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In re Wachovia Shareholders Litigation: The Case for the Common Benefit Doctrine

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Wachovia Corporation and First Union Corporation announced their proposed merger on April 15, 2001.[1] Subsequently, in opposition to the planned merger, eight named plaintiffs brought seven lawsuits against Wachovia claiming Wachovia's directors breached their fiduciary duties.[2] These shareholder suits were consolidated into one class action on July 6, 2001.[3] On July 20, the North Carolina Business Court held that certain "cross option provisions"[4] in the merger agreement were valid, but the "termination provisions"[5] contained therein were not.[6] The parties modified the merger agreement to comply with the court order, and on July 31, First Union's shareholders approved the merger.[7] Wachovia's shareholders followed with the approval of the merger on August 3.[8] On September 13, 2002, the court dismissed the remainder of the shareholders' claims with prejudice and granted them thirty days to file a fee petition.[9] The business court granted the plaintiff's fee request based on the common law doctrine known as the common benefit or corporate benefit rule.[10] Wachovia appealed the ruling, and the North Carolina Court of Appeals reversed the business court's award of attorney's fees, holding that prior panels of the court of appeals had declined to adopt the common benefit doctrine into

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1. *In re* Wachovia S'holders Litig. (*Wachovia II*), 168 N.C. App. 135, 136, 607 S.E.2d 48, 49 (2005).
2. *Id.* A claim for breach of fiduciary duty is brought pursuant to N.C. GEN. STAT. § 55-8-30 (2005). For the elements of the claim, see *infra* note 45 and accompanying text.
3. *In re* Wachovia S'holders Litig. (*Wachovia I*), No. 01 CVS 4486, 2003 WL 22996328, at *2 (N.C. Super. Ct. Dec. 19, 2003), *rev'd*, 168 N.C. App. 135, 607 S.E.2d 48 (2005).
4. *See Wachovia II*, 168 N.C. App. at 136, 607 S.E.2d at 49 (describing the cross option device as a mechanism that would operate to award the jilted partner a $780 million "break-up fee" if the merger failed and the other party merged with another partner within 18 months).
5. *See id.* (explaining that "[u]nder the non-termination provision, Wachovia and First Union agreed their merger agreement would not terminate until January of 2002 even if either of their shareholders failed to approve the merger in the initial vote").
6. *Wachovia I*, 2003 WL 22996328, at *4.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.* at *15, *20. For a discussion of the common benefit doctrine, see *infra* notes 17–23 and accompanying text.

the North Carolina common law.[11] The North Carolina Supreme Court denied review.[12]

This Recent Development argues that North Carolina should adopt the common benefit doctrine and permit the award of attorney's fees in shareholder class action suits that confer a substantial benefit on a corporation. If the doctrine of stare decisis prevents the North Carolina appellate courts from incorporating the common benefit doctrine into the common law, the North Carolina General Assembly should enact legislation adopting the doctrine. A similar statute permitting the award of attorney's fees in derivative suits already exists. This Recent Development proceeds by first comparing derivative suits to shareholder class action suits and then argues that shareholder class actions, because of fewer procedural impediments than derivative suits, are a better mechanism for litigating claims of breach of fiduciary duty arising from mergers. In order to encourage profit-motivated plaintiffs' attorneys[13] to bring breach of fiduciary duty claims contesting a merger as shareholder class actions, attorney's fees must be awardable when either a common fund or common benefit has been secured. Otherwise, these attorneys will direct their efforts toward less efficient derivative claims, where attorney's fees are awardable by statute.

Absent statutory authority, attorney's fees are generally not recoverable in North Carolina,[14] and no North Carolina statute currently permits recovery of attorney's fees in shareholder class action suits.[15] However, there are exceptions to this rule, grounded in the equitable doctrine of unjust enrichment,[16] known as the common

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11. *Wachovia II*, 168 N.C. App. at 139–41, 607 S.E.2d at 51–52 (citing Madden v. Chase, 84 N.C. App. 289, 292, 352 S.E.2d 456, 458 (1987)).

12. *In re* Wachovia S'holders Litig. (*Wachovia III*), 359 N.C. 411, 613 S.E.2d 25 (2005).

13. *See* John C. Coffee, *Understanding the Plaintiff's Attorney: The Implication of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 678 (1986) (discussing "the concept of the plaintiff's attorney as an entrepreneur who performs the socially useful function of deterring undesirable conduct").

14. *Wachovia II*, 168 N.C. App. at 138, 607 S.E.2d at 50 (citing Horner v. Chamber of Commerce, 236 N.C. 96, 97, 72 S.E.2d 21, 22 (1952)). This is a generally accepted common law doctrine known as the "American Rule." *See* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975) (enunciating the American Rule as simply, "[i]n the United States, the prevailing litigant is ordinarily not entitled to collect a reasonable attorney's fee from the loser").

