SHAREHOLDER LITIGATION IN AUSTRALIA AND THE UNITED STATES: COMMON PROBLEMS, UNCOMMON SOLUTIONS

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To what extent should the decisions of companies' directors and controlling shareholders be challenged in litigation brought by disgruntled shareholders? The response in the United States tends to differ from that in Australia and Great Britain and to produce divergent legal rules for the regulation of shareholder litigation. Nonetheless, to some extent these dissimilar legal rules reflect common policy concerns created by shareholder litigation. This article begins with a brief sketch of the development of rules governing shareholder derivative suits, actions in which the shareholder sues on behalf of a company in which he owns shares alleging that the company has failed to pursue an action on account of a wrong done to it. It traces the subsequent evolution of controls imposed on shareholder litigation in each country, using a comparative perspective to illustrate relative strengths and deficiencies.

I Early Developments

People who know little else of the law applicable to shareholder suits in Britain and Australia know—however vaguely—of *Foss* v. *Harbottle* and the continuing legacy of this 1843 case. The rule in *Foss* v. *Harbottle*[1] proceeds from the position that the company itself is the proper plaintiff in an action on account of wrongs done to it; the rule is generally understood to bar a shareholder's suit on account of a wrong allegedly done to a company if the wrong complained of could be approved or ratified by an ordinary resolution (adopted by simple majority vote) of the company's shareholders. Thus, the bar does not reach transactions that are not eligible for validation by a majority vote of the company's shareholders, rendering *Foss* v. *Harbottle* inapplicable to actions alleging an injury to the plaintiff's personal rights or interests rather than rights and interests of the corporation, to actions alleging that the transaction

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[1] (1843) 2 Hare 461; 67 E.R. 189.

was *ultra vires* the corporation, or that the transaction or events constituted a fraud on the minority by a majority of the shareholders. The rule in *Foss* v. *Harbottle* does, however, preclude shareholder suits that challenge directors' and officers' decisions that do not fall into these excepted categories, such as claims of negligent mismanagement of the company's affairs and claims of ratifiable breaches of the fiduciaries' duty of loyalty to the company.

In some respects, the conventional black letter formulation of the rule in *Foss* v. *Harbottle* appears to have overtaken the case itself. Indeed, the case appears to be more about pleading than about conceptions of internal corporate governance or about rules defining plaintiffs' standing to sue. The Vice-Chancellor's judgment tests the adequacy of the plaintiff's bill against the defendants' demurrers, illustrating that "[u]ncertainty is a defect in pleading of which advantage may be taken by demurrer".[2] Among its other deficiencies, the plaintiff's bill failed to allege that the company lacked a governing body, or that no general meetings of shareholders were held, or that the company's directors were not functioning as directors. True, the relevance of these matters to the demurrers suggests some contemporary understanding of restrictions on shareholders' ability to sue, but perhaps one far from the rigidity of the conventional statement of "the rule in *Foss* v. *Harbottle*". For one thing, the Vice-Chancellor's analysis of the deficiencies in the Bill is preceded by the statement that cases may arise of injury to corporations done by some of their members, in which "the claim of justice would be found superior to any difficulties arising out of the technical rules respecting the mode in which corporations are required to sue".[3]

The rule in *Foss* v. *Harbottle* is also attributed in part to an 1847 case, *Mozley* v. *Alston*, in which the defendants' demurrers to the shareholder-plaintiff's bill were granted.[4] Like *Foss* v. *Harbottle*, the judgment in *Mozley* v. *Alston* appears to be concerned with the adequacy of the plaintiff's pleading—in *Mozley* v. *Alston* the plaintiff alleged that a majority of the shareholders agreed with his opinion—and the absence of any reason "to admit a form of pleading which was originally introduced on the ground of necessity alone, to a case in which it is obvious that no such necessity exists".[5] The plaintiff in *Mozley* v. *Alston* was also unable to establish the unavailability of an adequate remedy in law and sought an injunction in a form that, in the Court's assessment, would not be feasible. Nonetheless, the significance of these procedural contexts disappeared from the classic statement of "the rule in *Foss* v. *Harbottle*" given in 1902 in *Burland* v. *Earle*:[6]

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[2] *Id.* 503; 207. *Cf. Estmanco (Kilner House)* v. *Greater London Council* [1982] 1 All E.R. 437, 443 (Ch.Div.) (doubting whether the author of the judgment in *Foss* v. *Harbottle* "foresaw the vigorous and active life which his decision would lead, or the many controversial obscurities that would arise about actual or possible exceptions from the rule that he was laying down.")

[3] *Supra* n. 1 at 492; 203.

[4] (1847) 1 Ph. 790.

[5] *Id.* 801.

[6] [1902] A.C. 83 at 93.

> It is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their power, and in fact has no jurisdiction to do so. Again, it is clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should *prima facie* be brought by the company itself. These cardinal principles are laid down in the well-known cases of *Foss* v. *Harbottle* . . . and *Mozley* v. *Alston* . . . .

The desire to read *Foss* v. *Harbottle* and *Mozley* v. *Alston* as cases that lay down cardinal principles, rather than cases concerned with pleading and equitable remedies, probably has explanations that transcend the modest scope of this paper. One consequence of the practice of distilling these cases into "cardinal principles" is that the content of these principles may become indeterminate, as different readers distill different essences from the same context-bound material.[7] The central academic preoccupation then becomes a quest to discover the "true" rule in *Foss* v. *Harbottle*, rather than to recapture the contemporary understanding of mid-nineteenth century legal materials.

The counterpart to *Foss* v. *Harbottle* in the United States—in duration of legacy if not precise analogy of doctrine—is *Hawes* v. *City of Oakland*,[8] decided by the United States Supreme Court in 1882. Many aspects of the current regulation of derivative suits in the United States can be traced to *Hawes*. In *Hawes* the Court did not adopt the rule in *Foss* v. *Harbottle* to preclude shareholder suits raising specified types of claims. Instead the Court, using the power it then had to make rules of general equity jurisprudence, established four procedural regulations for shareholder derivative actions. First, prior to filing suit, *Hawes* required the prospective plaintiff to make a demand on the corporation's shareholders that they take action to resolve his grievance, including perhaps endorsing an action against the prospective defendants or removing them from corporate office. When suit was filed, *Hawes* required that the plaintiff's complaint allege that a demand was made, or the reasons that excused the plaintiff from making the demand, such as its likely futility under the circumstances. Second, *Hawes* imposed a comparable requirement of demand on the corporation's directors as a prerequisite to the initiation of a derivative suit, acknowledging that the demand could be excused if making it would be futile. Third, *Hawes* required the plaintiff's complaint to plead with particularity facts establishing compliance with these requirements, and to allege that the derivative suit had not been instituted as a result of collusion among the parties to create federal

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[7] See Wedderburn, "Shareholders' Rights and the Rule in *Foss* v. *Harbottle*", [1957] *Cam. L.J.* 194 at 195 (noting discrepant formulations of the Rule in twentieth-century texts); see also *Hawkesbury Development Co.* v. *Landmark Finance Pty. Ltd.* [1969] 2 N.S.W.R. 782 at 791-2 (noting dispute as to "real elements" of Rule).

[8] 104 U.S. 450 (1882).

jurisdiction over an action that would otherwise be litigated in state rather than federal court. Fourth, *Hawes* required the plaintiff to allege that he owned shares at the time of the wrong complained of, or that his shares devolved on him by operation of law.

Even on an elementary level, the differences between *Hawes* and the rule in *Foss* v. *Harbottle* are noteworthy and pervade the later development of derivative litigation in each country.[9] The demand requirements in *Hawes*, although establishing prerequisites for a derivative suit, do not foreclose the possibility of shareholder litigation of some types of claims, as does the rule in *Foss* v. *Harbottle*. That is, the rule in *Foss* v. *Harbottle* precludes shareholder suits raising certain types of claims, and presumably enables defendants successfully to move to dismiss such actions. In contrast *Hawes* regulates derivative suits by establishing preconditions to the plaintiff's eligibility to sue, but does not exclude claims from litigability. Indeed, *Foss* v. *Harbottle* has been criticized precisely because it is not a demand requirement: the rule turns on whether shareholders *could* ratify the transaction and not on whether they have done so or have explicitly been given the opportunity to do so.[10]

Hawes was decided in an era in which the United States Supreme Court frequently cited and discussed English precedents and often used them as persuasive authority; thus the Court's treatment of *Foss* v. *Harbottle* is of interest in assessing the contemporary (albeit trans-Atlantic) reading of that case. *Hawes* explains that *Foss* v. *Harbottle* asserts the primacy of the company's right to sue, subject to qualification when the "claims of justice" would supervene "the technical rules" regarding the mode of the company's action. The remaining discussion of *Foss* v. *Harbottle* explains why the Vice-Chancellor's judgment found the plaintiff's bill to be fatally defective: it failed to allege the absence of a board of directors who might have brought the suit, while the plaintiff failed to meet its duty to call a shareholders' meeting to obtain the action of a majority of the shareholders on the matters in issue.[11] The latter proposition, of course, comes close to treating *Foss* v. *Harbottle* as support for the requirement of demand on shareholders imposed by *Hawes* itself. Did the Court that decided *Hawes* simply fail to perceive the significant difference between a demand requirement and the rule in *Foss* v. *Harbottle*? A more likely explanation is that the Court read *Foss* v. *Harbottle* as a case interpreting requirements of pleading against facts that did not compel any departure from them. Thus, the nineteenth century reading of *Foss* v. *Harbottle*, at least in Washington, D.C., may not have been as a rigid rule of claim-preclusion.

Hawes also differs from the rule in *Foss* v. *Harbottle* because it regulates derivative suits by imposing as a precondition to suit the require-

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[9] But see A. Afterman, *Company Directors & Controllers* (1970) at 156 (discussing "American version of the Rule").

[10] See L.C.B. Gower, *Modern Company Law* (4th ed. 1979) at 646.

[11] *Supra* n. 8 at 454-56.

ment that the plaintiff make a prior demand on the corporation's directors. By requiring demand on directors, *Hawes* expressly acknowledges a proper role for the corporation's directors in initiating and controlling litigation professedly brought on the corporation's behalf. This may stem in part from the statutory definition of directors' managerial prerogatives in the United States. Corporation statutes in the United States typically provide that directors shall have power to manage the corporation's business and affairs; in contrast, in Australia as in Britain the definition of directors' prerogatives and the division between directors' powers and those of shareholders is accomplished in the corporation's articles. In short, the statutory basis for directors' managerial prerogatives in the United States may enhance the scope of directors' power as it affects litigation brought on the corporation's behalf.

In Australia, the plaintiff in a derivative action must show that the company is unwilling or unable to sue; as making a demand on the directors is the best way of doing so, the Australian regulation of derivative actions embodies an inchoate demand requirement.[12] Finally, the rule in *Foss* v. *Harbottle* may represent the continuing legacy of the long-discarded notion in English company law that directors are merely agents of shareholders[13] because it suggests the shareholders have residual power, by a majority vote, to compel the directors to take actions that fall within the scope of management. If so, the rule is not consistent with the conception of directors' powers that underlies a demand requirement.

In any event, the U.S. cases treat litigation-related questions as falling within the directors' business judgment—as discretionary choices about the management and control of the corporation's business—if the directors act in good faith and are disinterested in the outcome of the litigation. Thus, if the directors refuse the prospective plaintiff's demand, and the plaintiff then brings a derivative suit, the court will dismiss the suit unless the plaintiff can establish that the directors acted wrongfully in refusing the demand.

The directors, if they act in informed good faith, may refuse the plaintiff's demand that they sue upon a claim for a number of reasons, including of course a low likelihood of success on the merits. The directors may also with propriety decide not to sue upon a claim that may succeed on its merits, if the costs of pursuing the action outweigh the likely amount of recovery, or if the action would jeopardize valuable commercial relationships between the corporation and the defendants. Thus, directors may have good faith reasons to decline to sue that are not related to the narrow legal merits of the underlying claim itself.

As noted above, the plaintiff may be excused from making a demand

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[12] *Cf. Hawkesbury Development Co. Ltd.* v. *Landmark Finance Pty. Ltd.* [1969] 2 N.S.W.R. 782, 790-91 (company's receivership does not require departure from rule in *Foss* v. *Harbottle* because its directors, still in office, have capacity to bring action).

[13] *Automatic Self-Cleansing Filter Syndicate Co. Ltd.* v. *Cunninghame* [1906] 2 Ch. 34, rejects the view that a majority of the shareholders could override a directors' decision, except through a regulation adopted by an extraordinary resolution, which would require a super-majority.

on directors if the exercise would be futile. U.S. jurisdictions[14] vary in the stringency with which they define "futility"; the analysis in this paper focuses principally on Delaware because its popularity as a *situs* for incorporation of publicly-held corporations makes the Delaware position more than one among fifty-three equally interesting possibilities. The Delaware test for excuse focuses on the relationship between the directors and the transaction challenged in the suit.

The plaintiff in a derivative suit to which Delaware law is applicable is excused from making a demand on the corporation's directors only if the complaint alleges facts that create a reasonable doubt whether the challenged transaction resulted from a valid exercise of informed business judgment by the directors.[15] Under this test, demand would be excused if a majority of the directors had a personal pecuniary stake in the transaction they approved, for then their approval would not meet the criterion of disinterest posited by the business judgment concept; likewise demand would presumably be excused if the directors' approval of the transaction was insufficiently deliberative and informed to be characterized as an exercise of judgment. But in the absence of such circumstances, Delaware law requires the prospective derivative plaintiff to make a demand on the corporation's directors, thereby acknowledging the directors' power to initiate and control litigation brought on the corporation's behalf. Demand is not excused, moreover, simply because the plaintiff names all directors as defendants.

Despite its more-than-superficial dissimilarities to the rule in *Foss* v. *Harbottle*, the requirement of demand on directors in fact shares an underlying policy rationale. The rule in *Foss* v. *Harbottle* and succeeding Commonwealth precedents are often said to represent a policy of judicial reluctance to interfere in matters of corporate "internal management" and to reflect judicial deference to the existence of defined organs of corporate decision making. Thus, some claims are effectively non-justiciable because they could be the subject of decisions made by the corporation's shareholders. The requirement of demand on directors could be attributed to a comparable deference. That the prospective derivative plaintiff must make a demand on the corporation's directors, unless they have some personal stake in the transaction at issue or are otherwise disqualified from acting, may similarly stem from judicial deference to the corporation's "internal management" vested in its board of directors.

