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Defending the Quiet Life: The Role of Special Counsel in Director Terminations of Derivative Suits

Deborah A. DeMott*

It is a truism that corporate officers and directors do not fancy defending their decisions in derivative litigation. Similarly, it is widely accepted that although derivative suits, like many other kinds of litigation, are susceptible to abuse, they serve as some deterrent to improper or incompetent management behavior by permitting shareholders to assert, on their corporation’s behalf, claims against corporate managers or third parties.1

Some of the procedural rules peculiar to derivative suits have been developed in response to the perceived abusiveness of some derivative actions.2 Others, however, stem from the practical awkwardness implicit in derivative litigation:3 Although the behavior complained of has harmed the corporation rather than individual stockholders and although the asserted cause of action belongs to the corporation, it is prosecuted by a representative shareholder rather than by the corporation’s typical managerial voice, its board of directors. One procedural solution to this awkwardness has been to give the corporation’s directors an opportunity to review the derivative suit and take over its maintenance on the corporation’s behalf. For example, many jurisdictions require that the derivative plaintiff either demand that the corporation’s directors take over the suit or explain why such a demand would be futile.4 Failure to meet this demand requirement may result in dismissal of the suit. One explanation excusing the demand is that the board of directors is controlled by the derivative suit defend-
Ants. In recent years several courts have created an additional ground for dismissal of derivative suits. Under the rule developed by these courts, if the corporation’s board of directors determines in a sufficiently disinterested fashion that a derivative suit is not in the corporation’s best interests, the court should dismiss the suit in deference to the board’s disinterested exercise of business judgment.

The business judgment doctrine holds that a director who makes a good faith business decision, using reasonable care and diligence, will not be personally liable if the consequences of that decision go awry. When the business judgment defense is unavailable, the directors who made the decision must show that the decision was in the corporation’s best interests and was not made in a negligent or self-interested fashion. This article will review the extent to which the business judgment doctrine is relevant to a board’s recommendation to terminate derivative litigation, and the function of corporate counsel in assisting and shaping the board’s decision.

I. Applicability of the Business Judgment Doctrine

The leading case applying the business judgment doctrine to directors’ recommendations that derivative litigation be terminated is Auerbach v. Bennett, a 1979 decision of the New York Court of Appeals. The derivative complaint in Auerbach alleged that four of the corporation’s directors and its outside auditors had breached duties owed to the corporation in connection with bribe and kickback payments made abroad and in the United States. The transactions had

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5 H. HENN, supra note 2, § 365, at 771-72.
9 In Burks v. Lasker, 441 U.S. 471 (1979), the Supreme Court of the United States held that federal courts adjudicating cases under the Investment Company Act, 15 U.S.C. §§ 80a-I to 80a-64, as amended by Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275 (amendment adding §§ 80a-53 to 80a-64), and the Investment Advisers Act, 15 U.S.C. §§ 80b-1 to 80b-21, as amended by Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275, should apply state law to determine whether the disinterested directors of an investment company may terminate a derivative suit brought against the other directors. The Court found that no federal policy conflicted with such dismissals. In subsequent cases, the lower federal courts have differed as to whether other federal securities regulations conflict with, and thereby preclude, director terminations of derivative actions alleging federal securities violations. Compare Galef v. Alexander, 615 F.2d 51, 63-64 (2d Cir. 1980) (policies of federal proxy regulation would be undercut by director termination of suit alleging proxy violations) with Lewis v. Anderson, 615 F.2d 778, 814 (9th Cir. 1979), cert. denied, 101 S. Ct. 206 (1980) and Abbey v. Control Data Corp., 603 F.2d 724, 731-32 (8th Cir. 1979), cert. denied, 444 U.S. 1017 (1980) (federal proxy regulation not weakened by disinterested directors’ decision to terminate derivative litigation). See generally Ferrara & Steinberg, A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism, 129 U. PA. L. REV. 263, 297-300 (1980).
been investigated earlier by the corporation’s audit committee and described in its report filed with the Securities and Exchange Commission (SEC). After the complaint was filed, the corporation’s board created by resolution a “Special Litigation Committee,” composed of three directors who had joined the board after the doubtful transactions had occurred, to consider the corporation’s stance regarding the derivative suit. After reviewing the work of the corporation’s audit committee, interviewing some individual defendants and seeking the advice of the special counsel it had engaged, the committee decided that the corporation’s best interests would not be served by continuing the derivative litigation. Based on the committee’s recommendation, the trial court granted summary judgment, dismissing the complaint against all defendants. Although the intermediate appellate court reversed, the court of appeals reinstated the trial court’s dismissal.

The court of appeals characterized the case as one governed by the business judgment doctrine, which “bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes.” This doctrine, according to Auerbach and numerous commentators, is grounded in notions of efficiency—that courts are not capable of reviewing the correctness of business decisions, which are shaped by a wide range of factors and which typically defy assessment by any single explicit standard. For courts to attempt to “second-guess” directors’ decisions is, moreover, potentially unfair to defendants, who made decisions under circumstances courts cannot realistically recreate.

The Auerbach decision may be criticized on two separate grounds. First, it is questionable whether the business judgment doctrine should apply to board decisions to terminate litigation against directors. For example, in Maldonado v. Flynn the defendant officers and directors were alleged to have improperly

