Comment

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Litigation Supply Should Not Exceed Shareholder ADR Demand: How Proper Use of the Demand Requirement in Derivative Suits Can Decrease Corporate Litigation

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INTRODUCTION

Imagine that you are a shareholder of a Fortune 500 company.[1] One morning you wake up, open today's edition of *The New York Times*, and see an article on the front page about your company.[2] You read the headline, and your jaw drops: the CEO has a five-million-dollar salary despite the fact that he spends more time on vacation in Cabo, Mexico, than he does in the boardroom. Assuming that you love this company and are not willing to sell your shares, what recourse exists? For you, your fellow shareholders, and even the company itself, the answer depends on the state in which your company is incorporated.[3]

To confront corporate misfeasance, a shareholder may bring either a class action lawsuit[4] or a derivative lawsuit.[5] In the last twenty

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[1] To view the current list of America's largest corporations, see *Fortune 500: Our Annual Ranking of America's Largest Corporations*, CNN MONEY (May 23, 2011), http://money.cnn.com/magazines/fortune/ fortune500/2011/full_list.

[2] Under the shareholder primacy principle, shareholders are the legal owners of a publicly held corporation while the officers and directors of the corporation are the shareholders' agents. *See* Ian B. Lee, *Efficiency and Ethics in the Debate About Shareholder Primacy*, 31 DEL. J. CORP. L. 533, 535 (2006) (Shareholder primacy is "the view that managers' fiduciary duties require them to maximize the shareholders' wealth and preclude them from giving independent consideration to the interests of other constituencies.").

[3] *See* Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 108–09 (1991) (holding that the demand requirement is substantive state law and thus is controlled by the internal affairs doctrine). The doctrine exists to maintain the objective of "having the rights and liabilities of those persons with respect to the corporation governed by a single law." *Id.* at 106 (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. e (1971)).

[4] *See* FED. R. CIV. P. 23.

[5] *See* FED. R. CIV. P. 23.1; Grimes v. Donald, 673 A.2d 1207 (Del. 1996); Marx v. Akers, 666 N.E.2d 1034 (N.Y. 1996). It must be noted that FED. R. CIV. P. 23.1 was amended in 2007. *See infra* note 29. However, the Advisory Committee's Note states that

years, class action litigation has increased substantially while derivative litigation has remained stagnant.[6] The reason behind this trend is simple: while class action lawsuits allow parties to sue a corporation directly, parties filing derivative suits must go through the process of requesting that the company essentially sue itself by making demand upon the company.[7] Because of this languid process, savvy plaintiffs' attorneys have long evaded corporate codes by skipping over the demand procedure while state case law permitted them to do so.[8] As a result, companies fight hundreds of class action lawsuits every year in court without ever having the opportunity to resolve disputes with shareholders internally.[9]

There is a way to fix this problem. It starts with states amending the demand requirement in their corporate codes. If shareholders avoid the requirement because it consistently leaves them in the dark about their rights, it is the state legislature's responsibility to modify state corporate codes—the codified version of each state's demand requirement—by revitalizing the originally intended dispute resolution policies of demand. The Model Business Corporation Act's (MBCA)[10] demand procedure, which eighteen states have adopted already,[11] could provide the best statutory framework for

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the changes are "intended to be stylistic only." FED. R. CIV. P. 23.1 advisory committee's note. This analysis will focus on the language of the new rule. However, because the 2007 revisions were only stylistic in nature, this does not change prior analyses of the rule in any consequential manner.

6 Jesse Tiko Smallwood, *Nationwide, State Law Class Actions and the Beauty of Federalism*, 53 DUKE L.J. 1137, 1152 (stating that "state court class action filings increased 1,315 percent" in the 1990s).

7 *Compare* FED. R. CIV. P. 23 (allowing any party to sue directly), *with* FED. R. CIV. P. 23.1 ("The complaint must be verified and must . . . (3) state with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and (B) the reasons for not making the effort.").

8 *See Grimes*, 673 A.2d 1207 (setting the standard for demand excusal in Delaware); *Marx*, 666 N.E.2d 1034 (qualifying the excusal standard for New York corporations). Demand excusal is discussed *infra* Part II.

9 For a comprehensive list of current class action lawsuits, see CLASS ACTION WORLD, http://www.classactionworld.com (last visited Feb. 6, 2012).

10 MOD. BUS. CORP. ACT (2006) [hereinafter MBCA].

11 *See* ARIZ. REV. STAT. ANN. § 10-742 (2011); CONN. GEN. STAT. ANN. § 33-722 (West 2011); FLA. STAT. ANN. § 607.07401 (West 2011); GA. CODE ANN. § 14-2-742 (West 2011); HAW. REV. STAT. § 414-173 (West 2011); IDAHO CODE ANN. § 30-1-742 (West 2011); ME. REV. STAT. ANN. tit. 13-C, § 753 (2011); MICH. COMP. LAWS § 450.1493a (2011); MISS. CODE ANN. § 79-4-7.42 (West 2011); MONT. CODE ANN. § 35-1-543 (West 2010); NEB. REV. STAT. § 21-2072 (2011); N.H. REV. STAT. ANN. § 293-A:7.42 (2011); N.C. GEN. STAT. § 55-7-42 (2011); TEX. BUS. ORGS. CODE ANN. § 21.553 (West 2011); UTAH CODE ANN. § 16-10a-740 (West 2011); VA. CODE ANN. § 13.1-672.1

derivative lawsuits. The MBCA's version strengthens the alternative dispute resolution (ADR) policies behind the requirement[12] and is the best solution for reducing the number of class actions and overall volume of litigation between companies and their shareholders.

This Comment explores the contours of the demand requirement—the forgotten ADR mechanism available to all litigating shareholders—and how its efficient use could be beneficial for all parties as well as for the greater corporate community. Part I describes the derivative suit and the demand requirement generally, with particular attention focused on the procedures in Delaware and New York. Because these two states have the highest number of domestic incorporations of all states,[13] it is important to see how their processes change the landscape of the requirement.

Part II delves more deeply into the demand requirement and begins to explain its ADR policies and characteristics. Part III describes the MBCA model and explains why it gives the best possibility for improvement with corporate ADR. Part III discusses the positive effects in the states that have adopted the MBCA and how the same changes to other corporate codes could be the best way for companies and shareholders to save time and money. Finally, the Comment reemphasizes the importance of the demand requirement, argues why more states and corporations would benefit from it, and promotes the MBCA as an effective model for the future.