15. However, attorney's fees are recoverable in derivative suits. *See* N.C. GEN. STAT. § 55-7-46 (2005).

16. The common fund and common benefit doctrine both "rest[] on the perception that persons who obtain the benefit of a lawsuit without contributing to its cost are

fund and common benefit doctrines.[17] The common benefit doctrine rejected in *Wachovia II* allows the award of attorney's fees when a common benefit has been secured.[18] The common benefit doctrine provides that:

> [A] litigant who confers a common ... benefit upon an ascertainable stockholder class is entitled to an award of counsel fees and expenses for its efforts in creating the benefit .... [T]o be entitled to an award of fees under the [common] benefit doctrine, an applicant must show ... that: (1) the suit was meritorious when filed; (2) the action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved; and (3) the resulting corporate benefit was causally related to the lawsuit.[19]

Although North Carolina has not adopted the common benefit doctrine, it has adopted its close counterpart, the common fund doctrine.[20] The common fund doctrine permits a court

> without statutory authorization, [to] order an allowance for attorney fees to a litigant who at his own expense has maintained a successful suit for the preservation, protection, or increase of a common fund or of common property, or who has

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unjustly enriched at the successful litigant's expense." Boeing Co. v. Van Gemert, 444 U.S. 472, 478 (1980). The North Carolina Supreme Court recognized these equitable underpinnings as early as 1890. *See* Gay v. Davis, 107 N.C. 269, 269, 12 S.E. 194, 194–95 (1890) ("In the absence of statutory provision, the courts, in the exercise of chancery powers, [can] make allowances [of] ... reasonable compensation to counsel ....").

17. *Wachovia II*, 168 N.C. App. at 138, 607 S.E.2d at 50–51.

18. *Id.* at 141–42, 607 S.E.2d at 52. A common benefit is distinguished from a common fund by the fact that a common benefit may be non-monetary. *See* Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 392 (1970) ("The fact that this suit has not yet produced, and may never produce, a monetary recovery from which the fees could be paid does not preclude an award based on th[e common benefit.]").

19. United Vanguard Fund v. Takecare, Inc., 693 A.2d 1076, 1079 (Del. 1997). Judge Tennille adopted a very similar framework for North Carolina in *In re Quintiles Transnational Corp. Shareholder Litigigation,* No. 02 CVS 5348, 2003 WL 22998088, at *2 (N.C. Super. Ct. Dec. 19, 2003), filed the same day as *Wachovia I*, holding that:

> [a]s a general rule, the trial court should determine three things before deciding the amount of the fee .... First, the court looks to see if the action was meritorious at the time it was filed .... Second, it must determine that there was an ascertainable benefit received by the class. Third, it must determine if there existed a causal connection between the action and the benefit.

20. *See* Horner v. Chamber of Commerce of Burlington, 236 N.C. 96, 98, 72 S.E.2d 21, 22 (1952) (noting that the common fund doctrine has been applied by the North Carolina Supreme Court in various classes of cases).

> created at his own expense or brought into court a fund, which others may share with him.[21]

Accordingly, attorney's fees are generally recoverable when a class action results in the securing of a common fund[22] but not when a class action secures a common benefit.[23]

A large amount of shareholder litigation is initiated as a result of proposed mergers. Regulation of mergers of publicly owned corporations is almost completely the domain of state law.[24] The merger of North Carolina corporations must follow the procedure laid out in section 55-11-03 of the North Carolina General Statutes in order for the merger to be lawful.[25] Shareholders can bring two types of lawsuits to contest the merger: derivative or shareholder class action suits.[26]

The method of challenging corporate conduct that many traditionally identify with shareholder-brought litigation is the derivative suit. A derivative suit is "brought by one or more

21. Farm Bureau Ins. Co. of N.C. v. Blong, 159 N.C. App. 365, 374, 583 S.E.2d 307, 313–14 (2003) (quoting Bailey v. State, 348 N.C. 130, 159–60, 500 S.E.2d 54, 71–72 (1998)).

22. Faulkenbury v. Teachers' & State Employees' Ret. Sys. of N.C., 345 N.C. 683, 697, 483 S.E.2d 422, 431 (1997) (applying the common fund doctrine to class action lawsuits).

23. *Wachovia II*, 168 N.C. App. at 140–41, 607 S.E.2d at 51–52. In the underlying litigation that gave rise to *Wachovia I*, the substantial benefit conferred by the litigation was the invalidation of a deal protection device, which, if allowed to stand, would have tied the hands of the shareholders when voting to approve the merger by greatly penalizing the corporation that did not approve the merger. *See* First Union Corp. v. Suntrust Banks, Inc., No. 01 CVS-4486, 2001 WL 1885686, at *38 (N.C. Super. Ct. Aug. 10, 2001) (holding that the non-termination provision created a "coercive condition impeding the free exercise of the Wachovia shareholder's right to vote on the merger"). What is important to note is that only equitable relief was available to invalidate this termination provision, as is the case with the invalidation of any deal protection device. Interview with Ben F. Tennille, Special Superior Court Judge for Complex Business Cases, North Carolina Business Court, in Greensboro, N.C. (Aug. 10, 2006). Therefore, although the corporation is benefited, it is not benefited financially. *Id.* Thus, litigation attacking unlawful deal protection devices can never result in securing a common fund. *Id.*

24. Robert B. Thompson & Hillary A. Gale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 861 (2004) ("State law continues to provide the legal skeleton for the corporate form, and state fiduciary duty litigation continues as a mechanism frequently utilized to monitor managers.").

25. *See* N.C. GEN. STAT. § 55-11-03 (2005); *see also* Carolina Coach Co. v. Hartness, 198 N.C. 524, 528, 152 S.E. 489, 491 (1930) ("Legislative sanction is essential, not only to the creation, but to the merger or consolidation of corporations.").

