OF BABIES AND BATHWATER: DETERRING FRIVOLOUS STOCKHOLDER SUITS WITHOUT CLOSING THE COURTHOUSE DOORS TO LEGITIMATE CLAIMS

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ABSTRACT

The Delaware Supreme Court's May 8, 2014 Opinion in ATP Tour, Inc. v. Deutscher Tennis Bund *("*ATP*") marked a sudden and potentially transformative moment in the relationship among corporate boards, their stockholders, and the Delaware legal system. This Article observes that a failure to legislatively override the* ATP *precedent would likely have eliminated virtually all types of stockholder litigation. Notably, on June 24, 2015, Delaware Governor Jack Markell signed into law the Delaware General Assembly's amendment to the DGCL that legislatively overruled* ATP*, to the extent it would apply to public companies. The General Assembly's amendment, codified at Section 102(f), is generally consistent with the core conclusion of this Article, which was largely written before the Corporation Law Council first proposed what became DGCL Sections 102(f), 109(b), and 114(b). The authors submit, however, that in light of the continued efforts by the U.S. Chamber of Commerce and others to undermine and eliminate core stockholder protections, as well as certain judicial rulings that attempted to broadly grapple with a narrow problem, the passage of the amendment cannot be the last word on the topic. Indeed, while Delaware has recently adopted variants of the proposals advocated in this Article for ways to fight the problem of "disclosure-only" settlements, other states continue to flirt with empowering directors to eliminate liability altogether, including through fee-shifting provisions.*

The Article asserts that the "nuclear option" of allowing boards of public companies to employ fee-shifting bylaws against stockholders whose interests they are supposed to represent is poor policy and departs from well-established legal principles. Moreover, such a draconian use of corporate power is not needed to curtail the problem of frivolous lawsuits that achieve no material benefit for stockholders while providing corporate defendants with broad releases. In opposing fee-shifting bylaws, the authors provide legal and policy reasons not to permit bylaws or charter provisions to impede fundamental stockholder rights, including the right to enforce fiduciary duties through litigation.

After detailing the reasons to reject the enforcement of fee shifting bylaws, the authors propose an alternative to fee shifting to reduce the number of cases that provide no material benefit to stockholders and put a strain on corporations and the judiciary. Expanding upon the logic

that underlies then-Chancellor Strine's rejection of a settlement in the Medicis *litigation, the authors propose a two-part test that would eliminate the weakest two-thirds of all stockholder litigation. Under the authors' proposed test, before "disclosure-only settlements" are approved, the Court would affirmatively determine that: (1) the disclosures providing the purported consideration to stockholders are, in fact, material, and (2) subject to judicial discretion to approve a broader release for good cause shown, the release is limited to the benefit of the disclosures obtained, so as to ensure that meritorious claims that were not properly vetted by counsel are not inadvertently or thoughtlessly released. While corporate actors would lose their access to overbroad litigation releases, they could still obtain protection from future suit for conduct that was genuinely vetted through the litigation process. Most important, by applying the above-proposed rule, the number of frivolous suits will decrease, the increasingly hostile criticism of stockholder litigation in the merger context will lose its basis, the societal burden posed by meritless suits will be curtailed, and core stockholder rights and the societal benefit of meaningful stockholder litigation will be preserved. The authors note—and discuss in the Epilogue – that the Court of Chancery's recent ruling in* In re Trulia Inc., Stockholder Litigation *broadly marks a departure from the prior practice of routinely approving "disclosure-only" settlements and adopts numerous of the concepts set forth below.*

TABLE OF CONTENTS

I. INTRODUCTION[1]

Too much has been said and written about perceived problems in the world of deal-related stockholder litigation.[2] True, it is troubling that a majority of public corporation mergers results in a lawsuit.[3] While the

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[1]We would like to quote Professor Coffee as stating that "[p]rivate enforcement of [state corporation] law and . . . federal securities laws is imperfect. . . . But there's a strong argument with a very simple theme: You don't throw the baby out with the bath[water]. We . . . are going to create chaos." John C. Coffee, Jr., Testimony before the SEC Investor Advisor Committee, Fee-Shifting Bylaws: Can They Apply in Federal Court?—The Case for Preemption app. 2 (Oct. 9, 2014), *archived at* https://perma.cc/QEA7-CHUE (quoted material no longer available).

[2]When using the term "stockholder litigation," we generally refer to all types of claims arising under state corporation law, as well as claims arising under federal securities laws. Based on context, however, we occasionally focus more on state law claims than federal securities claims, or vice versa. Specifically, we use "stockholder litigation" to include both derivative litigation, in which an investor sues on behalf of a corporation, and stockholder class action litigation, in which an investor sues on behalf of a class of similarly situated investors.

[3]Matthew D. Cain & Steven Davidoff Solomon, Takeover Litigation in 2014 1-2 (Feb. 20, 2015) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2567902 (observing that 94.9% of deals valued at $100 million or

volume of litigation grabs headlines, the real problem is the percentage of these stockholder lawsuits that achieve little, if anything, for stockholders, while giving away overbroad liability releases for corporate defendants and paying both plaintiffs' and defendants' lawyers. Reducing the incentives to bring the weakest lawsuits in the first place is beneficial for corporate actors looking to pursue a deal in good faith, for investors, and for the judiciary. However, those seeking to empower senior executives and directors without limit, such as the U.S. Chamber of Commerce, are using the sheer number of merger-related lawsuits to urge so-called solutions that would immunize corporate executives and directors from accountability for all wrongdoing, regardless of how egregious their misconduct.[4] We believe it is critical that purported solutions not throw out the proverbial baby with the bathwater.

The rhetoric surrounding problems in the stockholder litigation field has become overblown.[5] Recent court rulings and legislative acts have endorsed measures that seemed unthinkable less than a year ago.[6] Before the Delaware Supreme Court decided *ATP Tour, Inc. v.*

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more result in litigation); OLGA KOUMRIAN, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2013 M&A LITIGATION 1 (2014), *archived at* https://perma.cc/L2PP-MYSX ("For the fourth consecutive year, shareholders filed suit in more than 90 percent of M&A deals valued over $100 million. In 2013, 94 percent of M&A deals were challenged by shareholders."); William Savitt, *Shareholders in This, That and the Other Court*, NAT'L. L.J., Sept. 16, 2013, at 26, *archived at* http://perma.cc/BYZ2-3J2C ("The average merger transaction draws almost five lawsuits . . . . Equally striking is the increase of deals attacked in multiple jurisdictions.").

[4]*See, e.g.*, Marc Wolinsky & Ben Schireson, *Deal Litigation Run Amok: Diagnosis and Prescriptions*, REV. SEC. & COMMODITIES REG., Jan. 8, 2014, at 1, *archived at* http://perma.cc/TYX4-EJ3T ("[T]he system is broken . . . shareholder plaintiffs are imposing a dead weight on society and an unwarranted burden on corporate America and the courts."); *Shark Attack: Why American Firms Cannot do Business Without Getting Sued*, ECONOMIST (June 2, 2012), *archived at* http://perma.cc/U2ZG-ZJCY (describing "the shark-munched world of mergers and acquisitions"); Robert M. Daines & Olga Koumrian, *Merger Lawsuits Yield High Costs and Questionable Benefits*, N.Y. TIMES DEALBOOK (June 8, 2012, 10:38 AM), *archived at* http://perma.cc/3T2Z-BK59 (stating that deal litigation may "impose excessive costs on the companies involved and their shareholders," while delivering uncertain benefits); *see also* Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 559-60 (2015) (summarizing the debate on stockholder litigation); David H. Webber, *Private Policing of Mergers and Acquisitions: An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions*, 38 DEL. J. CORP. L. 907, 920 & n.83 (2014) (identifying the benefits that institutional investors have achieved by pursuing smart stockholder litigation).

[5]*See, e.g.*, Ann Woolner, Phil Milford & Rodney Yap, *Merger Suits Often Mean Cash for Lawyers, Zero for Investors*, BLOOMBERG BUS. (Feb. 16, 2012, 1:59 PM), *archived at* http://perma.cc/NJQ6-QBKH.

[6]For example, in September 2014, the Oklahoma legislature adopted an amendment to its General Corporation Act mandating derivative-suit fee shifting. *See* S.B. 1799, 2014 Leg., 2013-2014 Reg. Sess. (Okla. 2014).

Deutscher Tennis Bund,[7] no one publicly advocated the idea of allowing boards to unilaterally impose bylaws that immunize them from representative litigation to hold them accountable for self-dealing or other corporate misconduct.[8] While the *ATP* opinion expressly applies to non-stock member corporations only, the opinion arguably has a broader reach.[9] In the wake of *ATP*, over fifty public companies adopted fee-shifting bylaws.[10]

This Article examines the *ATP* ruling from legal and policy precedent perspectives. Finding that *ATP* is inconsistent with various well-established common law and statutory protections for stockholders, we find that it is likely to eliminate all stockholder litigation, irrespective of merit. The inability of fee-shifting bylaws to differentiate between meritorious and frivolous suits, while impairing fundamental stockholder rights, is a critical flaw with the entire concept, regardless of whether *ATP* can be read to conform to Delaware law.[11] Accordingly, the authors support the March 6, 2015 proposal from the Delaware Corporation Law Council to legislatively prohibit the use of fee-shifting provisions in the public company context, which the General Assembly adopted as Delaware law on June 24, 2015.[12] Rather than simply criticize *ATP* and

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[7]91 A.3d 554, 560 (Del. 2014).

[8]*See* Liz Hoffman, *Shareholder Suits May Prove Costly*, WALL ST. J. (May 18, 2014), http://www.wsj.com/articles/SB10001424052702304908304579565850165670972?alg=y.

[9]*See* Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 3 n.10 (2015) (noting the difference between non-stock and stock corporations is likely immaterial).

[10]*See, e.g.*, *Investors Opposing Fee-Shifting Bylaws*, KTMC WHISTLEBLOWER (Kessler, Topaz, Meltzer & Check LLP), May 1, 2015, *archived at* http://perma.cc/JRH9-G9FU.

[11]Griffith, *supra* note 9, at 27 ("Because such provisions chill the good claims along with the bad, they fail to advance the fundamental public policy interests underlying shareholder litigation").

[12]The operative language of the amendment, codified as Section 102(f), reads as follows:

> The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title.

Proposed Amendments to DEL. CODE. ANN. tit 8, § 102, adopted as S.B. 75, 2015 Leg., 148th Gen. Assemb., Reg. Sess. (Del. 2015). A similar sentence has been added to Section 109(b) that prohibits corporations from putting such provisions in the bylaws. Proposed Amendments to DEL. CODE. ANN. tit 8, § 109, adopted as S.B. 75, 2015 Leg., 148th Gen. Assemb., Reg. Sess. (Del. 2015). Section 115 defines "intracorporate claims" as follows:

> [C]laims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.

support the legislative proposal, we propose a carefully tailored answer to frivolous litigation, which mitigates abuses, conforms to longstanding legal principles, and preserves the benefits of board accountability and meritorious stockholder litigation.

In Part II, we analyze the Delaware Supreme Court's *ATP* ruling, highlighting that it will empower directors to unilaterally impose bylaws to avoid accountability to the stockholders whose assets they manage.[13] In Part III, we observe that *ATP* finds its origins in the debate over forum selection bylaws. Even if directors can use bylaws to require that suit be brought in a particular forum, however, the ability to impose financial harm on stockholders who seek to hold their agents accountable does not legally follow.

In Parts IV and V, we detail the policy and legal problems with director-imposed fee-shifting bylaws, putting in question the relationship between stockholders and boards that forms the foundation of the modern public corporation. If the reasoning of *ATP* were extended to public corporations, several bedrock principles of corporate law would be overridden, upsetting the balance of powers between stockholders and boards that has been in existence for decades.[14] No longer will boards have to stay in their proverbial "lane," and avoid impairing their stockholders' core personal rights and powers.[15] Statutory distinctions between the substantive rights and powers set forth in a corporate charter and the procedural rules set forth in bylaws will be rendered irrelevant if directors have free reign to rewrite substantive stockholder rights as they

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Proposed Amendments to DEL. CODE. ANN. tit 8, § 115, adopted as S.B. 75, 2015 Leg., 148th Gen. Assemb., Reg. Sess. (Del. 2015).

[13] *See infra* Part II.

[14] *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 844-46 (2005) (discussing the current balance of power between the board and stockholders); *see also* Jennifer Hill, *The Shifting Balance of Power Between Shareholders and the Board: News Corp's Exodus to Delaware and other Antipodean Tales* 15-16 (Vanderbilt Univ. Law Sch., Law & Econ. Research Paper No. 08-06, 2008), *available at* http://ssrn.com/abstract=1086477 (contrasting the origins and principles of United Kingdom and Australian corporate organization with those of the American system); Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1762-63 (2006) (discussing the value of the traditional balance of power favoring managerial flexibility and arguing against disturbing the current equilibrium codified in Delaware law).

[15] *See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 239 (Del. 2008) (characterizing a bylaw stockholders proposed to adopt as an "internal governance contract" and holding it to be an impermissible limitation on directors' obligation to exercise fiduciary duties); Datapoint Corp. v. Plaza Sec. Co., 496 A.2d 1031, 1036 (Del. 1985) (affirming preliminary injunction prohibiting enforcement of bylaw that was "so pervasive as to intrude upon fundamental stockholder rights guaranteed by statute").

see fit.[16] Moreover, director-imposed bylaws that impair substantive stockholder rights, including the right to sue, do not fit the standard definition of an enforceable contract.[17] Centuries of contract law makes clear that contracts cannot be materially changed without consideration or the ability to rescind.[18] Further, if bylaws standing alone are contracts, then fee-shifting provisions in corporate documents are plainly related-party transactions that are void or voidable pursuant to DGCL Section 144, absent one of three statutory safe harbors: (1) approval by disinterested and independent directors of the company; (2) approval by a disinterested and fully informed stockholder majority; or (3) judicial determination that the transaction was entirely fair to the company and its stockholders.[19] Such director-adopted fee-shifting bylaws also conflict with Rule 11, which pertains to frivolous litigation filings.[20] Moreover, since federal securities law generally preempts any state law or agreement that would absolve individuals governed by federal disclosure law of liability for violations,[21] Delaware potentially risks yielding its leadership position to federal law if it allows corporate directors to effectively block stockholder suits regardless of their merit.[22]

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[16]*See, e.g.*, Christopher M. Bruner, *Shareholder Bylaws and the Delaware Corporation*, 11 TRANSACTIONS: TENN. J. BUS. L. 67, 68 (2009) (discussing the balance between bylaw and charter rights).

[17]*See generally* 3 RICHARD A. LORD, WILLISTON ON CONTRACTS § 7:5 (4th ed. 2008).

[18]Director-driven changes to corporate bylaws may be viewed as unilateral alterations of the contract with the existing shareholders. In the absence of an exchange of consideration for the decrement in substantive rights, the alteration would not be binding for a common law contract. *See generally id.*

[19]DEL. CODE ANN. tit. 8, § 144(a) (2006); *see In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 614 (Del. Ch. 2005) ("In the absence of [a ratification by a majority of disinterested directors or by a shareholder vote], the transaction is presumed voidable absent a demonstration . . . that the transaction is fair."); *see also* Nagy v. Bistricer, 770 A.2d 43, 54 n.21 (Del. Ch. 2000) ("[A] self-dealing transaction that falls within the statute's reach is voidable unless, at minimum, one of the statutory categories that creates an exception to voidability is satisfied.").

[20]*See, e.g.*, John C. Coffee, Jr., *Fee-Shifting and the SEC: Does It Still Believe in Private Enforcement?*, COLUM. L. SCH. BLUE SKY BLOG (Oct. 14, 2014), *archived at* http://perma.cc/7Z92-9GYQ (discussing the application of Rule 11 of the Federal Rules of Civil Procedure to fee-shifting determinations in the context of federal regulatory litigation). Rule 11 in both the Federal Rules of Civil Procedure and the Rules of the Court of Chancery provide for an award of sanctions. *See infra* Part IV.C.

[21]Starr Int'l Co. v. Fed. Res. Bank of N.Y., 742 F.3d 37, 41-42 (2d Cir. 2014), *cert. denied*, 134 S. Ct. 2884 (2014) (finding that the Federal Reserve Bank of New York's federal interest in "stabilizing the national economy" preempted any state fiduciary duty law the Bank may have assumed by stepping into the shoes of AIG to rescue it from bankruptcy).

[22]*See* John C. Coffee, Jr., *Federal Preemption and Fee-Shifting*, COLUM. L. SCH. BLUE SKY BLOG (Jan. 26, 2015), *archived at* http://perma.cc/HTJ5-8NGW.

