United States. State legislatures and courts have attempted to curtail shareholder derivative litigation in numerous ways, including establishing bond requirements, enacting permissive indemnification statutes, and imposing heightened pleading requirements; each has "been proclaimed in turn as the death knell of the

387. *Corporations Act 2001* (Cth) ss 232–235.

388. *See supra* notes 362–78 and accompanying text (discussing the requirements for leave to continue a derivative action and requirements for the business judgment rule). Australia's Corporations Act also permits a former shareholder to pursue a derivative action. *Corporations Act 2001* (Cth) s 236(1)(a).

derivative suit."[389] Likewise, scholars have argued that shareholder derivative lawsuits are broken and need reform.[390] One reform proposal suggests restricting the filing of such suits to shareholders who own a sufficient stake in the company to ensure effective representation of the corporation's interests.[391] Similarly, another suggested reform proposes that fiduciary duties be imposed on lead plaintiffs in shareholder derivative actions.[392] One scholar proposes the use of an "equity trustee," who would serve as the shareholders' representative and monitor management.[393]

Other scholars advocate that shareholder derivative litigation should be eliminated entirely. In publicly traded corporations, a separation exists between ownership and control.[394] Shareholders provide capital and bear the financial risk of the enterprise, while directors control and manage the shareholders' capital with their expertise.[395] This separation of powers results in a principal-agent relationship in public corporations.[396] Principal-agent theorists contend that a cause of action against directors or a third party, such as a supplier in breach of a contract, is an asset that is properly left to the directors' expertise.[397] These scholars argue that although market mechanisms may align directors and shareholders' financial interests, they do little to ensure that shareholders and their attorneys act in the interest of the corporation and all of the shareholders.[398] Similarly, they assert that "a meritless [derivative] suit brought by a plaintiff without the corporation's best interest in mind can become a significant drain on

389. James D. Cox, *Searching for Corporation's Voice in Derivative Suit Litigation: A Critique of* Zapata *and the ALI Project*, 1982 DUKE L.J. 959, 959 (1982) ("Like the heroine in a Saturday matinee, the derivative suit has repeatedly appeared to be at the cliffs of disaster.").

390. Erickson, *supra* note 49, at 1830.

391. *Id.* at 1830–31 ("The time is coming, however, when we will have to address the broader question of whether to draw the curtain on shareholder derivative suits altogether. My study finds that shareholder derivative suits are broken, a conclusion that leads to two possible—but very different—avenues for reform. If shareholder derivative suits are duplicative of other litigation, then corporate law may not need them. If, on the other hand, shareholder derivative suits have the potential to serve as an independent and meaningful check on corporate misconduct, then policymakers and scholars should focus on reforming these suits.").

392. Amy M. Koopmann, *A Necessary Gatekeeper: The Fiduciary Duties of the Lead Plaintiff in Shareholder Derivative Litigation*, 34 J. CORP. L. 895, 914–21 (2009).

393. Kelli A. Alces, *The Equity Trustee*, 42 ARIZ. ST. L.J. 717, 720–21 (2010) (explaining that the equity trustee would be elected by the seven largest shareholders, paid by the corporation, and would owe fiduciary duties to the shareholders).

394. Alan J. Meese, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629, 1631 (2002).

395. *Id.* at 1681.

396. *Id.*

397. *Id.*

398. *Id.* ("A major weakness of representative litigation in general is that the agent controlling the litigation often does not have the same interests as the principal.").

the corporation's and its shareholders' resources."[399] They also argue that shareholder derivative litigation is an ineffective mechanism for controlling directors' conduct.[400] For these reasons, principal-agent theorists conclude that shareholder derivative litigation should be abolished.[401]

Others argue that the board of directors should be abolished.[402] If a union between ownership and control occurred, then shareholders would be in control, corporate governance would improve, and "it might be possible to restrict or eliminate derivative lawsuits."[403] It has been argued that while the law places accountability for corporate decisions on boards of directors, "boards cannot be meaningfully responsible for corporate decisionmaking," and "[m]oney spent on pursuing litigation against corporate directors is wasted, by and large, as directors are shielded from personal liability . . . ."[404] A unification of ownership and control, however, is unlikely to occur in public corporations or large private corporations within the United States. Professor Lynne L. Dallas proposes instead that corporations adopt a dual board structure; a conflicts board composed of independent directors would monitor for conflicts, while a business review board composed of a mix of directors would perform the other board functions.[405] She also proposes that a full-time "board ombudsman," who is independent from the corporation's management, be appointed "by independent directors on the conflicts board or unitary board" to assist them in monitoring conflicts.[406]