Likewise, comparable policy rationales support other aspects of legal controls on derivative litigation developed in the United States and in the Commonwealth jurisdictions. Common concerns include a fear of repetitious litigation, brought by successive shareholder-plaintiffs against the company, and a concern to suppress litigation that is frivolous or is

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[14] For these purposes, fifty-three jurisdictions are relevant in the United States—the fifty states plus the District of Columbia, the Virgin Islands and the Commonwealth of Puerto Rico, all of which have corporation statutes.

[15] See *Aronson* v. *Lewis* 473 A.2d 805 (Del. 1984).

brought merely to harass. In the United States as well as the Commonwealth, regulations of derivative litigation have attempted to devise a credible mechanism to determine whether the interests of the company itself—or the interests of all or a majority of its shareholders—are best served by the maintenance of the action. To be sure, the details of these regulations differ, in some respects markedly so.

II Inevitable Tensions Evolve

A. *On the U.S. front*

Perhaps inevitably, after *Hawes* v. *City of Oakland* derivative litigation in the United States evolved into a well-established but always controversial institution. Several separate elements in this evolution contributed to the complexity and subject-matter focus of derivative litigation. *Hawes*, as noted above, was a product of the Court's exercise of equitable rule-making power, and, more generally, of an era in which the United States Supreme Court actively determined rules of general federal common law, including principles of equity jurisprudence.[16] This era ended in 1938 with the Court's decision in *Erie Railroad* v. *Tompkins*;[17] thereafter, the development of federal "common law" was restricted to cases raising federal questions, that is those raised by federal statutes or the United States Constitution.[18] *Erie*, and subsequent interpretations of the Court's reasoning in that case, also restricted the Court's ability, through its rule-making powers granted by the federal Rules Enabling Act, to prescribe rules of substantive law in addition to rules regulating procedure in federal court litigation.[19] As a consequence, the "substantive" law applicable to derivative suits brought in federal court is state law, in most instances that of the company's state of incorporation. As it happens, the federal rules of civil procedure contain a rule specifically addressing derivative suits,[20] and whether that rule should be interpreted simply to make applicable the pertinent provisions of applicable state law—such as demand requirements—or whether it imposes of its own force significant regulation of derivative suits, is a question on which federal courts have disagreed,[21] as have commentators.[22] The Supreme Court has not addressed this

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[16] The Court's venture into general federal common law began with *Swift* v. *Tyson* 41 U.S. (16 Pet.) 1 (1842). In *Swift* the Court held that federal courts had power to determine "general" federal common law if no state statute governed the subject, in cases in which federal subject matter jurisdiction was based on the parties' diversity of citizenship. On "local" questions, principally created by disputes involving real property, *Swift* required federal courts to follow state common law.

[17] 304 U.S. 64 (1938).

[18] Debate continues over the scope and source of federal courts' common law powers. See, e.g., Field, "Sources of Law: The Scope of Federal Common Law" 99 *Harv. L. Rev.* 883 (1986).

[19] See, e.g., *Hanna* v. *Plumer* 380 U.S. 460 (1965).

[20] Fed. R. Civ. Proc. 23.1.

[21] Compare *Daily Income Fund* v. *Fox* U.S. (Stevens, J., concurring), with *Shlensky* v. *Dorsey* 574 F.2d 131 at 141-42 (3d Cir. 1978).

[22] Compare J. Moore & J. Kennedy, *Moore's Federal Practice* 23.1.19 (1985) with DeMott, "Demand in Derivative Actions: Problems of Interpretation and Function", 19 *U.Cal.Davis L. Rev.* 461 (1986).

question directly. It has, however, held that in derivative actions raising claims under the federal securities law, state law governs issues concerning the right to control the litigation, unless the state law in question conflicts with the policies represented by the provision of federal securities regulation from which the claim arises.[23] Thus, the residual legacy of *Hawes* must be separated from the era of "general federal common law" when the Court's law-defining powers extended to matters that now quite clearly are seen as properly within the province of state law.

Departing from the legacy of *Hawes*, relatively few of the states continue to require the prospective plaintiff to make a demand on the corporation's shareholders prior to commencing a derivative suit. Although the states differ on the circumstances excusing the demand on directors, in contrast that aspect of *Hawes's* regulation of derivative suits continues to be generally imposed. Two factors explain the decline of demand on shareholders. First, the likely quality of the shareholders' decision, at least in large corporations, may not justify the costs of making the demand. Requiring the demand to be made if the corporation has a large number of shareholders imposes considerable expense and burden on the plaintiff; further the shareholders in such a corporation will not deliberate together in a body but will simply review written materials, not a mode of decision-making likely to produce a deliberate collegiate judgment. Second, if the putative defendants communicate with the shareholders—if, for example, they are the corporation's directors—and the shareholders refuse the demand, the plaintiff under judicial interpretation of federal securities statutes then has an independent right to sue to challenge the accuracy of the communications received by the shareholders.[24] As a result, the derivative suit would be pretermitted but would be replaced by a non-derivative direct action focused on the defendants' communications with the company's shareholders.

Coupled with the decline in the requirement of demand on shareholders, however, is the imposition in many U.S. jurisdictions of additional regulation of derivative suits that is inapplicable to most other types of civil litigation. About one third of the states impose special security for expense requirements on derivative plaintiffs, and most U.S. jurisdictions have rules controlling the settlement or voluntary dismissal of derivative suits and class actions. Each of these requirements in turn responds to somewhat different concerns about derivative litigation.

Security for expense statutes require the plaintiff to post security, out of which the defendants' litigation costs can be paid if the suit is unsuccessful. Most of these statutes are by their terms inapplicable if the plaintiff owns more than a specified amount of stock. They began to be

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[23] See *Burks* v. *Lasker* 441 U.S. 471 (1979).

[24] Rule 14a-9 makes it a violation of the Securities Exchange Act of 1934 to solicit proxies by means of statements that omit or mis-state material facts and thereby are misleading. In *J. I. Case & Co.* v. *Borak* 377 U.S. 426 (1964), the Court held that a private plaintiff had an implied right to sue for money damages and injunctive relief on account of violations of rule 14a-9. S. 14(a) of the Securities Exchange Act confers rule-making authority on the SEC to prescribe rules regulating the solicitation of proxies.

enacted by the states in the 1940's in response to assertions that many derivative suits were frivolous and were brought as "strike suits" to exact a settlement of little benefit to anyone other than the plaintiff's attorney. These statutes represent an exception to the general U.S. rule that parties bear their own expenses in litigation, including attorney's fees, in that they shift the defendants' litigation expenses on to the unsuccessful plaintiff. That most such statutes exempt plaintiffs who are substantial shareholders[25] suggests that these statutes were designed to respond to the suit brought by a plaintiff with a small stake both in the company and in the merits of litigation brought on its behalf. As it has long been customary—and is indeed legal—for attorneys to represent clients in such litigation on a contingent fee basis, the attorney's investment in human capital in pursuing the action may well exceed the value of the plaintiff's equity investment in the company. In practice, however, the security for expense statutes do not appear to deter many plaintiffs, because once the defendant moves to require that the security be posted, the court stays the action to permit the plaintiff to seek additional shareholders as plaintiff-intervenors so as to meet the requisite amount of shareownership to exempt the action from the statutory security requirement. As a result, some defendants omit the demand because the plaintiff's quest for intervenors will lead to greater publicity for the claims alleged in the complaint.

The potential for disparity in economic interest between the plaintiff's attorney and the plaintiff is similarly part of the explanation for the special treatment of voluntary dismissals and settlements of derivative litigation. Although in general parties bear their own litigation costs in the United States, a long-standing convention has permitted the plaintiff's attorney's fees to be taxed to any common fund recovered by the plaintiff on behalf of a class or a company, whether created as a result of judgment after trial or through a settlement agreement. Thus, the plaintiff may have little investment in the company, and no investment in the suit if the attorney has been engaged on a contingent fee basis; the attorney is likely to receive a fee, however, if the action is settled. The individual defendants' interest in negotiating the agreement is to minimize their personal financial contribution and loss.

All these factors combined suggest that the dynamics of settlement negotiation may not adequately protect the interests of the corporation and all of its shareholders because none of the actors in the negotiating process has economic interests that are necessarily closely aligned with those of the corporation. In response, the federal rules of civil procedure, and most states, require judicial approval of any settlement or voluntary dismissal of a derivative suit, and require the court's approval to be preceded by notice to the corporation's shareholders of the terms of the settlement agreement. The notice enables any shareholder who objects to

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[25] See, e.g., N.Y. Bus. Corp. Law s. 627. In contrast, the California security for expense statute leaves to the court's discretion the determination whether under the circumstances of the case security should be required and does not provide a threshold amount for exemption. See Cal. Corp. Code s. 800.

the terms of the settlement to come forward. Most importantly, the court critically reviews the terms of the agreement, including the amount to be paid to the plaintiff's attorney and the basis on which the fee was computed. If these requirements are complied with, the judgment of dismissal or settlement bars relitigation of the same claim by any other shareholder.

One additional development in the United States is crucial to understanding the role presently played by derivative litigation. As in the Commonwealth, special regulations imposed on derivative suits make it attractive, when possible, to litigate individual (or non-derivative) claims rather than derivative claims. Cases in the United States, in contrast to the Commonwealth, have long recognised that the same facts could give rise to individual as well as derivative claims.[26] Further, federal courts have long held that private litigants have implied rights to sue under several sections of the federal securities laws, including the general anti-fraud provision[27] and that regulating proxy solicitations[28] and other communications in connection with shareholder voting or shareholder action. Facts that include an allegedly misleading solicitation of a shareholder vote—as a practical matter amalgamations and other fundamental transactions—create an individual cause of action under the federal securities laws, at least for public companies, and the resulting litigation tends to be an individual or class action raising the federal securities claims rather than a derivative action contesting principally the merits of the transaction itself.

In short, the pervasive reach of the federal securities laws, and of the private litigation thereby engendered, means the typical derivative suit in the United States does not arise in a factual context in which a shareholder vote was required to approve a transaction. Derivative actions thus tend to focus on transactions or events of less fundamental significance, those that under state corporation law do not require shareholder approval. Examples are management compensation and self-dealing transactions between the corporation and its directors or controlling shareholders. Those are, however, situations in which the defendants, if they have acted wrongfully, have derived a personal pecuniary benefit through a corporate position. Thus, the factual setting of the typical derivative action may not be a fundamental transaction, but it may well be one in which the defendants have indulged in self-interested diversions from their fiduciary duty of loyalty to the company's interests.

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[26] See *Jones* v. *Ahmanson* 1 Cal. 3d 93; 81 Cal. Rptr. 592; 460 P. 2d 464 (1969); *cf. Goldex Mines Ltd.* v. *Revill* 7 O.R. 2d 216 at 224-26 (Ct. Ap. 1974) (stressing importance of clearly differentiating derivative from direct claims in pleading).

[27] An implied private cause of action under s. 10(b), the general anti-fraud provision in the Securities Exchange Act, was first recognised in *Kardon* v. *National Gypsum Co.* 69 F. Supp. 512 (E. F. Pa. 1946) and was most recently endorsed by the Supreme Court in *Herman & Maclean* v. *Huddleston* 459 U.S. 375 (1983).

[28] See *J. I. Case & Co.* v. *Borak* 377 U.S. 426 (1964).

B. *On the Commonwealth front*

Although not as complicated as developments in the regulation of derivative litigation in the United States, the legacy of *Foss* v. *Harbottle* is troubled in some respects. Of principal concern are the difficulty of determining the plaintiff's right to sue without litigating the merits of the case, the prospect that the costs of the litigation may exceed the benefit realised by the company, and the problematic nature of the shareholders' involvement. An additional awkwardness is caused by the absence of effective prospective regulation of communications to shareholders. The litigation in *Prudential Assurance Co.* v. *Newman Industries Ltd.*, culminating in the Court of Appeal's 1982 judgment,[29] is a useful illustration of all these matters.

At issue in *Prudential Assurance* was a transaction in which Newman purchased the principal assets of another company, TPG, allegedly on the basis of an overvaluation. Two of Newman's directors, who owned 25% of TPG's shares, induced Newman's board to approve the purchase, without disclosing an earlier agreement between Newman and TPG covering some of the same assets, under which substantial cash payments had been made to TPG. As mandated by Stock Exchange listing requirements, the acquisition agreement was submitted to Newman's shareholders, but the circular from the directors omitted to mention (among other things) the prior agreements and payments, as well as one director's dissent from the board's approval of the acquisition.

All in all, not an edifying scenario. The rule in *Foss* v. *Harbottle*, coupled with the nature of securities legislation in Great Britain (and Australia for that matter) meant that the focus of the litigation inevitably became the plaintiff's standing to sue derivatively on behalf of the company. In contrast, and despite its complexity, corporate regulation in the United States has the great advantage of addressing separately the quality of the company's communications with its shareholders, and the process through which their consent to a transaction was obtained. In a public company such as Newman Industries, any material a company's management propose to send to its shareholders to solicit proxies or votes on any matter must be filed in advance of its distribution with the federal Securities and Exchange Commission (the SEC) which reviews the material;[30] the gravity of the omissions and misstatements in Newman's circular make it highly likely that they would be detected by the SEC's staff in its review. The SEC has long had a rule, promulgated under its rule-making authority under the Securities Exchange Act of 1934, making it illegal to solicit a shareholder's proxy using a statement that omits or misstates a material fact.[31] If the company failed to rectify the disclosure problem, the SEC would have power to sue in federal district court for

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[29] [1982] 2 W.L.R. 31 (Ct.App.).
[30] See Rule 14a-6.
[31] Rule 14a-9.

an injunction against the distribution of the defective circular, or against consumnation of the acquisition transaction unless the shareholders approved the transaction on the basis of resolicitation with a proper circular.

