CORPORATE GOVERNANCE, COLLECTIVE ACTION AND CONTRACTUAL FREEDOM: JUSTIFYING DELAWARE'S NEW RESTRICTIONS ON PRIVATE ORDERING

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ABSTRACT

Prior to passage of the 2015 amendments to the Delaware General Corporation Law, fee-shifting and forum selection provisions seemed to offer Delaware corporations an easy way to escape a rising tide of multi-jurisdictional shareholder litigation. With the 2015 amendments, however, the Delaware legislature significantly restricted the ability of the state's corporations to adopt such provisions and, in doing so, repudiated a series of cases rejecting shareholder challenges to the incorporation of both fee-shifting and forum selection bylaws. Currently, Delaware corporations are prohibited from including fee-shifting provisions in their organizational documents; forum selection provisions are acceptable, but only if they allow shareholder litigation to proceed in Delaware. For a business-friendly jurisdiction that generally favors private ordering, this was an extraordinary step. Proposed explanations include interest group politics and the influence of the Delaware bar. At least one commentator has argued that the issues arising out of these provisions and the limitations on their use have exposed flaws with Delaware's contractual view of the corporation.

This Article takes a different approach to Delaware's new restrictions on private ordering. It focuses on the effect that fee-shifting and non-Delaware forum selection provisions would have on a variety benefits that result from having shareholder litigation involving Delaware corporations adjudicated in the Delaware courts. Because these benefits require a stream of disputes to be channeled into Delaware courts, their ongoing generation presents a collective action problem. It is possible to view Delaware's new limitations on private ordering as its solution. This is not to say that Delaware should have ignored the rapid increase in shareholder litigation and duplicative filings. Instead, that task has appropriately fallen to the Delaware courts, which have adopted a new, more skeptical stance toward the settlement practices that drove the explosion in shareholder litigation. Together, Delaware's new legislation and its new approach to the settlement of shareholder litigation represent an appropriate balance

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between the need to address the increase in frivolous, multi-jurisdictional filings and the importance of maintaining the benefits that arise from the adjudication of shareholder disputes in Delaware courts.

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I. INTRODUCTION

During the first half of the 2010s, publicly traded corporations experienced an explosion of shareholder litigation, and in particular, litigation challenging mergers and acquisitions. In 2014, 93 percent of public company mergers and acquisitions valued over $100 million were the subject of litigation.[1] Ninety-six percent of deals valued at $1 billion or more were challenged.[2] Calendar years 2012 and 2013 saw similar results.[3] Oftentimes, claims were filed almost immediately after the first public announcement of the transaction. And, in many situations, multiple plaintiffs' firms, all hungry for a slice of an eventual fee award, filed duplicative actions in multiple fora. Usually, these actions were settled quickly, often without any monetary compensation for shareholders. In a typical disclosure-only settlement, defendants would agree to provide additional disclosures in exchange for a broad release, and the plaintiffs' attorneys would receive a fee award as a result of securing this "corporate benefit."[4]

Prior to June 2015, some Delaware corporations began to experiment with so-called "private-ordering solutions" to escape these abusive practices. The general consensus among scholars, practitioners, and judges was that Delaware corporations could deter frivolous filings and attempt to protect themselves from multi-jurisdictional filings by amending their organizational documents to include a fee-shifting provision (requiring shareholder plaintiffs to pay their own and the defendants' fees if not substantially successful on the merits) and a forum-selection provision (limiting the jurisdiction(s) in which suits can proceed).[5] After a series of Delaware opinions upheld the addition of

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[1] CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2014 M&A LITIGATION (2014), http://tinyurl.com/Corner-2014.

[2] *Id.*

[3] 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, 558-59 (2015) (noting that "in 2012, 93% of deals over $100 million and 96% of deals over $500 million were challenged" and that in 2013, "97.5% of deals over $100 million were challenged").

[4] For explanations of the state of merger-related litigation by members of the Delaware judiciary, *see In re* Trulia, Inc. Stockholders Litig., 129 A.3d 884, 887 (Del. Ch. 2016); *see also In re* Riverbed Tech., Inc. Stockholders Litig, 2015 WL 5458041, at *1 (Del Ch. Sept. 17, 2015).

