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COUNSEL FEES IN STOCKHOLDERS' DERIVATIVE AND CLASS ACTIONS—HORNSTEIN REVISITED

Douglas G. Cole*

IN 1939, the first in a series of four comprehensive law review articles by Professor George D. Hornstein was published on the subject of the award of counsel fees in stockholders' derivative suits and corporate class actions.¹ These articles highlighted equitable principles peculiar to such actions, previously not fully understood by either attorneys or the courts, which have made derivative and class actions extremely effective weapons in the battle for corporate democracy. Three very basic questions were posed and answered: 1) Who will pay for the attorneys fees and expenses incurred in such litigation? 2) What factors govern the award of counsel fees? 3) How are they calculated?

Using the legal principles collected in Hornstein's articles, the United States Supreme Court in 1970 in *Mills v. Electric Auto-Lite Co.*² allowed an interim award of litigation expenses and reasonable attorneys fees incurred in proving a violation by corporate officers of the securities laws. Because the *Mills* decision has had a profound impact on corporate derivative and class actions, it is important to now re-examine the basic legal theories which are involved, as well as to touch upon those areas of the law in which difficult problems remain unanswered.

I. WHO WILL PAY THE AWARD

Although as a general rule the successful party in litigation is not reimbursed for his counsel fees and expenses,³ the courts have recognized that departure from this principle is desirable and probably necessary in derivative and class actions. Because of the large sums generally in-

*Member of the Ohio Bar. A.B., Oberlin College, 1942; I.A., Harvard Business School, 1943; J.D., University of Cincinnati, 1948.

¹Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658 (1956); Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 COLUM. L. REV. 1 (1947); Hornstein, *Problems of Procedure in Stockholder's Derivative Suits*, 42 COLUM. L. REV. 574 (1942); Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784 (1939).

²396 U.S. 375 (1970).

³Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784, 786 (1939).

volved and the unequal resources available as between the individual plaintiff and the corporation for conducting such litigation, derivative and class actions would be effectively deterred without a satisfactory answer to the question of who will bear the burden of the legal fees and expenses. American courts have developed a series of equitable doctrines which answer this inquiry in a manner that has fostered and encouraged such suits.

The first of these principles was early announced by the United States Supreme Court in *Trustees v. Greenough*.⁴ A bondholder successfully brought suit to have fraudulent conveyances on the part of trustees set aside, and then sought reimbursement for counsel fees and expenses. The Court allowed counsel fees, applying reasoning that when a litigant salvages assets in which others will share, *i.e.*, creates increases, or protects a fund for the benefit of a class of which he is a member, the resultant fund may be charged with all necessary expenses incurred in achieving that result. The expenses of the successful litigant are paid, not by the unsuccessful litigant, but by the class which would have had to pay them had it brought suit itself.⁵

Two theories lay behind this rule, 1) the theory of representation or agency by the one member of the class on behalf of all in securing counsel, and 2) the quasi-contractual theory that each member of a class receiving benefit from the litigation brought by counsel should contribute his due proportion of the legal expenses so incurred.⁶

Of equal importance was the rule announced in *Sprague v. Ticonic National Bank*⁷ in which the Supreme Court held that nothing in the

⁴ 105 U.S. 527 (1881).

⁵ See Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784, 786-88 (1939).

⁶ *Id.* at 789. Contribution from the entire fund has been required even as to those shareholders, generally members of management, who opposed plaintiff's litigation since, in benefiting from the litigation as a member of the broad class of shareholders, they now had a legal interest in that which they formerly held illegally. See *German Evangelical St. Marcus Congregation v. Archambault*, 404 S.W.2d 705 (Mo. 1966); *Leggett v. Missouri State Life Ins. Co.*, 342 S.W.2d 833 (Mo. 1961); *Heckelman v. Geyer*, 252 Pa. 123, 97 A. 193 (1916).

A corollary to this rule is that the loss of an unwarranted advantage gained by one through illegal means cannot be used to demonstrate a detriment. As stated in *Jesser v. Mayfair Hotel, Inc.*, 360 S.W.2d 652 (Mo. 1962):

. . . A claim of loss cannot be based upon a failure to make a profit out of the wrongful and unauthorized act which would not have been permitted to stand in any event. *Id.* at 659.

⁷ 307 U.S. 161 (1939).

Trustee v. Greenough doctrine indicated that the action must actually bring money into the court as a pre-requisite to an order for reimbursement of expenses. Rather the foundation of the court's power to reimburse such expenses lies in the original authority of the chancellor to do equity in a particular situation.

The third principle, which evolved from the *Sprague* rule, is that where the litigation has conferred a substantial benefit on the members of an ascertainable class, and where the court's jurisdiction over the subject matter of the suit makes possible an award that will operate to spread the cost proportionately among them, reimbursement of legal fees will be awarded, regardless of whether an actual money recovery has been obtained in the corporation's favor. Examples would include situations where the wrongful issuance of shares for an inadequate consideration has been set aside, the cancellation of an illegal and onerous contract has been accomplished, or the termination of a voting trust has been achieved.⁸ The theory behind an award in such successful cases is that the litigation, although not bringing a fund into court, has benefited the holders of all shares by enhancing the value thereof.⁹

The fourth principle is that first formulated in *Schechtman v. Wolfson*,¹⁰ but more effectively stated in *Bosch v. Meeker Cooperative Light & Power Association*,¹¹ to the effect that a corporation may receive a substantial benefit from a derivative suit and therefore be liable for counsel fees incurred, even though the benefit cannot be calculated in monetary terms.¹²

Even when it is difficult or impossible to assign a monetary value to the particular substantial benefit in the case of derivative and class actions based upon violations of the SEC statutes and rules, the courts feel that such actions vindicate the statutory policy, involve corporate ther-

⁸ *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 393-94 & nn.18-20 (1970).

⁹ See *Allen v. Chase Nat'l Bank*, 180 Misc. 259, 40 N.Y.S.2d 245 (Sup. Ct. 1943).

¹⁰ 244 F.2d 537, 540 (2d Cir. 1957).

¹¹ 257 Minn. 362, 101 N.W.2d 423 (1960).

¹² The test of whether there has been a "substantial benefit" in a particular case may be stated generally as:

[A] substantial benefit must be something more than technical in its consequence and be one that accomplishes a result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder's interest. *Id.* at 367, 101 N.W.2d at 427.

The *Bosch* decision is discussed in more detail at p. 271 *infra*.

apeutics, and furnish a benefit to all shareholders by providing an important means of enforcement of such statutes.¹³

The major contribution made by *Mills v. Electric Auto-Lite Co.*¹⁴ in this area is in its pronouncement that such non-monetary benefits involving corporate therapeutics can furnish the basis for an interim award of litigation expenses and attorneys fees, even before the merits of the controversy have been adjudicated.

One student note has suggested that the *Mills* decision may so encourage derivative litigation that such actions will prove a prohibitively expensive liability to the corporation.¹⁵ This fear has been expressed throughout decades of derivative litigation, and should be no more valid in the future than it has been over the past thirty years, as such award is made only if the cause of action is validly established, and, thus, a benefit, monetary or otherwise, has been secured for the corporation and its stockholders. The benefits accorded to the corporation and their stockholders should continue in the future to outweigh greatly the corporate expense involved.

