

OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE
THE SUPREME COURT
OF THE
UNITED STATES

CAPTION: JILL S. KAMEN, Petitioner V. KEMPER FINANCIAL
SERVICES, INC., ET AL.

CASE NO: 90-516

PLACE: Washington, D.C.

DATE: March 27, 1991

PAGES: 1 - 44

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1 IN THE SUPREME COURT OF THE UNITED STATES

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3 JILL S. KAMEN, :

4 Petitioner :

5 v. : No. 90-516

6 KEMPER FINANCIAL SERVICES, :

7 INC., ET AL. :

8 - - - - - X

9 Washington, D.C.

10 Wednesday, March 27, 1991

11 The above-entitled matter came on for oral
12 argument before the Supreme Court of the United States at
13 11:06 a.m.

14 APPEARANCES:

15 RICHARD M. MEYER, ESQ., New York, New York; on behalf of
16 the Petitioner.

17 MICHAEL R. DREEBEN, ESQ., Assistant to the Solicitor
18 General, Department of Justice, Washington, D.C.; on
19 behalf of the Securities and Exchange Commission, as
20 amicus curiae in support of the Petitioner.

21 JOAN M. HALL, ESQ., Chicago, Illinois; on behalf of the
22 Respondents.

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C O N T E N T S

ORAL ARGUMENT OF	PAGE
RICHARD M. MEYER, ESQ.	
On behalf of the Petitioner	3
MICHAEL R. DREEBEN, ESQ.	
On behalf of the Securities and Exchange Commission, as amicus curiae in support of the Petitioner	13
JOAN M. HALL, ESQ.	
On behalf of the Respondents	21
REBUTTAL ARGUMENT OF	
RICHARD M. MEYER, ESQ.	
On behalf of the Petitioner	42

1 P R O C E E D I N G S

2 (11:06 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument
4 next in No. 90-516, Jill S. Kamen v. Kemper Financial
5 Services.

6 Spectators are admonished the Court remains in
7 session. There is to be no talking in the courtroom until
8 you get out beyond the walls here.

9 Mr. Meyer, you may proceed whenever you are
10 ready.

11 ORAL ARGUMENT OF RICHARD M. MEYER

12 ON BEHALF OF THE PETITIONER

13 MR. MEYER: Mr. Chief Justice, and may it please
14 the Court:

15 This action was brought by a shareholder of Cash
16 Equivalent Fund to recover damages for two wrongs. The
17 one at issue before the Court today is a proxy violation,
18 the deception of the fund shareholders by a proxy
19 statement which induced them to approve a management
20 agreement with the investment advisor, which I will refer
21 to as KFS, by misrepresenting comparative fees paid to KFS
22 by other mutual funds managed by KFS. That
23 misrepresentation was in violation of rules of the
24 Securities and Exchange Commission.

25 The --

1 QUESTION: Mr. Meyer, can I just ask one
2 question? What remedy do you seek for that violation?

3 MR. MEYER: We are seeking damages, and --

4 QUESTION: And who is the we? To whom would the
5 damages be paid?

6 MR. MEYER: We ask that the damages be paid to
7 the fund.

8 QUESTION: To --

9 MR. MEYER: To Cash Equivalent Fund, which is
10 the mutual fund involved.

11 QUESTION: I see. So it's in the nature of a
12 derivative action, then?

13 MR. MEYER: This is a matter which the Solicitor
14 General takes --

15 QUESTION: Right.

16 MR. MEYER: -- a somewhat different view of. We
17 have always taken the view that it is in the nature of a
18 derivative action, yes.

19 This -- the matter now before the Court requires
20 the review of an unprecedented holding by the court of
21 appeals for the Second Circuit that the claim must be
22 dismissed --

23 QUESTION: The Seventh Circuit.

24 MR. MEYER: Seventh Circuit. I beg your pardon.
25 That the claim must be dismissed because a plaintiff must,

1 prior to bringing the action, in all cases, make a
2 precomplaint demand upon the board of directors to bring
3 the action, even if such a demand would be futile.

4 I propose to discuss this morning three
5 questions. First, whether a demand must be made even
6 though futile. Second, the practical consequences of
7 requiring a precomplaint demand. And finally, the
8 question of what law applies.

9 On the first question, whether a demand must be
10 made even if futile --

11 QUESTION: Can you answer that question without
12 explaining first what law applies?

13 MR. MEYER: I agree --

14 QUESTION: Or are you going to say it doesn't
15 make any difference?

16 MR. MEYER: I am going to say that it doesn't
17 make any difference. That's correct. And the order, I
18 agree, Justice White, does suggest that it is presented in
19 inverse order, but I believe that you will see, as the
20 argument unfolds, the conclusions become compelling. At
21 least I hope they will become compelling.

22 Beginning with the question of making a demand
23 when it is futile, it's an ancient precept of the common
24 law that the law does not require a futile act. And that
25 precept has been applied to demand on directors by this

1 Court in cases going back well over 100 years. The
2 decision by the court of appeals for the Seventh Circuit
3 is the only judicial decision that I have been able to
4 find or that has been cited by any party suggesting that
5 even though the demand is futile it must nevertheless be
6 made. These futility --

7 QUESTION: Excuse me there. It has been
8 proposed by several respected organizations, such as the
9 American Bar Association, I gather, and the American Law
10 Institute.

11 MR. MEYER: The American Law Institute and the
12 American Bar Association have adopted -- taking the
13 American Law Institute, which has been a little more
14 active in the area, a -- what they call a tentative draft,
15 which is, I think they are now up to tentative draft
16 number 10, which suggests what is called the universal
17 demand requirement. That is, demand may be made in every
18 case, and that this will obviate the difficulty of
19 determining whether or not the demand is in fact futile.
20 It will compel a demand. And indeed this is somewhat in
21 line with the reasoning of the Seventh Circuit which cites
22 at some length the tentative draft of the American Law
23 Institute. The basic -- excuse me.

