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# SHAREHOLDER LITIGATION AFTER THE FALL OF AN IRON CURTAIN

*The pattern of class and derivative stockholder actions has changed in recent years, which the author attributes, in part, to the closing of the dominant plaintiffs' securities law firm. In this article he identifies five recent trends, beginning with venue wars and ending with Section 220 suits.*

By Boris Feldman *

For half a century, the Cold War provided a degree of stability and predictability to the world. East and West were passionate adversaries. But each knew the rules of the game. Certain incursions would be tolerated; others, not. Patterns of behavior, observed over decades, informed game-theoretic decisions on both sides.

The fall of the Iron Curtain changed all that. With the West's victory over the Soviet Union, and the collapse of European communism, international relations became more complex, not less. In the void created by the evaporation of the U.S.S.R. (and the dismemberment of its client states), many new players entered from stage left. Their behavior could not be predicted with the same confidence as the old Rodina. Each sought its own role in the world.

This paradigm may provide a useful way of understanding what is going on in the world of shareholder class actions and derivative lawsuits. For decades, the rules of the road in securities litigation were relatively well-marked. True, the rules changed from time to time: *viz.,* the Private Securities Litigation Reform Act, SLUSA, etc. But even though the applicable legal and procedural requirements evolved periodically, the basic patterns of behavior were stable and predictable.

Those patterns have been disrupted and perhaps discarded in recent years. The reason should not be surprising: the bipolar world of shareholder litigation is no more. For many years, the dominant plaintiffs' securities law firm was Milberg Weiss. After it split into East and West coast firms, they nevertheless together remained the 800-pound gorilla of the shareholder litigation jungle. A few other firms earned a seat at the table and became powers in their own right. But the fundamental patterns of behavior continued. A defense lawyer could predict, with some confidence, the likely response to this or that tactical move. Moreover, the dominant plaintiffs' firms exercised some discipline on their side of the curtain; they had substantial influence over small firms and parvenus.

Not any longer. For reasons of both retirement and incarceration, the plaintiffs' world that we knew for

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decades is gone. There is no longer any dominant firm, nor even an oligarchy. Firms that had been under the influence of the market leaders are now free agents. New entrants have appeared, eager to prospect their own piece of land. Their behavior is less predictable (and often less rational). In my opinion, this view of the environment helps explain five recent trends in shareholder litigation that, in isolation, do not make sense.

### *Trend One: Venue Wars*

Until recently, deciding where to sue a company for securities fraud was not rocket science: sue in the district in which the company maintained its headquarters. True, someone occasionally would sue in another venue. But such instances were rare. In the last few years, they have become common. In part, this may simply reflect judge-shopping: a plaintiff does not like the judge who drew the case in the home forum, so he sues elsewhere hoping for a more hospitable turn of the wheel. More than that, though, some firms have decided that they have a better shot at participating in the litigation if they appear somewhere where no other suits have been filed. This has led to a rise in the number of transfer motions and Judicial Panel on Multidistrict Litigations ("JPML") proceedings well beyond what one traditionally experienced. In the old days, one of the dominant firms would have reached out to the wandering lawyer and exerted some "influence." Now, there is less influence to exert.

This has become especially true in derivative suits involving Delaware corporations. Even before the dissolution of the bipolar world, multiple-forum derivative suits occurred: one set of plaintiffs would sue in the headquarters state, another in Delaware. But even then, the plaintiffs often worked things out *inter se*. Not any more. It has become routine for a defendant to have to file multiple motions to stay redundant cases in various state forums. Indeed, some judges have themselves entered the fray, seeming to think that they are "better" at handling these cases than others. Thus, what was once routine – "where is the litigation?" – has become an area of added expense and uncertainty.

### *Trend Two: Demand Letters*

For years, demand letters on a board prior to filing a derivative suit were as rare as white tigers. The plaintiffs' bar generally viewed demand letters as self-defeating, because they were held to constitute an acknowledgement that demand was not futile and therefore subjected a decision by the board rejecting the demand to a more deferential standard of scrutiny.