In Part VI, we offer an alternative to fee-shifting bylaws that reduces the incentive to pursue cases that offer little benefits to stockholders but gives broad releases to corporate defendants, without eliminating meritorious stockholder litigation. Our proposal is simple: (1) legislatively prohibit public corporations from imposing fee shifting against stockholders as proposed by the Delaware Corporate Law Council; and (2) apply and modestly expand the holdings of Vice Chancellor Laster's application of the materiality standard in *In re Sauer-Danfoss Inc., Shareholders Litigation*,[23] and then-Chancellor Strine's rejection of a "disclosure only" settlement in *In re Medicis Pharmaceutical Corporation*.[24] In a disclosure-only settlement, stockholder-plaintiffs should show that the consideration for settling their claims—supplemental disclosures—is material as a matter of law.[25] A disclosure that is not material as a matter of law is not consideration as a matter of fact.[26] Without consideration, there should be no settlement.[27] Defendants seeking a release in a disclosure-only settlement should show that the release is limited in scope to the disclosures being used as consideration for that release, rather than serving as virtually unfettered insurance protection against a future suit for claims that were never vetted.[28] We believe that limiting the availability of a broad release in the disclosure-only settlement context is good policy, in part because corporate boards are required by both federal and state law to make

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[23]65 A.3d 1116 (Del. Ch. 2011).

[24]Transcript of Record, *In re* Medicis Pharm. Corp. S'holders Litig., 2014 WL 1614336 (Del. Ch. Feb. 26, 2014).

[25]For a general discussion of disclosure-only settlements, see Fisch, Griffith & Davidoff Solomon, *supra* note 4, and J. Travis Laster, *A Milder Prescription for the Peppercorn Settlement Problem in Merger Litigation*, 93 TEX. L. REV. 129 (2015).

[26]*See In re Sauer-Danfoss*, 65 A.3d at 1119:

> With one exception, the twelve disclosures in question would not have provided consideration for a settlement and will not support a fee award. One of the disclosures was made at a time when the plaintiffs had not yet asserted a disclosure claim, much less a claim that was meritorious when filed. Ten disclosures were not material, conferred no benefit on stockholders, and will not support a fee. That leaves one: a disclosure correcting an errant description of the 52-week high and related measuring period for the trading price of the Company's common stock. For that disclosure, I award $75,000.

[27]*See* Fisch, Griffith & Davidoff Solomon, *supra* note 4, at 568 ("If the court determines that the benefits provided by a settlement are illusory, the plaintiff class will not have received any consideration . . . and the settlement will not be seen as fair. In such a case, the court might properly refuse to approve the settlement.").

[28]*See* Edward B. Micheletti, Jenness E. Parker & Bonnie W. David, *Delaware Courts Question Long-Standing Practice of Approving Disclosure-Based Deal Litigation Settlements*, INSIGHTS (Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates), Oct. 22, 2015, at 3, *archived at* https://perma.cc/W74G-288F ("[D]isclosure-based deal litigation settlements involving a broad release of claims are no longer routinely being approved by the Court of Chancery.").

material disclosures whether or not they obtain a personal release.[29] Nevertheless, we recognize that there are instances when a genuinely adversarial and thorough litigation process results in a successful disclosure-only settlement and comforts the judicial system that a reasonable release will not likely immunize serious misconduct that remains hidden due to counsel's lack of diligence.[30] Thus, courts should still permit a release when defendants show "good cause."[31]

A modified application of the holdings of *In re Sauer-Danfoss* and *In re Medicis* strikes a far more effective balance of stockholder rights with director powers than applying the *ATP* decision to public corporations.[32] As shown by the Chamber of Commerce's immediate opposition to the Delaware Corporate Law Council proposal,[33] however, powerful forces continue to seek ways to eliminate all liability of corporate directors, whether or not they engage in disloyal or bad faith conduct.

II. *ATP*: ALLOWING DIRECTORS TO USE BYLAWS AS A WEAPON AGAINST THEIR STOCKHOLDERS TO AVOID ACCOUNTABILITY

A. *The Right to Sue is a Personal Stockholder Right*

One of the fundamental principles of Delaware corporate law is that the business affairs of a corporation are managed by or under the direction of its board of directors.[34] The grant of that power over another

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[29]*See* Robert O. Wilson, *A Defense of Disclosure-Based Settlements in US M&A Litigation*, FINANCIER WORLDWIDE MAG. (Feb. 2013), *archived at* http://perma.cc/G8ZH-D9CV (discussing the importance of material disclosures).

[30]*See* Alexis Yee-Garcia, M. Todd Scott & Jim Kramer, *The End of Disclosure Only Settlements in M&A Cases? Not So Fast*, SEC. LITIG., INVESTIGATIONS & ENFORCEMENT (Orrick, Herrington & Sutcliffe LLP), Oct. 29, 2015, at 1, *archived at* http://perma.cc/44C5-4WNW (alterations in original) ("The incentives of attorneys on both sides can be such that 'the potential claims belonging to the class [are not] adequately or diligently investigated or pursued.'").

[31]*See infra* Part VI.B.

[32]*See infra* Part IV.

[33]A.W. Chip Phinney III, *Delaware Bar Proposes Amendments to Ban Fee-Shifting Provisions and Allow Delaware-Only Forum Selection Provisions in Corporate Charters and Bylaws*, NAT'L L. REV. (Mar. 27, 2015), *archived at* http://perma.cc/E9HT-7VTQ ("[The] President of the Institute for Legal Reform of the U.S. Chamber of Commerce, has been quoted as saying that the [Delaware Corporate Law] Council's proposed fee-shifting ban is 'a huge win for Delaware's lawsuit business at the expense of shareholders in Delaware companies.'").

[34]DEL. CODE ANN. tit. 8, § 141(a) (2006); Quickturn Design Sys., Inc v. Shapiro, 721 A.2d 1281, 1291, 1292 (Del. 1998) ("One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and

person's property only works because it is constrained by the existence and enforcement of fiduciary duties.[35]

A stockholder's right to enforce management's breach of fiduciary duty and contractual rights, either directly or derivatively, is a personal property right.[36] When someone buys stock, she personally acquires a bundle of property rights, which includes the right to sue corporate fiduciaries for breach of their duties to the stockholders.[37] Courts have recognized that the stockholders' ability to exercise this right is a core part of Delaware's governance system and essential to constrain board and management overreaching.[38] For example, in *In re Anderson Clayton Shareholders Litigation*, then-Chancellor Allen noted "the significant institutional role of class and derivative actions in the enforcement of the fiduciary duties assumed by corporate officers and directors."[39] Similarly, the Delaware Supreme Court has expressly affirmed the importance of the stockholders' right to hold fiduciaries accountable through litigation, stating that "[t]he machinery of corporate

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affairs of a corporation. . . . Section 141(a) . . . confers upon any newly elected board of directors *full* power to manage and direct the business and affairs of a Delaware corporation.").

[35]*See* Robert Flannigan, *The Economics of Fiduciary Accountability*, 32 DEL. J. CORP. L. 393, 393 (2007) ("The conventional function of fiduciary regulation is to control opportunism in limited access arrangements."); *see also* Charion L. Vaughn, Note, *Power Corrupts: Honest Services Fraud and Fiduciary Duties*, 50 WASHBURN L.J. 713, 731-32 (2011) (indicating that fiduciary duties "create minimum standards that regulate the behavior of officers, directors, and those in comparable positions" and "protect corporations' shareholders").

[36]*See* Julian Velasco, *The Fundamental Rights of a Shareholder*, 40 U.C. DAVIS L. REV. 407, 421-22 (2006).

[37]*See* Logan v. Zimmerman Brush Co., 455 U.S. 422, 428 (1982) (considering it "settled" that "a cause of action is a species of property"). The right of suit has been treated as a personal property right since Greek and Roman law. *See* Jeremy A. Blumenthal, *Legal Claims as Private Property: Implications for Eminent Domain*, 36 HASTINGS CONST. L.Q. 373, 373-74 (2009):

> Historically, claims of action, choses in action, rights of suit, and lawsuits themselves have been treated as personal and inalienable; indeed, three doctrines developed since the time of Greek and Roman law to prohibit the transfer or sharing of lawsuits.
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> Nevertheless, causes of action are increasingly being seen as alienable and, in various contexts, as forms of property.

[38]*See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) ("The machinery of corporate democracy and the derivative suit are potent tools to redress the conduct of a torpid or unfaithful management."); Sun Equities Corp. v. Computer Memories Inc., 1988 WL 13565, at *2 (Del. Ch. Feb. 16, 1988) (Allen, C.) ("The law does recognize that [shareholder actions] are an important part of the overall mechanism of corporate governance.").

[39]*In re* Anderson Clayton S'holder Litig., 1988 WL 97480, at *5 (Del. Ch. Sept. 19, 1988).

democracy and the derivative suit are potent tools to redress the conduct of a torpid and unfaithful management."[40]

Until the Delaware Supreme Court's opinion in *ATP*, the judiciary seemed to fairly balance the important powers of directors with the substantive rights of stockholders.[41] As applied to corporate bylaws, that meant that director-adopted bylaws had to be equitable to be valid.[42] Moreover, a board using a bylaw to unilaterally strip stockholders of substantive rights would presumably overstep its authority.[43] While the statutory provisions of the DGCL give little express guidance on bylaws, its structure is informative as to treatment of stockholders' substantive rights: to sell, vote, and sue.[44] Textual analysis and the interplay of DGCL Sections 102(a)(4) and 109 show that the DGCL permits the regulation of procedural stockholder rights through bylaws, while requiring that substantive limitations on stockholder rights appear in charter provisions.[45] Specifically, Section 102(a)(4), in conjunction with

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[40]Rales v. Blasband, 634 A.2d 927, 933 (Del. 1993) (quoting *Aronson*, 473 A.2d at 811).

[41]*See, e.g.*, Abigail Pickering Bomba et al., *Fried Frank Discusses Delaware Corporations' Expansive Powers with Respect to Bylaws*, COLUM. L. SCH. BLUE SKY BLOG (Feb. 25, 2015), *archived at* http://perma.cc/EQM4-C7RN (quoting Governor's resolution) ("'[*ATP*] upset[] the careful balance that [Delaware] has strive[n] to maintain between the interests of directors, officers, and controlling stockholders, and the interest of other stockholders . . . .'").

[42]*See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (Del. 2014) ("Legally permissible bylaws adopted for an improper purpose are unenforceable in equity."); *Datapoint Corp. v. Plaza Sec. Co.,* 496 A.2d 1031, 1036 (Del. 1985) (invalidating board-adopted bylaw amendments in part because the "underlying intent" behind them was "to give management an opportunity distribute 'opposing solicitation material'" to challenge written stockholder consents); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) (holding that management's attempt to "utilize the corporate machinery" to advance the bylaw date of the stockholders' meeting "obstruct[ed] the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management" and was thus void).

[43]*See In re Osteopathic Hosp. Ass'n of Del.,* 191 A.2d 333, 336 (Del. Ch. 1963), *aff'd,* 195 A.2d 759 (Del. 1963) (invalidating a membership bylaw as unreasonable because a "change of so fundamental a character [to] the structure of th[e] rather unique organization" was improper without the consent of "the group whose interests [we]re adversely affected"—*that is,* the association's members).

[44]*See* DEL. CODE ANN. tit. 8, § 159 (2006) (describing shares of stock as "transferrable personal property"); DEL. CODE ANN. tit. 8, § 212 (2006) (setting forth stockholder voting rights); DEL. CODE ANN. tit. 8, §§ 325, 327 (2006) (establishing stockholder rights to sue directly and derivatively). Chancellor Bouchard also touched upon this point in *Strougo v. Hollander*, 111 A.3d 590, 595 n.21 (Del. Ch. 2015) (citing WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 177 (2d ed. 2007)); Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 453-54 (2014)).

[45]DEL. CODE ANN. tit. 8, § 102(b)(4) (2006); DEL. CODE ANN. tit. 8, § 109 (2006).

Section 151(a), requires that limitations on the "powers," "preferences," and "rights" appurtenant to stock ownership must be set forth in a corporate charter.[46] This contrasts with the language of Section 109(b), which provides that bylaws cannot be inconsistent with the law or the corporate charter, and which does not trump the requirements of Sections 102(a)(4) and 151(a).[47] This statutory hierarchy requires interpreting Section 109(b) as permitting bylaws that "relate to" the rights or powers of stockholders, so long as such bylaws do not impair substantive powers, preferences, and rights.[48]

This interpretation is consistent with judicial precedent. The law clearly prevents stockholders from using bylaws to override the core powers of directors.[49] In *CA, Inc. v. AFSCME Employees Pension Plan* ("*AFSCME*"), stockholders sought to exercise their statutory right to adopt a bylaw requiring the company to pay the fees of stockholder-sponsored proxy solicitations if they enjoyed some measure of success.[50] In invalidating this stockholder-sponsored bylaw, the Delaware Supreme Court recognized the power of stockholders to adopt bylaws under Section 109 of the DGCL, but insisted that the bylaw was facially invalid because, as written, the court could conceive of hypothetical situations in which the bylaw would conflict with the board's core right to exercise its business judgment in managing the company's affairs.[51] Until *ATP*, one

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[46]DEL. CODE ANN. tit. 8, § 102(a)(4) (2006); DEL. CODE ANN. tit. 8, § 151(a) (2006).

[47]§ 109(b); § 102(a)(4); §151(a). When a court addresses the question of whether corporate action conforms with the corporate contract, it examines whether the action complies with all higher levels of the corporate contract, "comprising (i) the Delaware General Corporation Law, (ii) the corporation's charter, (iii) its bylaws, and (iv) other entity-specific contractual agreements, such as a stock option plan, other equity compensation plan, or, as to the parties to it, a stockholder agreement." Quadrant Structured Prods. Co. v. Vertin, 2014 WL 5465535, at *3 (Del. Ch. Oct. 28, 2014).

[48]§ 109(b) ("The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to . . . the rights or powers of its stockholders . . . .")

[49]*See* Stephen M. Gill, Kai Haakon E. Liekefett & Leonard Wood, *Structural Defenses to Shareholder Activism*, REV. SEC & COMMODITIES REG., June 18, 2014, at 151, 155 n.32, *archived at* http://perma.cc/C6GM-DXWA ("Stockholder-adopted bylaws cannot usurp from directors the power to manage the business affairs of the corporation.").

[50]CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 229-30 (Del. 2008).

[51]*Id.* at 238 ("The certified questions, however, request a determination of the validity of the Bylaw in the abstract. Therefore . . . we must necessarily consider any possible circumstance under which a board of directors might be required to act. Under at least one such hypothetical, the board of directors would breach their fiduciary duties if they complied with the Bylaw."). The analysis of the *AFSCME* Court was similar to the application of judicial scrutiny under the First Amendment when the government imposes content-based restrictions on speech. Applying "strict scrutiny," such restrictions are invalid for "overbreadth" if a regulation that bans unprotected speech also prohibits or chills protected speech in the process. *See, e.g.*, Ashcroft v. Free Speech Coal., 535 U.S. 234, 255-58 (2002). Thus, the government faces a heavy presumption against exercising its power to broadly regulate speech. *See id.* In *AFSCME*, the Delaware Supreme Court similarly presumed that a

would reasonably expect the same judicial skepticism and scrutiny if a board were to adopt a bylaw that overrode the stockholders' core rights to vote, nominate, sell shares, and bring suit.[52]

B. *The* ATP *Decision*

ATP arose in an unusual manner. The board of ATP Tour, a Delaware non-stock membership corporation, sought to enforce a bylaw imposing fee shifting on any current or former members if the claim did not "substantially" achieve "the full remedy sought" in the complaint.[53] The plaintiff members brought suit against ATP and six of its seven board members in the U.S. District Court for the District of Delaware for federal antitrust and breach of fiduciary duty claims.[54] After ATP obtained a favorable trial verdict, it moved to recover $17 million in legal fees pursuant to its fee-shifting bylaw.[55] The district court held that federal antitrust law preempted the corporate bylaw and denied the motion.[56] On appeal, the Third Circuit Court of Appeals reversed and vacated the lower court's order, holding that the court should first address the validity of the bylaw before considering federal preemption.[57] While both the Third Circuit and the district court expected that Delaware law would invalidate a fee-shifting bylaw, the district court certified the question of the fee-shifting bylaw's enforceability to the Delaware Supreme Court.[58]

On May 8, 2014, the Delaware Supreme Court held that boards of non-stock membership corporations can unilaterally adopt a fee-shifting bylaw.[59] Never citing or acknowledging its own *AFSCME* ruling,[60] the

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stockholder-adopted bylaw should be invalidated if it indirectly implicated matters of business judgment. *See AFSCME*, 953 A.2d at 238.

[52]*See supra* note 49 and accompanying text.

[53]*See* Deutscher Tennis Bund v. ATP Tour, Inc., 2009 WL 3367041, at *1 (D. Del. Oct. 19, 2009).

[54]*Id.*

[55]*Id.*

[56]*Id.* at *4 ("Permitting corporations accused of anticompetitive conduct to enforce bylaws with such potent deterrent potential would be antithetical to the purposes of the Sherman Act.").

[57]Deutscher Tennis Bund v. ATP Tour Inc., 480 Fed. App'x 124, 127-28 (3d Cir. 2012).