Professor Stephen Bainbridge has also advocated for the abolition of shareholder derivative litigation. He argues that "derivative litigation appears to have little, if any, beneficial accountability effects" but imposes "a high cost constraint and infringement upon the board's authority."[407] In support of abolishing derivative litigation, Professor Bainbridge argues that "various forms

399. Koopmann, *supra* note 392, at 897.

400. Meese, *supra* note 394, at 1681–82.

401. *Id.*

402. *See* George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 902–03 ("The problems of corporate governance will not be solved until ownership and control are united. . . . If corporate boards serve little purpose and if reform proposals . . . promise scant improvement, perhaps the board of directors should be abolished."); *see also* Alces, *supra* note 91, at 785–86 (arguing that the board of directors should be eliminated and its functions assigned to "the real corporate decision makers": the officers, investors, and other "parties in interest that are essential the firm's daily operations and capital structure").

403. Dent, *supra* note 402, at 915.

404. Alces, *supra* note 91, at 784.

405. Lynne L. Dallas, *Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson*, 54 WASH. & LEE L. REV. 91, 93 (1997).

406. *Id.* at 130–31; *see also* Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 SAN DIEGO L. REV. 781, 820 (2003) (recommending that a board include "employee directors who have incentives to protect their stakes in the corporations and who are able to provide diverse perspectives and information to improve the quality of board decisionmaking").

407. BAINBRIDGE, *supra* note 16, at 404.

of market discipline" exist to hold directors accountable for their actions.[408] At a minimum, he urges courts "to discourage derivative litigation."[409] Professor Bainbridge is also one of many scholars who oppose Delaware's current formulation of the business judgment rule defense,[410] which is another area of shareholder derivative litigation frequently debated by U.S. scholars.[411]

In addition, empirical studies of U.S. shareholder derivative litigation have led some commentators to argue for abolition of derivative actions. Empirical studies show that settlement rates appear to be higher in shareholder derivative actions than other civil litigation cases and that such settlements tend to award plaintiffs' attorneys large legal fees.[412] One empirical study also documented the prevalence of derivative lawsuit settlements focused on general corporate governance reforms, rather than solutions to specific allegations of

408. *Id.*

409. *Id.* ("[I]t seems unlikely that courts or legislatures will eliminate derivative litigation any time soon. In the meanwhile, courts should use the tools at hand to discourage derivative litigation.").

410. Bainbridge, *supra* note 28, at 101; *see also* Brown, *supra* note 127, at 55 (arguing that "the business judgment rule was not meant to apply to conflict-of-interest transactions" and advocating that approval of a conflicted decision by a majority independent board should "only shift to the plaintiffs the burden of showing the unfairness of the transaction"); Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287, 336–37 (1994) (advocating for the abolition of the business judgment rule and concluding that courts should apply the ordinary negligence standard to review directors' actions).

411. *See* Bainbridge, *supra* note 28, at 83–84 ("Countless cases invoke it and countless scholars have analyzed it. Yet despite all of the attention lavished on it, the business judgment rule remains poorly understood."); *see also* Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, 2000 WIS. L. REV. 573, 573 (2000) (noting that "thousands of pages of corporate law scholarship and commentary have been devoted to" the business judgment rule); Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 270 (1967) (stating the business judgment rule is "one of the least understood concepts in the entire corporate field"). Many commentators agree with the courts' burden-shifting formulation of the business judgment rule as a standard of liability. *See, e.g.*, Arsht, *supra* note 72, at 133; Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 444–45 (1993). Other commentators believe that this formulation simply restates the principle that defendants are entitled to summary judgment when the plaintiff fails to make a prima facie case and advocate that the rule instead should be viewed as an abstention doctrine. *See, e.g.*, Bainbridge, *supra* note 28, at 101; D. A. Jeremy Telman, *The Business Judgment Rule, Disclosure, and Executive Compensation*, 81 TUL. L. REV. 829, 830 (2007).