24 QUESTION: It goes along with this. Does the
25 American Law Institute, like the Seventh Circuit opinion

1 here, also say that the business judgment rule would not
2 be applied to the determination of the directors?

3 MR. MEYER: The -- no, I don't believe they say
4 that. On the contrary, the basic rationale followed by
5 the court of appeals in this case is that the introduction
6 of a universal demand requirement is suggested by the
7 recent developments in the growth of special litigation
8 committees. Even where, as in the present case, the board
9 of directors is directly implicated in the wrong, the
10 court below says the board can create a special litigation
11 committee by -- perhaps by expanding its number, bringing
12 in people who were not involved in the wrongdoing. These
13 committees supposedly will dispassionately review the
14 facts of the matter, make a recommendation to the board of
15 directors, and the board will act accordingly.

16 QUESTION: Well, Mr. Meyer, under the Seventh
17 Circuit's view, if a demand is made and refused, what's
18 the legal effect of that on the suit? Can it go forward?

19 MR. MEYER: That is a question --

20 QUESTION: Under the Seventh Circuit's holding?

21 MR. MEYER: That is a question that has not been
22 answered. And the Seventh Circuit --

23 QUESTION: And how do you understand its holding
24 in that regard? What would be the effect?

25 MR. MEYER: I understand it in the following

1 way, that assuming that a special litigation committee is
2 formed and makes a recommendation, which invariably is a
3 recommendation that the litigation not go forward, that's
4 invariably the case --

5 QUESTION: Well, it may or may not be. Let's
6 assume it is a recommendation not to go forward.

7 MR. MEYER: All right. The question then
8 becomes one of reviewing the determination of the special
9 litigation committee, and the focus of the litigation has
10 now changed. We are now looking to see not whether the
11 original complained of conduct was inappropriate. We're
12 not looking to see whether a fiduciary accused of self-
13 dealing has satisfied the fiduciary's normal burden of
14 justifying the intrinsic fairness of his dealings with his
15 corporation. We are looking instead to see whether an
16 independent committee (a) had some kind of bias or
17 conflict of interest, and (b) whether it exercised a
18 judgment that was so egregious that no reasonable
19 businessman could be said to have come to a similar
20 judgment.

21 This is such an enormous burden to place upon a
22 shareholder who is, in this particular case and in many of
23 these cases, attempting to enforce the public policies,
24 important public policies --

25 QUESTION: Well, then the legal issue changes,

1 as I understand you, Mr. Meyer? The plaintiff has a
2 harder row to hoe if a demand is made and turned down than
3 if the plaintiff can simply show that a demand would be
4 futile?

5 MR. MEYER: Mr. Chief Justice, I submit that the
6 plaintiff has an impossible row to hoe.

7 QUESTION: Well, could you answer my question?
8 I asked you to compare two burdens.

9 MR. MEYER: Yes. The burden of reviewing -- the
10 burden that the plaintiff has where a demand is made and
11 turned down is virtually insuperable.

12 QUESTION: So the futility exception really
13 gives the plaintiff a leg up, then. It allows it to
14 litigate under different standards than if its demand is
15 turned down?

16 MR. MEYER: That's correct. That's correct, and
17 the futility exception is the one that has been recognized
18 by this Court for well over 100 years and by every court
19 that has ever passed upon the question. The --

20 QUESTION: But Mr. Meyer, excuse me. I thought
21 the Seventh Circuit had explicitly repudiated imposing
22 upon the disappointed would-be plaintiff that kind of a
23 burden. I thought what the Seventh Circuit is saying is
24 in exchange for always requiring a request to be made we
25 will not impose the normal business judgment rule.

1 MR. MEYER: At one point in its opinion the
2 Seventh Circuit does suggest that. At other points in its
3 opinion it suggests quite the contrary. But I submit to
4 you that the first suggestion made by the Seventh Circuit,
5 I don't know if it comes in that order, but in our
6 discourse it's the first suggestion, is an illogical
7 suggestion to follow.

8 After all, why go to the trouble of forming a
9 special litigation committee, having it go through an
10 extensive investigation, hiring counsel, making a report,
11 and then coming back to court and the court saying we're
12 going to totally ignore it. We'll pretend it hasn't
13 occurred, and we will review the bringing of the
14 litigation as though it didn't exist. Manifestly it must
15 have some purpose, and manifestly if these special
16 litigation committees are to exist, which ineluctably
17 follows from the imposition of a universal demand
18 requirement, then the courts must give some deference to
19 the recommendations of special litigation.

20 QUESTION: I thought the Seventh Circuit went
21 through -- I don't know where it is in the opinion. Oh,
22 yes, on 13A of the petition for cert. We seem to be
23 dealing with 13A and 14A today. The opinion gives four
24 reasons why demand may be inappropriate, and it went
25 through the bases, possible bases for requiring demand,

1 and only one of which is what you have just addressed.
2 Another purpose of it is to let the corporation take over
3 the suit if it wishes. Now, that purpose would be fully
4 served whether or not you apply the business judgment
5 rule.

6 MR. MEYER: There are a number of reasons why
7 demand may not be futile. In this case, clearly demand
8 was futile. And I would submit that the arguments that
9 even where it is futile some good may nevertheless come
10 out of making a demand is not really an appropriate
11 consideration for courts to consider. For example, in the
12 Fox case which is oft cited in the briefs, the Court came
13 to the conclusion that demand would be futile because
14 under the statute the corporation was disabled from
15 bringing the claim. And that's a little bit different
16 from what we have here.

17 But in that case the petitioner argued that even
18 though the corporation could not bring the claim -- it
19 also involved a mutual fund -- demand would serve many
20 useful intra-corporate purposes. It would cause the
21 directors to focus on the contract with the investment
22 advisor. They might revise the contract. They might even
23 fire the investment advisor. All other intra-corporate
24 rearrangements could be made.

25 That's always true, but I submit that the

1 purpose of the Federal Rules of Civil Procedure are, while
2 undoubtedly having some effect on corporate governments,
3 are really directed toward corporate litigation and not
4 with the operation of corporate law internally. And
5 therefore I don't subscribe, obviously, to the Seventh
6 Circuit's views on this matter.