[58]Deutscher Tennis Bund v. ATP Tour, Inc., 2013 WL 4478033, at *1 (D. Del. Aug. 20, 2013). Perhaps because it involved a non-stock corporation or because it began in federal court, there is no indication that anybody in the corporate governance field identified the case as one that could be of interest, much less fundamentally alter the corporate governance litigation landscape.

[59]ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 557-58 (Del. 2014).

ATP Court treated director-approved bylaws touching upon core stockholder rights very different from its treatment of stockholder-approved bylaws affecting core director rights.[61] While in *AFSCME*, the Court had conceived of a hypothetical way in which a stockholder-adopted bylaw might affect core director powers and would therefore be facially invalid,[62] the *ATP* court held that as long as it could conceive of a hypothetical situation in which the bylaw did *not* violate Delaware law, it would be upheld—leaving it to the members of the corporation to challenge the bylaw in a future "as-applied" circumstance.[63] The court never assessed whether fee-shifting bylaws conflict with core stockholder property rights.

An easy way to explain the *ATP* ruling is to conclude that it is limited to the context of non-stock member corporations.[64] Such a reading is difficult to extract from the plain words of the opinion. To the contrary, the court's reasoning seemed to go out of its way to imply that bylaws, even those which are unilaterally adopted by board of directors, must be treated in every way as an independent contract—separate and apart from the charter and the DGCL—between the corporation and its stockholders.[65] The Court reasoned that because bylaws are independent contracts, and fee-shifting provisions are permissible in contracts, directors could unilaterally impose fee-shifting bylaws on stockholders.[66] The Court also made clear that fee-shifting bylaws would bind stockholders who joined the non-public corporation after the bylaw was adopted, and that fee shifting was viable even if the plaintiff was largely successful in litigation.[67]

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[60] *Id.* at 554-59.

[61] *Id.*

[62] CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 238 (Del. 2008).

[63] *ATP*, 91 A.3d at 558 ("That, under some circumstances, a bylaw might conflict with a statute, or operate unlawfully, is not a ground for finding it facially invalid.").

[64] *See* Herbert F. Kozlov & Lawrence J. Reina, *Delaware Supreme Court Approves Fee-Shifting Bylaw for Non-Stock Corporations*, BUS. L. TODAY, June 2014, at 1, *archived at* http://perma.cc/K8M4-WMDQ ("Because ATP is a non-stock, membership corporation, some might suggest the reach of the court's decision should be limited to only non-stock corporations . . . .").

[65] *ATP*, 91 A.3d at 558 (quoting Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010)) (characterizing corporate bylaws as "contracts among a corporation's shareholders").

[66] *Id.* ("Because corporate bylaws are 'contracts among a corporation's shareholders,' a fee-shifting provision contained in a nonstock corporation's validly-enacted bylaw would fall within the contractual exception to the American Rule.").

[67] *Id.* at 555. The bylaw at issue in the *ATP* case stated the following:

> In the event that (i) any [current or prior member or Owner or anyone on their behalf ("Claiming Party")] initiates or asserts any [claim or counterclaim ("Claim")] . . . against the League or any member or Owner . . . and (ii) the Claiming Party . . . does not obtain a judgment on the merits that substantially

The anti-stockholder litigation tone of the opinion is hard to ignore.[68] Indeed, in commenting on how a board-adopted fee-shifting bylaw would be held enforceable, the Court stated that deterring litigation, with no condition that the litigation is "frivolous," would generally be a proper corporate purpose.[69] Within days of the *ATP* opinion, prominent corporate law firms issued client alerts suggesting that boards of public stockholder corporations consider adopting similar bylaws.[70] As of March 1, 2015, boards of over fifty public entities adopted fee-shifting provisions.[71] As explained herein, a widespread expansion of fee-shifting provisions would be tantamount to giving corporate directors and officers immunity against all claims, regardless of merit.[72]

If *ATP* is applied to public corporations, the message is clear: stockholders cannot amend bylaws to preemptively dictate how proxy

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> achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the League and any such member or Owners for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) (collectively, "Litigation Costs") that the parties may incur in connection with such Claim.

Id. at 556 (alterations in original).

[68] *See ATP*, 91 A.3d at 557-60; Lee Rudy, *Bylaw Madness: Boards Writing Their Own Rules for Litigation*, KTMC BULLETIN (Kessler, Topaz, Meltzer & Check LLP), Fall 2014, at 11 *archived at* http://perma.cc/7GXH-K3VL.

[69] *ATP*, 91 A.3d at at 560 ("The intent to deter litigation, however, is not invariably an improper purpose. Fee-shifting provisions, by their nature, deter litigation. Because fee-shifting provisions are not *per se* invalid, an intent to deter litigation would not necessarily render the bylaw unenforceable in equity.").

[70] *See, e.g.*, Peter A. Atkins, Allison L. Land, Edward B. Micheletti & Edward P. Welch, *Fee-Shifting Bylaws: The Delaware Supreme Court Decision in* ATP Tour*, Its Aftermath and the Potential Delaware Legislative Response to the Decision*, INSIGHTS (Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates), Oct. 22, 2014, *archived at* https://perma.cc/95YG-VZYE; ATP Tour, Inc. v. Deutscher Tennis Bund , DEL. L. UPDATES (Potter, Anderson & Corroon LLP), May 8, 2014, *archived at* http://perma.cc/F9GR-X5HJ.

[71] *See Investors Opposing Fee-Shifting Bylaws*, *supra* note 10.

[72] *See Strougo v. Hollander,* 111 A.3d 590, 595 (Del. Ch. 2015) (indicating that adopting a fee-shifting provision would deter an average stockholder from bringing a suit against directors, given the stakes). Another way to effectively immunize all but the most egregious misconduct is through "minimum-stake-to-sue" bylaws, which require a potential plaintiff to deliver written consents from the owners of at least a certain percent of the company's outstanding shares in order to bring a class action or derivative suit. *See* Alison Frankel, *Shareholder Challenges Minimum-Stake-to-Sue Bylaw*, REUTERS, Jan. 21, 2015, http://blogs.reuters.com/alison-frankel/2015/01/21/shareholder-challenges-over-minimum-stake-to-sue-bylaw/ (explaining a bylaw amendment that "require[d] shareholders to deliver written consent from the owners of at least 3 percent of the company's outstanding shares in order to bring a class action or derivative suit" was "intended to stop shareholders without a real financial interest in the outcome of their own case from hijacking deals and forcing the company to defend meritless litigation").

costs will be allocated (*i.e.*, the bylaw invalidated in *AFSCME*), but directors can unilaterally amend the bylaws to preemptively allocate litigation costs to stockholders, even for claims that are largely vindicated (*i.e.*, the bylaw upheld in *ATP*).[73] This disparate treatment creates an imbalance in the law. When considering a facial bylaw challenge, courts should not ignore the nature of the bylaw and the rights affected. Analogizing bylaws to acts of Congress can be helpful in this regard. Traditionally, when a citizen brings a facial challenge to an act of Congress, the government merely has to show a rational basis for the legislation.[74] However, the government's burden increases significantly when legislation infringes upon a fundamental right, such as the free speech and association rights protected by the First Amendment.[75] In that case, courts will strike down the legislation if the government cannot show that the legislation is narrowly tailored to achieve a compelling governmental interest.[76]

Under Delaware law, as well as most other jurisdictions, stockholders have three core substantive rights: nominating and voting for directors, selling their shares, and suing those who violate their fiduciary, securities law, and contractual duties.[77] Put differently, the stockholders' rights to vote, nominate, sell shares and bring suit for misconduct can be viewed as the corporate equivalent to fundamental citizens' rights guaranteed by the U.S. Constitution.[78] When directors impair the stockholders' ability to exercise their substantive rights, skeptical judicial scrutiny is warranted.[79] The standard for directors who act for the principal purpose of preventing stockholders from exercising their fundamental right to elect a majority of new directors was set forth

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[73]*See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 232 (Del. 2008); *ATP*, 91 A.3d at 559.

[74]United States v. Carolene Prods. Co., 304 U.S. 144, 152 & n.4 (1938).

[75]*See id.*; Skinner v. Oklahoma *ex rel.* Williamson, 316 U.S. 535, 541 (1942).

[76]*See, e.g.*, R.A.V. v. City of St. Paul, 505 U.S. 377, 403 (1992); Bd. of Trs. of State Univ. of N.Y. v. Fox, 492 U.S. 469, 480 (1989).

[77]*See, e.g.*, ROBERT C. CLARK, CORPORATE LAW § 3.1, at 93-105 (1986) (discussing the extent of these rights); *see also* WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 96 (4th ed. 2012) ("[T]he default powers of shareholders [are] three: the right to vote, the right to sell, and the right to sue."); Strine, *supra* note 44, at 453-54 ("In American corporate law, only stockholders get to elect directors, vote on corporate transactions and charter amendments, and sue to enforce the corporation's compliance with the corporate law and the directors' compliance with their fiduciary duties."); Velasco, *supra* note 36, at 409.

[78]*See* Velasco, *supra* note 36, at 409.

[79]*See* Christopher Fawal, Note, *Protecting Shareholder Access to Director Elections: A Response to* CA, Inc. v. AFSCME *Urging the Adoption of a* Blasius *Standard of Reivew for the Exercise of a Fiduciary-Out Clause*, 59 DUKE L.J. 1457, 1487 (2010) ("[A] weaker standard of scrutiny when board actions directly impede shareholder actions is improper.").

in the seminal case of *Blasius Industries, Inc. v. Atlas Corporation*, where then-Chancellor Allen crafted a stringent test that permitted a board to so act if the board could show a compelling justification for its decision.[80] Likewise, enhanced judicial scrutiny applies when directors prevent the company's stockholders from deciding to sell their shares.[81] Delaware authorities and sound corporate governance principles strongly suggest that courts should apply a similarly stringent test to assess director actions that impinge on the stockholders substantive right to bring a suit for director misconduct.[82]

Viewed this way, the legislature and judiciary can easily distinguish between the vast majority of bylaws that regulate true internal corporate affairs and are presumptively valid, and bylaws that impair substantive stockholder rights and should be subjected to strict judicial scrutiny and presumed invalid.[83] Such an approach would be supported by both *AFSCME* (in terms of limiting bylaws to internal process) and the "compelling justification" standard adopted in *Blasius* (requiring skeptical judicial scrutiny of director efforts to override the core stockholder right to elect directors).[84]

III. THE LAW OF UNINTENDED CONSEQUENCES: HOW OVERBLOWN ANTI-STOCKHOLDER RHETORIC LED FROM *BOILERMAKERS* TO *ATP*

A. *Before* ATP*, Bylaws Were the "Process-Based" Part of the Broader Contract Between Companies and Stockholders*

Prior to *ATP*, decades of case law treated bylaws as a specific type of agreement that is like a contract, interpreted using contractual interpretation principles, but that exists for a limited purpose and operates under a particular set of rules.[85]

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[80]Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988).

[81]Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 91-92 (Del. Ch. 2011) (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)) ("[I]t is well-settled that when a poison pill is being maintained as a defensive measure and a board is faced with a request to redeem the rights, the *Unocal* standard of enhanced judicial scrutiny applies.").

[82]*See* David S. Newman, *Delaware Serves Shareholders the 'Poison Pill':* Moran v. Household International,, Inc., 27 B.C. L. REV. 641, 661 (1986) (observing that "strict judicial scrutiny of corporate directors is neither novel nor extreme").

[83]*See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 234-35 (Del. 2008) (stating that bylaws are meant to assist boards with the process and procedures of making corporate decisions); *Blasius*, 564 A.2d at 659 (advocating a higher level of judicial scrutiny for director efforts to "interfer[e] with the effectiveness of a stockholder vote").

[84]*See AFSCME*, 953 A.2d at 234-35; *Blasius*, 564 A.2d at 659.

[85]*See, e.g.*, Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 940 (Del. Ch. 2013) (explaining that Delaware holds bylaws to be part of a "flexible contract

Read together, Sections 102(a)(4) and 109 of the DGCL make clear that bylaws can be used to change procedural stockholder rights but not substantive stockholder rights, which require stockholder approval in the form of a charter amendment.[86] Specifically, Section 102(a)(4) of the DGCL provides that "powers, preferences and rights, and the qualifications, . . . thereof, which are permitted by [DGCL] § 151" with respect to stock of a public corporation *shall* be set forth in the certificate of incorporation.[87] Thus, qualifications on the "right to sue" inherent in the stock of a public corporation must be included in the charter.[88]

Under Section 109(b), bylaws may contain any provision "relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees," but only if those provisions are not inconsistent with the law or the certificate of incorporation.[89] The express hierarchy of authority between Sections 102(a)(4) and 109(b) make clear that bylaws may "relate to" rights or powers of stockholders, but only if they do not substantively qualify, limit, or restrict those rights.[90]

Decades of case law came to the same conclusion.[91] In 1933, the Court of Chancery noted the following:

> [A]s the charter is an instrument in which the broad and general aspects of the corporate entity's existence and nature are defined, . . . the by-laws are generally regarded as the proper place for the self-imposed rules and regulations deemed expedient for its convenient functioning to be laid down.[92]

Delaware courts reiterated this concept over the years, with the Court of Chancery stating the following in 2004:

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between a corporation and [its] stockholders"); *Airgas*, 8 A.3d at 1188 ("[C]harters and bylaws are contracts among a corporation's shareholders . . . ."); Kidsco Inc. v. Dinsmore, 674 A.2d 483, 492 (Del. Ch. 1995) (citation omitted) ("[B]y-laws are a contract between the corporation and its stockholders . . . .").

[86] DEL. CODE ANN. tit. 8, § 102(a)(4) (2006); DEL. CODE ANN. tit. 8, § 109 (2006).

[87] § 102(a)(4) (emphasis added).

[88] Notably, Section 102(a)(4) of the DGCL further makes clear that this provision does not apply to nonstock corporations, such as the one at issue in the *ATP* decision. *See id.*

[89] § 109(b).

[90] § 102(a)(4); § 109(b).

[91] *See, e.g.*, CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 234-35 (Del. 2008) ("It is well-established Delaware law that a proper function of bylaws is not to mandate how the board should decide specific substantive business decisions, but rather, to define the process and procedures by which those decisions are made.").

[92] Gow v. Consol. Coppermines Corp., 165 A. 136, 140 (Del. Ch. 1933).

> Traditionally, the bylaws have been the corporate instrument used to set forth the rules by which the corporate board conducts its business. To this end, the DGCL is replete with specific provisions authorizing the bylaws to establish the procedures through which board and committee action is taken. . . . [T]here is a general consensus that bylaws that regulate the process by which the board acts are statutorily authorized.[93]

In reaching its decision in *ATP*, however, the Court addressed Section 109 of the DGCL in isolation, without addressing Sections 102 or 151.[94] If one reads Section 109 in isolation, there is potentially no limit on the type of bylaws that a board can pass.[95] For example, one might conclude that a board can adopt an exculpatory provision in the company's bylaws. Of course, Section 102(b)(7) allows adoption of such a clause only in the charter.[96] But under *ATP*, so long as stockholders have the theoretical ability to later change a bylaw (a practice so fraught with hurdles and expenses that it rarely happens, regardless of the subject of the bylaw), the scope of permissible director-approved bylaws seems limitless.[97]

As explained below, the historical conception of the proper subject matter for bylaws seems to have been stretched modestly to accommodate forum selection.[98] If *ATP* applies to public companies, this historical distinction will have been abandoned altogether.[99]

B. *How the Reasoning in Support of Forum Selection Was Stretched to Endorse Fee Shifting*

The doctrinal arc that ends with *ATP* started with a more modest discussion about the problem of identical lawsuits in multiple fora.[100]

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[93]Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1078-79 (Del. Ch. 2004).

[94]*See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (Del. 2014).

[95]*See* § 109(b); *see also* L. John Bird, Comment, *Stockholder and Corporate Board Bylaw Battles: Delaware Law and the Ability of a Corporate Board to Change or Overrule Stockholder Bylaw Amendments*, 11 U. PA. J. BUS. L. 217, 225 (2008) (opining that the power to amend corporate bylaws under Section 109 is almost solely given to the board of directors).

[96]DEL. CODE ANN. tit. 8, § 102(b)(7) (2006).

[97]*See ATP*, 91 A.3d at 559.

[98]*See infra* Part III.B.

[99]*See ATP*, 91 A.3d at 555.

[100]In 2011, then-Chancellor Chandler noted the problems and byproducts of the increased trend towards multi-forum suits in deal litigation. *In re* Allion Healthcare Inc. S'holders Litig., 2011 WL 1135016, at *4-5 (Del. Ch. Mar. 29, 2011).

