

# *RESPONSES*

## **FINALITY OF JUDGMENTS IN CLASS ACTIONS: A COMMENT ON *EPSTEIN v. MCA, INC.***

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*In this Response, Professor Allen contends that in arguing that plaintiffs in state court proceedings are unable to fairly and effectively bargain for the release of exclusively federal claims, the court in Matsushita II reached a judgment that is inconsistent with established concepts of finality of judgments, with design of an effective class action mechanism, and with the policies and precedents of full faith and credit. Although the centrality of the federalism idea has waxed and waned, the Supreme Court has generally encouraged respect by the lower federal courts of the processes and judgments of state courts. The existing system of decentralized state and federal courts allowed for the development of the Delaware Court of Chancery as a de facto specialized court of fiduciary and business law, which has been a positive force in the economy. The Matsushita II court, by contrast, does not accord respect to state court determinations of adequacy under Rule 23 and thus potentially reinvents the problem of inefficiency and second-guessing that is solved by the rule of finality and recognition of judgments. Commentators favoring Matsushita II's disregard for state court judgments erroneously believe that state court judges possess less integrity than their federal counterparts. A litigant is entitled to only a conscientious judicial determination of the issues according to law in a proceeding that meets constitutional minimums—a task that state courts are ably equipped to handle and that federal courts should not lightly disturb.*

The remand opinion of the Court of Appeals for the Ninth Circuit in *Epstein v. MCA, Inc.*<sup>1</sup> (*Matsushita II*), which once more denied recognition to a final judgment entered and a release authorized by the Delaware Court of Chancery, is remarkable. Essentially, *Matsushita II* deprives the Supreme Court opinion in the same case of its

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<sup>1</sup> 126 F.3d 1235 (9th Cir. 1997), reh'g granted (9th Cir. 1998) [hereinafter *Matsushita II*].

effect.<sup>2</sup> *Matsushita II* accomplishes this by using the argument that plaintiffs in state court proceedings are unable to fairly and effectively bargain for the release of the exclusively federal claims arising under the Securities and Exchange Act of 1934 (the 1934 Act).<sup>3</sup> This argument was explicitly considered by both the Delaware Court of Chancery<sup>4</sup> and, more importantly, by the Supreme Court of the United States.<sup>5</sup> Neither court accepted the Ninth Circuit's conclusions. Correctly understood, the ruling of either court binds the Court of Appeals, under either the Full Faith and Credit Act<sup>6</sup> in the case of the Court of Chancery, or Article III of the Constitution in the case of the Supreme Court. Indeed, the Supreme Court's opinion expressed the clearly correct view that "a Delaware court would afford preclusive effect to the settlement judgment in this case."<sup>7</sup>

The *Matsushita II* majority apparently disagreed. Under the "adequacy of representation" rubric, it reinstated its previous conclusion that the Court of Chancery judgment and the release it authorized were not entitled to the recognition the Full Faith and Credit Act mandates for valid final judgments.<sup>8</sup> *Matsushita II* breaks new ground in holding that a member of a Federal Rule of Civil Procedure 23(b)(3) class action who elects not to opt-out of the class remains free after the entry of a final judgment to attack that judgment collaterally on the ground that the class was not adequately represented in the original suit. This result is novel,<sup>9</sup> and inconsistent with established concepts of finality of judgments, with design of an effective class action mechanism, and with the policies and precedents of full faith and credit. This result plainly has the potential to do substantial injury to the utility of the class action mechanism, as Professors Kahan and Silberman explain.<sup>10</sup> Finally, *Matsushita II* is notable for its unwillingness to accord respect to the judgment of the Vice Chancellor

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<sup>2</sup> See *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367 (1996) [hereinafter *Matsushita I*].

<sup>3</sup> 15 U.S.C. § 78a (1994).

<sup>4</sup> See *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024, at \*4, (Del. Ch. Feb. 16, 1993), reprinted in 18 Del. J. Corp. L. 1053, 1061 (1993) [hereinafter *MCA II*].

<sup>5</sup> See *Matsushita I*, 516 U.S. at 378-79.

<sup>6</sup> 28 U.S.C. § 1738 (1994).

<sup>7</sup> *Matsushita I*, 516 U.S. at 378.

<sup>8</sup> See *Matsushita II*, 126 F.3d 1235, 1255-56 (9th Cir. 1997).

<sup>9</sup> See, e.g., *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (3d Cir. 1994) (holding that state court has power to allow parties to release exclusively federal claims arising from same transaction or occurrence as state law claims and that a subsequent suit in federal court is barred by federal full faith and credit statute).

<sup>10</sup> See Marcel Kahan & Linda Silberman, *The Inadequate Search for "Adequacy" in Class Actions: A Critique of Epstein v. MCA, Inc.*, 73 N.Y.U. L. Rev. 765, 773-86 (1998).

whose two written opinions on the settlement hearings in the state action, *In re MCA, Inc. Shareholder Litigation*,<sup>11</sup> are self-evidently thoughtful, conscientious efforts to resolve a case properly pending before him.

Judge Diarmuid O'Scannlain's dissent, on the other hand, is lucid, respectful of the letter and the spirit of the Supreme Court's opinion and thus of the federalist traditions of our law, and, in my opinion, correct. Perhaps the most insightful and illuminating statement in Judge O'Scannlain's dissent is the observation, put with collegial delicacy, that "the majority and the Supreme Court do not share the same vision."<sup>12</sup> Indeed, the vision of the proper place of state courts in our federalism enforced by the Supreme Court in *Matsushita I* and a long series of prior cases<sup>13</sup> seems strikingly at odds with the vision of the majority in *Matsushita II*.