7 The third point that I want to talk to, and I
8 would like to address this as briefly as possible because
9 I do want to reserve, if permitted, some time for
10 rebuttal. The third point I want to address is what law
11 applies to the case. Our view is that State law should
12 apply to the case, in this case Maryland law, unless that
13 State law is so inconsistent with the enforcement of the
14 important Federal public policies underlying the proxy
15 rules, in this case section 20 of the Investment Company
16 Act, that to insist upon the enforcement of the rule and
17 impose burdens upon plaintiffs seeking to enforce that
18 public policy would thwart the public policy.

19 This may sound like a heads, I win, tails, you
20 lose proposition, but it's -- there is support for it in
21 the cases. Galef v. Alexander, which is cited in our
22 brief, is on point. We also mention Levitt v. Johnson.
23 And there is a --

24 QUESTION: Where -- what courts decided these
25 cases?

1 MR. MEYER: These are appellate courts, circuit
2 courts.

3 QUESTION: Federal courts of appeals?

4 MR. MEYER: Federal courts of appeal.

5 There is a decision by this Court in Boil v.
6 United Technologies which did indicate that Federal common
7 law would prevail where State tort law would threaten a
8 result that was contrary to what was involved in that
9 case, the Government defense contractor defense.

10 Unless there are further questions I would like
11 to reserve the remaining time for rebuttal.

12 QUESTION: Very well, Mr. Meyer.

13 Mr. Dreeben, we'll hear from you.

14 ORAL ARGUMENT OF MICHAEL R. DREEBEN

15 ON BEHALF OF THE SECURITIES AND EXCHANGE COMMISSION,

16 AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER

17 MR. DREEBEN: Thank you, Mr. Chief Justice, and
18 may it please the Court:

19 Prior to the decision below it was the law in
20 virtually all jurisdictions that shareholders need not
21 make demand before commencing a derivative action where
22 that demand would be futile. In this case the court of
23 appeals abolished the traditional futility exception and
24 replaced it with a rule that requires universal demand in
25 every case.

1 In our view, the court of appeals erred in
2 addressing this question as one of Federal common law for
3 the courts of appeals to decide as they perceive the
4 policy balances to require. Rather, State law should
5 govern this area of core governance of corporations'
6 internal affairs, absent a conflict with Federal policy.

7 QUESTION: Mr. Dreeben, that's a little odd,
8 isn't it, because this is an action brought under a
9 Federal statute?

10 MR. DREEBEN: That's correct, Justice O'Connor.

11 QUESTION: A Federal cause of action. And the
12 cases saying that you nevertheless look to State law are a
13 little unusual, it seems to me.

14 MR. DREEBEN: Well, I think the case that's
15 closest related to the particular problem here today is
16 Burks v. Lasker.

17 QUESTION: Yes.

18 MR. DREEBEN: It's quite similar, really.

19 QUESTION: Yes.

20 MR. DREEBEN: It was another derivative action
21 under the Investment Company Act.

22 QUESTION: Yes. I guess I just don't understand
23 that case, and why, when you have a cause of action based
24 on violation of a Federal law you would have to look to
25 State law for one of these initial sort of procedural

1 requirements.

2 MR. DREEBEN: Well, there are two responses I'd
3 like to give to that. First of all, the question of
4 whether demand is required or not is a Federal question
5 because the cause of action arises under a Federal
6 statute. There is no doubt about that. The next issue is
7 from what source does Federal law derive the rule of
8 decision. This Court has in many contexts held that even
9 when a question is governed by Federal law, Federal law
10 may turn to State law rather than fashioning an entire
11 body of law on its own. I think the Kimbell Foods case is
12 the outstanding example of this, and the Court applied a
13 very similar principle in Burks v. Lasker when it comes to
14 the law of corporations. Corporations, after all, are
15 created under State law.

16 When Congress regulated in the Investment
17 Company Act, as it did in the other securities acts to
18 regulate corporate activities, it did not provide for
19 Federal chartering of corporations. It relied on States
20 to charter corporations and to basically regulate the
21 activities of corporations subject only to the predominant
22 Federal policy. So Federal law displaces State law to the
23 extent it is necessary to achieve Federal goals.
24 Otherwise State law governs.

25 QUESTION: What if the State law says that there

1 will be a demand made in every case?

2 MR. DREEBEN: That -- in our view the initial
3 step for a court to follow is to adopt that rule, and then
4 to consider whether it infringes any Federal policy to
5 follow it. That question, of course, isn't here today,
6 since we don't have a State that provided for universal
7 demand, although there are several. I think that the real
8 way to answer whether it conforms to Federal policy is to
9 look at what happens after demand is made.

10 Does that -- does the making of demand in a
11 particular State give the corporation a leg-up in
12 dismissing the derivative action? If it does and the
13 corporation is invested with too much power to cut off a
14 Federal claim, there may very well be a conflict with
15 Federal policy. But it probably will not flow from the
16 demand requirement itself. It more likely will flow from
17 what happens after demand is made and refused.

18 QUESTION: And how do you read the Seventh
19 Circuit's holding about -- insofar as that is concerned?

20 MR. DREEBEN: Well, the Seventh Circuit thought
21 it could achieve a nice distinction, a very logical, tidy
22 distinction between a Federal rule of universal demand and
23 State law governing what happens after demand is made.
24 The problem with that approach is, although it sounds nice
25 in theory, in fact it doesn't work. The reason it doesn't

1 work is because many States place an integral connection
2 between whether a shareholder has to make demand and what
3 standard of review is subsequently applied to the board of
4 directors' decision.

5 So Delaware, for example, which is a leading
6 State in corporate law, says that if a demand is required
7 of the shareholder and not excused, then the directors'
8 subsequent decision not to sue is judged very
9 deferentially under the business judgment rule. On the
10 other hand, if demand is futile because the board is
11 either biased or too implicated in the transaction to act
12 on it, then a much higher standard of review applies when
13 the corporation attempts to terminate the suit.