I
THE DEMAND REQUIREMENT AND ITS ROLE IN THE DERIVATIVE SUIT

A. Derivative Suits

While class action lawsuits garner the most press,[14] derivative suits provide a more cooperative option for shareholders to fix companies. Through enabling statutes in state corporate codes, derivative plaintiffs can assert their rights against all types of "wrongdoers," including employees within the company and third parties that

(West 2011); WIS. STAT. ANN. § 180.0742 (West 2011); WYO. STAT. ANN. § 17-16-742 (West 2011).

12 These policies are discussed in depth *infra* Part III.

13 DALE ARTHUR OESTERLE, THE LAW OF MERGERS AND ACQUISITIONS 137 (3d ed. 2005) (stating that "[a]pproximately 60 percent of the largest industrial firms are incorporated in Delaware").

14 *See* CLASS ACTION WORLD, *supra* note 9.

harmed the corporate entity.[15] While shareholders must overcome many hurdles to bring a derivative suit,[16] those steps are meant to facilitate the parties' collaboration to avoid court appearances.[17] Experts already note the beneficial role collaboration plays in the corporate landscape in creating relationships with suppliers;[18] collaboration between shareholders and boards of directors[19] would yield similar benefits. The derivative lawsuit is therefore a valuable tool that should remain the top choice for any shareholder trying to amend an in-house problem.

1. General Theory and Procedure

Generally speaking, when a shareholder brings a derivative suit, he or she steps into the shoes of the corporation in order to sue a third party on the corporation's behalf.[20] Such suits are useful because an attentive shareholder may spot a problem through certain sources, such as newspapers,[21] that the company's agents were too preoccupied to notice. Of course, the suits are usually based on problems caused by those agents themselves,[22] and so this option exists for those shareholders who do not trust the officers hired to resolve the company's problems from within.

Once a shareholder steps into the shoes of the company, the party being sued is the group of individuals who run the company or a third

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15 Carol B. Swanson, *Juggling Shareholder Rights and Strike Suits in Derivative Litigation: The ALI Drops the Ball*, 77 MINN. L. REV. 1339, 1345 (1993). For explicit language about the derivative suit being within shareholders' rights, see, for example, N.Y. BUS. CORP. LAW § 626(a) (2011) ("An action may be brought in the *right* of a domestic or foreign corporation . . . by a holder of shares . . . ." (emphasis added)).

16 *See* FED. R. CIV. P. 23.1.

17 *See* Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984) (describing the demand requirement as a threshold mechanism designed to "prevent abuse and to promote intracorporate dispute resolution").

18 *See generally* INST. OF MGMT. & ADMIN., HOW TO DETERMINE THE SUPPLIER RELATIONSHIP MANAGEMENT MODEL (2003) (advocating the use of collaboration and other forms of ADR when drafting contracts with suppliers).

19 "Board(s) of directors" is hereinafter "board(s)."

20 *See* Grimes v. Donald, 673 A.2d 1207, 1215 (Del. 1996) ("If a claim belongs to the corporation, it is the corporation, acting through its board . . . which must make the decision whether or not to assert the claim.").

21 *See In re* Cendant Corp. Derivative Action Litig., 96 F. Supp. 2d 394, 401 (D.N.J. 2000) (plaintiffs found grounds for suit based on facts in a *New York Times* article).

22 *Compare Grimes*, 673 A.2d at 1210 (plaintiff sued the board based on an allegedly wasteful employment agreement), *with* Marx v. Akers, 666 N.E.2d 1034, 1040 (N.Y. 1996) (plaintiff sued board on alleged self-dealing through excessive awards).

party.[23] Considering that the officers' and directors' primary function is to make money for the shareholders,[24] the shareholder has the prerogative to sue those agents who breached their fiduciary duties.[25] In that sense, the derivative suit is analogous to parents punishing their children for shirking their chores: while the parents lose time and must expend effort, they do so with the hope that their punishment will incentivize better behavior by their children.

2. Standing Requirements for Derivative Suits

Because a shareholder sues to redress an injury to the company rather than an injury to the shareholder itself,[26] potential plaintiffs must satisfy a number of strict standing requirements to bring suit.[27] Each state may differ on its precise requirements. However, the majority of states[28] follow the standing requirements of Federal Rule of Civil Procedure (FRCP) 23.1.[29] A discussion of those requirements follows.

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[23] *Grimes*, 673 A.2d at 1210.

[24] Lee, *supra* note 2, at 535. Lee defines shareholder primacy as "the view that managers' fiduciary duties require them to maximize the shareholders' wealth and preclude them from giving independent consideration to the interests of other constituencies." *Id.*

[25] For a general discussion on fiduciary duty doctrine, see Paula J. Dalley, *To Whom It May Concern: Fiduciary Duties and Business Associations*, 26 DEL. J. CORP. L. 515, 519–29 (2001).

[26] *See* Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 95 (1991) ("Devised as a suit in equity, 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 . . . .").

[27] *See* Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984) ("[B]ecause the derivative action impinges on the managerial freedom of directors, the law imposes certain prerequisites to the exercise of this remedy.").

[28] Most states that have not adopted the MBCA, *see supra* note 11, have adopted some form of the *Federal Rules of Civil Procedure*. Judith Schemel Suelzle, Note, *Trust Beneficiary Standing in Shareholder Derivative Actions*, 39 STAN. L. REV. 267, 276 (1986).

[29] The current version of FED. R. CIV. P. 23.1 reads:

> (a) Prerequisites. This rule applies when one or more shareholders or members of a corporation or an unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association.
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> (b) Pleading Requirements. The complaint must be verified and must: (1) allege that the plaintiff was a shareholder or member at the time of the transaction complained of, or that the plaintiff's share or membership later devolved on it by operation of law; (2) allege that the action is not a collusive one to confer jurisdiction that the court would otherwise lack; and (3) state with particularity:

First, to bring suit under the FRCP, the plaintiff must have been a shareholder at the time of the wrong, or "the plaintiff's share or membership [in the corporation] later devolved on it by operation of law."[30] If an individual learns of the problem, buys shares of the corporation, and then attempts to sue on behalf of the corporation, standing would prevent that individual from proceeding with the suit.[31] Second, the law requires that the shareholder have a stake in the company so that as long as the suit continues, the plaintiff will share in the stock's financial gains or losses during the litigation.[32] This requirement deters plaintiffs who would prefer a high stock price

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> (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and (B) the reasons for not obtaining the action or not making the effort.
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> (c) Settlement, Dismissal, and Compromise. A derivative action may be settled, voluntarily dismissed, or compromised only with the court's approval. Notice of a proposed settlement, voluntary dismissal, or compromise must be given to shareholders or members in the manner that the court orders.

FED. R. CIV. P. 23.1 was revised in 2007, but the changes were stylistic only. *See supra* note 5. As such, pre-2007 case law interpreting Rule 23.1 remains applicable and useful.