Suddenly, however, demand letters have become as fashionable as Burberry knockoffs. A common experience is that plaintiff *A* files a derivative lawsuit, asserting demand futility. Plaintiff *B*, late to the party, decides instead to send a demand letter to the board (usually pasting the complaint's allegations into the demand letter).

This can actually be advantageous to a defendant. Courts often will stay even prior-filed derivative suits while the board considers a subsequent demand, even though it comes from a different party.

But one way to understand the increasing use of demand letters is the desire of secondary players to get in on the action. Indeed, it is not uncommon, even after a derivative plaintiff has lost his suit, for a different plaintiff then to appear and make demand – presumably hoping that if the suits are eventually settled, he will get a piece of the action.

### *Trend Three: Ubiquitous Derivative Suits*

In days gone by, a shareholder class action was not automatically followed by a derivative lawsuit. Usually, something extra was needed. Obviously, if a company reported a major accounting problem and restatement, derivative suits would be filed. Ditto for significant regulatory problems. But just missing a quarter was not usually enough to trigger a derivative suit, even though the stock drop was large enough to spawn 10b-5 class actions.

Now, derivative suits are *de rigeuer*. The derivative bar monitors class action filings as closely as the Section

16 bar tracks Form 4's. Like a moth drawn to a candle, the derivative plaintiffs just cannot resist cribbing the class complaints, even though the company's setback does not suggest any breach of fiduciary duty by the board. Once again, the explanation is obvious: different suits for different folks.

### *Trend Four: Automatic Merger Suits*

When giants roamed the earth, they did not sue over every single public company merger. Of course, if a deal was poorly received by the market, or if management seemed to be siphoning off too much of the transaction value, lawsuits would follow.

In recent years, shareholder suits challenging a merger have become reflexive. Announce a deal, and the first suits will follow within hours no matter how large the premium or how well-shopped the deal. The lawsuits have established a set pattern: initial allegations of breach of fiduciary duty, asserting claims that have been rejected dozens of times by the precedents; then, after the preliminary proxy statement has been filed, amending to transform the suit into a disclosure case (again, asserting disclosure obligations that have been obliterated by the courts).

In addition to the uptick in frequency of such suits, the big change has been in their end-of-life. Historically, once the deal closed, the suits went away. As easy as it was to settle a shareholder suit pre-close, with meaningless supplemental disclosures plus a handsome fee to the plaintiffs, it was nearly impossible to settle them post-close: no therapeutics were available, and the buyer (having closed the deal) was not going to pay more; therefore, no path to a fee. Thus, if the defendants could defeat a preliminary injunction seeking to block the deal, the litigation eventually dried up.

Now, merger suits survive the closing. In my own experience, the amended allegations concocted post-close range from weak to laughable. I do not know of many cases in which these post-close suits have resulted in a payout to plaintiffs. Nevertheless, seeking a place in the sun, they persist.

### *Trend Five: Section 220 Suits*

Delaware corporate law permits a shareholder to request corporate records for a legitimate purpose. This provision, Section 220, historically spawned very little litigation. In the last year, it has caught fire. Probably more 220 cases have been filed in the last year than in all prior recorded history combined. Why? Part of the answer is that Delaware judges have been urging plaintiffs to take advantage of "the tools at hand" in crafting derivative complaints. But in my opinion the greater cause is that a cottage industry has arisen in 220 suits. They are quick, cheap ways for a plaintiff's firm to "get in on the action" when they are otherwise unlikely to be invited to the table for a derivative settlement. In many of these requests, there is no way for the company to avoid a suit: whatever they offer, the plaintiffs ask for more, until they have created an impasse and gotten a ticket to sue. This 220 epidemic is unlikely to be solved without intervention by the Delaware legislature.

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I suppose the good news in all this is that, unlike the world stage, in the litigation microcosm, there are no Chechniyas or Srebrenicas. The battlefield involves money, not lives.

As the economy turns, with the ongoing turmoil in global financial markets, together with the launching of some richly valued Web 2.0 enterprises, we can expect that the new, more fragmented world of plaintiffs' securities lawyers will continue to amaze and surprise us with their innovation and resilience. ■