In commenting briefly on this case, the issues it raises, and the commentary it has stimulated, I propose to proceed in stages as follows. First, I want to provide what I suppose is the appropriate frame for considering the question of finality of state court class action judgments in federal courts by referring to principles of our federalism and the basics of the law of full faith and credit. Second, I want to review some aspects of the proceedings in the Delaware Court in order to show that ideas deployed in *Matsushita II* were argued before the Court of Chancery and rejected. Third, I want to ask whether the approach to collateral review of class actions taken in *Matsushita II*, even if it were justifiable doctrinally, makes sense as public policy. Finally, I wish to comment briefly on some of the commentators, especially Professors Kahan and Silberman<sup>14</sup> and Professor Morrison.<sup>15</sup>

In all of this, I admit that I speak more in my role as a former Chancellor of the Delaware Court of Chancery than in my newer role as a professor of law. As a former state court judge, I am anxious that the principles of our federalism that are so deeply rooted in our history and in Supreme Court jurisprudence be carried forward and applied with intellectual honesty and commitment. In this, I probably represent the polar opposite, for example, of Alan Morrison, whose comment in this volume displays a suspicion and distrust of the integrity of state courts that my experience does not allow me to share.

<sup>11</sup> 598 A.2d 687 (Del. Ch. 1991) [hereinafter *MCA I*]; *MCA II*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 16, 1993), reprinted in 18 Del. J. Corp. L. 1053 (1993).

<sup>12</sup> *Matsushita II*, 126 F.3d at 1257.

<sup>13</sup> See infra notes 16-18, 20-22.

<sup>14</sup> See Kahan & Silberman, *supra* note 10.

<sup>15</sup> See Alan B. Morrison, The Inadequate Search for "Adequacy" in Class Actions: A Brief Rejoinder to Professors Kahan and Silberman, 73 N.Y.U. L. Rev. 1179 (1998).

## I

*A. The Supreme Court and the Demands of Our Federalism*

The creation of a functioning, stable federalist system of government has presented both a centuries-long challenge and one of the greatest successes of our constitutional government. Future developments of the European Union will demonstrate to the world how difficult the task of creating and operating a federalist legal order is and how substantial our accomplishment has been. Relations between state and federal courts under a single Constitution provide a special aspect of the problems of a federalist system. That special problem has occupied a central place in the jurisprudence of the Supreme Court. The case law governing abstention by federal courts,<sup>16</sup> the case law governing federal court injunctions of pending state court proceedings,<sup>17</sup> the teachings respecting exhaustion of state court remedies prior to federal habeas corpus proceedings,<sup>18</sup> application of the Rules of Decision Act<sup>19</sup> and choice of law problems,<sup>20</sup> and judicial pronouncements interpreting the Full Faith and Credit Act,<sup>21</sup> present some, but not all, of the contexts in which the Supreme Court has worked to manage the relationship between federal and state courts, within the radiant generalities of our Constitution.

Federalism represents a political choice, and it has never been universally embraced. The centrality of the federalism idea has waxed and waned over our history, of course, but the thrust of Supreme

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<sup>16</sup> See, e.g., *Louisiana Power & Light Co. v. City of Thibodaux*, 360 U.S. 25 (1959) (affirming federal district court's decision staying proceedings pending state supreme court proceedings); *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943) (holding that federal courts may stay jurisdiction out of respect for independence of state action); *Railroad Comm'n of Texas v. Pullman Co.*, 312 U.S. 496 (1941) (holding that it may be necessary to stay federal action pending authoritative determination of difficult state law issues).

<sup>17</sup> See, e.g., *Younger v. Harris*, 401 U.S. 37 (1971) (holding that possible unconstitutionality of state statute does not in itself justify injunction against state enforcement of statute).

<sup>18</sup> Compare *Fay v. Noia*, 372 U.S. 391 (1963) (holding that in habeas corpus proceedings, federal courts need not view state decisions regarding federal constitutional issues as *res judicata*) with *McCleskey v. Zane*, 499 U.S. 467 (1991) (holding that assertion of claim in second federal habeas petition that was not raised in first habeas petition constituted abuse of the writ) and *Wainwright v. Sykes*, 433 U.S. 72 (1977) (holding that federal court may not hear habeas petition where defendant failed to follow state procedural rule).

<sup>19</sup> 28 U.S.C. § 1652 (1994).

<sup>20</sup> See *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938) (requiring use of state substantive law in federal diversity actions).

<sup>21</sup> See *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461 (1982) (holding that 28 U.S.C. § 1738 requires federal courts to give preclusive effect to state administrative agency's rejection of employment discrimination claim); *Allen v. McCurry*, 449 U.S. 90 (1980) (holding that state court ruling on federal constitutional issues collaterally estopped defendant from bringing 42 U.S.C. § 1983 claim in federal court).

Court authority has encouraged respect by the lower federal courts of the processes and judgments of state courts.<sup>22</sup> In *Matsushita I*, the Supreme Court dealt with only a detail of this important subject. But, in an age in which corporate mergers and acquisitions constitute the prototype business transaction—and affect hundreds of billions of dollars and millions of shareholders annually—that detail has practical significance. Every corporate merger gives rise to potential claims of breach of fiduciary duty by corporate directors or violations of state statutes, both of which present questions of state law. Every such transaction also potentially gives rise to claims of breach of disclosure obligations under the 1934 Act as well. Since the corporation law of the State of Delaware, which is the most often relevant corporation law in the nation, requires that corporate directors make full and honest disclosure of relevant facts when they recommend a merger (or otherwise ask for shareholder action),<sup>23</sup> these state law and federal law theories can look rather similar and, in all events, usually arise out of the same general set of facts. Importantly, however, while the United States District Courts have pendant jurisdiction to hear related state claims,<sup>24</sup> state courts are not authorized to determine claims arising under the 1934 Act.<sup>25</sup> Thus it becomes relevant to know whether a representative shareholder who has brought a state claim class action suit in a state court on behalf of all similarly situated shareholders may, as part of an overall settlement of all claims arising from the merger, grant a release of federal claims owned by the class. If he or she does so, what are the rights of the released party thereafter, if granting the release was approved by a state court pursuant to a settlement hearing on notice and with an opportunity to be heard?

