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Felzen v. Andreas: The Seventh Circuit Shuts Its Doors to Derivative-Suit Appeals by Unnamed Shareholders

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INTRODUCTION

Imagine this:

You own 300 shares of stock in ABC, Inc. Since you purchased the stock five years ago, ABC, Inc.'s profits have increased significantly and as a result, the value of its stock has nearly doubled. Through several other investments, you have diversified your portfolio and are now very active in managing several investments.

Unexpectedly, you hear that a United States Grand Jury is investigating possible violations on the part of ABC, Inc.'s directors. Dozens of suits were filed, many of which were consolidated into one shareholders' derivative suit.

As a resident of Arizona, you feel remote and unattached to the litigation taking place in Illinois. Similarly, because your investment in ABC, Inc. is only one of several others in your portfolio, monitoring the legal status of your investment interest seems valueless. Nevertheless, the named representative plaintiffs' counsel continue to pursue the claim.

Three weeks later, you receive notice that a settlement has been preliminarily approved. While assessing the settlement, you determine that its terms are unfair. Specifically, the settlement offers minimal compensation to you and the corporation as compared to the large sums received by counsel in the form of past and future fees.

You are frustrated because the value of the stock is sure to depreciate. Furthermore, the benefits of the settlement are inadequate. Various dissatisfied shareholders appear in the District Court of Delaware to voice their objections to the settlement. Despite the shareholders' complaints, the court approves the pro-

posed settlement. Two shareholders file an appeal to contest the fairness of the settlement.

Scenario 1—The Objection Requirement

> The appellants are entitled to an appeal because under this procedure, they are only required to appear in the district court to object to the settlement.

Scenario 2—The Intervention Requirement

> The appellants are unable to appeal. To appeal the settlement it is necessary to become a formal party to the record through intervention, pursuant to Rule 24 of the Federal Rules of Civil Procedure.

The scenarios suggested in this hypothetical depict two very different procedural possibilities confronting unnamed shareholders[1] who wish to challenge the fairness of a settlement. For the past thirteen years, courts have applied each of the two procedures inconsistently, leaving adversely affected litigants guessing as to which particular procedure governs.[2] In general, the disagreement among circuits necessarily led to inconsistent judgments and corresponding uncertainties regarding the outcome of particular disputes. Moreover, because unnamed parties in representative suits have legally protected interests that are often difficult to monitor,[3] such parties need settled rules to adequately protect their interests. In other words, the rights of unnamed parties must be sufficiently safeguarded by sound, practical and consistent procedure.

The issue of an unnamed party's right to appeal applies to two types of representative litigation—the class action[4] and derivative

1. The term "unnamed shareholders" refers to represented shareholders in derivative litigation. They are represented by the named plaintiff, who is the party of record in the action. Likewise, the term "unnamed class members" refers to represented class members in class action suits.

2. For example, the Seventh Circuit, in *Felzen v. Andreas*, overturned over twenty years of precedent requiring a class member or shareholder to object in the underlying proceeding in order to appeal an adverse decision. Felzen v. Andreas, 134 F.3d 873 (7th Cir. 1998); *infra* Part II.B.

3. *See, e.g.*, Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1308-10 (3d Cir. 1993) (discussing various agency costs inherent in class and derivative actions).

4. The class action is a device governed by Rule 23 of the Federal Rules of Civil Procedure, whereby a large group of similar claims are joined and adjudicated as one for purposes of judicial economy and the ability to aggregate a large number of claims with relatively small value that are not worth individual litiga-

suit.[5] In the context of class actions, Rule 23 of the Federal Rules of Civil Procedure allows a named plaintiff to bring and maintain a suit as the representative of a class of similarly situated litigants when certain requirements are met.[6] Further, the rule protects represented parties by requiring court approval of dismissal or compromise and that "notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs."[7] For derivative actions, Rule 23.1 sets forth, in essence, the proper party to bring a derivative action, the required contents of the complaint and the conditions under which a shareholder may not proceed with the suit.[8] Similar to Rule 23, Rule 23.1 provides protection to the represented individuals by requiring court approval of a dismissal or compromise and notice to all shareholders.[9]

Most class actions and derivative suits are settled prior to a judgment on the merits.[10] Unnamed shareholders or class members often seek an appeal in response to an allegedly unfair settlement because interests of unnamed parties are often ignored in settlement agreements. Most courts and commentators agree that settlements in representative litigation are marred by agency costs: unnamed class members and shareholders in class and derivative actions are unable to competently monitor the suit and

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tion. *See* Herbert Newberg & Alba Conte, Newberg on Class Actions § 1.01 (3d ed. 1992). The suit is brought by a named representative plaintiff on behalf of all individuals who are part of the class. *See id.* Any recovery inures to each individual class member, depending on the type and extent of the injury claimed. *See id.*

5. The derivative suit is an action, under Rule 23.1 of the Federal Rules of Civil Procedure, by a shareholder who seeks to enforce a corporate cause of action. The action is derivative "when the action is based upon a primary right of the corporation, but is asserted on its behalf by the stockholder because of the corporation's failure, deliberate or otherwise, to act upon the primary right." Black's Law Dictionary 305 (6th ed. 1991). Unlike the class action, any recovery inures directly to the corporation and only indirectly to shareholders.

6. *See* Fed. R. Civ. P. 23(e); *infra* note 36 (providing the text of Rule 23).

7. Fed. R. Civ. P. 23(e); *see infra* note 36.

8. *See* Fed. R. Civ. P. 23.1; *infra* note 112 (providing the text of Rule 23.1).

9. Pursuant to Rule 23.1, "[t]he 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." Fed. R. Civ. P. 23.1; *see infra* note 112.

10. *See* Thomas M. Jones, *An Empirical Examination of the Resolution of Shareholder Derivative and Class Action Lawsuits*, 60 B.U. L. Rev. 542, 544-45 (1980) (finding that a vast majority of derivative suits are settled prior to judgment).

often, conflicts of interest between plaintiffs' counsel and the litigants lead to unfavorable results for unnamed members.[11] Therefore, the rights of unnamed members remain unprotected, especially considering the predominance of unfair settlements in class and derivative actions.

This Note focuses on the Seventh Circuit's decision in *Felzen v. Andreas*.[12] In *Felzen*, two unnamed shareholders were denied an appeal of the district court's settlement approval in a derivative action.[13] The Seventh Circuit disallowed the appeal because the two unnamed shareholders failed to intervene in the lower court.[14] On writ of certiorari, an equally divided United States Supreme Court affirmed the Seventh Circuit's aforementioned decision in the case of *California Public Employees' Retirement System v. Felzen*.[15] Hence, the Supreme Court held that unnamed shareholders must do more than object in the lower court in order to be entitled to an appeal.

The dispute in *Felzen* focused on two alternatives that would entitle an unnamed shareholder to appeal an unfavorable settlement. The first alternative, for the purposes of this discussion, is referred to as the "objection requirement."[16] This practice is less burdensome to the represented party because it does not require

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11. *See infra* Part III.E.

12. 134 F.3d 873 (7th Cir. 1998).

13. *Id.* at 874-76.

14. *See id.* The named shareholder plaintiffs moved to dismiss the appeal on the grounds that the unnamed shareholders had not intervened in the underlying proceeding pursuant to Rule 24. *See* Brief for Petitioners at 9, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (No. 97-1732). The Seventh Circuit granted the motion to dismiss for want of jurisdiction, holding that the unnamed shareholders could not appeal the settlement because they did not intervene in the district court. *See Felzen*, 134 F.3d at 873-77. Intervention, pursuant to Rule 24, is a device by which non-parties may become formal parties to the action when an applicant, upon timely motion, claims an interest that is substantially related to the subject of the action, and that the disposition of the action without the applicant may severely impair his or her ability to protect that interest. *See* Fed. R. Civ. P. 24; *see also infra* note 64 (setting forth the requirements of Rule 24).

15. 119 S. Ct. 720 (1999) (per curiam). The California Public Employees' Retirement System (one of the two unnamed shareholders who appealed to the Seventh Circuit) petitioned for the writ of certiorari to the Supreme Court. *See* 67 U.S.L.W. 3049 (U.S. July 21, 1998) (No. 97-1732).

16. The term "objection requirement" refers to the proposition that a represented party may appeal without first becoming a named party to the suit. Instead, a right to appeal is preserved if the represented party appears in the lower court to object to a proposed order. *See infra* Part I.

him to become a named party (party of record) to be entitled to an appeal; it is sufficient that the party appears and objects to the proposed order in the lower court.[17] The procedure's history can be traced back to English Common Law, and until the United States Supreme Court's decision in *California Public Employees' Retirement System*, it was the preferred practice in the Third Circuit.[18]

The second alternative is the intervention requirement.[19] In order to preserve a right to appeal, the unnamed party must intervene in the suit pursuant to Rule 24 of the Federal Rules of Civil Procedure.[20] The intervention requirement differs markedly from the objection requirement because it obligates an unnamed party to formally become a party of record under Rule 24.[21] In addition, this procedure may be especially burdensome. Unnamed parties and their attorneys are faced with both economic and time constraints. For instance, they must first hire an attorney, who, in turn, must review the case and prepare a motion to intervene. Unlike the objection requirement, this procedure garnered support only recently—it developed as the preferred procedure in several circuits and, in the context of derivative suits, is now mandatory pursuant to the United States Supreme Court's decision in *California Public Employees' Retirement System*.[22]

While focusing on the strengths and weaknesses of the Seventh Circuit's decision in *Felzen v. Andreas*, this Note argues that unnamed parties in each type of representative litigation—the class action and derivative suit—should receive different treatment in terms of a right to appeal. Traditionally, courts have treated unnamed shareholders and class members equally in terms of a right to appeal.[23] Accordingly, the Seventh Circuit's opinion in *Felzen* is insightful because it distinguishes between the

17. *See infra* Part I.

18. *See id.*

19. The term "intervention requirement" refers to the procedure that requires an unnamed party to become a formal, named party to the action pursuant to Rule 24 of the Federal Rules of Civil Procedure. *See id.*

20. *See infra* note 64.

21. *See infra* Part I.

22. In the context of class actions, this practice is supported by the Fifth, Sixth, Seventh, Eighth, Tenth, and Eleventh circuits. *See* 5 James Wm. Moore et al., Moore's Federal Practice § 23.1.10 (3d ed. 1999).

23. Research on the issue leads me to this conclusion. Until *Felzen*, courts did not provide separate analyses for class and derivative actions. *See infra* Part I. This Note contends that separate treatment is warranted. *See infra* Part III.

derivative suit and class action; it acknowledges that an unnamed shareholder in derivative litigation is in a very different position than a class member in a class action.[24] Nevertheless, the court found the differences to be insignificant in light of an unnamed shareholder's right to appeal. Thus, this Note argues that while the Seventh Circuit's method of reasoning was appropriate, its analysis disregarded several important factors that should have led the court to the opposite conclusion. That is, shareholders in a derivative suit have a stronger argument in favor of appeal via the objection requirement than do class members in the context of class actions.

Part I of this Note provides a historical summary of caselaw on the issue. It furnishes separate treatment for each type of representative litigation—the class action and derivative suit. In addition, each section incorporates the relevant rules of procedure. Part II is a statement of the case, *Felzen v. Andreas*, as well as a synopsis of the Seventh Circuit's opinion. Part III provides an argument against the intervention requirement for unnamed shareholders in derivative actions. In general, the discussion will consider the premise that the differences between derivative suits and class actions mandate their separate treatment in terms of an unnamed party's right to appeal.

Various reasons support this conclusion. First, this Note criticizes the Seventh Circuit's conclusion that unnamed class members in class actions have a stronger argument for a more liberal appellate procedure than unnamed shareholders in derivative actions. Actually, a closer look at the differences between class and derivative actions reveals that the very opposite is true—shareholders in derivative actions have a greater right to appeal, without intervention, than individuals in class actions. Second, greater protection for shareholders' rights and increased court supervision in the context of derivative actions benefits our economy by furthering the incentive for shareholder investment and deterring inadequate corporate management practices. Third, regarding the issue of appellate rights in representative litigation, this Note argues that the Federal Rules of Civil Procedure afford significantly less protection to shareholders in derivative actions. Thus, shareholders should enjoy rights that would allow them to protect their

24. Felzen v. Andreas, 134 F.3d 873, 875 (7th Cir. 1998).

interests through appeals. Fourth, the Seventh Circuit's supporting authority in *Felzen* is inapplicable to whether a shareholder must intervene in derivative suits. Finally, the prevalence of unfair settlements in derivative suits warrants a more liberal appellate procedure for shareholders in such actions. For these reasons, this Note concludes that shareholders in derivative actions should not be required to intervene under Rule 24 in order to appeal a settlement in a derivative action.

I. MAY UNNAMED PARTIES APPEAL? A HISTORICAL SUMMARY

The issue of an unnamed party's right to appeal can be traced back to nineteenth century-England. Unlike the relatively complex class action and derivative suit of today, representative litigation was once analyzed solely on principles of equity. Thus, many early cases favored a more liberal appeals procedure for unnamed parties—courts were concerned more with what was fair in a particular situation and less with rigid procedural rules.

Not surprisingly, several-nineteenth century cases in our legal system followed the equitable approach of England's common law.[25] These early decisions stand for the proposition that unnamed parties have a right to appeal when their interests are affected in the original proceeding.[26] In fact, many twentieth-

25. *See generally* William Weiner & Delphine Szyndrowski, *The Class Action, From the English Bill of Peace to Federal Rule of Civil Procedure 23: Is There a Common Thread?*, 8 Whittier L. Rev. 935 (1987) (explaining the development of the class action under Rule 23 from the early Bill of Peace and manor cases in England).

26. Several early cases in our legal system held that an unnamed party has a right to appeal. *See* Hinckley v. Gilman, 94 U.S. 467, 468-69 (1876); Butterfield v. Usher, 91 U.S. 246, 248-49 (1875); Milwaukee R.R. Co. v. Soutter, 72 U.S. (1 Wall.) 660, 662 (1866); Minnesota Co. v. St. Paul Co., 69 U.S. (1 Wall.) 609, 634-35 (1864); *see also* Frederic Calvert, Parties to Suits in Equity 1-38 (1837) (arguing that those with an interest in the "object" of the suit should be made parties). For example, under principles of equity, an unnamed party is afforded judicial review if his rights are affected in an underlying proceeding. In *Blossom v. Milwaukee R.R. Co.*, 68 U.S. (1 Wall.) 655 (1863), the United States District Court for the District of Wisconsin ordered a decree foreclosing a mortgage and commanding a sale of a road in a suit against the Milwaukee and Chicago Railroad Company. Blossom bid on the road at a marshal's sale, but the sale never materialized. *See id.* He appeared in the district court seeking to validate the sale. *See id.* The court refused the sale and Blossom challenged this order on appeal to the United States Supreme Court. *See id.* On a motion to dismiss the appeal, the Supreme Court was to consider whether Blossom, who was not a named party to the underlying suit, had a right to prosecute an appeal. *See id.* At the outset of the Court's opin-

century decisions are grounded in equitable principles stemming from the Nineteenth century.[27] In *West v. Radio-Keith-Orpheum Corp.*,[28] Judge Learned Hand held that a creditor, who was not a party of record, had standing to appeal where the decree in the original suit affected his legal interests.[29] Judge Hand noted that the appellant was "invited" to appear for the purpose of confirming an agreement to settle debt because he was sent notice of the proposed agreement.[30] In short, numerous early twentieth century

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ion, Justice Miller recognized that the appellant had no right to appeal from any decree made prior to his bid for the land. *See id.* Justice Miller noted the difference in the case at hand because the appellant had acquired an interest in the proceeding by way of his bid on the land. *See id.*

> It, however, seems to be well settled, that after a decree adjudicating certain rights between parties to a suit, other persons having no previous interest in the litigation may become connected with the case, in the course of the subsequent proceedings, in such a manner as to subject them to the jurisdiction of the court, and render them liable to its orders; and that they may in like manner acquire rights in regard to the subject matter of the litigation, which the court is bound to protect.