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9 47 N.Y.2d at 626, 393 N.E.2d at 998, 419 N.Y.S.2d at 924.
10 64 A.D.2d 98, 108, 408 N.Y.S.2d 83, 88 (App. Div. 1978). The court found that summary judgment was premature because plaintiff had not had the opportunity to conduct pretrial discovery.
11 47 N.Y.2d at 627, 393 N.E.2d at 998, 419 N.Y.S.2d at 924. The issues in Auerbach are complicated by the confusing procedural stance of the case. The original representative plaintiff failed to appeal from the trial court award of summary judgment dismissing the complaint. Subsequently another shareholder sought to intervene for the purpose of pursuing an appeal. Intervention was permitted by the intermediate appellate court, and upheld by the court of appeals. Id. at 629, 393 N.E.2d at 999, 419 N.Y.S.2d at 926. However, the intervening plaintiff was confined by the court of appeals to the record as presented to the intermediate appellate court, and thereby to the evidentiary infirmities of the case as developed by the original plaintiff. Id. at 636, 393 N.E.2d at 1003, 419 N.Y.S.2d at 929.
12 Id. at 629, 393 N.E.2d at 1000, 419 N.Y.S.2d at 926.
14 413 A.2d 1251 (Del. Ch. 1980), rev’d & remanded sub nom. Zapata Corp. v. Maldonado, No. 113-1980 (Del. May 13, 1981). The procedural history of Maldonado has been tortuous. After the case was briefed and argued before the chancery court, a federal district judge in New York, where suit on the same facts had been commenced, held that the directors’ decision to terminate the derivative litigation was a proper exercise of business judgment mandating judicial dismissal of the action. Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980). The chancery court noted the federal developments in its opinion and granted the defendants leave to move to dismiss. 413 A.2d 1251, 1263 n.2 (Del. Ch. 1980). The chancery court later dismissed the case on res judicata grounds, holding that the plaintiff assumed the risk of inconsistent adjudication when he elected to begin two actions. 417 A.2d 378 (Del. Ch. 1980). However, the court stayed the dismissal until the Second Circuit decided the appeal from the district court decision. Maldonado v. Flynn, 559 SEC. REG. & L. REP. (BNA) A-2 to A-4 (Del. Ch. 1980). The same disputed transactions are involved in Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980). See generally Hinsey, Maldonado (NY) v. Maldonado (DE): Which Prevails?, Legal Times of Wash., Aug. 4, 1980, at 18.
amended the corporation’s stock option plan to benefit themselves. The Delaware Chancery Court held that while the business judgment rule does afford a presumption of propriety to corporate directors’ decisions and a defense if directors are sued by stockholders, “nothing in it grants any independent power to a corporate board of directors to terminate a derivative suit.”\(^5\) According to the court, directors’ authority to terminate a derivative suit must stem from sources external to the business judgment rule.\(^6\) Of course, the business judgment rule might nonetheless be available as a defense if directors are sued for failing to assert a claim on the corporation’s behalf against a third party, since the plaintiff would then be challenging the directors’ management of corporate affairs. But even in such a case the chancery court would not have treated the business judgment rule as authorizing a board decision to terminate the suit against the directors.\(^7\) However, characterizing the rule as exclusively defensive in its operation rather than potentially offensive as well—as solely a shield and never a sword—is not particularly helpful in resolving the question underlying both \textit{Auerbach} and \textit{Maldonado}: Under what circumstances should a court defer to directors’ assessments of the utility to the corporation of derivative litigation?

The Delaware Supreme Court made a useful start at answering that question in its recent opinion reversing and remanding the vice-chancellor’s decision in \textit{Maldonado}. The supreme court held that corporate directors, as an incident of their general power conferred by statute to manage the corporation’s business and affairs,\(^8\) are empowered to make decisions concerning corporate litigation and that they may delegate this power to a disinterested board committee.\(^9\) Indeed, the court stated that even if the derivative plaintiff would be excused from making a demand of the board, the board retains its delegable power to “manage” the corporation’s interests in the litigation.\(^10\) However, the court in \textit{Maldonado} made a distinction not made in \textit{Auerbach} between the disinterested directors’ power to act for the corporation and the weight a court should give to their determinations. In doing so, the court noted that “there is sufficient risk in the realities of a situation like the one presented in this case to justify caution beyond adherence to the theory of business judgment.”\(^11\) Consistent with this caution, the court remanded the case to the chancery court to determine (1) whether the board committee was independent, acted in good faith, and could show reasonable bases for its actions (matters on which the corporation has the burden of proof), and (2) whether, in the court’s own “independent business judgment,” the action should be dismissed.\(^12\) The court described this second step of review as essential to the role a court should play in balancing legitimate stockholder claims asserted in a derivative suit against the corporation’s best interests as determined by an independent board committee.\(^13\) In particular, the court de-

\(^{15}\) 413 A.2d at 1257.
\(^{16}\) Id. The court’s rejection of directors’ authority to terminate derivative litigation against fellow directors was challenged by a federal district court purporting to apply Delaware law in a derivative action. See Abramowitz v. Posner, [current] Fed. Sec. L. Rep. (CCH) ¶ 97,921, at 90,961 (S.D.N.Y. 1981).
\(^{17}\) 413 A.2d at 1257.
\(^{19}\) No. 113-1980, slip op. at 17-19 (Del. May 13, 1981).
\(^{20}\) Id. at 18.
\(^{21}\) Id. at 22.
\(^{22}\) Id. at 26-28.
\(^{23}\) Id. at 28.
clared that the lower court should consider whether committee determinations that appear proper under the first step of review nonetheless fail to meet the spirit of the court's criteria, and whether the stockholder grievance deserves further consideration in light of the corporation's interests. In addition, relevant matters of law and public policy may be considered.

In striking what it characterizes as a "middle course" between judicial deference to litigation committee decisions and "unbridled plaintiff stockholder control" of derivative litigation, Maldonado represents a novel effort to inject substantive judicial scrutiny into the preliminary phases of derivative litigation. In effect, its solution is a pragmatic compromise that permits early termination of derivative litigation in some circumstances while not limiting the courts' review of litigation committee decisions to a formal assessment of the committee's independence. How expansively the chancery court exercises its review powers will, of course, determine whether Maldonado's standard is significantly more searching than that established in Auerbach. If, indeed, the lower courts extensively scrutinize the merits of derivative suits in deciding whether to adopt litigation committees' recommendations that they be terminated, the utility of such committee effort would not be readily apparent. Although Maldonado does not explicitly state the degree of deference a chancery court should pay to disinterested directors' business judgment, the breadth of the criteria set forth for the lower courts' review suggests such deference may be slight and may vary considerably from case to case. This treatment of committee business judgment is, then, a sharp departure from the judicial self-abnegation envisioned in Auerbach.

Auerbach may also be criticized on the ground that its deference to litigation committee determinations is difficult to harmonize completely with New York's treatment of the demand requirement. If a corporation's board of directors refuses a shareholder's demand that it sue, the shareholder must show, as a condition to maintaining his own suit, that the directors' refusal constituted a breach of duty rather than a good faith exercise of judgment in assessing the corporation's interests. Nonetheless, treating the litigation committee's decision as an exercise of business judgment and as grounds for dismissing the suit is not simply the demand requirement in a different guise, since Auerbach would require dismissal even when a demand would so clearly be futile that it would not be required. Such an excuse would be available under New York law if the defendants comprise a majority of the board of directors or otherwise control the board.