It is, of course, not obvious that a well-designed federalist system of decentralized judicial power should permit a state court to release

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<sup>22</sup> See, e.g., *Migra v. Warren City Sch. Dist.*, 465 U.S. 75, 84 (1984) ("[P]etitioner's state-court judgment in this litigation has the same claim preclusive effect in federal court that the judgment would have in . . . state courts."); *Kremer*, 456 U.S. at 483 (stating that state procedures for evaluating employment discrimination claims satisfied due process requirements); *Allen*, 449 U.S. at 104-05 (requiring federal courts to give preclusive effect to state court rulings on federal constitutional issues). The idea that state courts provide a parallel judicial system entitled to dignity equal to that of the lower federal courts with respect to the resolution of questions within their jurisdiction is not universally accepted. Compare Burt Neubourne, *The Myth of Parity*, 90 Harv. L. Rev 1105, 1105 (1977) (criticizing notion that "state and federal courts are functionally interchangeable forums likely to provide equivalent protection for federal constitutional rights") with Paul M. Bator, *The State Courts and Federal Constitutional Litigation*, 22 Wm. & Mary L. Rev. 605, 636-37 (1981) ("[T]he state courts will and should continue to play a substantial role in the elaboration of federal constitutional rights.").

<sup>23</sup> See *Zirn v. VLI Corp.*, 681 A.2d 1050, 1056 (Del. 1996).

<sup>24</sup> See 28 U.S.C. § 1367 (1994).

<sup>25</sup> See Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1994).

claims that the state court is not empowered to adjudicate. But on close consideration, most federal appeals courts that have considered the question have concluded that the authorization of the release of class claims arising from the facts subject to adjudication is, absent constitutional defects in the process, entitled to protection under the Full Faith and Credit Clause.<sup>26</sup> The Ninth Circuit Court of Appeals reached a different conclusion in *Epstein v. MCA, Inc.*<sup>27</sup> It held that the inability of the state law plaintiff to try the federal claim disabled a state court from releasing such a claim in a way deserving of the respect of a federal court.<sup>28</sup>

In *Matsushita I*, the Supreme Court of the United States reversed the Ninth Circuit.<sup>29</sup> It observed that under the Full Faith and Credit Act, the federal court must look to the law of the jurisdiction rendering a judgment to determine whether the first court had jurisdiction to approve the release, even though federal law clearly prevented the first court from adjudicating the claim.<sup>30</sup> The Supreme Court determined that under Delaware law the Court of Chancery did have such jurisdiction.<sup>31</sup> The Supreme Court thus confirmed the entitlement to full faith and credit recognition of valid state court judgments that approve the release of federal claims arising from the same operative facts as those subject to a state court adjudication.

### B. Matsushita II

In *Matsushita II*, the Court of Appeals addressed the question of whether the Delaware judicial process had afforded class members due process of law. Specifically, the Ninth Circuit panel addressed the adequacy of the class representation in the Delaware litigation.<sup>32</sup> In addressing this issue, the majority of the panel expressed the view that the Delaware court had not previously evaluated adequacy and, alternatively, that since Mr. Epstein had not personally appeared in Delaware, he could not be foreclosed from litigating the due process character of the Delaware proceeding in any case.<sup>33</sup>

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<sup>26</sup> See, e.g., *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (1st Cir. 1991) (holding that state courts can approve and enforce settlements releasing exclusively federal claims); *TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456 (2d Cir. 1982) (same); *Abramson v. Pennwood Inv. Corp.*, 392 F.2d 759 (2d Cir. 1968) (same).

<sup>27</sup> 50 F.3d 644 (9th Cir. 1995).

<sup>28</sup> See id. at 664.

<sup>29</sup> See *Matsushita I*, 516 U.S. 367, 387 (1996).

<sup>30</sup> See id. at 381.

<sup>31</sup> See id. at 382.

<sup>32</sup> See *Matsushita II*, 126 F.3d 1235, 1240-41 (1997).

<sup>33</sup> See id. at 1240-42.

I suggest that the *Matsushita II* panel's reliance on the elementary notion that judgments entered in contravention of due process of law are not entitled to recognition reflects a fundamental misunderstanding of the doctrine of full faith and credit. The question is not whether Mr. Epstein has to be accorded due process of law if he is to be bound by the class action in Delaware—of course he must. The question is, when the trial court fully complies with the provisions of Rule 23, how many times will a class member who elects not to take his or her opt-out right be free to have the question of the adequacy of the rendering court's process adjudicated? Existing law and, I think, good sense would suggest once is enough. *Matsushita II* suggests that each nonappearing member of the class will be free—*seriatim* in theory—to seek another adjudication of compliance with Rule 23.

## II

### A. Basics of Finality of Judgments and Full Faith and Credit

The finality of judgments validly entered is an elementary characteristic of our legal system. A party is entitled to only one adjudication of a claim or defense by a court with jurisdiction. This basic rule is premised on the knowledge that all human processes are imperfect. The rule of finality recognizes that permitting substantive review by a second court of an issue that was fairly adjudicated in a prior litigation between the same parties can provide no assurance that the judicial system will produce any higher proportion of "right" answers to factually or legally difficult questions. Relitigation only assures us that legal problems will stay unresolved longer and will cost more to resolve. Thus, where a court has jurisdiction over both the person and the subject matter, there is no good reason to permit judicial second-guessing of one court by another absent corruption of the process. Reasonable protection against substantive errors of judgment can, and are, built into the legal system by rights to appeal.