Id. at 65-66.

The Court subtly points out two important principles that afford a right to appeal to an unnamed party. First, the appellant "may become connected with the case" by subjecting himself "quoad hoc" to the jurisdiction of the court. *Id.* For example, the party appears at the proceeding so as to announce his interest in the matter. *See id.* Second, a party may have acquired legal rights that entitle her to an appeal. *See id.*

27. *See* Weiner & Szyndrowski, *supra* note 25, at 935-77. On suits in equity, Justice Story stated:

> [i]t is a general rule in equity, that all persons materially interested, either as plaintiffs or defendants in the subject matter of the bill ought to be made parties to the suit, however numerous they may be. The reason is that the court may be enabled to make a complete decree between the parties, may prevent future litigation by taking away the necessity of a multiplicity of suits, and may make it perfectly certain, that no injustice shall be done, either to the parties before the court, or to others, who are interested by a decree, that may be grounded upon a partial view only of the real merits. When all the parties are before the court, it can see the whole case, but it may not, where all the conflicting interests are not brought out upon the bill.

Zechariah Chafee, Jr., Some Problems in Equity 204 (1950) (quoting West v. Randall, 2 Mason 181, 190-91 (R.I. 1820)).

28. 70 F.2d 621, 624 (2d Cir. 1934).

29. *Id.*

30. *See id.* The appellant in *West* was a creditor whose interests were affected by a proposed agreement to settle a debt. *Id.* The appellant received notice of the agreement and appeared to object to the proposed order. *See id.* Judge Hand held that the appellant had standing because he was brought in "in invitum" (upon notice from the court). *Id.*

courts upheld an unnamed party's right to appeal when the party was invited by the court to safeguard his rights.[31]

In time, courts developed an "objection requirement" for unnamed parties. That is, to be entitled to an appeal, an unnamed party need only object in the district court. For example, in the 1930 case of *Pianta v. Reich*,[32] the Second Circuit concluded that a non-party appellant had standing to appeal the lower court's order in a receivership suit. According to the court, the appellant creditor, although not an original party to the suit, had standing to appeal because he appeared in the lower court to oppose the order.[33] "The appellant, having appeared in opposition to the order to show cause, is 'like a defendant who is summoned by process of court and after an adverse ruling has the right to appeal.'"[34] Although some courts and commentators clearly advocated the "objection requirement" later in the twentieth century,[35] its roots stem back prior to the adoption of the Federal Rules.

A. *The Class Action—An Unnamed Class Member's Right to Appeal*

In response to an evolving society, the drafters of the Federal Rules promulgated Rule 23 to encourage the class action.[36] The

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31. For other situations in England in which unnamed parties were treated as formal parties, see Weiner & Szyndrowski, *supra* note 25, at 954. For a discussion of the link between English suits in equity and early American case law, see Timothy A. Duffy, *The Appealability of Class Action Settlements by Unnamed Parties*, 60 U. Chi. L. Rev. 933, 940-42 (1993).

32. 77 F.2d 888 (2d Cir. 1935).

33. *See id.* at 890.

34. *Id.* (quoting Christian v. R. Hoe & Co., 63 F.2d 218, 218 (2d Cir. 1933)). Arguably, the phrase, "having appeared in opposition to" is synonymous with appearing and objecting to the court's order.

35. *See infra* Part II. Most courts, though, adopted the intervention requirement in class actions. *See infra* Part II.A. At the time *Felzen* was decided, the Third Circuit adhered to the objection requirement in derivative actions. *See infra* Part II.B; *see also* Bell Atl. Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993) (holding that intervention was not required in the Third Circuit for derivative actions).

36. *See* 7a Charles Alan Wright et al., Federal Practice and Procedure §1752 (2d ed. 1986).

> The aggregation of individual claims in the context of a classwide suit is an evolutionary response to the existence of injuries unremedied by the regulatory action of government. Where it is not economically feasible to obtain relief within the traditional framework of a multiplicity of small individual suits for damages, aggrieved persons may be without any effective redress unless they may employ the class-action device.

Deposit Guar. Nat'l. Bank v. Roper, 445 U.S. 326, 339 (1980). In pertinent part, Rule 23 states:

(a) **Prerequisites to a Class Action.** One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) **Class Actions Maintainable.** An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient ajudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) **Determination by Order Whether Class Action to Be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.**

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude the mem-

device has proven useful in two ways: (1) it combines claims common to a multitude of persons, when it would be impracticable to have each litigate separately and (2) provides access to the courts when a particular claim would otherwise be lost because of the size of the claim in relation to its cost.[37]

In essence, the class action permits the joining of multiple parties in one single action as long as each claim involves similar questions of law and fact that originate out of the same transaction or event.[38] The trial court makes the initial determination of

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ber from the class if the member so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if the member desires, enter an appearance through counsel.

(3) The judgment in an action maintained as a class action under subdivision (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c)(2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) **Orders in Conduct of Actions.** In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

Fed. R. Civ. P. 23.

37. *See* 5 Moore, *supra* note 22, § 23.02.

38. *See* 5 Moore, *supra* note 22, § 23.02.

whether a suit can be properly "certified" and maintained as a class action.[39] However, courts continue to disagree on the proper interpretation of Rule 23.[40] There is general agreement, though, that Rule 23 is to be considered in light of its objectives:[41] to promote judicial economy, provide a remedy when an individual action is uneconomical or overly burdensome, spread costs of the suit among the multitude of litigants and protect the defendant from an excessive amount of claims (some of which could produce inconsistent judgments).[42]

The issue of whether unnamed class members may appeal in class action suits highlights two crucial aspects of Rule 23. First, any final judgment in a class action is binding on all class members under principles of res judicata (claim preclusion) or collateral estoppel (issue preclusion).[43] Thus, there are serious implications to all class members who choose not to opt out of the class.[44] Second, Rule 23 requires notice to all class members in the event of dismis-

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39. *See* 5 Moore, *supra* note 22, § 23.02. The trial court usually has broad discretion in deciding whether to certify a class. *See* 5 Moore, *supra* note 22, § 23.04.

40. *See* 5 Moore, *supra* note 22, § 23.03.

41. *See* 5 Moore, *supra* note 22, § 23.03.

42. *See* 5 Moore, *supra* note 22, § 23.03. Indeed, the class action proves to be beneficial, especially as our society expands. The class action is aptly explained in light of its two purposes:

> (1) to save time and energy by eliminating the need of joining and bringing into court a large and unmanageable number of people thus avoiding a multiplicity of actions; and (2) to provide a measure of fairness in those situations where the law clearly presents a right which, individually, is not worth pursuing by ensuring that a multitude has redress against wrongs they might otherwise have foregone.

Weiner & Szyndrowski, *supra* note 25, at 935.

43. *See* 5 Moore, *supra* note 22, § 23.11.

44. *See* 5 Moore, *supra* note 22, § 23.11. In class actions maintained under subdivision (b)(3), members of the class must receive notice so that they may be excluded from the class, and consequently, any binding judgment in that particular suit. *See* Fed. R. Civ. P. 23 (b)(3); *see also infra* Part III (arguing that an unnamed shareholder's inability to opt out of the class is significant in terms of whether he or she should be able to appeal).

sal or settlement.[45] Indeed, these are just two features of the rule that concern the rights of unnamed class members.[46]

Subsequent to the adoption of Rule 23, courts applied the Second Circuit's analysis in *Pianta* to class action suits. For instance, in *Ace Heating & Plumbing Co. v. Crane Co.*,[47] the Third Circuit permitted an appeal to an unnamed class member who knew the terms of the settlement and chose not to opt out of its binding effect.[48] The court noted the irony of appealing a settlement that had already been approved by the unnamed class members.[49] In allowing the appeal, however, the court stated that "ordinarily, aggrieved class members may appeal any final order of a district court in proceedings held pursuant to Rule 23."[50] The court emphasized that within a class, there may be groups of small claimants who have no chance to prosecute their actions unless they join in with the class.[51] Consequently, for some class members, "the option to join is in reality no option at all," and thus, they would face "equally unpalatable alternatives—accept either nothing at all [by opting out] or a possibly unfair settlement."[52] Thus, the Third Circuit favored a more liberal appellate procedure for unnamed class members.

In 1977, just a few years after *Ace Heating,* the Ninth Circuit faced an almost identical situation in *Marshall v. Holiday Magic,*

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45. *See* Fed. R. Civ. P. 23; *supra* note 36 (providing the text of Rule 23). Rule 23(e) states that "[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." *Supra* note 36.

46. Additionally, to ensure that the rights of unnamed class members are protected, a plaintiff must satisfy certain prerequisites in order to sue as representative of a class. *See supra* note 36 (providing the text of Rule 23).

47. 453 F.2d 30 (3d Cir. 1971). *Ace Heating* involved consolidated appeals from the "Plumbing Fixture Antitrust Cases." *Id.* at 32. For the procedural history of the underlying litigation, see Philadelphia Hous. Auth. v. American Radiator & Standard Sanitary Corp., 322 F. Supp. 834 (E.D. Pa. 1971) and Philadelphia Hous. Auth. v. American Radiator & Standard Sanitary Corp., 323 F. Supp. 364 (E.D. Pa. 1970).

48. The appellants in *Ace Heating* were unnamed members of the plaintiff class. *Ace Heating*, 453 F.2d at 32. Class members were given the opportunity to opt out of the action knowing the terms of the proposed settlement. *See id.* at 32-33.

49. *See id.* at 33.

50. *Id.* at 32.

51. *See id.* at 33.

52. *Id.*

Inc.[53] In *Marshall*, unnamed class members appealed a court-approved settlement in a class action alleging antitrust and securities violations.[54] The Ninth Circuit acknowledged that because "their legal rights [were] affected by the settlement," they were able to appeal.[55]

The Seventh Circuit also encountered a line of cases that questioned the appellate rights of unnamed class members. In *Research Corp. v. Asgrow Seed Co.*,[56] the court held that unnamed class members, who had not intervened or appeared in response to notice of a proposed settlement, did not have standing to maintain an appeal.[57] Although the court denied the appeal, it stated that "[i]f a class member intervenes or even appears in response to a notice pursuant to [Federal Rule of Civil Procedure] 23(e) and objects to the dismissal or compromise, he has a right to appeal from an adverse final judgment."[58] Therefore, under *Research Corp.*, where a class member receives notice of a proposed settlement, "a person in disagreement with the terms of a settlement must take, at least, these minimal steps to preserve his right to appeal."[59] For the time being, *Research Corp.* evidenced the preferred alternative in the Seventh Circuit.[60] Subsequently, in *Armstrong v. Board of School Directors*,[61] the Seventh Circuit reaffirmed *Research*

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53. 550 F.2d 1173 (9th Cir. 1977).

54. *Id.* at 1175-76.

55. *Id.* (citing Ace Heating & Plumbing Co. v. Crane, Co., 453 F.2d 30, 32-33 (3d Cir. 1971)).

56. 425 F.2d 1059 (7th Cir. 1970).

57. *Id.* at 1060-61.

58. *Id.* at 1060 (citation omitted); *see also* Carlough v. Amchem Prods. Inc., 5 F.3d 707, 713-14 (3d Cir. 1993) (citing *Ace Heating* and holding that unnamed class members could appeal a district court's approval or disapproval of a settlement).

59. *Research Corp.*, 425 F.2d at 1060-61. The ability to object to a court's order depends on whether the class received proper notice, and thus, because class members in *Research Corp.* had "both actual and constructive knowledge of the settlement and since they took no steps to object to the settlement prior to the entry of judgment, the appeal must be dismissed." *Id.* at 1061.

60. The Seventh Circuit, in *Felzen v. Andreas*, 134 F.3d 873 (7th Cir. 1998), overruled *Research Corp.* *See infra* Part II.B.

61. 616 F.2d 305, 327 (7th Cir. 1980) (involving class members who were allowed to intervene to contest a settlement approval and citing *Research Corp.* as authority entitling a right to appeal an adverse judgment if the unnamed party appears in response to Rule 23(e) and objects to a settlement); *see also* Patterson v. Stovall, 528 F.2d 108 (7th Cir. 1976) (allowing appeal to absent class members where class members appear and object in underlying proceeding).

Corp.[62] Thus, an unnamed class member's right to appeal was well settled in the Third, Ninth and Seventh Circuits.[63]

Beginning in 1987, a new line of cases proposed an intervention requirement for unnamed parties who sought judicial review of an unfavorable order. In essence, courts required an unnamed class member to become a named, formal party to the record under the intervention procedure set forth in Rule 24 of the federal rules.[64] In contrast to the objection requirement, intervention is an additional procedural impediment because it demands a tripartite showing that: (1) the intervenor has an interest in the action, (2) a failure to intervene will impair an ability to protect that interest and (3) the named parties do not adequately represent the intervenor's interest.[65] In addition, intervention must be timely, considering the extent to which it disturbs the proceedings or prejudices the existing parties.[66]

In 1987, the Eleventh Circuit adopted the intervention requirement in *Guthrie v. Evans.*[67] In *Guthrie*, an unnamed class

62. *Armstrong*, 616 F.2d at 327.

63. The Seventh Circuit's position on the issue has changed. *See infra* notes 96-100 and accompanying text.

64. Rule 24 of the Federal Rules of Civil Procedure states, in pertinent part:

> (a) **Intervention of Right.** Upon timely application anyone shall be permitted to intervene in an action: (1) when a statute of the United States confers an unconditional right to intervene; or (2) 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 of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately protected by existing parties.
>
> (b) **Permissive Intervention.** Upon timely application anyone may be permitted to intervene in an action: (1) when a statute of the United States confers a conditional right to intervene; or (2) when an applicant's claim or defense and the main action have a question of law or fact in common. In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties.
>
> (c) **Procedure.** A person desiring to intervene shall serve a motion to intervene upon the parties as provided in Rule 5. The motion shall state the grounds therefor and shall be accompanied by a pleading setting forth the claim or defense for which intervention is sought.

Fed. R. Civ. P. 24.

65. *See* Jack H. Friedenthal et al., Civil Procedure § 6.10, at 367-68 (2d ed. 1993).

66. *See id.* at 375.

67. 815 F.2d 626 (11th Cir. 1987).

member attempted to appeal the district court's entry of final judgment.[68] In a case of first impression in the circuit,[69] the court held that the unnamed class member did not have standing to appeal from a final judgment.[70] The court's decision, however, is most notable for its analysis in support of an intervention requirement. The court denied standing to the non-intervening unnamed class member for three reasons:

> [*f*]*irst*, such individuals cannot represent the class absent the procedures provided for in Rule 23 of the Federal Rules of Civil Procedure. *Second*, class members who disagree with the course of a class action have available adequate procedures through which their individual interests can be protected. *Third*, class actions could become unmanageable and non-productive if each member could individually decide to appeal.[71]

In effect, to preserve an appeal, unnamed parties were obligated to intervene under Rule 24.

The court in *Guthrie* asserted that an unnamed party had no standing to appeal because it had not been determined that he or she could satisfy the requirements of Rule 23.[72] For example, Rule 23(a) requires that named parties will fairly and adequately represent the interests of the class.[73] But unlike the named representative parties who may appeal but have decided not to, the unnamed appellant has not necessarily met the class action prerequisites of

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68. *Id.* at 627. In this inmate class action, the individual appellant sought to challenge the prison conditions at a Georgia State Prison even though neither the class representatives nor the class counsel appealed from the judgment of the district court. *See id.*

69. The court noted that there were "no cases in this Circuit squarely on point." *Id.* Additionally, the opinion stated that "[n]o case law ha[d] been located in any circuit that resolves this issue." *Id.* The court wrote in reference to case law on the specific issue of an unnamed party's right to appeal a final judgment. *See id.*

70. *See Guthrie*, 815 F.2d at 627.

71. *Id.* at 628.

72. *Id.*

73. *See* Fed. R. Civ. P. 23; *supra* note 36 (providing the text of Rule 23).

