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THE ROLE OF THE OBJECTOR AND THE CURRENT CIRCUIT COURT CONFUSION REGARDING FEDERAL RULE OF CIVIL PROCEDURE 23.1: SHOULD NON-NAMED SHAREHOLDERS BE PERMITTED TO APPEAL ADVERSE JUDGMENTS?

*Cecilia Lacey O'Connell**

A party's right to appeal a final judgment is deeply rooted in American legal tradition.¹ Less certain, however, is a nonparty's right to appeal such judgments.² This ambiguity concerning the right to appeal also arises when the litigation involves non-named parties, such as in cases of class actions and shareholder derivative litigation, wherein absent class members and shareholders are considered parties to the suit only for "certain purposes."³

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1. See ABA Comm. on Standards of Judicial Admin., 3 STANDARDS RELATING TO APPELLATE COURTS § 3.10 commentary, at 18 (1994 ed.) (characterizing appellate review as "a fundamental element of procedural fairness as generally understood in this country"); see also 28 U.S.C. § 1291 (1994) (granting jurisdiction to courts of appeal for all final decisions of the district courts of the United States); FED. R. APP. P. 3, 3-4 (detailing procedural requirements for parties seeking appeal); *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 175 (1803) (noting the importance of appellate review within the American judicial system, as it "revises and corrects the proceedings in a cause already instituted"); Steven Shavell, *The Appeals Process as a Means of Error Correction*, 24 J. LEGAL STUD. 379, 408-11, 425-26 (1995) (proposing that appellate review encourages trial court judges to exercise more diligence and make fewer errors due to the prospect of reversal). Due process guarantees do not mandate appellate review as long as "a full and fair trial on the merits is provided." *Lindsey v. Normet*, 405 U.S. 56, 77 (1972). The *Lindsey* Court noted, however, that when appellate review is afforded, "it cannot be granted to some litigants and capriciously or arbitrarily denied to others without violating the Equal Protection Clause." *Id.* at 77.

2. See 15A CHARLES ALAN WRIGHT ET. AL, FEDERAL PRACTICE AND PROCEDURE § 3902.1, at 102 (2d ed. 1992). Although the rule that a nonparty cannot appeal a judgment appears "sensible," there exists a range of exceptions to this axiom whereby nonparties should be treated as parties due to their interest in or relationship to the pending litigation. See *id.* at 102-06. The law, however, remains unsettled and courts have failed to formulate uniform standards governing nonparty appeals. See *id.* at 102.

3. See 1 HERBERT B. NEWBERG, NEWBERG ON CLASS ACTIONS §§ 1.07-.08 (2d ed. 1985) (highlighting the legal inconsistencies of nonparty status and noting that while class members are considered parties as to the binding effect of judgments, they are not considered parties for purposes of filing briefs or motions and actively participating in trial); see

In class actions and shareholder derivative suits, members of a class aggregate their claims and entrust a named representative to litigate a common complaint on their behalf.⁴ Such a system permits the litigation of claims that otherwise would remain unheard due to the claim's small size relative to the costs of trial.⁵ Litigation under Federal Rule of Civil Procedure 23.1 (Rule 23.1 or Rule), for example, specifically provides a necessary check on corporate management through the use of derivative

also Deposit Guar. Nat'l Bank v. Roper, 445 U.S. 326, 357 (1980) (Powell, J., dissenting) (emphasizing the risks inherent in ambiguous party status and the problems presented when courts analyze class members' rights in terms of physical presence rather than interest in the litigation). Case law and commentaries use various terms denoting status, sometimes interchangeably. Within the context of this Comment, however, those who are members of a shareholder class but are neither the named representatives nor formal parties will be termed non-named parties.

4. See FED. R. CIV. P. 23(a) (stating "[o]ne or more members of a class may sue or be sued as representative parties"); FED. R. CIV. P. 23.1 (stating "[i]n a derivative action brought by one or more shareholders . . . [t]he derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated"); 5 MOORE'S FEDERAL PRACTICE § 23.02, at 23-22 to 23-23 (3d ed. 1998) (explaining that the purpose of representative litigation is to achieve expeditious and economic resolution of multi-party litigation); see also General Tel. Co. of the Southwest v. Falcon, 457 U.S. 147, 156 (1982) (emphasizing that class actions are the exception to the rule that litigation is conducted by named parties); Gottlieb v. Wiles, 11 F.3d 1004, 1011 (10th Cir. 1993) (discussing the need for protective mechanisms in both class actions and derivative litigation due to the representative nature of the suits); Timothy A. Duffy, Comment, *The Appealability of Class Action Settlements by Unnamed Parties*, 60 U. CHI. L. REV. 933, 933 (1993) (emphasizing the need for increased court supervision and procedural safeguards in class actions due to reliance upon a class representative).

Often the term "class member" is utilized to refer to a non-named party in Rule 23 class action litigation. See, e.g., 1 NEWBERG, *supra* note 3, §§ 1.07-.08. In the context of Rule 23.1 litigation, shareholder derivative actions, which is considered a special type of class action no longer governed by Rule 23, parties other than the named representative are generally referred to as "non-named parties," perhaps in an effort to connote the relevant rule. Compare 5 MOORE'S FEDERAL PRACTICE, *supra*, §§ 23.1.10[1][b] (using the term "non-parties" to refer to absent shareholders) with HON. THOMAS A. DICKERSON, CLASS ACTIONS: THE LAW OF 50 STATES § 1.10[1] (1998) (referencing "class members" in discussing absent parties in the class action context). See generally 5 MOORE'S FEDERAL PRACTICE, *supra*, §§ 23 App.101, at 23App.-24 to 23App.-25 (discussing the evolution of Rule 23(b) to Rule 23.1); 23.1 App.100, at 23.1App.-7 to 23.1App.-8, § 23.1.02[5] (discussing the interaction between Rules 23 and 23.1).

5. See *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1309 (3d Cir. 1993) (emphasizing the purpose of class and derivative litigation as enabling small claims to be litigated); see also John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 677-78 (1986) (analyzing the role of "agency costs" in representative litigation and recognizing that the class members often have "only a nominal stake" in the resolution of the suit). See generally Duffy, *supra* note 4, at 940-44 (providing an overview of judicial approaches to the appealability of representative litigation while considering as a variable the level of the plaintiff's interest in the suit).

suits.⁶ By permitting the assembly of a class of shareholders, the derivative suit seeks a collective remedy for injuries to corporate interests, while the reality of potential litigation forcefully deters future abuse of the corporate form and director misconduct.⁷ Although this access to judicial redress, without the personal expenditure of time and cost for complex litigation, can benefit a non-named party initially, the final disposition of the case may prove less satisfactory.⁸ Often, after relinquishing control of the claim to a named representative, a non-named party may find the proffered settlement inadequate.⁹ Yet, the non-named

6. See FED. R. CIV. P. 23.1 (providing for suit by one or more shareholders when a corporation has neglected to enforce a legal right); see also *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 547-48 (1949) (discussing the need for procedural devices to permit shareholders to litigate on behalf of a corporation in the context of a state derivative statute). Incorporation vested management with broad discretion in the execution of "other people's money," while the increased dispersal of shareholders and resulting lack of effective accountability of corporate management provided increased opportunities for abuse. See *id.* at 547. Equity provided a remedy to this "stockholder helplessness" through the shareholder derivative suit and thus became "the chief regulator of corporate management." See *id.* at 548; see also Daniel J. Dykstra, *The Revival of the Derivative Suit*, 116 U. PA. L. REV. 74, 77, 80 (1967) (arguing the importance of the derivative suit and its "increasingly essential role in [the] economy" by citing the "broad managerial discretion" afforded directors in terms of "property, dividends, capital, compensation, indemnification, preemptive rights, by-laws, and delegation of authority") (footnotes omitted). See, e.g., DEL. CODE ANN. tit. 8, §§ 121-22, 141-145 (1998) (listing the broad powers and duties conferred upon corporate management).

7. See *Cohen*, 337 U.S. at 548 (noting that the derivative device "afford[s] no small incentive to avoid . . . grosser forms of betrayal of stockholders' interests"); Dykstra, *supra* note 6, at 78-79 (emphasizing the role of the derivative suit as the "corporate policeman" who "day in and day out" monitors the internal affairs of a corporation, bridging the separation of control and ownership and thereby checking any tendency toward corporate misconduct); George D. Hornstein, *Future of Corporate Control*, 63 HARV. L. REV. 476 (1950) (arguing that the existence of the device proves to be a significant deterrent to corporate misconduct). But see Bryant G. Garth et al., *Empirical Research and the Shareholder Derivative Suit: Toward a Better-Informed Debate*, 48 LAW & CONTEMP. PROBS. 137, 139 (1985) (arguing against the significance of the shareholder device in today's corporate world due to the "illusory or de minimis compensation" secured by shareholders as a remedy, and the questionable role of shareholders and courts removed from the pressures of the everyday business world in establishing standards of moral conduct for corporations).

8. See Reinier Kraakman et al., *When Are Shareholders Suits in Shareholder Interests?* 82 GEO. L.J. 1733, 1735-37 (1994) (noting the low rate of success for shareholder suits considering the high monetary awards to plaintiffs' counsel; constructing an economic model to ascertain whether shareholders, rather than only the corporation, actually benefit from representative litigation).

9. See *Rosenbaum v. MacAllister*, 64 F.3d 1439, 1443-47 (10th Cir. 1995) (determining the standing of an objector to a shareholder suit who argued that the proffered settlement, which included over \$2.5 million in attorney's fees and only corporate governance measures, did not benefit the corporation); *Bell Atlantic*, 2 F.3d at 1310-11 (arguing that corporate governance measures secured by the named plaintiff were "illusory"); Tryforos

party's ability to object to the settlement may be limited.¹⁰

Courts have struggled recently with the proper procedural limitations to place upon non-named parties desiring to appeal the dismissal or settlement of class action and shareholder derivative litigation.¹¹ In several circuits, a non-named party is now required to intervene formally in the litigation to preserve a right to appeal the merits of the judgment.¹² In others, an appearance is the only prerequisite to the right to appeal.¹³ This Term, an evenly divided United States Supreme Court affirmed, without opinion, a circuit court decision requiring intervention, further obscuring the right to appellate review for individuals within a class of persons.¹⁴ Due to the absence of judicial guidance from the Supreme Court and the continued incongruity of federal procedural law, the issue of appealability by non-named parties in derivative litigation is of paramount concern.¹⁵

This Comment first examines the development of Rule 23.1, emphasizing its equitable origins and shared history with Federal Rule of Civil Procedure 23 (Rule 23). Part I explores the operation of the Rule during

v. Icarian Dev. Co., 518 F.2d 1258, 1260-63 (7th Cir. 1975) (determining an objector had standing to argue against the default judgment of shareholder litigation following the named plaintiffs' failure to litigate the case).

10. See 7C CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 1839, at 182 (2d ed. 1986) (stating that an objector to a settlement can appeal the settlement order but the objector's right to appeal may be limited). *But see* 15A WRIGHT ET AL., *supra* note 2, § 3902.1, at 102-03 (stating that nonparties of any kind, including shareholder objectors, have no right to appeal adverse settlements).

11. Compare *In re Painewebber Inc. Ltd. Partnerships Litig.*, 94 F.3d 49, 53 (2d Cir. 1996) (holding that non-named class members need not intervene to preserve the right to appeal); *Carlough v. Amchem Prods., Inc.*, 5 F.3d 707, 713 (3d Cir. 1993) (same); *In re Cement Antitrust Litig.*, 688 F.2d 1297, 1309 (9th Cir. 1982) (same), *with Shults v. Champion Int'l Corp.*, 35 F.3d 1056, 1059, 1061 (6th Cir. 1994) (requiring intervention pursuant to Federal Rule of Civil Procedure 24); *Croyden Assocs. v. Alleco, Inc.*, 969 F.2d 675, 679-80 (8th Cir. 1992) (same); *Walker v. City of Mesquite*, 858 F.2d 1071, 1073-74 (5th Cir. 1988) (same); *Guthrie v. Evans*, 815 F.2d 626, 628 (11th Cir. 1987) (same). See generally *infra* Parts I.D., II. (discussing the circuit split).

12. See *Felzen v. Andreas*, 134 F.3d 873, 876 (7th Cir. 1998), *cert. granted in part sub nom. California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 29 (1998), *aff'd* 119 S. Ct. 720 (1999); *Shults*, 35 F.3d at 1061; *Loran v. Furr's/Bishop's Inc.*, 988 F.2d 554, 554 (5th Cir. 1993); *Croyden Assocs.*, 969 F.2d at 679-80; *Guthrie*, 815 F.2d at 628-29.

13. See *Bell Atlantic*, 2 F.3d at 1310; see also *Gottlieb v. Wiles*, 11 F.3d 1004, 1011 (10th Cir. 1993) (discussing the Seventh Circuit's decision).

14. See *California Pub. Employees' Retirement Sys.*, 119 S. Ct. 720 (1999).

15. See *Petition for a Writ of Certiorari at 1, Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998) (asserting that the current circuit split creates confusion regarding federal procedural law and the purpose of Rule 23); *Shareholder Lawsuits: Nonintervenor Cannot Later Appeal Settlement*, NAT'L L.J., Feb. 1, 1999, at B23 [hereinafter *Shareholder Lawsuits*] (concluding that "the Supreme Court's 4-4 split means the issue will remain clouded").

the dismissal or settlement of an action, and the competing approaches of the circuits in determining the requirements for the preservation of appeal by non-named parties. Next, Part II analyzes the implications of these distinct approaches, on both the shareholder derivative suit as a judicial device and in the context of the goals and purposes of the Federal Rules of Civil Procedure. Part III asserts that requiring an appearance by an objecting non-named party, rather than formal intervention, will most adequately serve the principles of the American judicial system. This Comment concludes by recommending the use of new judicial mechanisms in tandem with existing provisions of federal procedure to reinforce the efficacy of an appearance requirement.

I. THE RISE OF RESTRICTIONS ON APPELLATE REVIEW UNDER FEDERAL RULE OF CIVIL PROCEDURE 23.1

A. Federal Rule of Civil Procedure 23.1

Rule 23.1 establishes the procedure through which the judiciary enforces the fiduciary duties of corporate managers.¹⁶ To litigate a corporate injury, one or more stockholders sues derivatively in place of the corporation that has neglected or declined to enforce a legal right.¹⁷

16. See FED. R. CIV. P. 23.1 (stating that the scope of the Rule applies to shareholders who wish “to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it”); see also Kraakman et al., *supra* note 8, at 1733-34. Rule 23.1 sets forth only the procedural requirements of shareholder derivative actions. See FED. R. CIV. P. 23.1; see also *Brown v. Ferro Corp.*, 763 F.2d 798, 802-03 (6th Cir. 1985) (applying substantive law of Ohio and federal procedural rules to shareholder action). Derivative suits are therefore subject to state substantive law and can be heard only by federal courts on the basis of diversity jurisdiction or a federal question. See *id.*; see also Rules Enabling Act, 28 U.S.C. § 2072(b) (1994) (prohibiting federal procedural rules from enlarging substantive rights); *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 79-80 (1938) (holding that state substantive law and federal procedural law apply in diversity actions).

17. See FED. R. CIV. P. 23.1; Kraakman et al., *supra* note 8, at 1734; see also 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, § 23.1.02[3][b], at 23.1-10 to -11 (listing types of corporate injuries that can be litigated through a derivative suit). Acceptable claims may include: fraud on the corporation, see *Bagdon v. Bridgestone/Firestone, Inc.*, 916 F.2d 379, 383 (7th Cir. 1990), failure of the corporation to pursue legal rights or litigation, see *Peck v. General Motors Corp.*, 894 F.2d 844, 847-48 (6th Cir. 1990), or claims against corporate officers or majority shareholders for waste or mismanagement, see *Burghart v. Landau*, 821 F. Supp. 173, 177 (S.D. N.Y. 1993), *aff'd* 9 F.3d 1538 (2d Cir. 1993). But see *Hawes v. Oakland*, 104 U.S. 450, 460 (1881) *impliedly overruled by* *Kamen v. Kemper Financial Services, Inc.*, 500 U.S. 90 (1991) (dismissing a shareholder claim due to the personal nature of the asserted right; emphasizing the importance of the corporate structure within the shareholder suit). Examples of injuries that must be pursued through standard litigation because they are direct or personal and not “corporate” in nature include actions to compel dividends, suits arising from interference with voting rights, and

In 1966, the promulgation of Rule 23.1 separated derivative actions from Rule 23 class actions.¹⁸ Rule 23.1 requires a litigant to comply with several procedural safeguards: verification of the complaint as involving a corporate injury; a statement of contemporaneous ownership of stock; an affirmative allegation of a lack of collusion among the shareholders; and an explanation of the exhaustion of internal, non-judicial remedies.¹⁹ In recognition of the representative nature of derivative litigation, the Rule warns that a suit is subject to dismissal should the named plaintiff cease to “fairly and adequately represent” the concerns of the class of shareholders.²⁰

Reflecting the public policy favoring settlement of derivative litigation prior to a decision on the merits,²¹ the Rule includes two specific re-

individual contract claims. See 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, § 23.1.02[3][b], at 23.1-11 to -12.

18. See FED. R. CIV. P. 23.1, advisory committee's note on the 1966 Amendments. Equity Rule 94, adopted in 1882 by the Supreme Court to codify prior case law originally governed shareholder derivative litigation. See 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, § 23.1App.100 (Historical Appendix). The rule required “[e]very bill brought by one or more stockholders in a corporation, against the corporation . . . which may properly be asserted by the corporation must be verified by oath and must contain an allegation that the plaintiff was a shareholder.” Equity Rule 94, 104 U.S. ix., ix-x. (1882) (superseded by Equity Rule 27). In 1912, Equity Rule 27 replaced Equity Rule 94 with only slight modification. See RALPH C. FERRARA ET AL., SHAREHOLDER DERIVATIVE LITIGATION: BESIEGING THE BOARD § 1.03, at 1-17 (1998). The most textually similar current rule is Federal Rule of Civil Procedure 23(b) adopted in 1938. See *id.*; see also 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, § 23.1App.100, at 23.1App-7 to -8.