412. *See, e.g.*, Romano, *supra* note 48, at 60–61 (finding that in a study surveying all shareholder suits brought from the late 1960s to 1987, that only 128 reached final resolution and of those 65% settled); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 525–26 (1991) (finding that the general civil litigation settlement rate is 60% to 70%, but, in a small sample of securities class actions, 100% of cases settled).

misconduct.[413] These studies provide support for the view "that many derivative suits are strike suits in which the real winners are not corporations or their shareholders, but attorneys."[414] Viewing the empirical evidence, one scholar concluded that "shareholder litigation appears to be more open to abuse by frivolous lawsuits than other fields of private litigation."[415] At a minimum, the deterrence value of derivative suits may be lessened because so many suits end in dismissal or settlement.[416]

Aside from the possibility of strike suits, some commentators argue that shareholder derivative litigation should be severely limited for other reasons. Professors Henry Butler and Larry Ribstein note that "even if the procedural problems of a derivative suit are solved, it is not clear if the derivative suit is an appropriate remedy because the benefits of the derivative remedy remain unclear."[417] They question whether a monetary damages award "serves any compensatory role, since many of the shareholders of the corporation at the time recovery is administered are likely to have bought their shares at prices that already reflected the wrong from the shareholders whose shares were devalued by the wrong."[418]

While courts in the United States have not explicitly stated that shareholder derivative actions should be abolished, courts have frequently noted their dislike for such actions. In *Marx v. Akers*, the New York Supreme Court stated that "[b]y their very nature, shareholder derivative actions infringe upon the managerial discretion of corporate boards."[419] For this reason, courts "have historically been reluctant to permit shareholder derivative lawsuits," and when permitted, courts have restrained their power "to direct the management of a corporation's affairs."[420] Similarly, courts often state that directors are "better-suited than courts to make business decisions" and defer to the directors' decisions even though challenged by shareholders.[421]

Abolishing the derivative lawsuit, however, may not solve all the burdens imposed by frivolous and abusive shareholder litigation. Shareholders may still

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413. Erickson, *supra* note 49, at 1823 (finding that derivative lawsuits are disproportionately filed against large public companies, are expensive for corporations, and do not benefit the corporations based on a study showing that almost 70% of suits are dismissed and nearly all of the remaining 30% settle).

414. *See* Romano, *supra* note 49, at 61; *see also* Alexander, *supra* note 412, at 525–26; Erickson, *supra* note 49, at 1756.

415. Tim Oliver Brandi, *The Strike Suite: A Common Problem of the Derivative Suit and the Shareholder Class Action*, 98 DICK. L. REV. 355, 368 (1994).

416. *Id.* at 1826–27.

417. Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 54–55 (1990).

418. *Id.* at 55.

419. Marx v. Akers, 666 N.E.2d 1034, 1037 (N.Y. 1996) (citing Gordon v. Elliman, 119 N.E.2d 331, 335 (N.Y. 1954)).

420. *Id.*

421. *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919); *see also* Branson, *supra* note 66, at 637; Costa, *supra* note 74, at 46.

file direct shareholder lawsuits asserting injuries in their individual capacities, rather than to the corporation as a whole.[422] Using a direct lawsuit, "[a] skillful plaintiff or plaintiff's attorney may find various ways to attack the corporate officials' alleged wrongdoing."[423] Nevertheless, shareholders' claims would be limited without the ability to proceed derivatively, because not all derivative claims can be creatively pled as direct claims involving individual injuries.

B. U.S. Critics' Influence on the Shareholder Derivative Statutes Enacted by the United Kingdom, Canada, and Australia

If shareholder derivative litigation were universally disfavored, one would expect countries to be abandoning such litigation through legislative enactments or judicial rulings, particularly other common law countries such as the United Kingdom, Canada, and Australia. The true state of affairs, however, is quite different; the United Kingdom, Canada, and Australia have recently enacted statutes expressly authorizing shareholder derivative lawsuits on broader grounds than permitted at common law. Critics calling for the abolition of U.S. shareholder derivative litigation thus did not deter these countries from expanding the availability of shareholder derivative actions.