26. *See* Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 135 (2004). Recently, shareholder class action suits in mergers and acquisitions have become the dominant form of corporate litigation, outnumbering derivative suits by a wide margin. *Id.*

shareholders to enforce a claim that belongs to the corporation."[27] However, a derivative suit is not an efficient method for bringing a breach of fiduciary duty claim in the context of mergers because of the procedural hurdles that a plaintiff must overcome before the claim can be resolved, particularly the demand requirement and the dismissal procedure.

The demand requirement mandates that the shareholder plaintiffs must serve a demand on the corporation to take appropriate action to correct the alleged misconduct or bring the lawsuit itself ninety days before a derivative suit is filed.[28] As a consequence of this approximately three month hiatus, the shareholder plaintiff must delay the start of legal proceedings, allowing the alleged misconduct to continue to cause injury to the corporation. However, North Carolina recognizes two exceptions to the demand requirement. One exception allows plaintiffs to bypass this requirement if they can show that irreparable harm to the corporation would result if they must wait for the ninety days to expire.[29] Entitlement to this exception may be difficult to prove due to the absence of a clear standard of what constitutes irreparable harm.[30] The second exception arises if the corporation notifies the plaintiff that it has refused the demand.[31] A third common exception, known as the futility exception, is not recognized in North Carolina.[32] Thus, as a result of the lack of a clear

27. RUSSELL M. ROBINSON, III, ROBINSON ON NORTH CAROLINA CORPORATION LAW § 17.01 (6th ed. 2000). A shareholder may not bring a derivative suit unless the shareholder was a shareholder of the corporation at the time of the act giving rise to the claim or became a shareholder "through transfer by operation of law from one who was a shareholder at that time; and ... [f]airly and adequately represents the interests of the corporation in enforcing the right of the corporation." N.C. GEN. STAT. § 55-7-41.

28. § 55-7-42; *see also* Alford v. Shaw, 72 N.C. App. 537, 540, 324 S.E.2d 878, 881 (1985), *modified and aff'd*, 320 N.C. 465, 358 S.E.2d 323 (1987) ("The demand requirement serves the ... purpose of allowing the corporation the opportunity to remedy the alleged problem without resort to judicial actions, or, if the problem cannot be remedied without judicial action, to allow the corporation, as the true beneficial party, the opportunity to bring suits first against the alleged wrongdoers.").

29. § 55-7-42.

30. Due to a lack of cases dealing with the issue, it is unclear what constitutes a showing of irreparable harm in North Carolina. However, Judge Tennille, in a separate decision, indicated that a pleading claiming irreparable harm to the corporation may be insufficient absent a pleading of breach of fiduciary duty by the directors. Winters v. First Union Corp., No. 01 CVS 5362, 2001 WL 34000144, at *2–*3 (N.C. Super. Ct. July 12, 2001).

31. N.C. GEN. STAT. § 55-7-42(2).

32. For an explanation of the futility exception see *Alford*, 320 N.C. at 471–72, 358 S.E.2d at 327 ("An equitable exception to the demand requirement may be invoked when the directors who are in control of the corporation are the same ones (or under the control of the same ones) as were initially responsible for the breaches of duty alleged. In such

standard in pleading irreparable harm, the fact that early notification of refusal is unlikely, and the unavailability of the futility exception, the demand requirement is a significant procedural hurdle for a plaintiff to overcome and will often unnecessarily delay the resolution of pending derivative litigation.

The other procedural hurdle that plaintiffs must overcome in a derivative suit is surviving the corporation's potential motion to dismiss.[33] A court can dismiss an action upon a motion of the corporation if a group of independent directors of that corporation charged with considering whether the claim is in the best interest of the corporation recommends seeking dismissal.[34] The rationale for using independent directors to assess the merits of derivative suits is that independent directors are not beholden to management, and thus they are best positioned to make the decision whether a derivative suit will be in the best interest of the corporation.[35] However, the assumption that independent directors are truly independent of management may be questioned.[36] Accordingly, it may be difficult

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case, the demand of a shareholder upon directors ... would be futile and as such is not required for the maintenance of the action.").

33. N.C. GEN. STAT. § 55-7-44(a) ("The court shall dismiss a derivative proceeding on motion of the corporation if one of the groups specified in subsection (b) or (f) of this section determines in good faith after conducting a reasonable inquiry ... that the maintenance of the derivative proceeding is not in the best interest of the corporation.").

34. § 55-7-44(b). This decision to dismiss is

> made by: (1) A majority vote of independent directors present at the meeting of the board of directors if the independent directors constitute a quorum; or (2) A majority vote of a committee consisting of two or more independent directors appointed by majority vote of independent directors present at a meeting of the board of directors, whether or not the independent directors constituted a quorum.

Id. In the alternative, "[t]he court may appoint a panel of one or more independent persons upon motion of the corporation to make a determination whether the suit shall be dismissed." *Id.* § 55-7-44(f). This committee is often known as the special litigation committee. If the suit does survive dismissal, then it cannot be settled or discontinued absent the permission of the court. *Id.* § 55-7-45.

35. James D. Cox and Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83, 83–84 (1985) (arguing that in the context of mergers, the belief that independent directors act solely in the interest of shareholders and not, in some degree, in their own self interest is an "unsubstantiated belief").