Due to the inclusion of derivative litigation within the class action procedure, Rule 23.1 utilized similar procedures for dismissal and compromise as class actions. See 7C WRIGHT ET AL., *supra* note 10, § 1821, at 13. In 1966, extensive revision of Rule 23 resulted in the separation of derivative litigation and class actions into two separate rules through the adoption of Rule 23.1. See FED. R. CIV. P. 23.1, advisory committee's note on the 1966 Amendments. This revision formally included the requirements of notice and the dismissal or compromise and adequate representation in the text of Rule 23.1. See FED. R. CIV. P. 23.1 advisory committee's note on the 1966 Amendments; see also FERRARA ET AL., *supra*, § 1.03, at 1-19-20. One of the reasons for this demarcation was the recognition that derivative actions could be brought even when the number of shareholders was too small to justify a class action. See 7C WRIGHT ET AL., *supra* note 10, § 1821, at 13-14. Derivative and class actions may still be combined, however, when the injury alleged affects the entire corporation and is maintainable by a number of shareholders as a class. See, e.g., *Rosenbaum v. MacAllister*, 64 F.3d 1439, 1441 (10th Cir. 1995).

19. See FED. R. CIV. P. 23.1 (listing pleading requirements).

20. See *id.*; see also *Larson v. Dumke*, 900 F.2d 1363, 1364, 1366-67 (9th Cir. 1990) (utilizing an abuse of discretion standard on appeal, to ascertain whether the trial court's finding of adequate representation was appropriate); *Davis v. Comed, Inc.*, 619 F.2d 588, 593-94 (6th Cir. 1980) (listing factors to consider in determining the adequacy of the plaintiff shareholders as representatives of the class).

21. See *In re Pacific Enter. Sec. Litig.*, 47 F.3d 373, 378 (9th Cir. 1995) (noting the judicial policy favoring settlement of shareholder derivative litigation; stating that derivative shareholder suits that proceed to trial are “rarely successful”); *Maher v. Zapata Corp.*, 714

quirements concerning the dismissal or compromise of the cause of action.²² First, prior to the resolution of the litigation, notice of the compromise must first be sent to all shareholders, and second, the court must approve the settlement based on fairness.²³

B. Early Law: An Emphasis on Equitable Considerations

Courts deciding shareholder derivative claims predating the adoption of the Federal Rules of Civil Procedure often considered the equitable origins of derivative actions.²⁴ At common law, a shareholder wishing to redress a corporate injury, such as a director's breach of fiduciary duty, lacked sufficient standing because the corporation, and not the shareholder, suffered the injury-in-fact.²⁵ Equity overlooks this distinction and permits the shareholder to stand in the shoes of the corporation and seek relief.²⁶ Thus, even though the corporation is designated as the defendant, the corporation is actually the plaintiff, suing in the name of an

F.2d 436, 455 (5th Cir. 1983) (favoring settlements of shareholder litigation due to the "unpredictable" nature of such suits); *see also* CARL ROBERT ARON ET AL., 2 CLASS ACTIONS: LAW & PRACTICE § 26:17 (1987) (recognizing both in practice and caselaw "a clear public policy" favoring out of court resolution of shareholder derivative litigation); *cf.* Bell Atlantic Corp. v. Bolger, 2 F.3d 1304, 1314 n.16 (3d Cir. 1993) (reasoning that the Federal Rules of Civil Procedure are designed to encourage settlements).

22. *See* FED. R. CIV. P. 23.1 (requiring notice and court approval of a settlement); *see also* Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 532 n.7 (1984) (emphasizing that the requirement of notice and court approval are designed to protect the legitimate interests of the company and its shareholders).

23. *See* FED. R. CIV. P. 23.1; *see also* Hansberry v. Lee, 311 U.S. 32, 40 (1940) (holding that due process requires that a litigant whose rights are adjudicated be afforded notice and an opportunity to be heard); Papilsky v. Berndt, 466 F.2d 251, 257-58 (2d Cir. 1972) (ruling that notice is essential to ensuring that the interests of the corporation and *absent* stockholders are addressed); 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, § 23.1.10[2][a] (listing substantive requirements for voluntary dismissals including fairness, adequacy, reasonableness, and a lack of fraud or collusion; noting the importance of such considerations given the interests of non-party shareholders).

24. *See, e.g.,* Hawes v. Oakland, 104 U.S. 450, 453 (1881), *impliedly overruled by* Kamen v. Kemper Financial Services, Inc., 500 U.S. 90 (1991); Dodge v. Woolsey, 59 U.S. (18 How.) 331, 341 (1855); *see also* FERRARA ET AL., *supra* note 18, § 1.03 (providing an overview of the equitable history of Rule 23.1).

25. *See* Lewis v. Knutson, 699 F.2d 230, 237-38 (5th Cir. 1983). *See generally* Fox, 464 U.S. at 527-28 (discussing the nature of the corporate injury and the necessary reliance upon equitable principles to create a cause of action).

26. *See* Hawes, 104 U.S. at 454 (stating that the equitable principles discussed in *Dodge* allow a stockholder "to step in between" the corporation and the wrongdoer and take control of the litigation of rights belonging to the corporation); *see also* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 547-48 (1949) (noting the rationale for the application of equitable remedies, as the separation of control and ownership in the corporate structure).

owner, the shareholder.²⁷

The Supreme Court's decision in *Dodge v. Woolsey*²⁸ is generally considered the first to "firmly establish[]" American courts' ability to dispose of shareholder derivative actions through equitable devices.²⁹ The Court provided remedies that were otherwise unavailable to the single litigant, by granting standing through equity, to a bank shareholder desiring to redress the corporate bank's willingness to pay an unconstitutional tax.³⁰ In response to the Court's permissive holding in *Dodge*, numerous shareholders filed derivative suits.³¹

In *Hawes v. Oakland*,³² the Court subsequently imposed several procedural and substantive guidelines for derivative litigation, narrowing the availability of the remedy but preserving its equitable nature.³³ A shareholder in the Contra Costa Waterworks Company filed suit against the

27. See *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) (referring to the dual nature of the corporate entity in shareholder derivative suits).

28. 59 U.S. (18 How.) 331 (1855).

29. FERRARA ET AL., *supra* note 18, § 1.03, at 1-13. The court rationalized the intervention between the corporation and its owners by citing a breach of trust. See *Dodge*, 59 U.S. at 341. The Court noted,

[i]t is now no longer doubted, either in England or the United States, that courts of equity, in both, have a jurisdiction over corporations, at the instance of one or more of their members; to apply preventative remedies by injunction, to restrain those who administer them from doing acts which would amount to a violation of charters, or to prevent any misapplication of their capitals or profits.

Id.; see also FERRARA ET AL., *supra* note 18, § 1.03, at 1-13 (discussing the role of equity in the *Dodge* rationale).

30. See *Dodge*, 59 U.S. at 339, 341; see also FERRARA ET AL., *supra* note 18, § 1.03, 1-13 to -14 (concluding that equity provided a form of recovery for the shareholder who had no standing at law to commence a civil action for a director's breach of fiduciary duties). A single litigant was barred from bringing an action on his own behalf as the grievance alleged was not personal. See *Cohen*, 337 U.S. at 547-48. See generally 7C WRIGHT ET AL., *supra* note 10, § 1821, at 9 (discussing the equitable origins of Rule 23.1 and emphasizing the corresponding application of equity maxims and principles to shareholder derivative litigation).

31. See *Hawes*, 104 U.S. at 452 (stating that the issue of shareholder derivative standing is "a matter of very great interest, and of growing importance in the courts of the United States;" describing the recent abuses of the device by shareholders to gain federal jurisdiction over claims); see also FERRARA ET AL., *supra* note 18, § 1.03, at 1-15.

32. 104 U.S. 450 (1881).

33. See *Hawes*, 104 U.S. at 452, 460-61 (justifying the use of the equitable device and limiting its use to certain corporate wrongs after exhaustion of extra-judicial remedies and pleading of grievances with particularity); see also *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 530-33 (1984) (discussing the Court's decision in *Hawes* as predicated upon the need to establish defined requirements for maintaining a derivative suit in light of the potential for abuse); FERRARA ET AL., *supra* note 18, § 1.03, at 1-15 to -16 (underscoring that the *Hawes* Court issued procedural requirements in the wake of numerous shareholder suits).

company, the City of Oakland, and trustees and directors of the company.³⁴ The substance of the shareholder's allegation involved the unlawful conversion of the company's water by the city for non-emergency uses.³⁵ The shareholder argued that the company's compliance with the city's demand for use of the water decreased the value of his shares.³⁶ The lower court dismissed the case for lack of standing and the absence of a valid controversy, on the basis that the corporate by-laws included a water agreement with the city.³⁷

On appeal, the Supreme Court fleetingly discussed the merits of the case but spent considerable time refining the necessary elements of a corporate cause of action.³⁸ Noting the characteristics of the "body politic and corporate," as well as equitable principles espoused in several English cases, the Court refused to extend jurisdiction to a shareholder pursuing an essentially personal claim.³⁹

The *Hawes* Court then set forth the circumstances that would permit a stockholder to sustain, in his own name, a suit that litigates corporate rights.⁴⁰ These substantive circumstances include *ultra vires* actions by

34. See *Hawes*, 104 U.S. at 450-51.

35. See *id.* at 451.

36. See *id.*

37. See *id.* at 451-52.

38. See *id.* at 450-52 (discussing the merits of the case); at 452-60 (reviewing the equitable history of shareholder suits and the *Dodge* decision); at 460-62 (delineating elements of a proper shareholder cause of action).

39. See *id.* at 453-54, 461-62. The Court characterized the personal injury complained of in the case before it as "diminished" dividends. See *id.* at 462.

40. See *id.* at 460-61. The issue of whether an injury is corporate or personal is still debated. See 7C WRIGHT ET AL., *supra* note 10, § 1821, at 8-9 (noting the determination of whether a suit is derivative or direct is not resolved easily). The courts today often term the injury either "[d]irect," and therefore personal to the shareholder, or indirect, and therefore necessitating that the shareholder sue "derivatively." See *id.* at 4-8. Specifically, the cause of action must be founded upon a corporate right for the shareholder to maintain the action on a representative, not personal, basis. See *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 528 (1984). Correspondingly, the remedy sought must benefit the whole corporation. See *Gottlieb v. Wiles*, 11 F.3d 1004, 1014-15 (10th Cir. 1993).

Today the text of Rule 23.1 refers to the verification of a corporate cause of action, noting that the injury to the corporation must be alleged as "enforc[ing] a right which may properly be asserted by it." FED. R. CIV. P. 23.1. This verification requirement is often linked to a desire to avoid "strike suits," in which a shareholder brings a suit lacking substantial factual basis, with the goal of obtaining a settlement. See *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 370-71 (1966) (assessing the verification requirement in light of "strike suit" abuse); see also FERRARA ET AL., *supra* note 18, § 1.03, at 1-18 (defining a "strike suit" as a suit lacking a basis in law or fact and instead being brought "simply for the purpose of obtaining an extortion-like settlement from the defendants or the corporation's management"). See generally John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 13-33

corporate management,⁴¹ fraudulent transactions by management that could damage the corporation or shareholders' interests, destructive or oppressive actions of either corporate ownership or a majority of shareholders, and "other cases" justifying the exercise of equitable powers to prevent "irremediable injury."⁴² Perhaps due to the breadth of this last category, the Court attached several additional limitations to the pleading stage of derivative actions.⁴³

During the same term as the decision in *Hawes*, the Court codified the procedural limitations through the adoption of Equity Rule 94.⁴⁴ More than one hundred years after *Hawes* and the subsequent adoption of federal rules governing civil procedure, the courts continue to apply these equitable principles and criteria to shareholder derivative litigation.⁴⁵

(1985) (providing an economic analysis of "strike suits"; proposing that multiple cases must be considered to understand the merit of frivolous actions to plaintiff attorneys).

41. The term *ultra vires* refers to acts beyond the scope of the powers of a corporation as delineated in the corporate charter. See *State ex rel. v. Holston Trust Co.*, 79 S.W.2d 1012, 1016 (Tenn. 1935). The *Hawes* Court noted that when a corporate board of directors acts in its own interests or in a manner destructive of the company, the aid of equity could be invoked. See *Hawes*, 104 U.S. at 460.

42. *Hawes*, 104 U.S. at 460.

43. See *id.* at 460-61. These limitations included a showing by the shareholder, "to the satisfaction of the court," that internal remedies had been previously pursued. See *id.* Rule 23.1 retains this requirement today and courts commonly refer to it as the "intra-corporate" demand. See FED. R. CIV. P. 23.1 (stating that "[t]he complaint shall also allege . . . the efforts . . . made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority").

In addition to averring with particularity a shareholder's initial non-judicial attempts, the shareholder must allege that he or she was an owner of the stock at the time of the complained-of transgressions or that he or she received the shares by operation of the law. See *Hawes*, 104 U.S. at 461. This requirement continues today and is known as the "contemporaneous ownership" requirement. See 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, at § 32.1.07[1]; FED. R. CIV. P. 23.1 (stating that the plaintiff must be "a shareholder . . . at the time of the transaction of which the plaintiff complains or . . . devolved on the plaintiff by operation of law"). Finally, in response to the spate of shareholder suits utilizing the diversity of shareholder citizenship to gain federal jurisdiction, the *Hawes* Court required an affirmative statement by the shareholder that the suit was not collusive. See *Hawes*, 104 U.S. at 461. Rule 23.1 still requires this preliminary statement. See FED. R. CIV. P. 23.1.

44. See *Quincy v. Steel*, 120 U.S. 241, 245 (1887) (referring to *Hawes* and stating "[i]n order to give effect to the principles there laid down this court at that term adopted Rule 94 of the Rules of Practice for Courts of Equity of the United States"); 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, at § 23.1App.01[3].

45. See, e.g., *Fox*, 464 U.S. at 528 (addressing the corporate right and injury prerequisites); *Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R. Co.*, 417 U.S. 703, 708 (1974) (mandating "contemporaneous ownership" and disregarding the corporate entity in deference to fairness and public interest); *Sax v. World Wide Press, Inc.*, 809 F.2d 610, 614-15 (9th Cir. 1987) (ruling that the grievance pleaded by the plaintiff was essentially personal in nature and not the proper subject of a shareholder derivative action).

The equitable origins of Rule 23.1 have also led to the use of equitable defenses in

C. Operation of the Rule: Mechanics of Dismissal and the Influence of Rule 23

The unique attributes and equitable origins of Rule 23.1 account for the requirements that notice and court approval be effected prior to finalizing any settlement.⁴⁶ These requirements aim to increase shareholder participation and to prevent private settlement of a suit that allows the named plaintiff and his or her counsel to profit personally.⁴⁷

In addition to encouraging just settlements, courts have utilized the notice requirement to assess whether a non-named party should be granted appellate review.⁴⁸ In *Cohen v. Young*,⁴⁹ the Sixth Circuit held that an objector to a shareholder derivative settlement had standing to argue on appeal against the merits of the compromise and the right to present evidence.⁵⁰ Of central importance to the court's reasoning was the objector's appearance in court, in response to the court's show cause notice regarding the proposed settlement.⁵¹ The court analogized this notice to a summons by process of the court, and held that the appellant was a party of right.⁵² This status automatically provided the objector with a right to present evidence and to advocate in court against the compro-

shareholder derivative actions. See 7C WRIGHT ET AL, *supra* note 10, § 1821, at 12; see also *Koster v. (American) Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 530-532 (1947) (permitting the application of the equitable defense that one who seeks redress from a court of equity must do equity).

46. Cf. FED. R. CIV. P. 23.1 (requiring notice and court approval of dismissal or compromise in derivative actions); Amendments to Rules on Civil Procedure – Admiralty and Maritime – Criminal Procedure with Report of the Judicial Conference, 39 F.R.D. 73, 108 (1966) (Advisory Committee's Note on Rule 23.1) (noting the distinctive aspects of shareholder litigation, which necessitated a separate rule and additional procedural requirements; supporting the court's authority to direct settlement proceedings by noting the "inherent power" of the court); cf. also 1 NEWBERG, *supra* note 3, § 22.81, at 162 & n.422 (explaining that although class actions and derivative litigation create similar procedural problems, the division of the two rules resulted in separate, specific requirements for each); *supra* notes 21-22 and accompanying text (discussing the tendency toward settlement in representative litigation and the need for corresponding protective mechanisms).

47. See 7 WRIGHT ET AL., *supra* note 10, § 1839, at 175-76 (asserting that requirements of court approval and notice afford protection to shareholders from disadvantageous settlements).

48. See *Shults v. Champion Int'l Corp.*, 35 F.3d 1056, 1061 (6th Cir. 1994) (determining that the notice of a class action settlement was not sufficiently "mandatory" and therefore did not necessitate a grant of appellate review); *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942) (concluding that a non-named shareholder had standing to appeal the merits of a settlement as the notice was analogous to a court summons).

49. 127 F.2d 721 (6th Cir. 1942).

50. See *id.* at 724.

51. See *id.*

52. See *id.* The court expanded this grant of standing by concluding that implicit in a right to appeal is a general right to be heard. See *id.*

mise.⁵³

The Sixth Circuit further supported this broad grant of judicial audience by addressing the purpose of court notice.⁵⁴ Emphasizing that the goals of then-Rule 23(c) did not justify settlements that were solely the product of attorneys' recommendations, the court noted that implicit in the notice requirement is a request for "broader information."⁵⁵ This procedure benefits the court considering a settlement, through the receipt of advice and "views of all parties concerned."⁵⁶ Consequently, an objector to a settlement may serve to ensure a more judicious and informed settlement.⁵⁷

Should a shareholder subsequently learn of the settlement by court notice, however, his or her ability to object to the proposed compromise presently varies by jurisdiction depending on the form of the objections.⁵⁸ The forms of objection available to non-named parties arguing against a settlement may include written objections, appearance at the hearing by counsel, or appearance at the hearing by the non-named party.⁵⁹ Some courts have required formal intervention pursuant to Federal Rule of Civil Procedure 24.⁶⁰

53. *See id.*

54. *See id.* at 725.

55. *Id.*

56. *Id.* The court summarized its analysis, stating "the rule was adopted to secure not routine approval of a consent decree, but in order to insure supervision of the court for the protection of the corporation and all the stockholders." *Id.*

57. *See id.* at 725-26 (concluding that the court would be unable to protect the interests of the corporation and the hundreds of absent stockholders through singular reliance upon the advice of plaintiff's counsel).