Over the past decade, stockholders have increasingly filed identical lawsuits in multiple fora, particularly in the M&A context.[101] Without bothering to actually quantify or objectively assess the true societal cost from multiple forum litigations (no doubt because in almost every instance of multi-forum parallel litigations, only one action in one court was actively litigated while the remainder were stayed and additional cost from parallel litigation was marginal, at best), the corporate community determined that multi-forum litigation was a plague that must be squashed.[102]

As a proposed solution to this supposed "epidemic," in the spring of 2007, a prominent corporate attorney suggested that Delaware corporations select Delaware as the exclusive forum for intra-corporate litigation in their bylaws.[103] Notably, that article advocated that directors could unilaterally amend the contract without the consent of the stockholders and without either consideration or an opportunity to rescind.[104]

Delaware courts did not initially embrace the author's suggestion that bylaws were a proper means to select a judicial forum.[105] Most notably, in his opinion in *In re Revlon, Inc. Shareholder Litigation*, Vice Chancellor Laster noted that "if board of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond [under Section 102(b)(1) of the DGCL] with charter provisions selecting an exclusive forum for intra-entity disputes."[106] The Vice Chancellor spoke specifically of charters, which require stockholder approval, and never suggested that companies could achieve forum selection through a bylaw alone.[107] Perhaps recognizing that stockholders are not losing too much sleep about the purported (but never objectively quantified) costs of multi-forum litigation and might be

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[101]The average merger deal now attracts nearly five separate suits, with roughly three quarters of those taking place in Delaware and in another jurisdiction at the same time. *See* Savitt, *supra* note 3, at 26.

[102]*See Allion Healthcare*, 2011 WL 1135016, at *4 (examining the "increasingly problematic fallout" from multi-forum deal litigation).

[103]Theodore N. Mirvis, *Anywhere But Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions*, M&A J., May 2007, at 17-18, *archived at* http://perma.cc/8A54-Z5HE.

[104]*Id.*

[105]*See In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) (identifying charter provisions as appropriate means to select an exclusive forum). *But see* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939 (Del. Ch. 2013) (holding forum-selection bylaws statutorily and contractually valid and enforceable as forum-selection clauses).

[106]*In re Revlon*, 990 A.2d at 960.

[107]*See id.*

opposed to giving up their choice of forum, Delaware companies were initially reluctant to adopt exclusive forum provisions in their charters.[108] Less than 5%, or twenty-one out of 430 Delaware companies filing for an IPO in 2010 had an exclusive forum selection clause in their charter.[109]

In 2013, then-Chancellor Strine's decision in *Boilermakers* squarely empowered boards to unilaterally select a forum for intra-corporate litigation.[110] The court ruled that director-adopted forum-selection bylaws are facially valid under Delaware law.[111] True to prior precedent, the court held that a corporation's bylaws are part of a larger, binding contract among directors and stockholders under the rubric of the Delaware General Corporation Law, which permits a corporation, through its charter, to grant directors the power to adopt and amend bylaws unilaterally.[112] In other words, the court held that when stockholders acquire stock, they consent to the directors' power to amend bylaws.[113] As long as the proper subject matter for bylaws remained constrained, however, this aspect of the ruling did not portend a

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[108]Matthew C. Baltay, *Exclusive Forum Bylaws Are Going Mainstream: What's Next, Bylaws Eliminating Shareholder Class Actions?*, BOSTON BAR J. (Apr. 22, 2015), *archived at* http://perma.cc/X8FD-UMF5 (noting the increase in exclusive-forum provisions since *Boilermakers*).

[109]Brian J.M. Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137, 171-72 (2011). Professor Coffee identifies four possible explanations for corporations' caution towards adopting forum-selection clauses:

> (1) [L]egal uncertainty deters some issuers, particularly in view of pending litigation; (2) for other issuers, apathy still reigns, as the prospect of M&A litigation is not sufficiently material to them to justify an advance response; (3) more corporations appear to fear that proxy advisors will resist such a proposed charter amendment and cause institutional investors to vote it down; and (4) some corporations may actually want multi-forum litigation because it reduces the likely settlement they will have to pay in the event of a future M&A transactions in which they are the target.

John C. Coffee, Jr., *Foreword: The Delaware Court of Chancery: Change, Continuity – and Competition*, 2012 COLUM. BUS. L. REV. 387, 401.

[110]Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939 (Del. Ch. 2013).

[111]*Id.*

[112]*Id.* at 957.

[113]*Id.* at 958 ("Where, as here, the certificate of incorporation has conferred on the board the power to adopt bylaws, and the board has adopted a bylaw consistent with [Section 109(b)], the stockholders have assented to that new bylaw being contractually binding.").

fundamental change in the delicate balance of power within the public corporation.[114]

While the propriety of forum-selection bylaws that never receive stockholder approval should raise corporate governance questions, *Boilermakers* could still be reconciled with statutory provisions, including Section 102(a)(4) of the DGCL, and Delaware precedents.[115] Forum-selection bylaws, even if they arguably "qualify" stockholder rights by limiting the forum where a stockholder can bring a lawsuit, are still procedural and do not fundamentally impede stockholders from asserting substantive rights vis-à-vis their agents on the board.[116] But once the Delaware courts empowered directors to use bylaws to dictate where stockholders can pursue their claims without expressly linking that power to the process versus substance distinction, corporate advocates had a path towards advising directors to adopt bylaws in ways that would substantially qualify and impair stockholders from asserting their core property rights.[117]

Notably, the amendment codified as Section 109(b) addresses both forum selection and fee shifting, statutorily enshrining the former while invalidating the latter.[118] This different treatment is consistent with the arguments made herein, and reflects a balanced approach between the board's ability to decide procedural issues through bylaws while preserving core stockholder rights.[119] Besides falling on the process side of the line set by *AFSCME*, forum-selection bylaws serve the additional purpose of preserving Delaware's ability to develop its corporate common law through its own judicial system.[120]

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[114] *See Boilermakers*, 73 A.3d at 951 (explaining that bylaws typically "do not contain substantive mandates, but direct how the corporation, the board, and its stockholders may take certain actions").

[115] *See infra* note 116 and accompanying text.

[116] *See Boilermakers*, 73 A.3d at 939 (describing the bylaws as "establishing . . . procedural rules for the operation of the corporation").

[117] *See* Richard A. Rosen & Stephen P. Lamb, *Adopting and Enforcing Effective Forum Selection Provisions in Corporate Charters and Bylaws*, PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP, Jan. 8, 2015, at 6 n.17, *archived at* http://perma.cc/MAN8-JPVW (cautioning boards "that voting recommendations by the two most prominent proxy advisors [Glass Lewis and ISS] may be affected by the adoption of a forum-selection clause without stockholder approval").

[118] *See supra* note 12 (detailing the proposed amendments to the DGCL).

[119] *See supra* note 45 and accompanying text.

[120] *But see* David J. Berger, *Delaware Court of Chancery Upholds Forum Selection Bylaw*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 15, 2014), *archived at* http://perma.cc/7NAV-H9MC (discussing Providence v. First Citizens BancShares, Inc., 99 A.3d 229 (Del. Ch. 2014)):

> Chancellor Bouchard ended his analysis by noting that his conclusions were further supported by "important interests of judicial comity." Indeed, he remarked that just as Delaware expects that other jurisdictions,

C. Commonwealth REIT*: From Selecting Forum to Dictating the Terms on Which Stockholders Bring Suit*

The breadth of the *Boilermakers* decision enticed some boards to test how much they could change the balance of power with their stockholders through unilaterally adopted bylaws.[121] If *Boilermakers* allowed directors to select the court in which stockholders could sue directors and officers, the next logical question was whether directors could adopt bylaws that actually limit stockholders' access to the courthouse itself.[122]

A few months after *Boilermakers* was decided, a Maryland court cited that case in applying to public stockholders a board-adopted bylaw requiring arbitrations of all stockholder litigation, under a set of discovery and other procedural limitations that the directors themselves dictated.[123] The case involved allegations by CommonWealth REIT's largest stockholders that its trustees had breached their fiduciary duties in resisting a hostile takeover bid.[124] Citing the *Boilermakers* discussion about the board's power to unilaterally adopt provisions addressing intra-corporate dispute resolutions, the Maryland court held that all stockholders assent to a contractual framework that enforces bylaws adopted without stockholders consent, including after the stock purchase itself.[125] Now that directors could not only decide where stockholder could sue, but also the rules under which they could seek to effectuate their rights, whether directors could eliminate stockholder lawsuits altogether became the final frontier.[126]

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after *Chevron*, will enforce forum selection provisions designating Delaware as the selected forum, so too should Delaware courts enforce bylaws designating another jurisdiction, lest the Delaware courts "stray too far from the harmony that fundamental principles of judicial comity seek to maintain."

[121] *See* Liz Hoffman, *'Only In Delaware' Ruling A Win For Boards, But Tests Await*, LAW360 (June 27, 2013, 8:55 PM), *archived at* http://perma.cc/T5T7-B4SS (noting critics' worry that "upholding the [forum-selection] bylaws opens the door to abuse").

[122] *See* Strougo v. Hollander, 111 A.3d 590, 595 (Del. Ch. 2015) ("[T]here [are] serious policy questions implicated by fee-shifting bylaws in general, including whether it would be statutorily permissible and/or equitable to adopt bylaws that functionally deprive stockholders of an important right: the right to sue to vindicate their interests as stockholders.").

[123] *See* Katz v. CommonWealth REIT, No. 24-C-13-001299 (Md. Cir. Ct. Balt. City Feb. 19, 2014).

[124] *Id.* at 2.

[125] *Id.* at 28-29.

[126] Although not decided under Delaware law, the *CommonWealth REIT* case oversteps the dividing line set up by *AFSCME* with respect to bylaws. *See supra* note 83 and accompanying text. Whereas a forum-selection provision is arguably "process-based" and

D. *The Real World Implications of Applying* ATP *to Public Corporations*

In the wake of the *ATP* decision, prominent national law firms, including at least two law firms counting former members of the Delaware Court of Chancery as partners, publicly issued statements suggesting that their current and potential board clients "seriously consider adopting fee-shifting bylaws of their own."[127] Although decided in the context of a non-stock corporation, lobbyists and lawyers representing entrenched directors of public corporations were urging their clients to use a broad reading of *ATP* to immunize their conduct from judicial oversight by imposing liability for associated fees and expenses directly on stockholders.[128]

By the end of 2014, over fifty public companies, including multi-billion dollar companies, adopted either bylaws or charter provisions requiring a stockholder who is not completely successful in litigation to pay the legal fees of corporate defendants.[129] Indeed, reflecting an aggressive but predictable response to the *ATP* decision, and the ambiguity created by the Delaware legislature's delay in a statutory clarification or correction, some corporations adopted bylaws similar to or even more extreme than those approved in *ATP*.[130]

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only determines where the stockholder can bring claims, the arbitration provision at issue in *Commonwealth REIT* also altered substantive stockholder rights, including a prohibition on fee awards and fee shifting through indemnification. For its part, *ATP* did not cite *AFSCME*. As explained herein, if *ATP* applies to public corporations, it appears to have overruled *AFSCME*'s process versus substance distinction *sub silentio*. *See infra* Part V.

[127] *Delaware Supreme Court Endorses "Fee-Shifting" Bylaw in Certified Question of Law*, CLIENT MEMO (Wilson, Sonsini, Goodrich & Rosati), May 12, 2014, at 2, *archived at* https://perma.cc/3ZDB-LUPP; *Delaware Supreme Court Finds Fee-Shifting Bylaws Permissible*, CLIENT MEMORANDUM (Paul, Weiss, Rifkind, Wharton & Garrison LLP), May 9 2014, *archived at* http://perma.cc/NRU2-DQ7X. *Contra* Theodore N. Mirvis, David A. Katz, Trevor S. Norwitz & William Savitt, *With a Note of Caution, Delaware Rules Fee-Shifting Bylaws Facially Permissible*, CLIENT MEMO (Wachtell, Lipton, Rosen & Katz), May 21, 2014, *archived at* https://perma.cc/Z565-PCHG ("While the [*ATP*] opinion facially approves a 'fee-shifting' bylaw that imposes the cost of defense in intracorporate litigation on the losing party, we advise caution for public company boards considering adopting such a bylaw to apply to stockholder litigation generally.").

[128] Alison Frankel, *The Latest in Restrictive Corporate Bylaws: Small Shareholders Can't Sue*, REUTERS, Nov. 13, 2014, *archived at* http://perma.cc/7H72-A2MJ (describing a novel variation of a litigation-limiting bylaw permitting stockholders to bring class or derivative claims against the company only upon procurement of "written consents from the owners of at least 3 percent of the outstanding shares"); *see also supra* note 71.

[129] *See Investors Opposing Fee-Shifting Bylaws*, *supra* note 10.

[130] This bylaw provision, adopted by American Spectrum Realty, Inc. on July 18, 2014, is typical:

Fee-shifting provisions undermine all representative stockholder litigation, regardless of merit. In traditional stockholder litigation, stockholder-plaintiffs seek to correct misconduct for the benefit of all stockholders.[131] Hence, under the ruling in *ATP*, stockholders face a dilemma of recovering only part of any damage award if they win, while paying the full defense fee if they obtain a partial win.[132]

In this context, no matter how strong a case, and irrespective of whether a stockholder is willing to bear the cost of paying for its own counsel or chooses to pursue claims through contingency counsel, few, if any, stockholders could initiate or support an action in which the stockholders' personal liability for the company's defense costs is completely out of the stockholders' control and will rise exponentially the longer a case continues.[133] Indeed, it will be difficult for even the largest

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> To the fullest extent permitted by law, in the event that (i) any current or prior stockholder of the Corporation or anyone on their behalf, in the capacity of a stockholder of the Corporation ("Claiming Party") initiates or asserts any claim or counterclaim against the Corporation ("Claim") or joins, offers substantial assistance to or has a direct financial interest in any Claim against the Corporation and/or any director, officer, employee or affiliate (including any Claim filed derivatively on behalf of the Corporation), and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the Corporation and any such director, officer, employee or affiliate for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) that the parties may incur in connection with such Claim.

American Spectrum Realty, Inc., Amended and Restated Bylaws at Article XV (adopted July 18, 2014).

[131] *See* Griffith, *supra* note 9, at 27.

[132] By threatening to impose defense counsel's fees on a stockholder-plaintiff, fee-shifting bylaws strike at the very purpose and nature of class and derivative stockholder litigation. *See* Noerr v. Greenwood, 2002 WL 31720734, at *2 (Del. Ch. Nov. 22, 2002) ("Class actions enable parties that have small individual stakes to overcome the often-prohibitive transactional costs of bringing a lawsuit, by suing on behalf of other parties who are similarly situated."); John C. Coffee, Jr., *Litigation and Corporate Governance: An Essay on Steering Between Scylla and Charybdis*, 52 GEO. WASH. L. REV. 789, 812 n.54 (1984) (addressing certain criticisms of corporate law and acknowledging that "so long as a contingent fee system is essential to the enforcement of derivative actions, the English rule of fee shifting would deter most plaintiffs from commencing such an action, because the nominal plaintiff stands to receive no portion of the recovery in a derivative action (if successful) and yet would be liable for the other side's attorneys' fees (if unsuccessful).").

[133] *See* Paul Weitzel, *The End of Shareholder Litigation? Allowing Shareholders to Customize Enforcement Through Arbitration Provisions in Charters and Bylaws,* 2013 BYU L. REV. 65, 78 (noting that because shareholder litigation suits are costly, "as a compensatory device, they are grossly inefficient").

institutional investors to take the risk of paying millions, or tens of millions, of dollars in defense attorneys' fees to correct corporate misconduct when their individual, pro rata share of the potential benefit or recovery created by the litigation will only be a fraction of the total benefit sought, and when achieving a "full remedy" is not possible absent lengthy proceedings.[134] As the general counsel of CalPERS, the largest public pension fund in the United States, noted in the *CommonWealth REIT* case, CalPERS would not be able to justify stockholder litigation due to the fact that pro rata benefit of any class or derivative recovery to CalPERS itself would make up only a fraction of the expenses of litigation.[135]

Fee-shifting provisions also undermine stockholder activist activities.[136] Under *ATP*, if directors can unilaterally impose fee shifting on their stockholders to deter litigation, they may also be able to justify fee shifting for proxy activities that are not entirely successful, especially if the activist engages in litigation.[137] Indeed, if directors can rewrite bylaws to impose litigation costs on complaining stockholders, one struggles to see why the same board could not turn the *AFSCME* fact pattern on its head and impose proxy fight costs on activist stockholders, who would then be deterred from exercising their franchise rights.[138]

As a result, directors and officers will be largely insulated from accountability for breaches of fiduciary duty.[139] Indeed, fee-shifting

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[134]For example, the fees at issue in *ATP* were $17,865,504.51. *See* Brief for Appellees at 1, ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014) (No. 534, 2013).

[135] Affidavit of Peter H. Mixon, Katz v. CommonWealth REIT, No. 24-C-13-1966 (Md. Cir. Ct. Balt. City June 10, 2013) (on filed with Authors).

[136]*See* Edward Timlin, *Dispatches from the Battleground: Will Fee-Shifting Bylaws Keep Shareholders from the Courthouse?*, ADVOC. FOR INSTITUTIONAL INVESTORS (Bernstein, Litowitz, Berger & Grossmann LLP), July 1, 2015, at 1, *archived at* http://perma.cc/G8K6-65W3 (recognizing that "no rational stockholder will seek to vindicate their rights in the face of personal exposure to unknown, uncapped, and uncontrollable defense costs").