Company law and securities regulation in Australia and Great Britain, as they now stand, do not create a comparably simple mechanism for discovering and rectifying the use of "tricky circulars", and in turn derivative actions like *Prudential Assurance*, brought after the transaction has been approved by the shareholders and presumably consumnated, are confused by the history of inadequate or deceptive communication between the company's directors and its shareholders. One result is to complicate the court's differentiation between injuries done to the company and injuries done to the shareholders, because the shareholders' approval of the transaction that allegedly injured the company may have been influenced by the deception but once the deception has occurred, its effect and significance may be difficult to isolate.[32] Some litigation of "tricky circular" questions has occurred in Australia under s. 52(1) of the Trade Practices Act, which prohibits corporations from engaging in misleading or deceptive conduct.[33] Although under s. 80 of the Act "any person" may sue for injunctive relief on account of violations,[34] the absence of a pre-circulation filing requirement differentiates the Australian treatment from proxy regulation in the United States. The English Companies Act 1985 is innocent of reference to these matters.

A central issue in *Prudential Assurance* was the plaintiff's standing to sue on account of the injury inflicted on the company through the allegedly inflated acquisition price, the Court of Appeal having taken the position that the personal and representative claims alleged by the plaintiff concerned injury suffered directly in the first instance by the company itself and thus were not independent claims.[35] In the Chancery Division, Vinelott, J. held that the exception to the rule in *Foss* v. *Harbottle* permitting a derivative action when the prospective defendants control the company (and thus make shareholder action in general meeting not a credible decision) should be interpreted broadly, so that the plaintiff could sue derivatively if the defendants own a majority of the shares, or

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[32] This problem is illustrated by *Winthrop Investments* v. *Winns* [1975] 2 N.S.W.L.R. 666 at 706 (discussing "artificial basis" on which court must evaluate disclosure made to shareholders' meeting).

[33] See *Bell Resources Ltd. & Anor* v. *The Broken Hill Proprietary Co. Ltd.* (1986) A.T.P.R. 40-702 (Fed. Ct., 27 May 1986). At issue in *Bell Resources* was a profit forecast communicated to BHP's shareholders that, in the plaintiff's view, misled shareholders as to the company's profitability and the completeness of the information in the forecast. In a seventeen page judgment, the court dismissed the applicants' claim for relief; one explanation for the length of its judgment is the difficulty of applying the general statutory language to a type of corporate communication that is not the principal focus of trade practices regulation.

[34] Under s. 82, any person who suffers loss or damage as a result of a violation may recover that loss or damage in an action. The court's ability to grant *injunctive* relief under s. 80 is expressly made independent of any necessity to show a likelihood of substantial damage, for s. 80(4)(c) provides that the court's power to grant an injunction restraining a person from engaging in conduct may be exercised "whether or not there is an imminent danger of substantial damage to any person" if the conduct occurs.

[35] *Supra* n. 29 at 48-49 (characterising plaintiffs' personal action as "a means of circumventing the rule in *Foss* v. *Harbottle*").

through other means by manipulation of their position in the company could ensure that the action was not brought by the company.[36] In general, Vinelott, J. said, the court should be able to "have regard to any . . . circumstances which show that the majority cannot be relied upon to determine whether it is truly in the interests of the company that proceedings should be brought".[37] Vinelott, J. also interpreted the rule in *Foss* v. *Harbottle* to permit an exception whenever the interests of justice would otherwise be frustrated.[38] The consequence, however, was that the plaintiff's standing to sue could not be determined independently of litigation on the merits of the action. The breadth of this exception to *Foss* v. *Harbottle* is called into question by the judgment of the Court of Appeal, which reasons that the "independent justice" exception cannot realistically be applied without trying the case on its merits, thereby undercutting the basic litigation-avoiding rationale of *Foss* v. *Harbottle* itself.[39] Vinelott, J.'s views on control, however, appear not to have been rejected, at least not explicitly.[40]

Relatedly, the Court of Appeal held that Vinelott, J. also erred in failing to resolve the question of the plaintiff's standing as a preliminary issue prior to the plaintiff's presentation of its case. Prior to proceeding, the Court of Appeal held, the plaintiff must establish a *prima facie* case that the company is entitled to the relief claimed, and that the action fits within the proper boundaries of the exception to the rule in *Foss* v. *Harbottle*.[41] This solution, at least formally, avoids the problem of the trial-within-a-trial created by an open-ended "interests of justice" exception. It does, however, preface the trial with a fact-finding prelude by imposing an evidentiary burden on the plaintiff that inevitably reaches to the substance of many issues of fact underlying substantive claims. But problems of this sort are inevitable unless *Foss* v. *Harbottle* is to admit of no exceptions other than those created by questions unrelated to factual inquiries.

To be sure, this type of problem is not unique to derivative litigation in Great Britain; the resolution of other "preliminary" issues creates the same potential for relitigation of the same factual matters, albeit under different guises. An analogous preliminary issue in derivative litigation in the United States arises if the action is brought in federal district court on the jurisdictional basis of the parties' diversity of citizenship; the question that may arise is whether the corporation should be realigned as a party-plaintiff or maintained as a party-defendant, with realignment as a plaintiff destroying diversity jurisdiction if any remaining defendant

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[36] *Prudential Assurance Co.* v. *Newman Industries Ltd.* [1980] 3 W.L.R. 543 at 583-84 (Ch. Div.).

[37] *Id.* 583.

[38] *Id.* 581-82.

[39] *Supra* n. 29 at 47.

[40] *Id.* 47-48. See also Note, "Directors' Duties and the Rule in *Foss* v. *Harbottle*", (1983) 10 *Syd. L.R.* 156 at 158-60.

[41] *Supra* n. 29 at 48. This approach was followed in *Estmanco (Kilner House) Ltd.* v. *Greater London Council* [1982] 1 All E.R. 437 at 477 (Ch. Div.).

is a citizen of the same state as the corporation. In *Smith* v. *Sperling* the federal district court conducted a fifteen-day hearing to determine whether the interests of the corporation were sufficiently antagonistic to those of the plaintiff to maintain its alignment as a defendant. The court determined that they were not and realigned the corporation as a plaintiff.[42] Inevitably, the hearing examined the transactions challenged in the derivative suit to try to determine whether management's decisions were adverse to the corporation's interests. The United States Supreme Court, *per* Douglas, J. observed that the district court's effort had been a "time consuming, wasteful exercise of energy on a preliminary issue in the case", which had been eight years in the federal court system solely on the issue of federal subject matter jurisdiction. Instead, the Court held that antagonism was sufficiently established when the corporation's management defended a course of conduct attacked by the stockholder-plaintiff, thereby making the corporation through its management hostile to the enforcement of the claim. In the Court's view, whether a "real collision" is present between the parties can be determined by the district court through an assessment of the pleadings and the nature of the dispute set forth therein; the merits of the suit need not be tried to resolve the jurisdictional dispute.

Should the *prima facie* showing required by the Court of Appeal in *Prudential Assurance* to establish the plaintiff's standing be characterized as a "time-consuming, wasteful exercise of energy on a preliminary issue"? If the plaintiff succeeds in surmounting the hurdle of establishing its standing to sue, at least some of the factual issues explored in the trial on the merits will touch upon if not overlap completely with the factual content of the "*prima facie*" showings. Likewise, relitigation of factual issues would be the lot of the successful plaintiff under the district court's approach to determining proper alignment of parties in *Smith*. But if the only practicable alternative is that chosen by Vinelott, J., that is, awaiting the conclusion of litigation on the merits to determine whether the interests of justice require that the plaintiff have standing to sue, treating the standing issue as preliminary, and chancing some relitigation may well be preferable. Another solution is the Court's in *Smith* v. *Sperling*: requiring that "preliminary" or jurisdictional issues be resolved on the basis of the pleadings. The Court of Appeal expressly rejects this possibility in *Prudential Assurance*, without much explanation[43] but perhaps because the plaintiff might otherwise be tempted to allege "fraud" or

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[42] 354 U.S. 91 at 93 (1957). The alignment problem arises because the Court determined early in its adjudication of diversity jurisdiction cases that "complete" diversity among the parties was required – that is, if citizens of the same state were plaintiffs and defendants, the presence of diversity in citizenship among the parties to the action would be defeated. See *Strawbridge* v. *Curtiss* 7 U.S. (3 Cranch) 267 (1806).

[43] *Supra* n. 29 at 47-48. The Court of Appeal proposes that the court might stay the action to permit a shareholders' meeting so that the Court's resolution of whether the action falls within an exception to *Foss* v. *Harbottle* can be informed by the conduct of, and proceedings at the meeting. *Id.* at 48. Something of the same procedural dilemma is created by the pleading burden currently imposed in Delaware to excuse the making of a demand on directors. In *Aronson* v. *Lewis, supra* n. 15 the Delaware Supreme Court made applicable to excuse a requirement of "particularized pleading" of factual allegations; a practical difficulty this creates is that the plaintiff is not entitled to take discovery on demand issues.

"control" in the complaint. Indeed, the difficulty of developing a workable test for plaintiffs' standing without creating the necessity for a trial within or prior to the trial on the merits, suggests that the rule in *Foss* v. *Harbottle* reposes too much of the regulation of shareholder litigation on the standing issue.[44] Developments in the United States after *Hawes* present problems of their own, but they have the advantage of giving segmented or differentiated treatment to different issues and concerns. The statutory regulation of derivative actions in Canada requires the prospective plaintiff to satisfy the court that pursuit of the action will be in the company's best interests.[45] This requirement likewise creates the potential for relitigation of factual issues. The extent to which relitigation does occur, however, depends on the court's interpretation of its mandate. Similarly, in requiring the plaintiff to make "*prima facie*" showings, *Prudential Assurance* uses a standard whose meaning has been defined differently by many judges in varied contexts.[46]

The development of the *Prudential Assurance* litigation also illustrates that the costs of maintaining and successfully prosecuting a derivative suit may, when the suit is eventually concluded, far exceed the financial benefit realized by the corporation. The Court of Appeal finally determined that the defendants, by dishonestly concealing the earlier acquisition agreements and the payments made under them, caused £45,000 in damage to the company, a not insignificant amount, but one that paled in comparison to the "small fortune" running into six figures apparently spent by the plaintiffs on legal fees.[47] As *Prudential Assurance* was settled prior to the court's resumption of hearings on the costs question, and as the English practice does not require the court to review the terms of a settlement of a derivative suit, the extent to which the plaintiff's costs were paid by the defendants is unknown.

Extreme disparities between the plaintiff's costs and the benefit to the corporation are less likely to arise in derivative litigation in the United States. One control is the personal economic self-interest of the plaintiff and her lawyer. As noted above, even victorious parties bear their own litigation costs in the United States, excepting exceptional circumstances; successful derivative litigation is an exception in that it produces a "common fund" for the corporation and all its shareholders, to which the plaintiff's attorney's fees may be charged. Thus, the plaintiff's attorney has a strong disincentive against investing human capital in the action beyond the probable amount of recovery likely to be realised in a settlement agreement or after trial. Further, any settlement or voluntary dismissal

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[44] One Australian judgment acknowledges the necessity, in appropriate cases, of distinguishing the standing issue from the liability issue, see *Hurley & Anor.* v. *B.G.H. Nominees Pty. Ltd.* (1982) 1 A.C.L.C. 387 at 390 (S.A. Sup. Ct., King C.J.), and of conducting the inquiry on standing on the assumption that the allegations pleaded in the statement of claims are true.

[45] The Canadian statutes also require the would-be plaintiff to satisfy the court that the corporation's directors would not diligently prosecute the action and that the prospective plaintiff is acting in good faith. See, e.g., Canada Business Corporations Act, s. 232(2)(a).

[46] See R. P. Meagher, W. M. C. Gummow & J. R. F. Lehane, *Equity: Doctrines and Remedies* (2nd ed. 1984) at 563-70.

[47] *Supra* n. 29 at 61.

requires court approval in most jurisdictions, and an element of the court's analysis is the relationship between the amount of attorneys' fees and the economic benefit retained by the corporation.

Prudential Assurance is of further significance because it calls into question the feasibility and credibility of shareholder involvement in decisions concerning derivative litigation. The rule in *Foss* v. *Harbottle*, as described above, barred derivative litigation of claims that could be the object of shareholder action in general meeting; it precluded litigation independent of whether the shareholders had taken action or had an opportunity to take action formally presented to them. In more recent English cases, the court has stayed the litigation pending submission of the claim to a shareholder meeting.[48] This has the great advantage of assuring that the shareholders have actual notice of the claim and a formally-presented opportunity to act upon it; effectively it converts the litigation-precluding rule in *Foss* v. *Harbottle* into a requirement of demand on shareholders comparable to that imposed by the United States Supreme Court in *Hawes*.

Of separate concern, however, is the credibility of the shareholders' response. Vinelott, J.'s judgment in *Prudential Assurance* doubts the probative value of any shareholder resolution addressed to the claims raised derivatively:

> Given that the board were deceived and, at least in part, as a result of that deception viewed [the dissentient director's] conduct in this hostile way, there was in my view no real possibility that the question whether proceedings should be commenced by the company would ever be put to the shareholders in a way which would enable them to exercise a propr judgment as to whether it was in the interests of the company that the litigation should be commenced.[49]

The shareholders' ability to make a "proper judgment" would be vitiated by their dependence on the directors for guidance, while the directors, having earlier been deceived themselves, still seemed to ally themselves with the individual defendants who had earlier deceived them. The decline in the United States of the requirement of demand on shareholders acknowledges on similar grounds the vulnerability of the shareholders' response to the demand. If the individual defendants, as in *Prudential Assurance*, appear likely to be in effective control of the channels of communication between the corporation and its shareholders, inevitably scepticism attaches to the shareholders' rejection of the demand and the process culminating in the rejection.

But in what direction shoud this scepticism lead? One alternative, as in the majority of U.S. jurisdictions, is the elimination of a separate

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[48] E.g., *Hogg* v. *Crampthorn* [1967] Ch. 254. In *Prudential Assurance* the Court of Appeal suggests that a stay of proceedings to permit a shareholders meeting to be held "may well be right". [1982] 2 W.L.R. 31 at 61.

