

Private Enforcement of Corporate Law: An Empirical Comparison of the UK and US

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Abstract

It is often assumed that strong securities markets require good legal protection of minority shareholders. This implies both “good” law -- principally corporate and securities law -- and enforcement, yet there has been little empirical analysis of enforcement. We study private enforcement of corporate law in two common law jurisdictions with highly developed stock markets, the United Kingdom and the United States, examining how often directors of publicly traded companies are sued, and the nature and outcomes of those suits. We find, based on a comprehensive search for filings over 2004-2006, that lawsuits against directors of public companies alleging breach of duty are nearly nonexistent in the UK. The US is more litigious, but we still find, based on a nationwide search of decisions between 2000-2007, that only a small percentage of public companies face a lawsuit against directors alleging a breach of duty that is sufficiently contentious to result in a reported judicial opinion, and a substantial fraction of these cases are dismissed. We examine possible substitutes in the UK for formal private enforcement of corporate law and find some evidence of substitutes, especially for takeover litigation. Nonetheless, our results suggest that formal private enforcement of corporate law is less central to strong securities markets than might be anticipated.

Keywords: Private enforcement, corporate law, derivative actions, public enforcement, comparative corporate law

JEL Classifications: G38, K22, K41

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Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States

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It is often assumed that strong securities markets require good legal protection of minority shareholders. This implies both “good” law—principally, corporate and securities law—and enforcement, yet there has been little empirical analysis of enforcement. We study private enforcement of corporate law in two common-law jurisdictions with highly developed stock markets, the United Kingdom and the United States, examining how often directors of publicly traded companies are sued, and the nature and outcomes of those suits. We find, based a comprehensive search for filings over 2004–2006, that lawsuits against directors of public companies alleging breach of duty are nearly nonexistent in the United Kingdom. The United States is more litigious, but we still find, based on a nationwide search of court decisions between 2000–2007, that only a small percentage of public companies face a lawsuit against directors alleging a breach of duty that is sufficiently contentious to result in a reported judicial opinion, and a substantial fraction of these cases are dismissed. We examine possible substitutes in the United Kingdom for formal private enforcement of corporate law and find some evidence of substitutes, especially for takeover litigation. Nonetheless, our results suggest that formal private enforcement of corporate law is less central to strong securities markets than might be anticipated.

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I. INTRODUCTION

Nearly a century ago, Roscoe Pound memorably drew attention to the divide between “law in books” and “law in action.”¹ The distinction between substantive legal doctrine (“law in books”) and enforcement (“law in action”) is emerging as an important element in an ongoing debate about the extent to which law explains differences in financial markets around the world. Beginning in the late 1990s, a group of financial economists known collectively as “LLSV” reported in a series of widely cited studies that corporate and securities laws that protect minority shareholders are associated with deep and liquid securities markets and diffuse share ownership.² This research focused almost entirely on “law in books.” Enforcement—whether by public agencies or private individuals, whether civil or criminal, or whether through formal lawsuits or more informal channels—was left to one side.³

The “law in action” gap is particularly striking because of lively cross-country debate on the value of private lawsuits against company directors. Many in Europe, keen to expand domestic capital markets and improve corporate governance, view stronger private enforcement as desirable, and are seeking to change the procedural rules that inhibit private suits.⁴ Some in the United States see active enforcement as a core strength of U.S. markets that helps explain the tendency for firms cross-listed in the United States to trade at higher prices than similar non-cross-listed firms.⁵ Yet others in the United States lament allegedly excessive litigation against companies and directors, or worry that lawsuit-friendly rules

¹Roscoe Pound, *Law in Books and Law in Action*, 44 *Am. L. Rev.* 12 (1910).

²“LLSV” is shorthand for Rafael La Porta, Florencio López-de-Silanes, Andrei Shleifer, and Robert Vishny. See, for example, Rafael La Porta, Florencio López-de-Silanes, Andrei Shleifer & Robert Vishny, *Corporate Ownership Around the World*, 54 *J. Fin.* 471 (1999); Rafael La Porta, Florencio López-de-Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 *J. Pol. Econ.* 1113 (1998); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *What Works in Securities Laws?* 61 *J. Fin.* 1 (2006).

³In addition, recoding of corporate laws by lawyers has cast doubt on some of the LLSV results. Holger Spamann, *The “Antidirector Rights Index” Revisited*, *Rev. Fin. Studies* (forthcoming 2009), available at (<http://ssrn.com/abstract=894301>) (finding only a 0.41 correlation between original LLSV index and his own recoding). This criticism does not extend to these scholars’ later effort to code securities laws.

⁴See, e.g., Jonathan R. Hay & Andrei Shleifer, *Private Enforcement of Public Laws: A Theory of Legal Reform*, 88 *Am. Econ. Rev.* 398 (1998) (advocating use of private enforcement in transition economies); Guido Ferrarini & Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: The Parmalat Case*, in *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* 159, 194–206 (John Armour & Joseph A. McCahery, eds., 2006) (advocating increased private enforcement in Italy). But cf. Paul Davies, *Davies Review of Issuer Liability: Final Report* (2007), available at (http://www.hm-treasury.gov.uk/independent_reviews/davies_review/davies_review_index.cfm) (opposing significant expansion in private liability of U.K. issuers for securities mis-disclosure).

⁵See, e.g., John C. Coffee, *Law and the Market: The Impact of Enforcement*, 156 *U. Pa. L. Rev.* 229–311 (2007); Craig Doidge, G. Andrew Karolyi & Rene M. Stulz, *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices Over Time*, *J. Fin. Econ.* (forthcoming 2009), available at (<http://ssrn.com/abstract=982193>) (foreign firms that cross-list in the United States enjoy a significant cross-listing premium, even after the Sarbanes-Oxley Act; London listing provides no premium).

harm the competitiveness of U.S. markets and U.S. firms.⁶ In contrast, the United Kingdom is conventionally thought to be less litigious, but not *un*-litigious.⁷

The need to study private enforcement is obvious, but only a handful of previous studies have done so, probably because of the considerable difficulties involved in data collection. This article presents new evidence, based on hand-collected data sets from the United Kingdom and the United States, on the number and outcome of lawsuits brought against directors of publicly traded companies under corporate law.⁸ Our study is, we believe, the first comparative quantitative analysis of the private enforcement of corporate law.

The United Kingdom and the United States stand out as good choices for such a study. Both are common-law jurisdictions with strong judiciaries, low levels of government corruption,⁹ and highly developed stock markets.¹⁰ In both, most large business enterprises are publicly traded and many lack a blockholder large enough to exercise continuous, detailed oversight of management.¹¹ Hence, in the United States and the United Kingdom,

⁶Michael R. Bloomberg & Charles E. Schumer, *Sustaining New York's and the US' Global Financial Services Leadership* (2007), available at (http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf); Committee on Capital Markets Regulation, *Interim Report of the Committee on Capital Markets Regulation* (2006), available at (<http://www.capmktreg.org/research.html>); Joseph A. Grundfest, *The Class-Action Market*, Wall St. J., Feb. 7, 2007, A15 (op-ed) (securities fraud class actions are "an expensive, wasteful and unnecessary sideshow"); Peter J. Wallison, *Capital Complaints*, Wall St. J., Mar. 20, 2007, at A19 (op-ed). On the possible effect of the Sarbanes-Oxley Act on corporate risk taking, see Kate Litvak, *Defensive Management: Does the Sarbanes-Oxley Act Discourage Corporate Risk-Taking?* (Working Paper, 2009, available at (<http://ssrn.com/abstract=994584>)).

⁷Bloomberg & Schumer (2007), *supra* note 6, ex. 20 (63 percent of respondents to survey on New York's status as a financial center thought the United Kingdom was less litigious than the United States; 17 percent thought the United States less litigious; 20 percent thought the two about the same); Coffee (2007), *supra* note 5, at 266–68; Peter Montagnon, *The Cost to Europe of America's Class Action Addiction*, *Fin. Times*, Jan. 5, 2007, 15 ("UK shareholders find themselves less inclined to sue companies").

⁸By "publicly traded," we mean companies that are listed, and traded, on a stock exchange. Such firms are often simply called "public" companies in the United States; however, in the United Kingdom, "public" companies refer to companies formed as plcs, and thus eligible to become publicly traded—only a small minority of which in fact are. In the United Kingdom, companies traded on the London Stock Exchange are usually referred to as "listed" or "quoted." The term "publicly traded" is chosen for its intelligibility to readers from either jurisdiction.

⁹The United States and the United Kingdom score well on most measures of legal quality, and also score very similarly, including: efficiency of the judicial system (10 out of 10 for both), rule of law (10 for the United States and 8.57 for the United Kingdom), corruption (9.10 for the United Kingdom and 8.63 for the United States), risk of expropriation by the government (9.98 for the United States and 9.71 for the United Kingdom), and risk of contract repudiation by the government (9.98 for the United Kingdom and 9.00 for the United States). La Porta et al., *Law and Finance* (1998), *supra* note 2, at 1140–43.

¹⁰Over 1998–2007, the United States and the United Kingdom had mean ratios of stock market capitalization to GDP of 1.43 and 1.52, respectively, compared with a world mean of 0.99 and an OECD high-income country mean of 1.09. World Bank, *World Development Indicators* (2008), available at (<http://www.worldbank.org>).

¹¹See La Porta et al., *Corporate Ownership Around the World* (1999), *supra* note 2, at 497 ("in the United States and the UK . . . [even medium-sized] firms remain mostly widely held"). John Armour, Brian Cheffins & David Skeel, *Corporate Ownership and the Evolution of Bankruptcy Law: Lessons from the United Kingdom*, 55 *Vand. L. Rev.* 1699, 1704, 1715, 1750–52 (2002). Cf. Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 *Rev. Fin. Stud.* 1378 (2009) (U.S. public firms are on average no more diffusely held than in many other countries, but ownership of U.K. firms is the most diffuse in the world).

the primary corporate governance issue is considered to be ameliorating managerial agency costs rather than limiting self-dealing by major shareholders.¹²

We use our comparative study to test hypotheses about (1) the *role* and (2) the *rate* of private enforcement of corporate law. On the first point, since protection of minority shareholders is thought to be associated with deep and liquid securities markets and dispersed share ownership, one would expect private enforcement of corporate law to be fairly common in both countries. Should this conjecture be incorrect, it follows that robust securities markets can develop without extensive private enforcement of corporate law. Moreover, even if substantive corporate law is converging, as some scholars argue, convergence of the law in action may be far weaker.¹³ On the second point, the United States is more “litigation-friendly” than the United Kingdom in various respects, so we anticipate lawsuits against directors will be more common in the United States than in the United Kingdom.¹⁴

To test our hypotheses, we examine cases filed in Britain, supplementing existing research on reported cases, and cases that generate reported opinions in the United States, supplementing existing research on cases filed. We find that private enforcement of corporate law, through lawsuits against directors of publicly traded companies, is indeed more common in the United States than in the United Kingdom. However, our results do not support the hypothesis that private enforcement of corporate law is central to strong stock markets and dispersed share ownership.

Most strikingly, our findings indicate that the chances of a director of a publicly traded U.K. company being sued under corporate law are virtually nil. Indeed, directors of U.K. public companies that operate in the United States may face a greater likelihood of being sued under U.K. company law in the United States than in the United Kingdom, though with limited prospects for success. Even in the United States, directors face risk from private litigants less than is commonly imagined. There is only a small chance that directors of a publicly traded U.S. company will be sued for damages in a corporate law case serious enough to generate a reported judicial opinion and many such cases fail to survive a motion to dismiss or for summary judgment.

Our U.K. findings prompt questions about substitutes. We show that private enforcement of securities and insolvency law do not fill the gap left by corporate law since proceedings are rarely brought against directors of U.K. public companies under these laws either. Formal public enforcement against directors, principally under securities law, is also more robust in the United States. However, the U.K. regulatory regime does provide more potent protection than its U.S. counterpart in some important ways, especially for takeovers, with an emphasis on *ex ante* screening as opposed to *ex post* litigation.

¹²See, e.g., Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, *The Anatomy of Corporate Law* 35–37, 84–85 (2d ed., 2009).