58. *See supra* notes 10-14 and accompanying text (noting the current circuit court split regarding requirements to preserve appellate review).

59. *See Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1310 (3d Cir. 1993) (granting appellate review to non-named parties who attended settlement hearing and voice opposition); *Tryforos v. Icarian Development Co.*, 518 F.2d 1258, 1261 (7th Cir. 1975) *overruled by Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998) (concluding that written objections to the form of dismissal were sufficient to gain appellate review and within the "underlying purpose" of Rule 23.1's notice requirement); 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, § 23.1.10[3] (discussing current circuit confusion and noting various forms of objection utilized by non-named shareholders).

60. *See, e.g., Felzen v. Andreas*, 134 F.3d 873, 876 (7th Cir. 1998) *aff'd sub nom* California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999); *Shults v. Champion Int'l Corp.*, 35 F.3d 1056, 1061 (6th Cir. 1994); *Loran v. Furr's/Bishop's Inc.*, 988 F.2d 554, 554 (5th Cir. 1993); *Croyden Assocs. v. Alleco, Inc.*, 969 F.2d 675, 678-80 (8th Cir. 1992); *see also* FED. R. CIV. P. 24(a)(2) (stating "when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition . . . may . . . impair or impede the applicant's ability to protect that interest" an applicant will be permitted to intervene and become a named party "unless the applicant's interest is adequately represented by existing parties"). *Commen-*

These varying requirements regarding the proper steps an objector must take to secure an appeal are further complicated by the United States Supreme Court's ruling in *Marino v. Ortiz*.⁶¹ In *Marino*, white police officers, who were not parties to a consolidated class action arising under Title VII of the Civil Rights Act of 1964, objected to the consent decree.⁶² Although the officers presented objections to the district court, their failure to intervene formally proved destructive to their claim.⁶³ The Supreme Court, adopting a literal interpretation of Federal Rule of Appellate Procedure 3(c), concluded that the law regarding nonparty appeals was "well settled."⁶⁴ The text of Federal Rule of Appellate Procedure 3(c) utilizes the terms "party" and "parties" in delineating the necessary procedures for appeal.⁶⁵ The Court adhered to a strict textualist analysis of the rule, despite its admission that an exception could be entertained "when the nonparty has an interest that is affected by the trial court's judgment."⁶⁶ Refusing to depart from the literal words of Federal Rule of Appellate Procedure 3(c), the Court summarily held that it was "better practice . . . for such a nonparty to seek intervention for purposes of appeal."⁶⁷

tators continue to debate the "ease" of intervention. See Duffy, *supra* note 4, at 954-55; N.E. Paolini, Recent Development, *Walker v. City of Mesquite: The Nonappealability of Class Action Consent Decrees by Nonnamed Class Members*, 63 TUL. L. REV. 1732, 1738 (1989) (noting the inherent problems for class members in securing intervention, as the very nature of representative litigation assumes adequate representation of class members' interests by the named plaintiffs).

61. 484 U.S. 301 (1988) (per curiam).

62. See *id.* at 302-04.

63. See *id.* at 304.

64. See *id.* In addition to citing the rule and case law, the Court referenced *United States ex rel. Louisiana v. Jack*, 244 U.S. 397, 402 (1917). See *Marino*, 484 U.S. at 304. That seminal case denied Louisiana's request to appeal the purchase of land by a private individual from a state agency. See *Jack*, 244 U.S. at 398. The Court stated the reason for the denial as "no person can bring a writ of error [an appeal is not different] to reverse a judgment who is not a party or privy to the record." *Id.* at 402 (quoting *Bayard v. Lombard*, 9 How. 530, 551 (1850)) (emphasis added). Following this seemingly conclusive rationale, however, the Court did hint at some flexibility to the rule. See *id.* at 406. The Court noted that there was "a class of cases to which this case does not belong," with respect to which the authority of the Court to make new parties to a suit is plenary. See *id.* In determining whether the State was sufficiently "aggrieved" to invoke the discretion of the Court to name additional parties, the Court emphasized the lack of a "beneficial interest." *Id.* at 403-05.

65. See FED. R. APP. P. 3(c) (stating the "notice of appeal must specify the party or parties taking the appeal") (emphasis added).

66. *Marino*, 484 U.S. at 303-04 (citing *Marino v. Ortiz*, 806 F.2d 1144, 1152 (2d Cir. 1986)).

67. *Id.* The Court dismissed preemptively arguments of procedural unfairness by remarking that "denials of such [intervention] motions are, of course, appealable." *Id.*

Since *Marino*, courts have considered the attributes and goals of class action and shareholder derivative litigation in determining the rules' procedural effect on representative litigation.⁶⁸ The shared history of Rule 23, governing class actions, and Rule 23.1, governing shareholder derivative litigation, results in a similarity of procedural devices and goals.⁶⁹ Both rules seek to achieve like goals, such as judicial efficiency, by consolidating small claims that arise from the same controversy.⁷⁰ Consequently, when determining whether a non-named party may appeal, courts often defer to this goal of judicial economy.⁷¹

By contrast, courts have also utilized distinctions between the two rules to support rulings that may contradict this common goal of judicial economy.⁷² In *Gottlieb v. Wiles*,⁷³ the Tenth Circuit denied standing to a non-named party in a class action securities suit due to the party's failure

68. See, e.g., *Rosenbaum v. MacAllister*, 64 F.3d 1439, 1442-43 (10th Cir. 1995); *Gottlieb v. Wiles*, 11 F.3d 1004, 1010-11 (10th Cir. 1993) (comparing Rules 23 and 23.1 to determine if an objector in representative litigation should be granted standing).

69. See FED. R. CIV. P. 23, 23.1 & advisory committee's note on the 1966 Amendments (evidencing an identity of language and purpose with respect to requirements of court notice and adequate representation); see also, 1 NEWBERG, *supra* note 3, § 22.81, at 162-63 (noting that although Rule 23.1 has distinct attributes for pleading, the derivative suit is in reality "a special category of class suit," subject to similar concerns and analysis). Although the 1966 Amendments separated the rules governing derivative suits from class actions and added additional pleading requirements, the new Rule 23.1 did not "disturb the procedural balance previously established in this kind of litigation." Benjamin Kaplan, *Continuing the Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)*, 81 HARV. L. REV. 356, 386 & n.188 (1976).

70. See *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1309 (3d Cir. 1993) (addressing the issue of shareholder standing by considering the derivative suit's aggregation of multiple claims); *Rosenbaum*, 64 F.3d at 1442; Paolini, *supra* note 60, at 1734 (explaining that Rule 23 litigation is designed to prevent multiplicity of actions involving common questions and to obtain a final determination of the issues); see also *supra* note 4 and accompanying text.

71. See, e.g., *Felzen v. Andreas*, 143 F.3d 873, 876 (7th Cir. 1998) *aff'd by an equally divided court sub nom.* *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (per curiam) (recognizing the validity of monitoring to ensure just settlements, but refusing to consider the merits of the proffered settlement as the objectors had failed to intervene and become named parties); *In re Brand Name Prescription Drugs Antitrust Litig.*, 115 F.3d 456, 457 (7th Cir. 1997), *rev'd on other grounds*, 123 F.3d 599 (7th Cir. 1997) (denying appellate standing to non-named class members and those who had previously opted out due to the "veritable avalanche of appeals" and the dilution of control of the class that would inevitably occur). See generally FERRARA ET AL., *supra* note 18, § 1.05, at 1-35 (recognizing that although the procedural requirements of Rule 23.1 are focused on providing fairness to both shareholders and the corporation, the inherent complexity and burden of these requirements may forestall their use).

72. See, e.g., *Rosenbaum*, 64 F.3d at 1442-43 (permitting a non-intervening class member to appeal a settlement despite concerns that they may represent a lone dissident and reasoning that the same rationale should apply in the derivative context); *Gottlieb*, 11 F.3d at 1010-11.

73. 11 F.3d 1004 (10th Cir. 1993).

to intervene; however, the court noted that such appellate review should be available in shareholder derivative litigation.⁷⁴ In applying a balancing test weighing the fairness of the settlement and the preservation of judicial resources, the court utilized Rule 23.1 to emphasize the soundness of the denial of a non-named party's claim in a class action context.⁷⁵ The court noted that derivative litigation does not offer the same protective mechanisms as class actions, such as an affirmative and preliminary determination of adequate representation, opt-out provisions, and benefits accruing directly to both class members and named plaintiffs' counsel; therefore, it merits the protection of appealability.⁷⁶ Consequently, while the courts are increasingly cognizant of the necessary balance between procedural safeguards to protect absent non-named parties and the federal courts' goal of settlement in potentially protracted and costly litigation, the analysis of the propriety of non-named party appeals remains inconsistent and grounded in the factual circumstances of each case.⁷⁷

D. The Circuit Split: Competing Approaches to the Preservation of Appeals by Non-named Parties

1. The Third Circuit View: Policy Above Procedure

Early decisions in the Third Circuit liberally provided for appeals by non-named parties, even granting appellate review to non-named parties who had failed to object or appear in the trial court.⁷⁸ In 1993, however,

74. See *id.* at 1009-10 (denying appellate review to non-intervening class members for policy reasons, including judicial economy, but acknowledging that the same rationale was inapplicable in the shareholder derivative litigation due to the absence of protective mechanisms); see also *Rosenbaum*, 64 F.3d at 1442 (reasoning that the analysis utilized in *Gottlieb* "might be read to support" standing to appeal shareholder derivative litigation by objectors).

75. See *Gottlieb*, 11 F.3d at 1009-11 (refusing to extend appellate standing to class members who failed to intervene due to the potential for unlimited appeals; concluding, however, that in the shareholder derivative context these efficiency concerns were of less importance considering the lack of procedural protections).

76. See *id.* at 1011.

77. See *id.* at 1007 (explaining the balancing test); *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1307 (3d Cir. 1993); 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, § 23.02, at 23-22 to 23-33 (noting that while a goal of the Federal Rules of Civil Procedure is judicial economy, representative litigation is also designed to provide a remedy otherwise "not economically feasible" due to litigation costs).

78. See, e.g., *In re Pittsburgh & Lake Erie R.R. Co. Sec. & Antitrust Litig.*, 543 F.2d 1058, 1064-67 (3d Cir. 1976); *Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30, 32-33 (3d Cir. 1971). *Ace* is generally considered to have demonstrated the outer limit of appealability by non-named parties. See *Duffy*, *supra* note 4, at 934-35. The court found that non-named class members had standing to appeal a settlement in a nationwide antitrust case despite the fact that members had an opportunity to opt-out. See *Ace*, 453 F.2d at 32.

the Third Circuit limited this unconditional approach by requiring a court appearance to preserve the right of appellate review for non-named parties.⁷⁹ In *Bell Atlantic Corp. v. Bolger*,⁸⁰ the Third Circuit considered the appeal of several objecting shareholders arguing against the adequacy of a settlement approved by the lower court.⁸¹ The Third Circuit concluded that the terms of the settlement were in fact fair⁸² and held that the objectors who had appeared at the settlement hearing had standing to appeal the merits of the compromise.⁸³

The case arose following a 1990 settlement of consumer fraud claims instituted by the Attorney General of Pennsylvania against Bell Atlantic Corporation.⁸⁴ The expenditure of corporate assets pursuant to the settlement resulted in two parallel shareholder derivative actions.⁸⁵ One group of shareholders, represented by Seymour Lazar, instituted an action in the Pennsylvania state courts, while another shareholder group, represented by Martha Taub, initially made a demand and sought intracorporate relief.⁸⁶ Rejection of this initial demand on the corporation prompted the Taub group to file a derivative action in federal court on behalf of a class of Bell Atlantic shareholders.⁸⁷ Prior to filing, the Taub

Relying on *Ace*, later courts expanded the flexibility of nonparty appeals and reasoned that the adjudication of the legal rights of class members by settlement is sufficient to justify appellate standing. *See* *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1176 (9th Cir. 1977). The *Ace* court further reasoned that appellate review was a necessary check on unfair settlements. *See id.*; *Duffy, supra* note 4, at 935. The status of this holding is uncertain, however, given later holdings requiring at least an appearance to register an objection. *See Bell Atlantic* 2 F.3d at 1310; *Shults v. Champion Int'l Corp.*, 35 F.3d 1056, 1059, 1061 (6th Cir. 1994); *Croyden Assocs. v. Alleco, Inc.*, 969 F.2d 675, 679-80 (8th Cir. 1992); *see also* *Duffy, supra* note 4, at 935 (noting the uncertainty of *Ace*'s precedential value in light of subsequent holdings).

79. *See Bell Atlantic*, 2 F.3d at 1310.

80. 2 F.3d 1304 (3d Cir. 1993).

81. *See id.* at 1310.

82. *See id.* at 1318.

83. *See id.* at 1310.

84. *See id.* at 1306. The settlement involved a violation of Pennsylvania's unfair practices and consumer protection laws and resulted in \$40 million in customer refunds, consumer education trust fund contributions, and legal costs payable to the Attorney General. *See id.* at 1306 & n.2.

85. *See id.* at 1306.

86. *See id.* Lazar's group charged Bell Atlantic's officers and directors with mismanagement and breach of fiduciary duty. *See id.* The Taub group, in compliance with the Federal Rules of Civil Procedure, first "made a demand" on Bell Atlantic's board to recover corporate expenditures from those officers responsible for the mismanagement. *See id.*

87. *See id.* The complaint included three counts; the first two counts were comprised of federal and state claims based on non-disclosure and the third consisted of the derivative claim which alleged mismanagement and breach of fiduciary duties. *See id.*

group notified Lazar's counsel of the suit, yet Lazar did not attempt to intervene.⁸⁸ Following pre-trial preparation, the Taub group and Bell Atlantic reached a compromise.⁸⁹ The compromise included a release of all claims "arising from the Bell of Pennsylvania consumer fraud litigation," thereby precluding Lazar's pending state claim.⁹⁰ Pursuant to Rule 23.1, the proposed agreement was filed in district court and a notice summarizing the terms and announcing the date of the settlement hearing was sent to the shareholder class.⁹¹ In response, twenty-five shareholders, including Lazar, objected to the terms of the settlement.⁹² Counsel for Lazar and others attended the settlement hearing and argued against the compromise.⁹³ The district court, however, denied the objections and approved the settlement.⁹⁴

On appeal, the Third Circuit initially addressed contrary authority asserting the need for formal intervention under Rule 24 to preserve representative litigation's goal of judicial efficiency.⁹⁵ In a footnote, the court summarily disposed of recent Supreme Court precedent requiring intervention and lauding the ease and appealability of a Rule 24 motion.⁹⁶ Although *Marino* had advanced as the "better practice," intervention by nonparties to secure appellate review,⁹⁷ the Third Circuit concluded that

88. *See id.*

89. *See id.*

90. *See id.* at 1307. The settlement, in addition to providing non-pecuniary benefits to the corporation via the increased monitoring of sales and marketing staff, established a fee cap of \$450,000 for attorneys' fees. *See id.* Following the approval of the settlement, attorneys for the plaintiff were allocated just over \$420,000. *See id.*

91. *See id.* The shareholder class included all 1.1 million Bell Atlantic shareholders. *See id.* In addition to settlement terms and the hearing date, the notice included a description of the litigation. *See id.*

92. *See id.*

93. *See id.*

94. *See id.*

95. *See id.* at 1307-08. Terming the potential for multiple individual appeals "unwieldy," the court warned that such practice could defeat the purpose of class action litigation. *See id.* at 1308. Although the court declined at the outset to address whether class action and derivative suits necessitated different rules regarding objector standing, the court specifically cited the lack of an "opt-out" provision in Rule 23.1 litigation as a distinction that warranted consideration. *See id.*; *see also* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.02, at 41 (promulgated and adopted May 13, 1992) (noting that "shareholders normally cannot opt out of the class and pursue their own individual action"). Recognition of this distinction is fundamental to assessing the interplay between the binding effect of judgment and the need for appellate review. *See infra* II.A.1. (discussing the binding effects of judgment).

96. *See Bell Atlantic*, 2 F.3d at 1307-08 & n.6 (citing *Marino v. Ortiz*, 484 U.S. 301 (1988) and stating that unlike Lazar, the non-party appellants in *Marino* were neither members of a class nor shareholders).

97. *See Marino*, 484 U.S. at 304; *see also Bell Atlantic*, 2 F.3d at 1308.

this reasoning was inapplicable to the case at bar.⁹⁸ The Court distinguished *Marino* by noting that the resolution in that case involved strangers to a class action, whereas the *Bell Atlantic* case involved the rights of a shareholder objector who was neither a stranger nor a non-party to the underlying litigation.⁹⁹

Fundamental to the Third Circuit's analysis in *Bell Atlantic* were agency doctrine, which is analogous to the principles of derivative litigation, and policy considerations.¹⁰⁰ A preeminent policy concern involved the widespread problem of disproportionate attorneys' fees.¹⁰¹ In applying agency principles to derivative litigation, the court noted that such collective mechanisms may engender increased "information constraints," such as miscommunication, divided loyalties, and divergent prioritization of interests between the named representative and the entire class.¹⁰²

Finally, the court quickly deflected judicial concerns that the lack of procedural requirements necessary to obtain appellate review could create "unwieldy" litigation.¹⁰³ The court noted the benefits of representative litigation and held that the goal of fair and adequate settlements outweighed these procedural concerns.¹⁰⁴ In sum, the court in *Bell Atlantic* decided that if an objector attended a settlement hearing and voiced concerns before the district court, as Lazar did, his or her ability to appeal is guaranteed.¹⁰⁵

A lack of available information due to the named representatives' failure to relay the concerns and objections of the entire class could seriously impede the proper resolution of a case.¹⁰⁶ Ignorance of opposing

98. See *Bell Atlantic*, 2 F.3d at 1308 & n.6.

99. See *id.*; see also *supra* note 3 and accompanying text (explaining the unique status of shareholders as both parties and non-parties to suits depending on the stage of litigation).

100. See *Bell Atlantic*, 2 F.3d at 1308-10.

101. See *id.* at 1310. The court noted that the risk that a settlement could be reached in which the attorneys' fees were disproportionate to the relief granted was considerable. See *id.* The court therefore found that the risk demands flexibility in judicial procedure and an easy means to challenge derivative action settlement agreements. See *id.* See generally *Coffee*, *supra* note 40, at 33-69 (examining in detail the organization of plaintiffs' counsel financing and proposing scenarios to remedy abuse).