[5] Valian Afshar, Note, *A Blended Approach to Reducing the Costs of Shareholder Litigation*, 113 MICH. L. REV. 315, 318-19 (2014).

such provisions to corporate bylaws,[6] they appeared to be an optimal way of avoiding the quagmire of abusive litigation. Implementation required no judicial, regulatory, or legislative action; and, as long as a corporation's charter authorized the board to adopt bylaws unilaterally, it would not even require a shareholder vote.

Despite the potential of these private ordering solutions to help Delaware corporations protect themselves against abusive litigation, the Delaware legislature amended the Delaware General Corporation Law ("DGCL") in 2015 to restrict their implementation.[7] Fee-shifting provisions are now prohibited for stock corporations. Forum selection provisions are allowed, but only if they do not attempt to prohibit the filing of litigation in Delaware. For a jurisdiction that values contractual freedom and private ordering in the corporate law context, these new mandatory rules are a curious development. This is especially the case when one considers that, in passing these restrictions, the Delaware legislature repudiated widely acclaimed opinions in which both types of provisions were upheld.[8] One prominent commentator has denounced this legislation as bad public policy that will leave Delaware corporations vulnerable to litigation and could possibly lead to a decrease in the number of Delaware incorporations;[9] another views this back-and-forth as proof that Delaware's contractual approach to corporate law has been flawed all along.[10]

However, something appears to be working. Recent data shows that shareholder litigation has decreased dramatically.[11] Soon after the

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[6]ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 554 (Del. 2014) (upholding implementation of fee-shifting bylaw); City of Providence v. First Citizens Bancshares, Inc., 99 A.3d 229, 229 (Del. Ch. 2014) (upholding forum-selection bylaw designating courts in North Carolina as the exclusive forum for shareholder litigation); Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 934 (Del. Ch. 2013) (upholding forum-selection bylaw designating courts in Delaware as the exclusive forum for shareholder litigation).

[7]2015 Del. Laws, c. 40 (S.B. 75).

[8]*See infra* Part II.B.

[9]Stephen M. Bainbridge, *Fee Shifting: Delaware's Self-Inflicted Wound,* 40 DEL. J. CORP. L. 851 (2016).

[10]James D. Cox, *Corporate Law and the Limits of Private Ordering,* 93 WASH. U. L. REV. 257, 291-92 (2015-2016).

[11]*See* CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2015 AND 1H 2016 M&A LITIGATION 1 (2016), https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-2016 ("In 2015 and the first half of 2016, 84 and 64 percent of M&A deals valued over $100 million were litigated, respectively. This is the first time since 2009 that the rate has dipped under 90 percent."); Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2015* (January 14, 2016), available at http://tinyurl.com/2715890 (finding that the filing rate for completed and uncompleted transactions has fallen to 21.4% and that the percentage of transactions subject to multi-jurisdictional litigation has also fallen); Gregory A. Markel et al., *Delaware Judges Have Been Heard,* LAW360 (Feb. 2, 2016) ("[T]he number of

legislation prohibiting fee-shifting and non-Delaware forum selection provisions was passed, the Delaware Chancery Court began to crack down on the peppercorn settlements. Recently, the Chancery Court has made it clear that it is no longer willing to approve disclosure only settlements and the fee awards attached to them.[12] The age of the peppercorn settlement appears to be over, and with it, the end of much abusive shareholder litigation. By adopting a Delaware forum selection provision (the only private-ordering solution that is allowed), Delaware corporations are now equipped to force plaintiffs' attorneys to file actions in a single forum whose judges are approaching disclosure only settlements and fee awards with increased skepticism. Once a corporation adopts a Delaware forum selection provision, the plaintiffs' bar will have a difficult time escaping the consequences of this new case law by filing claims elsewhere.[13]

This Article explores Delaware's new restrictions on private ordering and, in particular, their significance for a jurisdiction with a strong policy in favor of contractual freedom. While there can be no doubt that the political clout of the Delaware bar played a significant role in passage of this legislation, this does not automatically mean that restrictions on fee-shifting and non-Delaware forum selection provisions are bad policy; nor does the presence of new mandatory rules establish that Delaware's contractual approach to corporate law is unsatisfactory or inaccurate. Instead, as I argue in this Article, there are strong justifications for the new limitations on fee-shifting and forum selection provisions, even under a contractual, pro-private ordering view of corporate law.