[137]*See* Shirley Westcott, *Proxy Advisor Policy Changes for 2015*, ADVISOR (Alliance Advisors LLC), Dec. 2014, at 6, *archived at* http://perma.cc/69GU-KPNV (noting that proxy advisory firms ISS and Glass Lewis "dislike[] . . . provisions that limit shareholders' ability to sue corporations" and will oppose fee-shifting measures or "only accept narrowly crafted provisions").

[138]*See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 240 (Del. 2008) ("[W]here the proxy contest is motivated by personal or petty concerns, or to promote interests that do not further, or are adverse to, those of the corporation, the board's fiduciary duty could compel that reimbursement be denied altogether.").

[139]*See, e.g.*, George C. Aguilar & Michael J. Nicoud, *Fee-Shifting After* ATP Tour, SEC. LITIG., Spring 2015 at 10, 14 (opining that fee-shifting "tips the scales of justice too far in corporate fiduciaries' favor, making it even more difficult for shareholders to address breaches of fiduciary duty").

bylaws incentivize defendant-directors to use their ability to spend stockholder funds to retain numerous and expensive law firms as a weapon to deter and undermine even the most valid of stockholder claims.[140] Without the realistic threat of representative stockholder litigation, there will be little to deter fiduciary misconduct.[141] Thus, the enforcement and monitoring functions played by stockholder litigation will be lost. Without question, the temptation for boards of directors to adopt fee-shifting bylaws, under the guise of deterring purportedly "frivolous" litigation, will be overwhelming, given that stockholders' only other recourses to hold their fiduciaries to account will be to vote them out of office or repeal the litigation limiting bylaw—themselves are not costless or seamless, and are a rarity.[142]

In justifying the application of *ATP* to public companies, some corporate advocates have compared *ATP*-style fee-shifting bylaws to fee shifting under the "English Rule" in which the "loser" in litigation pays the winners' fees.[143] Even a simple "loser pays" system leaves little or no room for investors to bring valid claims.[144] In explaining why American courts "have generally resisted any movement" towards the English Rule, former U.S. Supreme Court Chief Justice Earl Warren noted that "since litigation is at best uncertain one should not be penalized for merely defending or prosecuting a lawsuit, and . . . the poor might be unjustly discouraged from instituting actions to vindicate their rights if the penalty for losing included the fees of their opponents' counsel."[145]

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[140] *Id.* at 13 (noting that several sets of defense counsel may lead to higher attorneys' fees and unpredictable costs).

[141] *Id.* at 10 (characterizing the derivative suit as a "vital tool for enforcing fiduciary duties"); *see also* ERNEST FOLK, FOLK REPORT 97 (1967) (identifying "the basic justification" of derivative suits as the "enforcement of fiduciary duties").

[142] *See* Brett H. McDonnell, *Professor Bainbridge and the Arrowian Moment: A Review of the New Corporate Governance in Theory and Practice*, 34 DEL. J. CORP. L. 139, 147 (2009) ("The combination of state and federal law governing shareholder voting and proxy solicitation makes it prohibitively expensive for shareholders to put up their own candidates for the board, and they almost never do so except in the (increasingly rare) case of a hostile takeover."); *see also* John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 L. & CONTEMP. PROBS. 5, 80 (1985) (discussing litigation and its role in enforcing fiduciary duties); Brian J. Robbins & Jay N. Razzouk, *Why Litigation is Still a Shareholder's Best Option to be Heard*, ROBBINS ARROYO LLP (Dec. 14, 2010), *archived at* https://perma.cc/KY7Z-3YUY.

[143] *See* Herbert M. Kritzer, *The English Rule*, A.B.A. J., Nov. 1992, at 54, 55.

[144] *See* Coffee, *supra* note 1, at n.i (opining that fee-shifting provisions "[go] beyond a 'loser pays' rule and [are] in effect 'a-less-than-100%-successful-plaintiff-pays' rule").

[145] Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 718 (1967).

But *ATP* is not about "loser pays." It is about "substantial winner" pays.[146] Specifically, *ATP*-style fee-shifting bylaws go far beyond the English Rule, which merely requires the losing party to pay the winning party's attorney's fees without regard for the exact relief the winning party had requested.[147] A partial victory by a defendant on one small issue would not result in the entire fee being shifted to the plaintiff under the English Rule.[148] By contrast, following the Delaware Supreme Court's *ATP* decision, boards can unilaterally adopt a bylaw requiring payment of legal fees by any plaintiff member who is not entirely successful on all her claims.[149]

This rule chills almost all litigation. Even a plaintiff with a highly meritorious case knows that she will almost inevitably not get all of the relief sought.[150] Thus, absent a legislative clarification or correction, *ATP* may have spelled the end of stockholder litigation entirely, which in turn would eliminate the prospect of any form of governance of fiduciary misconduct, since there is no government regulator of fiduciary duties.[151] All fiduciary oversight was left to stockholders voting, selling or

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[146] *See* Lawrence A. Hamermesh, *Consent in Corporate Law,* 70 BUS. LAW. 161, 166 (2014):

> But the fee-shifting bylaw at issue in the *ATP* case prescribed a one-sided rule—only the plaintiff has to pay the other side's costs—and it has to pay those costs not just if it loses, but even if it wins many of its claims but fails to get substantially all the relief it sought.
>
> The Delaware Supreme Court [in *ATP*] was asked whether this bylaw was invalid on its face. The Court's response, in short, was no: such a bylaw is "facially valid."

[147] *See* Hensley v. Eckerhart, 461 U.S. 424, 443 n.2 (1983) (describing the English Rule as providing that "the losing party, whether plaintiff or defendant, pays the winner's fees").

[148] *See* Theodore Eisenberg & Geoffrey P. Miller, *The English Versus The American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 329 & n.5 (2013).

[149] And boards are adopting such bylaws. *See, e.g.*, American Spectrum Realty, Inc., Current Report (Form 8-K) (July 25, 2014) ("[T]he Company's Board of Directors approved amendments to the Company's bylaws, . . . to provide for fee-shifting with respect to certain types of litigation brought against the Company and/or any director, officer, employee or affiliate where the claiming parties do not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought.").

[150] Because Delaware law is highly protective of corporate directors, it is hard to fathom any situation in which a plaintiff could confidently file suit with the expectation of obtaining all relief sought. *See* Aguilar & Nicoud, *supra* note 139, at 11 (discussing the difficulties that shareholders face when bringing claims against directors and officers).

[151] *See id.* at 14 ("Fee-shifting . . . threatens to remove almost all the utility of the derivative action . . . .").

suing.[152] *ATP* gave directors a weapon to override at least some, and perhaps even all, of these core stockholder rights.[153]

IV. The Significant Legal Flaws of *ATP*

A. *The* ATP *View of Bylaw-as-Standalone Contract is Inconsistent with Basic Contract Law Principles*

Under basic contract law, modification of a contract between individuals requires mutual agreement and some form of consideration—*i.e.*, some benefit in exchange for the agreement or (at least) an opportunity to rescind the agreement.[154] Cases in which Delaware courts have upheld fee-shifting provisions in other types of contracts are instructive.[155] Courts have emphasized the fact that these provisions were included in the contract as part of a bargained-for exchange, such as in contracts for land or for goods or services, and have stated that the fee-shifting agreements may have been part of the reason that people were induced to enter into the contracts in the first place.[156] Further, while courts also allow such agreements in employment contracts, they are wary of the potential for disparities in bargaining power, and indicate that they might not always be enforceable.[157] The ability to bargain for such a provision is paramount.[158]

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[152] *See* Hamermesh, *supra* note 146, at 171 ("Delaware's corporate law system rests on the notion of private enforcement of fiduciary obligations.").

[153] *See* Steven Davidoff Solomon, *A Ruling's Chilling Effect on Corporate Litigation*, N.Y. TIMES DEALBOOK (May 23, 2014), *archived at* http://perma.cc/FXK7-2Z2N (quoting Delaware plaintiffs' law firm Grant & Eisenhofer as characterizing *ATP* as "a 'virtual abandonment' of shareholder rights").

[154] *See, e.g.*, De Cecchis v. Evers, 174 A.2d 463, 464 (Del. Super. Ct. 1961) (citations omitted) ("A contract having been made, no modification of it could be brought about without the consent of both parties and without consideration.").

[155] *See, e.g.*, Choupak v. Rivkin, 2015 WL 1589610, at *20-21 (Del. Ch. Apr. 6, 2015), *aff'd*, 2015 WL 8483702 (Del. 2015) (holding that plaintiff was entitled to recover its costs and expenses under contractual fee-shifting agreement set forth in defendant's employment contract, as well as under the bad faith exception to the American rule).

[156] *See* Dittrick v. Chalfant, 2007 WL 1378346, at *1 (Del. Ch. May 8, 2007) (citation omitted) ("In recognition that inclusion of . . . a clause [regarding payment of attorneys' fees] may well have helped induce a party to sign an agreement, Delaware courts will 'routinely enforce provisions of a contract allocating costs of legal actions arising from the breach of a contract.'"); *see also* Knight v. Grinnage, 1997 WL 633299, at *3 (Del. Ch. Oct. 7, 1997) ("The parties who enter into a contract have the opportunity during the course of their negotiations to add to the contract any provision appropriately bargained for which would place the responsibility for payment of attorney's fees on any party who either breaches the contract or fails to perform in accordance with the terms of the contract.").

[157] *See, e.g.*, Research & Trading Corp. v. Pfuhl, 1992 WL 345465, at *15 (Del. Ch. Nov. 18, 1992) ("[E]nforcement of a provision shifting legal fees in an employment contract

Board-adopted bylaws have neither of these attributes: stockholders neither specifically agree to the bylaw nor do they receive anything in return.[159] This type of authorization for unilateral modification might raise a Corbin or Williston eyebrow and is virtually unheard of in any type of contract.[160] Yet, the Delaware Supreme Court's endorsement of blanket stockholder "consent" (while ignoring the lack of any consideration or ability to rescind) opened the door to potentially impose significant liability on stockholders challenging fiduciary misconduct.[161]

If boards of directors of public corporations are permitted to upend the economic and legal rights of stockholders through unilaterally adopted bylaws, the notion of what it means to be a stockholder of a Delaware corporation will change radically.[162] The effect of this opinion can be mitigated with a simple rule: bylaws are "like" contracts, but cannot impair substantive investor rights.[163] This rule of law can distinguish forum selection clauses (whether in charters or bylaws) from fee-shifting provisions. Forum selection is arguably part of the procedural way in which intra-corporate disputes are adjudicated, without actually changing any of the substantive rights of investors, companies or directors.[164] Fee shifting, on the other hand, fundamentally impairs stockholders' substantive rights, while undermining both the balance the law should strive to achieve and limiting the judiciary's

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may, at least in some cases, offend the policy of the law that has sought to permit necessitous persons to avoid oppressive bargains that were forced upon them."); All Pro Maids, Inc. v. Layton, 2004 WL 1878784, at *12 (Del. Ch. Aug. 10, 2004) (recognizing policy concerns about fee-shifting provisions in employment contracts due to possible disparities in bargaining power).

[158] *See, e.g.*, Aveta Inc. v. Bengoa, 986 A.2d 1166, 1189 (Del. Ch. 2009) (noting courts' "settled expectations in bargained-for arrangements" regarding fee allocations).

[159] As was the case for the shareholders in *Boilermakers*. *See* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939 (Del. Ch. 2013) (rejecting arguments that the bylaws were invalid because they were adopted by the board unilaterally).

[160] *See, e.g.*, Union Pac. R.R. Co. v. Chi., Milwaukee, St. Paul & Pac. R.R. Co., 549 F.2d 114, 118 (9th Cir. 1976) (internal citations omitted) ("One party cannot unilaterally modify a contract without the consent of the other party or without consideration.").

[161] For instance, $17,865,504.51 in attorneys' fees was at issue in the *ATP* case. *See* Brief for Appellees at 1, ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014) (No. 534, 2013).

[162] *See* Davidoff Solomon, *supra* note 153 (quoting Delaware plaintiffs' law firm Grant & Eisenhofer that *ATP* "'undermines the very premise' of Delaware law").

[163] *See supra* notes 65-66 and accompanying text.

[164] *See* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 949 (Del. Ch. 2013) ("The settled approach of [Delaware] law regarding bylaws is that courts should endeavor to enforce them to the extent that it is possible to do so without violating anyone's legal or equitable rights.").

ability to ensure that the law evolves to maintain that balance as industry practices evolve.[165]

B. *Board-Adopted Fee-Shifting Provisions are Related-Party Transactions that are Void or Voidable*

Delaware's corporation law presumes that, in the normal course, boards conduct affairs with a focus on the best interests of the corporation.[166] Embedded in the rule, however, is the notion that the directors must not let personal interests, which may diverge from those of the corporation, guide their exercise of their statutory authority.[167] The law's suspicion of interested transactions is also embedded in the statute.[168] Specifically, Section 144 of the DGCL provides that a transaction between a corporation and an officer or director in which the director or officer has a financial interest is void or voidable unless the contract or transaction is approved, after full disclosure, either by: (1) a majority of the disinterested and independent directors; (2) a good faith vote of the disinterested stockholders; or (3) judicial determination that the transaction is fair to the company and its stockholders.[169]

Boards are inherently interested in and benefit from provisions that eliminate virtually all prospect of personal liability, regardless of the egregiousness of their conduct.[170] Thus, even if bylaws are standalone contracts that can deny stockholders substantive rights, adoption of fee-shifting provisions without stockholder consent constitutes a self-

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[165] *See* Strougo v. Hollander, 111 A.3d 590, 595 (Del. Ch. 2015) ("[There are] serious policy questions implicated by fee-shifting bylaws in general, including whether it would be statutorily permissible and/or equitable to adopt bylaws that fundamentally deprive stockholders of an important right: the right to sue to vindicate their interests as stockholders.").

[166] *See* DEL. CODE ANN. tit. 8, § 141(a) (2006)*; see also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (describing the business judgment rule as "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in honest belief that the action taken was in the best interest of the company").

[167] *Smith* v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("Since a director is vested with the responsibility for the management of the affairs of the corporation, he must execute that duty with the recognition that he acts on behalf of others. Such obligation does not tolerate faithlessness or self-dealing.").

[168] DEL. CODE ANN. tit. 8, § 144(a).

[169] *Id.*

[170] *See, e.g.*, Edward P. Welch & Robert S. Saunders, *Freedom and its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 854-55 (2008) (discussing DGCL Sections 102(b)(7) and 122(17)).

interested transaction that is void or voidable pursuant to Section 144.[171] By the same token, as many companies are held by controlling stockholders or groups, enforcement of a fee-shifting charter provision would require ratification of the disinterested majority, or at the very least, proof of entire fairness.[172]

Whether or not fee-shifting provisions are governed by Section 144, the duty of loyalty requires more skeptical judicial scrutiny than applied by the *ATP* court.[173] When directors use corporate power to entrench themselves by overriding the stockholder franchise, the business judgment rule makes way for the "compelling justification" standard.[174] Moreover, when a majority of a board's directors use powers to serve their personal interests (financial or otherwise), the "entire fairness" doctrine applies.[175]

The *ATP* court's interpretation of fee-shifting bylaws under Section 109 without reference to Sections 102 and 151—in effect, treating them like a bylaw regulating the location of a stockholder meeting or the presence of a quorum—was unfortunate and misguided. While true process-based bylaws should be routinely upheld under the business judgment rule, it is difficult (in the authors' view, impossible) to conceive of a situation in which a director-adopted bylaw imposing the threat of personal liability on stockholders who file non-frivolous claims, thereby insulating those directors from any accountability, can be viewed as anything other than a voidable interested transaction.[176] Some boards or corporate advocates may frame the issue in a benign manner, but fee-shifting bylaws are adopted necessarily with an inequitable end in mind—depriving stockholders of their fundamental right to sue to vindicate their interests as stockholders.[177] A board using its power over bylaws to impose the hammer of fee shifting is abusing its powers.

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[171] *See* § 144(a)(2).

[172] *See* EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS & DIRECTORS § 3:16 (2015).

[173] *See supra* Part II.B.

[174] *See MM Cos. v. Liquid Audio, Inc.*, 813 A.2d. 1118, 1130-32 (Del. 2003).

[175] *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.").

[176] Similar to the board's attempt to expand in *MM Companies*, fee-shifting provisions are inequitable because they deter both valid and invalid claims. *See MM Cos.*, 813 A.2d. at 1132 (citing Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971)) (noting it is a widely recognized Delaware corporate principle that "inequitable action does not become permissible simply because it is legally possible"); *see also supra* notes 68-72 and accompanying text (discussing *ATP*'s permissive remarks on deterring litigation).