36. *Id.* at 84–85 ("[S]everal psychological mechanisms can be expected to generate subtle, but powerful, biases which result in the independent directors' reaching a decision insulating colleagues on the board from legal sanctions."). *But cf.* Kenneth B. Davis, Jr., *Structural Bias, Special Litigation Committees, and the Vagaries of Director Independence*, 90 IOWA L. REV. 1305, 1309 (2005) ("While bias taints the decisionmaking process, it is certainly not the only criterion that determines the overall quality of the resulting decision.").

for the derivative plaintiff to avoid having the suit dismissed by the independent directors because they may be inclined to favor a pro-management resolution of the suit, such as dismissal, over the continuance of meritorious litigation. Therefore, the prospect of the special litigation committee dismissing meritorious claims makes this procedure all the more onerous. However, if the derivative suit clears all of these hurdles and is resolved in favor of the plaintiff, the plaintiff can recover "reasonable expenses, including attorney's fees."[37]

Shareholders can also contest the merger of the corporation and assert their shareholder rights via a shareholder class action suit.[38] Although derivative suits and shareholder class actions can arise from the same acts of corporate directors, shareholder class action suits do not have to contend with the same procedural obstacles as derivative suits.[39] Class action lawsuits are brought pursuant to Rule 23 of the North Carolina Rules of Civil Procedure, which allows a party to sue on behalf of a class when it is "impracticable" to bring all the parties before the court and adequate representation can be ensured.[40] Once

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37. N.C. GEN. STAT. § 55-7-46. Furthermore, the court can order the plaintiff to pay the defendant's expenses "incurred in defending the proceeding if it finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose." *Id.* § 55-7-46(2). In addition, the court is authorized to award a party its expenses when an opposing party files a

> pleading, motion, or other paper, if the court finds ... [it] was not well grounded in fact or was not warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it was interposed ... to harass or to cause unnecessary delay or needless increase in the cost of litigation.

Id. § 55-7-46(3).

38. ROBINSON, *supra* note 27, at § 24.01. An important distinction between the lawsuits is that a class action can only bring a claim alleging an injury to the individual shareholder's rights, while in derivative suits, the injury is to the corporation and the plaintiff is suing on its behalf. *Id.*

39. ROBINSON, *supra* note 27, § 24.01. *See In re* Wachovia S'holders Litig. (*Wachovia I*), No. 01 CVS 4486, 2003 WL 22996328, at *5 (N.C. Super. Ct. Dec. 19, 2003), *rev'd*, 168 N.C. App. 135, 607 S.E.2d 48 (2005) ("In the context of a proposed merger containing deal protection devices, the derivative statute does not work particularly well.").

40. N.C. R. CIV. P. 23(a). In North Carolina, "a 'class exists ... when the named and unnamed members each have an interest in either the same issue of law or fact, and that issue predominates over issues affecting only individual class members." Crow v. Citicorp Acceptance Co., 319 N.C. 274, 280, 354 S.E.2d 459, 464 (1987). To show impracticability, plaintiffs must "demonstrate substantial difficulty or inconvenience in joining all members of the class. There can be no firm rule for determining when a class is so numerous that joinder of all members is impractical." *Id.* at 283, 354 S.E.2d at 466. To ensure adequate representation, the plaintiffs must show that:

an action is certified as a class action, the court must approve any subsequent settlement or dismissal.[41] Furthermore, judges have broad discretion on whether to certify a class.[42] They also have discretion in selecting who will serve as lead counsel, what claims will be litigated, and who can be included in the class.[43]

A breach of fiduciary duty claim can be brought as either a derivative suit or a class action.[44] A breach of fiduciary duty claim is based on the allegation that a director violated one of the duties she owes to the corporation.[45] In the context of proposed mergers, breach of fiduciary duty claims brought by shareholders serve as potent vehicles for asserting the rights of shareholders.

> they have a personal, and not just a technical or official, interest in the action. Plaintiff has the burden of showing that the alleged representatives are members of the class and that the interest of absent class members will be adequately protected .... This requirement is not necessarily one of numbers, but is dependant on the adequacy and vigor with which those parties will protect the interests of the class.

English v. Holden Beach Realty Corp., 41 N.C. App. 1, 7, 254 S.E.2d 223, 230 (1979) (citations omitted), *overruled by* Crow v. Citicorp Acceptance Co., 319 N.C. 274, 354 S.E.2d 459 (1987).

41. N.C. R. CIV. P. 23(c).

42. *See* Maffei v. Alert Cable T.V. of N.C., Inc., 316 N.C. 615, 617, 392 S.E.2d 867, 870 (1986) ("[D]eciding whether to certify a class, a trial judge has broad discretion and may consider factors not expressly mentioned in N.C.G.S. § 1A-1, Rule 23.").

43. *See Wachovia I*, 2003 WL 22996328, at *6 (stating that "[t]here is less flexibility in a derivative action than in a class action, where the court can define the class and the claims to be pursued"). In *In re Quintiles Transnational Corp. S'holder Litig.*, No. 02 CVS 5348, 2003 WL 22998088, at *4 (N.C. Super. Ct. Dec. 19, 2003), Judge Tennille noted that:

> [t]he selection of lead counsel is seldom based upon the first to file rule. Increasingly courts are looking for class representatives who have a substantial interest in the litigation and who will fulfill their role as class representatives. The courts are also looking for counsel who have given some thought and research to their complaints and have not just pulled a form out of the file and rushed to the courthouse.