14 QUESTION: Mr. Dreeben, I understood the Seventh
15 Circuit to avoid that problem by federalizing the latter
16 question as well, that is by saying how much deference you
17 give to the board decision is also a Federal question, and
18 we will not adopt as a matter of Federal law the business
19 judgment rule.

20 MR. DREEBEN: Well, I am not sure that the court
21 said exactly either of those things. If it said -- if it
22 thought it was saying that it's a Federal question what
23 standard of review applies to the board of directors'
24 decision, then in effect it overruled *Burks v. Lasker*,
25 because *Burks v. Lasker* held that the power of corporate

1 directors to terminate a derivative action, even based on
2 a Federal statute, derives in the first instance from
3 State law unless it conflicts with Federal policy. So
4 there's a two-pronged inquiry.

5 I don't think that the court of appeals actually
6 intended that. I think what the court of appeals thought
7 is that we can have a Federal rule, which it thought was
8 procedural, of universal demand followed by the
9 application of State law as it's found. But the real
10 difficulty with that proposition, I think, is that State
11 law simply does not draw the distinction between demand
12 and the standard of review in every instance. In some
13 cases, in many, it ties them together. And once a
14 shareholder makes a demand under Delaware law, the
15 business judgment rule applies in every single case.

16 So under the Seventh Circuit's Federal universal
17 demand rule you have two options. One option would be to
18 say since the shareholder made a demand we now apply the
19 Delaware standard of review. It's the business judgment
20 rule, in every single case, even though Delaware might
21 have applied a different standard because demand was
22 actually futile.

23 The other alternative -- that alternative I
24 think is not only conceptually incorrect, it overrides
25 State policy needlessly.

1 The other alternative would be for the court to
2 engage in a hypothetical inquiry. Would Delaware have
3 excused demand in this case? If we answer that question
4 we'll then know what standard of review Delaware wanted to
5 apply. But if you engage in that inquiry you're right
6 back where you started. You're litigating demand
7 futility, and the court of appeals rule serves no purpose.

8 The basic reason why the court of appeals got
9 off on the wrong foot, I think, is it evaluated the demand
10 question as one of Federal procedure. It's really not.
11 It's really a rule that governs substantive law of
12 corporate internal affairs. A corporation may have a
13 claim that can be asserted in court, but it is an
14 artificial entity, and the question in a derivative action
15 is who has the right to speak for a corporation. Normally
16 it's the board of directors under State law, but State law
17 almost universally recognizes an exception for derivative
18 actions where the directors have wrongfully refused to
19 protect corporate claims. In that instance shareholders
20 may step in and speak for the corporation.

21 The demand rule stands as a threshold
22 requirement that helps to regulate when shareholders can
23 do that. The demand rule says that before shareholders
24 may take the extraordinary step of usurping the board of
25 directors' prerogatives, they have to make a demand on the

1 directors to see whether the directors want to take over
2 the suit or how they will react to it, to give them a
3 chance to make a corporate judgment.

4 State law, however, recognizes that in some
5 instances it would only obstruct the protection of
6 shareholder rights, who are, after all, the owners of the
7 corporation, to have to go to the very board of directors
8 that may be implicated in the transaction --

9 QUESTION: Well, how would it obstruct them if
10 you can do pretty much what you want in the way of
11 prosecuting your suit after a demand is turned down?
12 Wouldn't it simplify things?

13 MR. DREEBEN: It would simplify things if there
14 were a coherent way of applying it, and the way of
15 applying it were consistent with Federal law. But the way
16 that many States regulate derivative actions is that if
17 demand is excused the courts take a more active role in
18 regulating the directors' efforts to cut it off. If
19 demand is required, then the directors have a greater
20 power. They can rely on their business judgment and say
21 this derivative action should be terminated.

22 QUESTION: Well, might not the States change
23 some of their laws if -- in that regard, if a demand under
24 this statute were treated as a matter of Federal law, and
25 you say you require it in every case?

1 MR. DREEBEN: Well, it's certainly possible the
2 States might be forced to change their internal law of
3 corporations if Federal law reached out and grabbed a
4 portion of it. But there is no authorization --

5 QUESTION: This whole statute is a Federal
6 statute. I mean, it specifies for what the basis of suit
7 is. It's not as if you're suing under a State cause of
8 action.

9 MR. DREEBEN: That's true, Chief Justice
10 Rehnquist, and if the Court in *Burks v. Lasker* had ruled
11 that it is always a Federal question when directors can
12 terminate a derivative action under a Federal statute,
13 then we would not be here today arguing that State law is
14 the primary source. But once *Burks v. Lasker* and its
15 principles are established there is really no alternative
16 but to borrow the coherent set of State law rather than
17 simply taking one piece of it here and another piece of it
18 from Federal law.

19 Thank you.

20 QUESTION: Thank you, Mr. Dreeben.

21 Mrs. Hall, we'll hear from you.

22 ORAL ARGUMENT OF JOAN M. HALL

23 ON BEHALF OF THE RESPONDENTS

24 MRS. HALL: Mr. Chief Justice, and may it please
25 the Court:

1 The district court correctly dismissed the proxy
2 claim in this case, and the court of appeals correctly
3 affirmed that dismissal. We respectfully submit that
4 regardless of whether this Court chooses to apply Federal
5 law or State law, and regardless of whether the futility
6 exception is applied or the futility exception is
7 abolished, this Court should affirm the dismissal of the
8 proxy claim in this case.

9 I would like to make three points. First, both
10 courts below correctly concluded that the allegations of
11 futility in the complaint in this case were totally
12 inadequate to excuse the making of a demand upon the
13 directors.

14 Second, both courts below correctly concluded
15 that Federal law should apply in dealing with the demand
16 issue on this Federal cause of action. And third, the
17 court of appeals correctly held that under Federal law the
18 futility exception to the demand requirement should be
19 eliminated in order to promote important policies
20 underlying the demand requirement, including judicial
21 economy.