Yet the United States potentially influenced these countries in other ways. For instance, a majority of U.S. states have codified shareholders' right to file derivative actions through adoption of the MBCA, and this same trend toward codification can be seen in the United Kingdom, Canada, and Australia. These countries' statutory enactments authorizing shareholder derivative litigation even partially resemble the MBCA provisions adopted by many U.S. states. However, they did not imitate the exact statutory language of U.S. states, which leads to several questions. Why did the United Kingdom, Canada, and Australia choose to statutorily authorize shareholder derivative actions? Have these countries' statutory enactments been influenced by U.S. critics' call for limitations on derivative actions? Further, do these countries' statutes offer improvements for shareholder derivative litigation in the United States?

The United Kingdom, Canada, and Australia have adopted statutory schemes that authorize shareholder derivative lawsuits and that articulate the procedures and arguably the liability standards for such actions.[424] One obvious motivation for such statutes is to allow shareholders a means of redress for wrongdoing by corporate management. These countries may also be attempting to improve overall corporate governance by increasing shareholders' incentives to

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422. BAINBRIDGE, *supra* note 16, at 362–64.

423. Brandi, *supra* note 415, at 400. A shareholder may file a direct action if the cause of action belongs to the shareholder individually; for example, in claims involving oppression of minority shareholders. BAINBRIDGE, *supra* note 16, at 362–63.

424. Companies Act, 2006, c. 46, §§ 260–263, 171–180 (U.K.); CBCA, R.S.C. 1985, c. C-44, §§ 239–240, 122–123 (Can.); *Corporations Act 2001* (Cth) ss 236–239, 180 (Austl.).

oversee the activities of management. Similarly, because these statutes increase the possibility that directors can be held liable for misconduct, such as a breach of fiduciary duty, directors' awareness of that potential liability may improve corporate governance. To the extent that these countries were motivated to adopt their statutes for these objectives, one could argue that they were imitating, or at least replicating, the same often-recognized goals of U.S. shareholder derivative law.[425] More broadly, these countries may have statutorily authorized shareholder derivative actions in an effort to increase investors' confidence and to strengthen their ability to compete for capital within the competitive global economy. For instance, these countries may be seeking to better compete with U.S. corporations in which shareholders have the right to pursue such actions. Likewise, they might have specifically enacted such statutes to better compete for U.S. investors, who are familiar with the shareholder derivative action. If either of these scenarios were the motivation for these countries' statutes, they were purposefully imitating U.S. shareholder derivative litigation to attract investors.

It is unknown whether these new statutory schemes will increase the number of shareholder derivative actions filed and whether these statutes will ultimately improve shareholder oversight or director behavior. Since the current Companies Act was implemented, the United Kingdom has not experienced a dramatic increase in the number of shareholder derivative actions filed. Neither have Canada or Australia. However, all three countries have well-functioning judicial systems capable of effectively resolving shareholder derivative actions and providing remedies. More important, these countries' statutes have resolved the ambiguity that existed under common law about the availability and the requirements for pursuing a shareholder derivative action.

Setting aside the intent and ultimate success of these statutes, U.S. critics may have influenced the particular shareholder derivative statutes enacted by the United Kingdom, Canada, and Australia. As already shown, these countries' statutes replicate only certain aspects of the MBCA adopted by many U.S. states and of Delaware law,[426] so the limitations suggested by U.S. critics might have been carefully considered by these countries. For instance, these countries may have adopted provisions to deter the filing of weak or meritless lawsuits that harm the corporation by imposing costs that far exceed the benefits of such litigation to the corporation and its shareholders. If so, U.S. critics may have influenced these countries to adopt provisions that improve the shareholder derivative device.[427] In turn, the statutory provisions adopted by these countries may offer solutions for reforming or improving the deficiencies perceived by critics of shareholder derivative litigation in the United States.

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425. *See* Hurt, *supra* note 46, at 365–66.

426. *See supra* Parts III.A & C, IV.A & C, & V.

427. *See* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 510–11 (1987) (arguing that "there are benefits to those devices that reduce frivolous shareholder litigation").