The benefit of this discretion is that judges, in certifying shareholder class actions, can effectively police the action by appointing lead counsel and defining who may be a member of the class; this policing function may help eliminate frivolous actions.

44. *See Wachovia I*, 2003 WL 22996328, at *6 ("In most jurisdictions complaints based upon breach of fiduciary duty in the acquisition context are brought as class actions. The derivative action is generally reserved for conflict of interest claims . . . .").

45. Section 55-8-30 of the North Carolina General Statutes requires that a director

> shall discharge his duties as a director, including his duties as a member of a committee: (1) [i]n good faith; (2) [w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) [i]n a manner he reasonably believes to be in the best interests of the corporation.

N.C. GEN. STAT. § 55-8-30 (2005).

Breach of fiduciary duty claims brought in the context of mergers are best brought as state shareholder class actions because class actions allow for greater flexibility and speed in resolving the claim,[46] thus saving both parties court costs and other litigation expenses. Speed is crucial in mergers. The longer it takes to complete a merger, the greater the risk of third-party bids and lawsuits challenging the merger.[47] In addition, uncertainty about the success of the merger can lower share prices, and a timely merger best dispenses with this uncertainty.[48] The directors of corporations recognize the need for mergers to be completed quickly and structure their merger deals accordingly.[49] Judge Tennille noted the existence of this need in *Wachovia I*, stating that "[c]ompanies desiring to consummate a merger will generally move as swiftly as possible to complete the transaction .... There are sound business reasons for the rapidity ...."[50]

Due to the accelerated time frame of merger deals, derivative suits are an undesirable way to bring breach of fiduciary duty claims because their burdensome procedural requirements delay litigation.[51] As Judge Tennille noted, "[our] derivative statute does not adequately or specifically address the time pressure created in the merger of publicly traded companies."[52] One of these procedural hurdles, the demand requirement, requires the plaintiff to sit on his hands for three months before bringing his claim.[53] This hiatus is often futile because it is unlikely that the demand made upon the

46. *See Wachovia I*, 2003 WL 22996328, at *13 (arguing that a derivative action contesting a merger creates "needless procedural steps" that delay litigation; and, therefore, a derivative suit is not the "best vehicle for protecting shareholder interests.").

47. LEO HERZEL & RICHARD W. SHEPRO, BIDDERS AND TARGETS: MERGERS AND ACQUISITIONS IN THE U.S. 126 (1990) (stating that "[t]he risk of competition increases as the time between execution of the acquisition agreement and the actual change of control increases"). During the merger that is the subject of this Recent Development, the risk was realized that a third party would make a hostile bid before the merger was finalized. SunTrust Banks unsuccessfully attempted a hostile takeover in "one of the most expensive and highly publicized takeover battles in banking history." Lijun K. Yang, *First Union v. SunTrust Banks: The Fight for Wachovia and Its Impact on North Carolina Corporate Law*, 6 N.C. BANKING INST. 335, 336 (2002).

48. *Wachovia I*, 2003 WL 22996328, at *4 (stating that parties to merger desire that the merger be consummated quickly to avoid intervening factors, such as "natural disaster, financial market changes, strikes, and government intervention[,]" that negatively affect a merger).

49. *See id.* at *4.

50. *Id.*

51. *Id.* at *5.

52. *Id.*

53. *Id.* (arguing that "the ninety-day waiting period embodied in the statute does not provide a realistic time frame within which to deal with challenges to proposed mergers").

corporation by the shareholder will be accepted. The demand would most certainly call for a change in the merger proceedings, which the board of directors would be extremely reluctant to undertake in light of the need to expediently plan and execute the merger.[54] As a result, not only does the demand requirement delay litigation, it does so unnecessarily because there is little reason to expect the corporation will undertake the action for which the demand calls.[55]

Class action lawsuits have no requirements that cause such a delay, thus they are the better method of quickly resolving a shareholder breach of fiduciary duty claim. Class action plaintiffs can (and often do) file the action the day the merger is announced. Therefore, class actions as a whole are usually initiated earlier than derivative suits.[56] In a sample of complaints filed in the Delaware Court of Chancery during the years 1999–2000, Robert B. Thompson and Randall S. Thomas found that eleven percent of the complaints brought as derivative suits are filed within three days of the date of

54. *Id.* (noting that in "the acquisition environment, the board, in all probability, has considered the deal protection devices incorporated in the merger agreement at some length and, after consultation with counsel and investment bankers, has determined that to include those protections in the merger agreement would be in the best interest of the corporation"). Also, it is important to note that often the demand is made on the same directors who are accused of wrongdoing; thus, it follows that these directors usually will not acquiesce to accusations of wrongdoing by granting the derivative plaintiff's demand to modify actions that they have taken. *See* Tamar Frankel & Wayne M. Barsky, *The Power Struggle Between Shareholders and Directors: The Demand Requirement in Derivative Suits*, 12 HOFSTRA L. REV. 39, 41 (1983) ("If the directors are substantially implicated as defendants, demand on them, in some cases, is held to be 'futile.' "). To avoid this conflict of interest, the futility exception was created, but as already noted, North Carolina has expressly refused to incorporate it into state law.