22 Turning first to the insufficiency of the
23 allegations, the district court found that if you
24 disregard the conclusory allegations in petitioner's
25 complaint only two factual allegations of futility remain,

1 that the directors receive fees for serving as directors,
2 and the directors voted to send out the challenged proxy
3 material. Petitioner cites no case, State or Federal, in
4 which boilerplate allegations of futility such as these
5 have been held to excuse demand.

6 The Federal law as to facts which would be
7 sufficient to excuse the making of a demand is well stated
8 in the Kauffman case. In Kauffman the First Circuit said
9 that demand could be excused only upon a particularized
10 showing that the directors are so antagonistic to the
11 interests of the corporation that they could not discharge
12 their duties.

13 In our case the directors are not named as
14 defendants, nor are they alleged to have engaged in any
15 wrongdoing whatsoever. This is particularly significant
16 because full discovery on the merits was available to
17 petitioner in this case.

18 QUESTION: Ms. Hall, you may be dead right that
19 the allegations are insufficient, but neither the court of
20 appeals -- the court of appeals didn't rely on that
21 ground, did it?

22 MRS. HALL: They did, Your Honor. They did,
23 Your Honor.

24 QUESTION: But the questions presented by the
25 cert. petition don't raise that. I thought we took a case

1 assuming that there were sufficient allegations. You may
2 be right, but I'm just saying I'm not sure that's one of
3 the issues we're addressing under the cert. petition.

4 MRS. HALL: I think that issue is properly
5 before the Court and that it provides an independent
6 ground for affirming the judgment of dismissal, Your
7 Honor.

8 QUESTION: I see.

9 MRS. HALL: And it also is one part of the
10 holding of the court of appeals. The Seventh Circuit has
11 alternative holdings. They specifically find that the
12 allegations are insufficient, and then they go forward
13 with this alternative holding abolishing the futility
14 exception.

15 QUESTION: Can we say that's all -- well, that's
16 an alternative holding rather than dicta, then?

17 MRS. HALL: It is an alternative holding, we
18 believe. The Seventh Circuit expressly states that the
19 district court found the allegations of futility
20 insufficient, as do we.

21 QUESTION: Well -- gee, I -- see, I didn't
22 understand.

23 MRS. HALL: At both A16 and A17 of the Seventh
24 Circuit opinion, the Seventh Circuit finds the allegations
25 of futility to be --

1 QUESTION: 16 and 17?

2 MRS. HALL: -- insufficient.

3 QUESTION: What page was that on?

4 MRS. HALL: At A16, Your Honor. The court of
5 appeals states the district court thought these
6 allegations insufficient to excuse a demand under rule
7 23.1, as do we. That's at the conclusion of the first
8 paragraph under Roman numeral I. And at A17 -- no, I've
9 got the wrong page number there. Well, there's another
10 place in the opinion where the district court -- the court
11 of appeals refers to the able opinion of the court of
12 appeals finding that these allegations of futility are
13 insufficient, and then states we are in accord.

14 QUESTION: Mrs. Hall, I'm having trouble finding
15 what you're -- even A16. I have a --

16 QUESTION: I think if you say 6A, Ms. Hall,
17 you'll get to the --

18 MRS. HALL: I'm sorry. 6A.

19 QUESTION: -- portion of the appendix where the
20 "as do we" language is found.

21 MRS. HALL: 6A, Your Honor. Roman numeral I,
22 the first paragraph, the last sentence in the paragraph.
23 "Judge Nordberg thought these allegations insufficient to
24 excuse a demand under rule 23.1, as do we."

25 QUESTION: Well, but they do. But for quite

1 separate reason that you always have to make a demand.
2 That's how I interpreted that.

3 MRS. HALL: I think it's an alternative holding,
4 Your Honor, and provides an alternative ground for
5 affirmance of the dismissal in this case.

6 QUESTION: I don't see -- it isn't necessarily
7 alternative. Then they go, he goes on to explain why we
8 do, and the reason we do is that you always have to make a
9 demand, and therefore these allegations are not sufficient
10 to excuse a demand. Isn't that the --

11 MRS. HALL: I think he -- I think he also
12 reviews these particular allegations and finds them
13 insufficient, and goes on to say in addition that he is
14 abolishing futility as an exception to the demand
15 requirement.

16 Your Honors, even after substantial discovery in
17 this case petitioner did not make any charges of
18 wrongdoing against these directors, and we think that the
19 allegations of futility in this case were completely
20 inadequate, whether the Court chooses to apply Federal law
21 or State law.

22 We think that both courts below properly chose
23 to apply Federal law to the demand issue in this Federal
24 cause of action for two reasons. The first reason is that
25 petitioner induced both courts below to apply Federal law,

1 and waived any argument that State law applies.
2 petitioner cited only Federal law to the district court.
3 petitioner did not mention State law until her reply brief
4 in the court of appeals, and even then she argued only
5 that if the court did not apply Federal law, then State
6 law should be applied.

7 The district -- the court of appeals found that
8 the State law argument had been waived, relying upon a
9 rule of that court, a rather unremarkable rule which holds
10 that reply briefs are to be limited to matters in reply.
11 The court of appeals has consistently applied that rule in
12 both civil and criminal cases. Petitioner here failed to
13 comply with that rule, and the court of appeals properly
14 concluded that the State law argument had been waived.

15 QUESTION: Well, what should apply in another
16 suit where the State law argument is not waived?

17 MRS. HALL: In that instance, Justice O'Connor,
18 we submit that Federal law would apply, and that's the
19 second reason why we think Federal law properly applies in
20 this case. In Burks this Court stated that legal rules
21 that govern legal -- Federal causes of action are to be
22 treated as raising Federal questions. And since Federal
23 law applies to this Federal cause of action, the question
24 then becomes what is the source of this Federal law? Is
25 the Federal court going to look to Federal common law or

1 to State law?

2 In Burks this Court looked to State law to
3 supply the Federal rule of decision on the question
4 regarding directors' power to terminate shareholders'
5 derivative litigation. The Court found that applying
6 State law to the corporate law issue in that case would
7 relieve the Federal court of the burden of fashioning out
8 of whole cloth an entire body of Federal corporate law.