In an attempt to clarify the language of the original version of Rule 23.1, as well as the state codifications of the rule, courts have given varying interpretations of specific provisions over the years. *See, e.g.*, Grimes v. Donald, 673 A.2d 1207 (Del. 1996). It remains to be seen whether newer suits will challenge the common-law doctrine that is based on the old language to align with the revision or whether the states will amend their codes altogether.

30 FED. R. CIV. P. 23.1(b)(1).

31 This problem has shown itself more in Japanese derivative suits where instead of having a "contemporaneous ownership requirement," Japanese shareholders need only have owned shares for six months to be eligible to bring suit. *See* Mark D. West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 NW. U. L. REV. 1436, 1448 (1994). In contrast to the Japanese system, because the majority of damages from American derivative suits go back into the company itself, this category of suits has never been a "get-rich-quick" option for American shareholder plaintiffs; in fact, they are often more expensive than a shareholder feels is necessary. *See id.* at 1472–73 (describing the various ways in which a derivative suit proves costly to plaintiffs around the world); *see also* Morgan N. Neuwirth, Comment, *Shareholder Franchise–No Compromise: Why the Delaware Courts Must Proscribe All Managerial Interference with Corporate Voting*, 145 U. PA. L. REV. 423, 476 (1996) ("The shareholder derivative suit is an expensive, post hoc tool, designed 'only for remedying violations of legal norms, not for policing underperformance, slack, or incompetence.'" (quoting ROBERT CHARLES CLARK, CORPORATE LAW § 9.5, at 397 (1986))).

32 *See* Ann M. Scarlett, *Confusion and Unpredictability in Shareholder Derivative Litigation: The Delaware Courts' Response to Recent Corporate Scandals*, 60 FLA. L. REV. 589, 627 (2008) (describing how "[i]ncreased shareholder derivative suits could cause investors to lose confidence in director-managed corporations" thereby hurting the price of the stock in the market).

to litigation that might risk depreciating the stock's value.[33] Third, the plaintiff must "fairly and adequately" represent the other shareholders.[34] In other words, the hardship that the plaintiff-shareholder experienced must not be one that only he or she experienced personally but rather one that all shareholders suffered collectively; plaintiffs who have a significant number of shares of a particular corporation will often be able to meet this requirement.[35]

Additionally, because derivative suits are state substantive law,[36] many states have their own financial standing requirements that accompany the legal standing requirements.[37] For example, some states require a plaintiff to pay a bond to the corporation in order to bring suit,[38] while others require only specific parties to be paid upon the completion of the suit.[39] These additional requirements not only make derivative suits expensive, but they motivate shareholders to pursue a different legal route altogether, hence the growing popularity of class action lawsuits.[40]

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33 *See* Reinier Kraakman et al., *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1743 (1994) (explaining that derivative suits are rare when they will result in decreased corporate value).

34 *See* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 549 (1949) (noting that whichever shareholder is brave enough to bring a derivative suit becomes a "volunteer champion" who is acting as a "representative of a class comprising all who are similarly situated"); HER, Inc. v. Parenteau, 770 N.E.2d 105, 109 (Ohio Ct. App. 2002) (providing a comprehensive list of elements used to determine whether a shareholder fairly and adequately represents similarly situated shareholders).

35 *See* Estate of Soler v. Rodríguez, 63 F.3d 45, 48 (1st Cir. 1995) (plaintiff's ownership of 50.43% of all outstanding voting stock was sufficient for standing in a derivative suit); Albers v. Edelson Tech. Partners L.P., 31 P.3d 821, 827 (Ariz. Ct. App. 2001) (questioning whether holders of convertible securities and other low-percentage shareholders have standing to bring derivative suits).

36 *See* Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 108–09 (1991) (holding that the demand requirement is substantive state law).

37 *See, e.g.*, N.J. STAT. ANN. § 14A:3-6(3) (West 2011) (requiring a shareholder-plaintiff holding less than five percent of the outstanding stock of the corporation "to give security for reasonable expenses"); N.Y. BUS. CORP. LAW § 627 (McKinney 2012) (allowing the defendant corporation to request a bond from the plaintiff shareholder before commencement of the suit); WASH. REV. CODE ANN. § 23B.07.400(4) (West 2011) (shifting expenses onto plaintiff if the court finds the suit was filed "without reasonable cause"). All of these requirements add to the costs of filing a derivative suit; those costs do not exist in class action filings. *See generally* FED. R. CIV. P. 23 (excluding any type of provision related to the expenses involved in filing a class action).

38 *See* N.J. STAT. ANN. § 14A:3-6(3); N.Y. BUS. CORP. LAW § 627.

39 *See* MBCA § 7.46(2) (requiring the plaintiff to pay all expenses where the court finds that there was no "reasonable cause" for the claim); WASH. REV. CODE ANN. § 23B.07.400.

40 Websites such as CLASS ACTION WORLD, *supra* note 9, provide a quick and efficient tool for begrudged shareholders.

B. The Demand Requirement

Once a shareholder satisfies the state's requisite standing requirements, it must next make a demand before being able to bring a derivative suit.[41] In broad terms, a demand is an official request by a shareholder to a board to remedy a problem with the company. Theoretically, if the shareholder sues on behalf of the corporation, it follows that the plaintiff must request permission from the board to bring suit.[42] Therefore, the plaintiff "demands" the board to either fix the current deficiency or to allow the shareholder to take legal action. The requirement is thus designed to promote intracorporate dispute resolution and to fix the corporation as a whole.[43]

The codification of the demand requirement differs by state. However, because the majority of public companies are incorporated in Delaware,[44] this Comment will examine Delaware case law pertaining to the demand requirement of derivative suits.

1. Demand Requirements for Delaware Corporations

A demand in Delaware consists of a shareholder contacting the company's board of directors and explaining the perceived problem.[45] One common problem, for instance, which has been the subject of much litigation, is that executives receive "excessive compensation."[46] The communication between the shareholder and the board that comprises the demand could be as simple as a letter,[47] and it must state the issue the shareholder wishes to remedy.[48] Once the demand is made, the board may choose either to address the

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41 *See* Scrushy v. Tucker, 70 So. 3d 289, 300 (Ala. 2011) (showing that plaintiffs need both satisfaction of standing requirements and pre-suit demand for the court to have subject-matter jurisdiction).

42 *See* Grimes v. Donald, 673 A.2d 1207, 1215 (Del. 1996) (stating that the decision to assert the claim must ultimately come from the corporation itself).

43 *See id.* at 1216 ("[T]he demand requirement invokes a species of alternative dispute resolution procedure which might avoid litigation altogether."); Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984) ("[T]he [demand] requirement . . . exists at the threshold . . . to promote intracorporate dispute resolution.").