102. See *Bell Atlantic*, 2 F.3d at 1310.

103. See *id.*

104. See *id.*

105. See *id.*; cf. *Rosenbaum v. MacAllister*, 64 F.3d 1439, 1443 & n.2 (10th Cir. 1995) (explaining, by contrast to class actions, that an objector to a shareholder settlement need only appear at the settlement hearing and raise objections to preserve the right to appeal).

106. See *Bell Atlantic*, 2 F.3d at 1310.

positions, because the named plaintiff and his or her counsel present a unified, but not necessarily representative, front, contributes to a weakening of the adversarial process.¹⁰⁷ Consequently, the role of the objector is paramount to the creation and implementation of a fair settlement that is in the interests of the corporation and its owners, the shareholders.¹⁰⁸

2. The Seventh Circuit View: An Emphasis on Efficiency

Early precedent in the Seventh Circuit permitted appellate review by non-named shareholders through objection by appearance.¹⁰⁹ For example, *Tryforos v. Icarian Development Co.*¹¹⁰ involved a complicated derivative claim based on the misappropriation of corporate assets.¹¹¹ In *Tryforos*, the Seventh Circuit considered whether the non-named shareholder objecting to the dismissal of the claim with prejudice for failure to litigate had standing to appeal.¹¹² The lower court subjected the non-named shareholder to numerous and complicated orders including written objections and retaining local counsel, but nevertheless dismissed the claim.¹¹³

The Seventh Circuit reversed the decision of the lower court as to the objector's lack of standing, and as to the court's stipulations regarding what constituted a proper "appearance" by an objector.¹¹⁴ As an initial matter, the court indicated the conclusive presumption that a shareholder has an unquestioned interest in the dismissal, only the non-named

107. *See id.* The court observed that the plaintiffs' attorneys' and defendants' interests may "coalesce." *See id.* This resulting "mutual indulgence" often leads to a lack of criticism of the proffered settlement and, potentially, an absence of any plenary hearing on the merits of the settlement. *See id.*

108. *See id.*

109. *See Tryforos v. Icarian Dev. Co.*, 518 F.2d 1258, 1264 (7th Cir. 1975), *overruled by* *Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998); *Research Corp. v. Asgrow Seed Co.*, 425 F.2d 1059, 1060-61 (7th Cir. 1970), *overruled by* *Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998).

110. 518 F.2d 1258 (7th Cir. 1975), *overruled by* *Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998).

111. *See Tryforos*, 518 F.2d at 1260. The "bitter and protracted" proceedings, which included a succession of attorneys and a 77-page pre-trial order, culminated in the district court's dismissal of the action for failure to prosecute. *See id.* at 1260-62.

112. *See id.* at 1260, 1263.

113. *See id.* at 1261-62. The court's orders additionally included the shareholder subjecting himself to the jurisdiction of the court, although he was in Greece at the time of the hearing; forcing the shareholder to file a petition denying participation in pending litigation in another jurisdiction; and forcing the shareholder to provide evidence of the shareholder's stock ownership. *See id.*

114. *See id.* at 1263-64. The court was cognizant of the trial court's concern for efficiency but remained unpersuaded by the procedural arguments. *See id.*

shareholder's compliance with procedure was at issue.¹¹⁵ Emphasizing the notice requirement of Rule 23.1 as encouraging objections, the Seventh Circuit held that a non-named shareholder who appears pursuant to this notice may appeal an adverse decision even though he has not formally been made a party to the action.¹¹⁶

More recent cases in the Seventh Circuit, however, have narrowed the availability of the right to appellate review, first in class actions,¹¹⁷ then in derivative litigation.¹¹⁸ Consequently, the Seventh Circuit now requires formal intervention pursuant to Federal Rule of Civil Procedure 24 to preserve a non-named party's right to appeal an adverse judgment.¹¹⁹

Application for appellate review brought by non-named shareholders in *Felzen v. Andreas*¹²⁰ provided the impetus for this reversal of precedent. International price-fixing and criminal antitrust activity by the Archer Daniels Midland Company (ADM) prompted the underlying litigation.¹²¹ Following the well-publicized mismanagement of this corporation, shareholders filed suit in two states, which the Central District of Illinois subsequently consolidated.¹²² After two years of sparse discovery and failure to litigate vigorously, plaintiffs' attorneys reached a settlement with the insurance company for ADM.¹²³ Pursuant to Rule 23.1,

115. *See id.* at 1263.

116. *See id.* at 1264. The court feared frustration of the notice requirement, which provides that all shareholders, both named and non-named parties, must receive notice of a proposed settlement. *See id.* The court recognized that notice requirements did not create conclusively additional procedural burdens upon the lower court, as the filing of objections does not necessitate any determination as to their legal or factual sufficiency. *See id.*

117. *See In re Brand Name Prescription Drugs Antitrust Litig.*, 115 F.3d 456, 457 (7th Cir. 1997), *rev'd on other grounds*, 123 F.3d 599 (7th Cir. 1997) (following the Supreme Court's decision in *Marino* and reversing circuit precedent that permitted absent class members in class actions to appeal without intervention).

118. *See Felzen v. Andreas*, 134 F.3d 873, 876 (7th Cir. 1998), *aff'd by an equally divided court sub nom. California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (*per curiam*).

119. *See id.* (declining to hear appeal as shareholder had failed to intervene); FED. R. CIV. P. 24 (providing procedure whereby nonparties may intervene in a pending action).

120. 134 F.3d 873, 876 (7th Cir. 1998), *aff'd by an equally divided court sub nom. California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (*per curiam*).

121. *See* Petition for a Writ of Certiorari at ii, 4, *Felzen* (No. 97-1732). The resulting criminal fines totaled \$100 million, resulting in the largest criminal antitrust fine ever imposed at that time. *See id.* Three civil antitrust lawsuits increased the total award by another \$90 million. *See id.*

122. *See id.* at 5. The suits alleged failure to supervise employees properly and breach of fiduciary duties to stockholders; the suits sought recovery of \$190 million. *See id.*

123. *See id.* at 6. The settlement included an \$8 million fund earmarked entirely for legal fees, despite repeated calls for serious reform and corporate governance measures from many large institutional investors. *See id.* at 6-7.

the court held a preliminary hearing and ordered proper notice of the proposed settlement to all shareholders.¹²⁴ In response to this notice, two non-named shareholders, the California Public Employees' Retirement System and the Florida State Board of Administration, filed written objections and appeared at the settlement hearing.¹²⁵ Despite compliance with the court's notice, the court denied the objections and entered the settlement order.¹²⁶

While acknowledging that the federal courts disagree about the necessary procedural requirements, and despite contrary binding precedent, the Seventh Circuit determined on appeal that permitting parties only to appeal judgments was "well settled" law.¹²⁷ Characterizing the objectors' arguments for appeal as unsubstantiated, Judge Easterbrook reasoned that the Supreme Court's ruling in *Marino v. Ortiz* was conclusive; the audience of the court of appeals could not be extended to those who had failed to intervene.¹²⁸

The importance of corporate integrity and judicial efficiency were at the heart of the court's decision.¹²⁹ The court reasoned that the appellate forum risked becoming an "ombudsman" of internal corporate operations should appellate review be procured so easily.¹³⁰ In formally overruling numerous Seventh Circuit holdings, the court emphasized the need for self-restraint to avoid "fragment[ing] the control of the class action" and permitting the usurpation of the class representative.¹³¹ Despite acknowledging the necessary role of objectors in monitoring derivative litigation¹³² and the embattled status of derivative litigation generally due to abuse by plaintiffs' counsel,¹³³ the court concluded that the objec-

124. *See id.* at 7.

125. *See id.* These objections focused on the lack of any material benefit for the corporation from the settlement and the large attorneys fees. *See id.*

126. *See id.* at 7-8.

127. *See Felzen v. Andreas*, 134 F.3d 873, 874 (7th Cir. 1998) (quoting *Marino v. Ortiz*, 484 U.S. 301, 304 (1988)), *aff'd by an equally divided court sub nom. California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (per curiam).

128. *See id.* The court reasoned that *Tryforos* had summarily announced that shareholders could appeal and had relied solely on older precedent, district court opinions, and pre-*Marino* rulings. *See id.*

129. *See id.* at 874-75.

130. *See id.* at 874. By way of example, Judge Easterbrook noted that shareholders "have no more right to speak for the firm or control its litigation decisions than bondholders or banks or landlords," thus underscoring the attenuated nature of shareholders as representatives of corporate interests. *Id.*

131. *Id.* at 875 (quoting *In re Brand Name Prescription Drugs Antitrust Litig.*, 115 F.3d 456, 457 (1997)).

132. *See id.* at 876.

133. *See id.*

tors' failure to properly become a parties to the litigation was fatal.¹³⁴

Following the dismissal of the appeal by the Seventh Circuit, the Supreme Court granted the objectors' petition for certiorari.¹³⁵ On January 20, 1999, an evenly divided Court dismissed the complaint without an opinion, thereby upholding the Seventh Circuit's decision.¹³⁶ The Court's affirmance of the lower court's ruling renders the circuit court split a live controversy, continues the lack of uniformity of federal law, and avoids clarification of the interpretation of the Federal Rules of Civil Procedure 23 and 23.1.¹³⁷

II. THE CURRENT STATE OF OBJECTOR STANDING IN DERIVATIVE ACTIONS: AN UNEVEN BALANCE OF FAIRNESS AND EFFICIENCY

The approaches of the Seventh and Third Circuits propose vastly different procedural requirements to Rule 23.1 appeals due to an emphasis on only one factor of a two-part balancing test.¹³⁸ Although both approaches consider the fairness of the settlement and judicial efficiency in

134. *See id.* The court recounted the notice requirements and alluded to the purpose and goals of the procedural safeguards. *See id.* The court referenced significant commentary, which forecast the continued weakening of the shareholder derivative suit due to disproportionate attorney's fees and a general lack of efficacy. *See id.* Yet, procedural strictures determined the result. *See id.*

135. *See California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 29 (1998).

136. *See California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999). The 4-4 split resulted when Justice O'Connor recused herself for undisclosed reasons. *See id.*; *see also Shareholder Lawsuits*, *supra* note 15, at B23. Subsequent reports indicate that Justice O'Connor's ownership of ADM stock prompted the recusal. *See David G. Savage, Case Dismissed*, A.B.A. J., Mar. 1999, at 43.

137. *See* Petition for a Writ of Certiorari at 11, *Felzen* (No. 97-1732) (delineating the negative consequences of the current circuit split); *Shareholder Lawsuits*, *supra* note 15, at B23 (predicting continued ambiguity on the issue in the wake of the Supreme Court's affirmance); *see also* Brief for the United States and the Securities and Exchange Commission as Amici Curiae Supporting Petitioners at 1-2, *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 29 (1998) (No. 97-1732) (arguing against an intervention requirement and asserting the interest of the SEC "in protecting investors through effective corporate governance" and the "substantial interest" of the federal government in the procedure applicable in the class action context); Duffy, *supra* note 4, at 934.

138. *Compare Felzen v. Andreas*, 134 F.3d 873, 875-76 (7th Cir. 1998) (noting the potential fragmentation of control in a shareholder suit should a right of appeal be granted), *aff'd by an equally divided court sub nom. California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720, 720 (1999) (per curiam) *with Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1310 (3d Cir. 1993) (granting appeal by concluding that the fairness of settlements was of greater concern and merit than judicial economy). In another case, *Gottlieb v. Wiles*, the court characterized the test which applies to appeals by non-named parties as "a careful balancing of the need for efficiency with the need to ensure adequate protection for the individual members of [a] class." *Gottlieb v. Wiles*, 11 F.3d 1004, 1007 (10th Cir. 1993).

the determination of a non-named party's right to appellate review, each approach strongly favors one factor, often utilizing the same principles to advocate contrary resolutions.¹³⁹ Unfortunately, favoring either efficiency or fairness may prove detrimental to the goals of derivative litigation.¹⁴⁰

A. Preservation of Appeal by Appearance

The Third Circuit's analysis in *Bell Atlantic Corp. v. Bolger* emphasized fairness and only briefly mentioned aspects of efficiency which have constituted the *ratio decidendi* of contrary precedent.¹⁴¹ In its "fairness" analysis, the court discussed several aspects of the policy favoring flexibility of non-named party appeals in shareholder derivative litigation.¹⁴²

1. The Binding Effects of Judgments on Shareholders

The *Bell Atlantic* court declined to resolve whether different procedural rules should apply to shareholder derivative and class action litigation.¹⁴³ Instead, the court analyzed non-party shareholder appeals within the context of representative litigation and thus included both derivative and class action litigation in its purview.¹⁴⁴ This broad analysis, although grounded in the shared history of the two rules, is devoid of the specificity and practical distinctions that have characterized and strengthened

139. See *Felzen*, 134 F.3d at 875 (stating that the absence of an "opt out" provision in shareholder suits weakens the need for appellate review by non-named parties); *Bell Atlantic*, 2 F.3d at 1309 (stating that the absence of an "opt out" provision in shareholder suits supports the grant of appellate review).

140. See Brief of Amici Curiae Council of Institutional Investors in Support of Petitioners at 3, *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 29 (1998) (No. 97-1732) (arguing against an intervention requirement for non-named shareholders; noting the tendency for "valid shareholder objections [to] be ignored or improperly rejected by district courts preoccupied with clearing crowded dockets"); Duffy, *supra* note 4, at 954-55 (noting that requiring intervention to ensure judicial efficiency ignores the merits of the settlement and results in procedural complexities).

141. See *Bell Atlantic*, 2 F.3d at 1307-10. The court quickly dismissed the significance of precedent, insisting that whether a non-named party may appeal a settlement was "not settled." See *id.* at 1307 (citing two treatises in support of this proposition).

142. See *id.* at 1308-10 (noting the "opt-out" distinction between class and shareholder action, the "agency costs" of representative litigation which could preclude shareholder policing, and the importance of a judicious settlement in the corporation's best interests).

143. See *id.* at 1307-08 n.4 (declining to treat Rules 23 and 23.1 litigation distinctly in analyzing shareholder standing but citing MOORE'S FEDERAL PRACTICE, which holds that procedural principles regarding an objector's right of appeal are equally applicable in both class action and shareholder derivative litigation).

144. See *id.* at 1307 & n.4, 1308-09 (discussing class action cases and shareholder derivative suits in an examination of non-party appeals).

other decisions.¹⁴⁵ While the court only briefly referenced the lack of an “opt-out” provision in shareholder suits,¹⁴⁶ this distinction between shareholder and class actions merits a more fundamental consideration.¹⁴⁷

In Rule 23.1 litigation, non-named shareholders are bound to the disposition of the case despite their inability to opt-out.¹⁴⁸ Consequently, should these shareholders disagree with the settlement and yet prefer to remain non-named parties, their options are few.¹⁴⁹ As noted, in certain jurisdictions, dissenting shareholders may present their objections by appearance and thereby benefit from the procedural checks that appellate review affords.¹⁵⁰ If the jurisdiction requires intervention, however, shareholders have limited recourse.¹⁵¹ Shareholders may engage in a collateral attack on the settlement by alleging fraud on the part of the named representative or they may become a named party by moving for

145. Compare *id.*, with *Rosenbaum v. MacAllister*, 64 F.3d 1439, 1443 (10th Cir. 1995) (explaining the function of the opt-out procedure in class actions and in shareholder derivative suits when the non-party appeals only the attorney fee award); *Gottlieb v. Wiles*, 11 F.3d 1004, 1010-11 (10th Cir. 1993) (utilizing a comparative analysis of Rule 23 and 23.1 litigation to justify non-named shareholder appeals). See discussion *supra* Part I.C (discussing the use of a comparative analysis to determine an objector’s right to appeal).

146. See *Bell Atlantic*, 2 F.3d at 1307-08 n.4 (citing lack of an opt-out provision).

147. See generally *Gottlieb*, 11 F.3d at 1011 (emphasizing that the absence of an opt-out provision in derivative litigation necessarily results in all shareholders being “bound by the outcome regardless of their objections”).

148. See *id.* at 1011 (emphasizing that the absence of an opt-out provision in Rule 23.1 results in a decision binding on all shareholders “regardless of their objections”); 1 ROGER J. MAGNUSON, SHAREHOLDER LITIGATION § 8.22, at 127-28 (West 1998) (noting that shareholders are bound by the final judgment in Rule 23.1 litigation); see also 1 NEWBERG, *supra* note 3, § 1.08, at 13-14 (acknowledging that absent class members are considered parties to the litigation for some purposes such as a binding judgment).

149. See 10 FEDERAL PROCEDURE, LAWYERS EDITION §§ 25:39 to 25:40, 25:163 (1994) [hereinafter FEDERAL PROCEDURE] (listing intervention as an option for an objecting shareholder; emphasizing the *right* of intervention is qualified by a showing of inadequate representation; noting permissive intervention is dependent upon court discretion); MAGNUSON, *supra* note 148, § 8.22, at 128 (observing that a non-appearing shareholder’s remedy is to seek to set aside the settlement as fraudulent). A grant of a motion for intervention, however, results in named party status and the complexities of pleading requirements. See Brief for Petitioners at 34-35, *California Pub. Employees’ Retirement Sys. v. Felzen*, 119 S. Ct. 29 (1998) (compiling the “legal hurdles” and “practical disincentives” of intervention). Furthermore, the timing of such a motion may be crucial. See FEDERAL PROCEDURE, *supra*, § 25:187 (clarifying that after the dismissal of a shareholder suit an order denying intervention is permissive and discretionary, and consequently, non-appealable).

150. See *Bell Atlantic*, 2 F.3d at 1310; *supra* notes 13, 109 and accompanying text.

151. See MAGNUSON, *supra* note 148, § 8.22, at 128 (listing fraud as the only recourse for a non-appearing shareholder; concluding that approval of a settlement by a court is routinely “the end of the matter”).

intervention under Rule 24.¹⁵² Res judicata bars a shareholder from maintaining a new derivative action.¹⁵³ Consequently, the settlement proceeding litigates the non-named shareholder's interests, implicating his or her right to court access, thereby limiting appellate review and potentially compromising due process guarantees.¹⁵⁴

2. The Non-named Shareholder as Party and the Validity of the *Marino* Holding

While recognizing the Supreme Court's holding in *Marino* concerning the issue of appeals by nonparties, the *Bell Atlantic* court narrowed *Marino* by emphasizing that "the nonparty appellants in *Marino* were not members of the class or derivative action."¹⁵⁵ Thus, the *Bell Atlantic* court was free to hold that *Marino* does not apply to shareholders in derivative actions.¹⁵⁶ This limitation on the applicability of the Court's holding in *Marino* is consistent with the views of both courts and commentators.¹⁵⁷ As *Bell Atlantic* suggests, broad applicability of the *Marino* rule appears flawed for several reasons.¹⁵⁸

152. See *id.* § 8.22, at 127-28 (indicating that an objector can set aside a derivative suit settlement reached after proper notice and court approval only by alleging fraud in a collateral attack); see also FEDERAL PROCEDURE, *supra* note 149, § 25:163, at 127-28 (discussing the option of intervention under Rule 24).