Auerbach's analysis, however, focuses on the litigation committee's disinterestedness and good faith, rather than on the board's own ability to respond credibly to a demand that it sue. Presumably, if the litigation committee is composed of disinterested members and is sufficiently insulated from improper influences of

24 Id.
25 Id.
26 Id. at 25.
27 Koral v. Savory, Inc., 276 N.Y. 215, 218, 11 N.E.2d 883, 885 (1937). In Maldonado, the Delaware Supreme Court stated that under Delaware law the directors' refusal of a demand to sue will be honored, and the derivative suit dismissed, unless the refusal is wrongful. No. 113-1980, slip op. at 12-13. There is some suggestion of a contrary view in prior materials. See E. Folk, THE DELAWARE GENERAL CORPORATION LAW 489 (1972).
29 47 N.Y.2d at 631, 393 N.E.2d at 1001, 419 N.Y.S.2d at 927.
other board members, *Auerbach* would uphold the committee's determination even when a demand upon the board would not be required.

The apparent inconsistency between *Auerbach* and New York's demand rule cases arises partly from the narrowness of the *Auerbach* court's analysis. Rather than examining the circumstances that, under the demand rule, justify granting control over a derivative action to the corporation's board of directors or to the shareholder-plaintiff, the court presumes the existence of corporate "ownership" of the derivative suit and concludes that such ownership establishes the propriety of the directors' control of the suit. This, of course, bypasses the inquiry into proper control of the action mandated by the demand rule.

The fact that state corporation statutes permit disinterested directors to approve contracts between the corporation and interested directors does not compel, by analogy, judicial acceptance of litigation committee determinations to terminate derivative litigation. Most corporation statutes prevent such contracts from being voided on conflict-of-interest grounds if they are approved by the shareholders or by disinterested directors, or if the transaction is "fair" when approved. However, it has been held that compliance with the statutory approval procedures does not foreclose later judicial inquiry into the fairness of the transaction. *Auerbach*, on the other hand, attributes a finality to the disinterested directors' assessment of derivative litigation that does preclude judicial review of the merits of the litigation.

*Auerbach* might be harmonized with *Maldonado* by analyzing the nature of each shareholder-plaintiff's asserted cause of action. The shareholder's complaint in *Auerbach* alleged breaches only of the fiduciary duty of care owed to the corporation—claims for which the business judgment defense may be available. In such a case, the special litigation committee's determination could be persuasive. On the other hand, the shareholder's complaint in *Maldonado* alleged breaches of the fiduciary duty of loyalty. In such a case, dismissal under the business judgment rationale would be improper. However, the language of the opinions fails to support this distinction. *Auerbach* does not limit the availability of the litiga-

30 Id.
31 E.g., ALI-ABA MODEL BUS. CORP. ACT § 41(a) (1979); DEL. CODE ANN. tit. 8, § 144(a)(1) (1977).
32 See id.; W. CARY & M. EISENBERG, supra note 1, at 604.
34 See Dent, supra note 2, at 130-31. Some courts have interpreted the business judgment doctrine, as applied to litigation committees, in ways inconsistent with statutory provisions governing directors' conflicts of interest in approving transactions. These interpretations ignore existing statutory guidelines for duty of loyalty problems. See Busbaum, Conflict-of-Interests Statutes and the Need for a Demand on Directors in Derivative Actions, 68 CALIF. L. REV. 1122, 1128 (1980).

The analysis in *Maldonado* does presuppose that the shareholder's grievance is the proper object of a derivative suit. At a minimum, the suit must assert a corporate cause of action, rather than a cause of action alleging injury solely to the plaintiff's individual property rights as a stockholder. Nearly a century ago, in *Hawes v. Oakland*, 104 U.S. 450 (1881), the Supreme Court limited the circumstances in which a shareholder may bring a derivative suit:

We understand that doctrine to be that to enable a stockholder in a corporation to sustain in a court of equity, in his own name, a suit founded on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff, there must exist as the foundation of the suit—

Some action, or threatened action, of the managing board of directors or trustees of the corporation which is beyond the authority conferred on them by their charter or other source of organization;

Or such a fraudulent transaction completed or contemplated by the acting managers, in
tion committee route to suits alleging management mistakes or breaches of the duty of care, while *Maldonado*’s caution about using committee recommendations as grounds for dismissal is not limited to suits alleging self-dealing behavior or breaches of the duty of loyalty. While the nature of the plaintiff’s grievance may be relevant to some of the factors subsumed by the demand requirement, courts deferring to the findings of a special litigation committee and dismissing the derivative suit do not base their decision on the nature of the underlying corporate wrong.

A final asserted justification for using the business judgment doctrine to dismiss derivative suits is that decisions about litigation are, like other matters affecting the corporation’s interests, committed to the management of the board of directors, to be resolved by those directors able to address the question in a disinterested fashion. *Maldonado* appears to limit significantly the managerial prerogative of directors with regard to derivative litigation: It is the court rather than the directors that possesses the residual authority to balance the factors implicated by the suit and make a final assessment of the corporation’s interests. Thus, *Maldonado* presupposes that derivative litigation differs significantly from other litigation affecting the corporation’s interests, and that directors’ ordinary prerogatives of control are consequently reduced.

To be sure, *Auerbach* does not appear to recognize such a distinction, for it gives director decisions about derivative litigation the same judicial deference that would be given other board decisions about the corporation’s business and affairs. This invariant deference is legitimate only if the board of directors is capable, through its litigation committee, of objectively determining and pursuing the corporation’s interests, for if such capability cannot be assured, the business judgment doctrine is inapplicable.

II. The Business Judgment Doctrine Applied

The *Auerbach* court and other courts that apply the business judgment doctrine to terminations of derivative litigation vary considerably in the extent to which they evaluate the performance of special litigation committees and permit
the shareholder-plaintiff to challenge committee determinations. The business judgment doctrine does not apply when the directors making a decision have a material personal interest in its outcome, have not learned relevant facts before deciding, or have otherwise made the decision in bad faith. As a result, a litigation committee’s handling of its charge may be open to question in several respects, although the plaintiff bears the burden of establishing bad faith. The New York Court of Appeals in Auerbach inquired into the reasonableness of the scope and methods of the litigation committee’s investigation, exploring the number of witnesses interviewed at the committee’s behest and the number and nature of documents reviewed by the committee’s special counsel. Other courts, however, do not delineate what might justify a court’s conclusion that the committee’s decision was adequately informed. To be sure, Auerbach prescribes an inquiry which is in some respects impractical. Although courts are instructed to examine whether "the areas and subject . . . examined are reasonably complete and [whether] there has been a good-faith pursuit of inquiry into such areas and subjects," they must forgo examination of "what has been uncovered," and of the relative weight the committee assigned different factors in its deliberations. These instructions ignore the fact that "what has been uncovered" often suggests additional subjects for inquiry, and that an investigation’s adequacy is difficult to assess when its results are unknown. This practical problem is overcome by the broader judicial mandate conferred by the first part of the test in Maldonado; namely, that the court scrutinize the reasonableness of the bases for the committee’s decision as well as the committee’s independence and good faith.