[177] *See supra note 165 and accompanying text.*

C. ATP *Runs Counter to Delaware's Carefully Balanced Rule 11 Regime*

Addressing the specific problem of frivolous litigation did not require the blunt and overbroad solution of fee-shifting bylaws. First, Delaware already has a rule in place to deter abusive litigation.[178] Rule 11 of the Court of Chancery Rules of Procedure, which is modeled after Rule 11 of the Federal Rules of Civil Procedure, does not permit fee shifting merely because a claim is unsuccessful.[179] To the contrary, the Rule allows fee shifting only after a specific judicial determination that the claim was not based on a non-frivolous argument for the extension, modification, reversal of law, or the establishment of new law.[180] The sanction of fee shifting cannot be entered just because a party does not prevail.[181]

Moreover, the Rule explicitly prohibits a court from shifting fees without finding that the amount of fees shifted is necessary to deter repetition of the offending conduct.[182] In other words, the sanction of fee shifting must be precisely tailored to the objective of deterrence.[183]

As with the different standards applied to facial challenges of stockholder-adopted versus director-adopted bylaws, the divergence between the burden a stockholder faces to impose fee shifting on defendants under Rule 11 and the ease with which directors can unilaterally impose fee shifting under *ATP* is difficult to follow.[184] Most recently, the Court of Chancery assessed a request for an award of fees for purportedly egregious discovery abuses and misrepresentations to the

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[178] *See infra* notes 179-81.

[179] *Compare* DEL. CT. CH. R. 11(b)(2), *with* FED. R. CIV. P. 11(b)(2); *see also* DEL. SUPER. CT. CIV. R. 11(b)(2).

[180] DEL. CT. CH. R. 11(b)(2).

[181] *See id.*

[182] DEL. CT. CH. R. 11(c)(2) ("A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated.").

[183] *See id.*

[184] *Compare* DEL. CT. CH. R. 11(c)(1)(B) (permitting a court to award fees on its own initiative after directing a party to show cause or after a party has brought a motion showing that the opposing party acted improperly, made factual contentions with no evidentiary support, and improperly denied factual contentions), *with* ATP Tour, Inc., v. Deutscher Tennis Bund, 91 A.3d 554, 554, 558, 560 (Del. 2014) (holding that bylaws could effectively shift litigation expenses if adopted by the appropriate corporation procedures and for a proper corporate purpose).

court by an investment bank.[185] In *In re Rural Metro*, the court specifically found, as required to impose any fee shifting, a wide range of stunning misconduct by the defendant bank and its counsel.[186] While the court unequivocally found that affirmative misrepresentations to the court and similar judicial misconduct was "egregious," it did not rise to the level of being "glaringly egregious," and thus did not support a significant shifting of fees.[187] Regardless of the decision on appeal, it is clear that directors and their advisors will know that they can take aggressive litigation positions without exposing themselves to fee shifting under Rule 11.[188] Yet, under *ATP*, the directors can unilaterally expose stockholders to fee shifting even if the stockholder does nothing wrong, simply because the lawsuit is not completely successful.[189]

D. ATP *Invites Federal Preemption*

The stark contrast between the effect of fee-shifting bylaws on the rights of stockholders to hold their fiduciaries accountable and the requirements of Rule 11 underscores how such bylaws impair substantive stockholder rights. Unlike fee-shifting bylaws, Rule 11 cannot impair substantive rights.[190] The federal Rules Enabling Act prohibits the U.S. Supreme Court from promulgating any rule of

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[185] *See* Transcript of Record at *11, *In re* Rural/Metro Corp. S'holders Litig., 2015 WL 1523103 (Del. Ch. Feb. 12, 2015) (No. 6350-VCL) (discussing whether the standard for fee-shifting is "glaring egregiousness"); *In re* Rural/Metro Corp. S'holders Litig., 2015 WL 725425, at *2 (Del. Ch. Feb. 19, 2015) (ORDER) (denying lead plaintiff's request for fee shifting).

[186] Transcript of Record at *20-22, *In re Rural/Metro Corp.*, 2015 WL 1523103. The *Rural Metro* appeal was decided after this Article was submitted for publication. RBC Capital Mkts., LLC v. Jervis, __ A.3d __, 2015 WL 7721882 (Del. Nov. 30, 2015).

[187] Transcript of Record at *22, *In re Rural/Metro Corp.*, 2015 WL 1523103.

[188] *Id.* at *20-21 (favoring vigorous advocacy, but stating there is a line between "vigorous advocacy" and "glaringly egregious" behavior, such as "bad faith litigation conduct").

[189] ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 557-58 (Del. 2014) (finding facially valid a bylaw that shifts all litigation expenses to a plaintiff who "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought").

[190] *See* 28 U.S.C. § 2072(b) (1990) (stating that federal rules of practice and procedure "shall not abridge, enlarge or modify any substantive right"); *see also* Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co., 559 U.S. 393, 407 (citing Miss. Publ'n Corp. v. Murphree, 326 U.S. 438, 445 (1946)) ("What matters is what the rule itself regulates: If it governs only 'the manner and the means' by which the litigants' rights are 'enforced,' it is valid; if it alters 'the rules of decision by which [the] court will adjudicate [those] rights,' it is not."); Part II.A. (discussing substantive stockholder rights).

procedure that abridges, enlarges, or modifies any substantive right.[191] Rule 11 therefore does not, and cannot, alter substantive law, or tip the balance in favor of or against any particular parties.[192] As the drafters of Rule 11 acknowledged, a blanket fee-shifting rule would have done just that.[193]

Moreover, using state corporation law to undermine or insulate oneself from potential liability for all intra-corporate disputes (including disputes over the board's duty of candor and related disclosure obligations) may invite congressional action or judicial rulings harming Delaware's prominent role in setting corporate law.[194] Congress has, in recent years, shown little hesitancy to intervene in the corporate governance process, overturning state regulation, particularly when state law is perceived to inadequately protect the investing public.[195] The two most prominent (but not exclusive) examples are the corporate governance related provisions of the Sarbanes-Oxley Act of 2002[196] and the Dodd-Frank Act of 2010.[197] With respect to public companies, federal rather than state law now regulates the membership (and in many respects the functioning of) audit committees, provides a partial "say-on-pay" on executive compensation matters, and regulates certain financial relationships among corporations, and their directors and executive

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[191] § 2072(b); *see also* JEROLD S. SOLOVY, NORMAN M. HIRSCH & MARGARET J. SIMPSON, JENNER & BLOCK LLP, SANCTIONS UNDER RULE 11 169 (2010), *archived at* https://perma.cc/8WEA-4Y4X ("Rule 11 does not create a substantive cause of action.").

[192] *See* Solovy, Hirsch & Simpson, *supra* note 191, at 170 (explaining that if Rule 11 bestowed substantive rights upon litigants, it would violate the Rules Enabling Act).

[193] See Danielle Kie Hart, *Still Chilling After All These Years: Rule 11 of the Federal Rules of Civil Procedure and its Impact on Federal Civil Rights Plaintiffs After the 1993 Amendments*, 37 VAL. U. L. REV. 1, 18 (2002) (listing the use of Rule 11 as a fee-shifting device as one of the causes of the rule's chilling effects).

[194] *See* Atkins, Land, Micheletti & Welch, *supra* note 70 (discussing Delaware's legislative response to *ATP* and proposed legislation limiting its applicability); Ed Batts, *Delaware Hammers the Last Nail into the Coffin of Fee-Shifting Bylaws*, CORP. GOVERNANCE ALERT (DLA Piper), July 2015, at 2, *archived at* https://perma.cc/AAR9-UNVA (predicting "potential grave reputational harm" from the Delaware legislature's "knee jerk" reaction to *ATP*).

[195] Cary Coglianese et al., *The Role of Government in Corporate Governance* 1-2 (Harvard Univ. Ctr. for Bus. & Gov't, Working Paper No. RWP04-045, 2004), *archived at* https://perma.cc/K9YV-6CHG (characterizing corporate governance regulation reform as "a central item on the [Congressional] public policy agenda").

[196] *See* Sarbanes-Oxley Act, Pub. L. 107-204, 116 Stat. 745 (2002) (codified as amended at 15 U.S.C. § 7211 (2010)).

[197] *See* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) (codified at 12 U.S.C. § 5301 (2010)).

officers.[198] Since *ATP*'s effects can clearly be felt in interstate (and international) commerce, it should be no surprise that some members of Congress have publicly advocated intervention on the matter.[199]

Federal courts and the Securities and Exchange Commission will face pressure to find that Delaware law and similar state laws permitting fee-shifting bylaws are preempted to the extent they interfere with protected rights under the federal securities laws.[200] Most fundamentally, while Rule 11 is itself a rule of procedure, not one of substance, the Private Securities Litigation Reform Act ("PSLRA") arguably incorporates this procedural rule as a part of Congress' substantive regulation of securities transactions, including those involving Delaware companies.[201] Specifically, in PSLRA, Congress established a heightened pleading standard for federal securities claims to deter the filing of frivolous suits.[202] But Congress purposely went beyond the pleading standard.[203] Under Section 21D(c)(3) of the Securities Exchange Act of 1934 (which is part of PSLRA), a presumption in favor of fee shifting is created if any motion or pleading fails to comply with Rule 11(b) of the Federal Rules of Civil Procedure.[204] This two-sided and balanced approach is equally punitive to both sides in making fee shifting (rather than some lesser financial sanction) the presumptive

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[198] *See* H.R. 3763, 107th Cong. (2002) (enacted); H.R. 4173, 111th Cong. (2010) (enacted).

[199] *See, e.g.*, Letter from Senator Richard Blumenthal to SEC Chair Mary Jo White (Oct. 30, 2014), *archived at* http://perma.cc/P57X-W7DQ.

[200] While the Delaware courts have held that litigation limiting bylaws may only regulate stockholders' ability to bring internal affairs claims, some publicly traded companies continue to adopt bylaws provisions that purport to extend to any claim, including securities claim. *See* Kevin LaCroix, *IPO Companies and Fee-Shifting Bylaws*, D&O DIARY (Oct. 14, 2014), *archived at* http://perma.cc/JJ55-LAG6 (discussing public companies that have adopted fee-shifting bylaws "targeted at securities lawsuits"); *see also* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 952, 960 (Del. 2013) (noting that the "natural way" to interpret bylaws is so that they "cover only internal affairs claims brought by stockholders"); ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014) (confining discussion to intra-corporate claims); Henry duPont Ridgely, *The Emerging Role of Bylaws in Corporate Governance*, 68 SMU L. REV. 317, 325 (2015) (confirming that the *ATP* holding was confined to internal affairs claims); Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. (forthcoming 2015) (noting that Delaware courts have acknowledged that litigation-limiting bylaws have no application to securities claims, "which are not brought under Delaware law and do not concern Delaware-imposed duties").

[201] 15 U.S.C. § 78u-4(b) (2010).

[202] *See* 5A CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 1301.1 (3d ed. 2004).

[203] *See* Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. § 78 (2012)).

[204] 15 U.S.C. § 78u-4(c)(3)(A) (creating a presumption in favor of fee-shifting for failure to meet pleading requirements under Rule 11).

penalty.[205] But before allowing fee shifting, Congress specifically required the federal court to actually find a violation of Rule 11.[206] This aspect of substantive federal securities law almost certainly conflicts with automatic and one-sided fee shifting that leaves no role for judicial review.[207]

Moreover, both the Securities Act of 1933 and the Exchange Act of 1934 preempt provisions that cause persons to "waive compliance" with the requirements of these acts.[208] Whether or not a fee-shifting bylaw is a means to "waive compliance" with federal law is, of course, a matter of perspective. But to the extent that fee-shifting bylaws will effectively insulate directors from liability for their duty of candor and related disclosure obligations while private litigation under the federal securities laws is a well-established component of our overall disclosure law framework,[209] a failure to correct the effects of *ATP* in the public company context at least raises a credible question of preemption or inconsistency with the federal scheme.[210]

Analogizing fee shifting to a *de facto* form of indemnification for any misconduct—including knowing misconduct—the preemption question tilts against Delaware.[211] Indeed, it has long been accepted under federal law and Delaware law that intentional fraud cannot be indemnified as a matter of public policy.[212]

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[205] *See id.*

[206] *See id.* at § 78u-4(c)(3)(B) (requiring a violation of Rule 11(b)).

[207] *See* John C. Coffee, Jr., *"Loser Pays" and Federal Preemption*, SEC. LITIG., June 2015, at 2, 3, *archived at* http://perma.cc/3TBK-6UVN (discussing potential federal preemption of one-sided fee shifting and how it frustrates the PSLRA).

[208] *See* 15 U.S.C. § 78cc(a) ("Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder . . . shall be void.").

[209] *Basic* Inc. *v. Levinson*, 485 U.S. 224, 230-31 (1988) ("Pursuant to its authority under § 10(b) of the 1934 Act, 15 U.S.C. § 78j, the Securities and Exchange Commission promulgated Rule 10b-5. Judicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of § 10(b) and Rule 10b-5, and constitutes an essential tool for enforcement of the 1934 Act's requirements."); *Halliburton Co. v. Erica P. John Fund, Inc*., 134 S. Ct. 2398, 2407 (2014) ("[W]e have long recognized an implied private cause of action to enforce the provision [§ 10(b)] and its implementing regulation [Rule 10b-5].").

[210] *See* Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 J. L. & CONTEMP. PROBS. 215, 242 (1999).

[211] *See* Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1289 (2d Cir. 1969), *cert. denied*, 90 S. Ct. 913 (1970) (rejecting indemnification for an underwriter's knowing misrepresentations).

[212] *See id.* at 1288; Abry Partners V, LP v. F&W Acquisition LLC, 891 A.2d 1032, 1057 (Del. Ch. 2006).

In sum, to the extent fee-shifting provisions establish waiver of compliance with the federal securities laws, and an end run around the prohibition on indemnification for intentional torts, serious questions of preemption and validity arise. If Delaware law suddenly allows roughly half the public companies in America to override these critical components of federal securities laws by adopting fee-shifting bylaws, there is an increased chance the SEC and Congress will preempt Delaware law. Affirmative corrective action by the Delaware legislature heads off these serious issues.

V. DISTINGUISHING THE BABY FROM THE BATHWATER: UNDERMINING STOCKHOLDERS' RIGHT TO SUE IS HARMFUL AND UNNECESSARY

A. *Representative Litigation Provides Significant Benefits to Investors and Corporations Alike*

"So what?" readers of this Article may be asking themselves. "Who cares if representative stockholder litigation goes by the wayside?"

Everyone should care. Whatever problems exist in the stockholder litigation field, stockholders should never be stopped from pursuing credible claims for board misconduct, and society will be far worse off if stockholders are blocked from doing so.

Meritorious stockholder litigation can not only compensate aggrieved investors with a significant monetary recovery, but it also can serve as a deterrent to corporate executives who may have to contribute to the compensation and who want to avoid the "shaming effect" of adverse judicial rulings.[213] Smart litigation also elicits judicial guidance regarding the propriety of corporate practices, thus providing boards and their legal and financial advisors acting in good faith critical information about how to conduct themselves when making critically important decisions affecting the corporation and its stockholders.[214] In other

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[213] Justice Randy Holland touched upon this point during a speech in September 2015 at Delaware Law School, mentioning that one of the forces that constrains directors to comply with their fiduciary duties is the self-conscious need to preserve their reputations and avoid the embarrassment that litigation can bring. Justice Randy J. Holland, Speech for the Ruby R. Vale Distinguished Speaker Series, Delaware Fiduciary Duties: Case Dispositive Pre-Trial Motions (Sept. 29, 2015); *see also* Martin Petrin, *Assessing Delaware's Oversight Jurisprudence: A Policy and Theory Perspective*, 5 VA. L. & BUS. REV. 433, 461 (2011) ("Deterrence is traditionally one of the principal reasons for allowing shareholders to sue directors for fiduciary breaches."); James D. Cox, *The Social Meaning of Shareholder Suits*, 65 BROOK. L. REV. 3, 27 (1999) ("[S]ocially desirable inhibitions exist that contribute to shareholder suits serving a valuable deterrent to misbehavior by corporate managers.").

[214] *See* Donald F. Parsons, Jr. & Jason S. Tyler, *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, 70 WASH. & LEE L.

words, smart stockholder litigation not only remedies wrongs from the past, but it creates value-enhancing benefits for the future.[215]

Stockholder lawsuits often obtain monetary recovery or equitable relief for breaches of fiduciary duty or securities law violations that would not otherwise be available to aggrieved stockholders.[216] There are numerous examples of stockholders prosecuting breach of fiduciary duty claims and achieving meaningful economic or governance-based benefits for stockholders.[217] *In re Southern Peru Copper Corporation*

REV. 473, 484-85 (2013) (describing rapid adoption of revised merger agreement language by Delaware corporations and their attorneys following successful stockholder suit); William Savitt, *The Genius of the Modern Chancery System*, 2012 COLUM. BUS. L. REV. 570, 588-89 (noting that the Delaware Court of Chancery often provides important guidance on uncertain, but vital areas of corporate law).

[215]*See generally* Cox, *supra* note 213, at 7-8 (explaining that stockholder litigation provides compensation for past wrongs and deterrence of future behavior, and that "[m]ost of the content of the fiduciary obligations of officers, directors and controlling shareholders . . . is established through shareholder suits"); Parsons & Tyler, *supra* note 214, at 478 ("The plethora of [shareholder representative] cases has brought into sharper focus the civil procedure of shareholder representative actions. The results may affect how lead plaintiffs, their counsel, defense counsel, and courts in multiple jurisdictions can best handle such litigation . . . and ensure that it effectively serves the purposes for which representative forms of shareholder litigation were created.").