[49] *Supra* n. 36 at 585-86.

role for shareholder plebescites in connection with claims raised in derivative suits. Another is a return to the traditional claim-preclusion form of the rule in *Foss* v. *Harbottle*. This second outcome has the drawback of postulating that shareholders have full knowledge of, and opportunity to act upon, claims on behalf of their company, which as a factual assumption may not always be true. On the other hand, it has the advantage of not encouraging the view that the shareholder meeting is an institution capable of well-informed decision making on a collective basis. If, as Vinelott, J. suggests, one should have profound doubts about the quality of the decisions made at a shareholder meeting controlled or strongly influenced by the defendants, a rule which requires resort to this ritual has little—other than additional ritual—to recommend it.

III Current Dilemmas

A. *Litigation committees*

At present in the United States the most controversial issue in derivative litigation concerns the use of "litigation committees". As this question is one controlled by state law, and only five state supreme courts have addressed the litigation committee device, further evolution of the law is inevitable. Consider a situation in which, even under the most stringent requirements, the plaintiff would be excused from making a demand on the corporation's directors prior to instituting a derivative suit. Under the Delaware test described above, the plaintiff would be excused from making the demand if the complaint makes allegations raising a reasonable doubt whether the transaction under attack was the product of an exercise of the directors' business judgment. Demand would obviously be excused under this test if the plaintiff alleges that a majority of the corporation's directors received a personal pecuniary benefit from the transaction in question.

Although one might then suppose the plaintiff, freed of the demand requirement, would file suit and would then be able to litigate the case on its merits, this supposition would be mistaken, at least in some U.S. jurisdictions. In 1979, in *Auerbach* v. *Bennett*, the New York Court of Appeals held that, even in a demand-excused case, the corporation's directors had power to appoint a committee of disinterested directors to consider whether maintenance of the derivative suit would be in the corporation's best interests.[50] Disinterest for these purposes requires directors who were not named as defendants in the suit; the practice in many instances has been to appoint directors who were not serving on the board at the time of the transaction challenged in the derivative action. In *Auerbach* the court held the committee's recommendation should be

[50] 419 N.Y.S. 2d 920 (1979). In *Roberts* v. *Alabama Power Co.* 404 So. 2d 629 (Ala. 1981), without much elaboration, the Alabama Supreme Court appears to adopt this test. In *Alford* v. *Shaw* N.C. 349 S.E. 2d 41 (1986) the North Carolina Supreme Court followed *Auerbach*, but imposed on the plaintiff the burden with regard to the committee's good faith.

accorded the judicial deference due a business judgment; thus the derivative suit should be dismissed if the committee so recommends, the court's review being limited to whether the committee members were independent and whether they acted in good faith, taken in this context to include whether their investigation on its face appears to be adequate.

In *Auerbach* the complaint alleged that the corporation's directors and outside auditors had been negligent in their failure to detect payments made by corporate officers to officials of foreign governments. In essence, then, the claim in *Auerbach* was that the directors failed to fulfill their obligation to use appropriate care in their supervision of the corporation's affairs. *Auerbach* itself, however, does not limit the litigation committee device to such claims, and other courts have applied the "business judgment" standard articulated in *Auerbach* to cases in which the plaintiff's claim was premised on a breach of the defendants' duty of loyalty to the corporation, through a transaction tainted by self-dealing or conflict of interest.[51]

Auerbach's extension of the business judgment concept to encompass litigation committees has been rejected entirely by the Iowa Supreme Court, and in part by the Delaware Supreme Court. In the Delaware case, *Zapata Corp.* v. *Maldonado*, the court held that a court reviewing a litigation committee's recommendation had discretion whether to review the merits of the committee's position, to apply its own "independent business judgment" in determining whether the suit should be dismissed rather than deferring entirely to the judgment of the committee.[52] Although infelicitous in phrasing, the court's response to the use of litigation committees is grounded in practical reality: *Zapata Corp.* articulates the fear that committee members will so empathize with the plight of their fellow directors—the defendants—that they will be unable fairly to assess the merits of the suit. Indeed, some commentators have questioned whether the court itself will be able to play a sufficiently rigorous role in reviewing the committee's recommendation, given the ability of the committee to present its recommendation in a palatable—or at least presentable—guise.[53]

Whether the committee can generate a palatable rationale in support of its recommendation turns to a considerable extent on the sophistication and style with which it operates. Customarily litigation committees retain as special counsel a law firm that does not ordinarily represent the corporation. To permit the committee, aided by its counsel, to investigate the plaintiff's claims, the court will stay other actions in the derivative suit once the litigation committee is appointed. The product of the committee and its counsel may triumph eventually through its sheer bulk: the Delaware chancellor has estimated that most committees ultimately

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[51] E.g., *Lewis* v. *Anderson* 615 F.2d 778 (9th Cir. 1979), cert. denied, 444 U.S. 869 (1980).

[52] 430 A. 2d 779 (Del. 1981).

[53] See Cox, "Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of *Zapata* and the ALI Project", 1982 *Duke L.J.* 959.

produce reports of at least 150 pages and that litigation is on average delayed by two years.[54]

In *Miller* v. *Register & Tribune Syndicate*, the Iowa Supreme Court held that, if on the facts of the case the plaintiff would be excused from making a demand on the corporation's directors, the directors as a result lack power to control the derivative litigation and consequently have nothing to delegate to a litigation committee.[55] In effect, under *Miller's* reasoning, the interest of the directors which disqualifies them from acting on demand disqualifies them as well from participating in the selection of a committee. *Miller* suggests that the court could select the committee's members, if it desired non-party advice as to the merits of the suit; although the court's opinion does not expressly reject the possibility, that non-defendant directors could separately act to select a litigation committee is called into question by the court's reasoning, which stresses the awkwardness of the litigation committee's posture in dealing with claims against fellow directors.

Of assistance in evaluating these disparate responses to litigation committees is almost a decade of experience with litigation committees since *Auerbach* legitimated their use in 1979. No committee has ever recommended that a derivative suit in its entirety be continued. A few committees have found merit in portions of claims against individual defendants and recommended that those claims be settled,[56] and in a few instances after a litigation committee's investigation the corporation itself has pursued claims against former employees. The credibility of the institution, however, is called into question by the uniformity with which committees determine derivative actions not to be in the corporation's best interests. Surely in eight years some claims worth pursuing were raised derivatively. Indeed, in some reported cases, the committee's recommendation appears to have been at odds with the advice as to the merits of claims received from its counsel.[57]

Even under the Delaware standard of review, the mere availability of the litigation committee device appears to have created temptations to use such a committee in situations where its recommendation will simply not be credible. For example, in *Lewis* v. *Fuqua*, the complaint alleged that all directors save one had usurped an opportunity properly belonging to the corporation itself to invest in the common stock of another corporation.[58] After the plaintiff filed the derivative action, the directors appointed a litigation committee comprised of their one fellow director who had not himself invested in the common stock. He had close business and social ties to the board's chairman, a defendant in the suit. Even though the Chancery Court in Delaware found that the one-member

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[54] See *Kaplan* v. *Wyatt* 484 A.2d 501 (Del. Ch. 1984) aff'd, 501 A.2d 572 (Del. 1985).

[55] 336 N.W. 2d 709 (Iowa 1983).

[56] See *Alford* v. *Shaw* 324 S.E. 2d 878 at 886 (N.C. App. 1985), rev'd N.C. 349 S.E. 2d 41 (1986).

[57] See, e.g., *Miller* v. *Register & Tribune Syndicate* 336 N.W. 2d 709 (Iowa 1983); *Watts* v. *DesMoines Register & Tribune* 525 F. Supp. 1311 at 1321-22 (S.D. Iowa 1981).

[58] See 502 A. 2d 962 (Del. Ch. 1985).

committee lacked sufficient independence, and in this respect acted to affirm one's confidence in its discriminatory ability, any institution that creates such temptations is problematic. Likewise, in some cases in which all directors were named as defendants, the board nominated to the litigation committee "expansion directors" added to the board in the wake of the derivative litigation.[59]

This history calls into question whether the litigation committees function to discriminate between meritorious claims that should be pursued by the corporation itself or on its behalf derivatively, and claims that should be dismissed summarily. In light of the exacting standards applicable to demand on directors, at least in Delaware the derivative suits in which a litigation committee would be created are ones in which the original transaction at issue was not approved by directors in an exercise of informed business judgment, or in which a majority of the directors had a personal pecuniary interest. In all other situations the plaintiff is required to make a demand on directors. Given the demand threshold, what does the litigation committee contribute to a credible assessment of the merits of the action? The problems created by litigation committees would be reduced somewhat by a draft proposal from the American Law Institute's Project on Corporate Governance. Although the proposal essentially endorses the use of litigation committees, subject to Delaware-style judicial review, it would not permit a defendant to retain a personal pecuniary benefit if a derivative action is dismissed at the behest of a litigation committee. This proposal would restrict the effect of a litigation committee's recommendation where the risk of apparently improper bias in the committee's action is probably at its greatest: the retention of personal financial benefits realised by fellow directors and other defendants.

Finally, given all of these difficulties with the litigation committee device, one might wonder about the underlying causes of its attractiveness to the U.S. jurisdictions that have enthusiastically embraced it. A number of explanations come to mind. First, the court's ability to dispose summarily of the typical claim asserted derivatively is limited. Most such claims turn substantially on factual questions, and courts have long been unwilling to grant motions for summary judgment in such cases. Thus, even if a claim has little prospect of ultimate success on its merits, summary disposition is still unlikely and the litigation committee might thus appeal as a device to fill a perceived procedural interstice. A difficulty with this argument is that it presupposes the desirability of encouraging summary disposition of the types of claims likely to be raised derivatively. One might easily reject this presupposition and conclude that summary disposition of such claims ought not to be encouraged because they frequently involve issues of subjective intent.[60]

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[59] E.g., *supra* n. 56.

[60] See *id.* at 886 (summary disposition not favoured for claims involving issues of subjective intent).

In addition, derivative suits as a group, and the plaintiffs' bar, have qualities that might make some courts unduly susceptible to the appeal of the litigation committee. The prototypical plaintiff is a small shareholder, and a noticeable number of such plaintiff are repeat players who appear in such actions frequently. The economic interest of the plaintiff's attorney may be so transparently at stake in the litigation that the court is insufficiently sceptical of devices like litigation committees that do not appear to function well to discriminate between meritorious and less meritorious claims. Indeed, the strong self-interest of the plaintiff's bar appears to serve as a control on bringing actions that are so unlikely to succeed that their settlement value is minimal.

Moreover, the circumstances under which demand on the board should be excused have not been defined with great clarity in many jurisdictions. If demand is excused only when the transaction at issue is one in which a majority of the directors have a personal financial interest, the occasion for the appointment of a litigation committee is restricted to cases that on their face raise serious questions about the focus of the directors' loyalties. Other cases are subject to the demand requirement, so long as the plaintiff is unable to allege facts raising a reasonable doubt whether the challenged transaction was the product of the directors' business judgment. Unless the directors, under current Delaware law, acted with gross negligence,[61] or unless they had a personal economic interest in the transaction, the effect of the demand requirement is to place the control of suits raising claims on behalf of the corporation within the directors' discretionary business judgment. In jurisdictions with less exacting versions of the demand requirement,[62] more derivative actions elude the demand requirement, and some of these are actions challenging the directors' competence rather than their loyalty. Finally, some courts' acquiescence in the litigation committee as an instrument of the directors' "business judgment", even in demand-excused cases, may simply represent a transcendence of rhetoric over reality. The reality is a private non-judicial device to bring about the termination of litigation;[63] the rhetoric is derived from a prudent judicial deference to decisions about the operation of business enterprises. The gap between the two is obvious, and the litigation committee device ought not to commend itself to Australia or to the other Commonwealth jurisdictions.

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[61] See *Smith* v. *Van Gorcom* 488 A.2d 858 (Del. 1985). No Delaware case yet considers the demand issue in the context of a plaintiff's allegation that the directors' behaviour was grossly negligent but not self-interested; indeed *Smith* v. *Van Gorcom* itself was litigated as a class action. *Dicta* in an English opinion, *Daniels* v. *Daniels*, reasons that such an allegation would not fit within an exception to the rule in *Foss* v. *Harbottle*, so that only if the directors' negligence benefits themselves will the shareholder-plaintiff have standing to sue on the company's behalf. [1978] 2 W.L.R. 73, 79-80.

[62] See, e.g., *Barr* v. *Wackman* 36 N.Y. 2d 37; 329 N.E. 2d 180 (1975).

[63] As the Vice-Chancellor observed in *Lewis* v. *Fugua*, the litigation committee is "[t]he only instance in American Jurisprudence where a defendant can free itself from a suit merely by appointing a committee to review the allegations of the complaint". See 502 A. 2d at 967.

B. *Statutory Remedies for Oppression*

An unresolved question about shareholder litigation in Commonwealth countries is the scope of statutory oppression remedies, which are not subject to the limits imposed by the rule in *Foss* v. *Harbottle*. For example s. 320(1) of the Australian Companies Code authorises an application to a court for an order in relation to a company by a member who believes its affairs "are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members, or in a manner that is contrary to the interest of the members as a whole", or by a member who has analogous beliefs about an act or omission of the company, or a resolution of a class of members, or a proposed act, omission or resolution. S. 320(2) grants broad remedial power to the court to make orders, and, in contrast to comparable legislation in New Zealand, the court's ability to grant a remedy is not premises on a requirement that it find granting the remedy to be "just and equitable". Like the New Zealand statute, s. 320(4A) defines oppression or unfair prejudice against a person who is a member to include actions with those effects against the person "whether in his capacity as a member or in any other capacity . . . ." Under s. 320(2)(g) the court may make an order directing the company to institute, defend or discontinue proceedings or it may authorise a member to take these steps in an action "in the name and on behalf of the company". The section does not specify the criteria the court should use in deciding whether to make such an order.