Courts adopting special committee determinations as grounds for dismissing derivative suits also vary in the extent to which they permit the shareholder-plaintiff to undertake discovery on issues pertinent to the availability of the business judgment doctrine. Because these issues are ultimately factual, it seems inappropriate for a court to grant defendants’ motion for summary judgment in a derivative suit without allowing the plaintiff some discovery efforts. Otherwise, it would be difficult for the court to find that no triable issue of material fact exists.

Under the Auerbach approach, a court cannot evaluate the litigation committee’s relative weighting of the factors leading to its decision, although presumably

37 See Arst, supra note 6, at 115.
38 See id. at 119.
39 See Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980). In Maldonado, the burden of proving the litigation committee’s independence and good faith was placed on the corporation. See No. 113-1980, slip op. at 17-19 (Del. May 13, 1981). Cf. Gryenberg v. Farmer, [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,683, at 96,586 (D. Colo. 1980) (defendant corporation as the proponent on any issue involving litigation committee’s independence has the burden of proof).
41 See, e.g., Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), cert. denied, 444 U.S. 1017 (1980), aff ’d 605 F. Supp. 1242 (D. Minn. 1980); Cramer v. General Tel. & Elec. Corp., 582 F.2d 259, 275-76 (3d Cir. 1978), cert. denied, 439 U.S. 1129 (1979); Dent, supra note 2, at 108. In Abbey, as in Auerbach, the plaintiff conceded the adequacy of the committee’s investigation.
42 47 N.Y.2d at 634, 393 N.E.2d at 1002-03, 419 N.Y.S.2d at 929.
43 See text accompanying note 22 supra.
44 See Dent, supra note 2, at 107-08.
the court need not take at face value the committee's description of these factors. The committee in *Auerbach* singled out a number of factors, including the legal propriety of the defendants' actions, their lack of personal gain from the transactions in question, the drain on senior management's time if the litigation continued, litigation costs relative to the prospects for success, and the damage that continued publicity might work on the company's business.\(^{45}\) Even under the strictures of *Auerbach*, however, a court need not be completely supine in light of such general statements: It might critically examine predictions of unfavorable publicity and require a specific showing of the diversion of management resources likely in such litigation.\(^{46}\) The cost of maintaining the derivative suit relative to the prospects for success usually need not concern the corporation, since these litigation costs are borne by the derivative plaintiff rather than the corporation if the suit is unsuccessful. If the committee's concern is what the corporation will pay to defend the individual defendants, the court should seek specific forecasts of the amount of those expenses, and a demonstration that they represent reasonable uses of the corporation's assets.\(^{47}\)

Determining whether litigation committee members were sufficiently disinterested to warrant protecting their findings with the business judgment doctrine presents the court with an even greater problem. In *Auerbach* the committee members were held to be disinterested because they were not named as defendants and were not directors at the time the challenged transactions took place.\(^{48}\) The same lack of involvement has typified the committee members in some, but not all, cases taking the *Auerbach* approach.\(^{49}\)

Other courts have accepted a director's membership on a litigation committee even though his concern for the litigation's disposition was considerably more personal. For example, in *Lewis v. Anderson*\(^{50}\) the United States Court of Appeals for the Ninth Circuit upheld a trial court's summary dismissal of a derivative complaint, citing the determination of a three-member litigation committee.\(^{51}\) Although one committee member was a named defendant in the derivative litigation, the court concluded that he had not benefited from the stock option transactions challenged in the suit.\(^{52}\)
The Ninth Circuit’s willingness to treat the defendant director in *Lewis* as a “disinterested” committee member raises the question of what constitutes disinterestedness under this application of the business judgment doctrine. Under *Lewis*, interested committee members are those having a personal financial stake in the transactions underlying the derivative litigation. Under *Auerbach*, on the other hand, interested members are those having a stake in the litigation as defendants, or possibly as members of the board of directors in office at the time the disputed activities occurred. The breadth of *Lewis*’s definition of disinterestedness may be partially explained by federal cases insisting that shareholder-plaintiffs in derivative litigation meet the demand requirement of rule 23.1 of the Federal Rules of Civil Procedure even if outside directors are among the defendants in the suit, unless the plaintiff demonstrates that the defendant-directors’ approval of the contested corporate transaction was self-interested or biased. These cases cannot completely explain *Lewis*, however, since despite their insistence that the demand be made, they do not require that the trial court automatically dismiss the derivative suit if the directors decide not to bring suit after the demand is made.

*Auerbach* appears to be the sounder resolution of this question, for surely the relevant question is whether the committee member stands to gain personally from the committee’s decision to dismiss the suit, not whether he profited personally from the transaction found objectionable by the derivative plaintiff. Indeed, if the *Lewis* test were followed, any director who did not gain financially from board actions could serve on litigation committees, regardless of his immediate and direct interest as a defendant in obtaining a dismissal of the litigation.

Some commentators have suggested that the setting in which litigation committees operate undermines the independence of committee members, even those who are disinterested under the *Auerbach* test, and effectively assures that the committees will find derivative litigation not to be in the corporation’s best interests. This criticism seems confirmed by the fact that in every reported case the litigation committee apparently recommended that the derivative suit be dismissed. Like most other people, litigation committee members may simply find

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53 In *Auerbach* the court’s description of the composition of the litigation committee emphasized that none of its members were directors at the time of the challenged transactions or had had any prior dealings with the corporation. 47 N.Y.2d at 631-32, 393 N.E.2d at 1001, 419 N.Y.S.2d at 927.


56 Heit v. Baird, 567 F.2d 1157, 1162 n.6 (1st Cir. 1977). Similar judicial skepticism may attend disinterested directors’ attempts to settle derivative suits brought against fellow directors and controlling stockholders. In Clark v. Lomas & Nettleton Financial Corp., 625 F.2d 49 (5th Cir. 1980), cert. denied, 101 S. Ct. 1738 (1981), the court held that the corporation’s disinterested directors were incompetent to settle the derivative litigation because one of the codefendants was the corporation’s majority stockholder. The court pointed out that since this fact would excuse the derivative plaintiff from making a demand on the board, it should also disqualify the directors from taking action to terminate the litigation. *Id.* at 53-54. Indeed, the court observed that a more rigorous showing by plaintiff would be required to excuse the demand than to disregard subsequent director action regarding the suit. *Id.* at 54 n.5.