It should also be pointed out that the advent of Rule 23 of the Federal Rules of Civil Procedure,¹⁶ with its proscription against dismissal or compromise of class or derivative actions without the approval of the court has been a most effective bar to frivolous or strike suits. This rule has meant that counsel for the plaintiff has to shoulder the burden and expense of adequately preparing his case for trial under the watchful eye of the court, and that he cannot depend upon an early settlement based principally upon the recovery of attorneys' fees. Plaintiff's counsel must face the fact that before he is compensated for his time or expenses, a substantial benefit to the corporation or its shareholders or to the members of the class must be demonstrated. In dollars and cents,

¹³ *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 396 (1970).

¹⁴ 396 U.S. 375 (1970).

¹⁵ Note, *Mills v. Electric Auto-Lite Company: Proxy Violations—The Causation Question and the Award of Attorney's Fees*, 65 Nw. U.L. Rev. 854, 873-76 (1970).

¹⁶ FED. R. Civ. P. 23(e) provides:

Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

The last sentence of FED. R. Civ. P. 23.1 pertaining to derivative actions by shareholders provides:

The 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 shareholders or members in such manner as the court directs.

this has meant, by way of example, in three recent derivative actions within the knowledge of the author, from \$30,000 to \$40,000 in expenses incurred for expert witnesses in the fields of security analysis, accountancy and corporate operation, depositions, travel expenses and duplicating costs during discovery, with no hope of recoupment if the cases were not successfully concluded.¹⁷ With this much dependent on the outcome, plaintiff's counsel must be very sure of his legal position before he brings the action.

The *Mills* case should narrow the gap which previously existed between class actions and derivative suits, as to the measure of the benefit needed to be shown in order to secure an award of attorneys' fees. In the case of *Missouri Pacific Railroad Co. v. Slayton*,¹⁸ the plaintiffs brought a class action which secured a favorable decision as to the voting procedures between Class A and Class B stock, but the court of appeals denied the plaintiffs' attorneys' fees on the ground that the corporation did not derive the requisite benefit from the maintenance of the class action. Each plaintiff was therefore relegated to collection of his expenses from the individual shareholder members of his class, a formidable task.

Under the cases which preceded *Mills*, the courts required plaintiffs in a class action to establish a definite, measurable, pecuniary benefit to the class, whereas in a derivative suit all the plaintiff needed to show was a substantial benefit (even though not measurable pecuniarily) to the corporation or all of the shareholders in order to recover his attorneys' fees.¹⁹ While *Mills* was primarily a derivative suit, the Court of Appeals for the Third Circuit, in *Kaban v. Rosenstiel*,²⁰ in a pure class action, has correctly extended the *Mills* holding that attorneys' fees may be awarded in any case where the cause of action has "conferred a substantial benefit" as opposed to a measurable pecuniary benefit. The teaching of the *Mills* and *Kaban* decisions should prevent a repetition of the unfavorable result achieved in the *Slayton* case.

II. THE FACTORS GOVERNING THE AWARD

The general rules applicable to an award of counsel fees in actions

¹⁷ *Ramey v. Cincinnati Enquirer*, Civil No. 7704, 7707, 7720 (S.D. Ohio 1971); *Martin v. Ohio Casualty Ins. Co.*, Civil No. 7245 (S.D. Ohio 1970); *Cole v. Union Bankers Ins. Co.*, Civil No. 9286 (N.D. Texas 1970).

¹⁸ 407 F.2d 1078 (8th cir.), *cert. denied*, 395 U.S. 937 (1969).

¹⁹ See 14 Sr. Louis L.J. 324, 327, 332 (1969).

²⁰ 424 F.2d 161 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970).

where a monetary fund has been created or preserved have become well-settled, as discussed in Professor Hornstein's articles, and generally are not seriously questioned in particular actions.²¹ Three areas of bitter conflict remain, however, which seemingly can only be resolved on a case by case basis, at least until the emergence of more precise rules from far more cases than have been presently decided.

These troublesome areas include:

1) The kind and degree of proof necessary to establish the causal connection between the litigation and a subsequent settlement, unilateral rescission, or other form of corrective measure by the defendants during litigation, and before final judgment, which moots the cause.

2) The calculation of the benefit in cases involving either settlement or unilateral steps taken by the defendants during litigation mooting the action, particularly in those situations where the benefit is not capable of expression in monetary terms, and

3) The amount of the award in those cases in which it is impossible, or extremely difficult, to calculate the monetary value of the benefit, as well as those cases in which the calculated benefit is in excess of \$4,000,000.

A. Causal Connection

A most difficult situation for a plaintiff in either a derivative or a class action occurs when at some stage of the litigation before final judgment, the defendants take action without the knowledge or approval of the plaintiff or the court which effectively moots the issues raised in the litigation.

In such cases, the courts have awarded counsel fees to the attorney for the plaintiff shareholder, upon a finding that plaintiff's suit was meritorious, and that such meritorious action caused or substantially contributed to the action taken by the defendants to abandon, rescind or otherwise moot the action.²² The established rule is that such suits are meritorious if they could have survived a motion to dismiss.²³

The court will consider that even though a motion to dismiss has been granted because the issues have been rendered moot, it retains jurisdic-

²¹ See *Newmark v. RKO General, Inc.*, 332 F. Supp. 161 (S.D.N.Y. 1971).

²² See, e.g., *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir. 1970).

²³ *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir. 1970); *Chrysler Corp. v. Dann*, 43 Del. Ch. 252, 223 A.2d 384 (1966); *Rosenthal v. Burry Biscuit Corp.*, 42 Del. Ch. 279, 209 A.2d 459 (1959).

tion to consider whether plaintiff's action was meritorious, and whether his action caused or contributed to cause others to benefit.²⁴ The trial court generally has little difficulty in determining whether the plaintiff's underlying action was meritorious or not, based upon the inquiry as to whether it could have withstood a motion to dismiss. However, the courts have had more difficulty in enunciating a standard by which to judge whether it was plaintiff's meritorious action which caused the defendants to set aside their challenged acts, as opposed to the predictable statements of the defendants that they took such steps for business reasons having nothing to do with the litigation.

To date, the courts faced with this decision have not gone into an extended discussion of causation but have contented themselves with a simple finding that if the action was meritorious, it could be inferred that such litigation did cause defendants' unilateral acts which mooted the cause. The following language from the cases is typical:

The Court concludes that defendants' cancellation after plaintiff had prosecuted its action to the brink of success provides a sufficient basis for an inference that the cancellation was in fact due to plaintiff's efforts.²⁵

or:

We leave to the determination of the court below whether or not Levine's suit was relevant to Wills' prepayment of his note, i.e., whether there was a causal connection between the two incidents: in short, whether Levine's claim is valid.²⁶

or, the terse:

Actions speak louder than words.²⁷

In *Rosenthal v. Burry Biscuit Corp.*,²⁸ the court placed the burden of proof as to causation on the defendants, stating:

Where, as here, the matter has been rendered moot by the action of the defendants, I think it reasonable to impose on the defendants the

²⁴ *Levine v. Bradlee*, 378 F.2d 620 (3d Cir. 1967); *Gilson v. Chock Full O' Nuts Corp.*, 331 F.2d 107 (2d Cir. 1964); *Schechtman v. Wolfson*, 244 F.2d 537 (2d Cir. 1957); *Globus, Inc. v. Jaroff*, 279 F. Supp. 807 (S.D.N.Y. 1968); *Fletcher v. A.J. Indus.*, 226 Cal. App. 2d 313, 72 Cal. Rptr. 146 (1968).

²⁵ *Globus, Inc. v. Jaroff*, 279 F. Supp. 807, 810 (S.D.N.Y. 1968).

²⁶ *Levin v. Bradlee*, 378 F.2d 620, 625 (3d Cir. 1967).