Rule 23(a).[74] Thus, the appellant "has no standing to take any action on behalf of the class."[75]

According to *Guthrie,* a second reason to deny the right to appeal is because alternate avenues of relief are open to an objecting party.[76] Primarily, the objecting class member may move to intervene as of right in the district court.[77] Under Rule 24, an unnamed party may become a party of record upon timely application of a motion to the district court.[78] This practice is encouraged in light of the intervening parties' enhanced ability to "monitor the representation of their rights."[79] In addition, an objecting party may seek relief in a collateral proceeding on the grounds of inadequate representation.[80] Indeed, this collateral attack is available even after a final order in the district court.[81] Thus, one may appeal on the grounds of inadequate representation "when the class representative in the prior suit failed to appeal from the trial court's judgment."[82] Of course, a claim of inadequate representation is sensible considering that the objecting party has already appeared in court to voice objections to the proposed order.[83]

Finally, a class member may opt-out of the class.[84] This mechanism permits an individual to exclude himself from class representation, thereby eluding a binding judgment and preserving a right to pursue an individual claim.[85] Ultimately, with the availa-

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74. Unlike the original named plaintiffs, a court has not determined that the unnamed class members can satisfy the Rule 23(a) prerequisites for class actions. *See Guthrie*, 815 F.2d at 628; *accord* Croyden Assocs. v. Allelco, Inc., 969 F.2d 675, 678 (8th Cir. 1992); Walker v. City of Mesquite, 858 F.2d 1071, 1073 (5th Cir. 1988).

75. *Guthrie*, 815 F.2d at 628.

76. *Id.*

77. *See id.*

78. *See supra* note 64.

79. *Guthrie*, 815 F.2d at 628 (citations omitted).

80. *See id.*

81. *See id.*

82. Gonzales v. Cassidy, 474 F.2d 67, 69 (5th Cir. 1973).

83. *But see* Marcel Kahan & Linda Silberman, *The Inadequate Search for "Adequacy" in Class Actions: A Critique of* Epstein v. MCA, Inc., 73 N.Y.U. L. Rev. 765, 773-92 (1998) (asserting that an unobstructed ability to collaterally attack adequacy may not be the best solution).

84. *See Guthrie*, 815 F.2d at 628. Unlike class actions, shareholder derivative suits do not permit shareholders to opt-out. Thus, in derivative actions, shareholders have no choice but to be bound by the court's final order. *See infra* Part III.B.

85. *See infra* Part III.B. It is important to note that an individual's ability to opt-out is not available under a 23(b)(2) action for equitable relief; rather, the abil-

bility of these remedies, "there is no need to permit an individual to appeal a judgment with which the class representatives, and presumably the majority of class members are satisfied."[86] If individual unnamed class members were able to appeal unconditionally, they would frustrate the very purpose of the class action.[87]

Before *Guthrie*, most courts allowed appeals from unnamed parties as long as they had appeared and objected in the underlying proceeding.[88] It is sufficient to say that *Guthrie*, "the case that appears to be the progenitor of the modern trend in the federal courts,"[89] introduced a formidable line of reasoning supporting intervention in class actions.[90]

Following *Guthrie*, the Seventh Circuit decided two cases in the 1990s that significantly altered its earlier position supporting a more liberal avenue for appeals. In *In re VMS Limited Partnership Securities Litigation*,[91] the Seventh Circuit held that an unnamed class member had no right to appeal the district court's post-settlement order.[92] The court noted that its analysis was influenced by

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ity to opt out exists for a Rule 23(b)(3) action, pursuant to Rule 23(c)(2). *See supra* note 36 (providing the text for Rule 23).

86. *Guthrie*, 815 F.2d at 628.

87. *See id.* at 629.

88. *See supra* notes 28-63 and accompanying text.

89. Shults v. Champion Int'l Corp., 35 F.3d 1056, 1059 (6th Cir. 1994).

90. *But see* Carlough v. Amchem Prods., Inc., 5 F.3d 707 (3d Cir. 1993). The Third Circuit, in *Carlough*, found *Guthrie* distinguishable in the context of settlement appeals. *Id.* at 714. The court reasoned that unnamed class members have a greater right to appeal settlements because they appeared and objected in response to notice of the proposed settlement. *See id.* at 714.

> We think that a nonparticipating class member in a litigated action clearly would be in a less favorable position with respect to arguing that he has standing to appeal than such a class member in a settled action. [Federal Rule of Civil Procedure] 23(e) requires notice to class members of proposed dismissals or compromises of class actions but says nothing of litigated matters. This distinction suggests that a class member who is not a named party would be recognized as having greater rights to participate in a settled case than in a litigated case.

Id.

91. 976 F.2d 362 (7th Cir. 1992).

92. *Id.* at 369. The appellant filed formal objections to the proposed settlement. *See id.* at 364. The settlement was later approved and the district court made a post-settlement order approving the sale of land in which appellants had an interest. *See id.* at 365. This appeal was denied because "[i]n spite of its interest and participation in [the] [c]lass [a]ction prior to and after settlement, ERG was not a named plaintiff in the [c]lass [a]ction; ERG's posture as an unnamed [c]lass member curtails its right to appeal." *Id.* at 367.

Guthrie and its progeny.[93] However, because the case at hand concerned an appeal of a post-settlement order, its holding did not disturb an unnamed class member's right to appeal a settlement.[94] Thus, although the holding in *In re VMS Limited Partnership* was limited to post-settlement orders, the Seventh Circuit laid a foundation of change by "drawing on *Guthrie*'s reasoning."[95]

The Seventh Circuit reaffirmed its preference for the intervention requirement in *In re Brand Name Prescription Drugs Antitrust Litigation*.[96] Led by Chief Judge Richard Posner, the court denied standing to appeal from an order granting summary judgment.[97] This holding reflects *Guthrie's* concerns for judicial administration, i.e., that an appeal would frustrate the purpose of class actions.[98] Moreover, the aggrieved class members had other avenues of relief such as opting out, creating subclasses, replacing the class representative, or intervening in the action itself.[99] In short, the court concluded that "[i]f class members can file their own appeals, the coherence of the class is destroyed, the scope of the class action becomes unclear, and the control over the action becomes divided and confused."[100] Once again, the Seventh Circuit's decision did not totally foreclose the possibility of appeal by an unnamed class member who had not intervened. Like *In re VMS*

93. The court cited *Guthrie* and *Walker* in reference to "more recent cases" that used a different approach in attacking the issue. *Id.* at 367-68. "We are drawing on *Guthrie's* reasoning, however, to address the related issue of whether an unnamed class member can appeal a post-settlement order implementing the settlement agreement." *Id.* at 368 n.8; *see also* Bash v. Firstmark Standard Life Ins. Co., 861 F.2d 159, 164 (7th Cir. 1988) (noting *Guthrie* and *Walker* as case authority that holds that an unnamed class member may not appeal from a final judgment without having intervened).

94. Because the case at hand did not involve approval of a settlement, the court noted that *Research Corp.* still controlled in that context. *See In re VMS Ltd. Partnership*, 976 F.2d at 368; *see also Carlough*, 5 F.3d at 714 (excluding the intervention requirement from settlement appeals).

95. *In re VMS Ltd. Partnership*, 976 F.2d at 368 n.8.

96. 115 F.3d 456 (7th Cir. 1997).

97. *See id.* at 457-58. The court also considered the right to appeal for plaintiffs who had opted out of the antitrust class action. *See id.* at 457. Relying on the intervention requirement for nonparties, the court dismissed the appeal. Indeed, the court "would be facing a veritable avalanche of appeals if all opt-outs could appeal from any appealable judgment in the action." *Id.; see also* SEC v. Wozniak, 33 F.3d 13 (7th Cir. 1994) (holding that intervention is necessary for appeal by nonparties).

98. *See In re Brand Name Prescription Drugs*, 115 F.3d at 457-58.

99. *See id.*

100. *Id.* at 458.

Limited Partnership, In re Brand Name Prescription Drugs did not confront the issue of whether an unnamed party may appeal from an order approving a settlement.

In 1993, the Tenth Circuit adopted the intervention requirement in *Gottlieb v. Wiles*.[101] Under the *Guthrie* rationale, the court held that unnamed class members could not appeal the class action settlement unless they had intervened in the district court.[102] However, the court stated that intervention was required only with an "absence of any violations of the Rule 23 procedures intended to protect the rights of those unnamed class members."[103] In addition, the Tenth Circuit found the appellants' reliance on derivative suit precedent irrelevant to the issue at hand.[104] In this regard, the *Gottlieb* opinion is notable because it declares that "Rule 23.1 does not offer the same protective mechanisms offered by Rule 23."[105] Although not faced with the precise issue, the court implies that the distinct nature of derivative suits justifies its separate treatment.[106]

Until the Eleventh Circuit's decision in *Guthrie*, the appellate procedure for unnamed class members was more flexible. That is, courts generally allowed appeals in class actions when the dissatisfied class members appeared in the lower court to object to the court's proposed order. In 1987, *Guthrie* and its progeny introduced the intervention requirement for unnamed class members. This line of cases offered a persuasive rationale, indicating that the intervention requirement was the better practice for class-action appeals. Thus, several circuits mandated the intervention requirement in the context of class actions.[107]

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101. 11 F.3d 1004 (10th Cir. 1993).

102. *See id.* at 1007-13.

103. *Id.* at 1009. The court explained that if one of the protective provisions of Rule 23 was neglected (such as notice to the class member of an approved settlement), an unnamed class member does not have to intervene in order to appeal. *See id.*; *see also* Silber v. Mabon, 957 F.2d 697, 700 (9th Cir. 1992) (holding that objector had standing to appeal only the constitutionality of the notice procedure).

104. *See Gottlieb*, 11 F.3d at 1010-11.

105. *Id.* at 1011.

106. *See id.* at 1011 (citing Notes of Advisory Committee on Rules to the 1966 Addition of Rule 23.1, 28 U.S.C. App. 605 (1988)).

107. *See* Shults v. Champion Int'l Corp., 35 F.3d 1056 (6th Cir. 1994); Loran v. Furr's/ Bishop's, Inc., 988 F.2d 554 (5th Cir. 1993); Gottlieb v. Wiles, 11 F.3d 1004 (10th Cir. 1993); Croyden Assocs. v. Alleco, Inc., 969 F.2d 675 (8th Cir. 1992); Guthrie v. Evans, 815 F.2d 626 (11th Cir. 1987).

B. *The Derivative Suit—An Unnamed Shareholder's Right to Appeal*

The derivative action originated from principles of equity.[108] It is a suit brought by a plaintiff shareholder as representative of other fellow shareholders in a corporate cause of action.[109] The corporation is the real party in interest, with the nominal plaintiff shareholder "act[ing] in protection of its interest somewhat as a 'next friend' might do for an individual, because it is disabled from protecting itself."[110] Any derived benefit flows directly to the corporation and indirectly to the shareholders.[111]

In 1966, the derivative suit was given separate recognition in Rule 23.1 of the Federal Rules of Civil Procedure.[112] Similar to Rule 23, Rule 23.1 mandates that (1) the derivative suit shall not be compromised or dismissed prior to judicial approval and (2)

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108. *See* Koster v. Lumbermens Mut. Cas. Co., 330 U.S. 518, 522 (1947).

109. *See id.* at 522.

110. *Id.* at 523.

111. *See* Henry Winthrop Ballantine, Ballantine on Corporations §145, at 341 (revised ed., 1946).

112. Legal principles underlying the derivative suit stem as far back as the nineteenth century. *See* 5 Moore, *supra* note 22, § 23.1 App.01. Equity Rule 94 was promulgated in response to the United States Supreme Court's decision in *Hawes v. Oakland*. *See* 5 Moore, *supra* note 22, § 23.1 App.01 (citing Hawes v. Oakland, 104 U.S. 450 (1882)). Before the 1966 Amendments to the Federal Rules, derivative actions were managed under Rule 23(b). *See* 5 Moore, *supra* note 22, § 23.1 App.01. In 1966, Rule 23.1 was promulgated. *See* 5 Moore, *supra* note 22, § 23.1 App.02. It states:

> In a derivative action brought by one or more shareholders or members 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, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort. The 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 in enforcing the right of the corporation or association.

Fed. R. Civ. P. 23.1.

shareholders must receive notice of such a proposed order.[113] Moreover, Rule 23.1 provides that a 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 in enforcing the right of the corporation or association."[114] However, despite many similarities to Rule 23, the derivative suit warranted a separate rule, in part because it is an action that can proceed even when the shareholders are too few for a class action.[115]

Before the promulgation of Rule 23.1, the Sixth Circuit, in *Cohen v. Young*,[116] confronted the issue of whether an unnamed shareholder could appeal a decree approving settlement in a derivative action. In *Cohen*, an unnamed shareholder appeared with counsel to oppose the proposed settlement and file a petition to intervene in the action.[117] Ultimately, the court rejected the petition to intervene and approved the settlement "upon the sole ground that it was recommended by the attorneys of record."[118] The objecting shareholder's appeal was met by a motion to dismiss because the appellant was not a named party to the original suit and therefore, had no standing.[119]

The Sixth Circuit held that the appellant was "entitled as of right to prosecute the appeal."[120] The court cited *Pianta*, reasoning that the appellant, as an interested stockholder, responded to notice of a proposed settlement[121] and, thus, was "like a defendant who is summoned by process of court and after an adverse ruling

113. "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." *Id.*

114. *Id.* In contrast to the class action, where a preliminary finding of adequacy must be made by the court, the adequacy of a representative plaintiff in a derivative suit need not be assessed at its outset. *See* Gottlieb v. Wiles, 11 F.3d 1004, 1011 (10th Cir. 1993).

115. *See* 7c Wright, *supra* note 36, § 1821.

116. 127 F.2d 721 (6th Cir. 1942).

117. *Id.* at 723. The denial of intervention was inapposite to the court's decision because the appellant did not appeal this portion of the district court's order. *See id.* at 724.

118. *Id.* at 724.

119. *See id.*

120. *Id.*

121. *See id.*

has the right to appeal."[122] In short, the court applied the more liberal objection requirement to a derivative suit appeal.

In 1975, the Seventh Circuit approved of the objection requirement as applied to derivative actions in *Tryforos v. Icarian Development Co.*[123] In *Tryforos*, an unnamed shareholder responded to Rule 23.1 notice in order to object to a proposed dismissal of the case.[124] After the lower court denied the objections and dismissed the action, the court announced that the "the law is clear that a non-party shareholder who appears, pursuant to a Rule 23.1 notice, to present objections to a proposed dismissal or settlement of a derivative action may appeal an adverse decision even though he has not been formally made a party to the action."[125] By explicitly applying the issue to Rule 23.1 actions, the Seventh Circuit reaffirmed a right to appeal for objecting shareholders in derivative actions.

More recently, in *Bell Atlantic Corp. v. Bolger*,[126] the Third Circuit encountered a settlement appeal by unnamed shareholders in a derivative suit. In particular, three shareholders objected in the lower court, asserting that the settlement agreement accorded no benefit to the corporation—only to defendant directors and plaintiffs' counsel.[127] After the district court approved the settlement, the unnamed shareholders appealed to the Third Circuit.[128]

The named plaintiffs argued a "no-intervention, no-standing" rule—the appellants lacked standing because they were not named parties and because they failed to intervene in the lower court.[129]

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122. *Id.* (quoting Pianta v. Reich Co., 77 F.2d 888, 890 (2d Cir. 1935)).

123. 518 F.2d 1258 (7th Cir. 1975).

124. *Id.* at 1260. Presumably, the objections of the unnamed shareholder were critical—the shareholder, a resident of Greece, hired counsel to represent him and tender written objections on his behalf. *See id.* at 1261-62.

125. *Id.* at 1263 n.22. The court cited *Pianta* and *Cohen* as authority for this proposition. *See id.*

126. 2 F.3d 1304 (3d Cir. 1993).