55. Judge Tennille, in *Wachovia I*, argued that "[t]he speed with which transactions are completed requires that the ninety-day [demand] period be shortened. However, the mechanism for shortening the ninety-day waiting period is unclear." *Wachovia I*, 2003 WL 22996328, at *5. Therefore, as a minimum, if the common benefit doctrine is not adopted into North Carolina law, the General Assembly should provide a straightforward mechanism that allows a plaintiff to petition the court to shorten the demand period in a derivative suit. As argued above, in light of the speed with which mergers are consummated, the demand requirement renders a derivative suit wholly inadequate in large measure because of the artificial delay that it mandates. Accordingly, the creation of a straightforward procedure for seeking a judicially ordered shortening of the demand period could address this deficiency, and would provide plaintiffs with a more suitable way to bring a suit contesting the merger of two corporations.

56. *See* John F. Olson et al., *Pleading Reform, Plaintiff Qualification, and Discovery Stays Under the Reform Act*, 51 BUS. LAW. 1101, 1104 (1996) ("Less than five hours after Philip Morris announced it would reduce the price of Marlboro cigarettes by forty cents a pack, causing expected earnings to drop as much as forty percent, plaintiffs' lawyers filed the initial complaint."). This rush to file claims against corporations was termed a "race to the court house" in the House Conference Report accompanying the PSLRA of 1995. *See* H.R. REP. NO. 104-369, at 32 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 731.

the challenged transaction, whereas about two-thirds of class actions are filed within that time frame.[57] Initiating the litigation earlier provides a benefit for the corporation, which has a strong interest in resolving any litigation that contests the merger as quickly as possible.[58] Immediate filing also benefits the plaintiff, whose right as a shareholder to serve as a corporate watchdog will not be handicapped by an unnecessary delay.

Derivative suits are also ill-suited for contesting mergers and acquisitions due to a second procedural hurdle, the dismissal process. This process not only consumes the corporation's resources by requiring an investigation of the claims, it also allows the corporation to easily disregard or dispose of claims that could provide a legitimate benefit to the corporation. As Judge Tennille noted in *Wachovia I* and as argued earlier in this Recent Development, the independence of the directors who evaluate the claim is questionable.[59] In addition, the decision to attempt to merge with another corporation is not one that is reached quickly or lightly by the directors. The decision is a major event in the life of a corporation and can be very risky, so it is unlikely that the special litigation committee, which may be influenced by pro-management biases, would question the merger plans by allowing a derivative suit.[60] Thus, a derivative claim that contests the planned merger faces a steep uphill procedural battle before the claims are considered.[61] As a result, legitimate claims may be discontinued to the detriment of shareholders and the corporation. In contrast, a state class action cannot be dismissed on the recommendation of the corporation. The shareholder class action claim is independent of the corporation, and because of its certification as a class action, it cannot be dismissed or settled without first receiving the permission of the court.[62] Thus, shareholder class actions will continue in the face of the corporation's resistance and can often result in a hard-won benefit for the corporation.

57. *See* Thompson & Thomas, *supra* note 26, at 182 ("Clearly, derivative lawsuit attorneys are not in a race to the courthouse.").

58. *See supra* notes 47–50 and accompanying text.

59. *See supra* note 36 and accompanying text.

60. *See Wachovia I*, 2003 WL 22996328, at *5 (arguing that the extent to which the board has analyzed and considered the deal protections would weigh heavily against adopting a proposed modification).

61. *See id.*

62. N.C. R. CIV. P. 23(c).

Another advantage of class actions is that they very frequently result in settlement.[63] Settlement is a more efficient way of resolving disputes than trial and courts encourage settlement as a matter of public policy.[64] In the context of shareholder-initiated claims, settlement can reduce litigation expenses because the parties will not require legal services for a trial, which can be lengthy and expensive. Additionally, the settlement can be negotiated to include reasonable attorney's fees for the shareholder's attorney and a compromise decision to correct whatever deficiency in the directors' conduct is the subject of the claim. This result can be mutually advantageous to both parties and relatively inexpensive to secure.

Despite these advantages of class action suits, one rationale offered in support of derivative suits' dismissal and demand procedures is that they provide a way for corporations to dispose of vexatious strike suits. Strike suits are lawsuits, particularly derivative actions, which are brought by shareholders and are "often based on no valid claim, brought either for nuisance value or as leverage to obtain a favorable or inflated settlement."[65] The United States Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA)[66] to reduce the abuses of strike suits.[67] However, many class action suits filed in state court claiming breach of fiduciary duty still pose a serious threat to corporations because they are not governed by PSLRA[68] or a subsequent act, the Securities Litigation Uniform Standards Act (SLUSA),[69] as long as the class contains fewer than fifty members.[70]

63. *See* Thomas E. Willging & Shannon R. Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does It Make?*, 81 NOTRE DAME L. REV. 591, 648 (2006) (finding after conducting a nationwide survey of federal and state class actions that "almost all certified class actions settle"); *see also* Bryant G. Garth, Symposium, *Studying Civil Litigation Through the Class Action: Introduction*, 62 IND. L.J. 497, 501 (1987) (noting that, in a study of forty-six certified class actions in the Northern District of California, thirty-six such cases were settled and only ten were litigated).