[216]*See infra* note 217 and accompanying text (listing cases in which stockholder lawsuits resulted in monetary or equitable relief for breaches of fiduciary duties or securities law violations).

[217]*See In re* S. Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761, 819 (Del. Ch. 2011), *aff'd sub nom*. Ams. Mining Corp. v. Theriault, 51 A.3d 1213 (Del. 2012) (merger litigation resulting in $1.347 billion in damages); *see also* Opinion Letter at 4, *In re* Jefferies Grp., Inc. S'holders Litig., C.A. No. 8059-CB (Del. Ch. June 5, 2015) (discussing formal approval of a $70 million settlement that would be paid directly to the former target's stockholders); *In re* Rural/Metro Corp. S'holder Litig., 102 A.3d 205, 263 (Del. Ch. 2014) (awarding $75.7 million to stockholders in a lawsuit stemming from a company buyout); Notice of Proposed Settlement & Settlement Hearing at 6, *In re* News Corp. S'holder Derivative Litig., 2013 WL 3231515 (Del. Ch. June 26, 2013) (C.A. No. 6285-VCN) (discussing the approval of a $139 million settlement of stockholders' claims that the company's managers turned a blind eye to illegal conduct at the company); Stipulation and Agreement of Settlement, Compromise & Release at 18, *In re* Freeport-McMoRan Copper & Gold Inc. Derivative Litig., 2013 WL 616296 (Del. Ch. Feb. 14, 2013) (No. 8145-VCN) (approving a $137.5 million settlement to be paid to stockholders as a special dividend); Stipulation and Agreement of Compromise and Settlement at 8, *In re* Delphi Fin. Grp. S'holder Litig., 2012 WL 729232 (Del. Ch. Mar. 6, 2012) (C.A. No. 7144-VCG), 2012 WL 1802570 (approving settlement under which merger target's controlling stockholder to return $49 million in extra merger consideration received from the company's buyer); Stipulation and Agreement of Settlement at 9-10, *In re* El Paso Corp. S'holder Litig., 41 A.3d 432 (Del. Ch. 2012) (No. 6949-CS), 2012 WL 3893553 (approving a $110 million settlement between the target company and its stockholders who sought to block the sale of the company's pipeline business to Kinder Morgan for $21.1 billion, citing potential conflicts of interest); Stipulation and Agreement of Compromise and Settlement at 17, *In re* Del Monte Foods Co. S'holder Litig., 25 A.3d 813 (Del. Ch. 2011) (No. 6027-VCL), 2011 WL 4802848 (approving $89.4 million settlement of stockholder claims of flawed sale process of the target company).

Shareholder Derivative Litigation,[218] *In re Del Monte Foods Company Shareholder Litigation*,[219] *In re El Paso Corporation Shareholder Litigation*,[220] and *In re Activision Blizzard, Inc. Shareholder Litigation* ("*Vivendi-Activision*")[221] are illustrative of important monetary victories for stockholders and "teaching moments" for managers and directors.

In *Southern Peru*, the Court of Chancery issued a post-trial opinion ruling in October 2011 that the stockholder class was entitled to recover damages of $1.347 billion plus interest, which resulted in a payout of $2 billion, for breach of fiduciary duties in connection with an interested transaction.[222] This award, coming despite the existence of a special committee and other standard indicia of process, sent the clear message that lawyers had to be mindful that a deal process not be a simple "check-the-box" exercise that looks fair, but that it should actually be fair.[223] Indeed, besides the recovery for aggrieved investors, litigation also disciplines the conduct of directors and their advisors for the future.[224]

Since the favorable ruling in *Del Monte*, which resulted in a settlement of $89.4 million, investment banks have drastically cut back on their practice of providing "staple financing," in which they receive fees for advising a target board to sell, while they also receive fees for providing the buyer with the debt financing to complete the purchase.[225]

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[218]*In re S. Peru*, 52 A.3d at 819 (illustrating an landmark victory for stockholders that resulted in $1.347 billion in damages stemming from a claim for breach of fiduciary duties).

[219]Stipulation and Agreement of Compromise and Settlement at 17, *In re* Del Monte Foods Co. S'holder Litig., 25 A.3d 813 (approving $89.4 million settlement of stockholder claims of flawed sale process of the target company).

[220]Stipulation and Agreement of Settlement at 9-10, *In re* El Paso Corp. S'holder Litig., 41 A.3d 432 (Del. Ch. 2012) (No. 6949-CS), 2012 WL 3893553 (approving a $110 million settlement between the target company and its stockholders, who sought to block the sale of the company's pipeline business citing potential conflicts of interest).

[221]*In re* Activision Blizzard, Inc. S'holder Litig., 2015 WL 2438067, at *1, *15-16 (Del. Ch. May 21, 2015) (approving a settlement for $275 million and $72.5 million in attorney's fees from claims arising from a derivative suit alleging breach of fiduciary duties).

[222]*See In re S. Peru*, 52 A.3d at 819.

[223]*See id*. at 763-64, 797-98, 815.

[224]*See id*. at 800-801, 811, 819.

[225]Stipulation and Agreement of Compromise and Settlement at 17, *In re* Del Monte Foods Co. S'holder Litig., 25 A.3d 813 (Del. Ch. 2011) (No. 6027-VCL), 2011 WL 4802848 (approving $89.4 million settlement); *see* Michael J. de La Merced, *Del Monte and Barclays Settle Investor Lawsuit for $89.4 Million*, N.Y. TIMES DEALBOOK (Oct. 6, 2011, 1:16 PM), *archived at* http://perma.cc/PZ7M-Y6A8 (noting that banks have become hesitant to offer staple financing since the filing of the *Del Monte* lawsuit); Jeffrey McCracken, Cristina Alesci & Zachary R. Mider, *Barclays Leads LBO Financing Retreat After Del Monte Slap*, BLOOMBERG BUS. (Sept. 14, 2011, 12:01 AM), *archived at* http://perma.cc/268K-BXAG (noting that since the *Del Monte* opinion, no firm has offered staple financing for a buyout over $1 billion, and "[a]t least nine major investment banks, including Barclays, [had] reviewed their lending practices").

Besides providing a $110 million financial recovery, the plaintiffs in *El Paso* achieved a ruling that improved the way Wall Street banks review and uncover conflicts of interest with their advisory clients.[226] And, most recently, when the CEO of Activision conditioned his support for an otherwise stockholder-beneficial transaction with Vivendi on his obtaining massive side benefits, the parties were compelled to pay $275 million to resolve the matter on the eve of trial.[227] There are numerous other cases in which conflicted fiduciaries faced real consequences, providing valuable deterrents to repeat offenses by future boards.[228]

Consider also the growth and—hopefully, in light of recent rulings—litigation driven demise, of so-called "dead hand proxy put" provisions in corporate debt agreements.[229] These provisions automatically accelerate the repayment obligations in corporate loan agreements if a majority of the board is replaced by stockholders over the board's objection.[230] Without stockholder litigation, these provisions,

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[226]Stipulation and Agreement of Settlement at 9-10, *In re* El Paso Corp. S'holder Litig., 41 A.3d 432 (Del. Ch. 2012) (No. 6949-CS), 2012 WL 3893553 (discussing $110 million settlement); *see* Gina Chon & Anupreeta Das, *Goldman Reviewing Policies on Its Deal Makers' Conflicts*, WALL ST. J. (Mar. 16, 2012, 6:28 PM), http://online.wsj.com/articles/SB10001424052702304459804577285361058353548 (noting that Goldman Sachs, Barclays, Bank of America, and Citigroup were examining their processes for conflicts of interest in response to *El Paso*).

[227]*In re* Activision Blizzard, Inc. S'holder Litig., 2015 WL 2438067, at *1, *90 (Del. Ch. May 21, 2015) (approving a $275 settlement).

[228]*See, e.g.*, Jef Feeley & Phil Milford, *Xerox's $69 Million Settlement of ACS Suits Approved*, BLOOMBERG BUS. (Aug. 24, 2010, 1:29 PM), *archived at* http://perma.cc/T5YP-BX9P (stockholder class action resulting in settlement of $69 million, including $12.8 million personally paid by controlling stockholder); Stipulation and Agreement of Settlement with Certain Defendants at 3-4, 11-12, *In re* Delphi Corp. Sec., Derivative & "ERISA" Litig., 2007 WL 3120847 (E.D. Mich. 2007) (No. 05-md-1725) (approving $88.6 million settlement resulting from allegations of violations of Securities Exchange Act and misstatements regarding the companies financial condition); *In re* Rural/Metro Corp. S'holder Litig., 102 A.3d 205, 218-19, 263 (Del. Ch. 2014) (finding the Royal Bank of Canada's investment bank liable for approximately $76 million because it was conflicted, concealed its conflicts, and misled directors about company's value in order to quickly sell the company, resulting in an inadequate sale price for investors); *In re* Loral Space and Commc'ns Inc., 2008 WL 4293781, at *22, *31-32 (Del. Ch. Sept. 19, 2008) (holding that the dominant shareholder failed to satisfy its burden of proving the challenged transaction satisfied the entire fairness standard and equitably reforming securities purchase agreement that was central to the transaction).

[229]A "proxy put" provision is a provision in a company's debt agreement that defines the election of a majority of directors whose initial nomination arose from an actual or threatened proxy contest to be an event of default that triggers the lender's right to accelerate (*i.e.*, "put back") the debt. *See* F. William Reindel et al., *"Dead Hand Proxy Puts"—What You Need to Know*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 10, 2015), *archived at* http://perma.cc/4BAP-K5D2.

[230]*See* T. Brad Davey & Christopher N. Kelly, *Dead Hand Proxy 'Puts' Face Continued Scrutiny from Plaintiffs Bar*, BLOOMBERG BNA (June 12, 2015), *archived at*

which protect boards at the expense of the stockholder franchise, would become ubiquitous.[231] As a result of stockholder litigation however, courts have made clear that dead hand proxy puts improperly interfere with stockholder voting rights.[232]

In a 2009 ruling in *Amylin*, the Court of Chancery issued a stern warning to directors and banks that such provisions could be subject to legal challenge for breach of duty.[233] Notable to the *ATP* discussion, the *Amylin* plaintiff surely did not obtain "substantially all of the relief sought" in its complaint.[234] However, the temptation of directors to insulate themselves from being ousted proved too strong for boards to heed the court's stern warning, and they continued to put in place dead hand proxy puts.[235] In the recent *Healthways* litigation, the Court of Chancery made clear that boards are on notice of the *Amylin* decision and that stockholders now have viable claims for disloyalty and aiding and abetting breach of duty when boards and banks adopt "dead hand proxy puts" in debt agreements.[236] Though the process can be difficult, companies continue to use proxy puts, but the broad benefits for stockholders is clear.[237]

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http://perma.cc/329C-PSGP ("[A] proxy put provision makes a change of control through a proxy contest an event of default that accelerates all debt to be immediately due and payable.").

[231] *See generally* Yaron Nili, Pontiac General Employees Retirement System v. Healthways, Inc., HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 17, 2015), *archived at* http://perma.cc/X3AA-95FY (discussing shareholder litigation claims regarding dead hand "proxy put" provisions and suggesting that courts should closely scrutinize change of control put provisions).

[232] *See* San Antonio Fire & Police Pension Fund v. Amylin Pharm., Inc., 983 A.2d 304, 307 (Del. Ch. 2009) (noting that proxy put provisions "can operate as improper entrenchment devices that coerce stockholders into voting only for persons approved by the incumbent board to serve as continuing directors," the court construed the provision to allow the board to approve any person, "whether nominated by the board or a stockholder," as a continuing director, thus preventing an event of default under the provision).

[233] *Id*. at 315, 319 (cautioning that the board must be "especially solicitous to its duties both to the corporation and its stockholders" when negotiating rights that belong to the stockholder franchise).

[234] *See id.* at 319 (discussing which claims were granted and which claims were dismissed).

[235] *See* Davey & Kelly, *supra* note 230 ("These provisions are routinely included in credit agreements and indentures, and may have become even more prevalent in the wake of the current wave of stockholder activism.").

[236] *See* Transcript of Oral Argument at 80, Pontiac Gen. Emp. Ret. Sys. v. Healthways, C.A. No. 9789-VCL (Del. Ch. Oct. 14, 2014) ("There was ample precedent from this Court putting lenders on notice that these [proxy put] provisions were highly suspect and could potentially lead to a breach of duty on the part of the fiduciaries who were the counter-parties to a negotiation over the credit agreement.").

[237] *See* Davey & Kelly, *supra* note 230.

There are numerous other examples demonstrating the value of preserving the ability of stockholders to pursue claims to challenge corporate practices that may harm investor interests.[238] Thus, unless one's goal is to abolish accountability for corporate misconduct, any proposed solution for problematic practices in the stockholder litigation field requires an effort to fix identified problems without losing the value of the litigation process itself.

B. *A Proposed "Non-Nuclear" Method to Curtail Abusive Litigation*

When a doctor does not accurately diagnose a patient's symptoms, the doctor is more likely to recommend treatments that create worse problems than the symptoms themselves.[239] There is no point in treating a stomach virus with chemotherapy, and the chemotherapy does far more damage than the virus itself. We submit that fee shifting in response to problems in the stockholder litigation field is as misplaced as chemotherapy for the stomach virus.

Yet, as we criticize those who rationalize eliminating all forms of stockholder litigation by ignoring its benefits and overstating its detriments, we would be remiss to ignore that some stockholder litigation confers such minimal benefits that its costs should be an institutional concern.[240] As such, we try to further the discussion by identifying the

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[238] *See, e.g.*, Notice of Proposed Settlement of Class Action at 3-4, Minneapolis Firefighters' Relief Assoc. v. Ceridian Corp., C.A. No. 2996-CC (Del. Ch. Dec. 20, 2007) (stockholder class action resulting in settlement eliminating standstill agreement and other merger agreement provisions limiting possibility of higher bidder emerging); Plaintiffs' Motion for Preliminary Injunction and the Court's Ruling at 228-29, 231, 233-34, *In re* Ancestry.com Inc. S'holder Litig., Consol. C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012) (granting preliminary injunction, enjoining merger pending disclosure of "don't ask don't waive" standstill agreements, and suggesting that failure to waive standstills prior to judicial review would support substantive injunctive relief). For an example of an unsuccessful stockholder challenge that nevertheless informs advisors of where courts will draw the line, see Edward B. Micheletti & Sarah T. Runnells, *The Rise and (Apparent) Fall of the Top-Up Option "Appraisal Dilution" Claim,* M&A LAW., Jan. 2011, at 9, 12 n.3, *archived at* https://perma.cc/LAC3-Q8BD (citing *In re Gateway Shareholders Litigation* and noting that the "Top-Up options at issue were 'certainly not preclusive or coercive'").

[239] *See, e.g.*, Sandra G. Goodman, *Misdiagnosis is More Common than Drug Errors or Wrong-Site Surgery*, WASH. POST (May 6, 2013), *archived at* https://perma.cc/LDE7-ZWZF; Marty Makary, *How to Stop Hospitals From Killing Us*, WALL ST. J. (Sept. 21, 2012), http://www.wsj.com/articles/SB10000872396390444620104578008263334441352.

[240] *See* Teleconference on Plaintiff's Motion to Expedite and the Court's Ruling at 11, Stourbridge Invs. LLC. v. Bersoff, C.A. No. 7300-VCL (Del. Ch. Mar 13, 2012) ("[T]he increase in disclosure-only settlements is troubling. Disclosure claims can be settled cheaply and easily, creating a cycle of supplementation that confers minimal, if any, benefits on the class.")

real problems in the field and proposing solutions. Consistent with the agency-based focus of the corporate form itself, a real solution should focus on limiting the incentives to pursue and settle weak claims in return for the release of good claims, while still permitting stockholders to bringing viable suits.

What are these "worthless lawsuits" anyway? Can we separate the wheat from the chaff? The answer is yes. While some strong suits will fail for reasons beyond the plaintiffs' or counsels' control, and some seemingly meritless suits at the time of filing can occasionally uncover a corrupt process, a fair proxy for identifying weak claims are cases that result in a settlement providing only immaterial supplemental corporate disclosures.[241] Although we believe that material disclosures can create substantial benefits for stockholders, we do not quibble with the notion that many lawsuits are settled for disclosures that are not material for stockholders while giving broad releases to defendants and paying the lawyers for all parties.[242]

The hard question is: how can a legal system simultaneously encourage the policing of agents who manage and oversee large swaths of the nation's assets and productivity, while reducing the incentives to pursue and settle lawsuits that will result, at best, in immaterial supplemental disclosures? The answer, we believe, lies in establishing a two-prong approval standard for settlement agreements that reduces the incentives for shareholder plaintiffs to pursue claims that will likely result in immaterial disclosures and for corporate defendants to settle such weak claims to obtain a broad release for claims that have not been presented or vetted. Notably, this simple proposal flows directly from existing Delaware precedent, including Vice Chancellor Laster's application of the materiality standard in *In re Sauer-Danfoss*, and then-Chancellor Strine's rejection of a settlement in *In re Medicis*.[243]

Delaware law, like other states' law, generally favors the voluntary resolution of disputes, including "disclosure-only" settlements.[244] Many deal suits are settled in the initial stages of litigation.[245] As a result,

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[241] *See generally* Fisch, Griffith & Davidoff Solomon, *supra* note 4, at 611-12.