44 *See* OESTERLE, *supra* note 13.

45 *See* DEL. CH. CT. R. 23.1; *see also* FED. R. CIV. P. 23.1 (1966) (providing the text upon which the Delaware statute is based).

46 *See, e.g.*, *Grimes*, 673 A.2d at 1207; Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

47 *See Grimes*, 673 A.2d at 1211 (plaintiff's demand letter was sufficient under the corporate code).

48 *See, e.g.*, *id.* at 1211–12 (plaintiff's letter to the board stated explicitly, "I hereby demand that the Board . . . take immediate steps to abrogate . . . the Employment Agreement" of the defendant.).

problem or do nothing.[49] Usually, if the board chooses to address the problem, it will assemble a special litigation committee.[50]

Most plaintiffs, however, do not trust the board to remedy their demands.[51] As a result, they attempt to bypass the requirement by asking a court to "excuse" demand because it would be futile.[52] To do so, plaintiffs' attorneys plead in their pretrial motions why there is reasonable doubt that the board will diligently handle shareholders' complaints because the board members are conflicted.[53] If the judge is convinced, the court excuses the demand requirement and allows the suit to proceed to trial.[54] Suits in which the demand requirement is excused usually settle for millions of dollars, with the majority going to the plaintiff's attorney.[55] At the same time, the shareholder

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[49] In Delaware, the choice to seek or terminate litigation is governed by the "business judgment rule," an almost impenetrable barrier for shareholders. *See* John C. Coffee, Jr., *New Myths and Old Realities: The American Law Institute Faces the Derivative Action*, 48 BUS. LAW. 1407, 1412 (1993); Andrew C.W. Lund, *Rethinking* Aronson*: Board Authority and Overdelegation*, 11 U. PA. J. BUS. L. 703, 704 (2009) ("[After demand is made, b]oards are then free, within the boundaries of their fiduciary duties, to determine whether to accept or refuse the demand."). The business judgment rule is a presumption that directors make corporate decisions with the best interests of the company in mind. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52–53 (Del. 2006) (requiring a showing that the defendant directors acted grossly negligent in order to defeat the "business judgment rule presumptions"). Only a showing of gross negligence on the part of directors can rebut the presumption for duty-of-care purposes. *See id.* at 52.

[50] Special litigation committees are discussed *infra* Part II.2.

[51] *See* Kurt A. Goehre, *Is the Demand Requirement Obsolete? How the United Kingdom Modernized Its Shareholder Derivative Procedure and What the United States Can Learn from It*, 28 WIS. INT'L L.J. 140, 146 (2010) ("Many shareholders opt not to make a demand on the board of directors because the board often decides that the litigation is not in the best interests of the corporation and, thus, a court is unlikely to alter the board's decision and disturb its business judgment.").

[52] Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984). The original futility test was a two-prong, alternative inquiry that could easily be defeated by a diligent shareholder: "[U]nder the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Id.*

[53] *See Grimes*, 673 A.2d at 1216 (stating that there must be a "'reasonable doubt' . . . that the board is capable of making an independent decision to assert the claim if demand were made").

[54] The Delaware Supreme Court stated,

> The basis for claiming excusal would normally be that: (1) a majority of the board has a material financial or familial interest; (2) a majority of the board is incapable of acting independently for some other reason such as domination or control; or (3) the underlying transaction is not the product of a valid exercise of business judgment . . . .

Id. (internal footnotes omitted).

[55] This is true because all damages received by plaintiffs revert back into the corporation while the main profits come from the attorneys' fees. *See* DEL. CH. CT. R.

and the company both come out as losers: the shareholder obtains only a moral victory over his or her company, and the company suffers a financial and reputational blow. Therefore, excusal of the demand requirement based on futility both eliminates ADR between the parties and leads to outcomes that benefit neither the shareholder nor the company significantly.[56]

If the power to excuse demand mortally wounds the procedure, the effect of making demand, and the board refusing it, ultimately kills it.[57] In Delaware, once a shareholder makes actual demand upon a corporation, he or she waives a claim of excusal.[58] Therefore, considering the difficulty in pleading "wrongful refusal"[59] with particularity,[60] the shareholder may have already lost his or her case

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23.1(b)(i)–(ii) (entitling the winning party to "fees, costs or other payments as the Court expressly approves"); *see also* N.Y. BUS. CORP. LAW § 626(e) (McKinney 2011) (stating that plaintiffs' attorneys may receive "reasonable attorneys' fees" for either a judgment or settlement while the plaintiff is "limited to a recovery of the loss or damage sustained by them").

Another burdensome addition to the cost of derivative litigation is requesting the company's books and records. Normally, before a plaintiff files a derivative claim, he or she will request the company's books and records in order to find data that can bolster the complaint. Even before the derivative suit filing, attorneys' fees range from $10,000 to $25,000 for "simple stocklist cases" and from $20,000 to $50,000 for "straightforward books and records cases." Randall S. Thomas, *Improving Shareholder Monitoring of Corporate Management by Expanding Statutory Access to Information*, 38 ARIZ. L. REV. 331, 357–58 (1996). Professor Thomas discusses how a books-and-records request works well as a precursor to a demand futility claim notwithstanding its cost. *Id.* at 358.

56 *See* Werbowsky v. Collomb, 766 A.2d 123, 144 (Md. 2001) ("The futility exception essentially eliminates any chance at meaningful pre-litigation alternative dispute resolution. It also virtually assures extensive and expensive judicial wrangling over a peripheral issue that may result in preliminary determinations regarding director culpability that, after trial on the merits, turn out to be unsupportable.").

57 *See Grimes*, 673 A.2d at 1219 (creating a stronger standard to prove wrongful refusal of demand if a corporation chooses to set aside the complaint).

58 *See* Spiegel v. Buntrock, 571 A.2d 767, 774–75 (Del. 1990) (actual demand waived the right of excusal even if the suit was filed prior to formal demand).

59 The *Grimes* court described "wrongful refusal" and where it fits into the derivative suit analysis as follows:

> If a demand is made and rejected, the board rejecting the demand is entitled to the presumption of the business judgment rule unless the stockholder can allege facts with particularity creating a reasonable doubt that the board is entitled to the benefit of the presumption. *If there is reason to doubt* that the board acted independently or with due care in responding to the demand, the stockholder may have the basis *ex post* to claim wrongful refusal.