Many of the criticisms against U.S. shareholder derivative actions address the possibility of strike suits,[428] which can be described as suits filed by plaintiffs' attorneys solely or primarily for the purpose of obtaining fees, as opposed to achieving value for the corporation and its shareholders.[429] Some U.S. states have attempted to curb strike suits through the financial disincentive of bond requirements, while other states rely primarily on pleading requirements and the presumption of the business judgment rule defense to deter such suits.[430] The United Kingdom, Canada, and Australia have a much more potent financial disincentive: the loser pays rule.[431] Given the typically high costs of litigating shareholder derivative actions, the potential financial burden of paying the opponent's costs and attorneys' fees is a significant disincentive to filing such actions. Although courts can relieve unsuccessful plaintiffs of the obligation to pay their opponents' costs,[432] plaintiffs and their attorneys do not know if a court will do so until after the litigation ends. For this reason, these countries have less need to enact statutory provisions addressing strike suits. If U.S. legislatures were to adopt a loser pays rule for shareholder derivative litigation, it may prove to be an effective deterrent against strike suits. However, passage of such legislation may be difficult given the strength of the plaintiffs' bar and institutional shareholders in the United States.

Another financial disincentive for filing shareholder derivative actions exists in Australia: the prohibition against contingency fees. This financial disincentive exists to a lesser degree in the United Kingdom, which permits only conditional fee agreements. In the United States, and in most jurisdictions in

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428. *Id.* ("But, regardless of one's view on the overall desirability of shareholder derivative suits, there is general agreement that at least some fraction of such suits are 'strike' suits, brought only to enrich plaintiffs' attorneys."); Richard W. Duesenberg, *The Business Judgement Rule and Shareholder Derivative Suits: A View from the Inside*, 60 WASH. U.L.Q. 311, 331–33 (1982) (arguing that "[f]iling lawsuits with little or no merit has become, it seems, a way of life with many lawyers"). *But see* Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1749–50 (2004) (arguing that most derivative suits are not strike suits).

429. For example, some strike suits may be brought to force a settlement that generates large fees for plaintiffs' attorneys, but little to no value for the corporation and its shareholders. *See* Romano, *supra* note 49, at 65 (arguing that attorneys are the primary beneficiaries of derivative suits); Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351, 351 (2001) ("Shareholders seldom profit—suits are filed because their attorneys stand to reap substantial fees."); *see also* Hurt, *supra* note 46, at 381–82 (explaining that plaintiffs' attorneys hired on a contingency fee basis are in the driver's seat in derivative actions because of shareholders' collective action problem).

430. *See* Cox, *supra* note 389, at 959; *see also supra* note 44 (listing states with bond requirements); *supra* notes 77–87 and accompanying text (discussing protection of directors' decisions provided by the business judgment rule).

431. *See* Cheffins & Black, *supra* note 53, at 1406 (United Kingdom); Black et al., *supra* note 53, at 14 (Canada); Clark, *supra* note 53, at 148 (Australia).

432. *See* Cheffins & Black, *supra* note 53, at 1406 (United Kingdom); Black et al., *supra* note 53, at 14 (Canada); Clark, *supra* note 53, at 148 (Australia).

Canada, contingent fee agreements offer plaintiffs' attorneys a strong incentive to accept shareholder derivative actions even if the claims are weak.[433] Under a typical U.S. contingent fee agreement, the plaintiffs' attorneys will receive as much as 40% of the plaintiffs' recovery.[434] The plaintiffs' attorney may receive a windfall if the plaintiffs succeed because their actual fees are likely to be lower than the contingency fee, as most derivative cases settle.[435] If the plaintiff loses, however, the plaintiff's attorney must bear the costs with no reimbursement from the plaintiff.[436] By contrast, Australia does not permit contingency fees, which means the plaintiff must pay the attorney during the litigation and will likely not be reimbursed if unsuccessful.[437] The Australian statute thus does not need to counteract the incentives to file derivative actions that are created by contingency fees. Although the United Kingdom permits conditional fee agreements, such agreements do not offer plaintiffs' attorneys the same incentive to pursue shareholder derivative actions.[438] Under a conditional fee agreement, the attorney will recover only the amount of his fees if successful and must bear all the costs if unsuccessful.[439]