[242] *See id.* at 572; *see also* Joel Edan Friedlander, *How* Rural/Metro *Exposes the Systemic Problem of Disclosure Settlements*, 40 DEL. J. CORP. L. (forthcoming 2016).

[243] *See In re* Sauer-Danfoss Inc. S'holders Litig., 65 A.3d 1116, 1127 (Del. Ch. 2011); Transcript of Record, *In re* Medicis Pharm. Corp. S'holders Litig., 2014 WL 1614336, at *7, *9 (Del. Ch. Feb. 26, 2014).

[244] *See* Crescent/Mach I Partners, L.P. v. Dr Pepper Bottling Co. of Tex., 962 A.2d 205, 208 (Del. 2008) ("Delaware law favors settlements and treats them as binding contracts."); Rome v. Archer, 197 A.2d 49, 53 (Del. 1964) ("The law, of course, favors the voluntary settlement of contested issues.").

[245] *See* OLGA KOUMRIAN, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2014 M&A LITIGATION 4

courts in Delaware and elsewhere have until recently hesitated in scrutinizing "disclosure-only" settlements and the scope of the proposed release.[246] Instead, courts have begun to dramatically reduce fee awards for stockholder plaintiffs' counsel who presented "disclosure-only" settlements.[247]

Notably, in several recent cases, the Court of Chancery seemed to signal application of both a materiality-based standard and concerns about the breadth of releases.[248] In the spring of 2011, the Court of Chancery's opinion in *Sauer-Danfoss* signaled the beginning of a new era in regulating proposed settlements.[249] In that case, Vice Chancellor Laster indicated that "disclosure-only" settlements that provide no meaningful new information to stockholders would not be approved.[250] Vice Chancellor Laster's opinion in *Sauer-Danfoss* thus started a trend (in Delaware and other jurisdictions, including New York) of more vigorous judicial scrutiny of disclosure-only settlements, leading to the rejection of unmerited settlements and lowering fee awards.[251]

(2015), *archived at* https://perma.cc/H9CM-UXMF (noting that "the majority of the resolved 2014 M&A litigation settled").

[246] *See Disclosure-Only Settlements Face Continued Scrutiny in Delaware*, CLIENT ALERT (King & Spalding LLP), Sept. 23, 2015, at 1, *archived at* http://perma.cc/MR5Y-QDRM.

[247] *See, e.g.*, Matthew D. Cain & Stephen Davidoff Solomon, *Takeover Litigation in 2013* 5 (Ohio St. Univ. Moritz College of Law, Working Paper No. 236, 2014), *archived at* http://perma.cc/G6YM-AU2V ("Following the general decline in average attorneys' fees across states after 2011, Delaware also awarded lower average attorneys' fees of $450 million in 2013 compared to $650 million in 2012. This average also falls below the general sample average of $694 for all states."). Settling cases on a disclosure-only basis is not just a reputational harm, but is also economically unviable. For a discussion on how some firms deliberately under-prosecute claims to ensure that a modest fee award is still profitable, see *In re* Revlon, Inc. S'holder Litig., 990 A.2d 940, 945-46 (Del. Ch. 2010) (labeling this discussion as "No One Litigates Anything" and explaining that "firms who are early filers are often early settlers").

[248] *See* Transcript of Record, *In re Medicis*, 2014 WL 1614336, at *7, *9 (declining to approve a "disclosure-only" settlement because the supplemental disclosures did not support the release of claims being given by the stockholder class); *In re* Rural Metro Corp. S'holders Litig., 88 A.3d 54 (Del. Ch. 2014) (rejecting a "disclosure-only" settlement as inadequate).

[249] *In re* Sauer-Danfoss Inc. S'holders Litig., 65 A.3d 1116, 1137 (Del. Ch. 2011).

[250] *Id.* at 1137, 1140-41.

[251] *See, e.g.*, Transcript of Record, *In re* Talbots, Inc. S'holders Litig., Cons. C.A. No. 7513-CS (Del. Ch. Dec. 16, 2013) (emphasizing that materiality was key to whether the disclosure supported a fee award); *In re* Coventry Health Care, Inc. S'holders Litig., C.A. No. 7905-CS (Del. Ch. Aug. 29, 2013) (ORDER); Transcript of Record at *1, *In re* Transatlantic Holdings Inc. S'holders Litig., C.A. No. 6574-CS, 2013 WL 1191738, at *1 (Del. Ch. Feb. 28, 2013) (rejecting settlement and denying fee application, expressing serious doubts about the usefulness of the agreed upon supplemental disclosures); Transcript of Record, *In re* Theragenics Corp. S'holders Litig., C.A. No. 8790-VCL, 2014 WL 1813792, at *1 (Del. Ch. May 5, 2014) (rejecting disclosure-only settlement, finding that several possible instances of

We believe courts should be vigilant, not only of proposed settlements that offer no material benefits to stockholders, but also of settlements that "sell" a release where there has been insufficient vetting of the record.[252] Two recent examples highlight the institutional danger of issuing broad releases without sufficient inquiry. In 2008, Bank of America announced the acquisition of Merrill Lynch in a deal requiring the vote of the buyer's stockholders.[253] While lawyers challenged the deal on behalf of Merrill Lynch stockholders (a dubious proposition considering that Merrill was facing bankruptcy absent a deal),[254] nobody brought suit on behalf of Bank of America stockholders. If such a suit was filed, and a "disclosure-only" settlement was reached, the release included in such a settlement could have insulated Bank of America and its senior executives for very serious proxy violations.[255] The federal securities class action brought after those losses and the resulting government bailout package were disclosed led to a $2.4 billion settlement.[256] Delaware was arguably lucky that nobody filed suit on behalf of Bank of America's stockholders and settled before closing in exchange for a broad release and modest disclosures.

In 2012, the Delaware Court of Chancery was presented with a proposed settlement of stockholder claims arising from the acquisition of

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wrongdoing had been left unexplored and that the benefits highlighted by counsel were illusory); *In re SS & C Techs., Inc. S'holders Litig.,* 911 A.2d 816*, 820-21 (Del. Ch. 2006) (refusing to approve disclosure-only settlement, finding that the potential claims belonging to the class were adequately or diligently investigated or pursued); City Trading Fund v. Nye, 46 N.Y. Misc. 3d 1206(A), 2015 WL 93894, at *22 (N.Y. App. Div. Jan. 7, 2015)* (rejecting settlement, finding that proposed supplemental disclosures that defendants would provide were immaterial as a matter of law); Gordon v. Verizon Commc'ns, Inc., 2014 WL 725021, at *3 (N.Y. Sup. Ct. Dec. 19, 2014) (rejecting settlement and stating that "[m]erely providing additional information—unless the additional information offers a contrary perspective on what has previously been disclosed—does not constitute material disclosure" and that "[e]ven when the additional information goes to the sensitive details of a financial advisor's fairness analysis, the information becomes material only when it corrects a valuation parameter or uncovers a conflict").

[252] *See In re* Hewlett-Packard Co. S'holder Derivative Litig., 2014 WL 7240144, at *1 (N.D. Cal. Dec. 19, 2014) (rejecting attempt for a settlement for a third time, explaining that the proposed settlement may not have been fair for stockholders because it would have released the defendants from liability for events unrelated to the present litigation).

[253] *See* Joseph E. Bachelder III, *Merrill Bonuses Raised Issues in Merger with Bank of America*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 7, 2009), *archived at* http://perma.cc/H5TP-G8CV.

[254] *See id.*

[255] *See id.*

[256] *See* Dan Fitzpatrick, Christian Berthelsen & Robin Sidel, *BofA Takes New Crisis-Era Hit*, WALL ST. J. (Sept. 29, 2012), http://www.wsj.com/articles/SB10000872396390443843904578024110468736042.

Rural/Metro.[257] After one of the stockholder plaintiffs objected to the proposed settlement, the court rejected the settlement and appointed new counsel.[258] In 2014, the court awarded $76 million, and established important legal precedents.[259] In late 2015, the Delaware Supreme Court upheld that ruling in a scholarly opinion that struck a much-needed balance in reconciling many of the most significant fiduciary duty-related rulings of the previous several years.[260] Most important, one may never know how many finally approved settlements provided broad releases for no value, only to later preclude meritorious claims.

Under the first prong of our proposed test, stockholder plaintiffs would have the burden to demonstrate that the supplemental disclosures actually meet the legal test of materiality.[261] If a disclosure is the only consideration for a settlement, then the court should not approve the deal unless the disclosure is actually determined to be material. If the disclosures at issue do not meet the legal test of materiality, then stockholders get no consideration at all. We believe that despite the judiciary's disinclination to weigh the merits of claim in the context of a settlement, courts routinely make findings with respect to materiality outside the settlement context and deciding the materiality of a disclosure will be supported by extensive precedent and come naturally.[262]

We believe the application of an actual materiality standard will eliminate the inherently collusive nature of the settlement process. This is because few advisors of corporate defendants will rush to argue that immaterial disclosures meet the applicable test because such precedents will then be used against their clients outside the settlement context.[263] Many players in the M&A markets are "repeat players" and many more of the lawyers in the field fit that description.[264] Thus, there should be an institutional and strategic hesitance to try selling the Court the proverbial bill of goods just to get a settlement in a single case knowing that it will

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[257] *See* Stipulation and Agreement of Compromise and Settlement, *In re* Rural/Metro Corp. S'holder Litig., 2013 WL 4027958 (Del. Ch. Aug. 4, 2013).

[258] *See In re* Rural Metro Corp. S'holders Litig., 88 A.3d 54, 79 (Del. Ch. 2014).

[259] *In re* Rural/Metro S'holders Litig., 102 A.3d 205, 263 (Del. Ch. 2014).

[260] RBC Capital Mkts., LLC v. Jervis, __ A.3d __, 2015 WL 7721882 (Del. Nov. 30, 2015).

[261] *See generally In re* Sauer-Danfoss Inc. S'holders Litig., 65 A.3d 1116, 1127 (Del. Ch. 2011) (implicitly placing the burden of showing materiality on the plaintiff, for "if a complaint does not identify a material misstatement or omission, it cannot survive a motion to dismiss and therefore is not meritorious").

[262] *See id.* at 1127-28.

[263] *See id.*

[264] *See, e.g.*, William W. Bratton & Michael L. Wachter, *Bankers and* Chancellors, 93 TEX. L. REV. 1, 72 (2014) ("M&A is not a world of randomly-selected, one-time buyers and sellers.").

be used to argue for an injunction or denial of a motion to dismiss in the future. Thus, turning settlement approval rulings into binding precedent on materiality should make it less likely that defendants support settlements on disclosures that are really immaterial.

The second prong of the test would require a demonstration that the proposed release is directly related to the claims pursued in the litigation and proportionate to the supplemental disclosures, subject to judicial discretion to broaden the release for "good cause." A release on a disclosure only settlement should only cover the issue of disclosures, unless defendants convince the court that the nature of the litigation and the record before the court warrants a broader release. The presumption is against a broad release and the burden is on defendants to show "good cause" for expanding the release.[265]

By linking the approval of disclosure-only settlements to an actual and material benefit to stockholder interests while insisting that the scope of the release is limited to the actual benefit conferred, the judicial system would substantially reduce the incentive for stockholder plaintiffs' counsel to file suit with the expectation of settling for disclosures, and the incentive for defendants to "buy" a release with immaterial disclosures that provide no material benefit to stockholders.[266] This change, taken alone, significantly reduces the incentives to pursue or settle deal litigation that provides no real benefits to stockholders, while imposing greater scrutiny on counsel for both plaintiffs and defendants in representative litigation.

VI. CONCLUSION

This Article described the origins of the *ATP* decision and the profoundly harmful implications if that ruling is extended to public stockholder corporations. We believe extending the logic of the *ATP* decision to public corporations would eviscerate substantive stockholder property rights, significantly undermine director accountability for wrongdoing, and wreak doctrinal havoc. Moreover, we have described an alternative approach to addressing meritless representative litigation

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[265] *See* Settlement Hearing and Rulings of the Court, *In re* Aruba Networks Inc. S'holders Litig., Consol. C.A. No. 10765-VCL (Del. Ch. July 17, 2015), at *63, *66 (rebuking the attorneys for "weak" discovery record and stating that "the broad release agreed upon by the parties could not be justified by the record and stated that plaintiffs had failed to pursue legitimate claims, instead settling for a 'release for nothing'").

[266] *See generally* William D. Savitt, *Courts Are Rejecting Disclosure-Only Settlements: Rulings Show Disfavor for Lawsuits Filed After a Company's Announcement of a Proposed Merger*, NAT'L. L.J. (Aug. 24, 2015), *archived at* http://perma.cc/AC4F-9A22 (discussing a "grossly immaterial" disclosure settlement).

by requiring plaintiffs to show that a disclosure only settlement provides material benefits to the class and defendants that the scope of the release is appropriately tailored to the benefit of the disclosures obtained. While the judiciary can adopt a properly tailored solution to frivolous or "disclosure-only" fiduciary litigation, the Pandora's Box that was opened with *ATP* required a strong legislative fix. Section 102(f) of the DGCL, codified on June 24, 2015,[267] solved the *ATP* issue, but attacks on core stockholder property rights remain in Delaware and elsewhere.

VII. EPILOGUE

In the months since this Article was submitted for publication in the *Delaware Journal of Corporate Law*, several significant developments have proven the ability of the judiciary to address and curtail the problem of frivolous stockholder litigation while preserving the meritorious type of suit. In a series of recent rulings, including *In re Trulia, Inc. Stockholder Litigation* ("*Trulia*"),[268] *In re Riverbed Technology Inc. Shareholders Litigation*,[269] *In re Aruba Networks, Inc. Shareholder Litigation*,[270] and *Acevedo v. Aeroflex Holding Corp.*,[271] the Delaware Court of Chancery has either rejected or suggested future rejection of disclosure-only settlements. The court has effectively applied a variant of the test advocated in this Article, focusing on the actual materiality of the disclosures in some matters, focusing on the scope of the release in others, and at times balancing both key factors before deciding whether to approve a disclosure only settlement.

This is most directly reflected in *Trulia*, where Chancellor Bouchard refused to approve a disclosure-only settlement and stated such settlements would only be approved if the plaintiffs could show the disclosures were material and beneficial to stockholders and the release was narrowly tailored to address the specific claims in the litigation.[272]

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[267] Section 102(f) provides the following: "The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title." DEL. CODE. tit. 8, § 102(f), adopted as S.B. 75, 2015 Leg., 148th Gen. Assemb., Reg. Sess. (Del. 2015).

[268] *In re* Trulia, Inc. Stockholder Litig., C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016).

[269] *In re* Riverbed Tech. Stockholders Litig., C.A. No. 10484-VCG (Del. Ch. Sept. 17, 2015).

[270] *In re* Aruba Networks, Inc. Stockholder Litig., C.A. No. 10765-VCL (Del. Ch. Oct. 9, 2015).

[271] Acevedo v. Aeroflex Holding Corp., C.A. No. 9730-VCL (Del. Ch. July 8, 2015) (Transcript).

[272] *See In re Trulia, Inc.*, C.A. No. 10020-CB.

Critically, the recent decisions from the Court of Chancery have had the desired effect. While over 90% of all merger transactions[273] from 2011 to 2015 faced litigation, since the Court of Chancery began to reject disclosure-only settlements in mid-2015, the rate of litigation challenging uncompleted transactions reportedly fell to approximately 30%.[274]

If the authors can offer a closing thought, it is that the core message of this Article is not to outline the path to eliminate all disclosure-only settlements. Rather, the core message of this Article is that preserving the "good" type of stockholder litigation has to be a paramount concern. With *ATP*, the pendulum swung too far in favor of insulating directors and officers from legal accountability, regardless of their conduct, and too far against the vindication of stockholder rights. The passage of Section 102(f) marked the pendulum coming back towards a balance. But the judiciary is the ultimate preserver of that balance. Any effort to focus and correct the flaws of the stockholder litigation system must also come with a fair assessment of its virtues.

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[273]This only includes merger transactions where (i) the target is a U.S. firm publicly traded on the NYSE, AMEX, or NASDAQ stock exchanges; (ii) the transaction size is at least $100 million; (iii) the offer price is at least $5 per share; (iv) a merger agreement was signed and publicly disclosed in a SEC filing; and (v) the transaction was completed by January 2, 2016.

[274]Matthew D. Cain & Steven Davidoff Solomon, Takeover Litigation in 2015 (Jan. 14, 2016) (unpublished manuscript), *available at* http://ssrn.com/abstract=2715890.