153. See MAGNUSON, *supra* note 148, § 8.22, at 127-28.

154. See Paolini, *supra* note 60, at 1739 (asserting that "[t]he power to bind nonnamed class members with a consent decree that they had no part in negotiating is at the outer reaches of due process"); cf. *Lindsey v. Normet*, 405 U.S. 56, 77 (1972) ("[I]f a full and fair trial on the merits is provided, the Due Process Clause of the Fourteenth Amendment does not require a State to provide appellate review."). Thus the objectors' position supports a strong argument for the procedural protections of due process because they are dissenting from a settlement order rather than a full adjudication on the merits. See generally *id.*; Paolini, *supra* note 60, at 1739. The *Lindsey* Court additionally noted that appellate review cannot be extended to some "and capriciously or arbitrarily denied to others without violating the Equal Protection Clause." *Lindsey*, 405 U.S. at 77.

155. *Bell Atlantic*, 2 F.3d at 1308 n.6.

156. See *id.*

157. See Duffy, *supra* note 4, at 946-47 (arguing in favor of a more permissive rule than requiring non-party intervention under *Marino*); Paolini, *supra* note 60, at 1737-38 (noting the difficulties that would result from extending the *Marino* holding to include non-named class members); see also *supra* notes 155-56 and accompanying text; *infra* note 159 and accompanying text.

158. See *Bell Atlantic*, 2 F.3d at 1307-08; Petition for a Writ of Certiorari at 3, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 29 (1998) (No. 97-1738) (emphasizing that the court never "suggested" that persons already "privies to the proceedings - such as class members" need intervene prior to gaining the right to appellate review); Duffy, *supra* note 4, at 946 (discussing the literal and brief holding in *Marino* and noting that "several factors" argue for a more flexible rule for non-named parties); Paolini, *supra* note 60, at 1737-39 (citing the application of the *Marino* holding in *Walker v. City of Mes-*

First, to apply *Marino* in scenarios involving both nonparties and non-named parties ignores the subtle, yet important, distinction between the two statuses.¹⁵⁹ A nonparty is by definition a stranger to the suit who may argue for party status based on an interest in the litigation.¹⁶⁰ By imposing the *Marino* rule on both non-named parties and nonparties, the procedural checks implicit in appellate review are denied to non-named parties who possess an already demonstrated and proven interest in the litigation.¹⁶¹

Second, established caselaw and recognized judicial doctrines already treat nonparties as parties in numerous situations.¹⁶² Further, the very structure of the shareholder suit device recognizes non-named share-

quite, 858 F.2d 1071 (5th Cir. 1988); asserting that the dramatic broadening of the holding to include non-named class members who are parties to the suit resulted in unfairness to individual litigants). *But see* Brief in Opposition of Respondent Archer Daniels Midland Company at 5, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (No. 97-1732) (arguing that the *Marino* holding *a fortiori* applies to shareholders as they assert no personal claim, only the interests of the corporation remain at issue).

159. *See* *Shults v. Champion Int'l Corp.*, 35 F.3d 1056, 1060-61 (6th Cir. 1994) (declining to overrule circuit precedent allowing non-named parties to intervene by emphasizing that *Marino* only considered the standing of nonparties and not "non-representative members of a class or derivative suit"); 1 NEWBERG, *supra* note 3, § 1.07 (discussing issues raised by recognizing non-named parties as a special class of litigants). The Supreme Court appeared troubled by the Seventh Circuit's failure to recognize this distinction. *See* Transcript of Oral Argument at 56, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (No. 97-1732). At oral argument in California Public Employees' Retirement System v. Felzen, *Marino* was referred to as "a very different kind of case" in which the white officers "were certainly not represented by the black plaintiffs who were suing." *Id.* The court and counsel for ADM conceded that the objectors in *Marino* "were not members of the class." *Id.*

160. *See* *Hispanic Soc'y v. New York City Police Dep't*, 806 F.2d 1147, 1152 (2d Cir. 1986) (observing the exceptions to the party-only rule, including "when the nonparty has an interest that is affected by the trial court's judgment"), *affirmed sub nom.* *Marino v. Ortiz*, 484 U.S. 301 (1988); Brief for Petitioners at 11, *Felzen*, (No. 97-1732) (emphasizing that shareholders, unlike the litigants in *Marino*, have been invited to participate in the settlement hearing through court notice); *see also infra* Part III.B.1 (discussing the *de facto* party doctrine).

161. *See* *Duffy*, *supra* note 4, at 946; *see also supra* note 1 and accompanying text (discussing the importance of appellate review within the American judicial system).

162. *See* 15A WRIGHT ET AL., *supra* note 2, § 3902.1, at 122 (stating that nonparties are not always required to intervene formally to gain appellate review). Circumstances in which the court consistently has granted nonparty appeals include nonparties named in court orders, *see* *Hoxworth v. Blinder, Robinson & Co.*, 903 F.2d 186, 194 n.12 (3d Cir. 1990), an attorney arguing against sanctions on the attorney, not the party to the litigation, *see* *DeLuca v. Long Island Lighting Co.*, 862 F.2d 427, 429-30 (2d Cir. 1988), and nonparty witnesses disputing contempt orders, *see* *United States Catholic Conference v. Abortion Rights Mobilization, Inc.*, 487 U.S. 72, 76 (1988); *see also* Petition for a Writ of Certiorari at 20-21, *Felzen* (No. 97-1732) (cataloging the many instances in which the case law treats nonparties as parties for purposes of appeal); *infra* Part III.B.1 (discussing *de facto* party doctrine).

holders as parties in several instances.¹⁶³ For example, the court sends notice pursuant to Rule 23.1 to all shareholders, both named and non-named, announcing the proposed settlement and requesting their objections.¹⁶⁴ Consequently, it seems unclear why non-named parties are relegated to a status worse than that of nonparties with attenuated interests in the context of appellate review and intervention.¹⁶⁵

Third, if the Seventh Circuit's expansive reading of *Marino* is accurate, *no* non-named party could appeal without intervention, even those non-named parties who are subsequently precluded by judgment from litigating their claims.¹⁶⁶ The necessary consequence of this reasoning would be the invalidation of several well-established doctrines and an infinite number of vacated decisions.¹⁶⁷ Finally, the brevity of the per curiam opinion and citation to authority explicitly providing for exceptions to the party-only rule render the status of *Marino* ambiguous.¹⁶⁸

163. See 2 ARON ET AL., *supra* note 21, § 27:12, at 14 (noting "that the rights of non-party shareholders in a derivative action were too important to dispense with the notice requirement, since the failure to give notice 'strips an otherwise final judgment of its res judicata effect'" (quoting *Grima v. Applied Devices Corp.*, 78 F.R.D. 431, 432 (E.D.N.Y. 1978)); see also FERRARA ET AL., *supra* note 18, § 14.03, at 14-8 (discussing the preclusive effect of judgment on non-named shareholders when the named plaintiff is an adequate representative and all shareholders have received notice).

164. See FED. R. CIV. P. 23.1 ("The action shall not be dismissed or compromised without . . . notice of the proposed dismissal or compromise . . . to shareholders.").

165. See *Webcor Elecs. v. Whiting*, 101 F.R.D. 461, 463 (D. Del. 1984) (terming a motion of intervention by a nonparty objector a "superfluous procedural question"); 2 ARON ET AL., *supra* note 21, § 28:03, at 11-13 (reasoning that in most instances, objecting non-named class members will have appellate standing and analogizing the situation to that of non-named shareholders who may also be granted appellate standing on timely objection and evidence of their status as "affected part[ies]" of the proposed settlement); Duffy, *supra* note 4, at 946 (characterizing the requirement of intervention for non-named parties as "unwarranted").

166. See Brief for Petitioners at 11, *Felzen* (No. 97-1732) (describing a broad application of *Marino* as "untenable").

167. See *id.*; see also 15A WRIGHT ET AL., *supra* note 2, § 3902.1, at 106, 123 n.35 (listing circumstances in which nonparties are permitted to appeal, including application of the *de facto* party doctrine, nonparty witnesses, and Federal Rule of Civil Procedure 11 sanctions).

168. See *Marino v. Ortiz*, 484 U.S. 301, 304 (1988) (citing *United States ex rel. Louisiana v. Jack*, 244 U.S. 397 (1917), which held that a litigant "privity to the record" may have a right to appeal, especially should that litigant have a beneficial interest in the litigation's outcome); see *id.* at 402-03; Duffy, *supra* note 4, at 942-43 (questioning the status of *Marino*); see also Petition for a Writ of Certiorari at 9, *Felzen* (No. 97-1732) (terming the *Marino* ruling a "single aside" and noting the subsequent "gloss[ing]" that has occurred in post-*Marino* decisions).

3. How Court Notice Makes the Non-Named Shareholder a Monitor of Settlements

In response to conflicting holdings, the *Bell Atlantic* court noted the “different” approach taken by some circuits.¹⁶⁹ One such case, referenced but not discussed in the *Bell Atlantic* opinion, provides a solid foundation from which the propriety of appeals by non-named parties may be argued.¹⁷⁰ In *Cohen v. Young*,¹⁷¹ the Sixth Circuit emphasized the unique role of the non-named party.¹⁷² Because the non-named party received the court notice relaying the terms of the proffered settlement and requesting any dissenting shareholder to “show cause,” and as this notice is akin to a summons of process, the non-named party had a right to appeal.¹⁷³ Drawing from this rationale, a subsequent case in the Sixth Circuit considered the character of court notice to determine whether a non-named party had been sufficiently “haled” into court and thereby deserving of appellate review.¹⁷⁴ Despite holding that intervention is required for non-named class members to appeal, *Shults v. Champion International Corp.*¹⁷⁵ acknowledged that while a “mere voluntary appearance to state or file objections” could not confer standing, “a non-named party may . . . have standing to appeal if the district court has otherwise ‘summoned’ him into court.”¹⁷⁶

From the finding of appellate status, several additional procedural rights were granted to the shareholder, such as discovery and presentation of oral argument.¹⁷⁷ By granting procedural rights to shareholders, the court fulfilled the nexus between the need for appellate review and the purpose of Rule 23 notice.¹⁷⁸ The non-named shareholder was allowed to present objections and arguments on the merits of the proposed

169. See *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1308 (3d Cir. 1993).

170. See *id.* (citing *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942)).

171. 127 F.2d 721 (6th Cir. 1942).

172. See *id.* at 724 (granting appellant the right to argue and present evidence, subject to court control, although he was a non-named party).

173. See *id.*; see also Duffy, *supra* note 4, at 938 (recognizing that the *Cohen* approach “has become the most widely accepted solution” to the problem of non-named objector standing).

174. See *Shults v. Champion Int’l Corp.*, 35 F.3d 1056, 1060-61 (6th Cir. 1994) (declining appellate review to a non-named class member as the notice was not of a “mandatory nature”).

175. 35 F.3d 1056 (6th Cir. 1994).

176. *Id.* at 1061.

177. See *Cohen*, 127 F.2d at 724-25.

178. See *id.* (reasoning that granting a non-named party objector standing, based on his answering the lower court’s notice to show cause, fulfilled the notice requirement of Rule 23.1).

settlement and the court thereby received “broader information” from which to make a more judicious decision regarding the “fairness” of the compromise, thus fulfilling one of the goals of derivative litigation.¹⁷⁹

Precedent to which the Third Circuit looked in deciding *Bell Atlantic* recognizes the detriments of collective action to small claimants and the corresponding effect on the terms of the proposed settlement.¹⁸⁰ In *Ace Heating & Plumbing Co. v. Crane Co.*,¹⁸¹ the Third Circuit reasoned that the right to appeal without formal intervention provided the necessary check on “agency costs,” which threaten the integrity of class action and shareholder mechanisms.¹⁸² The term, “agency costs,” includes the additional expense that an individual litigant, as principal, may incur by policing aspects of the settlement proposal not voluntarily communicated by plaintiff’s counsel, the agent.¹⁸³ The *Bell Atlantic* court concluded that by reducing the agency costs associated with representative litigation, monitoring of litigation would increase correspondingly.¹⁸⁴ With monitoring capability facilitated by the ease of appeals, the court surmised that the fairness of settlements procured by counsel also would increase.¹⁸⁵

179. See *id.* at 725.

180. See *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1308-09 (3d Cir. 1993) (reasoning that the propriety of non-named shareholder appeals was implicit in the Third Circuit’s opinion in *Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30,33 (3d Cir. 1971)). In *Ace*, the court hypothesized the alternatives available to the small claimant who cannot feasibly litigate as a single party. See *Ace Heating & Plumbing*, 453 F.2d at 33. Without the opportunity to appeal an unfavorable settlement, the single litigant must accept either nothing or the adverse terms of the settlement. See *id.*

181. 453 F.2d 30 (3d Cir. 1971).

182. See *id.* at 32-33. Drawing from this precedent, the Third Circuit in *Bell Atlantic* cited both judicial and academic authority emphasizing agency cost concerns. See *Bell Atlantic*, 2 F.3d at 1309.

183. See *Bell Atlantic*, 2 F.3d at 1309-10 & nn.7-9; see also Coffee, *supra* note 40, at 33-48 (attributing the lack of monitoring of plaintiff’s counsel to geographic dispersal, disorganization, and relatively small personal economic incentive). Given the large numbers of clients who are often neither well-situated nor adequately motivated in conjunction with the relatively small individual claims endemic to class and derivative litigation, the cost of monitoring the settlement outweighs any potential benefit that the individual client could receive. See *Bell Atlantic*, 2 F.3d at 1309-10 & nn.7-9; see also Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs’ Attorney’s Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 3 (1991) (arguing that the monitoring system in place now does not really protect the interests of shareholders). This problem is compounded in derivative litigation where shareholders often first learn of the lawsuit upon receipt of the settlement notice. See *Bell Atlantic*, 2 F.3d at 1309-10 & n.9.

184. See *Bell Atlantic*, 2 F.3d at 1309-10.

185. See *id.*

4. *The Practical Inefficiency of Intervention*

The *Bell Atlantic* court acknowledged the importance of shareholder monitoring to a fair settlement, and the obstacles to this monitoring.¹⁸⁶ The court, however, failed to address in practical terms how an intervention requirement would chill this essential “policing” of settlements; because intervention requirements could place an additional burden on both the individual litigant and, potentially, the court.¹⁸⁷

The ease of intervention, especially in shareholder suits, is debatable.¹⁸⁸ Pursuant to Federal Rule of Civil Procedure 24, intervention in representative litigation ordinarily requires evidence of inadequate representation by the named plaintiff.¹⁸⁹ Non-named parties, by virtue of their inclusion in the representative class, are considered to possess the same general claim as the named representative; thus a trial court that accepts a Rule 24 motion effectively must reverse its prior ruling on the adequacy of representation.¹⁹⁰ A non-named party may also move for permissive intervention under Rule 24(b).¹⁹¹ Permissive intervention, however, depends on the discretion of the trial court and similarly may be defeated by evidence of adequate representation.¹⁹² Additionally, both

186. See *id.* (emphasizing the complexities for individual litigants to overcome, such as agency costs, problems of collective action, and the informational constraints of a large and often geographically diverse class; concluding that such obstacles to meaningful participation outweigh procedural concerns of efficiency).

187. See Petitioner’s Reply Brief to Oppositions of Archer Daniels Midland Company and Directors of Archer Daniels Midland Company at 4, California Pub. Employees Retirement Sys. v. Felzen, 119 S. Ct. 29 (1998) (No. 97-1732) (specifying the “burdens of becoming a party in modern commercial litigation (including submission to often unlimited depositions, compliance with Rule 26(a), and other discovery demands)”).

188. See FEDERAL PROCEDURE, *supra* note 149, §§ 25:39, 25:40 (giving examples that illustrate the inherent problems in intervention); see also Paolini, *supra* note 60, at 1738 (discussing the difficulties attendant to intervention); cf. Duffy, *supra* note 4, at 946 (arguing that an intervention requirement is unwarranted).

189. See FED. R. CIV. P. 24(a)(2) (providing intervention is a right where representation is inadequate); FEDERAL PROCEDURE, *supra* note 149, §§ 25:39, 25:44 (discussing the mechanics of intervention and the many hurdles a potential intervenor must overcome).

190. See 1 NEWBERG, *supra* note 3, §§ 1.07-08 (discussing legal rights and status of non-named parties); see also *supra* note 4 and accompanying text (citing the text of the Federal Rules of Civil Procedure 23 and 23.1; noting the goal of the rules to litigate simultaneously similar claims). In *California Public Employees’ Retirement System v. Felzen*, a substantial portion of the oral argument involved the inconsistency of the operation of Rules 23.1 and 24. See Transcript of Oral Argument at 9-10, 15-17, 38-41, *Felzen* (No. 97-1732). The practical result of approval of Rule 24 motion in the context of a Rule 23.1 suit could be the dismissal of the entire action for inadequate representation. See *id.* at 16.

191. See FED. R. CIV. P. 24(b); FEDERAL PROCEDURE, *supra* note 149, § 25:40 (permitting intervention if an applicant’s claim or defense and the existing litigation have common questions of law or fact).

192. See FEDERAL PROCEDURE, *supra* note 149, § 25:40; see also Petition for a Writ of

forms of intervention entail procedural complexities, timing concerns, and litigation costs not associated with appearance at a settlement hearing.¹⁹³ For instance, any procedural defect of a Rule 24 motion will invalidate the motion, and this denial is not appealable.¹⁹⁴ Consequently, the burden of seeking intervention may be prohibitively heavy for non-named parties.¹⁹⁵

In response to concerns regarding the legal obstacles attendant to Rule 24 motions, courts often note the uncontroverted appealability of denials of requests for intervention.¹⁹⁶ Nonetheless, only the intervention denial is appealable, not the settlement litigation in which the objector wishes to intervene.¹⁹⁷ Further, a grant of intervention does not necessarily address

Certiorari at 13 & n.13, *Felzen* (No. 97-1732) (concluding that potential denial of the right to appeal and the requirement of intervention relegate access to appellate review to the complete discretion of the trial judge).