Contingency fees play an important role in strike suits filed in the United States and essentially make the plaintiffs' attorney the real party in interest in derivative litigation.[440] If the United States were to follow Australia's example and prohibit contingency fees, plaintiffs' attorneys may be financially deterred from filing strike suits. However, legislatures are unlikely to prohibit contingency

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433. *See* Hurt, *supra* note 46, at 382; Say H. Goo & Rolf H. Weber, *The Expropriation Game: Minority Shareholders' Protection*, 33 HONG KONG L.J. 71, 94 (2003) ("In the United States, while the contingency fee system has made it possible for attorneys who are willing to fund the litigation to help solve the collective action problem, it has also encouraged attorneys to bring 'strike suits' only for the fees."); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1472–73 (2006) ("The plaintiff is a nominal holder while the real party at interest is the lawyer who stands to receive a contingency fee by winning or (more often) settling the case. . . . For example, the attorney . . . may bring a strike suit solely to provoke a strategic settlement . . . .").

434. *See* Brickman, *supra* note 48, at 706; Fitzpatrick, *supra* note 48, at 2045 n.9.

435. *See* Goo & Weber, *supra* note 433, at 94; Ribstein, *supra* note 433, at 1472–73 ("The plaintiff is a nominal holder while the real party at interest is the lawyer who stands to receive a contingency fee by winning or (more often) settling the case.").

436. *See* Kon Sik Kim, *The Demand on Directors Requirement and the Business Judgment Rule in the Shareholder Derivative Suit: An Alternative Framework*, 6 J. CORP. L. 511, 521 n.56 (1981) ("Moreover, because an attorney usually serves in derivative actions on a contingency fee basis and is therefore unlikely to be paid unless the suit is successful or favorably settled, he will carefully weigh the merits of the suit before undertaking it.").

437. *See* von Nessen, *supra* note 386, at 668, 683.

438. *See* Cheffins & Black, *supra* note 53, at 405.

439. *See id*.

440. *See* Hurt, *supra* note 46, at 381–82; *see also* Ribstein, *supra* note 433, at 1472–73 ("The plaintiff is a nominal holder while the real party at interest is the lawyer who stands to receive a contingency fee by winning or (more often) settling the case.").

fees only for shareholder derivative lawsuits, particularly since the possibility of strike suits exists in all types of cases. In addition, institutional investors would likely lobby against such a prohibition, arguing that it harms shareholders, reduces management's accountability, and may lead to corporate mismanagement. Legislatures are also unlikely to prohibit contingency fees in all cases because that would potentially harm plaintiffs in other types of cases, such as personal injury and employment cases. In addition, as with the loser pays rule, the strong plaintiffs' bar would likely make passage of legislation barring all contingency fees difficult. Further, various employee, labor, and victims' rights organizations may join plaintiffs' attorneys in lobbying against a prohibition on contingency fees in all cases.

Despite the existing financial disincentives, the United Kingdom, Canada, and Australia enacted provisions requiring shareholders to seek the court's permission to pursue derivative litigation.[441] One could argue that this requirement addresses the strike suit problem identified by U.S. critics because at the very beginning of a derivative suit, the court must make a determination that the case satisfies statutorily specified criteria and thus is worthy of proceeding. To some extent, these statutory provisions requiring leave of court to pursue derivative actions parallel the U.S. demand requirement, which requires courts to consider whether demand was wrongfully rejected by the board or, in some states, whether demand should be waived. Further, these statutory provisions may function similar to the U.S. business judgment rule, but at a slightly earlier stage in the proceedings. For these reasons, these countries' statutory provisions requiring leave of court to pursue shareholder derivative actions may not meaningfully differ from the court determinations required by U.S. law.