127. *See id.* at 1305. In an earlier settlement with the Pennsylvania Attorney General, Bell Atlantic was required to pay over $40 million for alleged violations of unfair practices and consumer protection laws. *See id.* at 1306 & n.2. Under the derivative suit settlement, Bell Atlantic agreed to reveal certain information in its upcoming proxy statement and agreed to follow new sales and marketing procedures in exchange for a release of all present and future claims relating to the allegations. *See id.* at 1306-07. In addition, the settlement awarded plaintiffs' counsel fees and expenses not to exceed $450,000. *See id.*

128. *See id.* at 1307.

129. *Id.*

This was a worthy argument in light of the recent trend towards the intervention requirement in class actions.[130] Nevertheless, the court held that the shareholders had standing to appeal because they had appeared in the district court to present objections to the proposed settlement.[131] Accordingly, the decision to allow appeals by the objecting shareholders reaffirmed earlier precedent in the circuit.[132] In addition, it followed the approach of other circuits that allowed appeals by unnamed, non-intervening parties.

The Third Circuit's analysis is significant for two reasons. First, although *Bell Atlantic Corp.* involved the appeal of a settlement in a derivative suit, the court analyzed the issue collectively with class action precedent.[133] The Third Circuit did, though, address the differences between the two types of suits, indicating that a separate analysis may be warranted.[134] The court did not, how-

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130. *See supra* Part II.A; Croyden Assocs. v. Alleco, Inc., 969 F.2d 675 (8th Cir. 1992); Guthrie v. Evans, 815 F.2d 626 (11th Cir. 1987). In addition, the United States Supreme Court mandated intervention, but on distinguishable facts. *See* Marino v. Ortiz, 484 U.S. 301 (1988) (per curiam). In *Marino* (discussed thoroughly in Parts II and III), an appeal was denied to non-party white police officers who were not class members in the underlying suit and who otherwise were wholly unattached to the proceedings. *Id.*

131. *See Bell Atl. Corp.*, 2 F.3d at 1310.

132. *Cf. In re* Pittsburgh & Lake Erie R.R. Co. Sec. & Antitrust Litig., 543 F.2d 1058 (3d Cir. 1976) (holding that an objecting pledgee had standing to appeal without having intervened in the underlying derivative action). Although not on point, the *Bell Atlantic* court also cited *Ace Heating & Plumbing Co. v. Crane Co.*, explaining that "[o]rdinarily, aggrieved class members may appeal any final order of a district court in proceedings held pursuant to Rule 23." *Bell Atl. Corp.*, 2 F.3d at 1308-09 (quoting Ace Heating & Plumbing Co. v. Crane Co., 453 F.2d 30, 32 (3d Cir. 1971)).

133. For class and derivative actions alike, the court compared the intervention requirement in the Fifth, Eighth and Eleventh Circuits with the different approach (objection requirement) followed by the Third, Sixth, Seventh and Ninth Circuits. *See Bell Atl. Corp.*, 2 F.3d at 1307-09.

134. *See id.* at 1307-08 n.4. The court noted one difference is that in derivative suits, any recovery inures in whole to the corporation on whose behalf the suit was brought, whereas in class actions, individual class members recover directly depending on the nature and extent of each claimed injury. *See id.* (citing *In re Pittsburgh & Lake Erie R.R. Co. Sec. & Antitrust Litig.*, 543 F.2d at 1068). In addition, the court recognized "that one of the rationales offered in support of an intervention requirement cannot apply to derivative actions. That is, unlike members of a class certified under Rule 23(b)(3), 'shareholders normally cannot opt out of the class and pursue their own individual action.'" *Id.* (quoting American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 7.02, at 635 (Proposed Final Draft, Mar. 31, 1992)).

ever, consider whether different procedures should apply because the parties did not assert the issue.[135]

Second, *Bell Atlantic Corp.* differentiates between an unnamed party's appeal of a court's judgment and an unnamed shareholder's or class member's appeal of a settlement in a class or derivative action.[136] The court's supposition rests on the idea that unnamed shareholders and class members should possess a more flexible procedure for appeals than non-parties who are not connected to the suit in any way.[137] Moreover, the court emphasizes that a settlement appeal should be more accessible than an appeal of a judgment on the merits of the case.[138] In support of this proposition, the court provides an extensive analysis of the propensity for unfair or collusive settlements in derivative suits.[139] In short, the *Bell Atlantic Corp.* opinion indicates that the intervention requirement is unsuited for settlement appeals in derivative actions.[140]

In *Rosenbaum v. MacAllister*,[141] the Tenth Circuit elaborated on the distinctions between class actions and derivative suits. The litigation involved a combined class action and derivative suit.[142] An objecting shareholder/class member, who had not intervened, objected to a settlement proposal on grounds that the $2,500,000 in

135. *See Bell Atl. Corp.*, 2 F.3d at 1307-08 n.4.

136. *Id.* at 1307-08. Essentially, the court is distinguishing the United States Supreme Court's decision in *Marino*, which required intervention when non-parties tried to appeal a consent decree, from the issue at hand, a settlement appeal in a derivative suit. *See id.* Part III.D contains a more thorough discussion of *Marino*. *See infra* Part III.

137. *See Bell Atl. Corp.*, 2 F.3d at 1307-10.

138. *See id.*

139. *See id.* at 1309-10. Specifically, the court noted collective action problems, where a large number of shareholders each have relatively small claims. *See id.* at 1309; *infra* Part IV. Moreover, agency concerns are often problematic in derivative suits because "it is counsel for the class representative and not the named parties, who direct and manage these actions." *Bell Atl. Corp.*, 2 F.3d at 1309 n.7 (quoting Greenfield v. Villager Indus. Inc., 483 F.2d 824, 832 n.9 (3d Cir. 1973)); *infra* Part III.E. Finally, the court referred to shareholders' inability to monitor the status of their claims in derivative litigation when their cost of monitoring the action often exceeds any resulting benefit. *See Bell Atl. Corp.*, 2 F.3d at 1309-10; *infra* Part III.E.

140. Certainly, the court's ultimate rejection of the intervention requirement was due in large part to concerns about settlement agreements in derivative actions. *See Bell Atl. Corp.*, 2 F.3d at 1309-10; *see also* Part III.E (providing a more in depth discussion of settlement problems in representative litigation).

141. 64 F.3d 1439 (10th Cir. 1995).

142. *See id.* at 1441.

attorneys' fees was outrageous as compared to the minimal economic benefits accruing to the corporation and shareholders.[143] After the lower court approved the settlement and the unnamed party appealed, the Tenth Circuit held that the appellant had standing to appeal the attorneys' fees-and-expenses portion of the settlement.[144]

Significantly, the Tenth Circuit allowed an appeal of the class/derivative action settlement, notwithstanding its intervention requirement for class actions.[145] The court declared that the rationale behind the intervention requirement did not apply to a non-intervenor's right to appeal attorneys' fees and expenses in class or derivative suits.[146] In short, the subject of the appeal, the amount of fees and expenses awarded to the lawyers, would not trigger the primary detriments resulting from an appeal of a settlement—delaying benefits to class members and deferring resolution of the defendant's liability.[147] In its application to derivative suits, the court found that an even greater right existed for shareholders to appeal attorneys' fees and expenses because (1) there is no chance to opt out of a derivative suit[148] and (2) "the court's fee award—to be paid out of the corporate treasury—would seem not to delay the benefits of the settlement."[149] Consequently, the Tenth Circuit proclaimed that the intervention requirement definitely did not apply to an appeal of attorneys' fees in a derivative action; arguably, it should not apply to an appeal of any kind in a derivative action.[150]

Traditionally, courts did not distinguish between derivative suits and class actions when determining appellate rights for unnamed parties. Until 1987, no circuit required intervention in

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143. *See id.*

144. *See id.* at 1441-43.

145. *See id.* at 1442-43; *see also* Gottlieb v. Wiles, 11 F.3d 1004 (10th Cir. 1993) (requiring intervention for a right to appeal settlement in a class action).

146. *See Rosenbaum*, 64 F.3d at 1442.

147. *See id.* at 1442-43.

148. Although it offered no rationale for this significance, the court opines that shareholders in derivative suits should have a right to appeal without intervention, due to the fact that they never are afforded a chance to opt out of the settlement in the first place. *See id.* at 1443; *cf.* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1307-08 n.4 (3d Cir. 1993) (noting the importance of a shareholder's inability to opt out in derivative actions).

149. *Rosenbaum*, 64 F.3d at 1443.

150. *See infra* Part III.

either type of representative litigation. The reasoning behind the intervention requirement as propounded in *Guthrie*—maintaining control of a class of litigants—was persuasive in the context of class actions. However, the Third and Tenth Circuits were correct in not applying *Guthrie*'s analysis to a derivative action. In fact, no court has ever required intervention in the context of an unnamed shareholder's right to appeal a settlement in a derivative suit. That is, until *Felzen v. Andreas*,[151] when the Seventh Circuit jumped on the intervention bandwagon.

II. *FELZEN V. ANDREAS*

A. *Lower Court Proceedings*

On June 28, 1995, the Archer Daniels Midland Company[152] (hereinafter referred to as ADM) disclosed to the public that three separate federal grand juries were investigating possible federal antitrust law violations.[153] Subsequently, several shareholders brought civil suits against ADM and its directors for allegedly violating both federal antitrust and securities laws.[154] Specifically, shareholders filed three derivative suits in the United States District Court in Illinois, and fourteen other derivative actions in Delaware, the state of ADM's incorporation.[155]

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151. 134 F.3d 873 (7th Cir. 1998).

152. Archer Daniels Midland Company will hereinafter be referred to as "ADM." ADM is a corporation in the business of producing food additives such as high fructose corn syrup, lysine and citric acid. *See In re* Archer-Daniels-Midland, Inc. Sec. Litig., Nos. 95 C 3979 & 95 C 4006, 1995 WL 645673, at *2 (N.D. Ill. Nov. 1, 1995).

153. *See* Brief for Petitioners at 2, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (No. 97-1732). In December of 1996, the federal grand jury indicted former ADM executive vice president Michael Andreas, Terrance Wilson (former president of ADM's Corn Processing Division) and Kazutoshi Yamada (managing director of Anjimoto Corp.). *See* 13 No. 8 Andrews Corp. Off. & Dir. Liab. Litig. Rep. 16 (Feb. 23, 1998). "It was reported that Mark Whitacre, the president of ADM's fast-growing BioProducts Division, had been an informant for the FBI and had recorded conversations of high-level ADM officials discussing price-fixing and other anti-competitive tactics." *Id.*

154. *See* Brief for Petitioners at 3, *California Public Employees' Retirement System* (No. 97-1732); *In re Archer-Daniels-Midland Inc. Sec. Litig.*, 1995 WL 645673 at *1.

155. *See* Archer Daniels Midland Co. 10-K, Sept. 29, 1997, WL SECNOW, at 87.

In mid-1996, the derivative suits were consolidated in the Central District of Illinois.[156] Paul Felzen, as trustee of the Louise Laskin trust, and Sandra Esner were named plaintiffs for the consolidated derivative action in the district court.[157] The complaint alleged "gross mismanagement" on the part of ADM's board.[158] The shareholders sought to recover $190 million that ADM had already paid in criminal fines and civil settlements.[159] On May 29, 1997, the company proposed a settlement to counsel for the shareholder-plaintiffs.[160] In essence, the settlement terms consisted of "$8 million to be paid by or on behalf of certain defendants in these actions to the company and certain changes in the structure and policies of the Company's Board of Directors."[161] The parties mailed notice of the proposed settlement (pursuant to Rule 23.1) to all ADM shareholders with directions to appear in the district court if they had any objections.[162]

Two unnamed shareholders (California Public Employees' Retirement System and Florida State Board of Administration) appeared in the district court to voice their objections to the

156. These derivative suits were aggregated as *In re Archer Daniels Midland Inc., Derivative Litig.*, Consolidated No. 14403. *See id.* at 89. On November 1, 1995, the court granted the defendants' motion to transfer the proceedings to the United States District Court for the Central District of Illinois. *See In re Archer Daniels Midland Inc., Securities Litig.*, 1995 WL 645673, at *1.

157. *See* Brief for Respondent at ii, *California Pub. Employees' Retirement Sys.* (No. 97-1732). Although not a shareholder himself, Paul Felzen is "a properly authorized representative who [may] bring a derivative suit on behalf of a corporation in which the trust or estate owns shares." Moore, *supra* note 22, § 23.1.07[3][c][ii]. Named defendants included nearly all then current directors of ADM (as well as the corporation itself as nominal defendant). *See* Brief for Petitioners at ii, *California Pub. Employees' Retirement Sys.* (No. 97-1732); Archer Daniels Midland Co. 10-K, Sept. 29, 1997, WL SECNOW, at 88.

158. *See* Brief for Petitioners at 5, *California Pub. Employees' Retirement Sys.* (No. 97-1732).

159. *See id.*

160. *See id.* at 6. Rule 23.1 mandates judicial approval of any settlement. *See* Fed. R. Civ. P. 23.1.

161. Archer Daniels Midland Co., 10-K, Sept. 29, 1997, WL SECNOW, at 89. About half of the $8 million fund was allocated to past attorneys' fees, while the other half was for future attorneys' fees "to be incurred by ADM in attempting to reform itself." Brief for Petitioners at 6, *California Pub. Employees' Retirement Sys.* (No. 97-1732).

162. *See* Brief for Petitioners at 7-8, *California Pub. Employees' Retirement Sys.* (No. 97-1732).

settlement.[163] Essentially, the objectors argued that the cash award (all of which was allocated to attorneys) and the promises for reform in corporate governance were inadequate.[164] On July 7, 1997, the district court granted final approval of the settlement.[165] Subsequently, the two objecting shareholders, who were not named parties in the District Court proceedings, appealed to the Seventh Circuit in disapproval of the settlement.[166]

B. *The Seventh Circuit's Decision*

In January of 1998, the Seventh Circuit, comprised of Chief Judge Posner and Circuit Judges Easterbrook and Flaum, handed down a decision that proved to be worthy of Supreme Court review.[167] The appeal presented the Seventh Circuit with the specific question of whether unnamed shareholders in derivative litigation, who appear and object to a proposed settlement in the district court, but do not intervene at any time, may nevertheless appeal the court's settlement approval.[168] Ultimately, the court

163. The shareholders objected to the settlement "on the grounds that it provided little or no benefit to the corporation: the cash benefit was all to lawyers and was excessive, and the corporate governance 'concessions' provided no material benefit to shareholders beyond what ADM had itself adopted a year earlier." *Id.* at 8. Of course, the actual benefits of the settlement are in dispute. In fact, one commentator described the settlement as "state of the art in American corporate governance today." Brief for Respondent at 4, *California Pub. Employees' Retirement Sys.* (No. 97-1732).

164. *See* Brief for Petitioners at 6, 8, *California Pub. Employees' Retirement Sys.* (No. 97-1732).

165. *See id.* The court found the settlement to be fair and reasonable, stating that "the overwhelming reaction to the proposed settlement [by shareholders] has been acceptance." Brief for Respondent at 5-6, *California Pub. Employees' Retirement Sys.* (No. 97-1732).

166. *See* Felzen v. Andreas, 134 F.3d 873, 874 (7th Cir. 1998). The two unnamed shareholder appellants are California Public Employees Retirement System (CalPERS) and Florida State Board of Administration (FSBA). *See id.* at 873. Calpers, "the biggest U.S. public pension fund . . . has billions invested in more than 1,600 U.S. companies." *CalPERS Softens Its Proposed Standards For Corporate Governance in the U.S.*, Wall St. J., Mar. 13, 1998, at A1, *available in* 1998 WL WSJ 3486094. Together, both pension funds own more than 4.5 million shares of ADM common stock; less than 1% of ADM's 530 million shares of common stock outstanding. *See* Brief for Respondent at 4 & n.8, *California Pub. Employees' Retirement Sys.* (No. 97-1732).

167. Although the Supreme Court granted certiorari to decide the issue, the case was ultimately passed over by an equally divided court that merely affirmed the Seventh Circuit's decision. *See* California Pub. Employee's Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (per curiam).