64. *See, e.g.*, *In re* Worldcom, Inc. Sec. Litig., No. 02 CIV. 3288(DLC), 2005 WL 2319118, at *15 (S.D.N.Y. Sept. 21, 2005) (stating that "public policy favors settlement, especially in the case of class actions").

65. BLACK'S LAW DICTIONARY 1475 (8th ed. 2004).

66. Pub. L. No. 104-67, 109 Stat. 737 (1995).

67. *See* H.R. REP. NO. 104-369, at 31 (Conf. Rep.) (listing the automatic filing of a lawsuit when a corporation's share price drops, the "targeting of deep pocket defendants[,]" using the discovery process to increase the cost of defending an action in order to force a settlement, among others, as abuses the act strove to prevent). These characteristics are the hallmarks of strike suits.

68. *See* 15 U.S.C. §§ 77z-1, 78u-4 (2000).

69. Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified at 15 U.S.C. § 77(p) (2000)).

70. 15 U.S.C. § 77p(f). Attorneys were able to elude the requirements of PSLRA by filing claims in state courts under state law. *See* Pub. L. No. 105-353, 112 Stat. 3227(2)

To counter the threat posed by strike suits, North Carolina should adopt practices to discourage attorneys from bringing these abusive suits. The North Carolina General Assembly can enact rules of civil procedure that apply some of the protections present in PSLRA to class actions bringing claims of breach of fiduciary duties. For example, PSLRA requires courts to review whether each party has complied with Rule 11 of the Federal Rules of Civil Procedure,[71] and if the court finds a violation, the imposition of sanctions is mandatory.[72] The General Assembly can adopt a similar provision for shareholder class actions in North Carolina that mandates review of each party's compliance with Rule 11 of the North Carolina Rules of Civil Procedure[73] and requires that a court impose sanctions if it finds a violation. It is interesting to note that similar sanctions are provided for in the statute that governs derivative suits.[74] This threat of sanctions for meritless claims would discourage profit-seeking attorneys from filing frivolous strike suits alleging breach of fiduciary duty. Furthermore, active judicial discretion in certifying the class can effectively police the claims and prevent strike suits from ever coming into being.[75]

("Since the enactment of [PSLRA], considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts."). In response to this tactic, Congress passed SLUSA, which removed "covered class actions" with over fifty named plaintiffs that allege "an untrue statement or omission of material fact . . . or that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security" to federal court. *See* 15 U.S.C. § 77(p)(b); *see also* Merrill Lynch v. Dabit, ___ U.S ___, ___ 126 S. Ct. 1503, 1510–11 (2006) (discussing Congress's aims in enacting PSLRA and SLUSA). It is important to note that PSLRA and SLUSA are not applicable to the class action suit that is the subject of this Recent Development because the claim brought in *Wachovia* was a pure breach of fiduciary duty claim and did not include a claim of misrepresentation in connection with the sale or purchase of securities.

71. Rule 11 requires each attorney to certify that her pleading, motion, or other paper that is presented to the court is not filed to harass, delay, or needlessly increase the cost of litigation, and that any allegation, contention, or denial of factual contention within are supported by evidence or are likely to be so supported after time for discovery. FED. R. CIV. P. 11(b).

72. *See* 15 U.S.C. § 77z-1(c)(1)–(2).

73. N.C. R. CIV. P. 11. The North Carolina version of Rule 11 closely mirrors the federal rule in that it requires that every attorney filing a court document must certify that it was not filed to harass, delay, or needlessly increase the cost of litigation, and where this rule is violated, sanctions are warranted. *See id.*

74. *See* N.C. GEN. STAT. § 55-7-46 (2005).

75. *See supra* notes 42–43 and accompanying text. Judge Tennille suggested this point in *Wachovia I*. *See In re* Wachovia S'holders Litig. (*Wachovia I*), No. 01 CVS 4486, 2003 WL 22996328, at *6 (N.C. Super. Ct. Dec. 19, 2003), *rev'd*, 168 N.C. App. 135, 607 S.E.2d 48 (2005) ("The derivative action . . . does not afford the trial court the degree of supervision it might exercise in the class action setting.").

In addition, there are further safeguards that the courts can impose to reduce possible abuses of the common benefit doctrine as applied in shareholder class actions. First, by awarding attorney's fees only when a shareholder class action secures a considerable and definable "substantial benefit" for the corporation, courts can ensure that the incentive to litigate only arises when it creates something of definite value to the corporation. If North Carolina adopts a high standard for what constitutes a substantial common benefit, attorneys will not file claims when the chances of the litigation resulting in the conferral of a substantial benefit is questionable. As profit-motivated actors, attorneys likely will not risk outlaying expenses on suits whose success in securing a common benefit for the corporation is remote. If the incentive for bringing meritless strike suits is reduced, attorneys will bring them less often.

As an additional safeguard against potential abuses of the common benefit doctrine, courts should demand that the plaintiff prove the existence of a strong causal connection between the benefit and the litigation before awarding fees in common benefit claims. Because of the tenuous nature of a "substantial benefit," courts may be tempted to accept a nebulous causal connection. To avoid this result, courts should demand a showing of a direct link between the litigation and the resulting substantial benefit. Lastly, courts must be sure to award only what they consider necessary attorney's fees and not fees that are the result of frivolous legal work aimed solely at increasing the fee award. The court should place the burden on the plaintiff's attorney to prove that the fees incurred were reasonably necessary to the litigation, and the court should make a searching inquiry into the fee request. This burden will put plaintiffs' attorneys on notice not to incur unnecessary fees by unduly extending litigation.