57 See Coffee, Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and An Effective Legal Response, 63 Va. L. Rev. 1099, 1233-36 (1977); Note, supra note 8, at 619-22. Cf. W. CARY & M. EISENBERG, supra note 1, at 926-27 (“In the modern publicly held corporation the reality is that outside directors are typically selected not by the board but by the chief executive, and in making these selections most chief executives will take into consideration whether the candidate can be counted on not to rock the boat.”).

58 See Dent, supra note 2, at 109 n.70. Professor Dent observes that, consequently, derivative suit
it difficult to pass adverse judgment on their peers. Moreover, they may identify with the defendants in the derivative litigation, imagining themselves in comparable positions in the future. Even if the litigation committee does not explicitly follow a corporate application of the Golden Rule ("Do unto others."), the setting in which it operates does not enhance the committee's ability to perceive merit in the litigation. These criticisms, however, are of a behavioral sort not characteristic of judicial opinions dealing with corporate matters. The courts' preference (and not surprisingly so) has been to express and analyze the rules of corporation law in formal terms. Thus, even if the preceding criticisms of litigation committees are sound, courts would prefer that they find expression in a more formal analysis.\[59\]

One proposed formal test for litigation committee independence turns on the composition of the board of directors appointing the committee.\[60\] Under this test, if a majority of the board members appointing the committee are not defendants in the derivative suit, the litigation committee is deemed disinterested for purposes of the business judgment rule; if a majority of board members are defendants, the committee is deemed interested. Although simple to apply, the test poses two difficulties. First, boards may manipulate the test by increasing the board's membership until the requisite nondefendant majority exists, thereby enabling the creation of an "independent" litigation committee.\[61\] There is no reason to suppose in such a case that the new directors and the litigation committee members have a demonstrably independent perspective on the merits of the derivative suit. Second, the test would validate litigation committee decisions in some cases in which the derivative plaintiff would not be required to make a demand on the board of directors.\[62\] To the extent that the defendants in these cases dominate the board but do not comprise a majority of it, the independence of decisions made by the litigation committee would be questionable.

Similar criticisms could be made of any test that measured the independence of a litigation committee designated by the board of directors by examining the process by which directors were elected. One such test might focus on whether nominations to the board are controlled by a committee of independent

defendants have "nothing to lose in obtaining the appointment of a litigation committee." Id. at 109. Cf. Lasker v. Burks, 567 F.2d 1208, 1212 (2d Cir. 1978), rev'd on other grounds, 441 U.S. 471 (1979) (emphasizing the unlikelihood that disinterested directors will decide adversely to their colleagues on a mutual fund board, with whom they "must constantly deal... in a spirit of accommodation").

\[59\] Interestingly, however, the Delaware Supreme Court in Maldonado did depart somewhat from the formality typical of judicial analyses of corporate law questions to venture a naturalistic prediction about litigation committee members' reaction to their situation. The court suggested that committee members may well empathize with the directors whose behavior they assess, and that the committee process may well be open to subconscious abuse that could not be detected through judicial investigations of committee independence, good faith and reasonableness. No. 113-1980, slip op. at 23 (Del. May 13, 1980). Nevertheless, these concerns do not lend themselves to expression in rules of formal and, thereby, predictable application.

\[60\] This test is suggested in Dent, supra note 2, at 110, 122-23.

\[61\] Adjustments in the number of nondefendant directors on the board are easiest to effect when there are vacancies on the board and the remaining members act to fill the vacancies. If there are no existing vacancies, they may be created if the size of the board is expanded by amending the provision in the corporation's bylaws or certificate of incorporation setting the number of directors. In a Delaware corporation, if the certificate confers bylaw power on the board, the bylaw amendment would not require shareholder approval. See Del. Code Ann. tit. 8, § 109(a) (1975). If the certificate of incorporation designates the size of the board, then a stockholder vote to amend it would be necessary.

\[62\] See text accompanying note 28 supra.
Presumably, directors who were nominated for board membership by an independent committee have sufficient formal independence to be able to appoint an independent litigation committee. Moreover, litigation committee members who are nondefendants and who were nominated for board membership by an independent committee will presumably exercise independent judgment in assessing derivative suits against corporate officers and fellow directors. However, any test focusing on the formal procedures for director nomination and election is open to the same possibilities of manipulation described above, although perhaps less directly so. The formal test of committee independence could be made more complex and less manipulable by requiring that no member of the independent nominating committee be a defendant in the derivative suit; this requirement could be coupled with the requirement that the independently nominated board have a majority of nondefendant members in order to appoint a disinterested committee. Such complexity would increase the difficulty of appointing a litigation committee with authority to dismiss derivative suits, and hence would likely reduce the number of such committees. Nevertheless, a committee appointed in compliance with such formal strictures would not necessarily be capable of dispassionately judging the corporation’s interest in the litigation. In short, all such formal tests of litigation committee independence suffer from a common deficiency: They fail to overcome the situational factors that undercut committee members’ ability to evaluate dispassionately the corporation’s interest in the litigation.

A somewhat more realistic way of gauging whether a litigation committee is capable of independently judging the merits of a derivative suit is suggested by the Second Circuit’s recent opinion in *Treadway Cos. v. Care Corp.* Treadway involved an attempted takeover by Care Corporation (Care) of Treadway Companies, Inc. (Treadway). In response to Care’s purchases, Treadway’s board of directors voted to issue a large block of Treadway voting stock to a third corporation, Fair Lanes, with which Treadway’s management had negotiated a merger agreement prior to Care’s purchases. Care challenged the Treadway board’s decision on the ground that its sole or primary purpose had been to perpetuate the board’s control of Treadway. Treadway asserted that its board had issued the stock pursuant to a good faith determination that a merger with Fair Lanes would be in the corporation’s best interests, whereas a takeover by Care would not be. Treadway argued that its directors’ good faith decision to issue the stock was protected by the business judgment doctrine, and that the court was therefore precluded from examining the wisdom of that decision. The Second Circuit held that, in challenging the applicability of the business judgment rule,
the plaintiff had the burden of showing that Treadway’s directors had an interest in the transaction, a burden the plaintiff failed to sustain.67

Despite the different factual setting of Treadway, the Second Circuit’s discussion of the directors’ lack of interest in the transaction is helpful in evaluating the institution of litigation committees. The court reasoned that since the Treadway directors (with one exception)68 had no personal interest in the fate of the Treadway-Fair Lanes merger, the steps they took toward facilitating the merger, including their decision to issue the stock, were proper exercises of business judgment.69 The court emphasized that none of the directors (with the same exception) expected to play any role in the merged corporation, expecting instead to lose their positions as Treadway directors and not receive directorships in the merged corporation. The court concluded that the directors’ decision to issue the stock had not been motivated by any improper interest in the transaction.70

When applied to the context of litigation committees, Treadway suggests that a committee’s interest in the outcome of its decision about derivative litigation be examined by evaluating whether the committee’s decision was motivated by its members’ expectation of having a future “role to play” in the corporation. Such an expectation appears to be the kind of interest in an outcome which, under the Treadway analysis, disqualifies the decision from the protection of the business judgment rule.