The common law doctrines of merger and bar, res judicata, and collateral estoppel are the legal system's principal devices for implementing the policy of finality. The Full Faith and Credit Clause<sup>34</sup> and Act<sup>35</sup> are the devices that allow the efficient concept of finality to be implemented in our polycentric federalist legal order. The baseline principle in this law is the observation that a court in which a collateral attack is made upon a final judgment must necessarily answer for itself the question of whether the foreign jurisdiction's judgment is a

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<sup>34</sup> See U.S. Const. art. IV, § 1.

<sup>35</sup> See 28 U.S.C. § 1738 (1994).

valid judgment before it recognizes and gives legal effect to that judgment.

However, in determining validity, only a limited number of considerations are open to parties bringing the collateral attack. They may attack the rendering court's jurisdiction over either the person or subject matter, or they may attack the judgment on the ground that the proceeding that gave rise to it denied them due process of law. But, if the rendering court afforded due process to the parties to the litigation before it, and if it had jurisdiction to enter the judgment, the inquiry is ended and the second court is required to accord the judgment the same effect it would have in the rendering jurisdiction.<sup>36</sup>

Significantly, in determining whether a foreign judgment is valid, the second court must apply the law of the first or rendering jurisdiction (including, of course, the Supremacy Clause).<sup>37</sup> This brings me to my final preliminary point. If the rendering jurisdiction has itself determined any question going to the validity of its judgment in a judicial proceeding that meets due process standards, that determination is binding on the second court.<sup>38</sup> For example, if personal jurisdiction is an issue that the defendant appears and contests, the defendant will be bound conclusively by the determination. A federal court will not be free later to determine that "minimum contacts" between the defendant and the rendering jurisdiction were not present, even though such contacts may be said to be elements of constitutionally necessary due process.

### B. Prior Adjudication—MCA Shareholders Litigation

Since the judgment to which the Ninth Circuit twice refused to accord recognition is a final judgment of the Delaware Court of Chancery, a brief review of the proceeding in that court is relevant. That suit and the later federal *Epstein* suit arose out of the same transaction in which Matsushita Electric Industries acquired all of the stock of MCA, Inc., a Delaware corporation. The acquisition was in the form of a two stage transaction; the first stage was a public cash tender

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<sup>36</sup> See, e.g., *Migra v. Warren City Sch. Dist.*, 465 U.S. 75, 85 (1984) (holding that state court judgment in 42 U.S.C. § 1983 case has same claim-preclusive effect in federal court that it would have in state court).

<sup>37</sup> See, e.g., *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 381 (1985) (holding that Full Faith and Credit Act "requires a federal court to look first to state preclusion law in determining the preclusive effects of a state court judgment").

<sup>38</sup> See *Middlesex County Ethics Comm. v. Garden State Bar Ass'n*, 457 U.S. 423, 433-34 (1982) (holding that state court's determination that disciplinary proceedings are "judicial in nature" merits federal court deference); *Allen v. McCurry*, 449 U.S. 90, 105 (1980) (holding that state court determination of Fourth Amendment issue precluded federal claim under 42 U.S.C. § 1983).

offer and the second stage was a merger in which the non-tendering shareholders of MCA were "cashed out."<sup>39</sup>

In the Delaware suit, the plaintiffs claimed that the directors of the company failed to fulfill their duties of care and loyalty and did not get the best available price for the company.<sup>40</sup> Plaintiffs in both the Delaware litigation<sup>41</sup> and in the federal litigation<sup>42</sup> claimed that Lew Wasserman, the CEO of MCA, received preferential treatment in the tender offer. Shortly after the close of the tender offer, Wasserman transferred his stock to Matsushita in exchange for preferred stock, not cash. The receipt of a different form of consideration by a fiduciary in connection with a merger theoretically opened Wasserman (and Matsushita as one who facilitated and participated in the alleged breach) to the possibility of a claim for breach of fiduciary duty. The claim would be that the consideration he received was more valuable, and that the greater value should have been distributed by the buyer to all of the other shareholders pro rata. Receipt of a different form of consideration also opened Wasserman and Matsushita to possible suits for violation of SEC Rules 14d-10<sup>43</sup> and 10b-13,<sup>44</sup> adopted under the 1934 Act, which mandate that all shares bought during a tender offer be bought pursuant to the public offer and that all holders be paid the same consideration. The first claim (breach of fiduciary duty) would be a state law claim. The second (violation of Rules 14d-10 and 10b-13) is a federal law theory, cognizable only in federal court.

The parties in the Delaware suit very promptly reached a proposed settlement that would have offered very little benefit to the shareholders and would have released the federal claims.<sup>45</sup> The Vice Chancellor, after notice and a hearing under Court of Chancery Rule 23 (modeled on Federal Rule of Civil Procedure 23), determined that the state law claims were "extremely weak."<sup>46</sup> He concluded that the federal law claims had "at least arguable merit"<sup>47</sup> and, in the exercise of judicial discretion, declined to approve the settlement.<sup>48</sup>

The defendants enjoyed greater success in the federal litigation brought shortly after the Chancery case. The MCA directors were

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<sup>39</sup> See *MCA I*, 598 A.2d 687, 690-91 (Del. Ch. 1991).

<sup>40</sup> See id. at 690.

<sup>41</sup> See id.

<sup>42</sup> See *Epstein v. MCA, Inc.*, 50 F.3d 644, 648 (9th Cir. 1995).

<sup>43</sup> See 17 C.F.R. § 240.14d-10 (1998).

<sup>44</sup> See id. § 240.10b-13 (1998).