¹³On convergence of substantive rules, see, e.g., Henry Hansmann & Reinier Kraakman, *The End of History in Corporate Law*, 88 *Geo. L.J.* 439 (2001); Mathias M. Siems, *Convergence in Shareholder Law* (2008).

¹⁴U.S. corporate law is state law; when we consider substantive corporate law doctrine we will assume Delaware law applies because it is standard practice for public companies to incorporate in Delaware. There are not, on the whole, large differences between states in the nature of directors’ duties.

The rest of the article is structured as follows. Section II outlines competing theories of the role of private enforcement in corporate law. Sections III and IV then describe prior quantitative studies of private enforcement, our empirical methodology, and our results for, respectively, the United Kingdom and the United States. Section V discusses substitutes. Section VI concludes.

II. THEORY AND PRIOR LITERATURE

A. The Role of Private Enforcement

For publicly traded corporations lacking a dominant shareholder, perhaps the biggest corporate governance challenge is control of managerial misbehavior, commonly referred to as managerial agency costs. Dispersed shareholders typically lack the incentives and/or the ability to monitor management, so managers have some latitude to manage badly or further their own interests at the expense of other participants in the firm. It is commonly assumed that directors' legal obligations—such as duties of loyalty and good faith, and disclosure requirements—help at least with the problem of self-interested actions. But deterrence presupposes a credible threat that breaches of duty will be sanctioned, which requires enforcement.

Recent literature has debated the relative merits of public and private enforcement of corporate and securities law in serving to promote and sustain stock market development.¹⁵ Proponents of private enforcement argue that private parties have better incentives to bring appropriate actions than do public agencies, and are thus more effective enforcers.¹⁶ One might call this a “private enforcement primacy” view.

In contrast, what can be called a “multiple mechanisms” view treats private enforcement as merely one of a number of mechanisms that can deter manager misconduct and provide the foundation for robust securities markets.¹⁷ On this view, public enforcement by securities regulators, stock exchange rules, shareholder exercise of governance rights, scrutiny of capital-raising transactions by investment intermediaries concerned with reputational capital, and the market for corporate control, among others, can all contribute to this outcome. Private enforcement is thus potentially useful,¹⁸ but not essential.

¹⁵See La Porta et al., *What Works in Securities Laws?* (2006), *supra* note 2; Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence* (Working Paper, 2008), available at (<http://ssrn.com/abstract=1000086>).

¹⁶See, e.g., sources cited *supra* note 2.

¹⁷See Kraakman et al., *supra* note 12, ch. 2; Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 *UCLA L. Rev.* 781 (2001); Brian R. Cheffins, *Corporate Ownership and Control: British Business Transformed* (2008); John Armour, *Enforcement Strategies in UK Company Law: A Roadmap and Empirical Assessment*, in *Rationality in Company Law: Essays in Honour of D.D. Prentice* 71 (John Armour & Jennifer Payne, eds., 2009).

¹⁸Even usefulness is sometimes challenged. See, e.g., Elliott J. Weiss & Lawrence J. White, *File Early, then Free Ride: How Delaware Law (Mis)shapes Shareholder Class Actions*, 57 *Vand. L. Rev.* 1797 (2004); John C. Coffee, *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 *Colum. L. Rev.* 1534 (2006).

A comparison of the United Kingdom and the United States can shed light on these contrasting theories. Both countries have deep and liquid securities markets and dispersed ownership of publicly traded corporations is commonplace. The private enforcement view therefore predicts the following:

H₁: If private enforcement of corporate law is essential to robust stock markets with dispersed share ownership, there will be vigorous private enforcement of corporate law in both the United Kingdom and the United States.

A failure to observe vigorous private enforcement in either jurisdiction would contradict the private enforcement primacy view, support the multiple mechanisms view, and prompt a search for substitutes.

B. The Rate of Private Enforcement

The rate of private enforcement of corporate law is likely to be shaped by differences in the legal environment, including the general rules of civil procedure, substantive legal duties imposed on directors, and procedural rules specifically governing shareholder litigation. These factors suggest that litigation against directors will be more common in the United States than in the United Kingdom. For instance, various features of civil procedure, summarized in Table 1, are more favorable to plaintiffs in the United States. In particular, the facilitation of class actions and the use of contingency fees stimulate entrepreneurial attorneys, whereas the U.K.'s "loser pays" fees rule will discourage representative litigation.¹⁹

At the same time, various features of corporate law, summarized in Table 2, make it easier for a U.S. shareholder to bring an action against directors than his or her U.K. counterpart. In particular, in the United States, the circumstances under which shareholders can bring a direct action against directors are broader and the rules governing derivative actions are more lenient. In addition, while much U.S. shareholder litigation involves takeovers,²⁰ in the United Kingdom, takeovers are governed by the Takeover Code, which largely precludes civil litigation concerning takeover bids.²¹

Under U.S. corporate law, directors owe duties of loyalty and care, supplemented by less clearly defined duties of disclosure and of special care when one's company is a takeover target.²² Cases alleging self-dealing by directors, preferential treatment of

¹⁹See generally Herbert M. Kritzer, *Lawyer Fees and Lawyer Behavior in Litigation: What Does the Empirical Literature Really Say?* 80 *Tex. L. Rev.* 1943 (2001).

²⁰See Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 *Vand. L. Rev.* 133 (2004) [hereinafter, Thompson & Thomas, *Delaware Class Actions* (2004)].

²¹John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation*, 95 *Geo L.J.* 1727 (2007).

²²See Bernard Black, *The Core Fiduciary Duties of Outside Directors*, *Asia Bus. L. Rev.*, July 2001, at 3, available at (<http://ssrn.com/abstract=270749>). There is also an even more inchoate duty of "good faith," but it is unclear how much this duty adds to the other duties.

Table 1: Contrasting U.S. and U.K. Civil Litigation Procedures

<i>Litigation Procedure</i>	<i>United States</i>	<i>United Kingdom</i>
Class actions	Under Federal Rules of Civil Procedure Rule 23(a), a judge must certify a class action before it can proceed. Relevant criteria include the class being so numerous it is otherwise impractical to join all members, the presence of questions of law or fact common to the class, and the risk of varying outcomes that would establish incompatible standards of conduct for those not participating in the litigation. Plaintiffs are routinely granted certifications to bring class actions against directors under corporate and securities law.	No direct equivalent to the U.S. class action. It is possible for litigants to seek a “group litigation order.” However, while class actions in the United States operate on an “opt-out” basis, a group litigation order is an “opt-in” system.
Allocation of legal expenses	Each side pays its own legal expenses, with the exception of successful derivative suits, where the corporation will pay the legal expenses of the shareholder litigant. Directors’ legal expenses are commonly both indemnified by the company and covered by D&O insurance.	“Loser pays” fees are typically assessed against the unsuccessful party in legal proceedings on a “standard basis” that covers litigation expenses “proportionately and reasonably incurred” and “proportionate and reasonable in amount.” ^{3a}
Contingency fees	Widely used by shareholder plaintiffs, which means that the downside risks associated with litigation are largely shifted to the lawyers.	In the corporate context, the “English rule” will tend to deter (compared to the U.S. rule) litigation in cases where the defendant’s legal fees are likely to be large since the plaintiff will realize only a pro rata portion of the recovery if successful, but risks paying all the defendant’s costs in the event of losing, particularly where the defendant can increase his or her chances of success by outspending the plaintiff and leave it to the plaintiff to pick up the tab. ^b

^aCivil Procedure Rules, 1998, S.I. 1998/3132, para. 44.5, ¶ 1; Lownds v. Home Office, [2002] 1 W.L.R. 2450, 2453.

^bEdward A. Snyder & James W. Hughes, The English Rule for Allocating Legal Costs: Evidence Confronts Theory, 6 J.L. Econ. & Org. 345, 349 (1990); James W. Hughes & Edward A. Snyder, Litigation and Settlement Under the English and American Rules: Theory and Evidence, 38 J. L. & Econ. 225, 227–28 (1995); Michael R. Boye, Dan Kovenock & Casper G. de Vries, Comparative Analysis of Litigation Systems: An Auction-Theoretic Approach, 115 Econ. J. 583, 585, 595–98 (2005).

Prohibited. “Conditional fee arrangements,” which are permitted, are a poor substitute because the maximum “upside” under such an agreement is a success fee amounting to 100% of hourly fees.

Table 2: Aspects of Corporate Law that Are More “Litigation-Friendly” in the United States

<i>Subject Matter of Regulation</i>	<i>United States</i>	<i>United Kingdom</i>
Standing to bring a derivative action	Shareholders must seek to be excused from making “demand” on the board to sue its own present or former members because the board is unlikely to do so. Demand is generally excused if the plaintiff pleads facts with sufficient specificity showing a likelihood of liability.	Traditionally, standing was very difficult to obtain, particularly in a publicly traded company. The company had to be under “wrongdoer control,” a requirement that could not be satisfied in many publicly traded companies due to the rarity of blockholders. ^a Also, the misconduct had to constitute “fraud on the minority,” an ill-defined concept involving the wrongdoers benefiting at the company’s expense. ^b
Shareholders’ ability to bring “direct” suits (with recovery paid directly to shareholders) against directors who breach their duties	Yes, if there is direct harm to shareholder interests, no if the harm is to the corporation.	Under the Companies Act 2006, a court will determine whether to grant leave by applying various statutory criteria, including whether the alleged misconduct has been ratified by the shareholders, whether bringing the suit is likely to promote the company’s success, and whether the shareholder bringing the suit is acting in good faith. ^c
Disputes concerning takeover bids	Direct lawsuits can proceed over key issues, such as the legality of defensive tactics and the fairness of a freezeout.	Very difficult. Directors rarely owe duties directly to shareholders and English courts tend to treat losses that shareholders suffer when the company is adversely affected as “reflective loss” for which the shareholders cannot recover directly. ^d

^aBirch v. Sullivan, [1957] 1 W.L.R. 1247 (Ch.).^bSee Brenda Hannigan, Company Law 458–61 (2003); Paul L. Davies, Gower and Davies: Principles of Modern Company Law 377–79, 458–61 (7th ed., 2003) (emphasizing the ill-defined nature of the concept).^cCompanies Act 2006, §§ 260–263.^dOn whom directors owe duties to, see Peskin v. Anderson, [2000] 2 B.C.L.C. 1, 14–15 (Ch.); Percival v. Wright, [1902] 2 Ch. 421, 423–25; Companies Act 2006, § 170(1). On “reflective loss,” see Johnson v. Gore Wood & Co, [2002] 2 A.C. 1.

“insiders” (directors, officers, and controlling shareholders), and other conflicts of interest are treated as involving the duty of loyalty. In the United Kingdom, the Companies Act 2006 codifies directors’ duties.²³ Prior to this codification, U.K. directors owed duties at common law to act in the best interests of the company, to avoid conflicts of interest, and to act with care, skill, and diligence. Directors of U.K. companies also face numerous regulatory and administrative obligations under companies legislation, but these obligations generally do not provide a legal foundation for civil suits.²⁴

In many circumstances where directors may have breached their duties, U.S. shareholders are able to commence and sustain litigation. This can be done in the form of a direct suit, if a director’s breach of duty has allegedly injured shareholders directly, or a derivative suit, where the harm is principally to the corporation (Table 2). In contrast, in the United Kingdom, absent exceptional circumstances, direct suits are not available, and derivative suits have also been extremely hard to sustain. Typically, the company is the only “proper plaintiff” in a suit alleging breach of duty, and the board will control litigation decisions.²⁵ Directors will rarely sue one of their own, and at common law gaining standing to sue derivatively was very difficult. Statutory reforms introduced in 2006 should make derivative suits moderately easier to sustain,²⁶ but by how much is not yet known.

When a shareholder in a U.K. company has had his or her personal rights infringed, the shareholder can sue in his or her own name to enforce the shareholder’s rights.²⁷ The principal basis for a direct claim is “unfair prejudice” resulting from the company’s conduct.²⁸ In theory, breaches of duty by the directors of a publicly traded company can amount to unfair prejudice, with a damages award as one potential remedy.²⁹ However,

²³The key duties of directors are to act within their powers, to promote the success of the company, to exercise independent judgment, to exercise reasonable care, skill, and diligence, to avoid conflicts of interest, to refrain from accepting benefits from third parties, and to avoid unauthorized self-dealing: Companies Act 2006 (U.K.), c. 46, §§ 170–177. This statutory statement of duties largely reflects the previous case law: Companies Act 2006, § 170. The statement came into force progressively in 2007 and 2008.