The members' right to sue under s. 320 and its Commonwealth counterparts is independent of the factors defining standing under the rule in *Foss* v. *Harbottle*. Whether the action succeeds is of course a separate question from the member's right to bring it. In *Wayde and Anor* v. *New South Wales Rugby League Ltd.*,[64] the High Court of Australia interpreted s. 320 to require a showing of unfair prejudice to the interests of the member, if the corporation's directors concededly made the decision adversely affecting the member's interests in good faith. The test used in the judgment of four of the justices was whether no board of directors acting reasonably could have made the decision contested in the member's action, which was to exercise the directors' power to determine member clubs' eligibility for a major rugby league competition so as to exclude a club from participating. Brennan, J.'s separate judgment acknowledges that under s. 320 the directors' good faith is "relevant to but not conclusive of the question whether relief should be granted"; whether to intervene under s. 320 is a question of "fact and degree" which the court should answer by inquiring whether reasonable directors (possessed of any special skill of the company's actual directors) would have decided the action was unfair in the disadvantage or burden imposed thereby on the member.[65] The test of unfairness is an objective one, according to Brennan, J., a

[64] *Wayde & Anor* v. *New South Wales Rugby League Ltd.*, (1985) 3 A.C.L.C. 799 (High Court).
[65] *Id.* 806.

test that defines unfairness by looking to ordinary standards of reasonableness and fair dealing.

New Zealand's counterpart legislation to s. 320 was interpreted by the Court of Appeal in *Thomas* v. *H. W. Thomas Ltd.* to be concerned with "conduct of the company which is unjustly detrimental to any member of the company whatever form it takes and whether it adversely affects all members alike or discriminates against some only . . ."[66] Thus, the judgment states it is unnecessary for the plaintiff to point to an "actual irregularity or to an invasion of his legal rights or to a lack of probity or want of good faith towards him on the part of those in control of the company."[67] *Thomas* thus interprets the scope of the oppression remedy to reach actions affecting all members, and that in turn reaches shareholders' claims that might otherwise be litigated as derivative suits on behalf of the company, so long as the "unjust detriment" standard is satisfied. The High Court's judgments in *Wayde & Anor* do not expressly address the application of s. 320 to decisions affecting the interests of all members, but the judgments likewise do not restrict the scope of s. 320 to actions adverse to fewer than all of a company's shareholders.

C. *Injunctive relief under s. 574*

The restrictions on shareholders' standing to sue imposed by the rule in *Foss* v. *Harbottle* may be inapplicable to actions for injunctive relief brought under s. 574 of the Australian Companies Code. Under s. 574, the court may grant an injunction against conduct that constitutes or would constitute a breach of the code, upon the application of the Commission or of "any person whose interests have been, are or would be affected by the conduct".[68] The court's power to grant the injunction is expressly made independent of any finding of imminent danger of substantial damage to any person.

Although s. 574 has been interpreted to confer standing on a target company to contest the adequacy of the take-over document circulated to its shareholders,[69] its application to a suit brought by an individual shareholder appears not to have been determined.[70] Further, the usefulness of s. 574 to a shareholder plaintiff may be limited in some situations. First, the action must involve conduct by the defendants that would constitute a breach of the Code. Obviously s. 229 of the Code will cover much of the ground of typical derivative litigation in the United States. However, in shareholder actions brought against defendants who are not officers or directors of the corporation, the claim asserted on the corporation's behalf may not involve any alleged breach of the Code. Second, s. 574 provides that the court "may" grant the injunction and may

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[66] *Thomas* v. *H. W. Thomas Ltd.* [1984] 1 N.Z.L.R. 686 at 693.
[67] *Ibid.*
[68] See s. 574(1)(b).
[69] See *Broken Hill Proprietary Co. Ltd.* v. *Bell Resources Ltd.*, (1984) 8 A.C.L.R. 609.
[70] See H. Ford, *Principles of Company Law* (4th ed. 1986) at 490.

in substitution or in addition require the defendant to pay damages to any person;[71] the court thus appears to have discretion to determine whether to award any remedy, and s. 574 itself does not prescribe standards by which that discretion should be exercised. Finally, s. 574 contemplates that private plaintiffs will be required to give undertakings as to damages as a condition to the court's aware of an interim injunction because it expressly provides that no such undertaking may be required when the Commission seeks an injunction. Thus, whether s. 574 effectively abolishes the rule in *Foss* v. *Harbottle* turns on the nature of the claim asserted by the particular plaintiff and, if interim injunctive relief is sought, on the plaintiff's ability to invest in the undertaking as to damages. The plaintiff's willingness to make any investment in the suit is, of course, reduced by the fact that the award of any relief under s. 574 is within the court's discretion. But the undertaking is not given unless an injunction is granted; it serves as the consideration for the order. Those qualifications aside, s. 574 defines with striking breadth both the court's power to grant injunctive relief and prospective plaintiffs' eligibility to sue. This breadth is evidenced by the fact that persons are eligible to sue under s. 574 who would not have standing to bring a derivative action in most U.S. jurisdictions, which require the plaintiff at least to have been a shareholder at the time of the wrong alleged.[72] Many U.S. jurisdictions additionally require the plaintiff to continue as a shareholder throughout the pendency of the litigation.[73] Thus, the impact of s. 574 on the law of standing is not limited to its effect on the rule in *Foss* v. *Harbottle*, free as it is of any requirement that plaintiffs demonstrate contemporaneous or continuing shareholding.

IV Conclusion

As the preceding discussion illustrates, the regulation of derivative litigation in the United States has long differed from the Commonwealth tradition, although in both systems common policy concerns, broadly defined, can be said to underlie diverse legal rules. Further, statutory developments in Australia now enable some claims to be litigated, free of the controls traditionally imposed on derivative litigation. Although the precise extent of this liberation is unknown, it parallels the treatment of many claims arising under the federal securities laws in the United States.

It would, however, be a profound mistake to think that these Commonwealth developments will produce the volume or style of shareholder litigation that has long typified the United States. Indeed, even if Commonwealth parliaments were to unequivocally repudiate the rule in *Foss* v. *Harbottle* in all respects, institutional differences that transcend legal rules would continue to discourage extensive shareholder litigation

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[71] See s. 574(8).

[72] See, e.g., Rule 23.1 of the Federal Rules of Civil Procedure.

[73] See D. DeMott, *Shareholders' Derivative Litigation*, s.4:03 (1987).

in Commonwealth jurisdictions. The relevant institutional differences define the economic attractiveness of shareholder litigation to the actors involved in bringing it. The legality of contingent fee representation in the United States has encouraged the development of a specialised plaintiff's bar for securities and derivative litigation, a bar whose services are available to a plaintiff with a plausibly meritorious claim who need not make any investment to finance the litigation. Further, an unsuccessful shareholder-plaintiff would not under the United States practice pay the defendants' attorneys fees.[74] The practical effect of the state security for expense statutes, which would shift these costs on to the unsuccessful plaintiff, is effectively limited, as explained above. The limited downside risk to the plaintiff in the United States, coupled with the entrepreneurial quality of the plaintiff's bar, would always make shareholder litigation—at least of some types of claims—more attractive than in the Commonwealth.

Whether this is desirable raises somewhat larger questions than can be addressed here. Conventional wisdom in the United States has long accepted the utility and legitimacy of private litigation as a supplement to official actions to enforce compliance with the law.[75] One need not be entirely sanguine about all aspects of the litigation-favouring legal culture of the United States, however, to think that corporations' directors and controlling shareholders ought not to evade entirely the legal accountability furthered by shareholder litigation.

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[74] In some circumstances, the plaintiff may not incur this liability in England. In *Wallersteiner* v. *Moir (No. 2)*, the Court of Appeal held that a company could be ordered to indemnify the plaintiff against his costs in bringing a derivative suit on its behalf, and that if the action failed, the company itself should be liable for the defendants' costs if the plaintiff had reasonable grounds for bringing the action. See [1975] 1 All E.R. 849 at 858-59 (C.A.).

[75] This is sometimes referred to as the "private attorney general" concept. The Supreme Court first applied the concept to private actions under the federal securities laws in *J.I. Case & Co.* v. *Borak* 377 U.S. 426 (1964).

REFLECTIONS ON THE FALSE CONFLICT IN THE CHOICE OF LAW PROCESS

*MICHAEL C. PRYLES**

One of the outstanding developments in the conflict of laws this century has been the growth of the unique American approaches to choice of law. Most of the theories are the work of academic writers but they have received judicial endorsement to varying degrees in recent years. However perhaps the most influential American approach to choice of law, that of interest analysis, which was so strongly championed by Brainerd Currie, has its genesis in the United States Supreme Court decisions on full faith and credit. Some of the American writers were active before the Second World War, including Walter Wheeler Cook and David Cavers. Currie wrote in the 1950's as did Ehrenzweig and it is in the post-war era that these theories have gained wide acceptance in the United States.

The writers of the American school have put forward a number of different approaches to choice of law but many of them share certain features. Commonly they seek to avoid jurisdiction-selecting rules which they regard as artificial and unjust. Rather the solution to choice of law is sought in an examination of the content of the conflicting laws themselves and an analysis of the policies behind those laws and their relevance to the interstate situation. Some of the approaches would avoid altogether the necessity of classifying a legal problem or conflicting laws and would immediately focus on the content of those laws. Observers outside the United States have questioned whether the new American learning is relevant to other countries. Sir Otto Kahn-Freund has described Albert Ehrenzweig's theory as "an American product which cannot be exported".[1] Likewise, Professor Kurt Lipstein of Cambridge has said that the American doctrines "were conceived in order to satisfy the needs of the conflict of laws under the American Constitution"[2] and that "it is quite another problem whether the countries outside the Federal system of the United States should heed the voices from the United States".[3] The Australian courts have shown little sign of abandoning the traditional

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[1] Kahn-Freund 124 *Recueil des Cours* 1968 II at 60.

[2] Lipstein 135 *Recueil des Cours* 1972 I at 162.

[3] *Id.* 163.

approach to choice of law which involves classifying a problem to determine the appropriate jurisdiction-selecting choice of law rule. That is, a problem is classified so that the appropriate choice of law rule can be determined. This choice of law rule will indicate which country's law applies, irrespective of the content of that law. The decision on choice of law precedes and is not predicated upon an examination of the terms of the law of the selected jurisdiction unless its application is found to be contrary to the forum's public policy. But this is not to say that there has been no modification of the traditional methodology and that American approaches have been entirely without influence. In one recent case the Victorian full court held that it was not always necessary to classify a claim and that a right predicated on a statute of a sister-state could be enforced without recourse to traditional choice of law rules.[4] In other cases the technique of interest-analysis has found some favour.[5]

Many of the American approaches to choice of law incorporate the doctrine of the false conflict. In some it is used as a preliminary device to determine whether a decision on choice of law is necessary. In others it forms an integral part of the choice of law process itself. The purpose of this article is not to evaluate the contemporary American approaches on choice of law but only to look at one aspect, namely the doctrine of the false conflict. Even with regard to this matter, the article does not purport to be an exhaustive examination of that doctrine as it exists in the United States. That has been done by others, notably by Peter Westen in an article published in the *California Law Review*.[6] It is here proposed to look at the doctrine of the false conflict in the Australian context and to evaluate it and the part it might play in Australian private international law.

False conflict defined

In his very informative article, Westen comprehensively examines the doctrine of the false conflict in the United States. First there is the matter of terminology. Not all writers have spoken of "false conflicts" and some have referred to "false problems", "spurious conflicts", "pseudo conflicts" and "superficial conflicts". Clearly, however, false conflicts is the term more generally employed. Westen then proceeds to examine the more substantial problem of what is a false conflict. He adopts Professor Caver's enumeration of four situations where false conflicts are thought to arise but adds three others which writers have suggested constitute false conflicts. Thus there are at least seven situations which arguably give rise to false conflicts:

1. Cases in which the laws of both states are the same.

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[4] *Borg Warner (Australia) Ltd.* v. *Zupan* [1982] V.R. 437.
[5] See e.g. *Corcoran* v. *Corcoran* [1974] V.R. 543.
[6] P. K. Westen "False Conflicts" (1967) 55 *Calif. L. Rev.* 74.

2. Cases in which the laws of two states, though different, yield identical results with respect to the specific issue before the court.
3. Cases in which two states have different laws, but only one state has an interest in having its law applied.
4. Cases in which states with different laws both have an interest in applying their own law, but in which the forum is prepared when the circumstances warrant, to give a moderate and restrained interpretation to the policy or interest of one state or the other and thus avoid the conflict.
5. Cases in which the laws of two states are involved, but neither has an interest in having its law applied.
6. Cases in which foreign law (or forum law, as the case may be) is referred to not as the rule of decision but as a datum for the state applying its law.
7. Cases in which the law of any one of several contact-states has not been pleaded.

After extensively reviewing the literature and cases, Westen concludes as follows:

> The concept of false conflicts has wide appeal and diverse meaning. In some cases, it is used to describe situations in which choice-of-law is moot. In other cases, it is used to describe the choice-of-law process itself. And in still other cases, it is used to describe situations in which choice of law has already been made. In each case, however, by characterizing a choice-of-law problem as a false conflict, the courts are asserting that only one law can be rationally applied to the facts at issue. The concept of false conflicts has value for courts which are sufficiently sophisticated to engage in the kind of reasoning it presupposes. The concept is also useful in eliminating as forceful precedent those choice-of-laws cases which are found to have involved no real conflict. But it is no shibboleth for solving the problems of private international law. Rather it is a challenge to counsel and courts alike to abandon the talismans of the past by confronting the task of accommodating legitimate state interests.[7]

We can accept that the concept of false conflicts bears diverse meanings and is not a unitary doctrine. Nevertheless it may, within some of its facets, have use in the Australian context by identifying situations in which a decision on choice of law is unnecessary. It is not proposed to review all the seven instances of suggested false conflicts listed above. Some of these clearly relate to and form part of a sophisticated choice of law process that is foreign to, and perhaps incompatible with, existing Australian techniques of choice of law. Other instances of false conflicts are obvious situations which gain nothing from being described as false conflicts. An instance is the 7th situation posed above, namely cases in

[7] *Id.* 122.

which the law of only one state has been pleaded. It is well established in Australian law that, absent a statutory provision to the contrary, a party who relies on foreign law must plead and prove that foreign law. A failure to do so simply means that the foreign law is irrelevant and the *lex fori* will be applied. This is a long established rule with which all lawyers are conversant and its description as a false conflict adds nothing to the understanding of a problem or the resolution of a conflict. It does not clarify an otherwise obscure position nor does it make for an easier solution of a perceived difficulty. Only perhaps in the field of torts has a doubt arisen concerning the operation of the rule requiring foreign law to be pleaded and proved. It has been suggested that the rule in *Phillips* v. *Eyre*[7a] is jurisdictional in nature and that a plaintiff must establish that a foreign tort is not justifiable according to the *lex loci delicti* and cannot simply rely on the *lex fori*.[7b] But within the Australian context the balance of authority holds that the law of a sister-state does not have to be pleaded and proved by the plaintiff.[7c] Likewise, the 6th situation posed above, cases in which the foreign law is referred to as datum, is an obvious instance where there is no true conflict of laws. Take for example the case of an action instituted in Victoria for damages for negligence arising out of a motor vehicle accident in New Zealand. If the governing law is that of Victoria (in accordance with High Court decisions) the law of New Zealand must still be consulted to ascertain the permitted speed limit and other road rules. Reference to New Zealand law as regards these matters is merely as datum to determine whether the defendant was negligent in accordance with the law of the forum. However, some of the instances, discussed by Westen, where American writers have asserted that foreign law was only relevant by way of datum are open to argument. In at least some of the situations put forward it would seem that the foreign law was more than datum.