673 A.2d at 1219 (emphasis added) (internal footnotes omitted).

60 *See* Note, *Discovery in Federal Demand-Refused Derivative Litigation*, 105 HARV. L. REV. 1025, 1028–29 (1992) (stating that most jurisdictions, including Delaware, prohibit shareholder plaintiffs from having the benefit of discovery before filing suit and, as a result, "[s]uch decisions create a virtually insurmountable obstacle for shareholders

merely by asking permission from the board.[61] As a result, many potentially substantive suits will be lost in the process as the shareholder is caught in an inevitable "Catch-22": the shareholder must either plead reasonable doubt or concede that the board was disinterested.[62] Thus, shareholders looking for help from Delaware courts for claims based on breach of fiduciary duty may be much more likely to turn to class action lawsuits than travel the labyrinthine paths of derivative suits.

Clearly, Delaware has all but eliminated the derivative suit by making demand as unattractive as possible. As the state with the most incorporations in the nation,[63] Delaware must lead the way for other states toward demand requirement reform.

2. Special Litigation Committees

Once a shareholder makes a demand, the corporation has the power to organize a special litigation committee.[64] This committee is composed of independent directors[65] and is specifically authorized by statute in some state corporate codes.[66] While special litigation committees may be formed to terminate all types of litigation against the company,[67] the committee's duties in derivative suits are twofold:

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who have no knowledge of the internal corporate decisionmaking process and will effectively bar many derivative suits regardless of their merit" (internal footnotes omitted)).

61 Applying the "reasonable doubt" standard to claims of wrongful refusal of demand is a much steeper burden on the shareholder than if he pleaded futility *ex ante*. *See Grimes*, 673 A.2d at 1219 (business judgment rule applies when reviewing *ex post*).

62 *See* Coffee, *supra* note 49, at 1413 (requiring the shareholder to plead reasonable doubt under the *Aronson* standard or concede that the board was disinterested).

63 For a discussion on Delaware's stranglehold on public company incorporations and the state's influence on corporate law doctrine across the country, see Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749 (2006).

64 13 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 6019.50 (perm. ed., rev. vol. 2011).

65 *Id.* To be considered an independent director, the individual must not have any conflict of interest—that is, he or she must be disinterested in the current litigation. *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 786 (Del. 1981) (holding that an inquiry into whether the committee is independent is a prerequisite to judging the decisions made by special ligation committees); Einhorn v. Culea, 612 N.W.2d 78, 91 (Wis. 2000) (adopting the Delaware standard of review for special litigation committees).

66 *See, e.g.*, GA. CODE ANN. § 14-2-744(b) (West 2011); IND. CODE ANN. § 23-1-32-4 (West 2011); N.H. REV. STAT. ANN. § 293-A:7.44(b) (2011); WIS. STAT. §180.0744(2) (2011). This standard has also been read into such statutes as DEL. CODE ANN. tit. 8, § 141 (2011). *See Zapata*, 430 A.2d at 782.

67 *See* FLETCHER ET AL., *supra* note 64.

(1) to investigate the allegations made by the shareholder[68] and (2) to decide whether litigation is necessary or dismissible.[69] While such committees serve the valuable purpose of dismissing meritless and otherwise frivolous strike suits,[70] they also have the effect of dismissing legitimate derivative lawsuits as well.[71]

For corporations, obvious drawbacks exist to creating and paying for a committee dedicated solely to terminating litigation by its own shareholders.[72] However, these committees have survived scrutiny from courts and even constitutional attacks.[73] As long as they exist, though, shareholders will continually face a roadblock to their claims, and grievances will continue without redress. The use of special litigation committees epitomizes the current sad state of derivative suit litigation. When examining the policies behind the rule, one can question whether the statutory framers ever foresaw such a result.

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[68] *See* Kesling v. Kesling, 546 F. Supp. 2d 627, 634 (N.D. Ind. 2008) ("The board may . . . establish a committee to investigate the allegations and determine whether the corporation should pursue litigation."); Bender v. Schwartz, 917 A.2d 142, 152 (Md. Ct. Spec. App. 2007) ("Once a demand is made, the corporation's board . . . must conduct an investigation into the allegations in the demand and determine whether pursuing the demanded litigation is in the best interests of the corporation. . . . The board may appoint a committee of disinterested directors to conduct this investigation." (citation omitted)).

[69] *See Kesling*, 546 F. Supp. 2d at 634–35 ("If the committee determines that pursuing a derivative action is not in the corporation's best interests, that determination is presumed to be conclusive.").

[70] *See* Black v. NuAire, Inc., 426 N.W.2d 203, 208 (Minn. Ct. App. 1988) ("The purpose of [the special litigation committee enabling statute] is to grant corporations the ability to respond effectively to the potential abuses of strike suits, in which a single dissenting shareholder, owning only one share of stock, may file a derivative suit for its nuisance value alone."); *see also* FLETCHER ET AL., *supra* note 64.

[71] For a discussion on the many ways meritorious claims fall on deaf ears, one of which is the demand procedure of derivative suits, see Douglas C. Buffone, Note, *Predatory Attorneys and Professional Plaintiffs: Reforms Are Needed to Limit Vexatious Securities Litigation*, 23 HOFSTRA L. REV. 655 (1995).

[72] Some intuitive problems include: the waste of corporate assets to gather and pay independent individuals to terminate litigation instead of working with the shareholders directly; the board handing off suits against its company instead of personally looking into the matter; and assigning an independent group, with possibly no ties to the company, to handle in-house complaints. *See* FLETCHER ET AL., *supra* note 64.

[73] *See* Starrels v. First Nat'l Bank of Chicago, 870 F.2d 1168, 1173 (7th Cir. 1989) (opining that despite the alternative dispute resolution justification for the demand requirement, the requirement leads to more litigation in the aggregate); FLETCHER ET AL., *supra* note 64 (citing Black v. NuAire, Inc., 426 N.W.2d 203 (Minn. Ct. App. 1988)).

II
THE ADR POLICIES BEHIND DEMAND

A. Theory and Purpose

Initially, the demand requirement looks like a mechanism of litigation procedure. However, when analyzing the requirement's intent, one sees that it creates a form of alternative dispute resolution within the company that effectively averts litigation. Three observations support this proposition.

First, in its simplest form, the demand requirement is a way to put a board on notice of both the problems it may overlook and shareholder disapproval of those problems.[74] If used properly, the demand requirement could be an effective mechanism for facilitating improvement of the day-to-day operations of a public company.[75] It is virtually impossible for boards of large companies to be aware of every single problem,[76] so when the demand requirement is utilized properly, shareholders may have the opportunity to increase internal awareness and ultimately raise profits for all. Second, as federal and state courts assert, the demand requirement purports to "exhaust intracorporate remedies" so that all damaging issues remain in-house.[77] Every company handles problems differently, but boards are often best equipped to fashion solutions themselves without legal interference.[78] If demand becomes the primary means of cooperation between stockholders and officers, there needs to be a mechanism that facilitates communication between all parties during the course of the

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74 Indeed, actual notice is particularly important when attempting to avoid timely suits. A private entity would be wise to enable an official ombuds to be in charge of complaints and to have the power to mediate disputes between the complainant shareholders and the board. *See* Special Feature, *Ombuds Standards*, 54 ADMIN. L. REV. 535 (2002) (describing the role that ombuds play in workplace disputes and the fact that the board needs to give the "ombuds" title to an individual before any communication to that individual is deemed actual notice).