193. See FED. R. CIV. P. 24(c) (requiring an applicant for intervention to serve a motion upon parties, including grounds for intervention and a proposed pleading setting forth the claims for intervention); FEDERAL PROCEDURE, *supra* note 149, §§ 25:44-45 (noting that intervention complaints must be verified and must fulfill contemporaneous ownership requirements of Rule 23.1); see also *Sierra Club v. Robertson*, 960 F.2d 83, 85 (8th Cir. 1992) (emphasizing the different standards of review utilized by circuits in assessing Rule 24 motions); Paolini, *supra* note 60, at 1733-34 & n.5 (noting that the pro se applicant for intervention in *Walker v. City of Mesquite*, 858 F.2d 1071 (5th Cir. 1988), failed to satisfy Rule 24's timeliness requirements; citing four-pronged test utilized by federal courts to determine whether a Rule 24 motion is timely and therefore valid for consideration); Petitioner's Reply Brief to Oppositions of Archer Daniels Midland Company and Directors of Archer Daniels Midland Company at 4, *Felzen* (No. 97-1732) (determining that the "costs and burdens" of achieving party status through intervention could negatively affect the ability of shareholders to participate).

194. See FEDERAL PROCEDURE, *supra* note 149, § 25:44; see also *id.* § 25:41 (indicating that permissive intervenors under Rule 24(b) must satisfy jurisdictional requirements and, consequently, a grant of intervention could destroy diversity of citizenship of the named parties and thereby defeat federal jurisdiction).

195. See Paolini, *supra* note 60, at 1738 ("Intervention is made even more difficult because there is usually a presumption that a class member's interests are adequately represented."); see also FEDERAL PROCEDURE, *supra* note 149, § 25:39 (identifying that failure to prove inadequate representation by the plaintiff in Rule 23.1 litigation negates any right to intervention an applicant may have possessed under Rule 24(a)); Duffy, *supra* note 4, at 955 (stressing the heavy burden of proving inadequate representation, which requires proof of collusion, adverse interests, or nonfeasance).

196. See *Marino v. Ortiz*, 484 U.S. 301, 304 (1988) (requiring intervention; deflecting potential fairness criticisms by stating that the denial of an intervention motion is "of course, appealable"). But see FEDERAL PROCEDURE, *supra* note 149, § 25:187 (noting that denial of a valid intervention motion after dismissal of the derivative claim is "permissive and discretionary and, thus, not appealable"); *supra* notes 186-194 and accompanying text (emphasizing that only procedurally valid motions for intervention are afforded uncontroverted appealability).

197. See Duffy, *supra* note 4, at 954 & n.112 (recognizing initial appellate review of the denial of intervention only; listing related complexities of intervention motions, such as varying standards of review and timing issues); see also *Kaisha v. United States Phillips*

the objector's immediate concerns.¹⁹⁸ Although the objector becomes a named party, the assent of the objector is not mandatory for settlement.¹⁹⁹ Rather, intervention is solely a formality to the preservation of appellate review.²⁰⁰

Intervention also may require additional court supervision, time, and costs, as parallel appeals of a named shareholder arguing against a settlement and an objector appealing a denial of intervention may result from a single settlement hearing.²⁰¹ Such a process effectively defeats the stated goal of judicial economy in representative litigation and the Federal Rules of Civil Procedure.²⁰²

B. Requiring Intervention to Preserve Judicial Efficiency

The Seventh Circuit's ruling in *Felzen v. Andreas* represents a recent formulation of the argument against non-named shareholder appeals.²⁰³ Similar to other decisions requiring intervention, the Seventh Circuit opinion is founded upon concerns for judicial efficiency.²⁰⁴ The Seventh Circuit addressed several components of the policy limiting appeals in

Corp., 510 U.S. 27, 34 (1993) (denying standing to petition for certiorari to a nonparty objecting to a settlement, as the nonparty was not challenging the denial of intervention; clarifying that a litigant may seek appellate review only of the ruling denying intervention).

198. See Duffy, *supra* note 4, at 954 (arguing that granting intervention does not help the objector influence the settlement, but only gives him standing to appeal).

199. See *Local Number 93, Int'l Ass'n of Firefighters v. City of Cleveland*, 478 U.S. 501, 529 (1986) (noting that an intervenor "does not have the power to block" a settlement because his or her assent is not a prerequisite to approval).

200. See Duffy, *supra* note 4, at 954 (stating that intervention only establishes standing for appeal). In reasoning the utility of requiring intervention, the Supreme Court during oral argument in *California Public Employees' Retirement System v. Felzen* acknowledged that a Rule 24 motion achieved the same result as an appearance. See Transcript of Oral Argument at 42-43, *California Public Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (No. 97-1732). The Court commented further that as the result is the same, namely, additional review of the proffered settlement, why should the Court adopt a more complicated mechanism stating, "why not just let sleeping dogs lie?" *Id.* at 43.

201. See Duffy, *supra* note 4, at 954; see also *supra* notes 186-94 and accompanying text (discussing the procedural complexities and legal hurdles of an intervention motion to the non-named party; alluding to the necessary additional court supervision of such motions).

202. See 7A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 1751, at 8 (2d ed. 1986) (noting that representative litigation devices are designed to prevent the multiplicity of actions); 5 MOORE'S FEDERAL PRACTICE, *supra* note 4, § 23.02, at 23-22 (stating that representative litigation permits the joining of multiple claims involving common questions of law and fact in a single action).

203. See *Felzen v. Andreas*, 134 F.3d 873, 876 (7th Cir. 1998), *aff'd by an equally divided court sub nom.* *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (per curiam).

204. See *id.* at 876; see also *supra* note 12 and accompanying text (listing circuits currently requiring intervention).

derivative litigation, including the preservation of corporate integrity, the avoidance of multiple appeals, the distinct attributes of shareholder suits, and the limited value of monitoring.²⁰⁵

1. Preservation of the Integrity of the Corporate Structure

Despite the history of shareholder suits in equity, the Seventh Circuit has downgraded the power and efficacy of the derivative device.²⁰⁶ Noting that the court was not an “ombudsman,” the Seventh Circuit in *Felzen* emphasized the corporation’s superior interest in the pending litigation relative to that of shareholders.²⁰⁷ The court observed that a grant of party status could create the risk of permitting any “affected” employee, vendor, or lawyer at a future point in time to object to a settlement as “improvident” or erroneous.²⁰⁸ The court’s reasoning is thus premised on equating the interests of shareholders with those of nonparties, thereby overlooking the circumstances in which shareholders are treated as parties and ignoring their status as members of the shareholder class by virtue of their ownership rights.²⁰⁹ In analogizing shareholders to “employees, vendors, and lawyers”—those with only contractual ties to the corporation—the court impliedly concluded that shareholders have no authority or interest within the judicial process.²¹⁰

To support this proposition, Judge Easterbrook explained the equitable foundation of derivative litigation, which permits a shareholder to redress not a personal grievance, but the more removed and esoteric “corporate injury.”²¹¹ Yet, the Seventh Circuit’s analysis ignored the development of the derivative action as a device to remedy injury within the distinct and unique relationship between the shareholders and the

205. See *Felzen*, 134 F.3d at 875-76.

206. See *id.* at 874 (holding that, contrary to previous practice, only parties may appeal judicial decisions).

207. See *id.*

208. *Id.* The court utilized a hypothetical in which the settlement of derivative litigation involved firing the chief executive officer. See *id.* Under current law, the affected employees could not appeal the settlement because they are not parties. See *id.* Should non-named parties be granted this right, however, the court impliedly warns that nonparties and strangers to the suit would react to the judicial order approving such a settlement by filing suit. See *id.*

209. See *id.* at 874. The court concluded, “[o]nly parties may appeal . . . [s]o too with shareholders who have no more right to speak” than any other nonparty with an affected interest. *Id.*

210. *Id.*

211. See *id.* at 875. The court cited several cases highlighting the nature of corporate injury, the benefits of litigation as enuring only to the corporation, and the analogy of the derivative action to a “*qui tam* action.” See *id.*

corporate body; a quasi-trust analogy.²¹² The structure of a derivative suit places the shareholder in the position of representative of corporate interests because the shareholder is an owner of the corporation.²¹³ Judicial recognition of abuse of the corporate form resulting from this separation of managerial control and ownership permitted equitable remedies to redress the situation and deter future misconduct.²¹⁴ Equity authorized the shareholder to sue on behalf of the corporation, thus ignoring the shareholder's lack of standing at law and recognizing the dual functions of the derivative action to litigate claims both against the corporation by the owners and by the corporation against the directors.²¹⁵ Thereby, the role of the shareholder in the corporate structure is accentuated.²¹⁶ In light of this equitable foundation, the Seventh Circuit's analysis, equating shareholder interests with mere contractual interests, appears incomplete.²¹⁷

This analysis, favoring the corporation's interests, seeks to preserve corporate integrity by weakening the role of the shareholder in derivative litigation.²¹⁸ Denial of standing to the non-named shareholder fulfills

212. See Bert S. Prunty, Jr., *The Shareholders' Derivative Suit: Notes on Its Derivation*, 32 N.Y.U. L. REV. 980, 989 & n.48 (1957) (providing a detailed analysis of the nature of the derivative suit through an analysis of the corporate form and early English caselaw).

213. See *id.*

214. See FERRARA ET AL., *supra* note 18, § 1.03, at 1-14 (citing *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949)). The *Cohen* court discussed the rise of the corporate framework and the need to institute a device to limit abuses. See *Cohen*, 337 U.S. at 547-48. As directors became "vested with almost uncontrolled discretion in handling other people's money," the temptation to "profit personally" occurred in an arena of little accountability. *Id.*; see also Kraakman et al., *supra* note 8, at 1736 (noting that shareholder suits have "corporate value" by deterring misconduct and sometimes recovering money judgments that reimburse the cost of the suit and injury sustained); *supra* notes 5-6 and accompanying text (discussing the purpose of derivative actions).

215. See *Hawes v. Oakland*, 104 U.S. 450, 454 (1881); Prunty, *supra* note 212, at 989 (noting that the complexities of "secondary" or derivative enforcement were absent in early shareholder cases). According to Prunty, early cases declined such abstractions regarding the corporate entity. See *id.* Rather, courts utilized a trust theory that emphasized both "enforceable duties and protected rights." *Id.* "When a shareholder sued the management he sued on a right belonging to shareholders, to enforce a duty owed to shareholders." *Id.*

216. See MAGNUSON, *supra* note 148, § 801, at 2 (recognizing that the corporation "has life and interests distinct from those of its temporary managers;" concluding that the shareholder device permits a shareholder to defend the corporation as "representative of its true interests"); Prunty, *supra* note 212, at 989.

217. See Prunty, *supra* note 212, at 994 (concluding that, despite evolutions of the derivative device since its early formulation and the recognition of the corporate form, both of the concepts of the corporate entity and the breach of the shareholder trust must be considered); *supra* Part I.B (discussing the role of equity in shareholder suits).

218. See *Felzen v. Andreas*, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd by an equally di-*

the desire of management to centralize the settlement process and accord more authority to parties potentially aligned with management, both of which could increase the likelihood of reaching a collusive compromise not fully in the shareholder's interests.²¹⁹ As the named representative and plaintiff's counsel become the sole force with which management's counsel must contend, a quick resolution that reflects management's view of corporate interests becomes more likely.²²⁰ Correspondingly, settlement provisions that favor the plaintiff or require extensive corporate governance measures and alterations in management may wane.²²¹

vided court sub nom. California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (per curiam) (accentuating that "the corporation holds the legal claim"). The Seventh Circuit delineated other areas in which shareholders are passive players—including diversity determinations—and concluded by declaring that "[s]hareholders have no more the attributes of parties when managers settle derivative litigation than when managers settle antitrust litigation." *Id.* at 875-76; *see also* Garth et al., *supra* note 7, at 139 (noting the array of procedural hurdles developed in the derivative suit context to address the concerns of corporate management, which views the derivative suit as a "major threat" to independent corporate control). Some of the procedural hurdles noted by the commentators include the utilization of the business judgment rule and standing limitations (e.g., the "contemporaneous ownership" rule). *See id.* at 139-40.

219. *See* Macey & Miller, *supra* note 183, at 46-47 (terming settlement hearings "pep rallies jointly orchestrated by plaintiffs' counsel and defense counsel"; noting that objectors are uncommon and often considered "rash" by trial courts anxious to settle and relieve crowded dockets). As defense counsel and plaintiffs' counsel desire a quick compromise to the suit, both are encouraged to present the settlement's terms as fair. *See id.* at 46; *see also* Petitioner's Reply Brief to Oppositions of Archer Daniels Midland Company and Directors of Archer Daniels Midland Company at 4, *Felzen* (No. 97-1732) ("[R]equiring shareholders to assume the costs and burdens of parties [through intervention] will decrease the likelihood of their participation and increase the opportunities for improper and collusive settlements to evade judicial detection.").

220. *See* Petition for a Writ of Certiorari at 6, *Felzen* (No. 97-1732) (detailing events culminating in a settlement agreement in *Felzen*, including plaintiff's counsel's concentration on reaching a compromise with the insurance company for ADM's directors). The resulting agreement allocated funds exclusively to pay attorneys' fees with no monetary return to the corporation for shareholders, despite a loss in value of \$190 million. *See id.* The settlement also failed to adopt reform measures designed to prevent future director misconduct. *See id.* at 7; *see also* 4 HERBERT B. NEWBERG & ALBA CONTE, NEWBERG ON CLASS ACTIONS § 22.101, at 22-405 (3d ed. 1992) (recognizing that although the derivative suit litigates corporate claims, a corporation's role in settlement negotiations should be minimal, as the suit is initiated only after directors have declined to commence the suit; noting that "the objectivity of the directors, which is necessary to negotiate seriously a fair and adequate settlement, may be open to question"); Macey & Miller, *supra* note 183, at 44-45 (underscoring the plaintiff's counsel's conflict of interest in derivative settlements as evidenced by a desire for a quick settlement under the common fund doctrine of attorney fee calculation, or alternatively, a delayed settlement under the lodestar formula).

221. *See* Coffee, *supra* note 40, at 9 (discussing the settlement of derivative suits as distinctive among lawsuit settlements due to the high ratio of reported settlements that favor the defendant; citing Thomas M. Jones, *An Empirical Examination of the Resolution of Shareholder Derivative and Class Action Lawsuits*, 60 B.U. L. REV. 542 (1980), which

This protection of corporate integrity could explain the conclusive effect the Seventh Circuit gave *Marino*.²²² If shareholder interests were akin to mere contractual interests, shareholders would, out of necessity, be required to prove a beneficial interest before they could be considered to have party status.²²³ The Seventh Circuit's rejection of precedent, which held that non-named shareholders are conclusively parties by court order²²⁴ and by the binding effect of judgment,²²⁵ is consistent with the minimization of the interests of the shareholder.

2. Multiplicity of Litigation

In a recitation of circuit precedent pertaining to representative litigation, the Seventh Circuit noted briefly a second rationale for the denial of appeals absent formal intervention.²²⁶ The court raised the potential for objectors to "usurp" the named plaintiff's role and "fragment the control" of representative litigation.²²⁷

Both courts and commentators have expressed concern that inefficiency and the expenditure of limited judicial resources would result if every non-named party were permitted to appeal an adverse settlement.²²⁸ The multiplicity of litigation stemming from the ease of appealability threatens the vitality and the rationale underlying the procedure

found a 20:1 ratio in favor of defendants). A study conducted by the National Economic Research Associates (NERA) indicated the rate of settlements in shareholder suits had grown 20% annually between 1991-1994, while the average settlement amount fell. FREDERICK C. DUNBAR ET AL., RECENT TRENDS III: WHAT EXPLAINS SETTLEMENTS IN SHAREHOLDER CLASS ACTIONS? i-v (1995). The study also revealed that despite this decrease in monetary awards accruing to the corporation and its shareholders, plaintiff's counsel's fees remained constant, accounting for roughly a third of each settlement. See *id.* at ii.

222. See *Felzen v. Andreas*, 134 F.3d 873, 874 (7th Cir. 1998), *aff'd by an equally divided court sub nom.* *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (per curiam).

223. See *Hispanic Soc'y v. New York City Police Dep't*, 806 F.2d 1147, 1152 (2d Cir. 1986) *amended by* *Marino v. Ortiz*, 482 U.S. 912 (1988), *aff'd* 484 U.S. 301 (1986), *United States ex rel. Louisiana v. Jack*, 244 U.S. 397, 402 (1917) (describing the process for non-parties to gain party status).

224. See *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942) (reasoning that a notice to show cause grants objector standing to appeal).

225. See *Gottlieb v. Wiles*, 11 F.3d 1004, 1011 (10th Cir. 1993) (concluding that non-named shareholders are entitled to appellate review, as they remain bound to the litigation's outcome regardless of their objections).

226. See *Felzen*, 134 F.3d at 875.

227. *Id.*

228. See *Gottlieb*, 11 F.3d at 1009 (acknowledging concerns about individual appeals); Duffy, *supra* note 4, at 939 (explaining the potential for a "myriad" of suits stemming from the settlement order).

of representative litigation.²²⁹ As representative suits were designed to consolidate homogeneous claims for the purpose of preserving judicial economy and limiting individual litigation costs, the prospect of “unpredictable and unlimited individual actions” could eviscerate the purpose of such litigation.²³⁰

Additionally, the ease of appealability by individual objectors could deter settlements.²³¹ The Federal Rules of Civil Procedure states as a general goal the encouragement of settlements prior to a trial on the merits, and emphasizes the resolution of cases by settlement as specifically vital to Rule 23.1 litigation.²³² Commentators celebrate the benefits of settlement, such as alleviating crowded court dockets, reducing litigation costs, and refocusing corporate efforts on business rather than pending litigation.²³³ Procedural devices that increase the likelihood of compromise could translate into the realization of some of these benefits for both shareholders and the corporation.²³⁴ Conversely, a procedural device that permits a lone dissenter to halt the settlement could prevent

229. See *Gottlieb*, 11 F.3d at 1009.

230. *Id.*

231. See *Duffy*, *supra* note 4, at 951 (“[A]ny rule that restricts the ability of unnamed class members to appeal will increase the probability that the class representatives will be able to settle the case.”).