168. *See Felzen*, 134 F.3d at 874.

denied the shareholders an appeal because they did not formally intervene in the proceeding.[169] In addition, the court extended the intervention requirement to class action settlements by way of dicta.[170] The following two sections discuss each analysis separately.

1. *Non-Parties May Not Appeal from a Decision of Any Kind in a Class Action*

Before the Seventh Circuit examined the specific issue in question—whether an unnamed shareholder may appeal the settlement of a derivative suit—the court stated that unnamed class members would have to intervene in the lower court to appeal in class actions.[171] In its analysis of class actions, the court relied primarily on the United States Supreme Court's decision in *Marino v. Ortiz*.[172] To support its position, the *Felzen* court also applied a strict interpretation of the language in Rule 3(c) of the

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169. *See id.* at 874-75. The shareholders contend that there was inadequate time in which to intervene. *See* Brief for Petitioners at 8, *California Pub. Employees' Retirement Sys.* (No. 97-1732). Notice of the proposed settlement was sent to all ADM shareholders on May 30, 1997. *See id.* at 7-8. July 3, 1997 was set as a deadline for written objections, with a final hearing on July 7, 1997. *See id.* at 8. The two shareholder petitioners, in their brief to the Supreme Court, emphasized the fact that they:

> had less than four weeks (once they actually recieved the notice) to review the Settlement notice, hire counsel, obtain and review copies of pleadings in the case weigh the fairness of the Settlement, draft a brief, and appear in court in Decatur, Illinois. Moreover, plaintiffs did not file their voluminous fee petition until June 30, 1997, leaving petitioners just four days to gain access to, review, analyze, and respond in writing to that document as well.

Id.

170. *See Felzen* 134 F.3d at 874-76. In the context of class actions, the decision in *Felzen* overruled three prior Seventh Circuit decisions—*Armstrong v. Board of Sch. Dirs.*, 616 F.2d 305 (7th Cir. 1980); *Patterson v. Stovall*, 528 F.2d 108 (7th Cir. 1976) and *Research Corp. v. Asgrow Seed Co.*, 425 F.2d 1059 (7th Cir. 1970). *See id.* at 875. In the context of derivative actions, the Seventh Circuit overruled *Tryforos v. Icarian Dev.* Co., 518 F.2d 1258 (7th Cir. 1975), a previous decision that allowed unnamed, non-intervening shareholders to appeal. *See id.* at 874-76. The *Felzen* court disagreed with the Third Circuit's position that unnamed shareholders had standing to appeal a settlement. *Felzen*, 134 F.3d at 876 (disagreeing with the Third Circuit's decision in *Bell Atl. Corp. v. Bolger*, 2 F.3d 1304 (3d Cir. 1993)).

171. *See Felzen*, 134 F.3d at 874-75.

172. *See id.* at 874-76; *see also* Marino v. Ortiz, 484 U.S. 301 (1988) (requiring intervention for white police officers, who were not class members in the underlying suit, in order to appeal from a consent decree).

Federal Rules of Appellate Procedure.[173] Significantly, no other court, besides *Marino*, had mentioned the possibility that this rule applied to the issue of appeals for unnamed parties.[174] The three judge panel also cited two recent Seventh Circuit opinions that required intervention for an appeal of a post-settlement order and summary judgment in class action suits.[175]

The court expressly relied upon *Marino*. Judge Easterbrook began the opinion with a quote from the Supreme Court's decision in *Marino*, which states

> "[t]he rule that only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment, is well settled. The Court of Appeals suggested that there may be exceptions to this general rule, primarily 'when the nonparty has an interest that is affected by the trial court's judgment.' We think the better practice is for such a nonparty to seek intervention for purposes of appeal; denials of such motions are, of course, appealable."[176]

According to the court, *Marino* simply stated that if one is not a party, one may not appeal.[177] Further, one is not considered a party unless named in the suit. Therefore, a class member or shareholder who is not a named party must become a named party in order to appeal.[178] In addition, the Seventh Circuit supported the intervention requirement by noting that a denial of a motion to

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173. *Felzen*, 134 F.3d at 874; Fed. R. App. P. 3(c); *infra* notes 182-89 and accompanying text.

174. *See infra* Part III.D. *But see* United States v. LTV Corp., 746 F.2d 51, 53-55 (D.C. Cir. 1984) (utilizing Rule 3(c) to deny an appeal to a non-party who did not intervene below).

175. *See Felzen*, 134 F.3d at 874-75. Although neither case is directly on point, the court followed the rationale behind *In re Brand Name Prescription Drugs Antitrust Litig.*, 115 F.3d 456 (7th Cir. 1997), and *In re VMS Limited Partnership Sec. Litig.*, 976 F.2d 362 (7th Cir. 1992). *See infra* Part I.A. *In re Brand Name Prescription Drugs* involved unnamed class members' appeals from an order granting summary judgment, while *In re VMS Limited Partnership* dealt with an appeal of a post-settlement order confirming a sale of the defendant's property. *See id.* Both of these cases followed and relied on the Supreme Court's decision in *Marino*. *See id.*

176. *Felzen*, 134 F.3d at 874 (quoting Marino v. Ortiz, 484 U.S. 301, 304 (1988) (citations omitted)).

177. *See id.* In *Marino*, the Supreme Court denied an appeal by non-party white police officers who challenged the settlement of a Title VII lawsuit between black and hispanic police officers and the City of New York. *Marino*, 484 U.S. at 302-04.

178. *See Felzen*, 134 F.3d at 874.

intervene is appealable.[179] Despite the appellants' attempts to distinguish the case law on which the Seventh Circuit rests its decision, the opinion stresses that *Marino* foreclosed all exceptions to an unnamed party's right to appeal.[180] Accordingly, the court allows for no exceptions that could detract from *Marino's* reasoning: a more liberal appeals procedure will disturb the manageability of the class action.[181]

Additionally, the court sustains its position with a narrow reading of Rule 3(c) of the Federal Rules of Appellate Procedure.[182] It provides, in pertinent part, that "[t]he notice of appeal shall specify the *party* or *parties* taking the appeal . . . ."[183] Its purpose, as implied by the *Felzen* court's interpretation of the rule, is to limit appeals to named parties only.[184] The court applies a "textual" interpretation of the language in Rule 3(c).[185] The opinion though, does not explain the rationale behind the assertion.[186] Instead, it cites *Marino*, where the Supreme Court refers to Rule 3(c) in support of its assertion that only parties may appeal.[187] Thus, similar to *Marino's* narrow reading of the rule, the Seventh Circuit

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

180. *See id.* at 875.

181. *See id.*

182. *See id.* at 874.

183. Fed. R. App. P. 3(c) (emphasis added). Rule 3 is titled "Appeal as of Right—How Taken." Fed. R. App. P. 3. Rule 3(c) is titled "Content of the Notice of Appeal." Fed. R. App. P. 3(c). In full, Rule 3(c) states:

> [t]he notice of appeal shall specify the party or parties taking the appeal; shall designate the judgment, order or part thereof appealed from; and shall name the court to which the appeal is taken. Form 1 in the Appendix of Forms is a suggested form of a notice of appeal. An appeal shall not be dismissed for informality of form or title of the notice of appeal.

Id.

184. *Felzen*, 134 F.3d at 874-75.

185. *See id.* This assertion is made based on the content of Rule 3. Rule 3(c) involves the content of the notice of appeal, and states, in pertinent part, that "[t]he notice of appeal shall specify the party or parties taking the appeal." Fed. R. App. P. 3(c). It does not explain the precise definition of "party," nor does it explain how the word "specify" shall be construed. Thus, the court applies a strict, textual interpretation of party as a person whose name is contained on record as plaintiff or defendant. *See also infra* Part III.D (providing further analysis of the court's interpretation of Rule 3(c)).

186. The *Felzen* opinion cites the rule four times without providing an explanation of why it is interpreted in such a manner. *Felzen*, 134 F.3d at 874-75.

187. *See id.* at 874.

also limits its meaning of "party" to a formal party to the record.[188] In essence, the Seventh Circuit contends that Rule 3(c) excludes appeals by both unnamed class members and unnamed shareholders who do not intervene.[189]

Finally, the *Felzen* court cites two recent cases in the circuit that require intervention.[190] In two post-*Marino* cases, *In re Brand Name Prescription Drugs*[191] and *In re VMS Limited Partnership*,[192] the Seventh Circuit held that unnamed class members must intervene to preserve a right to appeal.[193] Although both cases are distinguishable from the derivative suit settlement appeal in *Felzen* (*In re VMS Limited Partnership* involved an appeal of a post-settlement order and *In re Brand Name Prescription Drugs* dealt with an appeal of summary judgment), the court found these distinctions insignificant in light of the rationale behind the intervention requirement.[194] The court stated that:

> the distinction [was] inconsequential for purposes of Rule 3(c), the rationale of *Marino,* and the rationale of *Brand Name Prescription Drugs*: that the court should not "fragment the control of the class action" by allowing class members to usurp the role of the class representative without persuading the district judge that the representative is unfit or unfaithful, or that subclasses should be created.[195]

This authority, according to the court, mandates that only named parties may appeal because an unlimited right to appeal for all unnamed members will destroy the control of the class.

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188. *Compare* Marino v. Ortiz, 484 U.S. 301-04 (1988) (applying Rule 3(c) to appeals by non-parties), *with Felzen*, 134 F.3d at 874-75 (regarding an identical application of Rule 3(c), notwithstanding the fact that *Marino* involved an appeal by outside persons who were not even members of the plaintiff class).

189. *See Felzen*, 134 F.3d at 874-75. The petitioners, California Public Employees' Retirement System, disagreed with the court's application of Rule 3(c) by arguing that the title of Rule 3(c), "Content of the Notice of Appeal," suggests that the rule is concerned with the formal contents of the appeal and not the status of particular parties who may seek review. *See* Brief for Petitioners at 12, 28-29, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (No. 97-1732).

190. *Felzen*, 134 F.3d at 874-75.

191. 115 F.3d 456 (7th Cir. 1997); *see supra* Part I.A.

192. 976 F.2d 362 (7th Cir. 1992); *see supra* Part I.A.

193. *See Felzen*, 134 F.3d at 874-75.

194. *Id.* Under the Seventh Circuit's interpretation of *Marino*, the crucial question is whether the appeal is by a named party. Thus, the distinctions in *In re Brand Name Prescription Drugs* and *In re VMS Ltd. Partnership*—the nature of the order appealed from—are of no consequence.

195. *Id.* at 875 (quoting *In re Brand Name Prescription Drugs*, 115 F.3d at 457).

In both cases, the Seventh Circuit required intervention, reasoning that it enhanced the manageability of a large class of litigants by reducing the number of appeals by unnamed class members.[196] For example, in *In re Brand Name Prescription Drugs* and *In re VMS Limited Partnership*, the Seventh Circuit denied an appeal to unnamed class members because of concerns regarding its effect on a class' manageability.[197] Additionally, other alternatives exist: class members may opt-out, make a request for subclasses, or seek to replace the class representative.[198] In contrast, *Marino*'s rationale is implied. The opinion does not clearly illustrate the reasoning behind the intervention rule except for the court's assertion that it is "the better practice."[199]

Ultimately, the court in *Felzen* extinguished all possible exceptions to the intervention requirement in the context of class actions.[200] The court found it necessary to declare the law as it applied to class actions, even before it decided the appellate rights of the two shareholders in a derivative suit. Thus, the Seventh Circuit had "formally overrule[d] . . . any other case in [the] circuit that permits non-parties to appeal from a decision of any kind in a class action."[201]

2. *Non-Party Shareholders May Not Appeal from a Decision of Any Kind in a Derivative Suit*

Does the intervention requirement apply equally to shareholders in derivative actions? The court finally sought to answer the question at hand—whether "a shareholders' derivative action under Rule 23.1 [is] different from a class action under Rule 23 in a way that permits appeal by non-parties[.]"[202] In its analysis, the court highlights three points. First, the court found that the appellants' supporting authority was no match for *Marino*, the control-

196. *In re Brand Name Prescription Drugs*, 115 F.2d at 457-58; *In re VMS Ltd. Partnership*, 976 F.3d at 367-69.

197. *In re Brand Name Prescription Drugs*, 115 F.3d at 457-58; *In re VMS Ltd. Partnership*, 976 F.2d at 367-69. Presumably, a fewer number of unnamed members would appeal in light of the burdens associated with intervention.

198. *See id.*

199. Marino v. Ortiz, 484 U.S. 301, 304 (1988).

200. *Felzen*, 134 F.3d at 875.

201. *Id.*

202. *Id.*

ling Supreme Court precedent.[203] Second, some important distinctions between derivative suits and class actions revealed that shareholders in a derivative suit have less of a right to appeal than class members.[204] Third, notwithstanding the shareholders' dissatisfaction with the particular settlement, as well as the generally recognized problems with settlements in class actions and derivative suits, the court could not properly address this issue because the shareholders failed to become named parties.[205]

As a preliminary matter, the court distinguished the appellants' supporting Seventh Circuit precedent.[206] The appellants relied on *Tryforos v. Icarian Development Co.*,[207] an earlier Seventh Circuit decision that involved an appeal of a fee judgment in a shareholders' derivative suit.[208] In *Tryforos*, the Seventh Circuit allowed the objecting shareholder to appeal without becoming a formal party.[209] In particular, the *Felzen* court criticized *Tryforos* because it did not involve the question at hand in *Felzen*.[210] Additionally, although the *Tryforos* court stated that a non-intervening, unnamed shareholder was entitled to appeal a derivative suit settlement, its supporting authority was unconvincing.[211] In fact, the *Felzen* court explained that *Tryforos* boiled down to "an unexplained practice."[212] The *Felzen* court's supporting authority is

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203. *See id.* at 874-75; *infra* note 212 and accompanying text.

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

205. *See id.* at 876. The court stated that "[the unnamed shareholders'] failure to become parties prevents us from considering [the merits of the settlement]." *Id.*

206. *See id.* at 874.

207. 518 F.2d 1258 (7th Cir. 1975); *see supra* Part I.B.

208. *Tryforos*, 518 F.2d at 1260; *see supra* Part I.B.

209. *Tryforos*, 518 F.2d at 1263 & n.22; *supra* notes 123-25 and accompanying text.

210. *Tryforos* considered whether an unnamed shareholder had complied with the necessary requirements for filing objections to the proposed dismissal of a derivative suit. *Tryforos*, 518 F.2d at 1260-64.

211. Without much analysis, *Tryforos* provides a footnote on the issue in *Felzen*. *Tryforos* cites *Cohen v. Young*, and states that "[t]he law is clear that a non-party shareholder who appears, pursuant to a Rule 23.1 notice, to present objections to a proposed dismissal or settlement of a derivative action may appeal an adverse decision even though he has not been formally made a party to the action." *Id.* at 1263 n.22 (citing Cohen v. Young, 127 F.2d 721, 724 (6th Cir. 1942)). In addition, *Tryforos* cited *Ackert v. Ausman*, 217 F. Supp. 934, 935 (S.D.N.Y. 1963), "an odd reference for a rule of appellate jurisdiction." *Felzen*, 134 F.3d at 874.