Individual committee members appear more likely to be continued as board members if they recommend dismissal of a derivative suit rather than its continuance. This intuition seems supported by the fact that state corporation statutes authorizing the appointment of board committees retain in the board the authority to dissolve such committees, an authority which appears nonwaivable.71 Fur-

67 Id. at 382-84. By requiring the plaintiff to show that the directors were motivated by “an interest” in the transaction, Treadway may impose a more stringent test for the availability of the business judgment doctrine than do some earlier cases. For example, in Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964), the court held that directors’ judgments about the use of corporate funds were not proper business judgments if “the board has acted solely or primarily because of the desire to perpetuate themselves [sic] in office . . . .” Id. at 504, 199 A.2d at 554. Clearly, it is more arduous for the plaintiff to show that the directors’ sole or primary motivation was improper than to show that the directors had an interest in the transaction which motivated their decision. For, under Treadway, if the directors had other, proper motives beyond their improper interest, these contributing motives appear not to secure the protection of the business judgment doctrine for the directors’ decision; Cheff appears to make the business judgment defense available so long as some proper motive leavened the improper ones. Nonetheless, the Second Circuit’s later opinion in Crouse-Hinds Co. v. InterNorth, 634 F.2d 690 (2d Cir. 1980), neither reiterates nor rejects Treadway’s emphasis on “an interest” as the disqualifying factor under the business judgment test.

68 One director, who was also Treadway’s chairman and president, had been given a specific commitment of employment with the merged company. 638 F.2d at 370 n.26, 383.

69 Id. at 383.

70 Id.

71 Some state corporation statutes expressly provide that committees serve “at the pleasure of the board.” See, e.g., CAL. CORP. CODE § 311 (West 1977); N.Y. BUS. CORP. LAW § 712(c) (McKinney 1963). Under corporation statutes without any comparable express statement, the board would by implication have power to disband a committee it had created and undertake action itself, presumably limited by rights conferred on third parties by contracts entered into by the committee on the corporation’s behalf. See, e.g., DEL. CODE ANN. tit. 8, § 141(c) (1977). If the board could permanently delegate responsibilities to committees, and effectively waive its right to revoke the committee’s authority, it could commit the corporation’s residual managerial authority in a manner inconsistent with statutory provisions reposing such authority in the board. For example, the Delaware corporation statute provides: “The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .” Id. § 141(a). It would be difficult to argue that a committee with nonrevocable authority performed its functions “under the direction” of the board, because direction presupposes power to redirect. Nonetheless, this section of the Delaware statute might permit the board to make such
ther, especially if a majority of the board (or its dominant minority) is composed of defendants in the litigation, its practical control over the board nomination mechanism may insure that any litigation committee member who favors continuation of the litigation is not renominated or reelected to board membership.\(^\text{72}\)

In short, it is clear that most litigation committee members, unlike the directors in *Treadway*, expect to play a future role in the corporation and do not expect their membership on the board of directors to cease regardless of the conclusion they reach about the merits of the derivative suit. Further, litigation committee members would not expect the question of their future role in the corporation to be decided independently of their position on the derivative litigation. These expectations of playing a continuing role in the corporation are precisely the "interests" that, according to *Treadway*, disqualify directors' decisions from the protection of the business judgment doctrine. A subsequent Second Circuit opinion, *Crouse-Hinds Co. v. InterNorth, Inc.*,\(^\text{73}\) elaborates on *Treadway* by emphasizing that the burden of demonstrating the directors' interests is the plaintiff's, and that the disqualifying interests must have motivated the challenged transaction.\(^\text{74}\) *Crouse-Hinds* does not, however, vitiate the applicability of *Treadway*'s analysis to the actions of litigation committees, since it does not alter *Treadway*'s insight into the definition of interest itself.

Finally, the wisdom of the *Treadway* test is that it captures more realistically than formalistic tests the factors that inhibit litigation committees' independence. It is likely that most, if not all, litigation committee members expect to play a role on the board of directors in the future; it is also likely that this expectation is an inescapable factor in committee decisions about derivative suits. This alone suggests that the business judgment doctrine should not apply to such situations, if inevitably litigation committee decisions are afflicted with the "interest" described in *Treadway*. For even within the broader judicial review of litigation committee determinations established by *Maldonado*, assuring that directors are properly disinterested is a task of sisyphean dimensions.

### III. The Role of Counsel

Counsel assists litigation committees in two significant ways. First, counsel is likely to conduct much of the factual investigation on which the committee nonrevocable delegations to committees if such action is authorized in the corporation's certificate of incorporation, for § 141(a)'s language concludes "except as may be otherwise provided in this chapter or in its certificate of incorporation." *Id.* Finally, § 141(c)'s language authorizing the creation of committees simply provides that they "shall have and may exercise" authority of the board conferred upon them; it does not preclude the board's residual exercise of managerial authority.

Nonetheless, *Gall v. Exxon Corp.*, 418 F. Supp. 508 (S.D.N.Y. 1976), rejected a challenge to the litigation committee's independence premised on the fact that the full board was free to abolish the committee. The court reasoned that the relevant issue is the independence of the persons actually making the decisions, and concluded that the litigation committee members were disinterested and did exercise the powers of the full board to dismiss the litigation. *Id.* at 517. However, if the committee's hold on its power is tenuous, subject to revocation by a majority of the entire board, it is credulous to assign much weight to its posture as an independent entity. Indeed, in one reported instance, a corporation's full board abolished a committee when its investigation became invigorated at the SEC's suggestion. *See* *Coffee*, *supra* note 57, at 1236.