232. See FED. R. CIV. P. 1 (“These rules . . . shall be construed and administered to secure the just, speedy, and inexpensive determination of every action.”); FED. R. CIV. P. 16(a)(5) (citing a goal of pretrial conferences as “facilitating the settlement of the case”); 2 ARON ET AL., *supra* note 21, § 26:17, at 23 (recognizing in caselaw “a clear public policy favoring and encouraging out-of-court resolution” applicable to derivative suits particularly; noting that this policy creates a “restraint in the disapproval of compromise”); see also *supra* note 21 and accompanying text (discussing encouragement of settlements in the class action context).

233. See *Macey & Miller*, *supra* note 183, at 45 (alleging judges’ interest in settlement approvals, given their tremendous workload, despite other procedural reforms designed to conserve judicial resources); see also Frank H. Easterbrook, *Justice and Contract in Consent Judgments*, 1987 U. CHI. LEGAL F. 19, 19 (delineating the benefits of settlement, including avoidance of legal fees, “the expenses of discovery, the expenses of waiting, and the uncertainty of putting the matter to a court”); Sylvia R. Lazos, Note, *Abuse in Plaintiff Class Action Settlements: The Need for a Guardian During Pretrial Settlement Negotiations*, 84 MICH. L. REV. 308, 312 n.27 (1985) (recognizing that litigation costs include both out-of-pocket expenses and “opportunity cost[s],” such as diversion of company time and resources from profit-making ventures to supervision of the lawsuit). Other, more indirect opportunity costs of a full trial may include loss of consumer goodwill, negative publicity, and damage to community standing. See *id.* at 313.

234. See Lazos, *supra* note 233, at 312-16, 332 (noting the interests of class members, the named plaintiff, and the defendant in the class action context, and concluding that the appointment of a guardian during pretrial proceedings will encourage fair settlements thereby benefiting all interested parties). But see *infra* Part III.A.1 (maintaining that settlements are not conclusively beneficial).

such benefits.²³⁵

3. *Distinctions Between Shareholders and Class Members: Limiting the Need for Appellate Review*

According to the Seventh Circuit, distinctions between class actions and derivative litigation operate as a restriction to shareholders' judicial access.²³⁶ Of principal concern to the court in *Felzen* was a lack of any personal injury sustained by the shareholder class.²³⁷ The court specifically noted an "equitable argument" for granting non-named class members appellate review due to a "real grievance," but failed to acknowledge any such equitable consideration or injury in the derivative context.²³⁸ Rather, the court described the process whereby an investor takes control of the litigation of corporate interests in decidedly attenuated and limiting terms, thus distancing the shareholder's interest in the corporation from the corporation's legal claim.²³⁹ For example, Judge Easterbrook separated the shareholder from the litigation by noting that, unlike an injured class member, a shareholder cannot sustain subsequent personal injury.²⁴⁰ Furthermore, a shareholder does not have the power to displace the board of directors, cannot "opt out," and is not considered for diversity purposes.²⁴¹

This weakening of the role of the shareholder through a comparative analysis of Rule 23 and 23.1 litigation appears to cloak a general disfavor

235. See *Rosenbaum v. MacAllister*, 64 F.3d 1439, 1442 (10th Cir. 1995) (reasoning that the ease of nonintervenor appeals could postpone benefits that the parties might have enjoyed otherwise).

236. See *Felzen v. Andreas*, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd by an equally divided court sub nom. California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (per curiam).

237. See *id.* (stating simply, "in a shareholders' derivative action, the individual investor is not an injured party and is not entitled to litigate").

238. See *id.* (noting that a derivative suit "is brought by an investor in the corporation's (not the investor's) right to recover for injury to the corporation" (emphasis added)).

239. See *id.* The court underscored that the corporation suffers the damages and explained that the initiation of Rule 23.1 litigation is more akin to a *qui tam* proceeding. See *id.* The derivative suit is only a "default" mechanism, to be utilized when the directors breach a duty, and in some jurisdictions, only after fulfilling additional procedural prerequisites, such as committee investigations. See *id.*; see also Brief in Oppositions of Respondent Archer Daniels Midland Co. at 5, *Felzen* (No. 97-1732) (assessing the Seventh Circuit's analysis and agreeing that, unlike ordinary class members, shareholders "assert no personal claim, but only the interest of the corporation").

240. See *Felzen*, 134 F.3d at 875 (surmising that if investors receive new injury during the pendency of the litigation, this injury is only a corporate loss and the courts would preclude any attempt by a shareholder to redress this new injury in a direct action against the corporation).

241. See *id.*

of the derivative suit.²⁴² The Seventh Circuit's reliance on these distinctions fails to appreciate the legislative history of both rules.²⁴³ This history evidences an identity of language and treatment between class actions and derivative suits, especially in the context of dismissal and compromise.²⁴⁴ Consequently, the Seventh Circuit's concerns lay not merely with the ability of the objector to appeal, but more fundamentally with the role of Rule 23.1 litigation in the corporate framework.²⁴⁵

Despite the Seventh Circuit's choice to treat the two rules similarly, the opinion's emphasis on the dichotomy between class action and shareholder suits makes a strong argument for additional procedural limitations on the shareholder suit.²⁴⁶ For instance, the Seventh Circuit correctly recognizes the potential for continuing personal injury to a class member in comparing a class litigant with a shareholder who has only a monetary concern.²⁴⁷ This analysis, however, fails to consider the substantive remedy that shareholder litigation can yield in the form of increased corporate governance and declines to recognize the importance of a careful inquiry into the fairness of a settlement.²⁴⁸ Instead, the court dismisses these concerns in favor of procedural purity.²⁴⁹ Consequently, the court's emphasis on form over substantive fairness evidences veiled advocacy for greater corporate control of the shareholder device.²⁵⁰

4. The Decreased Role of Monitoring

The Seventh Circuit in *Felzen* admitted the important role of monitoring within the settlement process, noting that intervention "could be

242. See *id.* at 874-76.

243. See Brief for Petitioners at 30, *Felzen* (No. 97-1732); see also *supra* Part I.C.2 (analyzing the interaction between Federal Rules of Civil Procedure 23 and 23.1).

244. See FED. R. CIV. P. 23(e) ("A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs."); FED. R. CIV. P. 23.1 (same in substance); see also Brief for Petitioners at 30, *Felzen* (No. 97-1732) (concluding that Rules 23 and 23.1 were not divided for the purpose of according inferior rights to objecting shareholders versus objecting class members).

245. See *Felzen*, 134 F.3d at 875-76.

246. See *id.* at 875-76.

247. See *id.* at 875. Despite the Seventh Circuit's quick dismissal of direct injury to shareholders, the opinion later argues in the context of standing that "reduction in the market price of one's stock is injury." *Id.* at 876.

248. See *id.* at 876 (noting the usefulness of monitoring, the goals of Rule 23.1 notice, and the potential for unfair settlements, but declining any in-depth consideration of these issues due to the objector's failure to become a party).

249. See *id.*

250. See *id.* at 876.

justified” where a named plaintiff lacked faithfulness.²⁵¹ The court, however, declined to weigh these fairness concerns equally with the court’s desire for proper procedure and efficiency.²⁵² For the Seventh Circuit, procedure was of preeminent importance, and the non-named party’s failure to intervene precluded the court from considering the merits of the case.²⁵³

The court’s concern for formalities further obscures the nexus between fairness and proper procedure.²⁵⁴ Although the court considered the potential for abuse by plaintiffs’ counsel, and the resulting damage to the vitality of derivative litigation, the court never addressed how procedure could serve the interests of fairness.²⁵⁵ As the dissenting non-named parties objected to the very abuse and inequity that proper procedure was designed to ameliorate, the court’s concern that monitoring would not support and strengthen shareholder participation appears unfounded.²⁵⁶

III. EFFICIENCY AND FAIRNESS: PROVIDING THE PROPER BALANCE AND FULFILLING THE GOALS OF THE FEDERAL RULES OF CIVIL PROCEDURE

Resolution of the current circuit split will have significant consequences for the vitality of shareholder derivative litigation.²⁵⁷ An analysis of the current approaches to the issue reveals an emphasis on only one aspect of what should be a two-pronged inquiry that considers both fair-

251. *Id.* (citing many commentators who have argued that derivative actions do not promote beneficial corporate governance principles due to the abuses by plaintiffs’ counsel and the diversion of corporate resources from business to litigation).

252. *See id.* (recognizing the objectors’ concerns about a potentially unjust settlement, yet declining to consider the terms of the settlement and admonishing the objectors for their failure to become proper parties by stating that “the possibility that a district court’s judgment is erroneous does not dispense with the need for an appeal by a party”).

253. *See id.*

254. *See id.*; *see also* *Cohen v. Young*, 127 F.2d 721, 724-25 (6th Cir. 1942) (providing procedural rights to a shareholder called by the court to present objections, and linking these rights with the purpose of court notice and the need for “broader information”).

255. *See Felzen*, 134 F.3d at 876.

256. *See id.*

257. *See* *Petition for a Writ of Certiorari at 11, California Pub. Employees’ Retirement Sys. v Felzen*, 119 S. Ct. 29 (1998) (No. 97-1732) (per curiam) (noting that the current lack of uniformity in federal law creates practical procedural ambiguities for the named plaintiff, invites forum shopping, and confuses objecting shareholders to whom procedure applies); *see also* FERRARA ET AL., *supra* note 18, § 1.03, at 1-13 to 1-20 (acknowledging that despite reform movements directed toward Rule 23.1, and predictions of the Rule’s demise, the Rule remains resilient); Dykstra, *supra* note 6, at 74-75 (arguing, in the wake of significant numbers of strike suits and calls for reform, that the shareholder suit continues to flourish because of the elemental role such litigation plays in the contemporary economy).

ness of settlements and judicial economy.²⁵⁸ An approach that considers fairness and efficiency equally will better serve the goals of Rule 23.1 in particular and the Federal Rules of Civil Procedure in general.²⁵⁹ In light of these considerations and the structure of Rule 23.1, the procedure that most adequately satisfies both of these principles is appearance by the non-named party at the settlement hearing.²⁶⁰

A. Appearance Fulfills the Goals of Shareholder Litigation

1. Efficiency

An intervention requirement could create parallel appeals from a single settlement order.²⁶¹ Therefore, that procedure may place additional burdens on the individual litigant, especially in terms of litigation costs, while providing no reciprocal benefit of increased efficiency.²⁶² An appearance requirement, by contrast, allows the court to consolidate in one judicial hearing its determinations regarding the merits of the settlement

258. Compare, e.g., Brief for the United States and the SEC as Amici Curiae Supporting Petitioners at 6, *Felzen* (No. 97-1732) (alleging error in the Seventh Circuit's formulation due to singular reliance on procedural strictures at the expense of absent shareholder interests), with Brief in Opposition to Certiorari at 12, 16, *Felzen* (No. 97-1732) (chastising the Third Circuit approach for its failure to heed precedent and procedure; terming the arguments against the Seventh Circuit view mere "policy"); see also *supra* notes 12-15 and accompanying text (discussing the circuit split).

259. See *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 548 (1949) (emphasizing derivative litigation's purposes are to redress wrongs in corporate management and empower the shareholder to commence an action for judicial relief); *Gottlieb v. Wiles*, 11 F.3d 1004, 1009 (10th Cir. 1993) (noting the goals of representative litigation, including uniform resolution of similar claims); Dykstra, *supra* note 6, at 101 (concluding that any reform of shareholder litigation must strike a careful balance "between an overly restrictive approach which discourages and hampers corporate policing by shareholders, and a too generous approach which encourages nuisance actions").

260. See 2 ARON ET AL., *supra* note 21, § 27:12, at 14 (setting forth the goals of notice under Rule 23.1 as prevention of collusive settlements and the preservation of claims by those other than the named plaintiff); MAGNUSON, *supra* note 148, § 8.22, at 127-129, 131 n.16 (noting that the requirement of court approval of any compromise under Rule 23.1 is designed to ensure settlement fairness while also empowering district courts to judiciously resolve litigation); Duffy, *supra* note 4, at 951-52 (concluding that a requirement of appearance fulfills the goal of meaningful participation by shareholders in the settlement process without comprising concerns for judicial efficiency).

261. See *supra* note 201 and accompanying text (raising the potential for parallel appeals resulting from mandatory intervention requirement).

262. See Petition for a Writ of Certiorari at 16, *Felzen* (No. 97-1732) (noting the costs and inconveniences associated with both intervention and party status, including discovery obligations); see also *supra* Part II.A.4 (discussing the practical inefficiency of intervention); *supra* notes 5-8 and accompanying text (discussing the purpose of representative litigation to permit the adjudication of small claims which otherwise would remain unlitigated due to prohibitive court costs).

and whether access to appellate review should be granted.²⁶³ Providing this one locus for both determinations keeps all named parties apprised of the objections to the settlement.²⁶⁴ Thus, appearance would bring "broader information" to the court's attention efficiently through a procedure that is accessible to sophisticated and unsophisticated non-named parties alike.²⁶⁵

Concerns regarding the potential decrease in settlements resulting from eased appellate review for nonparties may be addressed by innovative mechanisms, such as the appointment of guardians *ad litem*.²⁶⁶ Also, increased shareholder participation may result in an increased number of settlements, so long as the involvement is controlled, as access to all relevant information in a given case may speed a resolution.²⁶⁷

Conversely, commentators have maintained that settlements are not always in the best interests of all parties.²⁶⁸ In addition to concerns for

263. See Duffy, *supra* note 4, at 948, 952-53 (arguing that appearance would eliminate the procedural pitfall of a litigant being denied access because he appealed the settlement's merits instead of the intervention denial; also, it would economize the process).

264. See *id.* at 948, 951-53 (predicting that separating the determination of party standing and the settlement's merits could create a breakdown in communication between the original named parties and the objecting nonparties, thereby preventing an informed evaluation of the settlement). If a non-named party objects to the settlement outside of the settlement hearing, the named plaintiff may be unaware of the existence of an objection to the settlement and its basis. See *id.* at 953. Consequently, the named plaintiff would be inadequately informed and may no longer be an adequate representative pursuant to Rule 23.1. See FED. R. CIV. P. 23.1.

265. See *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1309 (3d Cir. 1993) (emphasizing the potential for high "agency costs" associated with shareholder litigation and the concomitant importance of receiving additional information regarding the settlement's merits; granting objector standing without intervention); *Cohen v. Young*, 127 F.2d 721, 725 (6th Cir. 1942) (granting objector standing in anticipation of receipt of broader information and a more just settlement); Petition for a Writ of Certiorari at 16, *Felzen* (No. 97-1732). The appearance requirement permits both *pro se* litigants and those able to secure counsel the opportunity to present objections in court, thus improving fairness. See, e.g., *Walker v. Mesquite*, 858 F.2d 1071, 1073-74 (5th Cir. 1988) (denying objector standing to *pro se* litigants due to their failure to comply with procedural requirements for Rule 24 motions). Under this model a non-named party could appear in person at the settlement hearing, send written objections, or appear by counsel. See *supra* note 59 and accompanying text.

266. See *infra* Part III.B.2 (discussing the appointment of a guardian *ad litem* during pre-appellate negotiations).

267. See Duffy, *supra* note 4, at 956.

268. See Owen M. Fiss, Comment, *Against Settlement*, 93 YALE L.J. 1073, 1075 (1984) (asserting that despite encouragement of pretrial resolutions provided by the Federal Rules of Civil Procedure, settlements often involve coerced consent, unequal bargaining power, and the capitulation to forces beyond justice). The lack of authoritative consent is especially prevalent in representative litigation where a self-appointed representative speaks on behalf of an entire, yet often disconnected, class. See *id.* at 1079. One such example of coerced consent is *Wolf v. Barks*, 348 F.2d 994 (2d Cir. 1965), a case in which a

the substantive fairness of an agreement's terms, settlement may prevent a full and public adjudication of the merits of a particular issue.²⁶⁹ By providing judicial interpretations of significant legal issues, adjudications often establish clear legal principles and precedent from which the public and courts may benefit.²⁷⁰ A lack of authoritative interpretation may be especially acute in the context of shareholder derivative litigation.²⁷¹

Nonetheless, predictions of numerous appeals resulting from the conferral of appellate standing on non-named shareholders may be overstated, especially in light of the nominal, pro-rata recovery afforded shareholders.²⁷² Additionally, there exists a limited time frame in which a genuinely interested shareholder can formulate objections and make a proper court appearance, as a non-named shareholder generally learns of the litigation upon receipt of court notice announcing a settlement.²⁷³

Although increased appellate review may not eradicate completely concerns for the integrity of the corporate form, decisions from states with a long tradition of expertise in corporate law, such as Delaware and New York, favor non-named shareholder appeals without intervention.²⁷⁴

2. Fairness

An appearance requirement may result in increased shareholder par-

chief executive officer privately settled a suit with the named shareholder to preclude disclosure of management misconduct that would have been in the interest of shareholders. *See id.* at 995, 997; Fiss, *supra*, at 1078 & n.16.

269. *See* Fiss, *supra* note 268, at 1085-87.

270. *See id.* at 1085 (contending that settlement eviscerates the opportunity for an authoritative interpretation of the law and justice is thereby left undone); Roberta Romano, *The Shareholder Suit: Litigation without Foundation?*, 7 J.L. ECON. & ORGANIZATION 55, 85 (1991) (emphasizing that precedent creates a social benefit and serves as a tool of corporate governance; terming legal rules and interpretations of proper corporate conduct that result from such adjudication "public goods").

271. *See* Jeffrey A. Sanborn, Note, *The Rise of "Shareholder Derivative Arbitration" in Public Corporations: In Re Salomon Inc. Shareholders' Derivative Litigation*, 31 WAKE FOREST L. REV. 337, 339 (1996) (recognizing that although judicial opinions may be public goods, "only a limited amount of legal precedent actually results from derivative litigation because the vast majority of derivative actions are settled").