As demonstrated below, shareholder litigation results in important benefits for Delaware corporations. By generating publicly available information relating to both the state of Delaware law and the underlying facts and circumstances that gave rise to the disputes that are litigated, shareholder litigation plays a crucial role in making Delaware's current system of corporate governance possible. With this information, boards and their advisors are better able to plan future transactions, and they enjoy increased flexibility and freedom in doing so. Availability of this

lawsuits filed challenging public mergers dropped from 78 percent in the first nine months of 2015 to just 34 percent in the final quarter of 2015.").

[12] *See, e.g.*, *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 884 (Del. Ch. 2016).

[13] The success of this strategy depends, of course, on the willingness of other state courts to enforce Delaware exclusive forum selection provisions. Recently decided cases seem to indicate that other judges in other states are willing to enforce these provisions. *See, e.g.*, Hemg Inc. v. Aspen Univ., No. 650457/13, 2013 WL 5958388, at *3 (N.Y. Sup. Ct. Nov. 4, 2013); *See also* George S. Geis, *Ex-Ante Corporate Governance*, 14 J. Corp. L. (forthcoming). In one case from the Northern District of California, the court refused to enforce a forum selection bylaw. *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011).

information allows advisors to build valuable experience and expertise and to develop business practices that are tested in litigation. Production of this information also assists Delaware's longstanding practice of updating its corporate code regularly in response to the needs of the business community. Generation of factual information reduces shareholders' monitoring costs and facilitates other, non-legal accountability mechanisms (*e.g.*, reputational sanctions) that require factual information as an input. As a result, shareholders have less need for extensive, *ex ante* limitations on the conduct of both the corporation and its management or other more intrusive governance arrangements.

Difficulties arise, however, because in any given litigation, the costs are borne by the parties to the litigation, but the information it generates benefits a much larger group, many of which do not even exist yet. Because of this dynamic, fee-shifting and non-Delaware forum selection provisions present a collective action problem. While any individual Delaware corporation has an incentive to reduce or eliminate the individual costs of being involved in litigation through adoption of these provisions, adoption on a widespread basis would impair the benefits that are valuable to the entire population of Delaware corporations. Corporations that attempt to opt-out of Delaware litigation (while continuing to benefit from the information generated by litigation involving other corporations) are attempting to free-ride on those that continue to have their shareholder disputes adjudicated in Delaware courts.

In Part II, I discuss the shareholder litigation crisis and the rise of fee-shifting and forum selection provisions as potential solutions to the crisis. Part I also includes an analysis of Delaware's new restrictions on fee-shifting and forum selection provisions. In Part III, I explore the benefits that accrue to Delaware corporations as a result of the information that is generated by shareholder litigation in Delaware courts. In Part IV, I analyze the effect that widespread adoption of fee-shifting and non-Delaware forum selection provisions would have on the generation of these informational benefits and on other aspects of Delaware law. Finally, in Part V, I draw on the literature relating to the role of mandatory rules in corporate law and argue that there are persuasive justifications for Delaware's new restrictions on private ordering. In advancing this position, I rely on the impact that their widespread adoption would have on these benefits and on contractual freedom and flexibility in other corporate law areas. I also address Delaware's new case law on shareholder settlements and fee awards to argue that together with the new restrictions on fee-shifting and forum selection provisions, the state has adopted a well-balanced (and seemingly successful) solution to the shareholder litigation crisis.

II. THE SHAREHOLDER LITIGATION CRISIS AND PRIVATE ORDERING SOLUTIONS

A. *An Epidemic of Multi-Jurisdictional Shareholder Litigation*

Prior to the second half of 2015, it was not controversial to claim that shareholder litigation had entered a period of crisis.[14] Litigation related to public company transactions had become "pervasive,"[15] with claims being filed to challenge the vast majority of public company deals. In 2014, 93% of public company mergers and acquisitions valued over $100 million were litigated;[16] for deals worth more than $1 billion, the figure was 96%.[17] Calendar years 2012 and 2013 saw similar results.[18]

The volume of litigation was not the only problem - much of this litigation was multi-jurisdictional.[19] Because a Delaware corporation whose principal place of business is located in another state is subject to personal jurisdiction in both Delaware and the state of its principal place of business, most publicly-traded Delaware corporations and their management can face litigation at least four separate fora.[20] By 2010, the majority of shareholder litigations against Delaware corporations involved duplicative suits brought by multiple plaintiffs' firms in

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[14]*See, e.g.*, Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 499-500 (2015); 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, 558-59 (2015) (noting that "in 2012, 93% of deals over $100 million and 96% of deals over $500 million were challenged" and that in 2013, "97.5% of deals over $100 million were challenged"); J. Travis Laster, *A Milder Prescription for the Peppercorn Settlement Problem in Merger Litigation*, 93 TEX. L. REV. 129, 157-58 (2015); Edward B. Micheletti & Jenness E. Parker, *Multi-Jurisdictional Litigation: Who Caused this Problem, and Can It Be Fixed?*, 37 DEL. J. CORP. L. 1, 2 (2012).