9 We submit that this case is much different than
10 Burks. This case also involves a Federal cause of action,
11 so Federal law applies. But at the next step, which is
12 selecting the source of the Federal law, we submit that
13 there is no need here to look to State law. Here the
14 Federal court has a fully developed body of Federal common
15 law of demand which stems from this Court's decision in
16 Hawes in 1882 which created a demand requirement. Here
17 the Court does not need to fashion entirely out of whole
18 cloth a law of, Federal common law of demand. That law
19 already exists.

20 QUESTION: Well, how about the question of the
21 effect of the demand requirement? What happens if the
22 demand is rejected? Now what law do we look to?

23 MRS. HALL: Your Honor, the question of standard
24 of review is not before the Court in this case, and the
25 commission is in agreement with us on that point, that

1 this Court should not reach that issue in this case. The
2 court of appeals --

3 QUESTION: Well, we certainly have to be
4 concerned with it, because it seems to me the questions
5 are very much interrelated ultimately.

6 MRS. HALL: We think, Your Honor, that under
7 Burks the question of standard of review would be governed
8 by State law, and in fact that statement appears in the
9 opinion of the court of appeals.

10 QUESTION: But I take it the Solicitor General's
11 point is that that just brings us around to where we
12 began, because Delaware's law is predicated on the
13 assumption that there are two types of situations, one
14 where there is demand and one where there is demand
15 excused. And the reason that Delaware can afford to be
16 very -- to give great deference to its directors in the
17 demand required case is because there are whole other
18 class of cases where demand is excused and the suits can
19 then go forward without that deference.

20 So you're really asking us to apply a State law
21 which has not at all been developed for the contingency of
22 demand being required in every case. That is the
23 Solicitor General's argument, is it not?

24 MRS. HALL: I believe it is, Your Honor. I
25 can't speak for the Solicitor General. Let me say again

1 that the standard of review is not presented in this case,
2 and there are no questions of Delaware law presented in
3 this case. If State law applies it's only a Maryland law.

4 QUESTION: Well, I am suggesting, as Justice
5 O'Connor suggested, I believe, that it's necessarily
6 involved because you're asking us to adopt a standard that
7 might be completely unworkable.

8 MRS. HALL: I think the standard is not
9 unworkable, Your Honor. What the court of appeals did was
10 to adopt a very straightforward rule that in every
11 derivative case the shareholder must make a demand before
12 proceeding to the Federal court. The court of appeals
13 said nothing about what the standard of review should be.
14 Therefore what the court of appeals has done applies only
15 to steps that the shareholder must take before the
16 shareholder is permitted to go to court. After the
17 shareholder goes to court the very same State law which
18 now exists can be applied, only at that time --

19 QUESTION: But that law provides either no
20 answer or an answer that is quite incorrect because it is
21 premised on a false assumption.

22 MRS. HALL: No. At that point, for example in a
23 case which Delaware characterizes now as demand excused,
24 the shareholder plaintiff would still be required under
25 the court of appeals' opinion to make a demand. However,

1 the shareholder could then file suit if the demand was
2 refused and contend that this is a case in which demand
3 should have been excused. The Federal court could then
4 rule upon that with the benefit of actual experience
5 rather than having to deal with hypothetical facts about
6 what the board would have done had it been presented with
7 a demand.

8 Your Honors --

9 QUESTION: It may well be that even though you
10 do come full circle, I suppose, and have to confront the
11 same State law issues, you may not have to do it in as
12 many cases.

13 MRS. HALL: That's correct, Your Honor.

14 QUESTION: In some of the cases, presumably, the
15 corporation will decide to take up the cudgels on behalf
16 of the shareholder.

17 MRS. HALL: Either the corporation will decide
18 to take up the cudgels on behalf of the shareholders, or
19 in fact the board of directors of a corporation when they
20 are presented with demand have a whole range of intra-
21 corporate dispute resolution mechanisms available to them.
22 For example, the shareholder may be acting on mistaken
23 information. The corporation may be able to furnish
24 correct information and settle the dispute that way.
25 There's a whole range of options that the board of

1 directors can exercise when presented with a demand which
2 may totally obviate the suit so that it never, never
3 appears in the Federal courts.

4 QUESTION: But where those options do fail, you
5 really don't have any answer to the SG's argument that you
6 may have to get into the same kind of inquiry that we have
7 up to now been conducting or the courts have been
8 conducting under the futility rubric.

9 MRS. HALL: I have two answers. One is the
10 answer we have already discussed, which is that some of
11 those cases may never end up in court. The second answer
12 is, if they do end up in court, the court can then conduct
13 its analysis on the basis of actual facts rather than
14 hypotheticals, which is how litigation normally is
15 conducted.

16 This case differs from Burks for another reason,
17 which is that the court in Burks in dealing with the
18 question of when directors may properly terminate
19 shareholders' litigation was concerned with an issue of
20 the directors' powers, which this Court found to be a core
21 issue of corporate law --

22 QUESTION: Mrs. Hall, more precisely, what
23 exactly was the question decided in Burks what -- as to
24 what the directors could do? Was it whether they should,
25 would prosecute litigation or whether they would terminate

1 a shareholder's prosecution?

2 MRS. HALL: It -- I believe the precise
3 question, Your Honor, was whether they had the power to
4 terminate, whether a special litigation committee
5 appointed by the board of directors had the power to
6 terminate a suit brought under the 1940 act.

7 QUESTION: Brought by whom?

8 MRS. HALL: A shareholder.

9 QUESTION: By the shareholder.

10 MRS. HALL: A derivative suit.

11 QUESTION: Thank you.

12 MRS. HALL: In this case we're not -- we are
13 confronted with an issue involving the futility exception
14 to the demand requirement which is not a core issue of
15 corporate law. This question deals with the relationship
16 between the shareholder and the Federal court, and what
17 the shareholder has to do before he is permitted to file
18 suit in the Federal court. It is not an issue of
19 corporate law. It is an issue relating to demand, and as
20 I mentioned, we have a fully developed body of Federal
21 common law of demand stemming from this Court's decision
22 in Hawes.