²⁷ *Marlin v. Marsh & Marsh*, 189 Ark. 1157, 1158, 76 S.W.2d 965, 966 (1934).

²⁸ 43 Del. Ch. 279, 209 A.2d 459 (1949).

burden of showing that the cancellation was not in any way occasioned by the existence of the lawsuit. I hasten to emphasize that even if such a burden is sustained, the plaintiff's attorney would still be entitled to a fee if it is shown that the cause of action was meritorious.²⁹

A similar position was taken in *Maggiore v. Bradford*.³⁰ While the suit was pending, the stock transaction complained of, which permitted the Comer group to finance the purchase of their controlling shares from the corporation's assets, was voluntarily rescinded by the defendants, mooting the action. Upon application for legal fees, the district court held that it did not have the right to award fees in that situation. In reversing, the Court of Appeals for the Sixth Circuit held:

The District Court did not consider the right to an allowance of attorneys' fees on the basis of the liability of defendants to rescind the transaction and the case must be remanded for that purpose. The fact that the defendants rescinded the transaction before the court had an opportunity to pass upon the merits of the case would not, in our judgment, defeat the right to compensation.³¹

In *Vigran v. Hamilton*,³² the corporation had accepted an offer of \$90,000 for its buildings. A shareholder brought suit alleging the price was too low, whereupon the successful bidder then increased his price to \$126,000. The sale was closed and the litigation was thereby mooted. The court found a causal connection between the suit and the result, and awarded a \$3,000 fee based upon the benefit of the increase in price of \$36,000.

The shareholders' attorney in *Gilson v. Chock Full O' Nuts Corp.*,³³ made a demand on the corporation to recover insiders' short-swing profits. After some delay, the corporation filed suit and successfully

²⁹ *Id.* at 281, 209 A.2d at 461.

³⁰ 310 F.2d 519 (6th Cir. 1962).

³¹ *Id.* at 522. In a subsequent appeal on the issue of the amount of the attorney's fees, where the award was \$235,000 based upon the restoration of \$2,700,000 in assets to the corporation, the sixth circuit stated:

It cannot be said that the cancellation of the purchase of the Moore stock did not result from the action of the minority stockholders. Its cancellation inured to the benefit of the corporation by restoring \$2,700,000 in assets in lieu of the Moore stock. We are unable to say that the amount allowed is excessive.

Denney v. Phillips & Buttorff Corp., 331 F.2d 249, 251 (6th Cir. 1964).

³² 321 Ill. App. 541, 53 N.E.2d 250 (1944).

³³ 331 F.2d 107 (2d Cir. 1964).

collected the illegal profits. Upon suit for attorneys' fees based upon the efforts in calling such suit to the corporation's attention, the court stated:

It would run counter to effective enforcement of the statute [§ 16(b) of the Securities Exchange Act of 1934] wholly to deny compensation in such a case.³⁴

In *Mencher v. Sachs*,³⁵ the president of the defendant corporation issued a large block of stock to Milestone Drilling Company on the eve of a stockholders meeting. Milestone then voted its stock for management. Suit was brought to set aside the transfer of stock and the vote of such shares. Milestone thereupon surrendered the stock and the contract was cancelled, mooting the cause of action.

On the issue of causation, the court simply stated:

We agree with the Chancellor that this case was an appropriate one in which to allow counsel fees. . . .

. . . Cancellation of illegally issued stock is in itself a benefit. Although the benefit may be difficult of evaluation in dollars and cents, it is still a benefit.³⁶

Those few cases denying an award of counsel fees in such a situation do not discount the general observations made above.³⁷ The factual situation in each clearly indicates that the benefits or partial benefits achieved by the unilateral actions of the defendants could not be attributed to the plaintiff's actions.

B. Calculation of the Benefit

In both derivative and class actions, whether tried, settled or unilaterally mooted by some action taken by the defendants, the form of

³⁴ *Id.* at 110.

³⁵ 39 Del. Ch. 366, 164 A.2d 320 (1960).

³⁶ *Id.* at 367-68, 164 A.2d at 322-23.

³⁷ In *Wolfes v. Paragon Refining Co.*, 74 F.2d 193 (6th Cir. 1934) the board of directors recovered a debt owed to the corporation by its president and cancelled back salary payment to him on the day the derivative suit was filed, but before the board was aware of the filing. In *Derdiarian v. Futterman Corp.*, 254 F. Supp. 617 (S.D.N.Y. 1966), the court excluded the benefits achieved by a return of Class B stock, noting that the recovery thereof was not for the benefit of the plaintiff class and was not brought about by the plaintiff, but by separate negotiations conducted by the corporation's own counsel.

the relief accorded to the corporation and its shareholders grows in complexity with each passing year, posing extremely difficult tasks for plaintiff's attorneys in demonstrating the monetary value of such benefits, and for the court in fixing fees based thereon.

Calculation of Fees When Benefit Is Pecuniary

In settlements in which the corporation or its shareholders receive cash, the computation of the benefit presents very little difficulty to the court. Thus, in *Cherner v. Transitron Electronic Corp.*³⁸ a recovery of \$5,300,000 was paid into court, to be distributed after payment of legal fees and expenses to those shareholders who had purchased and/or sold Transitron stock after the SEC registration attacked by the suit.

In those cases in which definite and ascertainable liabilities are cancelled by the settlement, the courts also are able to translate these into monetary benefits, although with somewhat less ease. In *Krinsky v. Helfand*,³⁹ a lease, an employment contract and a stock option agreement were cancelled, and another lease renewed. The Delaware high court valued the total benefit to the corporation at \$500,000.

The difficulty in calculating the value of the benefit conferred mounts geometrically as the relief accorded utilizes novel methods of ending the litigation; methods tailored to ease the burden of payment by the responsible defendants, resulting in benefits which are difficult to value in dollars and cents. It is interesting to consider briefly at this point a few decisions which illustrate the various methods employed by the courts in evaluating the monetary benefit conferred by such settlements.

In *Pergament v. Kaiser-Frazer Corp.*,⁴⁰ the settlement, in addition to

³⁸ 221 F. Supp. 55 (D. Mass. 1963), *aff'd sub nom.* *Green v. Transitron Electronic Corp.*, 326 F.2d 492 (1st Cir. 1964). *See, e.g.*, *Newman v. Electronic Specialty Co.*, 71 CCH Sec. L. REP. ¶ 92955 (N.D. Ill. 1971) (\$1,200,000 was recovered); *Newman v. RKO General, Inc.*, 332 F. Supp. 161 (S.D.N.Y. 1971) (\$8,000,000 in short-swing profits was recovered); *Epstein v. Weiss*, 50 F.R.D. 387 (E.D. La. 1970) (fee determination based upon \$1,000,000 recovery paid into court may be found in 71 CCH Sec. L. REP. ¶ 92938 (E.D. La. 1970); *Barnes v. Osofsky*, 254 F. Supp. 721 (S.D.N.Y. 1966), *aff'd* 373 F.2d 269 (2d Cir. 1967) (\$775,000 was paid into court for distribution to those shareholders who had purchased stock after the SEC registration attacked by the suit); *Fox v. Glickman Corp.*, 253 F. Supp. 1005 (S.D.N.Y. 1966) (\$1,825,000 was similarly deposited); *Perlman v. Feldmann*, 160 F. Supp. 310 (D. Conn. 1958) (\$1,150,000 was paid into court); *National Bankers Life Ins. Co. v. Rosson*, 400 S.W.2d 366 (Tex. Civ. App. 1966) (\$1,025,000 was recovered by the corporation).