The two instances of false conflicts that will be discussed in this article are cases in which the laws of both states are the same and cases in which two states have different laws but only one state has an interest in having its law applied.

Identical laws

Perhaps the most obvious and appealing instance of a false conflict is the case where the laws of the relevant states are the same. In such a situation it might not be thought necessary to take a decision as to which state's law is formally being applied. Thus in *Pickering* v. *Pickering*[8] a decree of nullity was sought in relation to a marriage entered into between a woman who was born in Papua New Guinea and a man who was born

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[7a] (1980) L.R. 6 Q.B. 1 at 28-29.

[7b] See e.g. *Yorke* v. *British and Continental S.S. Co. Ltd.* (1945) 78 Ll.L.R. 181 at 184 (C.A.).

[7c] *Kemp* v. *Piper* [1971] S.A.S.R. 25 at 27; *Hewitt* v. *West Australian Newspapers Ltd.* (1976) 17 A.C.T.R. 15.

[8] (1978) 4 Fam. L.R. 349 at 352.

in Australia. The court found it unnecessary to decide which law governed the essential validity of the marriage as it found that the marriage was void under both Australian and Papua New Guinea law. In *Thorn L. & M. Appliances Pty. Ltd.* v. *Claudianos*[9] an issue arose, in proceedings in Queensland, as to whether certain agreements which were entered into in the Australian Capital Territory constituted hire-purchase agreements within the meaning of the hire-purchase legislation and were void for not having been executed in accordance with the requirements of that legislation. Campbell, J. held that the material provisions of the law of Queensland and of the Australian Capital Territory were identical so that the determination of which law was applicable was not material to the decision. However he observed that in his view the validity of the agreement should be determined in accordance with the law of the territory.

It might seem an obvious proposition that a decision on choice of law is not necessary, and indeed may not be desirable, in cases where the laws of the relevant states are the same. As Westen says "once the court has established that the relevant laws of each contact state are identical, it should refuse to entertain all choice-of-law arguments".[10] Nonetheless there are instances where Australian courts have embarked on a detailed examination of the question of choice of law when it was clear that the laws of the relevant states were the same. Moreover appeals have been taken on choice of law issues in precisely such circumstances. The outstanding case is *Koop* v. *Bebb*.[11] There a wrongful death action was instituted in Victoria arising out of an accident which had occurred in New South Wales. The relevant provisions of the Victorian Wrongs Act and the New South Wales Compensation to Relatives Act did not differ in any relevant respect. The High Court held that the action could proceed in Victoria primarily in accordance with Victorian law while McTiernan, J. who concurred in the result was of the view that the action could be maintained in Victoria pursuant to New South Wales law.

In the Victorian Supreme Court, Dean, J. had held that the Wrongs Act of Victoria did not apply because, on its true construction, it was limited to wrongful acts occurring in Victoria. A majority of the High Court rejected this construction. If, however, the Victorian legislation was expressly limited to wrongful acts which had occurred within Victoria, then an interesting situation would have presented itself. Would it have then been correct to say that there was a false conflict on the basis that the relevant provisions of Victorian law and New South Wales law were the same? Certainly they would be identical when viewed in the context of a domestic case but on the facts of this particular interstate case they would not be the same because the Victorian legislation would not, by its terms, have applied while the New South Wales legislation would have

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[9] [1970] Qd.R. 141 at 149.
[10] *Supra* n. 6, at p. 106.
[11] (1951) 84 C.L.R. 629.

extended to the situation. This point is tellingly made by Westen who remarks:

> In discussing false conflicts involving identical laws, commentators have often failed to state what they mean by the statement 'the laws of [all] states relevant to the set of facts are the same'. To say that the laws of two contract states are 'the same' might mean that each state would reach an identical result if all facts in the case were domestic. On the other hand, it might mean that each state would reach an identical result if faced with the same multi-contract case.[12]

An old decision of the Victorian Full Court well illustrates this point. In *Potter* v. *Broken Hill Pty. Ltd.*[13] a Victorian plaintiff patented a process for the extraction of metals from sulphur ores in New South Wales. The defendant was a Victorian company whom, the plaintiff alleged, had infringed the plaintiff's patent at its mines at Broken Hill, New South Wales. The plaintiff sought injunctive relief and damages. The Victorian Court was required to determine whether the wrong was actionable in Victoria according to the rule of *Phillips* v. *Eyre*.[14] This requires that the wrong must be of such a character that it would have been actionable if committed in the forum and not justifiable by the law of the place where it was done. There was no doubt that the second condition of the rule was fulfilled and the enquiry centred on the first condition. A majority of the court held that the action could not succeed because Victorian law knew no action for breach of a New South Wales patent. A'Beckett, J. dissented on the ground that while no obligation to observe a New South Wales patent existed in Victoria, it was sufficient that a Victorian court would afford redress for a wrong of the same character if committed in Victoria. Where the majority differed from the minority was that they tested Victorian law in relation to its operation to the very facts in the interstate case. However A'Beckett, J. looked at Victorian law in relation to its operation to a purely domestic case that involved the infringement of a Victorian patent in Victoria. Clearly both New South Wales law and Victorian law were identical in purely domestic cases for both possessed the tort of infringement of a patent and both laws provided for the registration of patents. They differed, however, in their application to this non-domestic case.

Where the laws of the relevant states are the same both in relation to their domestic operation and in relation to their interstate or international operation, then a choice of law is clearly unnecessary. It is a waste of resources, including valuable judicial time, and an unwarranted increase in costs to argue and determine unnecessary questions. However the

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[12] *Supra* n. 6, at 107-08.
[13] [1905] V.L.R. 612.
[14] (1870) L.R. 6 Q.B. 1 at 28-29.

situation of laws which are identical in their domestic operation but different in their interstate or international operation is more difficult. Generally the courts have perceived such a case as involving a true conflict of laws and have addressed the question of which law applies to the case. Take, by way of example, the decision of the Victorian Full Court in *Borg Warner (Australia) Ltd.* v. *Zupan.*[15] There an employee of the plaintiff was injured at Wodonga in Victoria when a motor vehicle he was driving to work in New South Wales was struck by another vehicle driven by the defendant who was a resident of Victoria. The plaintiff paid workers' compensation to the employee as he was obliged to do under the Workers' Compensation Act 1926 of New South Wales. The plaintiff then instituted proceedings against the defendant in Victoria seeking to be indemnified in respect of the compensation it had paid to its employee on the basis that the defendant was negligent and was legally liable to the employee. It relied on section 64 of the New South Wales Act which provides:

> (1) Where the injury for which compensation is payable under this Act was caused under circumstances creating a legal liability in some person other than the employer to pay damages in respect thereof—
>
> (a) . . .
>
> (b) if the worker has recovered compensation under this Act, the person by whom the compensation was paid shall be entitled to be indemnified by the person so liable to pay damages as aforesaid . . . .

The court discussed at great length the juristic basis upon which the claim founded on the New South Wales statute was enforceable in Victoria and concluded that it was. Murphy, J. observed that the Australian states had similar statutory provisions relating to workers' compensation and noted that the Victorian legislation contained a like right of indemnity on the person paying compensation:

> Every State and the Commonwealth has statutory provisions relating to workers' compensation. Many if not all statutes contain provisions relating to injuries sustained outside the State in which the contract of employment was made. Similarly they contain provisions designed to avoid overlapping to avoid double payments, that is to say to avoid the recovery of compensation for one injury under the provisions of two separate Workers' Compensation Acts, whether of two States, or of the Commonwealth and a State. They also contain provisions giving the person paying compensation a statutory right of indemnity in not dissimilar circumstances.
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> Such right is to be settled "by action": s. 64(1)(d) N.S.W. Act.
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> The Victorian and New South Welsh Workers' Compensation Acts contain such provisions. They are in this sense complementary,

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[15] *Supra* n. 4.

> and public policy demands that regard be had in Victoria to the statutory provisions of the State of New South Wales on this subject.[16]

Marks, J. expressed similar sentiments.[17] In *Borg Warner* the laws of the two states were the same in their domestic application but they differed in their interstate operation in that they only conferred a right of indemnity in respect of compensation "payable under this Act". The court did not say that there was a false conflict because the laws of Victoria and New South Wales were the same, but it took into account the similarity of the relevant laws in justifying application of the law of a sister-state which expressly purported to apply to this particular case.

Not dissimilar reasoning is found in the decision of Adam, J. in *Corcoran* v. *Corcoran*.[18] There the plaintiff was the wife of the defendant who was injured when the vehicle in which they were travelling and which was being driven by the defendant was involved in an accident in New South Wales. The parties were ordinarily resident and domiciled in Victoria. The plaintiff brought an action for damages in Victoria and the question of her entitlement to maintain the action was raised. By section 2 of the Marriage (Liability in Torts) Act, 1968, the Victorian parliament had abolished the common law immunity of a spouse from suits by the other spouse in respect of tortious acts. The State of New South Wales had also removed inter-spousal immunity in respect of torts resulting from motorcar accidents by section 16B of the Married Persons (Property and Torts) Act, 1901. However this was confined to actions involving accidents arising out of the use of vehicles registered in New South Wales. The Victorian court was concerned with the second condition of the rule in *Phillips* v. *Eyre*[19] which required that the act be not justifiable where committed. Adam, J. held that compliance with this condition should not be required in the circumstances of the case. He remarked inter alia:

> Furthermore, if one is looking for some question of policy on which to decide whether the rule in *Phillips* v. *Eyre* should be relaxed in this case, one finds, I think, without much difficulty a policy evident in the New South Wales legislation which would favour the allowing of this action in Victoria between the Victorian husband and wife driving a Victorian car. From the New South Wales legislation, it is clear that the legislature there has thought it proper to relax the old doctrine of inter-spousal immunity when the result of it would be injustice to a wife without any benefit to the husband. One can readily enough understand a general policy of discouraging litigation between husband and wife in tort because of the wider interests involved if these actions were allowed without restraint.

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[16] [1982] V.R. 437 at 444.
[17] *Id.* 460.
[18] See *supra* n. 5.
[19] *Supra* n. 14.

> The policy of the New South Wales legislation is to allow these actions, where by the requirements of its legislation the husband's car is subject to a policy of compulsory third-party insurance in New South Wales and accordingly, there will in substance be no question of personal litigation between husband and wife. In such a case there is no reason founded on public policy for denying to a spouse a right to sue the other spouse for damages sustained by wrongful conduct. The same policy which lies behind the New South Wales legislation, which in terms is locally confined to a case where the motor vehicle concerned is registered in New South Wales is effectuated in Victoria, although in general terms, by its legislation which, *inter alia*, operates to remove any bar to one spouse suing the other for damages in tort where the motor vehicle is registered in Victoria with the like consequence of a compulsory third party insurance. The circumstance that by allowing the present action in Victoria by wife against husband the policy manifested by the New South Wales Act would also operate in Victoria provides in my opinion an additional reason in justification of the relaxation of the second limb of the rule in *Phillips* v. *Eyre*. To allow Victorian law to govern the matter so far from contravening the policy of the New South Wales legislation promotes it.[20]

The New South Wales rule, in its application to the facts of this case, did not enable the wife to sue her husband. However, in deciding that the rule should not be permitted to defeat the action, the court in effect noted that the operation of New South Wales law and Victorian law in respect of domestic matters was the same and that, therefore, the policy enunciated by the legislatures of both states was in harmony. This supported the application of the law of the state which did extend to the transaction and which permitted the wife to sue her husband. Again, as in the *Borg Warner* case, the court did not say that the domestic identity of the laws of the respective states constituted a false conflict, but it used the domestic identity of the respective laws to justify application of the law of the state which extended to the interstate situation.

A preliminary question which arises under this aspect of the false conflict doctrine concerns the identification of the states whose laws must be scrutinised to see if they are identical. Westen speaks in terms of the laws "of each contact state".[21] This could be taken to mean any state which has a factual connection with the underlying transaction or occurrence, or it could be more narrowly construed to refer to those states, possessing a factual connection, which are interested in the disposition of the case. Certainly, the interest analysis approaches to choice of law focus on "the interested state". This is described by Westen in the following terms:

> Currie's elusive concept of an "interested" state has not escaped criticism. To say that a state is "interested" in the disposition of a

[20] [1974] V.R. 164 at 171.
[21] *Supra* n. 6, at 106.