²⁴On the reluctance of English courts to imply civil remedies for the breach of statutory duties, see *Lonrho Ltd. v. Shell Petroleum Co.*, [1982] A.C. 173 (H.L.).

²⁵On the difficulty of direct suits, see *Johnson v. Gore Wood*, [2002] 2 A.C. 1. On the “proper plaintiff” principle, see *Prudential Assurance Co. v. Newman Indus. Ltd. (No. 2)*, [1982] Ch. 204. This is an aspect of the board’s right to manage the company, typically granted in the company’s constitution. See *Breckland Group Holdings Ltd v. London & Suffolk Props. Ltd.*, [1989] BCLC 100.

²⁶Companies Act 2006, pt. 11.

²⁷Paul L. Davies, *Gower and Davies’ Principles of Modern Company Law* 623 (8th ed., 2008).

²⁸Companies Act 2006, § 994, formerly Companies Act 1985 (U.K.), c. 6, § 459.

²⁹Victor Joffe, David Drake, Giles Richardson & Daniel Lightman, *Minority Shareholders: Law, Practice and Procedure* 235 (3d ed., 2008) (breach of duty constituting unfair prejudice); Companies Act 1985, § 461; Companies Act 2006, § 996. Some commentators argue, however, that the unfair prejudice remedy should normally be confined to relief in respect of harm personal to minority shareholders. See, for example, Davies (2008), *supra* note 27, at 689.

English courts have generally been unreceptive to unfair prejudice claims involving publicly traded companies.³⁰

Since both civil procedure rules and substantive corporate law seem more “plaintiff-friendly” in the United States than in the United Kingdom, we expect that the rate of private enforcement of corporate law, relative to the number of publicly traded firms, will be higher in the United States. However, we are unable to say a priori by how much. So:

H₂: There should be a greater rate of private enforcement in the United States than in the United Kingdom.

III. THE UNITED KINGDOM

A. *Prior Literature*

Owing in large part to difficulties with data collection, there is little prior empirical research on enforcement in the United Kingdom of corporate law or securities law. For public enforcement, one cross-country study examines the budgets and staffing of enforcement agencies in 30 countries, including the United Kingdom and the United States.³¹ Another reports numbers of actions brought and penalties levied in Germany, the United Kingdom, and the United States.³²

For private enforcement, a few studies have used electronic databases of judgments to determine the incidence of suits against directors that result in a judicial opinion. Cheffins and Black report that the most recent derivative action against directors of a publicly traded company that resulted in a judicial decision was in 1981.³³ Armour finds there were six unfair prejudice petitions involving publicly traded companies that resulted in a judicial decision between 1998 and 2006, three of which involved allegations of misfeasance by the company’s directors.³⁴ In none of these cases did the plaintiff (called a “claimant” in the United Kingdom) seek damages or succeed with the action.

There are very few cases brought against directors of publicly traded companies under U.K. company law that have resulted in a judicial opinion. However, might claims be

³⁰See *Re Astec plc*, [1998] 2 B.C.L.C. 556; Davies (2008), *supra* note 27, at 693–94.

³¹Jackson & Roe (2008), *supra* note 15.

³²Coffee (2007), *supra* note 5, at 261–62.

³³Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 *Tex. L. Rev.* 1385, 1407 (2006), discussing *Prudential Assurance Co. v. Newman Indus. Ltd. (No. 2)*, [1982] Ch. 204. See also G.P. Stapledon, *Institutional Shareholders and Corporate Governance* 132 (1996) (citing *Prudential Assurance* as the only reported case where a U.K. institutional investor brought a derivative suit against directors of a portfolio company).

³⁴Armour (2009), *supra* note 17, at 84.

brought but settle before being adjudicated? Little is known about the incidence of claims filed, as opposed to those resulting in a judicial opinion.³⁵ Our study addresses this gap.

B. Methodology

Details of claims filed in U.K. courts—as opposed to judicial opinions to which they may give rise—exist only as confidential paper documents kept by the courts. To study these cases, one must obtain permission from court officials, and then review each file manually. On the other hand, unlike in the United States, there is no need for multijurisdictional searching. The United Kingdom is comprised of three jurisdictions in which companies can register (England and Wales, Scotland, and Northern Ireland). However, companies registered in England and Wales comprise the vast majority of U.K. companies traded on the London Stock Exchange. As of October 2008, for those companies traded on the Exchange that identified their region, 1,885 (92 percent) were from England and Wales, 152 from Scotland, and 3 from Northern Ireland.³⁶ Thus, if one can gain access to case files, searching cases filed in English courts will provide a largely complete picture of litigation patterns.

Claims brought under company law against directors of publicly traded companies registered as English or Welsh are almost certain to be brought in the Chancery Division of the High Court, based in London, and most likely in the Companies Court, a specialist list within the Chancery Division. Cases based on statutory remedies against companies with paid-up capital of more than £120,000—almost certainly the case for any publicly traded company³⁷—must be started in the Companies Court.³⁸ This includes unfair prejudice claims.³⁹

³⁵The Law Commission of England and Wales studied the incidence of unfair prejudice claims by hand-collecting data from court records during the period 1994–1995. It reported only six such claims filed against public companies (p.lcs). Law Commission of England and Wales, *Shareholder Remedies*, LCCP 142, 235–38 (1996). The Law Commission did not report how many, if any, of these claims were against publicly traded companies, nor provide any details about the content of the claims.

³⁶See <http://www.londonstockexchange.com/statistics/companies-and-issuers/companies-and-issuers.htm> (Excel spreadsheet available under List of All Companies, accessed Nov. 10, 2008; archived spreadsheets are available at <http://www.londonstockexchange.com/statistics/historic/company-files/company-files.htm>) (last accessed June 25, 2009).

³⁷Companies traded on the main list of the London Stock Exchange will almost surely satisfy this criterion, as a company seeking IPO on the London Stock Exchange main market must have a market capitalization of at least £700,000. There is no minimum market capitalization requirement for AIM, a second-tier exchange operated by the London Stock Exchange that allows smaller companies to carry out public offerings under more flexible rules than apply to the Exchange's Main Market (http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/airm_nuw/); London Stock Exchange, *AIM Brochure 3* (2007). However, since only 6 percent of AIM-listed companies have a market capitalization of less than £2 million (London Stock Exchange, *AIM Statistics August 2007* (<http://www.londonstockexchange.com/statistics/historic/aim/aug-2007.xls>)), very few, if any, are likely to have a paid-up capital of less than £120,000.

³⁸See Civil Procedure Rules 1998, S.I. 1998/3132, Practice Direction 49B (Applications Under the Companies Act 1985 and Other Legislation Relating to Companies), ¶¶ 1(2), 2; Her Majesty's Court Service, *The Chancery Guide 2005* ch. 20 (2005) (The Companies Court).

³⁹Companies Act 1985, § 459; Companies Act 2006, § 994.

During the period we study, the 2006 codification of directors' duties was not yet operative, so breach of duty claims were equitable in nature. These claims must be brought in the Chancery Division of the High Court,⁴⁰ but within that, can be brought in either the general Chancery Division or the specialist Companies Court list. However, London lawyers advised us that in practice these cases would be filed with high probability in the Companies Court.

We obtained permission from High Court officials to conduct a comprehensive review of all files in the Companies Court list for the years 2004, 2005, and 2006. This encompassed 27,099 claims. Our search strategy was as follows. We looked first for files in which one of the parties was a company legally capable of having publicly traded shares. These companies can be quickly identified because their name must include the suffix "plc."⁴¹ For cases involving plcs, we reviewed the file to see whether the suit involved a claim against directors. To find out which plc cases involved a publicly traded company, we cross-checked lists of companies traded on the main market of the London Stock Exchange and on AIM (the Alternative Investment Market).⁴²

Searching files in the general Chancery Division proved much harder than for the specialist Companies Court. With the Companies Court, all filings are in a single location, so once we gained access to files we needed no further assistance from court officials. However, mainstream Chancery Division court filings are held in a number of locations. Thus, for us to look at a particular filing involving a plc, court officials had to collect the files manually and bring them to us, which proved highly labor intensive. Chancery Division officials agreed to provide us two months' worth of filings, and we chose October and November 2006,⁴³ during which time a total of 629 cases were filed.

C. Results

1. Companies Court

Table 3 summarizes the results of our search of files in the Companies Court. Of the 27,099 files surveyed, 24 involved claims against directors of plcs, of which only six involved companies traded on the London Stock Exchange or AIM. Of these six, three were launched by private plaintiffs. The other three were disqualification actions brought by the government; we discuss these actions in Section V.C.2. Of the private suits, only one

⁴⁰Supreme Court Act (U.K.) 1981, c. 54, Sch. 1, ¶ 1.

⁴¹Companies Act 1985, § 25(1); Companies Act 2006, § 58(1).

⁴²Companies were classed as "publicly traded" based on their status when the action was commenced. Their status was determined by consulting the register of public documents kept at Companies House (<http://www.companieshouse.gov.uk>), which indicates whether a prospectus has been filed.

⁴³We chose months outside the summer and the holiday season since these are the months when suits are most likely to be filed.

Table 3: Claims Filed in U.K. Companies Court, 2004–2006, in Which Defendants Include Directors of Public Limited Company

Year	<i>All plcs</i>				<i>Publicly Traded Companies</i>			
	<i>No. of Claims</i>	<i>Plaintiff is</i>			<i>No. of Claims</i>	<i>Plaintiff is</i>		
		<i>Public</i>	<i>Private</i>	<i>Private, Seeking Damages</i>		<i>Public</i>	<i>Private</i>	<i>Private, Seeking Damages</i>
2004	9	7	2	2	2	1	1	1
2005	11	4	7	0	3	1	2	0
2006	6	4	2	1	1	1	0	0
Total	26	15	11	3	6	3	3	1
Mean	8.67	5	3.67	1	2	1	1	0.33

NOTE: Data on claims against directors of plcs in Companies Court from 2004–2006. The one case involving a claim for damages against directors of a publicly traded company was handwritten and filed without counsel, and was struck out for failure to meet the requirement to provide particulars.

involved a claim for damages.⁴⁴ Even this solitary filing did not appear to be a genuine claim, since the plaintiff acted without counsel, and filed only a handwritten statement of claim, with no supporting details. The case was struck out by the court when the plaintiff failed to submit full particulars within the stipulated time.

2. Chancery Division

Our survey of two months' worth of files from the Chancery Division serves as a robustness check on whether our search of the Companies Court missed significant numbers of claims against directors. Of the 629 claims filed during this period, only one involved a claim arising under company law in relation to a plc. The company was not publicly traded, and the action arose out of the same facts as one of the claims we found in the Companies Court during the same year. These findings are consistent with plaintiffs not bypassing the Companies Court with any frequency to bring lawsuits against directors of such firms.

3. Discussion

To put these findings in context, recall there were as of October 2008 nearly 1,900 U.K.-incorporated companies based in England and Wales traded on the London Stock Exchange and AIM.⁴⁵ If we do not discount the one case brought against directors of publicly traded companies as frivolous, this means the per-year likelihood of directors of a publicly traded firm being sued in English courts for damages under U.K. companies legislation was 1 out of nearly 6,000, or 0.017 percent. Hence, the annualized number of lawsuits filed

⁴⁴The other two were: (1) a claim requesting the court to call a shareholders' meeting to pass a resolution to remove and replace the board, which the incumbent board had sought to frustrate, and (2) a petition seeking an injunction regarding how the defendants were managing the company's affairs.

⁴⁵Supra note 36 and related discussion.

seeking damages against directors of publicly traded companies in the United Kingdom is effectively *zero* over our sample period. This suggests that when prior searches of judicial opinions failed to find suits against directors of publicly traded companies it was not because claims are settled or abandoned before being adjudicated, but because such claims are simply not filed.