272. *See* Brief for Petitioners at 35, *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (No. 97-1732) (per curiam). At oral argument in the Supreme Court, counsel for California Public Employees' Retirement System noted that, despite the dire predictions of numerous shareholder appeals, a mere twenty-five appeals have occurred in as many years. *See* Transcript of Oral Argument at 11, *Felzen* (No. 97-1732).

273. *See* *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1309 n.9 (3d Cir. 1993).

274. *See* *Prezant v. De Angelis*, 636 A.2d 915, 926 (Del. 1994) (permitting non-named shareholder appeals); *Posen v. Cowdin*, 44 N.Y.S.2d 842, 843-44 (N.Y. App. Div. 1943) (same). Additionally, this flexibility of appellate review exists in the partnership context. *See* *ICSC Partners, L.P. v. Kenwood Plaza L.P.*, 688 N.E.2d 5, 8 (Ohio Ct. App. 1996).

icipation and monitoring.²⁷⁵ This access to additional information from the entire class of shareholders will create more judicious settlements by providing a necessary check on plaintiff's counsel, who may be motivated to settle quickly and exclusively for monetary compensation.²⁷⁶ Consequently, an appearance requirement promotes fairness, which is the purpose of including notice and court approval in Rule 23.1.²⁷⁷

The appearance requirement also satisfies potential due process concerns by recognizing that the corporate rights of non-named shareholders are necessarily adjudicated through the settlement approval process.²⁷⁸ Due process in the context of representative litigation has been defined as the adoption of procedures that "fairly insure[] the protection of the interests of absent parties who are . . . bound by [the judgment]."²⁷⁹ The right to object, conveyed to all shareholders by court notice, affirms the shareholders' interest in the resolution.²⁸⁰ The right to appeal this resolution, should it be unsatisfactory, is implicit in the right to object.²⁸¹

By contrast, an intervention requirement does not presume a preexisting interest on the part of the intervenor.²⁸² Rather, the intervenor must prove an interest in the litigation and the right to participate may be conditioned entirely on judicial discretion rather than proper proce-

275. See Duffy, *supra* note 4, at 951-52 & n.99 (noting that non-named class members will be more willing to present objections if they are able to appeal the settlement).

276. See *Alleghany Corp. v. Kirby*, 333 F.2d 327, 331-32 (2d Cir. 1964) (detailing continued efforts of objectors in increasing settlement amount from \$700,000 to \$1 million and again to \$3 million).

277. See *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 532 n.7 (1984) (discussing the purpose of notice and court approval as the prevention of litigation under circumstances that "disserve the legitimate interests of the company or its shareholders"); *Stepak v. Tracinda Corp.*, Civil Action No. 8457, 1989 WL 100884, at *1 (Del. Ch. Aug. 21, 1989) (considering the settlement more critically due to the objectors' ardent opposition to the terms of the proffered settlement and concluding that the terms were neither fair nor reasonable).

278. See *Gottlieb v. Wiles*, 11 F.3d 1004, 1011 (10th Cir. 1993) (emphasizing the binding effect of judgments in shareholder actions as a rationale for granting objector standing without formal intervention); Paolini, *supra* note 60, at 1739 (recognizing the binding effect of a consent decree in the class action context; noting that a lack of non-named class member negotiation could touch upon the "outer reaches of due process" and calling for stringent procedural protections to redress this potential constitutional violation).

279. *Hansberry v. Lee*, 311 U.S. 32, 42 (1940).

280. See *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942); see also *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1176 (9th Cir. 1977) (granting standing to non-named class members as their rights were being adjudicated in the lawsuit).

281. See Brief for Petitioners at 2, *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (No. 97-1732) (per curiam) (concluding that the right to appeal is a "necessary component" of the right to object).

282. See *supra* notes 186-94 and accompanying text (discussing the mechanics of intervention).

dures.²⁸³

3. Equitable Considerations

Judicial and academic treatment of the issue of shareholder standing frequently recognizes the equitable foundation of the derivative suit.²⁸⁴ The Seventh Circuit, however, utilized equity to minimize the role of the shareholder within the derivative suit structure.²⁸⁵ Yet, the Seventh Circuit failed to consider other distinct attributes of equity jurisdiction that militate for an appearance requirement.

First, there exists no historical analogue to an intervention requirement in representative litigation.²⁸⁶ Rather, equity consistently favored the liberality of appeals in the representative context.²⁸⁷ For instance, equity recognized nonparty interests by applying the quasi-party doctrine that granted specific rights of participation to nonparties on appeal.²⁸⁸ In the derivative context, the quasi-party doctrine could expressly grant to the non-named shareholders the right of settlement approval.²⁸⁹

Second, equity jurisdiction is highly fact-specific and grants substantial discretion to judges in reviewing particular facts.²⁹⁰ This careful scrutiny of the specific attributes of each case, and the weighing of equities in response to particular circumstances, requires access to all relevant infor-

283. See *supra* notes 186-94 and accompanying text (discussing the mechanics of intervention).

284. See *Felzen v. Andreas*, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd by an equally divided court sub nom.* *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (*per curiam*); Duffy, *supra* note 4, at 940-42.

285. See *Felzen*, 134 F.3d at 875 (discussing equitable considerations in shareholder derivative and class actions); see also *supra* Part I.B (discussing the development of the derivative action).

286. See Duffy, *supra* note 4, at 940, 943 (stating that intervention has no historical foundation and arguing that a doctrine requiring intervention "rests on a clumsily reasoned line of inferences and unsubstantiated conclusions").

287. See *id.* at 940-41 (asserting that appeals in a class action context should be granted freely pursuant to equitable tradition; citing early British authority as representing "a long-standing appreciation of access to appellate review by persons whose rights and duties are being determined by the courts").

288. See Brief for the United States Government and SEC as Amici Curiae Supporting Petitioners at 12, *California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (No. 97-1732) (citing cases in which the Supreme Court recognized the quasi-party doctrine).

289. See *id.* at 12-13; see also FED. R. CIV. P. 23.1 (requiring notice and court approval).

290. See, e.g., *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 961 (Del. Ch. 1996) (emphasizing the crucial role of a fact intensive evaluation to promote fairness in a derivative settlement, especially because the settlement process engenders an "absence of a truly adversarial process . . . and legally assisted objectors are rare").

mation, which only flexible appeals can afford.²⁹¹

B. Recommendations for Procedural Mechanisms to Ensure the Efficacy of an Appearance Requirement

Although there are many benefits to an appearance requirement, concern for judicial efficiency and the integrity of the corporate structure in the wake of increased flexibility of non-named shareholder appeals are valid.²⁹² In response to these concerns, several procedural mechanisms could be utilized to preserve the goals of Rule 23.1 litigation while granting non-named shareholders appellate review under decreased constraints.

1. The De Facto Party Doctrine

Despite formal intervention, under the *de facto* party doctrine, courts permit appeals by nonparties who participate in court proceedings as if they were parties.²⁹³ Although no definitive lines establish what level of participation will suffice, courts apply a three-part test.²⁹⁴ This test considers the nonparties' participation in the lower court proceedings, whether the equities weigh in favor of hearing an appeal, and the personal stake of the nonparties in the litigation's outcome.²⁹⁵

291. See Duffy, *supra* note 4, at 940, 955-56.

292. See *Felzen v. Andreas*, 134 F.3d 873, 875 (7th Cir. 1998), *aff'd by an equally divided court sub nom. California Pub. Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (per curiam) (noting concern regarding the fragmentation of representative litigation); *Gottlieb v. Wiles*, 11 F.3d 1004, 1009 (10th Cir. 1993) (stating that allowing individual appeals risks the evisceration of the utility of representative litigation); *Bell Atlantic Corp. v. Bolger*, 2 F.3d 1304, 1308 (3d Cir. 1993) (asserting the potential for unwieldy litigation and the defeat of the goals of representative litigation as reason to deny standing to appeal to nonparties). At oral argument in *Felzen*, Justice Scalia analogized the prospect of successive appeals pertaining to one settlement as "a perpetual motion machine." Transcript of Oral Argument at 27, *Felzen* (No. 97-1732).

293. See 15A WRIGHT ET AL., *supra* note 2, § 3902.1, at 102, 106 (discussing the application of *de facto* party status in situations where persons participate in trial proceedings as if they intervened).

294. See *id.* Compare *Curtis v. City of Des Moines*, 995 F.2d 125, 128 (8th Cir. 1993) (granting standing to appeal and accepting briefs due to the party's active participation through court appearance), with *EEOC v. Louisiana Office of Community Servs.*, 47 F.3d 1438, 1442-43 (5th Cir. 1995) (denying standing to appeal for failure of the nonparty to plead, intervene, or participate; noting nonparty's adequate representation by class representative).

295. See, e.g., *Louisiana Office of Community Servs.*, 47 F.3d at 1442 (delineating the *de facto* party test); *SEC v. Wencke*, 783 F.2d 829, 834 (9th Cir. 1986) (same). An analogous doctrine was advanced by counsel at oral argument in *California Public Employees' Retirement System v. Felzen*. See Transcript of Oral Argument at 3-6, *Felzen* (No. 97-1732). Under the quasi-party doctrine, a person will be granted the right of appellate re-

In the context of Rule 23.1 litigation and to prevent the possibility of multiple appeals, this test could be applied to requests for appellate review by objecting non-named shareholders.²⁹⁶ Such a test would be consistent with the equitable foundation of Rule 23.1 and would ensure that those granted the right of appeal have evidenced meaningful participation and interest in the litigation.²⁹⁷ The test would provide a check on the number of appeals granted by considering the extent of a non-named party's interest, and may therefore alleviate concerns regarding corporate integrity.²⁹⁸

In determining the extent of a non-named party's interest in the litigation, the Private Securities Litigation Reform Act of 1995 (Reform Act) offers guidance.²⁹⁹ The Reform Act seeks to deter abuse by class action attorneys by giving control of the litigation to a "most adequate plaintiff."³⁰⁰ The Reform Act includes a rebuttable presumption that the plaintiff with the greatest financial interest is the "most adequate plaintiff."³⁰¹

view when they have been sufficiently summoned to court, have appeared and litigated their claim, and will suffer preclusion of their claim from the judgment. *See* Brief for the United States Government and SEC as Amici Curiae Supporting Petitioners at 5, *California Public Employees' Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (No. 97-1732) (citing cases in which the Supreme Court recognized the quasi-party doctrine). The doctrine has been utilized primarily in receiverhip and real property situations; however, the three requirements could translate to the shareholder derivative context. *See id.* at 5, 9-14. The requirements are consistent with the purposes of Rule 23.1, could alleviate efficiency concerns, and recognize due process concerns. *See id.*; *see also supra* notes 278-81, *infra* note 297 and accompanying text.

296. *See* *Gottlieb*, 11 F.3d at 1009 (recognizing potential for numerous appeals should requirements of appellate review be relaxed). Courts already had utilized these factors to some extent in previous rulings. *See* *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942) (granting appellate standing to an objecting non-named shareholder because court notice requesting him to show cause was akin to a summons); *cf. Gottlieb*, 11 F.3d at 1011 (distinguishing, in dicta, Rule 23.1 actions by noting the concerns that all shareholders remain bound by judgment).

297. *See* *Duffy*, *supra* note 4, at 956 (observing the importance of meaningful involvement to the fair resolution of derivative litigation).

298. *See supra* notes 219-21 and accompanying text (discussing the interests of corporate management in a centralized settlement process).

299. 15 U.S.C. §§ 77z-1, 78u-4 (West 1997). The Reform Act, promulgated in response to abuse in private securities class actions, instituted numerous reforms. *See* S. Rep. No. 104-98 at 4 (1995) *reprinted in* 1995 U.S.C.C.A.N. 679, 683. These reforms intended to discourage frivolous suits and excessive attorneys' fees while encouraging meritorious shareholder claims and voluntary corporate disclosure. *See id.*

300. *See* 15 U.S.C. §§ 77z-1(a)(3)(B)(i), 78u-4 (a)(3)(B)(i). This "most adequate plaintiff" would serve as the lead plaintiff. *See id.*

301. *See* 15 U.S.C. §§ 77z-1(a)(3)(B)(i), 78u-4 (a)(3)(B)(i) & (3)(B)(iii)(bb). The Reform Act intended to align the lead plaintiff with the interests of the class of shareholders and thereby avoid both professional plaintiffs and suits motivated solely for recovery of

Although a facile determination of interest by numerical and monetary calculation is questionable, the Reform Act serves as precedent to aid courts in deciding what constitutes a sufficient personal interest under the *de facto* party test.³⁰²

2. *Requiring Appearance at the Settlement Hearing and Narrowly Tailoring the Court Order Granting Appellate Review*

Concerns regarding the multiplicity of appeals could be alleviated by requiring that a non-named shareholder present objections, either in person or in writing, solely in the confines of the settlement hearing.³⁰³ Limiting objections to this single forum is consistent with the goals of Rule 23.1, which provides for participation by requiring court approval and notice.³⁰⁴ An ancillary benefit of limiting appeals exclusively to shareholders who demonstrate diligence in court attendance or proper submission of objections may be a decrease in the number of appeals and the grant of court audience to persons genuinely interested in the litigation's resolution.³⁰⁵

Further, the potential whirlwind of motions and discovery resulting from this provision of appellate standing could be abated through the use of a narrowly tailored court order.³⁰⁶ In addition to limiting discovery solely to the merits of the settlement, the court could delineate a schedule of proceedings and retain its jurisdiction to ensure proper compli-

attorneys' fees. See S. Rep. No. 104-98 at 10-11 (1995) *reprinted in* 1995 U.S.C.C.A.N. 679, 683. In deciding that this lead plaintiff would be selected on the basis of financial stake, Congress demonstrated confidence in institutional investors and recognition of the fiduciary obligations between institutional investors and their shareholders. See *id.* Emphasizing the ability of institutional investors to supervise settlement negotiations and assess the fairness of the compromise, Congress predicted that "the increasing role of institutional investors in class action will ultimately benefit the class and assist the courts." *Id.* at 11.

302. See *In re Cephalon Sec. Litig.*, No. Civ. A. 96-0633, 1998 WL 470160, at *5 (E.D. Pa. Aug. 12, 1998) (discussing appointment of lead plaintiff and rebuttable presumption under the Private Securities Litigation Reform Act of 1995).

303. See *supra* notes 261-63 and accompanying text (recommending the centralization of all objections to the settlement hearing). See generally Duffy, *supra* note 4, at 951 (recognizing that a class representative under this model need only be concerned with objections raised at the settlement hearing, rather than post-settlement hearing objections).

304. See *supra* note 254 and accompanying text (outlining the goals of notice and court approval).

305. Cf. *Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30, 32-33 (3d Cir. 1971) (suggesting in dicta that, if shareholders could choose to appeal after seeing the settlement, many of them probably would choose not to do so).

306. See *Saylor v. Bastedo*, 78 F.R.D. 150, 153 (S.D.N.Y. 1978) (granting a nonparty objector status, thus affording him an adequate opportunity for discovery, but limiting this right to the "facts going to the propriety of the settlement") (internal quotes omitted).

ance.³⁰⁷ A narrowly tailored order would be consistent with equity and the asserted interests of the shareholders in arguing exclusively the merits of the settlement, while conserving limited judicial resources.³⁰⁸

3. Appointment of a Post-Trial Guardian

Corporate management has lauded procedural devices that afford protection to corporate integrity and an opportunity for the corporation to “vindicate its own rights.”³⁰⁹ These devices include the requirement of making a demand prior to commencing a derivative action, the application of the business judgment rule, and the utilization of special litigation committees comprised of disinterested directors.³¹⁰ Similar to these mechanisms, the court could appoint a guardian *ad litem* to represent the interests of the shareholders during the settlement process and prior to appellate review.³¹¹ Commentators have noted that this procedure would provide representation for absent members and avoid settlements overly favorable to plaintiffs’ counsel, yet encourage a quick resolution by streamlining the receipt of information and emphasizing negotiation.³¹²

IV. CONCLUSION

In consideration of the fairness and efficiency principles underlying

307. See *id.* (limiting discovery to a six-month period, encouraging all objectors to participate in this discovery, and scheduling a settlement hearing to assess newly obtained evidence). Such judicial expression may be authorized by the court’s inherent power as specifically referenced in the Advisory Committee Note to the 1966 Amendments to Rule 23.1. See FED. R. CIV. P. 23.1 advisory committee’s note (“The court has inherent power to provide for the conduct of the proceedings in a derivative action . . .”).

308. See Brief for the United States and the SEC as Amici Curiae Supporting Petitioners at 27, *California Pub. Employees’ Retirement Sys. v. Felzen*, 119 S. Ct. 720 (1999) (No. 97-1732) (*per curiam*) (arguing for an appearance-only requirement in shareholder suits by analogizing the equitable doctrine of quasi-parties, which provides for non-party appeals but limits participation to that party’s cognizable interest). From this analysis the SEC concludes that “[a]n unfettered, though narrowly tailored, right to appeal the district court’s decision . . . will further the purposes underlying Rule 23.1 by ensuring the opportunity for appellate scrutiny.” *Id.*

309. *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 548 (1949); see also *Garth et al.*, *supra* note 7, at 139 (discussing procedural hurdles to shareholder litigation designed to provide corporate management with increased control).

310. See *Garth et al.*, *supra* note 7, at 139-41.

311. See *Macey & Miller*, *supra* note 183, at 47 (suggesting the institution of guardians *ad litem* as a possible reform and emphasizing the guardian’s neutral role in assessing a settlement because he would object for absent members unless a clear statement of the settlement’s fairness was provided).

312. See *id.* at 47-48 (suggesting that the guardian’s mere “presence in the litigation” would encourage fairness to the absent shareholders, especially if there were economic incentives); *Lazos*, *supra* note 233, at 309-11 (advocating appointment of a guardian).

Rule 23.1, placing unnecessary procedural requirements on the individual non-named shareholder seeking appellate review is problematic. Fulfillment of these dual principles can be achieved by requiring an appearance by the non-named shareholder within the confines of the settlement hearing to preserve the right to appellate scrutiny. The appearance requirement avoids unnecessary litigation costs, preserves the judiciary's limited resources, and ensures access to all relevant information needed to formulate a fair and judicious settlement. Concerns regarding multiple appeals and threats to corporate integrity can be mollified substantially by utilizing various procedural mechanisms. Although these mechanisms serve to limit the number of non-named shareholders to whom appellate review may be accorded, these procedural devices emphasize equity and propriety in tandem with judicial economy.