[15]Fisch et al., *supra* note 14, at 558.

[16]CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2014 M&A LITIGATION (2014), http://tinyurl.com/lpom3uh.

[17]*Id.*

[18]Fisch, et al., *supra* note 14, at 558-59 (noting that "in 2012, 93% of deals over $100 million and 96% of deals over $500 million were challenged" and that in 2013, "97.5% of deals over $100 million were challenged").

[19]John Armour, Bernard Black & Brian Cheffins, *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1363 (2012).

[20]Delaware corporations headquartered in another state (and most are) are subject to personal jurisdiction in the federal and state courts located in both Delaware and the state in which its headquarters is located. Daimler AG v. Bauman, 134 S. Ct. 746, 754-55 (2014).

different fora.[21] Delaware courts lost the ability to exercise "full control over corporate litigation, in the sense of being the sole forum."[22] Increases in both the overall volume of litigation and the number of actions filed per transaction caused commentators and practitioners to conclude that deal-litigation was simply "the plaintiffs' lawyer's transaction tax."[23]

The occurrence of widespread forum-shopping in this context was a particularly curious development. Under the generally applicable "internal affairs" doctrine, the law of the state in which a corporation is organized governs the internal affairs of that corporation, including issues relating to the fiduciary duties of directors and officers.[24] Delaware law typically applies to shareholder litigation involving Delaware corporations, even if filed elsewhere. For this reason, the rise of multi-jurisdictional filings could not have been motivated by a desire to secure more favorable substantive law, as it is many other contexts. Instead, the forum shopping trend was likely motivated by the fee distribution interests of smaller plaintiff-side corporate litigation firms[25] after recent disruptions in that sector of the legal services market[26] as well as a desire to secure non-Delaware judges who may be more favorable to plaintiffs.[27] Less-established firms filed duplicative litigations in a forum where no other firm had yet filed in an effort to force other, more-established firms to give them a seat at the settlement table and a portion of any fee award.[28] The newer firms could force their

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[21]Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation* (Yale Law & Econ. Research Paper No. 528, 2015), http://tinyurl.com/hg4487f. *See also* Micheletti & Parker, *supra* note 14; Brian J.M. Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137, 148 (2011).

[22]Armour et al., *supra* note 19, at 1363.

[23]Browning Jeffries, *The Plaintiffs' Lawyer's Transaction Tax: The New Cost of Doing Business in Public Company Deals*, 11 BERKELEY BUS. L.J. 55, 59 (2014).

[24]*See, e.g., Restatement (Second) of Conflict of Laws* § 302 (1971); Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 36 (2006) ("For disputes over a corporation's internal affairs – the relations among a firm's shareholders and managers – states generally apply the law of the incorporating state. The widespread acceptance of this doctrine enables a firm to incorporate under the law of any state, knowing its choice will be respected elsewhere.").

[25]Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multijurisdictional Litigation*, 106 NW. U. L. REV. 1753, 1797-1801 (2012).

[26]Brian Cheffins, John Armour, & Bernard Black, *Delaware Corporate Litigation and the Fragmentation of the Plaintiffs' Bar*, 2012 COLUM. BUS. L. REV. 428, 466 (2012).

[27]Gideon Mark, *Multijurisdictional M&A Litigation*, 40 J. Corp. L. 291, 301-02 (2015) (listing variety of explanations for the rise of multijurisdictional M&A litigation and concluding that "the true explanation . . . may reflect some combination" of them).