> particular case is not to say that its citizens or public officials will in any way take notice of the litigation. Saying a state is "interested" in a particular suit is legal shorthand for saying that it is *interested in having its law applied* to the facts of that case. A state is interested in applying its law to a suit when policies underlying that law would thereby be furthered. Policies underlying a law, in turn, are furthered when that law is applied to factual contexts which it was intended to resolve. Differently phrased, a state is interested in applying its law to a particular case when it can be said that the law was designed to encompass the facts of just such a case. Laws of a state, in turn, are not designed to dispose of all conceivable cases, but only of those having factual contact with the state such that it may be affected by the outcome of the suit. A state is so affected when one of the persons it presumes to protect is a party to the dispute, when misconduct it finds culpable transpired within the state, when its courts are invoked to resolve a dispute which it wishes to avoid, or when persons with a financial stake in the litigation are residents of the state.[22]

The problem of identifying the relevant states whose laws must be scrutinised exists under any choice of law technique that is not predicated on established choice of law rules with fixed criteria. Under our traditional choice of law rules whereby a contract is governed by the law chosen by the parties, the validity of an assignment of property is tested by the lex situs and so on, the choice of law rules themselves identify the interested or relevant state. But the adoption of the doctrine of the false conflict either as a preliminary technique to ascertain whether a decision on choice of law is unnecessary, or as an integral part of the choice of law process itself inevitably involves a scrutiny of potentially applicable laws and raises the question of which laws must be examined in this way. The problem of identifying the relevant laws may appear more formidable than it really is. In the first place it will be up to the parties to assert foreign law and it will only be the laws relied upon by the parties that will need to be scrutinised. Moreover, as the decisions in *Thorn L. & M. Appliances Pty. Ltd.* v. *Claudianos*[23] and *Pickering* v. *Pickering*[24] illustrate, there will usually only be two states which have contacts with the case or whose laws are relied upon by the parties.

Absence of conflicting interests

As Westen reminds us, the idea of a false conflict developed as a part of Currie's government-interest analysis.[25] The identification of false conflicts and their separation from true conflicts constituted an essential

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[22] *Id.* 80-81.
[23] *Supra* n. 9.
[24] *Supra* n. 8.
[25] *Supra* n. 6, at 79.

part of his choice of law process and, as a component of governmental interest analysis, cannot be divorced from it.

Currie drew a distinction between true and false conflicts. True conflicts arose when the laws of two or more interested states conflicted. It followed that, on Currie's analysis, if only one state was interested there was no true conflict to be resolved. Even if two states were interested there would be no true conflict if their laws were identical. We have already briefly noted Currie's concept of an "interested" state. The fact that a state has factual connections with a case does not *ipso facto* make it interested. It will only be interested if one or more of the policies that lie behind its domestic rule would be furthered by applying it to the facts of the interstate case at hand. Some American courts have adopted the interest analysis approach and have found an apparent conflicts case to be a false conflict on the basis that upon proper analysis only one state was interested in having its law applied to the resolution of the dispute. For example in *Williams* v. *Rawlings Truck Line Inc.*[26] G sold a car registered in his name to R. Both were residents of New York. G endorsed the registration card but did not remove the licence plates issued in his name. Shortly after the sale R, while driving the car in the District of Columbia, was involved in a collision with a truck. His passenger W, a resident of New Jersey, could not find R and instead brought an action against G. By New York law every car owner was liable for negligence in the use of vehicles driven without their permission. Moreover, in the circumstances G would have been estopped from denying his ownership because the licence plates had not been removed. No such estoppel operated under the law of the District of Columbia. The court identified two issues. The first was whether G was the owner of the car and this depended upon whether the New York rule of estoppel or the District of Columbia rule which allowed proof of sale applied. The second issue was, assuming that G was found to be the owner, whether his liability was to be measured under New York law or under the District of Columbia's statute which rendered an automobile owner vicariously liable for the torts of another committed while driving his car. On this first issue, the court examined the policy behind the District of Columbia law which permitted a registered owner to disprove ownership of a vehicle. The basic policy behind this law was identified to be the control of the giving of consent to irresponsible drivers by a person having that power rather than the imposition of liability upon a person having a naked legal title with no immediate right of control. The court considered that the law was designed to protect the persons and property of District of Columbia residents by encouraging safe driving and by providing injured parties with potential defendants. It noted that none of the parties to the suit was a resident of the District of Columbia, nor was the car registered there, hence the District of Columbia was not in

[26] (1965) 357 F.2d 581.

a position to assert an interest in the application of its law to the case. Such an application would not further the policies underlying the District of Columbia's law. On the other hand, New York had a substantial interest in the application of its rule of estoppel to the case. The New York rule was designed to enforce the vehicle registration laws of the state and thereby to maintain the integrity and accuracy of that state's vehicle registration system. The court concluded:

> In sum this case presents a classic "false conflicts" situation. Adoption of the New York doctrine of estoppel will further the interests of New York, but will not interfere with any of the articulated policies of the District of Columbia. On the other hand, application of the District's rule allowing proof of sale would impinge upon New York's interests without furthering any of the recognizable policies of the district. As a false conflicts case, our decision becomes simple: we apply the estoppel rule of New York, the only jurisdiction with an interest in having its law applied to the issue of defining ownership of the vehicle.[27]

Where only one state has significant contacts with the case and the other state has but minimal contacts, the interest analysis approach is easy to apply and leads to a predictable result. Thus *Kuchinic* v. *McCrory*[28] four Pennsylvania residents flew from Pittsburgh to Miami, Florida to attend a football game. On the return flight, while flying over Georgia, the 'plane crashed, killing all occupants. An action was instituted in Pennsylvania on behalf of the deceased passengers against the estate of the pilot. The court had no difficulty in determining that Pennsylvania was the only interested jurisdiction and that the case presented a false conflict:

> Indeed when properly analyzed the present cases are a prime example of what has been characterized as a "false conflict", for under no stretch of the imagination can Georgia be viewed as a concerned jurisdiction. In passing its statute, Georgia undoubtedly intended either to protect insurance companies from collusive suits or to prevent ungrateful guests from suing their hosts; it most assuredly did not mean to encourage the exercise of less than due care by those who use its highways or airways. Georgia's only contact with the present case, as the *situs* of the accident, is wholly fortuitous, whereas Pennsylvania, as the place where the host-guest relationship was established, where it was intended to terminate, and as the domicile of all four of the aircraft's occupants, is the state with the most significant interest in defining the legal consequences attaching to the relationship here involved. See *Griffith* v. *United Airlines, supra.*[29]

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[27] *Id.* 586.
[28] (1966) 222 A.2d 897.
[29] *Id.* 899-900.

Where a case has significant factual contacts with more than one state then a fairly comprehensive interest analysis is required in order to evaluate the interests of the states concerned. The court must identify the policies behind the laws of the relevant state and seek to determine whether any of those policies would be furthered by applying them to the interstate case at hand. There are several conclusions which the court may arrive at. In the first place, the court may decide that even while the case has significant contacts with more than one state, only one state has an interest in having its laws applied to that case. For example, in *Pfau* v. *Trent Aluminium Co.*[30] the plaintiff, a domicilary of Connecticut, and the defendant, a domicilary of New Jersey, were students at a college in Iowa. The defendant agreed to drive the plaintiff to Missouri for a weekend visit but they never reached their destination because they were involved in a collision enroute and whilst still in Iowa. The defendant's vehicle was registered in New Jersey in the name of a New Jersey corporation that belonged to the defendant's father and it was insured in that state. An action for the injuries sustained was brought by the plaintiff in New Jersey and the defendant pleaded a "guest statute" of Iowa which provided that a host-driver was not liable to his passenger-guest for ordinary negligence. Under the laws of New Jersey and Connecticut there was liability for ordinary negligence. There were significant contacts with Iowa. The journey had commenced there, both parties were resident in Iowa in the sense that they lived there while attending college and the accident occurred in that state. Nonetheless the court held that none of the policies that lay behind the Iowa guest statute would be furthered by applying them to the facts of this case. The court identified the policies of the Iowa statute as articulated by the Iowa courts. These were—to cut down litigation arising from the commendable, unselfish practice of sharing with others transportation in one's vehicle and to protect the good samaritan from claims based on negligence by those invited to ride as a courtesy, to prevent ingratitude by guests, to prevent suits by hitchhikers, to prevent collusion suits by friends and relatives resulting in excessively high insurance rates. The courts concluded as follows:

> The above policies expressed by the Iowa courts would not appear to be relevant to the present matter. This action will not increase litigation in the Iowa courts; no hitchhiker is involved; no Iowa insurer will be subjected to a "collusive suit" since the insurer is a New Jersey corporation; there is no "Good Samaritan" Iowa host-driver to be protected; and finally, there is no Iowa guest displaying his "ingratitude" by suing for ordinary negligence. The desire of Iowa to prevent collusive suits and suits by ungrateful guests and to cut down litigation would ordinarily apply to Iowa domiciliaries, defendants insuring motor vehicles there, and persons suing in its courts: *Mellik* v. *Sarahson.*[31]

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[30] (1970) 263 A.2d 129.
[31] *Id.* 131-132.

The statement that there was no Iowa host-driver to be protected nor an Iowa guest displaying his ingratitude may perhaps be debated. Though neither the plaintiff nor the defendant were domiciled in Iowa they were certainly resident in Iowa and lived there for substantial portions of the year. Likewise, the statement that "the desire of Iowa to prevent collusive suits and suits by ungrateful guests and to cut down litigation would ordinarily apply to Iowa domicilaries" may be questioned. Why would such policies not also extend to Iowa residents? Be that as it may, the court held that Iowa was not interested in having its laws applied to this case. It acknowledged, however, that Iowa had important contacts with the case and was the "seat of the relationship". The court then turned to the interests of New Jersey and Connecticut. Neither state had a guest statute and the court was of the view that Connecticut had a strong interest in applying its substantive law which permitted the plaintiff, who was domiciled in Connecticut, to recover for his host's ordinary negligence. The court also intimated that New Jersey possessed an interest. It too did not have a guest statute and permitted a guest-passenger to be compensated by his host-driver in cases of ordinary negligence. One might ask why the court felt that New Jersey was interested in applying its law so that a New Jersey defendant would have to pay damages to a plaintiff of Connecticut. The court reasoned as follows: "we are not certain that a defendant's domicile lacks an interest in seeing that its domicilaries are held to the full measure of damages or the standard of care which that state's law provides for. A state should not only be concerned with the protection and self-interest of its citizens. . . . In *Cohen* v. *Kaminetsky*, we emphasised a host's *duty* to his guests".[32] This passage indicates that a state's interests are to be broadly construed and not interpreted in a narrow or pedantic manner. On this basis one might wonder why the court did not conclude that Iowa had an interest in seeing that its policy of preventing suits by ungrateful guests did not extend to persons who were resident in Iowa and in respect of journeys that had been commenced in Iowa. The broad construction of New Jersey's interests stands in marked contrast to the narrow construction of Iowa's interests. In the end result the court concluded that there was a false conflict between the interests of New Jersey and Connecticut because their laws were identical. This underscores an important aspect of the doctrine of the false conflict as advanced by Currie. Primarily, a false conflict arises where only one state is interested. However if two or more states are interested there can still be a false conflict if their laws are identical. The *Pfau* case illustrates both facets of a false conflict. The laws of Iowa were held to be irrelevant because Iowa was not an interested state. The laws of Connecticut and New Jersey were both relevant, as they were interested, but the false conflict arose from the identity of their laws.

When two states are interested and their laws are found to be different then, on the Currie analysis, a true conflict is presented. In such

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[32] *Id.* 136.

a case the court has various options. Currie was adamant that the court was not in a position to weigh the competing interests and maintained that if one of the interested states was the forum its law should be applied. Currie was of the opinion that the law of the forum should almost invariably be applied to a case if the forum-state had an interest in the application of its laws even though another state possessed a like interest. Sometimes, however, the courts are prepared to weigh the interests of the competing states. In *Cipolla* v. *Shaposka*,[33] the plaintiff and the defendant had previously attended school together in Delaware. The defendant was a resident of Delaware and the plaintiff was a resident of Pennsylvania. On the 24th January 1966 after classes had ended for the day the defendant proceeded to drive the plaintiff to the plaintiff's home in Pennsylvania but a collision occurred while the vehicle was still in Delaware. The vehicle was registered in Delaware. In an action brought in Pennsylvania, the question which arose was whether the law of Pennsylvania or the law of Delaware applied. Delaware possessed a guest statute which prohibited a guest from recovering for his host's negligence and this would have precluded the plaintiff from recovering. Pennsylvania had no such legislation. The court held that Pennsylvania had an interest in applying its law so that the Pennsylvania guest could recover for injuries caused by the negligence of the plaintiff. The court also concluded that Delaware was interested in applying its law. In the first place, it was concerned that a Delaware defendant should not be required to compensate a guest in his vehicle. Further, the fact that the car was registered and housed in Delaware gave that state another contact because the insurance rates depended on the state in which the automobile was housed. Hence the court concluded that Delaware's contacts were qualitatively greater than Pennsylvania's and that Delaware had a greater interest in having its law applied to the issue. Justice Roberts dissented. He agreed with the majority that the case presented a true conflict but could not agree that Delaware had more than one policy underlying the issue before the court which required application of the Delaware guest statute. He did not believe that Delaware had enacted its guest statute for the purpose of lowering insurance rates of those who housed their vehicles in Delaware and observed that even if one assumed that the barring of guest-host suits did result in lower costs to insurance companies, it was far from clear whether the benefits would inure to Delaware residents or merely aid insurance companies doing business in Delaware. He concluded that the sole purpose of the Delaware guest statute was to protect a driver who generously and gratuitously transported another in his motor vehicle. Thus in view of the dissenting judge, the interests of the two states were approximately the same. In these circumstances, he thought the conflict should be resolved by applying the "better rule of law". In choosing the better rule, he examined the policies behind both rules to see which currently represented

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[33] 267 A.2d 854 (1970). See the symposium on this case at (1971) 9 *Duquesne Law Review* 347.

"the sounder view of the law" and concluded that allowing recovery by the guest for his host's negligence represented the better rule of law in the circumstances of the instant case.