23 There is an additional reason for applying a
24 Federal common law of demand, and that is the need for
25 uniform -- uniformity in the rules governing access to the

1 Federal courts. Legal proceedings in the Federal courts
2 should be administered under uniform, predictable rules.

3 QUESTION: May I interrupt here because I want
4 to be sure I understand.

5 MRS. HALL: Yes, Your Honor.

6 QUESTION: On the review -- I know you say it's
7 not before us now --

8 MRS. HALL: Yes.

9 QUESTION: But do you have the position there
10 that that is a matter of State law?

11 MRS. HALL: Yes. I believe under Burks.

12 QUESTION: But then why doesn't your, why wasn't
13 your uniformity argument apply equally to that?

14 MRS. HALL: Well, I think --

15 QUESTION: Because that, in last analysis that's
16 a question of access to the courts.

17 MRS. HALL: I think that that argument is
18 foreclosed by Burks, and we're not urging the overruling
19 of Burks. And also I think that that issue more directly
20 implicates the power of directors, which is a core issue
21 of corporate law.

22 QUESTION: Thank you.

23 MRS. HALL: Whereas our issue deals with the
24 right of shareholders to come to the Federal court.

25 We think that applying the laws of the 50 States

1 to, with regard to the futility exception to the demand
2 requirement will result in unnecessary litigation over
3 what should be a straightforward matter.

4 The virtue of a uniform Federal law of demand is
5 particularly evident under the Federal policy that is
6 reflected in the independent director provisions of the
7 Investment Company Act of 1940.

8 And in the Burks decision this Court considered
9 those independent director provisions and noted that those
10 directors are to serve as watch dogs for the interests of
11 all of the shareholders of the mutual funds. Applying a
12 uniform Federal law of demand will help ensure that the
13 demand rules do not evolve in such a way as to usurp the
14 watch dog role of the independent directors under the
15 Investment Company Act of 1940.

16 As my third argument, Your Honors, I submit that
17 this judgment can be approved on the separate ground that
18 the court of appeals correctly held that the futility
19 exception to the demand requirement should be abolished.
20 This was a very straightforward rule and would require
21 demand in all cases. We believe that abolishing the
22 futility exception will benefit the Federal judicial
23 system without unduly burdening shareholder plaintiffs,
24 and that abolishing the futility exception is a natural
25 evolution of the common law which will help sustain the

1 vitality of the demand requirement.

2 Looking first at judicial economy, when Hawes
3 was decided the Federal courts were in need of protection
4 from the collusive manufacture of diversity jurisdiction.
5 And today the Federal courts are confronted with cases
6 where the futility exception is routinely used in order to
7 avoid intra-corporate means of resolving disputes.

8 In each case involving the futility exception
9 the district court must confront as a threshold issue the
10 hypothetical fact-specific question as to whether demand
11 would have been futile because the board is alleged to be
12 biased or to have engaged in some improper conduct. We
13 submit that requiring demand in all cases is preferable to
14 expending time, money, and scarce judicial resources on
15 this hypothetical inquiry as to whether demand would have
16 been futile.

17 QUESTION: Mrs. Hall --

18 MRS. HALL: Yes, Your Honor.

19 QUESTION: Your opposing counsel says that the
20 demand requirement is not just kind of a mechanical thing
21 where you can abolish it and then everything will come out
22 all right -- come out the same way, and then -- but the
23 substantive standard of review of the shareholders' claim
24 is much different under the law of most States where
25 demand has been made and refused than it is where it is

1 shown to be futile. Do you agree with that statement?

2 MRS. HALL: I do not, Your Honor. As we have
3 been discussing, I think there is no logical or practical
4 reason that you cannot separate the making of a demand
5 from the standard of review, and the court of appeals said
6 several times in their opinion that they were not making
7 any link between the making of a demand and the standard
8 of review to be applied to the board's decision in dealing
9 with the demand. I think that requiring a demand will not
10 place any undue burden on shareholders. All they have to
11 do is write a letter to the board of directors of the
12 corporation, and that in turn allows the board of
13 directors of the corporation to have the option of trying
14 to take some kind of action which will obviate the
15 lawsuit. That does not place any burden on the
16 shareholder plaintiff other than mailing the letter.

17 It's only at this second stage, which is not
18 before the Court today, the stage of standard of review of
19 the board's action, of that, in connection with that --

20 QUESTION: May I ask this, Mrs. Hall?

21 MRS. HALL: Yes, Your Honor.

22 QUESTION: You're saying -- one of your
23 arguments is you'll save a lot of skirmish -- time
24 skirmishing about futility if you have an automatic demand
25 rule. But basically the -- when you allege futility

1 you're alleging that the decision makers are biased for
2 one reason or another, they're beholden or they've got a
3 financial interest. Is it not true that if you call for a
4 demand in every case the plaintiff will still make the
5 same charges? Won't he say you can't rely on this
6 decision not to litigate because the decision makers are
7 biased? So don't you get back to the same issue that you,
8 as when you have a futility requirement?

9 MRS. HALL: Not necessarily, Your Honor, because
10 there will be a certain number of cases in which the board
11 will be able to take action which will obviate the need
12 for a lawsuit.

13 QUESTION: But even -- that's not impossible
14 after a complaint is filed either.

15 MRS. HALL: It's not impossible, but it becomes
16 very unlikely, and the case law is very clear that demand
17 futility is to be determined as of the time suit is
18 commenced. The courts have recognized that as soon as a
19 lawsuit is filed, positions become hardened, people become
20 adversaries --

21 QUESTION: Maybe we need more reasonable lawyers
22 on both sides is what we need. There's no reason why that
23 has to be true.