Suppose we put aside the hand-written case, and conclude that there were zero genuine claims against directors over our three-year period in a sample of about 27,000 overall claims. What can we infer from the observed probability of 0/27,099 during this period that a claim, if made, would be against directors of a publicly traded company, about the expected number of such claims in another three-year period? We assume that we can treat corporate suits as existing with probability p in a hypothetical underlying population of suits filed in the Companies Court, with actual suits drawn at random from this population. An Agresti-Coull test for confidence bounds (Stata: `cii 27099 0, agresti`) provides a 95 percent confidence upper bound on the true probability that a suit will involve directors of 0.00014, implying a 95 percent likelihood that there would be four or fewer genuine suits over another three-year period. Thus, we cannot say with confidence that directors of publicly traded U.K. companies face *no* risk of being named as a defendant in a claim in English courts under U.K. company law, but can say with reasonable confidence that the risk is very low.

D. Claims Against U.K. Directors Filed in U.S. Courts

Many large U.K. public companies cross-list their shares on a U.S. stock market. Directors of these companies can readily become defendants in securities lawsuits filed in U.S. courts under U.S. securities law.⁴⁶ Corporate law, in theory, should be different. U.S. shareholders generally cannot bring an action against directors of U.K. public companies, even those that are cross-listed, under state corporate law.⁴⁷

U.S. shareholders can potentially sue directors of U.K. companies for breach of U.K. corporate law, but bring the claim in U.S. courts. In the U.S. portion of our research, we found three cases involving a reported decision between 2000 and 2007 where directors of U.K. public companies were sued in the United States for breach of duty. The U.S. courts dismissed two of the three cases under U.K. law.⁴⁸ However, in *RSL Communications plc v. Bildirici*, the defendant directors unaccountably agreed with the plaintiffs that New York law should apply (they sought only to reserve the right to argue later that U.K. law applied) and the court allowed the claim to proceed.⁴⁹ Even though the other two cases

⁴⁶For background, see Cheffins & Black (2006), *supra* note 33, at 1413–14.

⁴⁷This is a slight oversimplification. Some states, notably California, apply some provisions of their corporate law to companies principally located in that state, regardless of where in the United States they are incorporated. These states might also permit suits against directors of companies incorporated outside the United States.

⁴⁸*City of Sterling Heights Police & Fire Ret. Sys. v. Abbey Nat'l plc*, 423 F. Supp. 2d 348 (SDNY, 2006); *In re BP p.l.c. Derivative Litig.*, 507 F. Supp. 2d 302 (2007).

⁴⁹*RSL Commc'ns plc v. Bildirici*, U.S. Dist LEXIS 67548, at *9–11, 34 (SDNY, 2006).

were dismissed, it is striking that directors of cross-listed U.K. public companies could be at a greater risk of being sued under corporate law in the United States than in the United Kingdom.

IV. THE UNITED STATES

In the United States, a comprehensive search of all filed cases, similar to the one we conducted in the Companies Court of the Chancery Division, is impractical. Finding, let alone examining, every corporate law complaint in all 50 states plus federal courts would be a daunting task. To make our search manageable, we searched for suits that produced at least one written judicial decision. Our rationale was that directors are likely to contest cases more vigorously where there is a serious prospect they will have to pay out of their own pocket. These contested cases are likely to generate a written decision, often on a motion to dismiss or a motion for summary judgment.⁵⁰ The principal exception should be for cases where the company is insolvent and cannot pay legal defense expenses and no D&O insurance is available. The directors might then settle quickly, to avoid incurring defense costs.

A 2006 study by Black, Cheffins, and Klausner supports this logic. They searched for cases in which outside directors of publicly traded companies made personal, out-of-pocket payments, and found four such cases under corporate law between 1981 and 2005.⁵¹ Of these, three involved a published judicial decision. The fourth seems likely to fit the insolvent company/no insurance exception.⁵²

A. Prior Literature

Table 4 summarizes the prior empirical studies of shareholder suits under U.S. corporate law.⁵³ The studies differ across various dimensions, including the period studied, the states

⁵⁰An exception, where a director may agree to a personal payment without a written opinion being generated, is where the director is not insured (or insurance coverage is contested) and the company is insolvent, leaving no one to pay legal defense costs. A director might then be willing to settle early and quietly to limit legal expenses.

⁵¹Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 *Stan. L. Rev.* 1055, 1064–74 (2006).

⁵²In *id.*, Black, Cheffins, and Klausner found a similar pattern for personal payments by outside directors of public companies under securities law and ERISA law. Of nine such cases, eight had a prior judicial decision; while the ninth fit the insolvent company–no insurance exception.

⁵³Franklin S. Wood, *Survey and Report Regarding Stockholders' Derivative Suits* (1944); Thomas J. Jones, *An Empirical Examination of the Incidence of Shareholder Derivative and Class Action Lawsuits, 1971–1978*, 60 *B.U. L. Rev.* 306, 313–14, 319 (1980); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?* 7 *J.L. Econ. & Org.* 55, 60–62 (1991); Thompson & Thomas, *Delaware Class Actions* (2004), *supra* note 20; Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 *Vand. L. Rev.* 1747, 1772–77 (2004) [hereinafter, Thompson & Thomas, *Delaware Derivative Suits* (2004)]; Weiss & White (2004), *supra* note 19; Black, Cheffins & Klausner, (2006), *supra* note 51, at 1090–91.

Table 4: Prior Studies of Shareholder Suits Under Corporate Law Against Directors of U.S. Publicly Traded Firms

Study	Period Studied	Courts Studied	Shareholder Suit Statistics							Direct/Class Action	
			Firms Studied		Suits/Year		Plaintiff Court		Derivative		
			Type	No.	Total	Per Firm	Settlement Rate (%)	Success Rate (%)			
Wood (1944)	1932-42	NY	All companies (data summary covers only public companies)	52	—	16.2	—	2.6	—	X	
Jones (1980)	1971-78	All	Sample of Fortune 500 firms	190	29.0	0.15	74.7	—	—	X	X
Romano (1991)	1966-87	All	Random sample of 535 public companies traded on NYSE or NASDAQ	535	6.3	0.01	64.8	1.5	—	X	X
Thompson and Thomas (2004a)	1999-00	Del. Ch.	All Del. companies (data summary covers only public companies)	—	28.0	—	27.4	0.0	—	X	
Thompson and Thomas (2004b)	1999-00	Del. Ch.	All Del. companies (data summary covers only public companies)	—	119.0	—	31.7	0.0	—	—	X
Weiss and White (2004)	1999-01	Del. Ch.	Del. public companies that were merger targets during 1999-01	564	34.7	0.18	16.0	0.0	—	—	X
Black, Cheffins, and Klausner (2006)	1981-05	All	Public companies in which outside directors made personal payments	4	—	—	—	—	—	X	X

NOTE: Summary of prior empirical studies of shareholder suits under corporate law against directors of U.S. publicly traded companies. Settlement rate and plaintiff court success rate are as percent of all filed cases. Settlement rate and plaintiff success rate at trial exclude cases that were still pending at the end of the study period. Plaintiff success rate does not necessarily imply a damages payment. No. of suits is measured after combining multiple complaints involving the same set of facts; these complaints are normally consolidated into a single action in the courts.

of incorporation considered, and the type of lawsuits considered (derivative suits, class actions, or both). Although these differences make comparisons difficult, the studies collectively show that trials are uncommon and plaintiff wins at trial still more so, settlements are reasonably common, the annual odds of a firm being subject to a lawsuit are low, many suits involve takeover bids, and settlements are paid principally by D&O insurance. However, the proportion of cases settled (as opposed to being dismissed) appears to be lower today than during the 1970s and 1980s.

Among the more recent studies, we have already discussed the 2006 study by Black, Cheffins, and Klausner. A 1991 study by Romano examined shareholder suits against a sample of 535 publicly traded companies between the late 1960s and 1987. She found that most lawsuits settled, with just over half involving monetary recovery and with the vast majority of settlements being paid by D&O insurance. Romano did not examine how often directors were sued or how often they paid damages personally.

Delaware is the state of incorporation for about 60 percent of U.S. publicly traded companies.⁵⁴ In two related 2004 studies, Thompson and Thomas examined all complaints filed in the Delaware Court of Chancery in 1999 and 2000. They found 294 cases involving publicly traded companies where a breach of fiduciary duty was alleged, including 213 class actions (mostly related to takeover bids), 56 derivative suits, and 25 other “direct” suits. Thompson and Thomas did not offer data on how often the remedy sought was damages as opposed to an injunction—say, against a takeover.

A 2004 study by Weiss and White examined takeover-related class actions filed in Delaware courts and found that a majority of complaints are filed very soon after the transaction is announced, and most are dismissed with no recovery. Weiss and White found no trials with plaintiff wins, as well as evidence of attorney reluctance to press claims if substantial time and effort was likely to be required to yield a recovery.

Our study is intended to complement and build on these prior studies in three key ways: (1) by investigating corporate law litigation nationwide; (2) by examining in greater depth outcomes in cases that meet a threshold standard of seriousness; and (3) by focusing specifically on cases where directors were sued. We examine suits against both inside directors (those also serving as company officers) and outside directors.⁵⁵

B. Search Methodology

We searched for suits under corporate law that were: (1) brought by shareholders, creditors, bankruptcy trustees, or the company itself; (2) brought against one or more directors of a publicly traded U.S. company; and (3) produced one or more written decisions between January 1, 2000 and December 31, 2007 but no written decisions before January 1, 2000. We excluded cases that involved investment companies (whether organized as

⁵⁴Lucian A. Bebchuk & Alma Cohen, *Firms’ Decisions Where to Incorporate*, 46 *J.L. & Econ.* 383, 388, 391 (2003) (data as of 1999).

⁵⁵In theory, a suit could name officers but no directors. In practice, the officers most likely to be sued are typically also directors. Our search found no cases in which only officers were sued.

corporations or as business trusts) or publicly traded entities other than corporations (e.g., LLCs, limited partnerships, and real estate investment trusts).

We conducted an exhaustive search of Delaware cases. We first accessed all decisions in the Westlaw DEBUS database (Delaware business cases, both state and federal) between 2000 and 2007 that included the term “director” or “board.” This generated 368 decisions, which we read to determine whether the case belonged in our sample.

We discovered that DEBUS is both incomplete (it omits many Delaware corporate law decisions) and unstable (a few cases in our sample that were in DEBUS on one search date were missing at a later date). We therefore also searched all reported decisions on the Delaware Chancery Court website (which contains decisions from July 1, 2000 forward) that involved one of the terms “director” or “board” or “officer” or “chairman” or “CEO” or “CFO.” This produced 637 decisions; we read those that our DEBUS search had not found.

For cases outside Delaware, we first searched the Westlaw MBUS database, the multistate analogue to DEBUS (state only, with no non-Delaware federal cases), excluding Delaware cases. The broad search for “director” or “board,” which we used for Delaware cases, returned too many cases to read, so we chose narrower search terms that, in test searches, caught a high proportion of the cases found in a broader search that in fact belonged in our sample. We required that a decision include (1) “director” or “board”; (2) “public” or “stock exchange” or “NASDAQ”; (3) “shareholder or stockholder” in the same paragraph as “derivative” or “consolidat!” or “class action”; and (4) “fiduciary” or “care” or “Revlon” or “fair dealing” or “buyout.”⁵⁶ We carried out a similar search in the LEXIS “Mega” database, which covers all federal and state cases, and a supplemental search in this database for cases with “deriv! litig!” in the title. These searches returned 1,906 cases, which we read.

If an opinion did not state whether the company was publicly traded, we verified its status using the SEC’s EDGAR database of filings by publicly traded companies. A single set of facts often prompts multiple lawsuits launched by different law firms, which are often later combined, and sometimes produces multiple judicial decisions. We defined a “case” as a single set of facts prompting one or more lawsuits and one or more decisions. If the same facts produced both federal and state court decisions, we treated the case as a state case.