<sup>45</sup> See *MCA I*, 598 A.2d at 689-90.

<sup>46</sup> Id. at 694.

<sup>47</sup> Id. at 695.

<sup>48</sup> See id. at 696.

dismissed from the federal suit on the merits and, on the eve of trial, the District Court dismissed the complaint.<sup>49</sup> The Delaware parties then reopened negotiations and reached agreement for the payment of a two million dollar fund to the class, with the attorneys to seek a fee of \$691,000 from that fund.<sup>50</sup> The federal plaintiffs filed an appeal in California and sought expedition in consideration of their appeal. The Court of Appeals denied expedited treatment—a fact to which the Vice Chancellor made particular reference in his review of the second settlement application.<sup>51</sup>

Objectors appeared at the second settlement hearing before the Court of Chancery. The factual sections of their briefs set forth the alleged violations of the 1934 Act being pressed on behalf of the MCA shareholders.<sup>52</sup> The objectors submitted affidavits to the Vice Chancellor that included the full briefs of the *Epstein* plaintiffs on their then-pending appeal of the dismissal of their federal claim<sup>53</sup> and argued that the federal claims were viable and valuable.<sup>54</sup> Additionally, the objectors challenged the good faith of the class representatives. Among the argument sections of the briefs the objectors submitted to Court of Chancery were sections entitled: "The Second Proposed Settlement is Collusive and Should Not Be Approved,"<sup>55</sup> and, "The Court Should Postpone A Decision On the Second Proposed Settlement."<sup>56</sup> The brief shows that the gist of the collusion claim was an argument much like the one later set forth in *Matsushita II*: The ability of the state court to release claims that could not be tried in that court created an incentive, especially strong when the state law claims were weak, for the state plaintiffs' attorney to trade the merits of the federal claims for a fee.

The Vice Chancellor considered these arguments. On February 16, 1993, he issued an opinion rejecting them.<sup>57</sup> That opinion represents a candid, thoughtful evaluation of the merits of the state law

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<sup>49</sup> See *Epstein v. MCA, Inc.*, 50 F.3d 644, 648 (9th Cir. 1995) (summarizing district court judgments).

<sup>50</sup> See *MCA II*, Civ. A. No. 11740, 1993 WL 43024, at \*5 (Del. Ch. Feb. 16, 1993), reprinted in 18 Del. J. Corp. L. 1053, 1063 (1993).

<sup>51</sup> See id. at \*2, reprinted in 18 Del. J. Corp. L. at 1059.

<sup>52</sup> See Memorandum of Objector Pamela Minton De Ruiz in Opposition to the Proposed Settlement at 9, *MCA II* (Civ. A. No. 11740).

<sup>53</sup> See Affidavit of William A. Krupman at Exhibits B, C, F, G, H, *MCA II*, (Civ. A. No. 11740).

<sup>54</sup> See id. at 4-6.

<sup>55</sup> Memorandum of Objector Pamela Minton De Ruiz in Opposition to the Proposed Settlement at i, *MCA II* (Civ. A. No. 11740).

<sup>56</sup> Id.

<sup>57</sup> See *MCA II*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 16, 1993), reprinted in 18 Del. J. Corp. L. 1053 (1993).

claims and the federal law claims, placing emphasis upon the dismissal of those claims by the District Court, while acknowledging the pendency of the appeal and the denial of a motion for expedited review by the Ninth Circuit.<sup>58</sup> The opinion recognized the risks inherent in the settlement process when two alternative class actions are pending, and it considered and rejected as speculation the claim that the settlement was the result of collusion.<sup>59</sup> The settlement was approved, including the release of the federal claims.<sup>60</sup>

On appeal to the Delaware Supreme Court, the objectors' opening brief continued to press the point that "the Second Proposed Settlement is Collusive,"<sup>61</sup> and, in the reply brief, asserted the "Collusive Nature of the Settlement."<sup>62</sup> The Supreme Court of Delaware affirmed the judgment of the Court of Chancery.<sup>63</sup>

### III

#### A. Comment on *Matsushita II*

Crammed into a single sentence, the question posed by *Matsushita II* is the following: Should a member of a class of shareholders be free collaterally to attack a judgment entered on a settlement by a court in another state when (1) that shareholder was afforded notice of and a right to opt-out of the action and chose not to opt-out, and (2) the rendering court has, after a hearing on notice, adjudicated compliance with the terms of Rule 23 in an adversary proceeding and approved the settlement as fair?

While the Court of Appeals did not accept that the Delaware Court of Chancery adjudicated the adequacy of representation in the suit before the Delaware court, the more significant basis for its decision is the belief that a class member who does not actually appear in the state court action is always free in a second action to contest the constitutional underpinnings of the class suit and the judgment in it. This result is, of course, in considerable tension with the well-settled law of finality of judgments. If every member of the class who does not actually appear in a class suit prior to judgment is able to trigger a review of the quality of the efforts of those representing the class, we will have, insofar as class actions are concerned, reinvented the problem of inefficiency and second guessing that is solved by the rule of

<sup>58</sup> See id. at \*5, reprinted in 18 Del. J. Corp. L. at 1062.

<sup>59</sup> See id.

<sup>60</sup> See id. at \*1, reprinted in 18 Del. J. Corp. L. at 1057.

<sup>61</sup> Appellants' Opening Brief at 21, *In re MCA, Inc. Shareholders Litig.*, 633 A.2d 370 (Del. 1993) (No. 126, 1993).

<sup>62</sup> Appellants' Reply Brief at 1, *MCA Shareholders Litig.* (No. 126, 1993).