³⁹ 38 Del. Ch. 553, 156 A.2d 90 (1959).

⁴⁰ 224 F.2d 80 (6th Cir. 1955).

a cash payment to the corporation of \$500,000, included the personal guaranty by Kaiser of a ten-year \$34,000,000 loan from R.F.C. to the corporation, secured by his collateral deposit of \$10,000,000, and the purchase of equipment from the corporation at \$319,000,000 below its true value. The court credited these benefits together, without assigning a dollar value, as being worth an additional \$25,000 in attorneys' fees. In *Glicker v. Bradford*,⁴¹ the settlement effected a \$700,000 per year reduction in fund management fees, estimated to be of value for ten years, for a total estimated benefit of \$7,000,000.

The judgment in *The Herald Co. v. Bonfils*⁴² required that stock having an estimated value of \$6,429,299 be sold at auction. In another case the settlement required the corporation to issue up to two million options to the class of shareholders, each option also having a put. The court valued this package at \$1,200,000, based upon evidence of the market value of each item.⁴³

In *Ripley v. International Railways*,⁴⁴ the judgment resulted in the corporate receipt of \$8,000,000 cash, together with future rate increases with an estimated value of \$7,500,000. The court awarded legal fees based upon 20 per cent of the cash received, and an additional \$104,900 for what was described as "some reasonable compensation for the prospective benefits,"⁴⁵ for a total fee of \$2,104,900.

In *Christie v. Fifth Madison Corp.*,⁴⁶ 18,456 Class A shares were awarded to the corporation as treasury shares. The court fixed the benefit as the amount the corporation could receive if the shares were re-issued. In *Zenn v. Anzalone*,⁴⁷ in addition to a cash payment of \$3,300,000 the settlement effected an exchange of 130,000 non-voting for 130,000 voting shares of IDS (Investors Diversified Services, Inc.), vesting control of IDS in Alleghany Corporation. The court recognized that control had a speculative future benefit which, while more valuable to management than to the corporation, would be compensated for on a lower percentage ratio than that applied to the cash benefits.

⁴¹ 35 F.R.D. 144 (S.D.N.Y. 1964).

⁴² 315 F. Supp. 497 (D. Colo. 1970).

⁴³ *Derdiarian v. Futterman Corp.*, 254 F. Supp. 617 (S.D.N.Y. 1966).

⁴⁴ 16 App. Div. 2d 260, 227 N.Y.S.2d 64 (1962).

⁴⁵ *Id.* at 264, 227 N.Y.S.2d at 69.

⁴⁶ 35 Misc. 2d 570, 231 N.Y.S.2d 541 (Sup. Ct. 1962).

⁴⁷ 46 Misc. 2d 378, 259 N.Y.S.2d 747 (Sup. Ct. 1965).

Calculation of Fees When Benefit Is Non-Pecuniary

Those cases in which the court has found itself absolutely unable to place a dollar value on relief which nevertheless does benefit the corporation or its shareholders pose a very real problem to plaintiff's counsel seeking an award of legal fees, because the courts have been unable to formulate any consistent philosophy in arriving at the awards granted.

All courts agree, in the abstract, that in awarding fees to counsel in derivative and class action cases, they are to be governed by the standard of reasonableness with reference to the particular facts of each case. Nor is there any dispute that the following factors are to be weighed and considered:

. . . [T]he amount recovered for the corporation; the time fairly required to be spent on the case; the skill required and employed on the case with reference to the intricacy, novelty and complexity of issues; the difficulty encountered in unearthing the facts and the skill and resourcefulness of opposing counsel; the prevailing rate of compensation for those with the skill, experience and standing of the attorneys, accountants or others involved; the contingent nature of the fees, with the accompanying risk of wasting hours of work, overhead and expenses (for it is clearly established that compensation is awarded only in the event of success); and the benefit accruing to the public from suits such as this.⁴⁸

The cases are also uniform in holding that the results achieved rather than the time spent is the prime factor in fixing the fee.⁴⁹

Because of the frequency with which Professor Hornstein's articles⁵⁰ have been cited to the courts since 1939, most trial courts, after reciting the various factors to be taken into consideration, have become accustomed to applying a percentage ratio of the benefit accorded to determine the fee. However, no discernable pattern has emerged from those awards made in cases where there is no dollar benefit on which to base such a percentage, and the court necessarily is left to the application of the remaining factors such as time, skill, difficulty, contingency, the amount involved and the benefit to the public. An examination of the

⁴⁸ *Angoff v. Goldfine*, 270 F.2d 185, 189 (1st Cir. 1959).

⁴⁹ Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784, 811 (1939).

⁵⁰ See note 1 *supra*.

cases where a benefit has been found which is incapable of calculation in monetary terms will indicate the problems confronting such courts.

In *Bosch v. Meeker Cooperative Light & Power Association*,⁵¹ the judgment set aside an election of directors and an amendment to the by-laws, both adopted illegally to gain control of a cooperative corporation. This decision by the Supreme Court of Minnesota is a landmark in its enunciation of what substantial non-monetary benefit will justify an award of attorneys' fees, the court stating:

... [A] substantial benefit must be something more than technical in its consequence and be one that accomplishes a result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder's interest.⁵²

For having accomplished this substantial benefit in the case, the plaintiff's counsel received a fee of \$4,467.40.⁵³

In *Berger v. Amana Society*,⁵⁴ an amendment to the corporate charter was enjoined which would have permitted the sale of control by the issuance of Class B Stock. The trial court awarded fees of \$59,341 based solely on the time and skill of the attorneys. The Supreme Court of Iowa, citing the *Bosch* decision, raised the award to \$125,000, stating that some of the benefits were pecuniary in nature even though no fund was created and computation of their actual value in money might be difficult.

In *Dann v. Chrysler Corp.*,⁵⁵ the principal benefit was a modification of the executive incentive compensation plan, a long-range benefit characterized as therapeutic, incapable of expression in dollar terms, yet present and real. The referee stated that he was adopting a *quantum meruit* approach to translate the benefit and the fees into dollars.⁵⁶ Without spelling out what factors were included in such a *quantum meruit* approach, the referee awarded a total of \$450,000 in fees. This award was affirmed by the Supreme Court of Delaware, that court

⁵¹ 257 Minn. 362, 101 N.W.2d 423 (1960).

⁵² *Id.* at 365, 101 N.W.2d at 427.

⁵³ Figure disclosed by report of defense counsel.

⁵⁴ 253 Iowa 378, 111 N.W.2d 753 (1962). The fee was awarded in *Berger v. Amana Society*, 257 Iowa 956, 135 N.W.2d 618 (1965).

⁵⁵ 43 Del. Ch. 252, 223 A.2d 384 (1966), *aff'g* 42 Del. Ch. 508, 215 A.2d 709 (1965).

⁵⁶ 215 A.2d at 718. As "*quantum meruit*" literally means "as much as he deserved," the referee did not create a new standard by the use of this phrase.

holding that a valuation of such benefits "can be accomplished only by the exercise of sound business judgment."⁵⁷

In *Fletcher v. A. J. Industries, Inc.*,⁵⁸ the settlement provided for future arbitration of the potential monetary recovery by the corporation, together with an immediate change in corporate management. Citing *Bosch*,⁵⁹ the court found these results to be of substantial benefit, and affirmed the award of \$64,784 in fees, in advance of the arbitration. In so doing, this California court anticipated the result in *Mills v. Electric Auto-Lite Co.*,⁶⁰ as to an award of fees on an interim level.