75 For a discussion about the positive effects of an active shareholder–board relationship that creates a "mediating hierarchy," see Lee, *supra* note 2, at 439–41.

76 *But see* Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369–70 (Del. 2006) (holding that companies may face liability for failing to monitor their everyday operations).

77 Grimes v. Donald, 673 A.2d 1207, 1216 (Del. 1996); Aronson v. Lewis, 473 A.2d 805, 811–12 (Del. 1984); *see also* Cramer v. Gen. Tel. & Elecs. Corp., 582 F.2d 259, 275 (3d Cir. 1978).

78 *See, e.g.*, Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 SAN DIEGO L. REV. 781, 783–84 (2003) (opining that both insider-dominated and outsider-dominated boards are equated to more successful corporations in terms of return on assets).

procedure—for example, a special demand "inbox" for corporate counsel.[79] While the "excusal" doctrine hampers the method of communication created by demand, a reinforcement of demand's (intended) principle of intracorporate communication could positively reset the system.

Finally, demand keeps shareholders and boards out of the courtroom, saving litigation costs for both the individual shareholder and the company itself.[80] By contrast, plaintiffs who avoid the demand requirement and sue corporations directly through class actions force both parties to spend unnecessary time and money to resolve the issue.[81] Considering how little plaintiffs often ultimately recover, it would not be surprising if many were content with an ADR procedure that could both save money and fix the underlying problems.[82]

Though it is a method of civil procedure, the demand requirement is unquestionably an ADR mechanism that can bring shareholders and companies together to alleviate divisive problems within corporations. With this knowledge, state legislatures should amend their corporate codes to make the demand requirement a more accessible option.

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[79] *See* Elisa Westfield, Note, *Resolving Conflict in the 21st Century Global Workplace: The Role for Alternative Dispute Resolution*, 54 RUTGERS L. REV. 1221, 1225–28 (2002) (illustrating how ADR procedures increase communication and collaboration between directors and shareholders).

[80] Large corporations are now seeking the services of outside organizations as a means to increase the use of ADR between boards and shareholders in order to decrease litigation costs and effectively solve the problems of those aggrieved by the status quo. *See CPR and GE: Working Together to Grow ADR*, METRO. CORP. COUNS., July 2008, at 22.

[81] According to statistics provided by the Administrative Office of the U.S. Courts, the number of filed cases pertaining to "securities, commodities and exchanges" has risen by an average of 140 filings per year since the beginning of the recession in early 2008. U.S. Courts, *Cases Commenced, by Nature of Suit, 2005 Through 2009*, JUDICIAL BUSINESS 2009, at 146, *available at* http://www.uscourts.gov/Statistics/JudicialBusiness/JudicialBusiness.aspx?doc=/uscourts/Statistics/JudicialBusiness/2009/appendices/C02ASep09.pdf.

[82] For years, legal scholars have advocated, to no avail, the use of mediation at the early stages in corporate disputes. *See* Nancy H. Rogers & Craig A. McEwen, *Employing the Law to Increase the Use of Mediation and to Encourage Direct and Early Negotiations*, 13 OHIO ST. J. ON DISP. RESOL. 831, 839–47 (1998). More support from a seemingly litigious procedure such as demand could be a worthwhile adjustment that could lead to this positive change in corporate decision making.

B. Judicial and Academic Criticism of the Demand Requirement

While some courts acknowledge demand's positive characteristics,[83] others question whether the requirement's good intentions lead to actual change.[84] Indeed, some courts come close to mocking demand's dispute resolution policies.[85] Is this because courts are cynical about demand's effectiveness in the corporate setting, where share price and profits are the most important goal?[86] Or do the critics generally distrust boards to follow ADR processes properly? The answer is likely a combination of both; the way in which corporations and "dispute resolution" clash in the scholarship may explain why.

In a scathing critique of director indemnification,[87] Mae Kuykendall, a professor at Michigan State University School of Law, argues that the root of the problem lies in the presumed corporate landscape of "self-protecting boards, greedy lawyers, [and] passive

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[83] *See* Grimes v. Donald, 673 A.2d 1207, 1216 (Del. 1996) (noting how "[t]he demand requirement serves a salutary purpose"); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("[B]y promoting . . . alternative dispute resolution, rather than immediate recourse to litigation, the demand requirement is a recognition of the fundamental precept that directors manage the business and affairs of corporations.").

[84] For example, Judge Easterbrook, in *Starrels v. First National Bank of Chicago*, was quite explicit in his skepticism over demand's ADR policies:

> Why must shareholders demand that corporations act before filing suit? The rule could reflect a hope that the dispute will go away without litigation, that the board . . . will "do something" (or persuade the putative plaintiff that suit is pointless). Demand then initiates a form of [ADR], much like mediation. Steps to control the volume of litigation are welcome, and courts give this as a justification for the demand rule. It is not, however, a powerful one, because on balance the rule creates more litigation than it prevents.

870 F.2d 1168, 1173 (7th Cir. 1989).

[85] Note Vice Chancellor Steele's sarcastic tone as he describes the demand requirement and why it does not function well in the current suit:

> In the corporate context, the demand rule is intended to act as a gatekeeper to both encourage extra judicial intra-corporate solutions to internal problems and to bar meritless claims of self-interested decision making. How well this rule functions to encourage resort to the board is a question beyond our responsibility to answer. In all events in the limited partnership context, the doctrine fails to promote judicial efficiency at least when there is a single general partner.

Seaford Funding Ltd. P'ship v. M & M Assocs. II, 672 A.2d 66, 71 (Del. Ch. 1995).

[86] For a discussion on the shareholder primacy principle—the theory that a corporation's priority should be focused on shareholders' wealth—see generally Lee, *supra* note 2.