<sup>63</sup> See *In re MCA, Inc. Shareholders Litig.*, 633 A.2d 370 (Del. 1993).

finality and recognition of judgments. Why should the law compel that result? I suggest that so long as members of the class generally received due process in the rendering jurisdiction, no aspect of fundamental fairness to a class member who elects not to opt-out after notice compels that result.

In reaching its result, the Court of Appeals relied upon class action cases having nothing to do with full faith and credit. The panel asserted that Epstein had no obligation to opt-out of the class action, and according to the court, no obligation to monitor any aspect of the class proceeding.<sup>64</sup> From these correct premises the Court of Appeals concluded that such a class member remains free to raise challenges to the quality of the adjudication in the first forum.<sup>65</sup> But analytically, this step is a non sequitur.

Fundamental fairness to class members does not require this further judicial proceeding. A class member in a Rule 23(b)(3) class action is afforded due process of law by the conscientious application by the court of the requirements of Rule 23, including subparts (a), (b)(3), and (e). Fundamental fairness to class members who elect to remain in the class does not demand anything more.<sup>66</sup>

Assuming, as the Chancery Court concluded, that notice of the class action was constitutionally adequate and that the opt-out right contemplated by Rule 23(b)(3) was afforded to members of the class, and that the court determined that the elements of Rule 23(a) are satisfied, then it is certainly reasonable for the rendering forum, and for the federal judicial system, to conclude that class members consent to the exercise by the court of jurisdiction over their claim.<sup>67</sup> In such circumstances there ought to be no difference for due process purposes between a shareholder who is passive and one who appears at the hearing and actively participates through objection. If it is funda-

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<sup>64</sup> See *Matsushita II*, 126 F.3d 1235, 1244 (9th Cir. 1997).

<sup>65</sup> See *id.* at 1245.

<sup>66</sup> See *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-78 (1974) (rejecting district court's use of preliminary hearing on case's merits); *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553, 1560 (3d Cir. 1994) (stating that state court need only provide "notice plus an opportunity to be heard and participate in the litigation" in order to satisfy due process (quoting *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985))).

<sup>67</sup> It is true that for some number of class members the failure to opt-out probably represents not a knowing and intelligent choice but simple passivity. This fact could be used in support of an argument that only opting in (not currently contemplated by Rule 23) should suffice to constitute consent to adjudication of a claim by a non-resident. The legal material for such an argument could be readily fashioned, but what good reason would exist for accepting it? If a mandatory opt-in rule applied to only state court nationwide class actions, the predictable effect would be that plaintiffs' counsel would not bring these actions in state courts but would bring them in federal courts where they could be assured the advantage of inclusiveness.

mentally fair to foreclose one from collateral review, it is equally fair to preclude the other. The class member who elects not to opt-out, but to participate in the benefits of the action, has a legal right to those benefits and should, I suppose, be bound by the process that produces those benefits.

### B. *The Unrealism of the Reasoning of Matsushita II*

Even on its own assumptions, the majority opinion in *Matsushita II* is unpersuasive. The Court of Appeals concluded that the special fact that the federal claims could not be tried in the Court of Chancery bore importantly upon the constitutional adequacy of the representation in the state class action.<sup>68</sup> The Appeals Court argued, and the commentators agree, that plaintiffs were unable to assert appropriate leverage in any settlement negotiations in the state court action.<sup>69</sup> Moreover, the *Matsushita II* court at least thought that counsel would have been informationally disarmed as well, not having had access under the Federal Rules of Civil Procedure to discovery relating to the federal claim.<sup>70</sup>

The appeal of these two related arguments is superficial and unsound. An acquaintance with the reality of class and derivative litigation shows that these ideas—pressed as I have said before the Court of Chancery and the United States Supreme Court—are rooted not in the actual forces of work-a-day life, but in partial and flawed deduction. With respect to access to information, the breadth of discovery rights under Federal Rule of Civil Procedure 26 (widely adopted by the states) renders the imagined information problem illusory in M&A cases. First, defendants would very rarely be able to hide information bearing on a federal theory while fully meeting discovery obligations under the state law theory. More practically, however, if a defendant proposes that a release of federal claims be negotiated as part of an overall settlement, and if plaintiffs' counsel has even minimally acceptable professional ethics, defendants will be required to produce sufficient additional information to permit an appropriate evaluation of the claim. There is no ground to suppose that lawyers in state court adjudications have less professional integrity than those in federal court. Indeed, they are frequently the same lawyers. The information problem is not a real problem.<sup>71</sup>

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<sup>68</sup> See *Matsushita II*, 126 F.3d at 1249-50.

<sup>69</sup> See id. at 1249; see also, e.g., Morrison, *supra* note 15, at 1182.

<sup>70</sup> See *Matsushita II*, 126 F.3d at 1249.

<sup>71</sup> Some commentators, including Professor Morrison, do not trust plaintiffs' counsel (although Professor Morrison may be distrustful only when they are in state courts). These observers believe that counsel tends to sell meritorious claims for a fee. This suspicion is

The second thing that the Ninth Circuit, as well as Professor Morrison, seems to believe is that an inability to threaten to try the federal case "disarms" plaintiffs, depriving them of effective leverage, thus contributing to the claimed inadequacy of class representatives in this case. The idea—expressed in terms of the adequacy of representation rather than the more primary power to approve the release—appears to be that any representative who would negotiate a release with this little leverage is suspect. But, again from a practical perspective, this superficially plausible idea appears illusory. It is not correct that because a state court cannot try a 1934 Act claim, a state court plaintiff can not credibly threaten to go to trial on such a claim. In Wilmington, Delaware where the *MCA* case was settled, the federal court is located one block away from the state courthouse. The same lawyers practice in both courts and are perfectly capable of drawing up and filing a complaint overnight. Defendants understand this. The United States District Court in Delaware is as capable of scheduling trials expeditiously as any district in the country.