The courts have experienced particular trouble in valuing the benefit in those cases which have been mooted by the unilateral acts of the defendants at some point during the litigation. Aside from the problems of causation discussed earlier,⁶¹ the methods adopted by such defendants to immunize their conduct frequently defy easy dollar calculation.

In *Mencher v. Sachs*,⁶² a derivative action was instituted to cancel the issuance of stock. During the litigation the purchaser voluntarily surrendered the disputed shares. The Delaware Supreme Court commented that the cancellation of illegally issued stock is in itself a benefit, although difficult of evaluation in dollars and cents, and awarded a \$30,000 fee.

In *Rosenthal v. Burry Biscuit Corp.*,⁶³ the derivative action attacked stock options previously granted. The defendants unilaterally cancelled the options, thereby mooting the action. The court announced the correct rule to be applied to such cases:

... [I]n a case of this type the attorney for a successful plaintiff would in the normal course of events become entitled to a fee. . . . [I]t is a necessary corollary to this conclusion that such a plaintiff may not be deprived of a fee by action taken by a defendant which has the effect of curing the alleged wrong and rendering the controversy moot, unless it be demonstrated that the curing of the defect is in nowise related to the lawsuit and the lawsuit would not have succeeded in any event.⁶⁴

⁵⁷ 223 A.2d at 389.

⁵⁸ 266 Cal. App. 2d 313, 72 Cal. Rptr. 146 (1968).

⁵⁹ See note 51 *supra* and accompanying text.

⁶⁰ 396 U.S. 375 (1970). See p. *supra*.

⁶¹ See pp. 264-67 *supra*.

⁶² 39 Del. Ch. 366, 164 A.2d 320 (1960).

⁶³ 42 Del. Ch. 279, 209 A.2d 459 (1949).

⁶⁴ *Id.* at 280, 209 A.2d at 460.

Counsel reports that the ultimate fee awarded to plaintiff's counsel was \$5,000.

Similarly, in *Globus, Inc. v. Jaroff*,⁶⁵ the derivative action attacked a misleading proxy used to obtain a favorable vote on a stock option granted to the corporation president, who, after a motion to dismiss was overruled, cancelled the stock option agreement, alleging that he did so for reasons other than the pendency of the suit. The court held that it was permissible to infer that this cancellation was in fact due to plaintiff's efforts. Counsel report that upon the fee hearing, an award of \$5,000 was granted.⁶⁶

The simplistic approach to this dilemma is represented by the decision in *Maggiore v. Bradford*.⁶⁷ Corporate assets totaling \$2,700,000 were expended illegally to allow management to gain control. After the suit was filed, the purchase was rescinded. In evaluating the benefit to the corporation, the court said that it was a \$2,700,000 lawsuit, and based the award of fees on the amount involved.

C. Amount of Awards

Professor Hornstein noted with respect to the amount of awards that as of 1939, his examination of fifty-four cases indicated percentages ranging between 20 per cent and 33 1/3 per cent with the resultant average being slightly over 20 per cent.⁶⁸ Since his last article on this subject in 1956,⁶⁹ in which he repeated this observation, an examination has been undertaken of twenty-four later reported cases of awards of counsel fees in either derivative or class action cases, under factual situations which permitted the court to determine a monetary value for the benefit conferred. An Appendix to this article is provided to reflect the results of this examination. Both reported and unreported awards are included because, as was the case at the time of Professor Hornstein's

⁶⁵ 279 F. Supp. 807 (S.D.N.Y. 1968).

⁶⁶ *But see* Schechman v. Wolfson, 244 F.2d 537 (2d Cir. 1957). The derivative action sought an injunction against interlocking directors, who then resigned from the one corporation. Upon examination of the facts, the court of appeals concluded that the suit conferred no substantial benefit on the corporation, and denied all fees.

⁶⁷ 310 F.2d 519 (6th Cir. 1962).

⁶⁸ Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784, 813 & n.187 (1939).

⁶⁹ Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658, 665 (1956).

original article, many of the most important awards are not found in the reports.

Most of these decisions demonstrate the prescient nature of Hornstein's observations when he wrote that in time there would be a large enough number of such cases that standards would be set up and judicial discretion correspondingly limited.⁷⁰ What has happened is that most courts have relied upon Professor Hornstein's prior research, as reported in his articles, and have adopted his 20 per cent average as the standard without more. Indeed, in *Pergament v. Kaiser-Frazer Corp.*,⁷¹ the court made the flat statement that "no contention is made that 20% of the amount of recovery does not reasonably measure the value of services rendered."⁷²

In those cases where the court has been concerned principally with the results achieved by counsel, the sheer size of the benefit has not militated against an award based upon a percentage, even in those cases where the fees have exceeded \$1,000,000.⁷³

In other cases, however, the courts have applied a descending scale of percentages as the benefits recovered by the action have exceeded certain amounts.⁷⁴ In a recent case, *Newark v. RKO General, Inc.*,⁷⁵ the Securities and Exchange Commission in an amicus curiae brief argued that there comes a point where the judgment is so large that a fee based primarily on a percentage of recovery exceeds the limits of reasonable compensation. The Commission specifically urged that in the recovery of \$7,900,000, a fee allowance limited to \$1,000,000 was

⁷⁰ *Id.* at 681-82.

⁷¹ 224 F.2d 80 (6th Cir. 1955).

⁷² *Id.* at 83. For other decisions adopting the straight 20 per cent formula, *see, e.g.*, *Newman v. Electronic Specialty Co.*, CCH FED. SEC. REP. ¶ 92955 (N.D. Ill. 1971); *Mardel Securities, Inc. v. Alexandria Gazette Corp.*, 278 F. Supp. 1010 (E.D. Va. 1967); *Krinsky v. Helfand*, 38 Del. Ch. 553, 156 A.2d 90 (1959); *Zenn v. Anzalone*, 46 Misc. 2d 378, 259 N.Y.S.2d 747 (Sup. Ct. 1965); *National Bankers Life Ins. Co. v. Rosson*, 400 S.W.2d 366 (Tex. Civ. App. 1966).

⁷³ *See, e.g.*, *Zenn v. Anzalone*, 46 Misc. 2d 378, 259 N.Y.S.2d 747 (Sup. Ct. 1965) (award of \$1,876,000 made for litigation extending for some ten years in state and federal courts); *Ripley v. International Ry.*, 16 App. Div. 2d 260, 227 N.Y.S.2d 64 (1962) (\$1,500,000 in attorneys fees awarded plus \$92,000 as disbursements in successful derivative action resulting in \$8,000,000 recovery).

⁷⁴ *See, e.g.*, *Heddendorf v. Goldfine*, 167 F. Supp. 915 (D. Mass. 1958), *aff'd in part sub nom.* *Angoff v. Goldfine*, 270 F.2d 185 (1st Cir. 1959); *Winkelman v. General Motors Corp.*, 48 F. Supp. 504 (S.D.N.Y. 1942); *Mann v. Superior Court*, 53 Cal. App. 2d 272, 127 P.2d 970 (1942).