Whenever we found a decision, we searched for and read all prior or subsequent decisions in the case through April 2009. If a case produced more than one decision, we assigned the case to a year based on the first decision, and excluded from the data set cases with initial decisions in 1999 or earlier. When a case referred to another case that seemed as if it might belong in our data set, we read the other case and added it to the data set if appropriate. When a case that we read involved a shareholder suing successfully to see

⁵⁶The broad search for (director or board) (excluding Delaware cases) returned about 10,000 decisions, which was too many to read. In a test read of 250 decisions, only 10 (4 percent) fit the sample criteria. We therefore experimented with more restrictive searches. The search terms we ultimately used caught all 10 of the “test read” cases. We used “Revlon” in our search because duties imposed on directors when a board is on the verge of selling the company are often called “Revlon duties,” after *Revlon Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (Del. 1986).

Figure 1: U.S. corporate cases—totals by jurisdiction.



NOTE: Annual number of corporate law cases in database with one or more decisions over 2000–2007, in Delaware state court, other state courts, or federal court. If one case produces several decisions, we use the year of the first decision. Sample = 399 cases. See text for details on search method and sample definition.

corporate books and records, we checked for a later suit against the company's directors or officers, but did not include the books-and-records case in our data set because these cases do not directly implicate director liability.

C. Case Counts

Our searches found 151 Delaware cases, 73 non-Delaware state cases, and 175 federal-only cases fitting our sample criteria.⁵⁷ The total is 399 cases over eight years, or about 50 cases per year, involving 605 discrete decisions. Our Delaware count should be reliable, but we likely failed to find some non-Delaware state cases and some federal cases. Of our 399 cases, 305 (76 percent) involved Delaware-incorporated companies.

Figure 1 shows the annual totals for cases from Delaware, from other states, and from federal courts. There is year-to-year variation, but no strong time trend through 2005. There is an apparent increase in decisions in 2006–2007, coming almost entirely from a rise in federal cases. There is also a smaller rise in non-Delaware state cases, and a decline in Delaware cases. Regression analysis confirms that these trends are statistically significant at the 5 percent level. The decline in cases in Delaware courts is consistent with a trend just beginning to capture the attention of commentators, in which some plaintiffs bring corporate claims involving Delaware-incorporated companies in other courts.⁵⁸

⁵⁷In one instance, the same facts generated reported decisions both in Delaware and elsewhere. We treated the case as a Delaware case.

⁵⁸See Faith Stevelman, Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law, 34 Del. J. Corp. L. 57 (2009); John L. Latham & Alex Reed, Strategies for Mitigating the Hardships of Multi-Jurisdiction Stockholder Litigation, in Practising Law Institute, Corporate Law and Practice Course Handbook 19, 172 (2009).

Of the 399 cases in our data set, 148 (37 percent) involved companies listed on the New York Stock Exchange (NYSE); 128 (32 percent) involved companies listed on the NASDAQ National Market (NASDAQ); 54 (13.5 percent) involved Pink Sheets-traded companies; and 22 (5.5 percent) were listed on the American Stock Exchange or the NASDAQ bulletin board market. For 47 companies (12 percent) the decision indicated the firm was publicly traded but we could not locate a trading market.

As of year-end 2007, there were roughly 4,600 U.S. companies listed on the NYSE or NASDAQ.⁵⁹ This implies the directors of a company trading on one of these markets faced roughly a 1.1 percent annual chance of facing a suit under corporate law that generated one or more judicial decisions. A director's risk of being a defendant in a reported corporate law case is much lower in a publicly traded firm that is not listed on the NYSE or NASDAQ. While around 9,000 companies have shares traded on the Pink Sheets, we found only 11 reported cases per year against directors of these companies, for an annual risk of about 0.12 percent.

These annual figures overstate to some degree the risk of a director becoming involved in a lawsuit that meets our sample criteria because often, when a lawsuit is brought against directors of a public company, only some directors will be named as defendants. On the other hand, annual figures do not reflect the "career risk" that an individual will be named as a defendant in a reported case sometime during his or her career as a director. There are no data on typical tenure for inside and outside directors, but the median tenure for CEOs in U.S. public companies is seven to nine years.⁶⁰ There are also no available data on how many public company boards a typical director serves on over the course of a career. Given these uncertainties, it seems reasonable to estimate the life-time risk of a director being named as a defendant in a reported lawsuit at 10 times the annual risk, or around 10 percent.

There is a substantial gap between cases filed and those that yield a judicial decision. Thompson and Thomas report about 150 cases filed per year in Delaware in 1999 and 2000 involving publicly traded companies and claims for breach of fiduciary duty, most of which probably involved claims against directors. In contrast, our data set includes only about 20 Delaware-decided cases per year. A number of factors likely combine to explain the difference between these figures. First, Thompson and Thomas found that about 40 percent of their cases were dismissed without prejudice, with no relief.⁶¹ A written opinion in these cases is unlikely, and we found no such opinions in our search. Second, some cases will settle quickly. In the United States, unlike in the United Kingdom, these settlements

⁵⁹World Federation of Exchanges, Focus Report (Jan. 2008). There were about 2,400 companies listed on the NYSE and another 3,100 on the NASDAQ National Market. Excluding foreign cross-listed companies reduces these amounts to the 4,600 total reported in the text.

⁶⁰Eliezer M. Fich & Anil Shivdasani, Are Busy Boards Effective Monitors? ECGI Finance WP 55/2004, 36 (tbl. II) (8.68 years), available at (<http://ssrn.com/abstract=607364>); Eliezer M. Fich, Are Some Outside Directors Better than Others? Evidence from Director Appointments by Fortune 1000 Firms, 78 *J. Bus.* 1943, 1951 (tbl. 2) (2005) (9.03 years); James S. Linck, Jeffrey M. Netter & Tina Yang, The Determinants of Board Structure, 87 *J. Fin. Econ.* 308, 315 (tbl. 2) (2008) (7.1 years); Ivan E. Brick, Oded Palmon & John K. Wald, CEO Compensation, Director Compensation and Performance: Evidence of Cronyism? 12 *J. Corp. Fin.* 403, 408–09 (tbl. 2) (2006) (6.9 years).

⁶¹Thompson & Thomas, Delaware Class Actions (2004), supra note 20, tbl. 6.

Table 5: U.S. Corporate Cases—Summary Data

<i>Nature of Claim</i>	<i>Insider Only</i>	<i>Outsider Only</i>	<i>Insider & Outsider</i>	<i>Total</i>
Damages only	21	2	258	281 (70%)
Damages + another claim	4	0	70	74 (19%)
Injunctive + declaratory relief	4	0	37	41 (10%)
Other claims only	0	1	2	3 (1%)
Total	29 (7%)	3 (1%)	367 (92%)	399 (100%)

NOTE: Nature of claim and status of defendants for 399 corporate law cases resulting in one or more decisions over 2000–2007, in Delaware state court, other state courts, or federal court. Cases against directors often name the company as a defendant as well.

normally require judicial approval, but approval is often granted without a written opinion. Thompson and Thomas report that 25 percent of the cases in their sample settled; we do not know how many settled without a written decision. Third, some cases may sit quietly, with no action. The plaintiffs do not pursue the case, and the defendants either do not seek dismissal or eventually obtain a dismissal order without a written opinion.

D. Who Was Sued and Relief Sought

Since our primary concern is with director liability, we examined the relief sought. Table 5 summarizes the breakdown, by type of claim and type of defendant (inside directors, outside directors, or both).⁶² In a few cases, the decision refers generically to “directors” and we could not determine whether outside directors were among the defendants. These “undetermined” directors probably included outsiders, and we assume this below.

Of the 399 cases in our data set, 355 (89 percent) involved claims for damages. Most suits name both inside and outside directors as defendants (367 cases; 92 percent). All but three of the cases name at least some inside directors.

When a case involved both inside and outside directors, the insiders were usually the primary targets. The plaintiffs’ case was often built around allegations of misdeeds by insiders, described in rich detail, plus approval of the misdeeds by the outside directors, or allegations that they failed to notice or respond appropriately to the insiders’ actions. One suspects that in many cases, outside directors were named as defendants less because they were likely to be found liable than to put collective pressure on the board to settle, to facilitate the gathering of evidence through discovery, or, for a derivative suit, to justify a claim that the plaintiff be excused from the need to demand that the board bring the suit.

⁶²If the decision named the directors, but did not indicate their status as inside or outside, we verified their status using 10-K filings in the SEC’s EDGAR database. We also drew reasonable inferences from the nature of the litigation. For example, in a derivative case in Delaware, the plaintiffs invariably argue that they should be excused from making a demand on the board to sue its own members. To have a demand excused, the plaintiffs are effectively forced to sue a majority of the board, which will surely include some outsiders.

Table 6: Outcomes for Reported Decisions in Damages Cases

<i>Case Outcome</i>	<i>Insiders Only</i>	<i>Outsiders Only</i>	<i>Insiders & Outsiders</i>	<i>Total</i>
No relief				
Defendants' motion to dismiss or for summary judgment granted	11	0	173	184
Trial verdict for defendants	0	0	5	5
Relief				
Trial verdict for plaintiffs	2	0	8	10
Settlement	2	1	45	48
Outcome unknown; last-known result is				
Defendants' motion to dismiss or for summary judgment denied or partly denied	8	1	54	63
Settlement denied	0	0	6	6
Stay granted or denied	0	0	12	12
Other	1	0	26	27
Total	25	2	328	355

NOTE: Principal outcome for 355 corporate law cases with damages claims that resulted in one or more decisions over 2000–2007, in Delaware state court, other state courts, or federal court. Outcome is based on reported decisions and, where these do not indicate the outcome, a search for settlements (see text for search details).

E. Outcomes in Damages Cases

We also assessed case outcomes, focusing on cases that sought damages. Table 6 summarizes the results of the known outcomes for the cases in our data set. The most common outcome was for the defense to succeed on a motion to dismiss or for summary judgment. The defendants succeeded on such a motion in 52 percent (184/355) of the damages cases in our data set.⁶³ We also found 15 trials, of which plaintiffs won 10 against at least one defendant.

In many cases in our sample, the reported decisions did not provide a final outcome. We engaged in an extensive search for outcomes in these cases. We first Shepardized the reported decision(s) in question to see if any later cases citing them mentioned a settlement. We also examined a company's annual reports on 10-K for mention of a settlement, and conducted a web search for news stories or press releases referring to a settlement or other outcome.⁶⁴ We found 48 settlements. Overall, then, plaintiffs obtained some relief in 58 of the 355 damages cases (16 percent), but there are another 108 cases (31 percent) for which we could not find the outcome.

⁶³We recorded partial grants of a motion to dismiss or for summary judgment as motion denied. When there was more than one reported decision for a single case, we used the latest result. Some decisions dismiss a complaint, but allow refile of an amended complaint. We treated cases as dismissed if there was no further opinion arising from the same facts.

⁶⁴Under U.S. securities laws, companies must report annually on their "material" litigation. Some companies report shareholder lawsuits and the outcomes of these suits, but others treat the suit, the outcome, or both as immaterial and do not report them, either in their 10-K report or in a press release.

The 14 percent settlement rate implied by our data (48 cases out of 355) is a lower bound on the true settlement rate. If, say, half the cases with an unknown outcome settle, then plaintiffs would obtain some relief in about 30 percent of cases that warrant a written judicial decision. This is consistent with other recent studies, but well below the rates reported in some earlier studies (see Table 4).

F. Personal Payments

Even when directors are sued for damages, out-of-pocket payments by directors are unlikely, due to a series of protective devices that limit both directors' risk of being held liable and their risk of paying personally if they are held liable (as opposed to payment by the company or an insurer). These include the business judgment rule, a "Section 102(b)(7)" provision in the corporate charter that eliminates the personal liability of directors (but not officers) for duty of care violations, company advancement of legal expenses, indemnification by the corporation for damages paid (available for direct but not derivative suits), and D&O insurance.⁶⁵ The result is a sharp distinction between "nominal liability" (the risk of an adverse settlement or court judgment) and the risk of an actual "out-of-pocket" payment. The 2006 Black, Cheffins, and Klausner study found only two instances of out-of-pocket payments by *outside* directors in corporate law cases during the time period of the present study, both of which are outside our sample.⁶⁶

Black, Cheffins, and Klausner argue that the risk of a personal payment by an outside director rises substantially if a company goes bankrupt because it then may well be unable to indemnify the defendant directors or pay their legal expenses, which takes away one of the shields against personal payment. For the 171 damages cases in our sample that were not resolved on a motion to dismiss or motion for summary judgment, we searched for evidence that the company went bankrupt at a time that could affect its ability to indemnify directors or pay their legal bills.⁶⁷ We found 22 such cases, or an average of about three per year. However, none of these cases in fact resulted in a personal payment.

