

January 20, 1999

COURT FOLLOWS THE RULES IN SECURITIES DERIVATIVE SUITS

(California Public Employees' Retirement System v. Felzen)

Today the U.S. Supreme Court affirmed a lower court ruling that required shareholders to formally enter a case as parties if they wish to fight a proposed settlement on appeal. Because the Court was evenly divided—Justice O'Connor recused herself from the case—it issued only a brief opinion noting that the lower court judgment was affirmed.

This decision is a victory for the Washington Legal Foundation (WLF), who had urged the Court to follow the current federal law as enacted by Congress and not rewrite it to invent a right to appeal for shareholders who are disgruntled with a proposed settlement.

“Derivative actions serve the public interest, so long as they don't go too far,” said WLF Senior Counsel for Litigation Affairs Shawn Gunnarson. “Current federal law doesn't give shareholders the right to fight a proposed settlement on appeal unless they formally enter the case as parties. And we're pleased that the Court chose to follow the rules rather than rewrite them,” Gunnarson said.

The case before the Court involves California Public Employees' Retirement System (CalPERS) and the Florida State Board of Administration (SBA), two large pension funds. Both hold a substantial amount of stock in the Archer Daniels Midland Company (Archer Daniels). Archer Daniels became the target of a shareholder derivative action after it paid out \$190 million in criminal penalties and civil settlements that arose from charges that it fixed prices on certain commodities. CalPERS and SBA objected to a proposed settlement, but the federal district court decided to accept it anyway. CalPERS and SBA then tried to renew those objections (without formally entering the case as parties) in the United States Court of Appeals for the Seventh Circuit. The Seventh Circuit dismissed their appeal, however, holding that shareholders must become parties to appeal a district court's decision to accept a proposed settlement in a derivative suit.

In its brief opposing CalPERS, WLF argued that letting shareholders appeal without becoming parties would hurt the free enterprise system by increasing litigation costs. It noted that derivative lawsuits help corporations (and free enterprise) by ending the financial loss caused by unfaithful directors and officers. But such lawsuits can threaten free enterprise and the judicial system if allowed to go too far. The judicial system would become overburdened if every shareholder could delay settlement while an appeal dragged on indefinitely. And lawsuits meant to protect free enterprise would then ironically weaken it by raising litigation costs unnecessarily.

WLF is a public interest law and policy center with supporters nationwide. It devotes a substantial portion of its resources to promoting tort reform and reining in excessive litigation.

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