This possibility is lessened, or at least made more difficult to achieve, if board nominations are controlled by a committee of independent directors. *See* text accompanying note 63 *supra*. That committee's lease on life may be fragile indeed. *See* note 71 *supra*.


\(^{73}\) 634 F.2d at 702-04.
bases its deliberations. Investigative tasks may include interviewing corporate
directors, employees and non-employees, drafting questionnaires for distribution
to directors and employees, reviewing documents and assessing earlier investiga-
tions by other corporate committees, particularly the audit committee. Second,
counsel advises the committee as to the law applicable to its deliberations, espe-
cially regarding whether the investigation has revealed any illegality and the
range of discretion legally available to the committee in formulating its decisions.

Counsel's role in litigation committee decisions to terminate derivative suits
is especially significant if, as in *Auerbach*, the court defers to the directors' judg-
ment about the merits of the litigation. To the extent that counsel's advice
shapes or influences the committee's decisions, the lack of any subsequent judicial
review of the committee's actions translates counsel's function into one tanta-
mount to adjudication. Indeed, *Auerbach* itself suggests the relatively dominant
role that counsel might play in such a committee; as the court notes, the litiga-
tion committee in that case "promptly engaged eminent special counsel to guide
its deliberations and to advise it."75 Due to the court's willingness to apply the
business judgment doctrine to the committee's determination, special counsel's
"guidance" virtually replaced the conclusions about the defendants' activities
that would otherwise have been drawn by the court.

In many of the decisions adopting the *Auerbach* approach the litigation com-
mittee involved, like that in *Auerbach*, retained special counsel (defined as a law
firm not previously, or at least not regularly, retained by the corporation).76
None of these decisions, however, explains why the committee believed specially
retained counsel would be necessary or desirable. The committees were appar-
ently concerned with assuring counsel's independence; the corporation's regular
counsel might be financially dependent upon the corporation and thus feel inhib-
ited from giving disinterested advice to the litigation committee.77 Of course,
counsel independent in this sense may nonetheless view derivative suit defend-
ants sympathetically,78 but even commentators who oppose applying the busi-
ness judgment doctrine to litigation committees do not argue that such
committees should be obliged to engage counsel from among the plaintiffs' deriv-
ative bar.

Litigation committees' apparent concern with counsel's formal indepen-
dence is nonetheless perplexing in some respects. The business judgment doc-
trine presupposes that litigation committee members are sufficiently disinterested
to evaluate the litigation and decide on the corporation's behalf whether it
should be terminated. But if the committee members are disinterested, and if it
is their good faith exercise of business judgment which is protected, requiring
that they always have disinterested advisors may be unnecessary. In other in-
stances in which the business judgment of disinterested directors is protected
from judicial second-guessing, a similar concern with the independence of the

75 47 N.Y.2d at 635, 393 N.E.2d at 1003, 419 N.Y.S.2d at 929.
76 See, e.g., Abbey v. Control Data Corp., 603 F.2d 724, 727 (8th Cir. 1979), cert. denied, 444 U.S. 1017
(1980); Lewis v. Anderson, 615 F.2d 778, 780 (9th Cir. 1979), cert. denied, 101 S. Ct. 206 (1980); Cramer v.
General Tel. & Elecs. Corp., 582 F.2d 259, 265 (3d Cir. 1978), cert. denied, 439 U.S. 1129 (1979); Gall v.
77 See Dent, supra note 2, at 117-18.
78 Id. at 118.
directors’ advisors is not manifest. For example, corporation statutes that validate disinterested directors’ approval of transactions between other directors and the corporation do not require that the disinterested directors be advised by counsel with no financial ties to the interested directors. Rather, the statutory tests are whether adequate disclosure was made to the disinterested directors, and whether a majority of them voted to approve the transaction. In addition, one might wonder why counsel’s professionalism would not suffice in many instances as protection for the litigation committee members.

It is possible that the courts emphasize the independence of litigation committees’ counsel because they perceive counsel as playing a larger role in shaping such decisions than, for example, in advising on the legality of a proposed corporate transaction, and perhaps because they perceive directors as playing a correspondingly reduced role. But this explanation of the courts’ emphasis on the independence of counsel seems incompatible with the understanding of directors’ function implicit in the business judgment doctrine. Auerbach articulates this understanding to be that “by definition, the responsibility for business judgments must rest with the corporate directors: their individual capacities and experience peculiarly qualify them for the discharge of that responsibility.”

If directors, whose duties are emphasized by Auerbach to be nondelegable, in fact delegate responsibility for assessing the merits of derivative litigation to special counsel, then a major part of the rationale for applying the business judgment doctrine is severely undercut. Why special corporate counsel, rather than judges, are “peculiarly qualified” to make such decisions for the corporation is not apparent.

Identifying the client of special counsel advising a litigation committee is also difficult. If the client is the committee itself, rather than the corporation, doubt is again cast on the relevance of the business judgment doctrine, since that doctrine presupposes the interests of the decisionmaking directors and of the corporation.

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79 See, e.g., ALI-ABA MODEL BUS. CORP. ACT. § 41(a) (1979); DEL. CODE ANN. tit. 8, § 144(a)(1) (1977).
80 See note 79 and text accompanying notes 31-32 supra.
82 Id. at 633, 393 N.E.2d at 1002, 419 N.Y.S.2d at 928. If responsibility for determining the corporation’s position regarding the derivative suit is delegable to counsel, interested directors disqualified from service on a litigation committee might nonetheless attempt such a delegation in the hope of achieving, through counsel’s recommendation, dismissal of the suit even if a nominally disinterested committee could not be appointed. See Gammon, Derivative Suits, 12 REV. SEC. REG. 887 (1979). However, if all directors have an interest that disqualifies them from service on a litigation committee, they may have nothing to delegate to counsel. See Note, supra note 8, at 617-18.
83 The court in one case, Rosengarten v. International Tel. & Tel. Corp., 466 F. Supp. 817 (S.D.N.Y. 1979), took pains to demonstrate that such delegation did not occur. The court’s opinion reviewed the activities of special counsel and the litigation committee members, and concluded that two of the latter had “an impressively thorough participation . . . in the investigation,” reviewing “reams and reams” of documents supplied by counsel, interviewing witnesses, and closely supervising the preparation of the committee’s report. Id. at 824. Indeed, one member of the committee stated that he “participated in every word in this report.” Id. at 825. One member of the committee was considerably less active than the other two, however. Id. The court concluded that, although the committee relied on its counsel, it did so to no greater extent than “many busy public officials” who rely on their staffs, and that it was desirable for the committee to rely on counsel for legal advice. Id. If the two committee members’ involvement was “impressive” to the court, that fact may be due largely to a contrasting tradition of litigation committees less engaged in the details of questions delegated to them.
poration to be identical. If the client is the corporation, the American Bar Association's Code of Professional Responsibility asserts that counsel owes allegiance to the entity rather than to any particular group within it.84 Thus, if the litigation committee and the corporation are separate interests for purposes of counsel's representation, the legitimacy of decisions made by the committee on the corporation's behalf is doubtful.