Our results confirm Black, Cheffins, and Klausner's findings concerning the rarity of outside director personal liability. We found only one case in our sample with personal payments by outside directors, involving ICN Pharmaceuticals. The ICN board approved \$50 million in bonuses to both inside and outside directors under circumstances so raw that the award prompted a shareholder revolt. The shareholders installed a new board, which

⁶⁵For fuller discussion of directors' shields against personal liability, see Black, Cheffins & Klausner (2006), *supra* note 51.

⁶⁶*Id.*, tbl. 2. The first case, *Lone Star Steakhouse*, is outside our sample because it involved an ultra vires repricing of stock options, rather than a breach of fiduciary duty. The second case, reported to Black, Cheffins, and Klausner on a confidential case basis, is outside our sample because we are not aware of a reported decision. A third post-2000 personal payment case reported by Black, Cheffins, and Klausner, *Fuqua Industries*, is outside our sample because the first reported decision in this case was before 2000.

⁶⁷The director would be at risk if the firm was bankrupt during the facts relevant to the lawsuit, or went bankrupt after those facts but before the case was resolved. To find relevant bankruptcies, we conducted a web search for the company name and "bankruptcy" or "insolven*"; and also searched the company's annual reports on Form 10-K.

sued to recover the bonuses. The former outside directors settled the suit by agreeing to partially repay their bonuses.⁶⁸

We found, as well, that it is rare for *inside* directors to face out-of-pocket liability in a lawsuit arising under corporate law. In the ICN Pharmaceuticals case, the corporation secured personal payments from two principal executives in addition to payments by the outside directors. We found two other instances where inside directors made personal payments.⁶⁹ One involved HealthSouth. The court awarded summary judgment to the plaintiffs, who sued former CEO Richard Scrusby for restitution of bonuses that were paid based on false financial statements.⁷⁰ Scrusby also landed in jail for other misconduct. The second involved Tenet Healthcare, where the CEO paid \$1 million personally, and the CFO \$500,000, as part of an overall \$215 million settlement of a derivative suit and related securities class action suit, with the balance being paid by the company and D&O insurance.⁷¹

V. SUBSTITUTES FOR PRIVATE ENFORCEMENT

A. *Why Look for Substitutes?*

Our U.S. findings support our second hypothesis that, due to differences in civil procedure and substantive law, there will be more private enforcement in the United States than in the United Kingdom. However, the near-total absence of private litigation in the United Kingdom is inconsistent with the first hypothesis that private enforcement of corporate law is critical for the development of strong securities markets or dispersed ownership. It is theoretically possible that the low incidence of private enforcement in the United Kingdom shows not that U.K. private enforcement mechanisms do little to deter misconduct, but proves instead that they deter so effectively that no misconduct occurs and hence no enforcement is observed. This implication is at odds, however, with the fact that directors of U.S. public companies conduct themselves in a manner sufficient to generate around 50 cases a year with written decisions involving allegations of breach of duty, despite private enforcement being a *more* credible threat than in the United Kingdom due to the factors

⁶⁸See *Valeant Pharms. Int'l v. Jerney*, 921 A.2d 732 (Del. Ch. 2007) (ICN had changed its name to Valeant by the time the case was decided), *app. dismissed*, 2007 Del. LEXIS 245.

⁶⁹We also found one case where a CEO made a personal payment but the source of liability was not corporate law. In *Bansbach v. Zinn*, 801 N.E.2d 395 (N.Y. 2003), the company and its founder, majority stockholder and CEO Michael Zinn, were both convicted of violating campaign contribution law, and Zinn served a jail term. The company indemnified Zinn for his legal expenses, but a shareholder sued and the court blocked indemnification, leaving Zinn to pay his own legal expenses.

⁷⁰*Tucker v. Scrusby*, 2006 WL 2664197 (Ala. Cir. Ct. 2006), *aff'd*, 2006 WL 932013 (Ala. 2006), see also *Teachers' Ret. Sys. of La. v. Scrusby*, 2004 WL 423122 (Del. Ch. 2004).

⁷¹*Penn v. Tenet Healthcare Corp.*, 2007 WL 2729463 (Cal. Sup.); Bloomberg News, *Tenet Healthcare Agrees to Settle Fraud Lawsuits* (Jan. 13, 2008).

identified in Tables 1 and 2. It is also in tension with our finding that U.K. company directors are sometimes sued in the United States.

Even in the United States, private enforcement of corporate law may play a more limited role than is commonly thought in constraining corporate directors. Suits are common enough, as Thompson and Thomas's research shows. However, only a small fraction of the cases filed are sufficiently contentious to yield a single reported judicial opinion. Among those cases filed that generated a written opinion, in almost half the judge dismissed the claim. Trials are rare, averaging only about two per year. Although settlements are fairly common, they are almost always paid with other peoples' money; the risk that directors will make personal payments is small.

Our finding that private enforcement of corporate law is not critical for strong securities markets invites a search for substitutes. Since our most striking empirical finding is the absence of suits against directors of U.K. publicly traded companies, we focus primarily on what substitutes might exist in Britain. We examine three basic categories: private enforcement of related areas of law (securities and bankruptcy law), public enforcement, and shareholder governance rights. Extra-legal substitutes are surely also important, but are beyond the scope of this article.

B. Private Enforcement of Other Areas of Law

Our inquiry was limited to lawsuits brought against directors under corporate law. One potential substitute for litigation of this sort is private enforcement of obligations under other bodies of law that also constrain director actions and thus might also address managerial agency costs. Securities law and bankruptcy law are the most likely candidates.

1. Securities Law

Private lawsuits under securities law can substitute for, or least supplement, suits under corporate law. Circumstances in the United States illustrate this. U.S. securities law is highly protective of investors, both anecdotally and based on the one available quantitative "law in books" measure (see Table 7), while U.S. corporate law is not highly protective by international standards (see Table 8). Litigation, moreover, is common, with 150–200 federal securities class actions being brought annually,⁷² plus some number of non-class actions brought in state court. Research in progress by one of us (Black) confirms that almost all name inside directors, and a fair number name outside directors as well.

The situation in the United Kingdom is very different. Shareholders in a publicly traded U.K. company can potentially sue directors under both the Financial Services and Markets Act 2000 and the common law to recover losses caused by false or misleading disclosures in documents supporting a public offering of shares.⁷³ As a result, U.K. securities

⁷²See, e.g., Cornerstone Research, *Securities Class Action Filings 2008: A Year in Review (2009)*, available at (<http://www.cornerstone.com>).

⁷³Financial Services and Markets Act 2000, c. 8, § 90 (creating liability for "persons responsible" for misleading disclosures); § 79(3); Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations, 2001, S.I.

Table 7: Quantitative Assessment of Regulation of Securities Law

<i>Aspect of Securities Law</i>	<i>United States</i>	<i>United Kingdom</i>	<i>Average (49 Countries)</i>
<i>Disclosure</i> (based on whether the law requires delivery of a prospectus to potential investors and disclosure, in a public offering of shares, of executive compensation, blockholders, director share ownership, “large” contracts, and contracts with insiders)	1.00	0.83	0.60
<i>Liability standard</i> (based on the burden of proof an investor has to meet to recover damages from a company, its directors, advisors, and accountants for mis-disclosure in documents supporting a public offering of shares)	1.00	0.66	0.47
<i>Public enforcement</i> (based on the criminal liability for mis-disclosure by a company, its advisors, and accountants and on the rule-making powers, independence, investigative powers, and enforcement powers of a country’s securities regulator)	0.90	0.68	0.52

SOURCE: La Porta, Lopez-de-Silanes, and Shleifer (2006), Tables I, II.

law “in books” ranks fairly high on investor protection, if one focuses on liability for false or misleading disclosure in public offerings (Table 7). However, there is no U.K. equivalent to U.S. Rule 10b-5, the far-reaching provision that creates a private right of action for material misstatements that affect secondary trading of securities. Negligent misstatements in a company’s annual accounts and other financial documentation disseminated by directors of a U.K. publicly traded company can in theory form the basis for a suit by investors against the persons responsible for the disclosure, which can include its directors, but such a suit can succeed only in the rare event that the information was provided to guide a specific purchase or sale of shares.⁷⁴ In the United States, such reliance is assumed under the “fraud on the market” doctrine.⁷⁵ Finally, several of the U.K. procedural rules that impede suits under corporate law (Table 1) also discourage suits under securities law, including barriers to forming class actions, “loser pays” fee rules, and lack of a contingent fee system.

2001/2956, art. 6, ¶ (1)(b) (naming directors as a “person responsible”). On common-law liability, see *Al-Nakib Invs. (Jersey) Ltd. v. Longcroft*, [1990] 3 All E.R. 321, and *Possfund Custodian Tr. Ltd. v. Diamond*, (1996) 2 All E.R. 774 (Ch.). Statutory liability is more extensive in a variety of respects: *Encyclopedia of Financial Services Law* ¶ 2A-190 (Eva Z. Lomnicka & John L. Powell, eds., 1987–2001).

⁷⁴See, e.g., *Al-Nakib Invs. (Jersey) Ltd. v. Longcroft*, [1990] 3 All E.R. 321 and generally *Gore-Browne on Companies* ¶ 43.27 (Alistair Alcock, ed., 50th ed., 2004). In 2006, shareholders were given a right to sue the company for compensation for misleading periodic disclosure documentation, but not its directors. *Financial Services and Markets Act 2000*, § 90A; for background, see Davies (2007), *supra* note 4, at 25.

⁷⁵This difference underscores the hazards in measuring shareholder protection based on “law in books,” as the U.S. “fraud on the market” rule, which is critical to the viability of securities class actions, is not found in the statute books, but in case law. See *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

Table 8: Quantitative Studies of Shareholder Rights

<i>Study</i>	<i>Variables</i>	<i>Enforcement Taken into Account?</i>	<i>U.S. Score</i>	<i>U.K. Score</i>	<i>Cross-Country Average</i>
Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2006)	Anti-director index (recoded), based on (1) shareholders voting by mail; (2) absence of a requirement to deposit shares before a vote; (3) cumulative voting for directors; (4) relief to oppressed minority shareholders; (5) preemptive rights during share offerings; and (6) shareholder power to call a shareholder meeting	N/A	3 ^a	5	3.29 (72 countries)
Spamann (2006) ^b	LLSV anti-director index (recoded)	N/A	2	4	2.80 (46 countries)
Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2006)	Anti-self-dealing index, based on regulation ex ante (e.g., disclosure, approval by disinterested shareholders) and ex post (based on disclosure in periodic filings and ease of proving wrongdoing) of a transaction between a company and a majority shareholder	"Ease of proving wrongdoing" is one element of ex post regulation (based on standing to sue and access to evidence)	0.65	0.93	0.45 (72 countries)
Lele and Siems (2007) ^c	Shareholder protection index covering 1970–2005, using 60 variables, 42 involving protection of shareholders against boards and 18 involving protection against other shareholders	Ability to bring derivative litigation is one element of protection against the board	34 (in 2005)	38 (in 2005)	37.2 (5 countries) (in 2005)
Siems (2008) ^d	Shareholder protection index covering 1995–2005, using 10 variables, six involving protection of shareholders against boards	Ability to bring derivative litigation is one of the 10 elements	7.25	7.38	5.3 (20 countries) (in 2005)

^aOriginally coded as "5" in La Porta et al. (1998), supra note 2.^bSpamann (2009), supra note 3.^cPriya Lele & Mathias M. Siems, Shareholder Protection: A Leximetric Approach, 7 J. Corp. L. Stud. 17, 31 (2007).^dMathias M. Siems, Shareholder Protection Around the World (Leximetric II), 33 Del. J. Corp. L. 111 (2008).