⁷⁵ 332 F. Supp. 161 (S.D.N.Y. 1971).

appropriate and sufficient to provide the stimulus for enforcement of the short-swing provisions of Section 16(b) of the Securities Exchange Act of 1934. The court found that plaintiff's counsel had expended some 4,000 hours in presenting the action, and awarded \$750,000 in fees, including disbursements.⁷⁶

This concern is similar to that raised by Judge Wyzanski in *Cherner v. Transitron Electronic Corp.*,⁷⁷ where he noted that while there are courts which have allowed a high percentage of even a large fund as allowances to those whose efforts produced the fund, still, in a case involving \$5,300,000 in benefits, "unless the time spent and the skill displayed be used as a constant check on applications for fees there is a grave danger that the bar and bench will be brought into disrepute, . . ." ⁷⁸

So long as such awards are based primarily upon the results achieved, with no reimbursement available upon loss, then this contingent factor should, it is submitted, result in awards substantially higher than those based solely upon the time and labor involved. The courts should be able to reward counsel adequately and satisfy their own concepts of reasonableness by applying an essentially standardized graduated scale of percentages, without the necessity of imposing any arbitrary upper limit on the award.

III. PRO-RATA PAYMENT OF THE AWARD— THE THIRD-PARTY PURCHASER DILEMMA

As stated earlier, it has been a basic premise in derivative actions that while the suit is both derivative, *i.e.*, brought in the name of the corporation, and representative, *i.e.*, brought on behalf of all the stockholders, any recovery should be paid to the corporation which in turn should bear the cost of any fees awarded. Since the recovery, where monetary in nature, belongs to the corporation, no shareholder has the right to demand the immediate withdrawal of his proportionate share of the capital and claims of the corporate creditors could come before those of the shareholders. It has been generally agreed that a contrary rule would result in a multiplicity of suits.

A most unusual situation constituting an exception to this rule arises

⁷⁶ *Id.* at 164.

⁷⁷ 221 F. Supp. 55 (D. Mass. 1963).

⁷⁸ *Id.* at 61.

where, after the filing of a derivative suit alleging a breach of fiduciary duties on the part of the officers or directors, a sale of all or substantially all of the stock in the corporation is made to a third person at a price substantially above the prior-to-suit market price.

The earliest example of this factual situation may be found in two early Pennsylvania decisions.⁷⁹ In these cases, three corporate officers sold treasury shares to themselves at \$50 per share, and immediately resold them to a third person for \$64 per share. While the plaintiff's derivative action to recover this illegal profit was pending, the third-person buyer, Callery, purchased other shares from various shareholders, to the point of gaining control of the corporation.

After finding that the entire proceeds of the sale of the treasury stock, *i.e.*, \$64 per share, belonged to the corporation, the court determined that Callery, the purchaser, paying \$64 per share for the treasury stock, did not intend that \$14 of this price should be paid into the treasury and be deemed an asset of the corporation. Accordingly, the stockholders of record on the date Callery bought the treasury shares were entitled to the full benefit of the profit realized by the sale at \$64 per share, and payment should be made directly to each shareholder according to his respective stock holdings at that time.⁸⁰ In the same fashion, the court ordered that plaintiff's attorneys fees and expenses should be paid out of the entire fund recovered, pro-rata from all stockholders, including the defendants.⁸¹ To the defendants' argument that they should not have to bear the expense of the litigation against themselves, the court correctly pointed out that as stockholders, the defendants were interested in the fund, regardless of the fact that as individuals, they had breached their fiduciary obligations. Furthermore, by the decree they had become entitled to a legal share of a fund which

⁷⁹ *Hechelman v. Geyer*, 252 Pa. 123, 97 A. 193 (1916); *Provident Trust Co. v. Geyer*, 248 Pa. 423, 94 A. 77 (1915).

⁸⁰ In the sale of the shares of stock to Callery the intention of all the parties was that the purchaser took the property and assets of the corporation and the shareholders were to get \$64 per share for all stock transferred under the agreement. Under these circumstances, it is too plain for argument that the stockholders of record when the sale was made are entitled to the full benefit accruing either to them as individual shareholders, or resulting from the sale of treasury stock in which they were interested to the extent of their respective holdings. It is but fair to say that those who purchased the stock, and who now represent the management and control of the corporation, make no claim to any part of this profit.

Provident Trust Co. v. Geyer, 248 Pa. 423, 425, 94 A. 77, 79 (1915).

⁸¹ *Hechelman v. Geyer*, 252 Pa. 123, 97 A. 193 (1916).

previously they had obtained illegally, and because of this benefit to themselves as shareholders, they should share in the expense proportionately.⁸²

A. Choosing the Form of the Action—The *Kahan* Decision

The *Geyer* decisions were considered unique until the very recent case of *Kahan v. Rosenstiel*,⁸³ which reintroduced the role of the third-party purchaser into the larger problem of recovery of benefits and attorneys' fees. This case called into play the basic distinctions which exist between class actions and derivative suits, and emphasized the very real danger in not choosing the correct form of action.

The *Kahan* case was brought as a class action on behalf of all the common stockholders of Schenley Industries, Inc., except the defendants. The complaint alleged that Glen Alden Corporation had purchased 945,126 Schenley common shares from Rosenstiel, Schenley's controlling shareholder, at \$80 per share, but was offering all other shareholders, by tender, a package of cash and securities worth only \$60 per share at a time when a better offer to all shareholders existed in the form of a tender offer by P. Lorillard Company. While suit was pending, the tender offer was twice amended, the final offer being raised to a package admittedly worth \$80, thus mooted the basic cause of action. The plaintiff filed his petition for attorneys fees, alleging that through his efforts, a fund of \$83,000,000 had been created for the class he represented, *i.e.*, 4,150,000 shares at \$20 per share. In the interim the tender offer was completed.

Rather than seeking to enjoin the \$80 package payment by Glen Alden to the Schenley shareholders, or to assert a lien on that fund for his fees, the plaintiff claimed that the defendants, Glen Alden and its controlling shareholder, Riklis, in paying out the disputed funds without observing the procedural requirements of Rule 23 of the Federal Rules of Civil Procedure, were guilty of such unconscionable con-

⁸² Of additional interest in these cases is the holding by the court that the purchaser of the shares, Callery, did not have the right to share in that portion of the fund attributable to the shares then owned by him, and that the pro-rata distribution of the fund recovered was not in the nature of a dividend, which would follow the legal title to the stock, but was a purely equitable distribution to those shareholders of record as of the date of the illegal transfer of the treasury stock. *Id.* at 125, 97 A. at 195.

⁸³ 300 F. Supp. 447 (D. Del. 1969), *rev'd* 424 F.2d 161 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970).

duct as to warrant the imposition of attorney's fees against them as defendants.⁸⁴

The court of appeals sustained the plaintiff's contention, holding that he would be entitled to counsel fees from the defendants upon proof of a causal connection between his suit and the substantial benefit finally accorded to the class, and proof that the defendants' conduct in failing to observe the requirements of Rule 23 prevented the creation of a fund from which fees could be awarded.⁸⁵

The importance of this case is two-fold. First, it demonstrates the complexity of the legal issues presented by a third-party tender offer engrafted onto the normal problems of corporate tort litigation; and second, it raises the problem of the correct choice of remedies in such situations. In the *Kahan* case, the substantial benefits allegedly caused by plaintiff's action took the form of a markedly more generous tender offer, which was then accepted, so that each shareholder was in immediate possession of his direct benefit. Short of seeking and receiving an injunction establishing an attorney's lien on the amounts paid out to all shareholders under the tender, the plaintiff by his class action, because his suit was not brought on behalf of the corporation, was reduced to seeking and proving relief against the defendants as active wrongdoers.