In addition, these countries' leave of court statutory provisions may not deter, and may even encourage, the filing of shareholder derivative lawsuits. The criteria stated in the U.K.'s Companies Act, Canada's CBCA, and Australia's Corporations Act make the leave of court determination a fact-based inquiry into whether the applicant is acting in good faith.[442] The U.K.'s Companies Act also requires the court essentially to consider the importance that a director or officer would attach to continuing the case, which is another fact-based inquiry.[443] Similarly, the CBCA requires the court to consider whether the action is in the company's best interests.[444] Like the CBCA, Australia's Corporations Act requires the court to consider whether the action is in the company's best interests, but it also creates a rebuttable presumption that granting leave is not in the company's best interests if certain conditions are met.[445] One of those conditions requires the court to ascertain whether the directors have satisfied their fiduciary

441. Companies Act, 2006, c. 46, §§ 261–263 (U.K.); CBCA, R.S.C. 1985, c. C-44, §§ 239–240 (Can.); *Corporations Act 2001* (Cth) ss 236–237 (Austl.).

442. Companies Act, 2006, c. 46, § 263(3)(a) (U.K.); CBCA, R.S.C. 1985, c. C-44, § 239(b) (Can.); *Corporations Act 2001* (Cth) s 237(2)(b) (Austl.).

443. Companies Act, 2006, c. 46, § 263(3)(b) (U.K.).

444. CBCA, R.S.C. 1985, c. C-44, § 239(c) (Can.).

445. *Corporations Act 2001* (Cth) ss 237(2)(c), (3) (Austl.).

duties of good faith, loyalty, and care.[446] These fact-intensive inquiries give courts a great deal of discretion, which leads to unpredictability and thus may encourage attorneys to take the chance that a shareholder derivative lawsuit will be granted leave to continue.

U.S. critics of shareholder derivative litigation may believe that courts will use this discretion to prevent derivative actions from continuing, but the discretion could just as often be used to allow such cases to continue. Thus, even if U.S. states were to adopt similar statutory provisions expressly requiring shareholders to seek court permission to pursue derivative actions, it is difficult to predict with certainty how courts would generally exercise that discretion. For this reason, these statutory provisions cannot be hastily deemed to prevent or deter strike suits. Based on the long history of U.S. courts' deference to directors' business decisions under the current formulations of the business judgment rule, some may argue that courts would stop more derivative actions from continuing if given the explicit power to determine whether to grant leave for such actions. However, if a new statutory provision were enacted requiring courts to consider specific criteria before granting permission to continue derivative actions, then U.S. courts may interpret it as requiring a new level of scrutiny that differs from that historical deference. In the end, U.S. critics of derivative actions are unlikely to view such statutory provisions as an improvement of U.S. law, because shareholders can still second-guess directors' decisions by filing derivative lawsuits and force directors to defend their actions in arguing that the court should not grant leave to continue the lawsuits.

In addition, these countries' statutory provisions requiring shareholders to seek permission to pursue derivative actions vary from U.S. law in ways that may deter U.S. critics from advocating for their adoption in U.S. states. The United Kingdom permits shareholders to pursue derivative actions for conduct that occurred before the shareholder acquired his or her shares, and Australia permits former shareholders to pursue derivative actions.[447] Both of these provisions would likely exacerbate the perceived strike suits problem if adopted by U.S. states. They may also strengthen Professors Butler and Ribstein's argument that monetary damages do not serve a compensatory role.[448] For instance, when shareholders bring suit for conduct occurring before they acquired their shares, presumably the price they paid had already been reduced by the wrongful conduct. Interestingly, despite broadening the possible shareholder plaintiffs, these countries did not adopt any ownership stake requirement or impose fiduciary duties on such plaintiffs as advocated by U.S. critics. These countries also did not adopt provisions specifically designed to deal with the conflicts of interest among shareholders, or those between shareholders and plaintiffs' attorneys.[449]

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446. *Id.* s 237(3)(c).