But my point is, of course, not limited to Delaware or to this case. It is about how lawyers work in our federal system. Class action counsel know how to litigate in state as well as federal court with equal expertise. They can file complaints quickly and seek expedition. Knowing that the plaintiff could quickly file a 1934 Act claim in the federal court if necessary makes it unnecessary for the plaintiff to do so in order to have the leverage that a 1934 Act claim provides. Therefore, the principal practical consideration that the Ninth Circuit deploys to try to justify its relitigation is a mistaken view that the absence of judicial power to try a 1934 Act claim in state court materially affects the information available and the leverage of plaintiffs' class counsel in the state court forum.

#### IV COMMENT ON THE COMMENTATORS

The commentators differ in their reaction to *Matsushita II*. Professors Kahan and Silberman correctly identify the threat to the

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widely held by others, of course, and to some extent is almost certainly justified. Plaintiffs' counsel share the general tendencies and weakness of the species, even if happily not uniformly so. But this problem of "selling out" by "pilgrims" is a well known risk, protected against, to some extent, by the judicial process that requires notice, hearing, and judicial approval. This process is certainly not perfect, but the significant point is that the risk of selling out plaintiffs is a function of the way we have designed class action suits and exists in federal courts as well as state courts. Thus the potential for sell-outs is the reason the rendering court will have a hearing and will make a judicial determination of the fairness and adequacy of the settlement. It is not a reason for a second court to take up and re-determine a matter addressed by the rendering court.

utility of the class action device that the opinion represents.<sup>72</sup> They urge a more limited form of collateral review.<sup>73</sup> Professor Morrison, on the other hand, is not critical of *Matsushita II*.<sup>74</sup> He approves of its seizure, at the behest of class members in Rule 23(b)(3) class actions, of the power for federal courts to review the judicial administration of the class action suit in the rendering state court.<sup>75</sup> He minimizes the likely adverse consequences to the utility of class actions and, indeed, thinks that one of the apparent consequences of the decision would be quite positive.<sup>76</sup>

Professors Kahan and Silberman suggest a different and more limited form of collateral review than the review under which the panel feels entitled to engage. Under their more limited "process" review, the second court would ask the global question whether the first court had taken reasonable measures to protect federal interests and to guard against the deficiencies of global state court settlements.<sup>77</sup> They make some sensible suggestions how that might be done. Very significantly, in their view only those who objected in the state proceeding would have standing to make such collateral attack as they would permit.

Of course, state courts should take reasonable steps to protect federal interests—meaning when called upon to do so they should apply federal law with the same integrity, diligence, and commitment that they deploy in applying the law of the state. Of course, state courts should guard against deficiencies in the settlement process; this is precisely one of their obligations under Rule 23 and the Due Process Clause. Courts, whether state or federal, will do so by fashioning an adequate notice, by assuring that the terms of Rule 23(a) are met and, on settlement after notice and hearing, by evaluating the claims asserted and the claims proposed to be released on appropriate information and by according parties and objectors due process of law. These suggestions are noncontroversial. What is controversial in the Kahan and Silberman approach is the suggestion that class members who personally appear and submit an objection should be free to raise adequacy of counsel questions collaterally, even after receiving a ruling on that question by the court rendering judgment. I am not persuaded that fundamental fairness to class members requires this step. Absent corruption of the process in the state forum, their suggestion

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<sup>72</sup> See Kahan & Silberman, *supra* note 10, at 765-66.

<sup>73</sup> See *id.* at 786-92.

<sup>74</sup> See generally Morrison, *supra* note 15.

<sup>75</sup> See *id.* at 1188-90.

<sup>76</sup> See *id.* at 1186-87.

<sup>77</sup> See Kahan & Silberman, *supra* note 10, at 787.

seems enmeshed with contradictions and unnecessary to assure systematic fairness.

Professor Morrison's contribution to this issue is of an entirely different type than Professors Kahan and Silberman's thoughtful and moderate suggestions. Professor Morrison's comments reflect strong advocacy<sup>78</sup> for his "nationalist"—as opposed to a "federalist"—perspective.<sup>79</sup>

Why Professor Morrison likes *Matsushita II* is not mysterious. He distrusts state courts and would prefer to see class actions that have both state claims and 1934 Act claims tried or settled in federal courts. Thus Professor Morrison's comments clearly illuminate the federalism issue that is close to the core of the policy questions raised by this case. Do we think it is a social good to try to center (or to create incentives to center) litigation arising out of mergers and acquisitions in the federal court system? About this reasonable minds will differ. My own view, shaped by years of working in the Delaware Court of Chancery, is that especially in the areas of mergers and acquisitions law, there is social value in the existing decentralized system of state and federal courts. The evolution of the Court of Chancery of the State of Delaware as a de facto specialized court of fiduciary and business law has been a positive force in the economy. I suppose that a judicial ruling that for no very compelling reason creates any incentive to divert merger and acquisition cases from that court or other state courts disserves the public good.

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<sup>78</sup> A few examples of his strong advocacy: (1) Judge O'Scannlain is said to share the view that the representation in Delaware was inadequate, "in so far as he does not argue to the contrary." Morrison, *supra* note 15, at 1181. (2) Defendants settled in Delaware "because they believed that the scrutiny afforded the deal there would be greatly diminished." *Id.* at 1183. No evidence to support that fact is suggested. Recall that the Delaware court had refused to approve the release of federal claims the first time the matter was presented. See *MCA I*, 598 A.2d 687, 696 (Del. Ch. 1991). Also recall that the federal District Court had dismissed the case for failing to state a claim. See *Epstein v. MCA, Inc.*, 50 F.3d 644, 648 (9th Cir. 1995) (summarizing district court judgment). The logical inference is that the defendants could reach a deal with the Delaware plaintiffs but not with the federal plaintiffs. But this fact simply does not logically permit the further inference that either set of plaintiffs were more loyally protecting legitimate class interests. (3) Professor Morrison states that settling a state claim and negotiating the release of a federal claim in connection with it "is not in the best interests of the class members." Morrison, *supra* note 15, at 1184. This is a simple non sequitur. (4) Most evident of Professor Morrison's strong advocacy, and indeed unfair and offensive to state judges generally, is his statement respecting a perceived (by him) need to force state courts to give "proper consideration" to the federal claims. *Id.* at 1180.