Yet another approach adopted by some American courts is to devise choice of law rules or principles which indicate which interested state's law should be applied. The leading academic exponent of this approach is Professor David Cavers who, in his book entitled *The Choice of Law Process*, enunciated certain principles of preference to guide a court in choosing the appropriate law to govern a transaction or occurrence. In *Neumeir* v. *Kuehner*[34] the New York Supreme Court formulated certain rules regarding guest statutes and the choice of law. Chief Judge Fuld, delivering the majority opinion, set out the principles as follows:

> 1. When the guest-passenger and the host-driver are domiciled in the same state, and the car is there registered, the law of that state should control and determine the standard of care which the host owes to his guest.
> 2. When the driver's conduct occurred in the state of his domicile and that state does not cast him in liability for that conduct, he should not be held liable by reason of the fact that liability would be imposed upon him under the tort law of the state of the victim's domicile. Conversely, when the guest was injured in the state of his own domicile and its law permits recovery, the driver who has come into that state should not—in the absence of special circumstances—be permitted to interpose the law of his state as a defence.
> 3. In other situations, when the passenger and the driver are domiciled in different states, the rule is necessarily less categorical. Normally, the applicable rule of decision will be that of the state where the accident occurred but not if it can be shown that displacing that normally applicable rule will advance the relevant substantive law purposes without impairing the smooth working of the multi-state system of producing great uncertainty for litigants.[35]

In *Labree* v. *Major*[36] the Supreme Court of Rhode Island agreed with the New York court that a set of guidelines was preferable to an ad hoc approach. However, the Rhode Island court disagreed with the third principle stated by the New York court on the basis that it represented a retreat to the doctrine of the *lex loci delicti*. The court preferred a rule which looked to the residence of the parties rather than to the place of the accident and concluded that where a driver was from a state which allowed a passenger to recover for ordinary negligence, the plaintiff should recover irrespective of the law of his residence or the place of the accident.

The practice of some American courts in devising new choice of law rules or principles of practice, albeit in limited areas, indicates a desire

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[34] 286 N.E.2d 454 (1972).
[35] *Id.* 457-58.
[36] 306 A.2d 808 (1973).

to bring a degree of certainty and predictability as well as ease of application to the choice of law process which is lacking under the broad interest analysis approach. Certainly, interest analysis in terms of a comprehensive examination of the contacts of the relevant states and the application of the policies behind their laws to the case at hand is not likely to be adopted as an overall approach to choice of law in Australia. This is particularly so whether there are significant contacts between the case and more than one state. One only has to look at the numerous United States cases on guest statutes to see how the conclusions of the courts have varied and how difficult it can be as a practical matter to operate an interest analysis system with any degree of consistency and predictability. It is hardly surprising that New York courts have sought to enunciate firmer criteria to govern choice of law in this area.

In the area of guest statutes, the American decisions adopting an interest-analysis approach disclose a variation of thought. In the first place, there is the problem of identifying the policies behind the conflicting laws. Let us take the policies behind a guest statute which prohibits a guest from recovering against his host for ordinary negligence. In *Cipolla* v. *Shaposka*[37] the majority isolated two policies behind Delaware's guest statute. One was the prevention of suits by ungrateful guests and the other was a policy to keep down insurance premiums. However the dissenting judge took the view that it was no purpose of the Delaware law to lower insurance rates. In *Labree* v. *Major*[38] the Supreme Court of Rhode Island isolated only one policy behind the Massachusetts common law rule that one who injures another while conferring upon him a gratuitious benefit is not liable for less than gross negligence. The policy behind this rule was to protect a person who rendered a service gratuitously from ungrateful guests. In contrast, the Supreme Court of New Jersey in *Pfau* v. *Trent Aluminium Company*[39] discovered numerous objectives which lay behind the Iowa guest statute. These included the reduction of litigation from the commendable unselfish practice of sharing with others transportation in one's vehicle and the protection of the good samaritan from claims based on negligence by those invited to ride as a courtesy, the prevention of ingratitude by guests, the prevention of suits by hitchhikers, the prevention of collusion suits by friends and relatives resulting in excessively high insurance rates. However the court declined to hold that one of the objects behind the Iowa guest's statute was to ensure that defendants resident in Iowa were not deprived of funds.

In isolating the policies behind a guest statute some courts, such as that in the *Pfau* case, have said that the answer must be found in the purposes as articulated by the courts of the state where the rule was enacted or devised. Of course this will not always be possible because the courts of the relevant state may not have articulated those objectives. In any event,

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[37] *Supra* n. 33.
[38] *Supra* n. 36.
[39] *Supra* n. 30.

as the cases on guest statutes show, there are many possible objectives behind a guest statute and it may be an arbitrary judgment to say that some lie behind a particular statute while others do not. Moreover if the interest analysis approach is adopted on an international level where the competing law is that of a foreign country rather than a sister-state of a federation, it could be exceedingly difficult to identify the policies behind the foreign law. Proof of a foreign law in a foreign language is difficult enough, but the identification of the policies behind such a law would pose a formidable task.

Even if the policies behind a law can be identified with precision, the application of those policies to the interstate case is not always straightforward. We have already noted the possible discrepancies between a broad and narrow application of such policies. This is well illustrated by *Labree* v. *Major*.[40] There the defendants, who were residents of Rhode Island, drove to visit the plaintiffs at their home in Massachusetts. The plaintiffs and the defendants then went for a drive in the defendants' car and were involved in an accident in Massachusetts. The plaintiffs brought an action in Rhode Island and were met with the argument that the law of Massachusetts prevented a guest in a motor vehicle from recovering unless he proved gross negligence. The court noted that the basis of the Massachusetts rule was to protect a person who rendered a service gratuitously from ungrateful guests. In this case Massachusetts had no real interest in protecting a Rhode Island driver against ungrateful guests. But Rhode Island's policy of allowing recovery by passengers for the ordinary negligence of their hosts was not limited to the protection of Rhode Island guests. The state had an interest in enforcing the standard of care of an automobile operator no matter where his guests resided. But one might question why the court did not interpret the Massachusetts policy in a similarly broad way. The court observed that Massachusetts had no real interest in protecting a Rhode Island driver against ungrateful guests but, following the broad interpretation of the Rhode Island policy, did not Massachusetts have an interest in holding Massachusetts guests to the standard of conduct prescribed by Massachusetts law *viz.* that they should not be ungrateful to a host who gratuitously afforded them transport in his vehicle? In the case of the Massachusetts law the court applied the policy in a narrow way but in the case of the Rhode Island law the court applied the policy which underlay it in a broad way. It is submitted that there is a degree of inconsistency here.

It has been stated above that the Australian courts are unlikely to adopt interest analysis as an overall approach to choice of law particularly in cases involving significant contacts with more than one state. But it is obvious that where a case has significant contacts with only one state and only that state has an interest in the application of its law, then the forum is unlikely to apply the law of any other (disinterested) state. This is consistent with, and is arguably the basis of, many of the recent

[40] *Supra* n. 36.

Australian decisions dealing with choice of law in torts. Indeed, the important decision of the House of Lords in *Chaplin* v. *Boys*[41] can be explained on this basis. That case concerned an action between two British servicemen in respect of an accident which had occurred in Malta. By English law, the plaintiff could recover for both general and special damages, but by the law of Malta, only special damages could be recovered. In the view of Lord Wilberforce and Lord Hodson, Malta had no interest in applying its law to this case. As Lord Wilberforce remarked:

> The rule limiting damages is the creation of the law of Malta, a place where both plaintiff and defendant were temporarily stationed. Nothing suggests that the Maltese state has any interest in applying this rule to persons resident outside it, or in denying the application of the English rule to these parties. No argument has been suggested why an English court, if free to do so, should renounce its own rule. That rule ought, in my opinion, to apply.[42]

Likewise the Australian tort cases, *Kemp* v. *Piper*,[43] *Warren* v. *Warren*[44] and *Corcoran* v. *Corcoran*[45] can be regarded as decisions where the courts felt compelled to apply the law of a particular jurisdiction because it was the only interested jurisdiction. For example in *Corcoran* the action was between spouses who were resident and domiciled in Victoria in respect of an accident involving their Victorian registered car which had occurred in New South Wales. The issue was whether the spouses could sue each other. They possessed capacity under Victorian law but not by the law of New South Wales. Adam, J. remarked:

> Why should, in this case, the rule applicable in New South Wales apply in preference to that of Victoria? The only connection, as I indicated before, between the facts or the ingredients of this action with New South Wales is that the accident giving rise to the wife's injuries happened to occur in New South Wales. But when it is realized that the parties, the husband and wife, are both residents of Victoria, both domiciled in Victoria, were only fortuitously in New South Wales at the time of the accident, have no other connection whatsoever with New South Wales, and also that they were travelling in a car which is registered in Victoria, there would seem to me to be overwhelming reasons for treating this as a case where the Victorian law should be preferred to the New South Wales law on the issue, and the only issue where the laws conflict—the capacity of the wife to sue the husband. Not only has the cause of action a much closer contact with Victoria than with New South Wales but the interests of Victoria are more clearly involved than

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[41] [1971] A.C. 356.
[42] *Id.* 392.
[43] [1971] S.A.S..R. 25.
[44] [1972] Qd. R. 386.
[45] [1974] V.R. 164.

> any interests of New South Wales. The interests of New South Wales in maintaining inter-spousal immunity primarily concern husbands and wives who are connected with New South Wales. There would seem to be no obvious connection between any such policy of immunity in the New South Wales legislation, and husbands and wives who are unconnected with New South Wales, being residents of Victoria.[46]

However it must be said that not all cases conveniently fit within this pattern. In particular, the recent decision of the Supreme Court of Victoria in *Breavington* v. *Godleman*[47] arguably resulted in the application of the law of a disinterested state. There the plaintiff was a resident of the Northern Territory and was involved in an accident in that state. The three defendants were residents of the Northern Territory at the time of the action and had taken up residence in Victoria where the proceedings were instituted. The plaintiff brought a common law action seeking damages for the injuries he had sustained. By the law of the Northern Territory, an accident compensation scheme had been established and persons who were resident in the Northern Territory had had their common law rights severely curtailed. O'Bryan, J. held that the action could proceed in Victoria in accordance with Victorian law and he expressed the view that it would be unjust if the lex loci delicti were applied to restrict the plaintiff's common law rights. This case may be viewed as a blatant case of forum shopping. Almost all the contacts were with the Northern Territory and it is strange, to say the least, that the learned judge thought it unjust to hold a plaintiff to the law of the jurisdiction where he resided, where the accident occurred and where most of the defendants resided.[47a]

Despite *Breavington*, it is submitted that generally where only one state has significant contacts with the case and any real interest in the application of its law, then the forum is likely to apply the law of that interested state and not to give effect to the law of a disinterested state. Usually, however, this will be done by giving effect to a choice of law rule which should be accurate enough, or flexible enough, to ensure that only the law of the interested state is applied rather than by classifying a problem as a false conflict.

Much of the American learning on choice of law has been concerned with tort problems. While interest analysis is not confined to torts, it is undoubtedly the area that has engendered the most interest and has furnished the factual problems upon which the academic and judicial writers have constructed their approaches and developed their theories.

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[46] *Id.* 170-171.

[47] [1985] V.R. 851.

[47a] It is pleasing to record that since this article was written the Victorian Full Court has allowed an appeal (*Godleman* v. *Breavington*, Victorian Full Court, 27 October 1986). The court adopted the Lord Wilberforce "double actionability" interpretation of *Phillips* v. *Eyre* and held that no case had been made out for dispensing with the lex loci delicti. The court expressly recognised that the cause of action had a much closer connection with the Northern Territory than with Victoria and that the interests of the Northern Territory were more closely involved than the interests of Victoria.

There are some areas beyond torts where it is clearly legitimate to apply the law of a disinterested state. The outstanding example is contracts where, since the decision of the Privy Council in *Vita Food Products Inc.* v. *Unus Shipping Co.*,[48] it is accepted that the parties to a contract can choose the proper law of the contract and that their choice is not restricted to a legal system with which the contract is connected. There are sound reasons for permitting party autonomy in contracts. It brings certainty in relation to choice of law in an area where certainty is very desirable. There are also good reasons for not requiring the parties to choose the law of a state that has a significant contact with the contract. If the contracting parties are resident in different states, they may not be able to agree that one of their laws should apply and they may choose the law of a third state as a "neutral" law. Moreover, it is common for parties in international commercial transactions, particularly insurance, maritime transactions, and commodities contracts, to choose English law to govern such contracts even though neither party may have a substantial connection with England. Further, international conventions on choice of law in contracts permit party autonomy and do not restrict it to the law of a connected state. The broad rule of party autonomy without restriction is contained in Article 3(1) of the 1980 E.E.C. Convention on the Law Applicable to Contractual Obligations (The Rome Convention) and in Article 7(1) of the 1985 Hague Convention on the Law Applicable to Contracts for the International Sale of Goods.

Conclusion

1. The doctrine of the false conflict as developed in the United States by writers and accepted by some courts is not a complete choice of law methodology in itself. It aims to distinguish "true" conflicts from "false" conflicts but does not provide any basis for the resolution of a "true" conflict.
2. Even within the sphere of its operation, it is not a unitary concept bearing a single meaning. Different writers have put forward diverse situations, or combinations of situations, as representing a false conflict and there is no agreement as to what constitutes a false conflict.
3. The doctrine is closely associated with and is perhaps an aspect of the American interest analysis approach to choice of law. Thus it is unlikely to be adopted as a discreet technique in Australia.
4. However this does not mean that the two main spheres of its operation are irrelevant in the Australian context.
5. Where the laws of the relevant jurisdictions are the same, both in their domestic operation and in their application to the case before the court, then a decision on choice of law is unnecessary. *Koop* v. *Bebb*

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[48] [1939] A.C. 277.
[49] *Supra* n. 11.

is a case which should have been readily disposed of at first instance and should not have gone to the High Court.

6. Where the laws of the relevant jurisdictions are the same in their domestic operation but they differ in their application to the case before the court, a more difficult situation is presented. It is unlikely that Australian courts would classify the case as a false conflict. But if the domestic policies of the laws of the relevant jurisdictions are in harmony, there must be a strong argument for giving effect to these mutually shared policies by applying the law of the state which embodies these policies and which extends to the case. This was the situation in *Corcoran* v. *Corcoran*[50] and in *Borg Warner (Australia) Ltd.* v. *Zupan.*[51]
7. A false conflict is also said to arise where only one state is interested in having its law applied to the case. Often this will be an important factor in the choice of law equation, and the choice of law rules should be so devised (or should be flexible enough to ensure) that the law of the interested state is applied. However this will not invariably be the case and in some areas the desire for certainty or other interstate or international factors may prevail. Thus, for example, in relation to contracts effect may be given to the law chosen by the parties even though the stipulated legal system may bear little relationship to the underlying transaction.

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[50] *Supra* n. 20.
[51] *Supra* n. 4.