24 MRS. HALL: It just happens to be true.

25 QUESTION: Yeah, okay.

1 MRS. HALL: Your Honor, I think that this case
2 is a classic example of a situation where a demand should
3 have been made. If the fund directors in this case had
4 been presented with a demand instead of a complaint, they
5 might very well have chosen to distribute a revised proxy
6 material even if they didn't think that anything was wrong
7 with the original proxy material, just in order to avoid
8 the delay and expense of this litigation.

9 QUESTION: Yeah, but that wouldn't have done any
10 good because they have already hired the investment
11 advisor. It's already been approved. Sending out a
12 subsequent proxy statement wouldn't cure, assuming the
13 original hiring was incorrect.

14 MRS. HALL: Well, the mutual fund must seek
15 approval of its fees.

16 QUESTION: Right. And the hypothesis we have
17 here is that they used an incomplete proxy statement to
18 get approval of an improper investment contract.

19 MRS. HALL: That's correct. What I said is --

20 QUESTION: And if later on you send out a
21 corrected proxy statement, what good does that do?

22 MRS. HALL: Well, if, it gives the shareholders
23 the opportunity to vote with that additional information,
24 which petitioner claims they needed to have.

25 QUESTION: It gives them an opportunity for a

1 petition for rehearing in effect?

2 MRS. HALL: Right.

3 QUESTION: Yeah.

4 MRS. HALL: And it obviates the need for a
5 lawsuit on a proxy claim. Now in this case petitioner did
6 not sue until 6 months after the shareholders' meeting,
7 but even at that time the board of directors, if they had
8 been presented with a demand instead of a complaint, could
9 have called a special shareholders' meeting and sent out
10 revised proxy material and saved themselves the expense
11 and honor of appearing before the Supreme Court on this
12 issue 7 years after the shareholders' meeting.

13 QUESTION: Or they might have appointed an
14 impartial committee to resolve the question, as some
15 corporations do, I suppose --

16 MRS. HALL: That's correct, Your Honor.

17 QUESTION: -- which would also avoid ever having
18 to confront the futility question.

19 MRS. HALL: That's correct.

20 Your Honor, petitioner claims that the decision
21 of the court of appeals was a revolutionary decision. We
22 think that it was more evolutionary and in the tradition
23 of the common law, and that the decision of the court of
24 appeals abolishing the futility exception will help to
25 preserve the viability of the demand requirement.

1 Petitioner basically is taking the view that no
2 corporate director ever can be trusted to act fairly and
3 properly in considering a demand requirement, and it is
4 this view that probably explains why the futility
5 exception is eroding the demand requirement. If
6 shareholder plaintiffs invariably consider corporate
7 directors to be untrustworthy, then they will invariably
8 decide that a demand would be futile and they will always
9 rush to the Federal courthouse to file suit without making
10 a demand.

11 The inevitable result is that the demand
12 requirement is eroded, and the rule adopted by the court
13 of appeals which eliminates supposed futility as a reason
14 for not making a demand will preserve the viability of the
15 demand requirement and, we suggest, should be adopted by
16 this Court.

17 The allegations of futility in this case, Your
18 Honors, were totally inadequate. I suggest that my client
19 should no longer be required to defend against this proxy
20 claim where the allegations of futility are so
21 insufficient. These boilerplate allegations that the
22 directors received fees for their services and that they
23 voted to send out the challenged proxy material would not
24 constitute futility under any applicable law.

25 And this proxy claim should be dismissed, Your

1 Honors, whether this Court chooses to apply Federal law or
2 State law, whether you choose to apply the futility
3 exception or abolish the futility exception. Your Honor,
4 we respectfully request that the dismissal of the proxy
5 claim in this case be affirmed.

6 QUESTION: Thank you, Mrs. Hall.

7 Mr. Meyer, do you have rebuttal? You have 3
8 minutes remaining.

9 REBUTTAL ARGUMENT OF RICHARD M. MEYER

10 ON BEHALF OF THE PETITIONER

11 MR. MEYER: Thank you, Mr. Chief Justice. I
12 will be very brief. Hopefully I won't need to use the 3
13 minutes. At the risk of helping my opponent, I believe
14 Ms. Hall intended to have reference to page 17A of the
15 appendix with respect to the discussion of futility, the
16 last paragraph on that page. I won't take time to read
17 it, but I think if Your Honors read it you will see that
18 the court below says both things. And it's pretty clear
19 that it can't make up its mind whether the allegations are
20 sufficient to establish futility or not, and therefore
21 adopts a rule saying whether or not futile we must insist
22 on demand in all cases.

23 I should have referred before to the Borak case
24 as a case which insists on applying the Federal standards
25 no matter -- to proxy fraud case no matter what State law

1 would apply, and I submit that on that reasoning, which
2 was adopted in Galef subsequent to the Burks decision,
3 Burks is clearly distinguishable.

4 Burks was that unusual type of derivative action
5 that really was a business judgment case. There was no
6 self-dealing involved in Burks at all. That was a
7 question of whether management made a business judgment
8 mistake in purchasing Penn Central Commercial Paper from
9 Goldman Sachs. And in fact prior to the decision, I
10 think, management had instituted an action against Goldman
11 Sachs and effected a recovery.

12 The only other point I might make is that on
13 this question of waiver of State law, the State law
14 question was never really waived. It was never really
15 raised by either party. We said in our initial complaint,
16 we hadn't really made any demand allegations except with
17 respect to 36B. On the motion to dismiss, we amended the
18 complaint, added the demand allegations, and addressed the
19 argument of the defendants by saying we now have
20 allegations in the complaint that excuse demand, that it's
21 not merely a question, as you know from having read the
22 papers, of the fact that they got paid for being
23 directors. That would be simplistic.

24 Basically those are the points that I wanted to
25 raise on rebuttal, and unless the Court has questions I

1 thank you very much.

2 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Meyer.

3 The case is submitted.

4 (Whereupon, at 12:05 p.m., the case in the
5 above-entitled matter was submitted.)

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CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

*No. 90-516 - JILL S. KAMEN, Petitioner V. KEMPER FINANCIAL
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BY *Raymond F. Hartel*
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