<sup>79</sup> See Richard H. Fallon, Jr., *The Ideologies of Federal Courts Law*, 74 Va. L. Rev. 1141, 1151-64 (1988) (defining and discussing "federalist" and "nationalist" models of judicial federalism).

Professor Morrison apparently disagrees. He has a strong preference for a federal forum for the resolution of federal securities law claims, and, given the outcome of the Supreme Court's decision in *Matsushita I*, active collateral review of state court judgments is the best hope remaining to achieve that goal. Thus, where Kahan and Silberman see regrettable consequences of the panel's decision—principally the loss in utility of class action settlements—Morrison sees a desirable effect: a greater incentive to bring suits in the federal system. Logically, federal class action settlements as well as state court administered settlements can be subject to later review for "adequacy" under *Matsushita II*. But, as a practical matter, a plaintiff's attorney could be expected to feel that the risk of a federal court settlement being reviewed as the Ninth Circuit reviewed the Delaware settlement would be very slight. Thus, *Matsushita II* will act as an incentive to bring M&A litigation into federal courts where all aspects of the matter can be effectively resolved. Notwithstanding the Supreme Court's ruling in *Matsushita I*, he trumpets what he interprets as the "basic message" of *Matsushita II*: "[T]hat federal courts should look with considerable skepticism on state court class action settlements that release federal claims which state courts are forbidden to adjudicate . . ."<sup>80</sup> This strong taste for allowing such second opinions when the federal courts are the reviewing court appears to be driven by distrust of the competence, diligence, or perhaps even the integrity of state courts. While this general preference is not uncommon,<sup>81</sup> it is not universal.<sup>82</sup> In all events, Professor Morrison's regard for state courts is markedly low. Astonishing to me, at the outset of his comments he asserts that "state courts *will give federal claims proper consideration* only when federal courts are able to look over the shoulders of state court judges. . ."<sup>83</sup>

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<sup>80</sup> Morrison, *supra* note 15, at 1180.

<sup>81</sup> See, e.g., Neubourne, *supra* note 22, at 1105-06 (arguing that state courts are less receptive to vigorous enforcement of federal constitutional doctrine).

<sup>82</sup> See Paul M. Bator, *Finality in Criminal Law and Federal Habeas Corpus for State Prisoners*, 76 Harv. L. Rev. 441, 454 (1963) (arguing that, absent unsatisfactory state court process for deciding federal questions, federal courts should not redetermine merits of federal questions decided by state courts).

<sup>83</sup> Morrison, *supra* note 15, at 1180 (emphasis added). That state courts do not now give proper consideration to any released federal claims is assumed, not shown, as I doubt it could be. Certainly the facts of the *Epstein* case themselves do not suggest that such an assumption is justified. Recall that (1) the state court judge had at an earlier stage declined to approve a settlement that would have released the federal claims; (2) when he finally did so, the United States District Court had already dismissed the complaint for failing to state a claim upon which relief could be granted; and (3) the substantive claim itself—violation of the SEC's rule requiring that all holders of stock be paid the same consideration during the pendency of a tender offer—was not supported by even one case that held the rule was violated when a sale occurred after the tender offer had been closed. There were objectors

Is it true that state court judges require the prospect of collateral review by lower federal courts of their adjudication or settlement of class actions in order to afford the public reasonable assurance that a good faith and competent effort to achieve justice is being made? Not to put too fine a point on it, is it true that federal judges on average have greater integrity than state judges? Why should any of us think that is the case? One may conjecture that those state judges who are elected are, by reason of the fact that they must stand for election, less likely than life tenure federal judges to have the independence of judgment that justice requires. But even for those of us who agree that election of judges is a very poor idea, the notion that good policy requires lower federal courts to be available to reevaluate the state process when the state court has already adjudicated compliance with the requirements of Rule 23 seems incorrect and unwise. Certainly election of state judges has coexisted with the law assuring recognition in federal courts of state court judgments for a very long time.

I suppose better policy lies in embracing the values of federalism reflected in the policies of finality and comity and in applying those principles to Rule 23(b)(3) class actions. Litigation must come to an end. Perfection on earth is not the lot of humankind. So long as the judicial process in the first or rendering court was not corrupted in some way (by, for example, fraud on the court or corruption of the court itself) and all of the determinations and actions required by Rule 23 were made in the exercise of judicial judgment, due process has been accorded to the members of the class who have not opted out. All that any litigant should be entitled to is a conscientious judicial determination of the issues according to law in a proceeding that meets constitutional minimums. When the issue of whether those minimums are satisfied is itself actually adjudicated by the court in such a class action, that subject too is foreclosed from further adjudication by other courts, whether on the motion of one who actively participates or one who, having received notice and an opportunity to be heard, was passive.

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present at the settlement and the trial court judge therefore realized that his judgment would probably be subject to review on appeal. While Professor Morrison and others appear to disagree with the soundness of the Vice Chancellor's conclusion, it is foolish to suggest that *Matsushita II* is necessary to assure that state courts act responsibly. Our system has from the beginning assigned too much of our most important judicial work to these courts for us easily to accept that they lack competence or integrity.