[87] "Director indemnification" refers to the practice of corporations paying the bill for all judgments against their own directors. *See* Mae Kuykendall, *A Neglected Policy Option: Indemnification of Directors for Amounts Paid to Settle Derivative Suits–Looking Past "Circularity" to Context and Reform*, 32 SAN DIEGO L. REV. 1063, 1064 (1995).

shareholders."[88] In essence, parties for whom profits are the biggest priority are adverse to compromise; therefore, the judicial process is the only viable solution.[89]

The problem with this corporate profile, however, is that it chills positive avenues of reform. The consistent mistrust of the dispute-resolving abilities of boards and shareholders will always bring the parties back into the courtroom, costing both sides money that they would be better off spending improving the company as a whole.[90] As a response, Ms. Kuykendall advocates "fine-tuning the mechanism of derivative litigation rather than making wholesale decisions about its vitality."[91]

If derivative suits that proceed to court are the problem, and mere "fine-tuning" of the procedure is all that is needed to alleviate it,[92] then the solution lies in the procedure that is most ripe and ready for adjustment: the demand requirement. Jurisdictions such as Delaware and New York consistently allow demand to be avoided through futility and excusal case law. Therefore, state legislatures in those jurisdictions should amend their corporate codes and court rules so that demand becomes a mandatory procedure obligating the parties to work through their disputes before courts become involved. The MBCA provides a favorable model for state legislatures as to how to accomplish this feat.

III

INTEGRATING THE MBCA RULES WILL INCREASE IN-HOUSE DISPUTE RESOLUTION

A possible method to fix the current inadequacies of derivative suits in state corporate codes is for states to adopt the procedure set out in the Model Business Corporation Act.[93] At least eighteen states have adopted the MBCA method in full;[94] this number accounts for an increase of five states since *Marx v. Akers*,[95] and fourteen states since the Supreme Court held that demand was a matter of substantive

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88 *See id.* at 1065 (footnote omitted).

89 *See id.* at 1083–87.

90 *See id.* at 1072–75.

91 *Id.* at 1087.

92 *See id.*

93 MBCA § 7.42.

94 *See* Werbowsky v. Collomb, 766 A.2d 123, 141–42 (Md. 2001).

95 *See id.*; Marx v. Akers, 666 N.E.2d 1034 (N.Y. 1996). The *Marx* court set the precedent for how to decide futility for New York corporations.

state law in *Kamen v. Kemper Financial Services, Inc.*[96] With more support from the ADR community, that number can continue to grow nationally. The MBCA utilizes the dispute resolution mechanisms of a corporation by (1) reducing the number of futility claims, (2) increasing the amount of communication between shareholders and their agents, and (3) giving shareholders the right to bring suit if all else fails.

A. Reducing the Amount of Demand Futility Claims

As mentioned, a shareholder's pleading that demand is futile essentially removes the possibility that the shareholder and the corporation will resolve the dispute outside of the courtroom.[97] The MBCA procedure prevents that outcome by making demand mandatory for all shareholders and putting a time limit on how long a board has to decide how to respond.[98] Other courts have mentioned the positive potential of mandatory demand,[99] and hopefully the future results in those states that have adopted it will prove its efficacy.

1. Making Demand Mandatory

While Delaware and New York case law allows shareholders to avoid demand altogether through excusal claims, the MBCA has a universal demand requirement.[100] This means that demand must be made in every case with no special exceptions.[101] Under the MBCA, by making demand mandatory, shareholders' attorneys are forced to contact the board rather than run to court with pleadings of futility

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[96] *See* Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 103 (1991); *Werbowsky*, 766 A.2d at 141–42. One can assume that as soon as this opinion came down, states were quick to amend their corporate codes in a way that was attractive to both corporations and shareholders alike.

[97] *See supra* note 59. Because of difficulty in proving futility, a plaintiff who embarks on this path will have spent far too many resources and will therefore be less willing to negotiate with a company. *See generally* Kenneth B. Davis, Jr., *The Forgotten Derivative Suit*, 61 VAND. L. REV. 387 (2008) (describing the requirements for excusing demand as futile as the most rigorous).

[98] *See* MBCA § 7.42.

[99] *See Werbowsky*, 766 A.2d at 144; *Marx*, 666 N.E.2d at 1038.

[100] *See* MBCA § 7.42.

[101] *Id.* The statute's text dictates that demand is needed before "any" derivative suit is commenced; there are no exceptions. *Id.*

and excusal,[102] and their clients benefit as a result.[103] Moreover, because of the low costs associated with demand,[104] the requirement makes dispute resolution less expensive.[105]

An additional benefit of mandatory demand is that it removes the collective action problem that exists with most potential suits.[106] Often, because lawsuits are very expensive and time-consuming, even those shareholders aware of the problem are hesitant to bring suit themselves and would rather wait for a representative to take the reins.[107] However, a universal demand requirement puts everyone on equal footing: demand must always be the first step, and those who bring claims of excusal do not have the first shot at monopolizing the company's attention.[108] The demand requirement thus removes greedy, individual incentives for suing a corporation, allowing shareholders to work with boards to fix problems through a collaborative method rather than the adversarial method that dominates the American legal psyche.[109]

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[102] As is the general problem that now exists in federal courts, Delaware, and New York. *See* FED. R. CIV. P. 23.1; DEL. CH. CT. R. 23.1; N.Y. BUS. CORP. LAW § 626 (McKinney 2011).

[103] Mandatory rules have been advocated in directing the professional conduct of corporate attorneys in takeovers and might have the same positive effect on evolving methods of corporate governance. *See* Miriam P. Hechler, *The Role of the Corporate Attorney Within the Takeover Context: Loyalties to Whom?*, 21 DEL. J. CORP. L. 943, 980 (1996) ("The mandatory rule enforces both the attorney's and the board's monitoring function and simultaneously protects shareholders.").

[104] An e-mail, letter, or even a phone call to make demand does not cost nearly as much as making a formal demand for the shareholder books and records of a corporation. *See* Thomas, *supra* note 55, at 357–58.

[105] For a discussion on universal demand, see Shiro Kawashima & Susumu Sakurai, *Shareholder Derivative Litigation in Japan: Law, Practice, and Suggested Reforms*, 33 STAN. J. INT'L L. 9, 46–47 (1997).

[106] *See* Seung Wha Chang, *The Role of Law in Economic Development and Adjustment Process: The Case of Korea*, 34 INT'L LAW. 267, 282 (2000) ("To solve a collective action problem . . . it is often necessary for lawyers to take an initiative in bringing a derivative suit.").

[107] *See, e.g.*, J.W. Verret, *Dr. Jones and the Raiders of Lost Capital: Hedge Fund Regulation, Part II, a Self-Regulation Proposal*, 32 DEL. J. CORP. L. 799, 834 (2007) ("[M]any firms face a collective action problem. The profits from acting are exceeded by the individual cost of activism."); *see also* Davis, *supra* note 97, at 433 (For many derivative suits, "the prospect for meaningful monetary recovery is remote and, even when obtained, almost always will be covered by indemnification or insurance paid for by the corporation.").

[108] *See* FLETCHER ET AL., *supra* note 64 (describing how a special litigation committee is assembled for every lawsuit that is brought against the company whether demand was issued or not).