[28]Thomas & Thompson, *supra* note 25, at 1798-99.

way into settlement discussions by threatening to settle with defendants at a lower cost in exchange for a broad release that would cut-off the actions pending elsewhere.[29] This dynamic led to the rise of the "peppercorn" settlement, in which cases were regularly settled for nothing more than supplemental disclosures.[30] As long as plaintiffs' attorneys were able to portray this relief as a corporate benefit, their fees would be paid out of the corporate fisc.[31]

Settling defendants generally did not oppose this characterization and actually had an incentive not to: the releases they received were typically quite broad in comparison to the relief obtained for shareholders, especially given the fact that many of the claims covered by the releases were not investigated or vetted prior to settlement.[32] In exchange for having the corporation pay this transaction tax, defendants received a sort of deal-insurance against liability for a variety of claims.

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[29]*Id.* at 1799 ("[D]efendants generally insist on global settlements of all litigation related to a common fact pattern, whether it is filed in one court or many, and whether it is deal-related or a derivative claim . . . . This is what gives the new firms leverage to get themselves included in the settlement negotiations: if the older plaintiffs' firms do not include them, then they can refuse to settle their cases, or even worse, offer to settle them more cheaply in a reverse auction."). This strategic approach is made possible by the United States Supreme Court's holding in Matushita Elec. Indus. Co. v. Epstein, 516 U.S. 367, 369 (1996).

[30]Fisch et al., *supra* note 14, at 566 ("The vast majority of suits, however, settle exclusively for supplemental disclosure in the form of additional information in the merger proxy statement."). Professors Cain and Solomon report that only 4.8% result in a monetary benefit to shareholders. Cain & Solomon, *supra* note 14, at 479.

[31]*See, e.g.*, Tandycrafts, Inc. v. Initio Partners, 562 A.2d 1162, 1164-65 (Del. 1989) ("In the realm of corporate litigation, the Court may order the payment of counsel fees and related expenses to a plaintiff whose efforts result in the creation of a common fund . . . or the conferring of a corporate benefit. The definition of a corporate benefit, however, is much more elastic . . . . Changes in corporate policy or, as here, a heightened level of corporate disclosure, if attributable to the filing of a meritorious suit, may justify an award of counsel fees."); *In re Trulia*, 129 A.2d at 887 ("[T]his opinion discuses some of the dynamics that have led to the proliferation of disclosure settlements, noting the concerns that scholars, practitioners and members of the judiciary have expressed that these settlements rarely yield genuine benefits for stockholders and threaten the loss of potentially valuable claims that have not been investigated with rigor.").

[32]*In re* Riverbed Technology, Inc. Stockholders Litig., 2015 WL 5458041, at *3 (Del. Ch. Sept. 17, 2015) ("Where the defendants' interest may be captured via a broad release, inexpensive disclosures and a modest – in light of the value of the merger – fee award, there is little incentive for the defendants to engage in further litigation even if the claims are weak; and every reason to go forward to obtain via settlement what one member of this Court has termed 'deal insurance,' the broadest release possible."); Fisch et al., *supra* note 14, at 559; Laster, *supra* note 14, at 155.

B. *The Rise of Private Ordering Solutions*

As the merger litigation crisis reached its height, scholars, practitioners, and judges focused their attention on potential solutions.[33] For many, private-ordering solutions, which involved the adoption of fee-shifting and forum selection provisions, appeared to have great promise because they could be implemented without any legislative, judicial, or regulatory action. In the case of a corporation already in existence, adoption would require, *at most*, a vote of shareholders to either amend the bylaws or the certificate of incorporation. However, if the corporation's certificate of incorporation allowed the board to adopt bylaws unilaterally, then no shareholder vote would be necessary; a majority of directors could vote to amend the bylaws to incorporate one or both provisions.[34] And, of course, for corporations in the formation stage, these provisions could be easily added by incorporators at the outset in either the certificate of incorporation or bylaws.

With fee-shifting provisions, Delaware corporations could target the economics of shareholder litigation by requiring plaintiffs to pay all litigation costs if they did not secure a favorable judgment on the merits.[35] This would be a significant departure from the status quo, under which defendants' fees would typically be paid by an insurer or the corporation (pursuant to its indemnification obligations[36]) and plaintiffs'

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[33] *See, e.g.*, Sean J. Griffith, Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees, 56 B.C. L. REV. 1, 47 (2015); Fisch et al., *supra* note 14, 560-61; Laster, *supra* note 14, at 152; Quinn, *supra* note 21; Afshar, *supra* note 5, at 343.