Under these circumstances, a derivative action would appear to have offered the better alternative. The distinguishing factor between the class action and the shareholder derivative suit is the class represented by the plaintiff. Where the plaintiff seeks to protect an interest which is peculiar to himself or his particular class of stock, the action is a class action. However, when the plaintiff seeks to redress a breach of a fiduciary duty by management, the action is a derivative suit. In seeking redress from management the plaintiff represents the entire corporation by protecting all the shareholders from unwarranted conduct on the part of management. If the benefits achieved for the corporation by the action result in a direct payment to the shareholders, rather than to the corporation, plaintiff's counsel nevertheless would be entitled to an award of counsel fees under the *Mills* doctrine, and such an award could be enforced by a lien upon the funds prior to distribution to the individual shareholders.

⁸⁴ The plaintiff relied upon the rule utilized in *Taussig v. Wellington Fund, Inc.*, 187 F. Supp. 179 (D. Del. 1960), *aff'd* 313 F.2d 472 (3d Cir. 1963).

⁸⁵ *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir. 1970).

B. The Applicability of the Mills Doctrine—An Illustrative Case :

The recovery of attorneys' fees under the *Mills* doctrine in the third-party purchaser situation can best be demonstrated by posing an illustrative case. Assume a derivative action is filed alleging that as a result of a consent order brought by the Justice Department against *B*, the majority stockholder, *B* had agreed to divest itself of its 60 per cent ownership in the corporation *A*. Assume further that corporation *A*'s management then makes an offer to repurchase the same 60 per cent of its own stock for \$10,000,000 on terms and conditions which could impair its capital, would entail grave financial risks to the corporation and its remaining shareholders, and would involve the use of an untrue and misleading proxy statement seeking shareholder approval of the plan. After trial, and while the case is under submission, *B* notifies the corporation *A* and the court that it is invoking an escape clause in its contract as to pending litigation to terminate its contract. *B* thereupon enters into a new contract with a third-party purchaser, corporation *C*, under which *B* receives a total of \$12,000,000 and the remaining shareholders of corporation *A* are given the opportunity to tender at the same price per share. As a result of such tender, corporation *C* secures complete ownership of corporation *A*.

During these negotiations, the court hands down a tentative decision finding in the plaintiff's favor in the derivative action. While the merits of the litigation have been mooted by the intervention of the third-party purchaser, the court retains jurisdiction to pass upon plaintiff's application for legal fees, and imposes a lien of \$2 per share on the tender offer proceeds, pending such decision.

Ordinarily, when plaintiff's attorneys are awarded fees in a shareholder's derivative suit for the benefits produced by their services, the corporation is required to pay the fees since it directly receives the benefits, for the indirect benefit of all the shareholders. In that usual situation, the shareholders for the most part remain shareholders. The shareholder in those cases cannot insist on a direct pro-rata recovery, because 1) generally he has no right to demand his part of the firm's capital be withdrawn, 2) it could interfere with the payment of claims of corporate creditors, and 3) it would involve a multiplicity of suits.⁸⁶ However, the proposed hypothetical case produces the unique circumstance where the direct benefit to the corporation which the selling

⁸⁶ Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784, 785-86 (1939).

shareholders would have indirectly received had they remained shareholders is exchanged for a direct benefit to the selling shareholders in the form of an increased purchase price for their stock, which in turn means that most of the shareholders on whose behalf suit was brought are no longer shareholders of the corporation, and have in fact secured the withdrawal of their capital.

If under those circumstances the corporation were required to pay the entire attorneys' fees, the shareholders who sold their stock to corporation C would be unjustly enriched and the purchaser would indirectly be paying most of the fees as the new majority shareholder of the corporation. Although the purchaser must be presumed to have expected when it made its offer that there would be attorneys' fees taxed against the corporation, it does seem equitable that the selling shareholders, including B, should bear their fair share of the attorneys' fees.⁸⁷

This assumed case is directly analogous to those cases in which the corporation has been liquidated or otherwise become defunct prior to the recovery of the fund through shareholder litigation. In such cases, the courts have allowed the shareholders to recover directly for their proportion of the corporate claim, without going through the fiction of paying the fund into the corporation and then redistributing it to the shareholders on a pro-rata basis.⁸⁸

As stated in these cases, the fact that the fund realized through the derivative litigation is being paid directly to the shareholders rather than to the corporation does not change the basic action into one for the benefit of individual shareholders; it is but a procedural recognition of the fact that the corporate entity on whose behalf the suit was brought is no longer in existence. As such, the same rule which permits the award of attorneys fees to one who has created or preserved a fund for the corporation should be applied where one has created and preserved a fund which is being paid directly to the shareholders.

It is the role of equity to tailor its relief to unique situations, to resist inappropriate remedies carried forward from inapposite earlier decisions, in order to remain a viable, effective system of justice. The United States Supreme Court in *Sprague v. Ticonic National Bank*⁸⁹ made the following observation:

⁸⁷ See *Heckelman v. Geyer*, 252 Pa. 123, 97 A. 193 (1916).

⁸⁸ See, e.g., *Backus v. Finkelstein*, 23 F.2d 357 (D. Minn. 1927); *Sale v. Ambler*, 335 Pa. 165, 6 A.2d 519 (1939); *Bailey v. Jacobs*, 325 Pa. 187, 189 A. 320 (1937); *Commonwealth Title Ins. & Trust Co. v. Seltzer*, 227 Pa. 410, 76 A. 77 (1910).

⁸⁹ 307 U.S. 161 (1939).

But when such a fund is for all practicable purposes created for the benefit of others, the formalities of the litigation—the absence of an avowed class suit or the creation of a fund, as it were, through *stare decisis* rather than through a decree—hardly touch the power of equity in doing justice as between a party and the beneficiaries of his litigation. As in much else that pertains to equitable jurisdiction, individualization in the exercise of a discretionary power will alone retain equity as a living system and save it from sterility. In the actual exercise of the power to award costs “as between solicitor and client” all sorts of practical distinctions have been taken in distributing the costs of the burden of the litigation.⁹⁰

As stated in the *Mills*⁹¹ case, the basic concept is to spread the cost of such an award among all shareholders. The most common method of awarding attorneys’ fees in derivative actions is to tax the cost against the corporation, because this is the simplest, easiest and most equitable method in all cases where the beneficiaries of the lawsuit remain as shareholders of the corporation.

The only equitable result in the posited case is to fashion the same type of individualization of relief, and to hold that the shareholders, including *B*, should each pay their proportionate cost of receiving the benefits accorded to them by the litigation in addition to that portion of the fees that should equitably be paid by the corporation.

This does not result in such shareholders paying a corporate debt. They are paying their own debt, as beneficiaries of a fund created by the plaintiffs, in which each shareholder has accepted his share.

IV. CONCLUSION

As Professor Hornstein foresaw, time has allowed a sufficient number of cases to be decided to form the basis for setting and applying equitable standards in awarding a reasonable fee in those derivative and class actions where a monetary benefit can be demonstrated. The most common practice has been to set the fee at 20 per cent of the benefit, except in those cases in which the benefit is so large, by the standards of the particular court, that a declining series of percentages should be substituted.

⁹⁰ *Id.* at 167.

⁹¹ *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 394 (1970).

In those cases where the benefit is difficult to calculate in monetary terms, the courts have not generally spelled out with any great detail their reasons behind a particular award. This is most noticeable in those cases which have been mooted by unilateral action taken by the defendants, where the issue of cause and effect as between the litigation and the eventual benefit is contested, as well as the amount of the benefit and the fee to be awarded.