447. Companies Act, 2006, c. 46, § 260(4) (U.K.); *Corporations Act 2001* (Cth) s 236(1)(a) (Austl.).

448. Butler & Ribstein, *supra* note 417, at 54.

449. Hurt, *supra* note 46, at 382.

Additional aspects of Australian law would likely prove troubling to U.S. critics if adopted in the United States. Australia places the burden on directors to show that they satisfied their duties of good faith, loyalty, and care when the court determines whether the lawsuit is in the best interests of the company.[450] U.S. critics who think that shareholder derivative litigation already interferes with corporate management are likely to find Australia's statute even more problematic in this regard. Australia's corporate governance statutes are also unique in that a government agency is given the authority to enforce directors' fiduciary duties.[451] Critics of U.S. shareholder derivative litigation are unlikely to embrace a similar proposal in the United States, unless perhaps the government agency supplanted shareholders' right to bring derivative litigation, although they would likely find a government regulator problematic as well. If both shareholders and a government regulator could bring lawsuits alleging directors breached their fiduciary duties, U.S. corporations would have reason to fear that a shareholder derivative lawsuit would be filed after each action initiated by the regulator based on the example of U.S. securities law. Soon after the SEC begins actions to enforce U.S. securities laws and regulations, shareholder derivative lawsuits that challenge essentially the same conduct are often filed.[452] In any event, a unified federal regulator of all U.S. corporations is unlikely because corporations have historically been created and governed by state law.[453] However, this history perhaps could be overcome in the case of publicly listed corporations, which are already governed extensively by federal securities laws.[454]

Ultimately, the frequency and success of shareholder derivative actions is impacted by a number of factors that may vary among countries. For instance, the views of the judiciary and plaintiffs' attorneys of shareholder derivative actions may affect the number and type of actions that are filed. Similarly, the availability of contingency fee agreements will impact those issues. Shareholders' opinions about their role in corporate governance or about litigation generally may increase or decrease the number of derivative actions filed. This article's comparative

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450. *Corporations Act 2001* (Cth) s 237(3)(c) (Austl.).

451. *See* von Nessen, *supra* note 348, at 249; Welsh, *supra* note 355, at 922, 932.

452. *See* Hurt, *supra* note 46, at 365–66; *see also* Proxy Statements and Proxies Under the Securities Exchange Act of 1934, Securities Filings 2006, 1567 PLI/Corp 99, at 150 (2006) (noting that shareholder derivative lawsuits "ha[ve] naturally followed" SEC enforcement actions "against such industry leaders as Tyson Foods, Inc., The Walt Disney Company, and General Electric Company"); Michael D. Torpey et al., *Defending Securities Claims*, *in* ALI-ABA COURSE STUDY – SECURITIES LITIGATION: PLANNING AND STRATEGIES 691 (2008) (stating that "derivative actions usually still follow SEC enforcement and private securities class actions" within discussion of the interplay of securities class actions, derivative actions, SEC investigations, and criminal litigation).

453. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977); BAINBRIDGE, *supra* note 16, at 5.

454. *See* Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAND. L. REV. 859, 860 (2003) (noting that federal securities laws impose more stringent requirements on public companies than state laws).

analysis suggests that shareholder derivative litigation is not dying anytime soon. It also demonstrates that the statutory and judicial interpretations of such litigation in the United States can influence other countries. Legislatures, courts, and critics in the United States would be wise to learn from other countries' statutory enactments and judicial interpretations regarding shareholder derivative litigation.

VII. CONCLUSION

The recent statutory enactments in the United Kingdom, Canada, and Australia resemble certain aspects of U.S. shareholder derivative law, and therefore suggest that such actions will have continuing viability in the United States despite being intensely criticized by U.S. scholars. These statutes also suggest that shareholder derivative litigation has become a means by which countries seek to attract investors, whether through a perception of improved corporate governance by authorizing such actions or through simple imitation of the availability of such actions in the United States. However, investors familiar with U.S. shareholder derivative litigation should not assume that these countries' statutory enactments are replicating U.S.-style derivative litigation. Nor should investors assume that the expanded authorization of such litigation will necessarily improve corporate governance.

As shareholder derivative litigation spreads around the globe, U.S. critics urging its abolition have been largely ignored. Yet, the United States appears to have partially influenced the shareholder derivative statutes enacted by the United Kingdom, Canada, and Australia, and may well have been the competitive motivation for the adoption of such statutes. Rather than calling for the abolition of shareholder derivative litigation, U.S. critics must focus on reforming the perceived deficiencies of such litigation. By focusing on improvements, the United States can influence other countries as they develop and revise shareholder derivative procedures and standards. In turn, other countries' statutory and judicial developments may offer improvements for U.S. shareholder derivative litigation. With the global expansion of shareholder derivative litigation, U.S. critics must broaden their focus beyond the United States' experience with such actions.