In adopting the common benefit doctrine by judicial decision or legislation, North Carolina would be following the example of Delaware, which has adopted the common benefit doctrine,[76] as well as the United States Supreme Court.[77] The award of fees in both shareholder class actions and derivative suits serves as an engine that drives beneficial private oversight of corporations, which can protect corporations from the improper or unadvised decisions of its

76. *See* Tandycrafts, Inc. v. Initio Partners, 562 A.2d 1162, 1164 (Del. 1989) ("In the realm of corporate litigation, the Court may order the payment of counsel fees and related expenses to a plaintiff whose efforts result in the creation of a common fund, or the conferring of a corporate benefit.") (citations omitted).

77. *See* Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 391–92 (1970).

directors.[78] Attorneys file these suits in the hope of obtaining a fee award, but corporations reap the benefits of this economically motivated behavior when unlawful actions are corrected. However, these suits come at a price, which should be addressed by requiring a corporation to pay for the litigation that achieved the common benefit. Because fee awards drive private oversight of corporations, North Carolina should allow the award of fees when necessary to encourage this activity. The North Carolina General Assembly and North Carolina courts have recognized the benefits of fee-driven private oversight of corporations and have fostered it by allowing the award of fees in derivative suits and when litigation results in the securing of a common fund. As such, the state is not well served by precluding the award of fees when a common benefit is secured, especially in the context of state shareholder class actions contesting a merger.

It is interesting that section 55-7-46 of the North Carolina General Statutes provides for the recovery of attorney's fees in derivative suits when a substantial benefit has been conferred on a corporation.[79] This statute codifies the common benefit doctrine in the context of derivative suits[80] and signals legislative approval of the doctrine. In light of the preceding arguments, it does not follow that the General Assembly should award attorney's fees in derivative suits when a common benefit is secured, but not in a shareholder brought class action securing the same.

Some may argue that derivative suits provide procedural protections that help ensure the fee award does not attract vexatious suits, while class action suits do not provide the same protections. In addition, it could be argued that because the plaintiff in derivative suits is suing on behalf of the corporation, the plaintiff should not bear the cost of the litigation, whereas the plaintiffs in the class actions are suing on their own behalf and therefore should bear the costs of litigation. However, these distinctions may prove to be illusory. If the recommendations replicating the protections of

78. *See In re* Fuqua Indus., Inc. S'holder Litig., 752 A.2d 126, 133 (Del. Ch. 1999) (stating that in Delaware "[o]ur legal system has privatized in part the enforcement mechanism for policing fiduciaries by allowing private attorneys to bring suits on behalf of nominal shareholder plaintiffs. In so doing, corporations are safeguarded from fiduciary breaches and shareholders thereby benefit.").

79. N.C. GEN. STAT. § 55-7-46 (2005).

80. *See id.* This statute authorizes a court to "[o]rder the corporation to pay the plaintiff's reasonable expenses, including attorney's fees, incurred in the proceeding if it finds that the proceeding has resulted in a substantial benefit to the corporation." *Id.* § 55-7-46(1).

PSLRA are adopted in North Carolina, courts show a willingness to exercise their discretion in managing class action claims, and fee awards are strictly reviewed for propriety, there would be ample protections against strike suits in class actions claiming breach of fiduciary duty. Furthermore, the substantial benefit that would result in class action litigation would benefit both the corporation and the shareholders. Thus, like the derivative plaintiff, the class action plaintiff is pursuing a result that would benefit the corporation as a whole, not just himself.[81] Accordingly, the class action plaintiff should not bear the cost of litigation himself. The case for the adoption of the common benefit doctrine is further bolstered by its similarity to the common fund doctrine, which North Carolina already recognizes. The adoption of the common benefit doctrine would be a mere extension of the equitable common fund doctrine.

In conclusion, advocating the award of attorney's fees often raises the eyebrows of those who believe that plaintiffs' attorneys take advantage of fee awards at the expense of corporations and shareholders. While this may be true in some instances, a tightly controlled regime of awarding attorney's fees based on the common benefit doctrine can protect against these abuses. The Wachovia/First Union Merger resulted in the creation of the nation's fourth largest bank. Perhaps in light of the overall result, the fact that class action litigation resulted in the invalidation of a deal protection device may seem lilliputian. However, the power of shareholders to police mergers effectively is not. As North Carolina becomes home to more and more public corporations, the law must take account of the change and seek to provide a system that ensures both business growth and proper corporate governance. By incorporating the common benefit doctrine, North Carolina can continue its progress down this important path.

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81. For example, in the lawsuit that is the subject of this Recent Development, the court found that the merger agreement contained an unlawful provision that "tied the hands of Wachovia's board in an impermissible manner." *See In re* Wachovia S'holders Litig. (*Wachovia I*), No. 01 CVS 4486, 2003 WL 22996328, at *2 (N.C. Super. Ct. Dec. 19, 2003), *rev'd*, 168 N.C. App. 135, 607 S.E.2d 48 (2005).