[109] *See* John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215 (1983). The author

2. The Ninety-Day Time Limit for Response Before Subsequent Legal Action

Under Delaware and New York law, a shareholder is generally unaware of when the board will respond to his or her demand.[110] By contrast, the MBCA model imposes a ninety-day time limit for the company to respond.[111] The ninety-day time limit is actually generous to corporations because it allows a relatively extensive amount of time to plan the next step; the Japanese derivative suit, by contrast, allows only thirty days for the company to respond to the demand.[112] The intent of the time limit is that after a company receives notice of a pending suit,[113] it will do all that it can to work with the shareholders to alleviate the problem rather than contact the company's legal team.

The MBCA's time limit provides the board discretion only to resolve the dispute by answering the demand or to inform the plaintiff that the company feels it unnecessary to proceed with litigation. By removing a company's unlimited discretion on when to respond to a demand, the time limit forces the parties to collaborate promptly.[114] It is within the ninety-day time period that the parties can negotiate or mediate the problem so that a lawsuit never comes to pass.[115] The time limit thus confers three benefits: (1) it guarantees a response for the shareholder within a reasonable amount of time, (2) it gives an appropriate window for the company to make a decision to handle the

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depicts the American civil suit landscape as a hunting ground for opportunistic and aggressive plaintiff's lawyers. *Id.* at 276. Despite the article being a quarter century old, the general theme and message remain pertinent.

110 *See* Thomas, *supra* note 55, at 354–55. In his study, Professor Thomas finds that prior to filing a derivative claim, the amount of time the corporation takes to answer a books-and-records demand that helps the plaintiff write the complaint is as follows: "The median (mean) delay for shareholders obtaining the stocklist is forty-three days (112 days), while the median (mean) delay for shareholders not obtaining the stocklist is seventy days (187 days)." *Id.* at 355.

111 MBCA § 7.42.

112 *See* Kawashima & Sakurai, *supra* note 105, at 48.

113 *See* Andrea M. Matwyshyn, *Imagining the Intangible*, 34 DEL. J. CORP. L. 965, 1012 (2009) ("As a practical matter, the board should view this demand as a warning; shareholders are seeking an explanation of the rationale behind a particular corporate decision or omission which is alleged to have harmed the corporation.").

114 Contacting the aggrieved shareholder and discussing the problem would be much more cost effective than assembling a special litigation committee and preparing for a lawsuit.

115 It is at this point in the process where an ombuds or other forms of corporate mediation would certainly make a positive financial difference. *See, e.g.*, *Ombuds Standards*, *supra* note 74; Rogers & McEwen, *supra* note 82.

problem or to deny suit, and (3) it gives a fair amount of time for the company to prepare a defense if the suit goes forward.[116]

B. The MBCA Method Increases Communication Between the Board and Shareholders

A single demand letter from a shareholder is easy to forget, but hundreds of such letters will compel a board to have a healthy and much-needed conversation with its principals. A universal demand requirement provides the same incentive: it encourages open communication between shareholders and the board that puts the latter on notice of particular deficiencies.[117]

A shareholder meeting is one of the few opportunities where the board can interact with its shareholders, but these events suffer from lack of attendance.[118] One way to mitigate the effect of this problem is to promote the demand requirement as a communication tool rather than just a preamble to a lawsuit.[119] This way, every demand letter could be analogous to a question at a board meeting and yet get more attention than it normally would in the group setting. Demand pinpoints the problem and gives the parties the opportunity to collectively amend it. Like any negotiation tool, the demand requirement obligates both sides to replace their independent goals with the company's overall interests.[120] The demand requirement can even go so far as to improve personal relationships between the board and shareholders. It provides an opportunity for the board to respond to demand thoughtfully, which "demonstrates care in management

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116 As countries around the world continue to adopt the derivative suit and its prerequisites, scholars have advocated that the universal demand requirement would serve shareholders better if only because of the amount of time it saves all of the parties involved. *See* Jiong Deng, Note, *Building an Investor-Friendly Shareholder Derivative Lawsuit System in China*, 46 HARV. INT'L L.J. 347, 379 (2005) ("[D]emand is futile when the alleged offenders control the management of the corporation. In order to avoid wasting two months and to provide a timely remedy for shareholders, the SPC may wish to follow this approach and exempt futile demands." (internal footnote omitted)).

117 *See* Matwyshyn, *supra* note 113, at 1012.

118 *See* Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 870–71 (2010) (stating the general opinion that shareholder meetings suffer from poor attendance by those who are critical to the vote).

119 Of course, the present wording of the rule in the MBCA must be amended for such a progressive idea to take shape.

120 For a discussion on how all successful negotiators should focus on replacing the goals of the parties involved with interests, see Jill Schachner Chanen, *Collaborative Counselors: Newest ADR Option Wins Converts, While Suffering Some Growing Pains*, 92 A.B.A. J. 52 (2006).

and can, perhaps, prevent shareholders from selling shares out of anger."[121]

C. The MBCA Method Allows Shareholders to Bring Suit if All Else Fails

In any negotiation or mediation, talks sometimes break down, and litigation follows. While lawsuits should be avoided where possible, the MBCA model allows aggrieved shareholders the opportunity to go to trial if necessary.[122] This characteristic makes the MBCA model more attractive than the Delaware and New York models; the right to bring suit is never waived under the MBCA, so shareholders always have that option during negotiations.[123] Also, if the company is in fact breaking the law, the shareholder can always ask a judge or jury to make the determination of whether changes are needed in the structure of the company. Based on the facts and circumstances of individual cases, lawsuits are sometimes the only viable means of fixing the problem;[124] only the MBCA model allows shareholders the opportunity for both collaboration and litigation.

CONCLUSION

The demand requirement is an important ADR mechanism that deserves new life in the corporate law landscape. Because of its unpopular procedure, many plaintiffs have turned to large class action lawsuits that waste time and money while allowing the majority of problems within the company to go unchanged. In order to revitalize the derivative suit, state legislatures should follow the MBCA model and amend the demand requirement so that its beneficial dispute-resolving features are utilized. Furthermore, if state legislatures strive to include an ADR procedure like demand into the early stages of the process, intracorporate remedies would be the only line of defense against corporate suits, and the number of state-court filings would decrease immensely. By adopting the MBCA standard and adding a mediation component within the demand process, shareholders and boards will have the opportunity to work collaboratively when

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121 *See* Matwyshyn, *supra* note 113, at 1011.

122 MBCA § 7.42.

123 The Japanese system also allows a similar option for shareholders. *See* Kawashima & Sakurai, *supra* note 105, at 36–37.

124 Of course, the goal is to never allow a shareholder claim to get this far.

resolving company disputes, thus successfully bringing ADR back to where it is most needed: corporate law.