The stronger U.S. substantive liability rules and more liberal procedural rules suggest that there should be more securities suits in the United States than in the United Kingdom, per publicly traded company. This is strongly the case. While around 150 to 200 securities class actions are filed per year in the United States, such litigation is rare in Britain. According to searches of electronic databases of judicial opinions, between 1990 and 2006 there was only one reported case involving a claim under statutory rules creating liability for misleading information in public offering documents, and the directors were not named as defendants.⁷⁶ Over the same time period, two additional cases, both naming directors as defendants, were brought under common-law principles alleging negligent misstatements in prospectus disclosures.⁷⁷ Of these two cases, one was dismissed, while the other survived a motion to dismiss and likely settled. Thus, while private enforcement of securities law complements private enforcement of corporate law in the United States, in the United Kingdom, neither body of law receives significant private enforcement.

2. Bankruptcy and Insolvency Law

Law governing enterprises that cannot pay their debts (principally “bankruptcy law” in the United States and “insolvency law” in the United Kingdom) may create the possibility of claims against the directors of failed companies. U.S. bankruptcy law indirectly serves this function. It does not offer important substantive rights to shareholders or creditors beyond those in corporate and securities law, but does provide a process by which those in charge of a bankrupt firm can pursue those claims. A U.S. bankruptcy trustee will often pursue claims against directors, and these claims are a source of heightened risk for directors of making personal payments.⁷⁸

U.K. insolvency law could potentially serve this role as well. An insolvent company’s liquidator is authorized to bring any action in the name of the company, including a breach of duty claim against directors.⁷⁹ U.K. insolvency law also imposes a duty on directors to refrain from continuing to trade if there is no reasonable prospect of avoiding insolvency.⁸⁰

⁷⁶See Eilís Ferran, *Cross-Border Offers of Securities in the EU: The Standard Life Flotation*, 4 *Eur. Corp. & Fin. L. Rev.* 461, 476–77 (2007); Armour (2009), *supra* note 17, at 85–86. The case was *Axa Equity & Law Life Assurance Society plc v. National Westminster Bank*, [1998] C.L.C. 1177 (unsuccessful application for discovery of documents in relation to a securities law claim against the company’s auditors and directors). Our search also revealed evidence of a second claim, referred to in another decision, which did not itself produce an opinion. See *Re Barings plc (No 6)*, [2001] 2 B.C.L.C. 159 at [4] (application by creditors of insolvent firm to call a creditors’ meeting to replace liquidator; some parties were potentially creditors because they had launched a securities law claim against directors).

⁷⁷The cases were (1) *Al-Nakib Invs. (Jersey) Ltd v. Longcroft*, [1991] BCLC 7 (claim against company and directors; struck out at preliminary hearing) and (2) *Possfund Custodian Tr. Ltd v. Diamond*, [1996] 2 B.C.L.C. 665 (claim against company and directors, survived application to strike out, no final judgment so presumably settled). *Axa Equity*, discussed in the preceding footnote, involved both statutory and common-law claims.

⁷⁸See Black, Cheffins & Klausner (2006), *supra* note 51 (most U.S. cases with personal payments by outside directors involve insolvent firms and low, missing, or contested D&O insurance).

⁷⁹Insolvency Act (UK) 1986, c. 45, § 212; Sched. 4, ¶ 4.

⁸⁰This is known as liability for “wrongful trading.” Insolvency Act 1986, § 214.

However, in practice, liquidators rarely sue directors of insolvent companies. A study of electronic databases of judicial opinions found only one instance during 1990–2006 where an insolvency practitioner brought a claim against former directors of a publicly traded company, albeit one that resulted in significant personal liability for the defendant directors (all inside directors).⁸¹ The need for the insolvent company to pay the defendants' legal costs ahead of the claims of creditors if the claim fails may be an important reason why liquidators rarely pursue these claims.⁸²

In sum, in the United States, private enforcement of securities law complements private enforcement of company law, and bankruptcy law contributes to private enforcement of both. In the United Kingdom, private enforcement is rare, no matter where one looks. Our initial search for substitutes for private enforcement of corporate law has only deepened the puzzle—What feature of the U.K. environment might substitute for the near-total lack of civil lawsuits against directors under *any* of the principal bodies of law that might be expected to constrain directors of publicly traded companies?

C. Public Enforcement

Enforcement by public authorities provides an obvious alternative or supplement to private enforcement. It turns out that in the United Kingdom, at least one aspect of public enforcement—the U.K. Takeover Panel—may offer a partial substitute for private enforcement.

1. Securities Regulators

Jackson and Roe show that public enforcement of securities laws, measured via a proxy based on the budget and resources available to regulators, is at least as strongly correlated with stock market development around the world as is private enforcement, measured by reference to an index based on the formal ease of bringing a private lawsuit.⁸³ These findings imply that even if lawsuits brought by private plaintiffs are uncommon in the United Kingdom, enforcement by securities regulators can potentially fill the gap. However, if one looks at measures of regulatory output—the number of public enforcement actions brought and the size of the penalties imposed relative to market size—the United Kingdom trails the United States to a degree comparable to the disparity we report as regards private litigation.⁸⁴ Enforcement by securities regulators is thus an unlikely substitute for private enforcement in the United Kingdom of corporate or securities law.

⁸¹Armour (2009), *supra* note 17, at 86. The case was *Bairstow v. Queens Moat Houses plc*, [2000] 1 B.C.L.C. 549, [2001] EWCA Civ 712, [2001] 2 B.C.L.C. 531 (claim against four inside directors for breach of duty in paying dividends out of capital; directors held liable jointly and severally to repay £79 million).

⁸²Insolvency Act 1986, §§ 115, 176ZA; Insolvency Rules (UK) 1986, r. 4.218(1)(a)(i).

⁸³Jackson & Roe (2008), *supra* note 15.

⁸⁴Coffee (2007), *supra* note 5, at 261–63; Armour (2009), *supra* note 17, at 87–89.

2. Disqualification of Directors

In the United Kingdom, the Department for Business, Innovation and Skills (DBIS) has a number of enforcement powers in relation to company directors, notably the ability to seek an order disqualifying individuals from acting as company directors for a prescribed period.⁸⁵ About 1,500 individuals are disqualified each year from serving as directors, typically on the basis that the manner in which they managed an insolvent company indicates they are “unfit” to again serve as a director.⁸⁶ However, disqualifications of directors of publicly traded companies are rare, in part because it is uncommon for publicly traded companies to enter insolvency proceedings.

Our findings bear this out. If disqualification is by court order, the proceeding must be commenced in the Companies Court.⁸⁷ As detailed in Table 4, over 2004–2006, we found only three cases where disqualification proceedings were commenced against directors of publicly traded companies. A total of six directors were involved, five of whom were inside directors.⁸⁸ Only one of these proceedings resulted in a court order, disqualifying one (inside) director for 10 years.⁸⁹

Since 2000, directors have been able to give a “disqualification undertaking” without a court hearing, a sort of plea bargain that has the same legal effect as a disqualification order.⁹⁰ Over 2001 to 2006, 71 percent of disqualifications were by means of an undertaking rather than a court order.⁹¹ One would anticipate that a disqualification claim would often be filed before the director gives a disqualification undertaking. If so, our searches should capture these claims. However, some disqualification undertakings appear to be given before a claim is filed.⁹² Thus, our findings understate the number of disqualifications.⁹³

⁸⁵Company Directors Disqualification Act 1986 (UK), c. 46.

⁸⁶Armour (2009), *supra* note 17, at 99; Company Directors Disqualification Act 1986, § 6.

⁸⁷See Company Directors Disqualification Act 1986, § 6(3); Practice Direction: Directors Disqualification Proceedings, ¶ 4.1; Her Majesty’s Court Service, *The Chancery Guide 2005* ¶ 20.1 (2005).

⁸⁸Where the claim forms did not indicate whether the defendants were inside or outside directors, we determined their status by reference to their Notice of Appointment forms filed at Companies House.

⁸⁹Secretary of State for Bus. Enter. & Regulatory Reform v. Sullman, [2008] All E.R. (D.) 238 (Dec).

⁹⁰Company Directors Disqualification Act 1986, §§ 1A, 7(2A), 8(2A).

⁹¹See Armour (2009), *supra* note 17, at 99.

⁹²Adrian Walters, *Bare Undertakings in Directors Disqualification Proceedings: The Insolvency Act 2000, Blackspur, and Beyond*, 22 *Comp. Law.* 290, 294–95 (2001).

⁹³While our searches could not capture claims instances in which all directors gave undertakings before a claim was filed, thus obviating the need for a filing, we checked whether the three reported cases we found provide a full count of the disqualified directors. By searching the Register of Disqualified Directors maintained at Companies House (see <http://www.companieshouse.gov.uk/didir>) we found three additional inside directors (one named in each of the claims) who were disqualified by giving undertakings, one for seven years and two for four years.

In the United States, there is no company law regulator equivalent to DBIS, and hence no systematic public enforcement of corporate law. There is also no general director disqualification regime. However, the SEC has the power to bar individuals from serving as directors of publicly traded companies. A study by Karpoff, Lee, and Martin of directors of U.S. public companies who faced public enforcement by the SEC or the Department of Justice for financial misrepresentation over 1978–2006 found proceedings against 2,206 individuals—approximately 76 per year. Of these, 31 percent (about 25 per year) were barred from serving as a director or officer of a publicly traded firm, either permanently or for a period of time. Hence, disqualification trends further deepen rather than resolve the U.K. director litigation puzzle our findings pose.

3. The Takeover Panel

Enforcement by securities regulators and director disqualification do not rebalance the private enforcement discrepancy between the United Kingdom and the United States, but the manner in which takeovers are regulated does do so to some degree. Takeovers of publicly traded companies are common in both countries and, in the United States, lead to a large percentage of the lawsuits under corporate law. In contrast, for U.K. companies, the actions of all participants in takeover situations relating to U.K.-registered companies are governed by a comprehensive code of conduct known as the City Code on Takeovers and Mergers (the City Code), which is promulgated and administered by the Panel on Takeovers and Mergers (the Panel).⁹⁴ The Panel seeks to enforce the City Code, with a trademark feature being enforcement in real time.⁹⁵

The City Code often imposes tighter constraints on directors than directors' fiduciary duties under corporate law. As a result, compliance with the former will necessarily imply compliance with the latter. Moreover, the Panel normally bars parties from engaging in any litigation (apart from a reference to the antitrust authorities) that might frustrate an actual or potential takeover bid.⁹⁶ As a consequence, there is almost no litigation surrounding takeovers in the United Kingdom. Enforcement by the Panel is therefore potentially an important U.K. substitute for private enforcement.

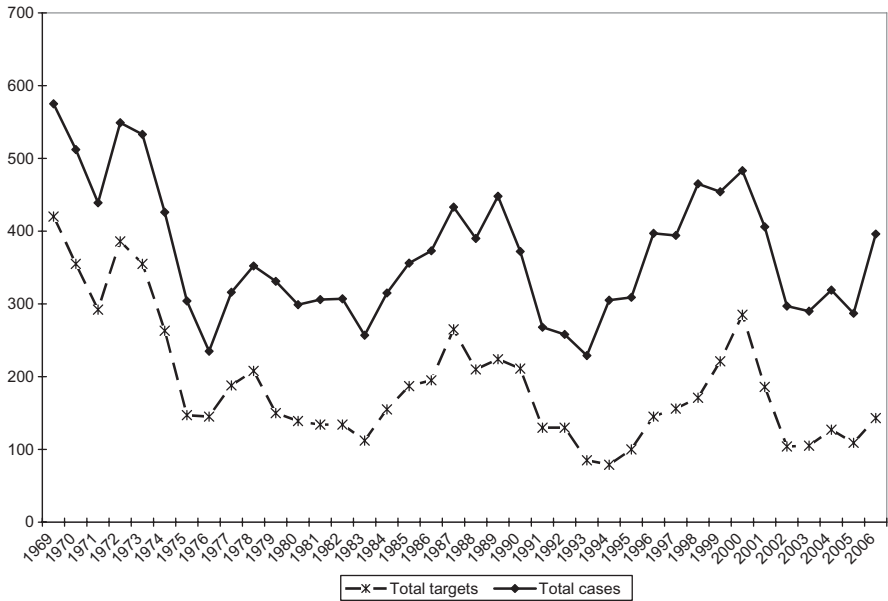
Data on the number of cases in which the Takeover Panel offers guidance confirm that it may be a substitute for civil enforcement of directors' duties.⁹⁷ During the 2004–2006 period covered by our analysis of cases filed, the Panel offered guidance on an average of

⁹⁴Companies Act 2006, §§ 942–959; City Code on Takeovers and Mergers (8th ed., 2006 + updates), available at (<http://www.thetakeoverpanel.org.uk>).