212. *Felzen*, 134 F.3d at 874. Specifically, the court stated that "[a]n unexplained practice does not offer shelter from a later opinion of the Supreme Court holding that only parties may appeal . . . ." *Id.*

equally unpersuasive; it applied class action precedent that did not involve the appellate rights of unnamed shareholders in derivative litigation.[213]

Next, the court sought to distinguish between class actions and derivative suits.[214] Under this approach,[215] the Seventh Circuit determined that a shareholder in a derivative action should not be treated differently from a class member so as to entitle the former to an appeal.[216] Of course, the court identified various differences between the class and derivative action.[217] But, as a result of its analysis, the court found that "shareholders have the weaker claim."[218] Thus, the *Felzen* court concluded that since unnamed class members must intervene, so too must unnamed shareholders in derivative actions.[219]

One difference between the class and derivative action, explained the court, is the injured party's identity.[220] As a prerequisite to a class action, each member of the class has an injury that is "typical" of the claims of the whole.[221] Furthermore, since all injuries within the class are alike, "which injured persons become the representatives, and which the 'mere' class members, is to a degree fortuitous and to a degree dependent on the entrepreneurial activity of the class counsel."[222] Primarily, "[i]t is the fact that each class member has a real grievance with the defendant that sets up at least an equitable argument for a class member who wants to appeal."[223]

In contrast, the court asserted that a shareholder in a derivative action is not injured per se.[224] In a derivative suit, an action is

213. *See infra* Part III.D.
214. *See Felzen*, 134 F.3d at 875-76.
215. Virtually all of the case law on the issue shows that derivative and class actions have been treated synonymously throughout history. *See supra* Part I.
216. *See Felzen*, 134 F.3d at 875.
217. *See id.* at 875-76.
218. *Id.* at 876.
219. *Id.*
220. *See id.* at 875.
221. Fed. R. Civ. P. 23(a).
222. *Felzen*, 134 F.3d at 875.
223. *Id.*
224. "Because a derivative action is brought by a shareholder on behalf of the corporation, the corporation must have suffered the injury that is the basis of the action." 5 Moore, *supra* note 22, § 23.1.02[3][b]. Nevertheless, the individual shareholder is adversely affected by the injury to the corporation because he or she owns shares in the corporation. *See* 5 Moore, *supra* note 22, § 23.1.02[3][b].

brought by an investor on behalf of the corporation because it is the corporation that has suffered the injury.[225] Procedurally, the suit is filed by a representative of the shareholders only when the corporation has refused to bring the suit in its own name.[226] Consequently, since the individual shareholders are not directly injured and thus, not entitled to litigate, the court concludes that unnamed shareholders should not be afforded party status.[227]

Moreover, the Seventh Circuit notes that class and derivative actions differ in terms of who is entitled to recover.[228] In a class action where monetary relief is sought, each class member is entitled to a portion of the aggregate recovery depending on the extent of injury and method for quantifying damages.[229] If injunctive or declaratory relief is sought, class representatives or subclasses may acquire the remedy on behalf of the whole class.[230] In either situation, each individual class member may be entitled to compensation.[231] But in a derivative action, the corporation obtains relief. The *Felzen* court noted 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."[232] The named plaintiffs merely "stand in the place of the corporation."[233] In other words,

225. *See Felzen*, 134 F.3d at 875; Charles Hansen, A Guide to the American Law Institute Corporate Governance Project 105 (Roger Clegg ed., 1995). "A derivative action differs from a class action in that a derivative action is brought on behalf of the entity in which the shareholders, as a class, have an interest, while a class action is brought on behalf of the class itself." 5 Moore, *supra* note 22, § 23.1.02[5].

226. *See* 5 Moore, *supra* note 22, § 23.1.02; *see also* Frank v. Hadesman & Frank, Inc., 83 F.3d 158, 160 (7th Cir. 1996) (explaining that before the action is commenced, the shareholder must make a demand on the board of directors to bring suit in the corporation's name).

227. *See Felzen*, 134 F.3d at 875 (citing *Frank*, 83 F.3d at 160) (asserting that "[o]nce the [derivative] suit [is] filed, the court would treat it much like a class action . . ." because the shareholder is a representative for all other investors). For a thorough discussion on the nature of the derivative suit and its resemblance to the class action, see Ballantine, *supra* note 111, §145, at 340-45. Indeed, other distinctions exist that are crucial to the issue. *See infra* Part III.A.

228. *Felzen*, 134 F.3d at 875.

229. *See* Newberg, *supra* note 4, §10.01, at 10-2.

230. *See id.*

231. *See id.*

232. *Felzen*, 134 F.3d at 875 (citation omitted).

233. 5 Moore, *supra* note 22, § 23.1.02[3][c].

since the alleged harm is to the corporation, it is the corporation that is entitled to any recovery.[234]

The court also asserts that in derivative suits it is the corporation, acting through its directors, that holds and controls any legal claim.[235] In fact, the corporation's directors are primarily responsible for the shareholders' investments—they "affect the interests of stockholders without notifying them or obtaining their consent; by investing in stock, they placed their funds at the management's disposal and obtained, in exchange, the right to choose future managers."[236] Therefore, shareholders in derivative litigation should not be treated as parties if they do not intervene, especially considering that their citizenship is ignored for diversity jurisdiction purposes[237] and they are unable to opt out of the litigation.[238]

Finally, the court briefly addresses the issue of settlements. In essence, the objecting shareholders opposed the settlement because it provided little monetary relief to the corporation in relation to the attorneys' fees[239] and the proposed reforms in corporate governance were deemed "valueless."[240] The court ignored these claims and disapproved of *Bell Atlantic Corp. v. Bolger*.[241] In *Bell Atlantic Corp.*, the Third Circuit allowed an appeal to a non-intervening shareholder because of the prevalence of collusive and unfair settlements in derivative litigation.[242] The *Bell-Atlantic Corp.* court focused on various "risks" in representative litigation that

234. *See* Hansen, *supra* note 225, at 105. This fundamental difference between derivative and class actions is plain when comparing "direct actions" to "derivative actions." A direct action exists when the plaintiff-shareholder ignores the demand requirement and pleads specifically that he or she has suffered a direct injury. *See id.* at 107, 129. Thus, in a direct action, any recovery inures to the plaintiff-shareholder directly. *See id.* at 129.

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

236. *Id.* at 875.

237. *See id.* (citing Smith v. Sperling, 354 U.S. 91 (1957)).

238. *See id.*; *see also infra* Part III (analyzing the effects of a shareholder's inability to opt out in derivative litigation).

239. *See* Brief for Petitioners at 6-7, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (No. 97-1732). Under the settlement, the "plaintiffs' attorneys agreed to release 'any and all causes of action' against ADM and the director defendants in return for $8 million—just 3.2 percent of the $250 million in claimed damages and less than 4.3 percent of the $190 million ADM paid in fines and compensation to the government and competitors." *Id.* at 6.

240. *Id.* at 7.

241. 2 F.3d 1304 (3d Cir. 1993); *supra* Part II.B.

242. *Bell Atl. Corp.*, 2 F.3d at 1304-10.

often affect the fairness of settlements.[243] But the court in *Felzen* did not respond to the Third Circuit's concerns regarding fairness of settlements in derivative suits.[244] Rather, it noted that derivative actions are generally harmful to the corporation because they "do little to promote sound management and often hurt the firm by diverting the managers' time from running the business while diverting the firm's resources to the plaintiffs' lawyers . . . ."[245] While ample evidence supports this proposition,[246] the court failed to address the problems of the settlement process in derivative actions. Instead, the court disposed of the settlement issue because "[the objectors'] failure to become parties prevent[ed] [the court] from considering this contention . . . ."[247] In sum, the three judge panel felt it inappropriate to consider the fairness of the settlement because the objecting shareholders were not formal parties to the litigation.

The Seventh Circuit left no exceptions for the hopeful objector who is not a formal party. According to the court, *Marino* and Rule 3(c) treat nonparty shareholders and unnamed class members identically—when neither is a formal party to the record, there is no right to appeal without intervention.[248] Furthermore, differences between a class and derivative action indicate that a nonparty shareholder has an even weaker argument in terms of a right to appeal.[249] As a result, the Seventh Circuit shut the door on two disgruntled shareholders without addressing the probable

243. *Id.* at 1309-10. For example, the *Bell Atlantic* court noted that shareholders' monitoring problems often lead to instances where plaintiffs' counsel and defendants collude to provide substantial settlement benefits for themselves, while slighting the interests of the corporation and shareholders. *Id.* at 1310; *see also infra* Part III.E (discussing incentives of plaintiffs' council and defendants that conflict with the interests of the corporation and unnamed shareholders).

244. *Felzen*, 134 F.3d at 876. The problem with *Bell Atlantic Corp.*, in the view of the *Felzen* court, is that "[t]he Third Circuit conceived of the question as whether the shareholder has standing, which is misleading." *Id.* The court went on to state that "[e]quating injury with party status is exactly the approach disapproved by *Marino*." *Id.* The court reasoned that because a shareholder is harmed by a reduction of his stock's market price, this fact does not necessarily confer party status because "[named] [p]arties are a subset of injured persons." *Id.*

245. *Id.* (citing Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497 (1991)).

246. *See* Reinier Kraakman et al., *When are Shareholder Suits in Shareholder Interests?*, 82 Geo. L.J. 1733, 1733-45 (1994).

247. *Felzen*, 134 F.3d at 876.

248. *See id.* at 875.

249. *See id.* at 876.

inadequacies of an $8 million settlement. Ultimately, the United States Supreme Court did little to resolve the issue when it affirmed the Seventh Circuit's decision by an equally divided court.

III. UNNAMED SHAREHOLDERS IN DERIVATIVE SUITS DESERVE GREATER APPELLATE RIGHTS

Unnamed shareholders in derivative actions should be allowed to appeal from a court's settlement approval without the added procedural step of intervention. This premise contrasts the Seventh Circuit's analysis in *Felzen*, where the court concluded that, as compared with class members' right to appeal, "shareholders [in derivative actions] have the weaker claim."[250] Shareholders in derivative actions should be entitled to a more flexible appellate process than class members in class actions. Thus, the intervention requirement, as it applies to an unnamed shareholder's appeal in derivative litigation, is an impediment that will ultimately consume both the benefits of derivative litigation and shareholders' rights in protecting their ownership interests.

The argument against requiring intervention in derivative litigation appeals is persuasive for several reasons. First, *Felzen* was wrongly decided by the Seventh Circuit. The court's analysis, though, was not entirely awry—unlike other courts that had confronted the issue of an unnamed party's right to appeal, the Seventh Circuit acknowledged that the class action and derivative suit each deserved independent analyses.[251] However, the court's examination of class action and derivative suits overlooked important distinctions demonstrating that unnamed shareholders in derivative actions have a stronger argument than class members in terms of a right to appeal.[252] As a result, the court's conclusion rests only on the strict and unyielding proposition that only named parties may appeal.

Second, policy considerations weigh in favor of protecting corporations and investors. The desire for corporate efficiency necessitates legal rules that maximize the benefits to and from corporations, minimize agency costs and deter managerial breaches of fiduciary duties. In this context, the derivative suit's

250. *Id.*
251. *See id.* at 874-76.
252. *See infra* Part III.C.

role is significant, primarily because it deters corporate directors from considering unlawful governing practices. Considering these theories, an intervention requirement ultimately prevents what is good for corporations and shareholders.

Third, the legal rules governing the derivative suit support the argument that unnamed shareholders in derivative litigation should be allowed to appeal without intervention. Unlike the provisions for class actions in Rule 23, Rule 23.1 does not allow shareholders to opt out of a derivative suit. Thus, a final judgment in derivative litigation, whether favorable or not, binds all shareholders. This consequence is particularly troublesome because derivative suits are often pursued not by aggrieved shareholders, but by plaintiffs' attorneys who have strong economic incentives to obtain a small recovery for the corporation and shareholders in exchange for a large award of attorneys' fees.[253] Therefore, a less rigorous procedure for appeals in derivative actions is necessary considering both the nature of the derivative suit and the inadequate protection provided to shareholders in Rule 23.1.

Fourth, there is no precedent that supports the intervention requirement in derivative suits. Since the intervention requirement was recognized in 1987, courts have been consistent in applying it in the class action context, reasoning that a lack of such a requirement would effectively destroy the manageability of the class. In addition, supporters of the intervention requirement point to other available alternatives to class members who disagree with various decisions by the named plaintiffs' attorneys.[254] Under these rationales, though, the intervention requirement should not apply to derivative suits because the purpose of the derivative action—to provide legal redress to the corporation—is achieved when unnamed shareholders are not restricted in their attempts to appeal unfair settlements. Thus, the precedent supporting the intervention requirement in class actions does not apply to derivative suits.

Finally, there are unique risks present in the context of derivative-suit settlements. Primarily, economic incentives for plaintiffs' attorneys and defendants lead to collusive settlements—both sides collaborate in order to maximize the benefits to each other,

253. *See* William Klein & John C. Coffee, Jr., Business Organization and Finance 196 (6th ed. 1996).

254. *See supra* Part II.A.

neglecting the interests of the aggrieved shareholders and corporation.[255] Adding to this abuse, in derivative suits, the litigation expenses are passed on to and paid by the corporation.[256] Indeed, an intervention requirement obstructs the shareholders' efforts to ensure that the benefits of suit accrue to the corporation and shareholders and not to ravenous plaintiffs' attorneys and blameworthy defendants. Accordingly, the intervention requirement increases the likelihood of unfair settlements; this result is especially inequitable in meritorious derivative actions.

A. *Critiquing the Seventh Circuit's Decision in* Felzen

The court advances several reasons why unnamed shareholders in derivative actions have a weaker argument for appeal than class members. First, the court compares the general characteristics of the class action and derivative suit. In class actions, explained the court, each class member has an individual injury and claim against the defendant. It then contrasted the derivative suit, where an investor is not directly injured and thus, not allowed to litigate individually.[257] This reason, argues the court, "sets up at least an equitable argument for a class member who wants to appeal."[258]

Basically, the court asks this question: Why should unnamed shareholders in a derivative action be able to appeal when they are not (1) entitled to litigate individually, (2) directly injured and (3) allowed to directly recover?[259] In its answer, the court relies on the distinction between direct and derivative actions—class members who sue directly have a stronger argument for an appeal than shareholders who sue derivatively.

In terms of an unnamed shareholder's right to appeal, the court's analysis is unconvincing. The purpose of the derivative suit is to recover for harm to the corporation when those who control the corporation, the directors, are unwilling to proceed with the action. Moreover, according to the Supreme Court, the purpose of the derivative action "was to place in the hands of the individual shareholder a means to protect the interests of the corporation

255. *See infra* Part III.E.
256. *See* Klein & Coffee, *supra* note 253, at 196.
257. *See* Felzen v. Andreas, 134 F.3d 873, 875 (7th Cir. 1998).
258. *Id.*
259. *See id.*

from the misfeasance and malfeasance of 'faithless directors and managers.'"[260] Therefore, the individual shareholder is entitled to litigate when "the corporation itself ha[s] refused to proceed after suitable demand . . . ."[261] A shareholder suing derivatively pursues relief directly for the corporation and indirectly for its shareholders collectively.[262] Indeed, since the shareholders bring the suit on behalf of the corporation, the shareholders have a duty to contest an inequitable judgment. The intervention requirement works the opposite result—it impairs shareholders' abilities to protect the interests of the corporation.

Another difference between class and derivative actions is the recovery of damages. The Seventh Circuit notes that, unlike class actions, in derivative actions the corporation receives the damages award.[263] Thus, when the injury is derivative, shareholders indirectly reap the benefits which inure directly to the corporation.[264] Again, as a matter of theory, any recovery does belong to the corporation. But for the purposes of appeals, shareholders have a legitimate ownership interest at stake—an interest that justifies a right to appeal an adverse judgment on the corporation's behalf. After all, "[t]he participants most directly affected by injury inflicted on the firm are the stockholders—for their investment is first to be wiped out."[265] So long as the appealing shareholders are initiating a challenge on behalf of the corporation as a whole, they should have standing to appeal without becoming a named party.

To further support its decision, the court gives additional reasons why "it [is not] surprising that stockholders other than the

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260. Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 95 (1991) (quoting Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949)).

261. Ross v. Bernhard, 396 U.S. 531, 534 (1970). The demand requirement is embodied in Rule 23.1 of the Federal Rules of Civil Procedure:

> The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort.

Fed. R. Civ. P. 23.1.

262. Since the corporation directly recovers, shareholders are said to indirectly recover by an increase in the value of their stock. *See* Ballantine, *supra* note 227, § 120, at 290.

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

264. *See* Mid-State Fertilizer Co. v. Exchange Nat'l Bank, 877 F.2d 1333, 1335-36 (7th Cir. 1989).