The characterization of special counsel's client is relevant to determining the extent to which derivative suit defendants may assert the attorney-client privilege to prevent discovery of communications made in the course of counsel's work. If the client is truly the committee itself, as an interest separate from the corporation, the privilege would seem to be broader than if the client is the corporation, albeit in the guise of a litigation committee. If counsel's client is the corporation, some courts have limited the attorney-client privilege in derivative litigation when the shareholder-plaintiff shows cause why the privilege should not be invoked.85 These courts reason that the corporation's stockholders are the ultimate beneficiaries of management's efforts and may be able to demonstrate that communications with counsel should not be kept secret. Although the Supreme Court in the recent case of Upjohn Co. v. United States86 articulated a broad scope for the protection granted by the attorney-client privilege in the corporate context, prior limits on the availability of the privilege in derivative litigation may remain unaffected, for Upjohn's facts do not pose the diversion in interests between corporate managers and stockholders present in derivative litigation.87

The practice of engaging special counsel for litigation committees stems in part from the apparent origin of such committees in investigations mandated or encouraged by the Securities and Exchange Commission.88 Due to a shortage of staff members to investigate allegations in the mid-1970's that corporations had made improper domestic and foreign payments, the SEC began to compel internal corporate investigations in settlements of enforcement actions. The SEC ordered these investigations to be conducted by committees of outside directors, who usually hired special counsel to assist them.89 Later, the SEC announced it would eschew enforcement actions against corporations that voluntarily under-

87 In Upjohn, the Internal Revenue Service had issued a subpoena for communications (written questionnaires and interview notes and memoranda) made to counsel in the course of the corporation's internal investigation of possibly illegal payments made by Upjohn to representatives of foreign governments. Thus, the party seeking discovery was not, as in a derivative suit, a representative of ownership interests on whose behalf the corporation was being managed. On the other hand, the Supreme Court's opinion emphasized the justification for a broad reading of the privilege in a corporate setting, suggesting that the court might be unsympathetic to creating exceptions to the privilege in derivative litigation. 101 S. Ct. at 683-84. In particular, the opinion stressed the need for certainty in knowing whether a communication is protected, along with the necessity that the lawyer be fully informed of the relevant facts before formulating legal advice. These factors would be relevant to derivative litigation as well.
88 See Sommer, The Impact of the SEC on Corporate Governance, 41 Law & Contemp. Prob. 115, 130-32, 131 n.71 (Summer 1977) (citing six SEC settlements which required inter alia the appointment of special counsel to conduct investigations into certain corporate practices).
89 See id. at 129-31. The investigations culminated in a report to be filed with the SEC.
took comparable investigations.\(^{90}\) In investigations mandated by settlements of enforcement actions, special counsel served as surrogate government investigators, accountable to the SEC or the court; their loyalties were not with the corporation as client. Counsel's loyalties were more problematic in the investigations undertaken in the "voluntary" phase of the questionable payments campaign, for although counsel's involvement was not formally at the behest of a court or prosecutorial agency, a major reason for employing counsel's services was to avert a full-blown government investigation.\(^{91}\) Counsel's identification with and loyalty to some interest other than the corporation are even more attenuated—and arguably non-existent—in the "business judgment" cases like *Auerbach*. In those cases the incentive for counsel's involvement is not even that of precluding a government investigation, but simply that of terminating a derivative suit.

Nonetheless, these confusions surrounding the role of, and the need for, special counsel help illuminate the proper role of the business judgment doctrine. If the courts' concern that counsel be independent reflects a judgment that counsel, rather than the directors, plays the dominant role in assessing the merits of the derivative suit, then the case for applying the business judgment doctrine to such decisions is weakened. Similarly, if counsel must be independent because of suspicions that even disinterested directors are not sufficiently so, that is itself a criticism of permitting director terminations of derivative suits beyond those sanctioned by the traditional demand requirements.

**IV. Conclusion**

Leading a quiet life appears attractive to many corporate managers. Indeed, in his writing about antitrust matters, John Hicks has shown that its attractiveness supersedes even that of maximum monopoly profits.\(^{92}\) The ideal quiet life would include the opportunity to indulge preferences for leisure and for work in an unstressful environment, free of market competition and—lest the obvious go unstated—the threat of defending derivative suits. To the extent that self-dealing and the quiet life tempt corporate managers, imposing upon them fiduciary duties owed to the corporation's stockholders serves to restrain efforts to self-deal and to make the quiet life a reality. Enabling such fiduciary duties to be enforced through derivative litigation would, of course, make such restraints more effective. Conversely, easing the dismissal of derivative suits would weaken their effectiveness in inhibiting managerial pursuit of the quiet life and other goals not consistent with shareholders' interests.\(^{93}\)

Treating the business judgment doctrine as an independent justification for the dismissal of derivative suits is not warranted. The doctrine presupposes that the corporation's directors have made a disinterested judgment about the matter under decision, an assumption that appears unrealistic as applied to litigation

90 See id. at 134-36.
91 See Note, Discovery of Internal Corporate Investigations, 32 STAN. L. REV. 1163, 1169-74 (1980).
92 More succinctly, "[t]he best of all monopoly profits is a quiet life." Hicks, Annual Survey of Economic Theory: The Theory of Monopoly, 3 ECONOMETRICA 1, 8 (1935).
93 See generally STAFF OF DIVISION OF CORPORATE FINANCE, SEC, 96TH CONG., 2D SESS., REPORT ON CORPORATE ACCOUNTABILITY 677-690 (Comm. Print 1980). The Staff Report's conclusion regarding the applicability of the business judgment doctrine to directors' evaluations of derivative litigation is simply that the doctrine affords "an important focal point for questions of corporate accountability." Id. at 689.
committees. There is no persuasive reason for allocating control over derivative suits to corporate directors, deferring completely to their judgments to terminate the suits, and thereby squelching judicial review on the merits of litigation. Finally, the position and function of counsel to litigation committees are awkward and raise additional doubts about the applicability of the business judgment doctrine to directors’ decisions about derivative litigation.