⁹⁵Armour & Skeel (2007), *supra* note 21, at 1729, 1743–45.

⁹⁶See City Code, *supra* note 94, r. 21.1; Weinberg and Blank on Take-Overs and Mergers ¶¶ 4-7114 to 4-7130B (William Underhill, ed., 5th ed., 1989, *supp.* 2006).

⁹⁷In the vast majority of cases, the Panel's response to a reference will be given in private. However, in a small minority of cases, the Panel will make a public ruling concerning the conduct of a particular bid situation.

Figure 2: Engagements by the Takeover Panel, 1969–2006.

NOTE: Data on total cases for 2005 and 2006 are estimates.
 SOURCE: TAKEOVER PANEL, ANNUAL REPORTS, 1969–2006.

287 cases per year,⁹⁸ or about 12 percent of the firms traded on the London Stock Exchange. Moreover, since 1969, the number of Panel engagements (Figure 2, black line) has exceeded the number of actual bids made (Figure 2, dashed line) by nearly 50 percent, meaning the Panel is clearly making rulings not only on bids that proceed but often in situations where a bid does not materialize.

D. Shareholder Governance Rights

Shareholder governance rights—powers enjoyed by shareholders over key decisions in the firm—also likely serve as a substitute for formal civil enforcement in the United Kingdom. Governance rights can reduce managerial agency costs by giving shareholders power to remove directors who do not act in shareholder interests as well as ex ante decision rights for transactions that could harm shareholder interests. On both counts, shareholders are better positioned in Britain than in the United States.⁹⁹

We have already seen that, in general terms, the United Kingdom scores highly on cross-country measures of shareholder rights, and outscores the United States (Table 8).

⁹⁸Takeover Panel, Annual Reports, 2005–2007.

⁹⁹Armour (2009), *supra* note 17, at 104–09.

The pattern is the same with respect to key specifics. U.K. shareholders, in contrast to their U.S. counterparts, generally enjoy preemptive rights when a company issues new shares, and U.K. institutions see these rights as providing important leverage when a firm needs capital.¹⁰⁰ Moreover, in the United Kingdom, shareholders owning 10 percent or more of the shares can call a shareholder meeting, whereas in the United States they generally cannot.¹⁰¹ In addition, U.K. directors, again unlike in the United States, cannot entrench themselves effectively against a resolution for their removal before the end of their term.¹⁰² Moreover, while U.K. institutional investors can join together informally to change a company's strategy or management with few legal obstacles, similarly-minded U.S. investors face various legal hazards.¹⁰³

Shareholder approval requirements are also more extensive in the United Kingdom than in the United States. In the United States, target company shareholders must vote on a merger with another company,¹⁰⁴ but almost all other transactions can be approved by the board alone. In the United Kingdom, shareholders have a veto over a range of potentially problematic transactions, such as managerial services contracts of greater than two years in duration, "substantial property transactions" between a director and his or her company, loans to directors, and political donations.¹⁰⁵ The London Stock Exchange Listing Rules also require that shareholders must approve transfers of assets to and from a company that exceed designated asset thresholds, and transactions between a company and a related party.¹⁰⁶

The United Kingdom also has a procedure involving a combination of shareholder veto rights and advance judicial clearance for major corporate transactions for which the United States has no counterpart. In the United Kingdom, a "scheme of arrangement" can be used to make mergers, share repurchases, debt reorganizations, and similar transactions

¹⁰⁰Companies Act 2006, §§ 560–577. See Iain MacNeil, Shareholders' Pre-Emptive Rights, 2002 J. Bus. L. 78, 78, 84–91, 95–97.

¹⁰¹Compare Companies Act 2006, §§ 303–305 (shareholders owning 10 percent of the shares collectively can call a shareholder meeting) with Delaware General Corporation Law § 211(d) (board of directors or persons authorized by the articles of incorporation or the bylaws can call a meeting). In most U.S. publicly traded firms, the shareholders have no rights to call a special meeting.

¹⁰²Companies Act 2006, §§ 168–169 (shareholders may remove directors without cause); Delaware General Corporation Law § 141(k)(i) (director removal must be for cause when a company has a classified board).

¹⁰³Bernard Black & John Coffee, Hail Britannia?: Institutional Investor Behavior Under Limited Regulation, 92 Mich. L. Rev. 1997–2087 (1994).

¹⁰⁴Delaware General Corporation Law § 251.

¹⁰⁵Companies Act 2006, §§ 188, 190, 197, 366.

¹⁰⁶See, e.g., FSA, Listing Rules, LR 10, 11, particularly LR 11.1.7. Companies listed on AIM, however, do not have to hold shareholder votes in relation to such transactions, and need only disclose their details. See London Stock Exchange, AIM Rules for Companies ¶¶ 12–13 (2007). In the United States, under NYSE and NASDAQ listing rules, the issuance of more than 20 percent of a company's previously outstanding shares requires shareholder approval.

Table 9: Schemes of Arrangement for U.K. Publicly Traded Companies, 2004–2007

<i>Year</i>	<i>No. of Schemes</i>	<i>Of Which, M&A Related</i>
2004	2	0
2005	4	2
2006	6	4
2007	13	12
Total	25	18
Mean	6.25	4.5

NOTE: Schemes of arrangement entered into by U.K. companies listed on the U.K. Official List or AIM, 2004–2007 that received court approval. “M&A-related” transactions involve either a cash-for-share or share-for-share acquisition, a de-merger, or a merger (whether cash-out or otherwise).

binding on investors.¹⁰⁷ The company must obtain 75 percent supermajority approval from each class of investors affected by the transaction and then apply for a court order that makes the arrangement binding on all concerned. The court must satisfy itself of the procedural fairness of the class representation and voting.¹⁰⁸ If it grants an order approving the scheme of arrangement, the ruling effectively bars a later challenge.

To assess how often schemes of arrangement are used in U.K. public companies, for 2004 to 2007 we searched for court orders for schemes of arrangement (they must be filed with the U.K. Registrar of Companies).¹⁰⁹ We matched these records with lists of firms traded on the London Stock Exchange Main List and AIM, then read orders involving these listed firms to determine the nature of the transaction. We found (Table 9) that schemes of arrangement are not frequent but are not rare either, with 25 such orders being granted over the four-year period. Most (18) of the 25 schemes approved during this period were M&A related, with 10 involving acquisitions of shares, three involving cash-out mergers, three involving share-for-share mergers, and two involving de-mergers (corporate “spinoffs”).

E. Discussion

Since our results for the United Kingdom contradict the private enforcement primacy view, we investigated potential law-related substitutes for formal private enforcement of corporate law. Across different bodies of law, the private enforcement pattern is similar to that for corporate law—formal private enforcement of securities law is also far more robust in the

¹⁰⁷Companies Act 1985, §§ 425–427; Companies Act 2006, §§ 895–900.

¹⁰⁸See, e.g., *Re Dorman Long & Co.*, [1934] Ch 635, 655–57.

¹⁰⁹Companies Act 1985, § 425(3); Companies Act 2006, § 899(4).

United States than in the United Kingdom and disqualification is a more potent sanction in the United States, at least for publicly traded companies. Public enforcement of securities law offers a similar picture.

However, we did find important areas where the U.K. regulatory regime provides more potent protection, with the emphasis being on ex ante screening as compared with ex post sanctions. The Takeover Panel resolves numerous contentious takeover matters by offering “real-time” dispute resolution as takeovers proceed. Shareholders in the United Kingdom have greater scope than their U.S. counterparts to dismiss directors not performing up to expected standards and to vote on key transactions. Finally, schemes of arrangement can be used to obtain advance judicial clearance for fundamental corporate restructuring. The latter two “shareholder governance” approaches bring us back to “law in books.” In important ways, the United Kingdom has stronger corporate law than the United States, in ways that let shareholders protect themselves without the need to file lawsuits.

It is plausible that these substitutes are sufficient so that, in the end, the scope for directors to resist takeover bids, take companies private at below-market prices, self-deal, or otherwise favor themselves are no greater in the United Kingdom than in the United States. Many U.S. scholars indeed prefer the U.K. system of takeover regulation.¹¹⁰ Others have advocated greater reliance on ex ante shareholder action and less on ex post litigation.¹¹¹ It is also possible that directors in both countries are constrained, in significant part, by other factors, not strictly legal. The most we can say is that the mix of constraints in each country is sufficient to support well-developed capital markets and diffuse share ownership, even when, as in the United Kingdom, formal private enforcement of corporate law is virtually nonexistent.

VI. CONCLUSION

Though this article has an overall comparative orientation, we have focused more on understanding Britain than the United States. The United Kingdom has strong substantive corporate law but almost no formal private enforcement of that law against directors of publicly traded companies. The absence of formal private enforcement highlights the importance of procedural rules, often general rules not limited to corporate cases, for the practical operation of substantive rules. Differences in general rules governing class actions, contingency fees, and who pays the winner’s legal expenses, in tandem with rules specific to corporate law that govern the availability of derivative actions and direct claims by shareholders, may do much to explain the large differences in levels of private enforcement.

¹¹⁰For an early statement of this preference, see Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 *Stan. L. Rev.* 819–91 (1981).

¹¹¹For an application of this approach to emerging markets, see Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 *Harv. L. Rev.* 1911–81 (1996).

The lack of formal enforcement in the United Kingdom—and its robustness in the United States despite relatively “weak” corporate law rules—also highlights the potential gap between law in books and law in action, which has been understudied in law-and-finance studies of the underpinnings of strong securities markets. U.S. corporate and securities law is often thought of as being highly protective of outside investors.¹¹² At least for corporate law, this is not because the substantive law is strong—by international standards it is not. The intensity of formal private enforcement may compensate for the modest substantive protections, producing a “shareholder-friendly” end result.

It is also possible, as some critics charge, that the United States suffers from *too much* private enforcement of corporate (and securities) law and might benefit at the margin from fewer—perhaps many fewer—lawsuits and thus lower litigation costs. We are not ready to go this far for two reasons. First, institutional differences between the two countries have to be taken into account. The situation with takeovers, a common source of lawsuits against directors of U.S. public companies, illustrates the point. In the United Kingdom, the work done by the Takeover Panel displaces the corrective role that litigation potentially plays in the M&A context. If the United States were to limit private lawsuits without introducing a similar regime, sharp practice might become an unwelcome hallmark of the market for corporate control.

Second, our results show that, with respect to corporate law, the risks directors of U.S. public companies face are not as large as is sometimes assumed. The annual odds that a NYSE or NASDAQ national market company would end up in our data set of suits that generated reported decisions were about 1.1 percent. The odds were considerably lower for smaller public companies. Also, more than half the cases we uncovered were dismissed at a preliminary stage of the proceedings. Our findings also suggest that the risk that directors would pay out of pocket is quite small—we uncovered only three instances with this result over an eight-year period. The upshot is that while directors of publicly traded U.S. companies are much more likely to be sued under corporate law than their British counterparts, lawsuits under corporate law are hardly an everyday occurrence and out-of-pocket liability is scarcely to be feared.

Other important points we simply have to leave open. We cannot say on the basis of our results what degree of formal private enforcement is optimal. Nor do we offer a view on how the optimal rate of formal private enforcement might vary depending on levels of public enforcement and informal enforcement. On the contrary, we suggest that one likely cannot answer those questions without a great deal of context on a full range of potential substitutes. Nevertheless, we have provided an empirical departure point for debate on these matters by providing empirical evidence showing how markedly rates of private enforcement differ in the United States and the United Kingdom and by showing that private enforcement of corporate law in the United States is not as robust as is often assumed.

¹¹²Mark J. Roe, *Corporate Law's Limits*, 31 *J. Leg. Stud.* 233, 257 (2002).

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