265. *Id.* at 1336.

named plaintiffs are not treated as parties in derivative litigation . . . ."[266] First, when determining diversity for jurisdictional purposes, courts ignore the citizenship of unnamed shareholders.[267] Notwithstanding the fact that unnamed shareholders are not treated as parties for determinations of diversity jurisdiction, unnamed shareholders should still be entitled to appeal because their rights are necessarily affected by a court's judgment.

Similarly, the court states that unnamed shareholders in derivative actions are not treated as parties because they are not allowed to opt out.[268] But in contrast to the court's analysis, this fact should afford unnamed shareholders a right to appeal without intervention because they have no choice but to bind themselves to the court's judgment. Like the interests of the named plaintiff-shareholders, who may appeal without intervention, the unnamed shareholders' interests in derivative litigation are equally affected. Named plaintiffs do not have more at stake—the fact that the suit is brought derivatively means that the corporation and all shareholders are affected as a whole.[269]

The identity of the named plaintiff usually means relatively little; a derivative action "is typically brought by a plaintiff's attorney who finds a shareholder, who may own only a few shares, to serve as the nominal plaintiff."[270] Because the named plaintiff's identity in derivative actions is a mere formality,[271] there should be no difference between the appellate rights of named and unnamed shareholders in derivative litigation. Furthermore, since unnamed shareholders in derivative actions are bound by the liti-

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266. *Felzen*, 134 F.3d at 875.

267. *See id.* at 875-76 (citing Smith v. Sperling, 354 U.S. 91 (1957)).

268. *See id.*; *see also infra* Part III.C (discussing the significance of shareholders' inability to opt out).

269. *See* Frank v. Hadesman & Frank, Inc., 83 F.3d 158, 160 (7th Cir. 1996).

270. Klein & Coffee, *supra* note 253, at 196. The court in *Felzen* recognizes this reality in the context of class actions. "All class members are identical in entitlement to litigate; which injured persons become the representatives, and which the 'mere' class members, is to a degree fortuitous and to a degree dependent on the entrepreneurial activity of the class counsel." *Felzen*, 134 F.3d at 875. Most commentators on the subject agree that it applies in derivative suits as well. *See, e.g.*, Klein & Coffee, *supra* note 253, at 196.

271. *See* Peter C. Kostant, Recent Development, *Corporations—Second Circuit Refuses to Allow Layman to Prosecute Derivative Action Pro Se*, 45 Fordham L. Rev. 1534, 1539 (1977) (explaining the role of the plaintiff in a derivative suit, in the words of Justice Jackson, as "a self-chosen representative and a volunteer champion").

gation decisions of the named plaintiffs' attorneys, and ultimately, a court's final judgment (because they cannot opt out), unnamed shareholders should have an opportunity to appeal without the added step of intervention.

Finally, the Seventh Circuit overstates a hypothetical that equates the appellate rights of shareholders with the appellate rights of third parties who may have contractual interests with the corporation.[272] This conclusion rests on the idea that corporations are nothing but a "nexus of contracts."[273] Under this theory, shareholders have mere contractual interests because when shareholders buy stock in the corporation, they have entered into an implied contract.[274] Again, such a contractual hypothesis can be supported in theory; however, this conclusion is not in line with the law. Shareholders may sue derivatively because they, as "beneficial owners," become entitled to pursue relief on behalf of the corporation.[275] Moreover, unlike shareholders, contractually related third parties are not entitled to any residuary interest.[276]

In sum, the Seventh Circuit's analysis in *Felzen* errs in two major ways. First, as a result of its comparison of class actions and derivative suits, the court wrongly decides that unnamed shareholders in derivative actions have a weaker claim to an appeal than class members in class actions. For the reasons previously stated, shareholders in derivative suits have at least an equal argument. The Seventh Circuit, though, came to the opposite conclusion. The court initially finds that intervention is required for

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272. The hypothetical, in addition to the court's response, states:

> Suppose the settlement of a derivative action induces the corporation to fire its CEO, or to curtail its purchases of fax machines, or to choose a different law firm. The affected employees, vendors, and lawyers could not appeal just because they believed the settlement improvident or the judge's action in approving it legally erroneous. Only parties may appeal. So too with shareholders, who have no more right to speak for the firm or control its litigation decisions than bondholders or banks or landlords, all of whom have contractual interests that may be affected by litigation.

Felzen, 134 F.3d at 874.

273. Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 12 (1991).

274. *See id.* This contract is a voluntary arrangement where the shareholders know little about the terms of the agreement—these rules are made by investment banks and managers, and are only subject to change through voting. *See id.* at 15-16.

275. Ballantine, *supra* note 227, § 119, at 289.

276. *See* Ballantine, *supra* note 227, § 117, at 289.

unnamed class members. Then, after comparing class and derivative actions, it bootstraps the intervention requirement to derivative actions because in its view, shareholders in derivative actions have less of a right to appeal than class members. The following discussion will assert various reasons why the court's finding is erroneous—unnamed shareholders in derivative actions have a stronger argument in terms of a right to appeal.

Second, the court's analysis adheres to an overly strict application of the term "party." According to the court, unnamed shareholders in derivative actions are not parties in the context of a right to appeal because (1) they are not parties for purposes of diversity determinations and (2) they are not parties since they may not opt out.[277] This rationale ignores the issue at hand—whether unnamed shareholders should have a right, without having to formally intervene, to protect their investments by appealing collusive settlements.

B. *The Benefits of the Corporation and Derivative Suit*

Corporations are accountable for our "big business."[278] In fact, corporations hold a significant part of this country's assets and, in addition, direct a large part of our country's new investments.[279] Hence, corporate efficiency necessarily leads to a flourishing economy.[280]

On a smaller scale, individual shareholders benefit from productive corporate activity in much of the same way. When a corporation acts efficiently, both the value of the company and the value of shareholders' stock increase.[281] One simple example of the perceived benefits derived from corporations occurred early in the twentieth century, when Delaware purposely enacted laws that

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

278. Klein & Coffee, *supra* note 253, at 104.

279. *See* Jeffrey Michael Smith, Note, *The Role of the Attorney in Protecting (and Impairing) Shareholder Interests: Incentives and Disincentives to Maximize Corporate Wealth*, 47 Duke L.J. 161, 163-64 (1997).

280. Best described by Judge Richard Posner's approach to the law, principles of efficiency "refer to a situation in which aggregate net benefits (the 'size of the pie,' to use the economists' metaphor) are as large as possible." George M. Cohen, Comment, *Posnerian Jurisprudence and Economic Analysis of Law: The View from the Bench*, 133 U. Pa. L. Rev. 1117, 1125-27 (1985). This idea of efficiency is advanced when wealth is maximized and when the benefits of a given policy outweigh the costs. *See id.*

281. *See id.*

would encourage more corporate charters in the state.[282] In realizing the substantial benefits of corporate activity, Delaware became the champion of American corporations.[283] Accordingly, when corporations are efficient, they produce obvious benefits on an individual, state and national level.

As a "chief regulator of corporate management,"[284] the derivative suit plays a large role in effectuating corporate efficiency.[285] Although some question the utility of derivative suits, this criticism stems from the fact that derivative suits are often abused by self-interested plaintiffs' lawyers.[286] But when viewed as a mechanism of corporate accountability,[287] derivative actions influence directors to adhere to fiduciary duties and protect shareholders' interests.[288] In fact, derivative suits may increase the value of corporations in two ways. First, the possibility of such a suit may act as a deterrent to directors' improper conduct. Second, the suit's ultimate recovery for, may exceed the costs to, the corporation.[289] Therefore, with the resulting benefits of derivative actions in mind, individuals are encouraged to invest in corporations because they are confident in their investments and trust the directors who protect and advance their interests.

The benefits of corporate efficiency and the utility of derivative suits are directly correlated to the issue of unnamed shareholders' rights to appeal in derivative actions. A move toward these ideals is possible only when shareholders are able to adequately monitor and protect their interests. To the contrary, a procedural barrier

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282. *See, e.g.*, Alexander G. Simpson, *Shareholder Voting and the Chicago School: Now is the Winter of our Discontent*, 43 Duke L.J. 189, 196-97 (1993).

283. *See id.*

284. Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949).

285. Professor Melvin A. Eisenberg discusses the relationship between the law, social norms, and corporate efficiency. *See* Melvin A. Eisenberg, Corporate Law, Social Norms, and Belief Systems 35 (unpublished manuscript, on file with author) (contending that "whatever the law does to increase the force of the social norm of loyalty, and further its internalization, will lead to greater efficiency and will therefore benefit shareholders as a class. Whatever the law does to diminish the force of the social norm of loyalty, and lessen its internalization, will have the opposite effect").

286. *See, e.g.*, Tim Oliver Brandi, *The Strike Suit: A Common Problem of the Derivative Suit and the Shareholder Class Action*, 98 Dick. L. Rev. 355, 357-58 (1994).

287. *See* Klein & Coffee, *supra* note 253, at 176.

288. *See* Klein & Coffee, *supra* note 253, at 176.

289. *See* Kraakman, *supra* note 246, at 1736.

such as the intervention requirement works an opposite result. By mandating intervention for unnamed shareholders in derivative litigation, courts make it more difficult for those attempting to safeguard their own interests and the interests of the corporation. Thus, if unnamed shareholders can appeal unfavorable judgments in derivative actions, without the added step of intervention, then they can monitor and protect individual and corporate interests. In addition, shareholders will then be able to advance the greater good of corporate efficiency.

C. *The Derivative Suit and Rule 23.1 Command Greater Protection for Shareholders*

Until *Felzen*, no court had actually used separate analyses for derivative suits and class actions. Remarkably, most courts have continually disregarded the fact that both rules offer distinctly opposite protective mechanisms in terms of an unnamed party's right to appeal. In short, while Rule 23 assures that unnamed class members are adequately protected, Rule 23.1 does very little to protect the appellate rights of unnamed shareholders in derivative litigation.

An examination of both rules evidences a need to provide a more liberal appellate procedure to unnamed shareholders in derivative actions. For example, unnamed class members have the ability to opt out of certain types of class actions.[290] Rule 23.1, though, does not allow shareholders to opt out of derivative suits.[291] In addition, Rule 23 mandates that the court make an affirmative determination, before the suit is even certified as a class action, that the named plaintiff for the class will adequately protect and represent the interests of the whole class.[292] In comparison, Rule 23.1 does not provide such protection.[293] In short, unnamed shareholders should be afforded a more liberal right to appeal because Rule 23.1 does not adequately protect their rights as represented litigants in the context of appeals.

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290. The ability to opt out is available only in Rule 23(b)(3) class actions. *See* Fed. R. Civ. P. 23(b)(3); *see also* Fed. R. Civ. P. 23(c)(2) (providing class members with notice and the choice of opting out of the suit).

291. *See, e.g.*, Gottlieb v. Wiles, 11 F.3d 1004, 1011 (10th Cir. 1993).

292. *See* Fed. R. Civ. P. 23(a)(4); *see also Gottlieb*, 11 F.3d at 1011 (explaining the greater protective mechanisms provided for class members in the text of Rule 23).

293. *See infra* notes 293-306 and accompanying text.

In reference to the issue of unnamed party appeals, Rule 23.1 does not assure adequate protection to represented shareholders. One provision in the rule protects shareholders' interests by mandating that each unnamed shareholder receive notice of, and an opportunity to object to, the court's proposed order.[294] Accordingly, unnamed shareholders are afforded only one procedural mechanism to protect their legal rights. An even more troubling aspect, however, is the fact that this protective measure only affords unnamed shareholders a right to object. In other words, if unnamed shareholders are unable to appeal without intervention, they may be left with no remedy if the court ultimately discards their objections.[295]

This adverse consequence is even more troublesome considering that shareholders cannot opt out of derivative suits.[296] The Tenth Circuit, in *Gottlieb v. Wiles*,[297] recognized the importance of a shareholder's inability to opt out because "all shareholders [will be] bound by the outcome [of the suit] regardless of their objections."[298] In *Gottlieb*, the court held that unnamed class members could not appeal unless they have been granted intervenor status by the court, or unless a violation of Rule 23 procedure has occurred.[299] More importantly though, the court explicitly stated that "[r]ule 23.1 does not offer the same protective mechanisms offered by Rule 23."[300] Thus, the Tenth Circuit implies that a different outcome may be warranted in light of a shareholder's inability to opt out in derivative litigation.[301] Indeed, other courts have also

294. *See* Fed. R. Civ. P. 23.1; *supra* note 112. Rule 23 provides the same protective mechanism for class actions arising under subsection (b)(3). *See* Fed. R. Civ. P. 23; *supra* note 36.

295. Many commentators agree that courts are not inclined to carefully consider shareholder objections, a consequence that will ultimately nullify the benefit of this protective mechanism. *See, e.g.*, Elliot I. Weiss & John S. Beckerman, *Let the Money do the Monitoring: How Institutional Investors can Reduce Agency Costs in Securities Class Actions*, 104 Yale L.J. 2053, 2066-71 (1995).

296. One reason that shareholders may not opt is because derivative suits often end in settlements, where the parties agree to an improved plan of corporate governance. *See* Tower C. Snow, Jr. et al., *The Settlement of Class and Derivative Claims*, 958 PLI/Corp 1105, 1120 (1996). If opt outs were allowed, implementing changes in corporate governance would be virtually impossible. *See id.*

297. 11 F.3d 1004 (10th Cir. 1993).

298. *Id.* at 1011.

299. *Id.* at 1012.

300. *Id.* at 1011.

301. *See id.*

recognized that unnamed shareholders in derivative suits may deserve a more flexible appellate procedure because Rule 23.1 denies them the possibility of opting out in derivative actions.[302]

Another deficient protective device embodied in Rule 23.1 is the "adequacy of representation" provision. The rule explicitly states that "[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 in enforcing the right of the corporation or association."[303] This protection is especially insufficient when compared to the corresponding provision for class actions in Rule 23.[304]

One problem with this provision in Rule 23.1, as opposed to Rule 23, is that the court is never required to make a positive determination that the named plaintiff adequately represents the interests of the corporation and unnamed shareholders[305]—instead, the court takes a back-seat and steps in only when it appears that the named plaintiff is neglecting the collective interest of the corporation and unnamed shareholders. This protective device's weakness becomes more evident when the suit is in the settlement stage. Scholars on the subject agree that judges, for various reasons, are not well positioned to critically evaluate the fairness of a

302. The Tenth Circuit has restated the importance of a shareholder's inability to opt out in derivative litigation. *See* Rosenbaum v. MacAllister, 64 F.3d 1439 (10th Cir. 1995). In *Rosenbaum*, the court allowed a non-intervening class member to appeal only the attorneys' fees portion of a combined class and derivative action. *See id.* at 1441-43. The court stated that this right applied even stronger in the context of a derivative suit, partly because a shareholder may not opt out of the action. *See id.* at 1443. The Third Circuit, in *Bell Atlantic Corp.*, explained that "one of the rationales offered in support of an intervention requirement cannot apply to derivative actions. That is, unlike members of a class certified under Rule 23(b)(3), 'shareholders normally cannot opt out of the class and pursue their own individual action.'" Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1307-08 n.4 (3d Cir. 1993) (quoting American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 7.02, at 635) (Proposed Final Draft, Mar. 31, 1992)).

303. Fed. R. Civ. P. 23.1; *supra* note 112.

304. In comparison, Rule 23 mandates that the adequacy requirement be met as a prerequisite to the class action suit. *See* Fed. R. Civ. P. 23(a)(4); *supra* note 36.

305. The Tenth Circuit, in *Gottlieb*, stated that "[u]nlike class actions under Rule 23, in shareholder derivative suits under Rule 23.1, a preliminary affirmative determination that the named plaintiffs will fairly and adequately represent the interests of the other class members is not a prerequisite to the maintenance of the action." Gottlieb v. Wiles, 11 F.3d 1004, 1011 (10th Cir. 1993).

particular settlement.[306] For example, in *Felzen*, one questions the plaintiffs' attorneys vigor in adequately protecting the shareholders' interests.

