The Baby and the Bath

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Joel Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, **Bus. Lawyer** (forthcoming 2017), available at SSRN.

At least since Karl Llewellyn crossed back over the Mississippi on his return from Montana,[1] legal scholars have understood the value of lived experience as necessary to demonstrate the significance of legal theory. One could even note the rise of empiricism over the last several decades as a further development of this kind of insight. Yet laboratory empiricism can teach only so much. Important as it is, taken alone it can miss the trees that populate the forest.

Joel Edan Friedlander's new paper is important precisely because it comes up to us from a place that numbers and theory alone cannot reveal. A highly experienced member of the Delaware plaintiffs' bar, Friedlander writes in response to recent developments that threaten further to limit the already highly limited institution of shareholder litigation.

Despite their rather unsavory origins,[2] restrictions on shareholder litigation help to keep in check the possibility of corporate extortion by plaintiffs whose only real interest in vindicating shareholders' rights is a quick settlement and high legal fees. Yet it is also the case that such suits serve the important function of enforcing against corporate directors those fiduciary duties that have been left still standing. While the litigation process can be abused, so can the corporate process, and no better legal institution for the insured integrity of the latter has yet been designed.

Although Friedlander's own personal interest in continued shareholder access to the courts is obvious, this paper is nicely balanced with real-world facts and modest claims. Empirical studies have demonstrated the worthlessness of much shareholder litigation, except of course to plaintiffs' lawyers. But as Friedlander notes from the start, those studies fail to understand that many such cases are settled without judicial opinion, thus escaping the notice of scholars. He sets out to use eight highly successful cases in which he has participated in order to analyze which potential reforms will achieve their goal of weeding out meretricious litigation without destroying significant value-adding lawsuits.

Four basic reforms are at issue: early settlement of disclosure claims; laws permitting fee-shifting bylaws; laws restricting expedited discovery; and the application of the business judgment rule to controlling shareholders upon compliance with certain procedural niceties.

As to early disclosure settlements that would preclude deeper investigation that could (and sometimes does) reveal the existence of significant loyalty claims, Friedlander approves of recent Delaware developments restricting early dismissal and suggests that courts also could rely more heavily on questions of adequacy of shareholder representation to ensure that plaintiffs' counsel is interested in more than simply hit and run.

He explores the problems inherent in fee-shifting arrangements, analyzing several cases to demonstrate the almost preclusive effect they would have on meritorious litigation at a premature stage. While I was not especially surprised by the size of defendants' legal fees, it did strike me as both interesting and impressive to see how relatively inexpensively plaintiffs' firms (or at least Friedlander's firm) can litigate. In any event, the asymmetry in fees would operate to preclude much meritorious litigation, just as security for expense statutes did with respect to derivative suits.

Somewhat related is the importance of expedited discovery. Giving due credit to the merits of restricting expedited discovery in and of itself, he assesses this reform in light of diminished fiduciary protections in cases where an informed and disinterested shareholder majority approves the deal. Left with substantive fiduciary protection and an obligation to produce only board minutes, proxy statements, and other corporate documents, defendants can pretty much prevent plaintiffs from getting past the door. Friedlander stresses the importance of emails and other forms of internal communication that would be revealed in discovery as essential to establishing a meritorious cause of action. Finally, he discusses the expansion of the business judgment rule to controlling shareholders as yet a further justification for demanding more balance in procedural litigation rules.

Friedlander's work is important. It is important to scholars as a cautionary tale about paying as much mind to what you don't know as to what you do know. More importantly, it highlights significant dimensions of shareholder litigation that argue in favor of cautious reforms that would sustain the possibility of significant shareholder recovery in appropriate places. With any sort of meaningful fiduciary duty increasingly melting away like Greenland's glaciers, it may be all we have left.

1. Karl N. Llewellyn & E. Adamson Hoebel, **The Cheyenne Way** (1941). [2]
2. Lawrence E. Mitchell, *Gentlemen's Agreement: The Anti-Semitic Origins of Restrictions on Stockholder Litigation,* 36 Queen's L. J. 71 (2010). [2]

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