In such instances, if it is impossible to fix a monetary value to the benefit, the courts have not consistently discussed the relative weight to be given to the remaining factors commonly examined in such applications. The time spent or the skill displayed, while relevant and easy to apply, cannot be the sole factors left to be weighed because such a limitation overlooks the all-important factor of the contingent nature of the representation, and the risks attendant thereto. Because of the stimulus to corporate democracy and prevention of illegality achieved by derivative actions, even in the absence of a calculable monetary benefit, attorneys should continue to be encouraged to undertake such actions for their clients. This means that fee awards in these cases must be generous.

In the absence of an ability to assign a monetary value to the benefit achieved by the action, the court should scrutinize most carefully the relationship between the result and the total monetary values affected by such litigation. In every case it is possible to assign a monetary value to the underlying transaction affected by the litigation,⁹² and, in conjunction with the factors of time, skill, complexity of issues and the risk involved in the representation, arrive at an award which is fair and reasonable. If done with a flavor of generosity without being ludicrous, constant standards will develop in time.

The most convenient tool to aid the court in such an examination is the percentage formula. A graduated scale, starting at 10 per cent on the first \$1,000,000 and then declining for each additional million dollars involved in the litigation, would provide a workable solution to this problem. The hope is that a sufficient number of judges will enunciate their reasons for the awards made in non-monetary benefit cases so that in time a reliable standard will emerge.

⁹² In *Denney v. Phillips & Buttorff Corp.*, 331 F.2d 249 (6th Cir. 1964), the disputed transaction involved \$2,700,000. The court used this as the measure of the case, awarding plaintiff's counsel \$235,000, or 8.7 per cent thereof.

APPENDIX

REPORTED CASES

<i>Case</i>	<i>Benefit</i>	<i>Fee</i>	<i>Percentage</i>
1. Ripley v. Int'l Ry., 16 App. Div.2d 260, 227 N.Y.S.2d 64 (1962)	\$8,000,000+ \$7,500,000 Future Benefits	\$2,104,900	20%+ \$104,900
2. Zenn v. Anzalone, 46 Misc. 2d 378, 259 N.Y.S.2d 747 (Sup. Ct. 1965)	3,300,000+ Intangible Benefits	1,876,000	20
3. Newmark v. RKO General, Inc., 332 F. Supp. 161 (S.D.N.Y. 1971)	7,920,681	750,000	9.4
4. Perlman v. Feldmann, 160 F. Supp. 310 (D. Conn. 1958)	1,150,000	450,000	39
5. The Herald Co. v. Bonfils, 315 F. Supp. 497 (D. Colo. 1970)	6,429,299	300,000	4+
6. Epstein v. Weiss, 1971 CCH FED. SEC. L. REP. ¶ 92938 (E.D. La. 1970)	1,000,000	300,000	30
7. Fox v. Glickman Corp., 253 F. Supp. 1005 (S.D.N.Y. 1966)	1,825,000	285,000	16
8. Green v. Transitron Electronic Corp., 326 F.2d 492 (1st Cir. 1964)	5,300,000	266,500	5
9. Maggiore v. Bradford, 310 F.2d 519 (6th Cir. 1962)	2,700,000	235,000	8.7
10. Newman v. Electronic Specialty Co., 1971 CCH FED. SEC. L. REP. ¶ 2955 (N.D. Ill. 1971)	1,200,000	240,000	20
11. National Bankers Life Ins. Co. v. Rosson, 400 S.W.2d 366 (Tex. Civ. App. 1966)	1,025,000	200,000	19
12. Derdarian v. Futterman Corp., 254 F. Supp. 617 (S.D.N.Y. 1966)	1,200,000	152,500	12½
13. Stull v. Kaymarq Consol. Corp., 1970 CCH FED. SEC. L. REP. ¶ 92508 (S.D.N.Y. 1969)	440,000	142,000	32
14. Berger v. Amana Soc'y, 257 Iowa 956, 135 N.W.2d 618 (1965)	5,000,000	125,000	2½
15. Krinsky v. Helfand, 38 Del. Ch. 553, 156 A.2d 90 (1959)	500,000	100,000	20

REPORTED CASES

<i>Case</i>	<i>Benefit</i>	<i>Fee</i>	<i>Percentage</i>
16. Pergament v. Kaiser-Frazer Corp., 224 F.2d 80 (6th Cir. 1955)	500,000	100,000	20
17. Angoff v. Goldfine, 270 F.2d 185 (1st Cir. 1959)	662,500	88,000	(Descending percentage 25% down)
18. Volvovitz v. VTR, Inc., 1971 CCH FED. SEC. L. REP. ¶ 93292 (S.D.N.Y. 1971)	400,000	75,000	18¾
19. Fletcher v. A.J. Industries, Inc., 266 Cal. App. 2d, 72 Cal. Rptr. 146 (1968)	200,000	64,784	32
20. Katz v. E.L.I. Computex, Inc., 1971 CCH FED. SEC. L. REP. ¶ 92994 (1971)	200,000	30,000	15
21. Mardel Sec., Inc. v. Alexandria Gazette Corp., 278 F. Supp. 1010 (E.D. Va. 1967)	125,000	25,000	20
22. Sarner v. Sarner, 38 N.J. 463, 185 A.2d 851 (1962)	483,738	25,000	5
23. Magida v. Continental Can Co., 176 F. Supp. 781 (S.D.N.Y. 1956)	47,000	12,000	25
24. Alexander v. Lindsey, 152 So. 2d 261 (La. Ct. App. 1963)	8,667	1,733	20

UNREPORTED CASES

<i>Case</i>	<i>Benefit</i>	<i>Fee</i>	<i>Percentage</i>
1. Martin v. Ohio Cas. Ins. Co., Civil No. 7245 (S.D. Ohio 1970)	\$6,300,000	\$ 630,000	10%
2. Manacher v. Reynolds, Del. Ch. Civil No. 1129 (May 26, 1961)	1,728,900	500,000	29
3. Fisher v. Kletz, N.Y.L.J. (S.D.N.Y., Dec. 9, 1971)	1,010,000	209,846	20½
4. Cole v. Union Bankers Life Ins. Co., Civil No. 9286 (N.D. Texas 1970)	600,000	200,000	33⅓
5. Zeitlin v. Bergen, Civil No. 66- 4479 (S.D.N.Y., July 23, 1971)	800,000	190,000	23¾

UNREPORTED CASES

<i>Case</i>	<i>Benefit</i>	<i>Fee</i>	<i>Percentage</i>
6. Loewi v. Fairchild-Hiller Corp., Civil No. 66-975 (E.D.N.Y. 1967)	600,000	180,000	30
7. Jamison v. Barr, Civil No. 69-2795 (S.D.N.Y., Oct. 1971)	600,000	175,000	29
8. Schilkret v. Feeley (Sup. Ct., N.Y. Co. 1957)	300,000	113,750	37½
9. Getz v. Baker, Index No. 13445/57 (Sup. Ct., N.Y. Co. 1966)	400,000	100,000	25
10. Spirt v. Bechtel, Civil No. 53-105 (S.D.N.Y., Oct. 4, 1959)	202,600	75,000	37
11. Levitt v. Johnson, Civil No. 63-389-w (D. Mass., Mar. 22, 1966)	250,000	62,500	25
12. Franklin v. Blaylock, Civil No. 62-4067 (S.D.N.Y., Nov. 20, 1964)	150,000	50,000	33⅓
13. Blau v. Mission Corp., Civil No. 64-54 (S.D.N.Y. 1954)	70,400	35,000	49
14. Entel v. Guilden, Civil No. 63-788 (S.D.N.Y. 1955)	120,000	32,000	26⅔
15. Blay v. Kagan, Civil No. 66-4196 (S.D.N.Y. 1968)	28,001	10,000	35.7