> In the over two years the case was pending, there is no record of either side issuing interrogatories, seeking or taking depositions, or propounding third-party subpoenas. Plaintiffs did file a three-page motion to compel production of certain documents. But that motion was never ruled upon and plaintiffs never pressed the issue.[307]

Certainly, if Rule 23.1 required the court to make an initial determination of adequate representation, the unnamed shareholders' interests would receive better protection.

D. *Precedent Does Not Support an Intervention Requirement in Derivative Suits*

In *Felzen*, the Seventh Circuit relies on three sources of authority, each of which is inapplicable to the issue of an unnamed shareholder's right to appeal in derivative litigation. First, the court adheres to the Supreme Court's decision in *Marino v. Ortiz*.[308] This case, however is distinguishable because it does not involve the appellate rights of represented shareholders in derivative litigation.[309] Second, the Seventh Circuit relies on Rule 3(c) of the Federal Rules of Appellate Procedure,[310] which, of course, the Supreme Court cited in *Marino*.[311] Third, the *Felzen* court relies on two prior class action cases in the circuit, requiring that un-

306. *See* Weiss & Beckerman, *supra* note 295, at 2066-71. Weiss and Beckerman point to two main reasons for this proposition. *See* Weiss & Beckerman, *supra* note 295, at 2066-71. First, the judge is not familiar with the circumstances and evidence present in the case. *See* Weiss & Beckerman, *supra* note 295, at 266-71. Second, judges are prone, in the interest of judicial economy, to encourage and approve settlement negotiations. *See* Weiss & Beckerman, *supra* note 295, at 266-71; *see also* Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1310 (3d Cir. 1993) (asserting that informational constraints impede the full benefits of the adversarial process).

307. Brief for Petitioners at 6, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (No. 97-1732).

308. *See* Felzen v. Andreas, 134 F.3d 873, 874-76 (7th Cir. 1998) (citing Marino v. Ortiz, 484 U.S. 301 (1988)).

309. *See Marino*, 484 U.S. at 304.

310. *See Felzen*, 134 F.3d at 874-75 (citing Fed. R. App. P. 3(c)).

311. *See Marino*, 484 U.S. at 304.

named class members intervene in order to appeal.[312] These class action cases, like *Marino*, were decided on a line of reasoning that does not apply to the issue of derivative actions in *Felzen*. In fact, the Seventh Circuit failed to cite to any court that required intervention in derivative actions. Instead, it merely disagreed with one circuit that did not require such a procedure.[313]

In essence, the *Felzen* court supports its holding with the Supreme Court's per curiam opinion in *Marino*. In *Marino*, white police officers, who were not parties to the underlying action and who had not attempted to intervene, were denied a right to appeal a consent decree approving a settlement.[314] Specifically, the Supreme Court held that "because petitioners were not parties to the underlying lawsuit, and because they failed to intervene for purposes of appeal, they may not appeal from the consent decree approving that lawsuit's settlement . . . ."[315]

Utilizing these words, the Seventh Circuit adopted a textual interpretation of the term "party."[316] In its view, the Supreme Court held that the term "party" refers only to those named as plaintiffs and defendants in the suit. Accordingly, because the two

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312. *Felzen*, 134 F.3d at 874 (citing *In re* Brand Name Prescription Drugs Antitrust Litig., 115 F.3d 456 (7th Cir. 1997) and *In re* VMS Ltd. Partnership Sec. Litig., 976 F.2d 362 (7th Cir. 1992)).

313. The court disagreed with the Third Circuit's decision to not require intervention in derivative suits. *See Felzen*, 134 F.3d at 876 (citing Bell Atl. Corp. v. Bolger, 2 F.3d 1304 (3d Cir. 1993)).

314. *Marino*, 484 U.S. at 304. In the Second Circuit Court of Appeals, African-American and Hispanic police officers alleged, under Title VII of the Civil Rights Act of 1964, that New York City's officer promotion examination had a disparate impact on the minority class. *See* Hispanic Soc'y. v. New York City Police Dep't., 806 F.2d 1147, 1150 (2d Cir. 1986). The district court approved a settlement that "called for the successive promotion of Blacks and Hispanics who had taken the examination until the alleged disparate impact was eliminated." *Id.* White police officers, who were not class members in the underlying suit, sought an appeal that was eventually dismissed by the Second Circuit because the appellants were not parties to the litigation. *See id.* at 1150-51. The Supreme Court of the United States granted certiorari and, in a per curiam opinion, affirmed the judgment of the Second Circuit. *See Marino*, 484 U.S. at 304.

315. *Marino*, 484 U.S. at 304. The Court further stated that "[t]he rule that only parties to a lawsuit, or those that properly become parties, may appeal an adverse judgment, is well settled." *Id.* The opinion in *Felzen* begins with this quotation. *Felzen*, 134 F.3d at 874.

316. The Supreme Court cited to United States *ex rel.* Louisiana v. Jack, 244 U.S. 397, 402 (1917), which stands for the proposition that only a party of record (named party) may appeal from a district court judgment. *Id.* at 304.

appealing shareholders in *Felzen* were not named parties, they were unable to appeal.

The case is inapplicable to an unnamed shareholder's right to appeal a settlement in derivative litigation.[317] In *Marino*, the appealing police officers were not even members of a class—they were, at most, outsiders who were interested in the suit's outcome. The *Felzen* court, however, did not explain why *Marino* pertained to a derivative action.[318] In fact, it is difficult to imagine how it applies at all; unlike shareholders in derivative actions, the non-party police officers in *Marino* are not represented parties, are not entitled to receive notice of a court's proposed order and have no right to present objections in the district court.[319] Hence, the Seventh Circuit's interpretation of *Marino* is untenable because the legal rights of non-parties are so insignificant as compared with the rights of shareholders.

In addition, the *Felzen* court relied on Federal Rule of Appellate Procedure 3(c).[320] The rule, entitled "Content of the Notice of Appeal," states that "[t]he notice of appeal shall specify the party or parties taking the appeal; shall designate the judgment, order or part thereof appealed from; and shall name the court to which the appeal is taken."[321] Although the Seventh Circuit never explained how the rule applies to shareholder appeals in derivative actions, the court implies that since the notice of appeal shall specify the party taking the appeal, only named parties may appeal, regardless of the circumstances.[322]

The court's reliance on this rule is misplaced. Primarily, Rule 3, in its entirety, deals solely with the filing and form requirements for appeals.[323] As the title of subsection three suggests ("Content

317. Other commentators agree that *Marino* does not apply because it involved nonparties. *See, e.g.*, Duffy, *supra* note 31, at 942-43.

318. The court did state that factual distinctions were insignificant in light of *Marino's* rationale. *See Felzen*, 134 F.3d at 875. The problem, however, is that *Marino's* rationale is not explained in the Supreme Court's one page per curiam opinion. *Marino*, 484 U.S. at 304.

319. As non-parties, the appellants in *Marino* are afforded none of the protections afforded to class members by Rule 23.

320. *Felzen*, 134 F.3d at 874-75.

321. Fed. R. App. P. 3(c); *see supra* notes 183-89 and accompanying text.

322. *See Felzen*, 134 F.3d at 874-75.

323. *See* Fed. R. App. P. 3(c). Rule 3(c) also states that "[f]orm 1 in the Appendix of Forms is a suggested form of a notice of appeal." *Id.* The rule's use of the word "form" suggests that it is concerned only with the form of the written appeal.

of the Notice of Appeal"), the rule does not purport to limit a court of appeals' jurisdiction to only named parties. Rather, the rule sets forth conventional and uniform requirements for written notices of appeals.

Moreover, appellate courts have traditionally allowed non-parties to appeal, notwithstanding the Supreme Court's current interpretation of Rule 3(c).[324] Presumably, the Supreme Court, in *Marino*, put this issue to rest when it cited Rule 3(c) for the proposition that non-parties may never appeal.[325] To the contrary, appellate courts have continued to allow appeals to non-parties without even mentioning the applicability of Rule 3(c).[326] As a consequence, the Seventh Circuit seems to have misplaced *Marino's* application of Rule 3(c).

Finally, the Seventh Circuit supports its decision in *Felzen* with two class action cases in which the court required intervention:[327] *In re VMS Limited Partnership Securities Litigation* and *In re Brand Named Prescription Drugs Antitrust Litigation*. Both cases relied on the Eleventh Circuit's decision in *Guthrie v. Evans*,[328] the first of "the more recent cases" that required intervention for unnamed class members in class actions.[329] In short, *Guthrie*'s reasoning was based on three factors. First, unnamed class members may not appeal because they have not been certified as adequate representatives of the class.[330] Second, unnamed class members, who disagree with a suit's course of action, have alternative procedures such as opting out of the action.[331] Third, allowing unnamed class members to appeal individually would

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324. *See* SEC v. Lincoln Thrift Ass'n, 577 F.2d 600, 602-03 (9th Cir. 1978); *see also* United States v. Schiavo, 504 F.2d 1 (3d Cir. 1974) (allowing appeal regarding a denial of an order enjoining the media from publishing information in a criminal trial); Overby v. United States Fidelity and Guar. Co., 224 F.2d 158 (5th Cir. 1955) (allowing non-party an appeal from a denial of a privilege claim).

325. Marino v. Ortiz, 484 U.S. 301 (1988).

326. *See* Keith v. Volpe, 118 F.3d 1386, 1391 (9th Cir. 1997) (allowing a non-party to appeal where the appellant participated in the lower court proceedings and where the equities of the case favored an appeal). The Ninth Circuit explicitly stated that *Marino* did not apply because the appellant in *Keith* was "haled into [the] action by the district court over his objections." *Id.* at 1391 n.7.

327. *Felzen*, 134 F.3d at 874-76.

328. 815 F.2d 626 (11th Cir. 1987).

329. *In re VMS Ltd. Partnership*, 976 F.2d at 367-68.

330. *See Guthrie*, 815 F.2d at 628.

331. *See id.*

frustrate the purpose of the class action because the action would then become unmanageable.[332]

There are two main reasons why the *Guthrie / In re VMS Limited Partnership / In re Brand Name Prescription Drugs* trilogy should not apply to the issue presented in *Felzen*. First, unlike these three cases, *Felzen* involved a shareholder derivative suit. As explained previously, similar treatment of class and derivative actions is inappropriate—the rights of shareholders in derivative actions are protected less adequately than the rights of class members.[333] Thus, unnamed shareholders in derivative actions deserve a more liberal appellate procedure.[334]

Second, at least two of the reasons in support of the intervention requirement, as put forth in *Guthrie*, do not apply in the context of derivative actions. Shareholders in derivative actions do not have the alternative of opting out of the suit. Moreover, allowing unnamed shareholders to appeal without intervention will not defeat the purpose of the derivative action. Rather, removing the added procedural burden of the intervention requirement will further the purpose of the derivative suit—"to place in the hands of the individual shareholder a means to protect the interests of the corporation . . . ."[335] Thus, the Seventh Circuit erred when it relied on the rationale of class action cases.

E. *The Intervention Requirement Will Increase the Prevalence of Unfair Settlements in Derivative Suits*

The pervasiveness of unfair and collusive settlements in derivative litigation is well known. Adding to this problem is the fact that the settlement rate in derivative actions is higher than in other areas of civil litigation.[336] Further, an even "greater problem may be the tendency for even meritorious actions to result in collusive settlements."[337] *Felzen* exemplifies this problem—the ultimate settlement amount paled in comparison to the ADM

332. *See id.*
333. *See supra* Part III.C.
334. *See supra* Part III.C.
335. Kamen v. Kemper Fin. Serv., 500 U.S. 90, 95 (1991).
336. *See* Brandi, *supra* note 286, at 368-69.
337. Klein & Coffee, *supra* note 253, at 196; *see also* Brandi, *supra* note 286, at 369 (discussing the prevalence of collusive settlements in the context of meritorious derivative actions).

directors' guilty plea and $100 million criminal antitrust fine.[338] Consequently, the intervention requirement imposed in *Felzen* effectively precluded judicial review of a typically unfair settlement.

Several reasons exist for unfair settlements in derivative actions. First, the named shareholder-plaintiffs in derivative suits rarely monitor the attorney's negotiations.[339] Likewise, the unnamed shareholders are unable to monitor the attorney's work because the costs of such monitoring will often exceed the value of their claims.[340] As a result, plaintiffs' attorneys are able to negotiate settlements that benefit their own self interests, while ignoring the interests of the corporation and shareholders.

Furthermore, in terms of settlement, the incentives for plaintiffs' attorneys and defendants conflict with those of the shareholders.[341] Plaintiffs' attorneys have strong economic incentives "to settle the a before trial, in spite of the merits of the case, because of conflicts between the attorney's personal desire to garner high fees and the underlying goal of maximizing recovery for the client."[342] By the same token, defendants in derivative actions have personal and economic incentives to settle the case as quickly as possible.[343] Certainly, these incentive conflicts exist, notwithstanding the particular merits of a derivative suit.[344]

Two unnamed shareholder-appellants in *Felzen* struggled to contest the faithfulness of the named plaintiffs and their attorneys, as well as the fairness of the settlement agreement. Considering

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338. The merit of the shareholders' derivative suit is undeniable. The ADM directors paid the largest criminal antitrust fine ever imposed, in addition to another $90 million to settle three civil antitrust lawsuits. *See* Brief for Petitioner at 3, California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (No. 97-1732).

339. *See* 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, 5 (1991).

340. *See id.* at 19-20.

341. *See id.* at 22-27.

342. Brandi, *supra* note 286, at 385; *see also* Kostant, *supra* note 271, at 1539 n.37 (citing Second Circuit authority asserting that there may be differences of interest in case).

343. *See* Brandi, *supra* note 286, at 386-88. Brandi provides two reasons why derivative defendants settle as soon as possible: (1) individual director defendants seek to avoid the risk of potential liability in the pending suit and (2) the existence of corporate insurance may cover the costs of director liability. *See* Brandi, *supra* note 286, at 386-88.

344. *See* Brandi, *supra* note 286, at 386.

the directors' extensive criminal and civil liability, the merits of the suit were obvious. As the Third Circuit aptly explained the problem: "[p]laintiffs' attorneys and the defendants may settle in a manner adverse to the interests of the plaintiffs by exchanging a low settlement for high fees. Such a risk cautions against creating obstacles to challenging derivative action settlement agreements."[345] Indeed, this is precisely what happened in *Felzen*—the Seventh Circuit declined to review the fairness of the settlement by requiring the extra hurdle of intervention.

CONCLUSION

In 1987, courts began to require intervention for unnamed party appeals. During the past thirteen years, though, courts have split as to whether unnamed class members must intervene in order to appeal a judgment in class actions. *Guthrie*'s line of reasoning, however, provided a legitimate argument for an intervention requirement in class actions.[346] Other courts also adhered to the intervention requirement as a result of the Supreme Court's decision in *Marino*.[347] Nevertheless, until *Felzen*, no court had ever required intervention for shareholders in derivative actions.

The reason for this is not clear.[348] However, this Note highlights several reasons why courts should not require intervention for unnamed shareholders in derivative suits. More importantly, courts should not examine class actions and derivative suits collectively because they are very different mechanisms of representative litigation. A separate analysis of class and derivative actions dictates a more liberal appeals procedure for unnamed shareholders in derivative suits than for unnamed class members in class actions. Thus, the intervention requirement acts as an unnecessary burden for unnamed shareholders who seek an appeal in derivative actions.

The Seventh Circuit, in *Felzen*, came to an opposite conclusion by relying on authority that does not consider the unique position

345. Bell Atl. Corp. v. Bolger, 2 F.3d 1304, 1310 (3d Cir. 1993) (citation omitted).

346. *See supra* Part II.A.

347. *See supra* Part II.A.

348. This proposition is made in reference to the Supreme Court's decision to affirm *Felzen*, per curiam, by an equally divided court. *See* California Pub. Employees' Retirement Sys. v. Felzen, 119 S. Ct. 720 (1999) (per curiam).

of unnamed shareholders in derivative actions. The Supreme Court summarily affirmed this decision by an equally divided court. Thus, until the issue in *Felzen* resurfaces, the appellate rights of unnamed shareholders in derivative litigation will remain unprotected.

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