[34] Delaware law generally vests the power to "adopt, amend or repeal" bylaws to the corporation's shareholders. 8 *Del. C.* § 109(a). However, the certificate of incorporation may give the board of directors power to take such action unilaterally. *Id.*

[35] See, for example, the fee-shifting bylaw that was upheld in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 556 (Del. 2014), which provided that:

> 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")] or joins, offers substantial assistance to or has a direct financial interest in any Claim against the League or any member or Owner (including any Claim purportedly filed on behalf of the League or any member), 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 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.

[36] 8 *Del. C.* § 145(a)-(b).

fees are paid by either the corporation (so long as plaintiffs can show that the litigation resulted in a corporate benefit) or out of any monetary recovery received from the defendants. Prior to adoption of a fee-shifting bylaw, a plaintiff's worst case scenario was having to pay his or her own fees (in the event the litigation terminated without creating a corporate benefit or a fund); this was not a significant threat, however, given the courts' typical willingness to construe "corporate benefit" broadly and the defendants' incentives to support fee applications in connection with settlement. With a fee-shifting provision in place, however, the worst case scenario would become much worse – the plaintiff would have to pay the defendants' fees as well as his own unless he met a standard of success not required under the corporate benefit doctrine.

With a forum selection provision, Delaware corporations could target the filing of multiple actions in different jurisdictions by designating the exclusive jurisdiction(s) for shareholder litigation. If litigation is filed elsewhere, a forum selection provision would allow the defendants to petition the court to dismiss or transfer the action to the jurisdiction designated in the provision.[37] If enforced, they would ensure that shareholder litigation against a corporation would proceed in a single jurisdiction (or, if the provision allows, multiple but limited jurisdictions). Arbitration provisions are a species of forum selection provision, and they did not go unnoticed. Some commentators urged corporations to adopt arbitration provisions in order to escape federal and state court adjudication of shareholder disputes completely.[38]

In a series of three cases decided prior to adoption of the 2015 amendments to the DGCL, Delaware courts upheld the use of both forum selection provisions (both Delaware and non-Delaware) and fee-shifting provisions. In the first case, *Boilermakers Local 154 Retirement Fund v. Chevron Corp.* ("*Boilermakers*")[39] the Chancery Court upheld a bylaw that designated courts in the state of Delaware as the exclusive forum for shareholder litigation. In the other forum selection case, *City of Providence v. First Citizens Bancshares, Inc.* (*First Citizens*),[40] the Chancery Court upheld a bylaw designating courts in the state of North

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[37]Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 326 (2013).

[38]*See, e.g.*, Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751, 808-09 (2015).

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

[40]City of Providence v. First Citizens Bancshares, Inc., 99 A.3d 229, 229 (Del. Ch. 2014).

Carolina as the exclusive forum for shareholder litigation. The Delaware Supreme Court upheld a fee-shifting bylaw in *ATP Tour, Inc. v. Deutscher Tennis Bund*[41] ("*ATP Tour*").

In all three of these cases (*Boilermakers, First Citizens*, and *ATP Tour*), the courts rely on a contractual conception of the corporation. The bylaws at issue in all three cases were enacted unilaterally by the board pursuant to provisions in the corporate charter that gave that power to the corporations' boards. According to the Delaware courts, a corporation's governing documents constitute a "flexible contract" that is binding upon shareholders.[42] Because in all three cases this contract gave the board the power to amend the bylaws unilaterally, specific shareholder consent to the added bylaw provisions was not necessary. According to the courts, when shareholders purchase shares in a company whose charter allows the board of directors to amend bylaws unilaterally, those shareholders agree, as a matter of contract, to be bound by future amendments. So long as bylaws adopted by the board under this scheme "relate[] 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,"[43] they are valid and binding on shareholders. The private ordering solutions at issue in *Boilermakers, First Citizens,* and *ATP Tour* all met this statutory standard easily, as they related to the rights of shareholders.

C. *Delaware's New Restrictions on Fee-Shifting and Forum Selection Provisions*

Reaction to these decisions, and particular the decision in *ATP Tour*, came swiftly. The Delaware Corporation Law Council almost immediately proposed legislation that would limit the *ATP Tour* decision to non-stock corporations and establish that shareholders of stock corporations cannot be subject to fee-shifting. After outcry from the business community in opposition to this proposal, the legislature asked the Delaware Bar to study the situation and make a recommendation the following year.[44]

This culminated in the inclusion of a provision addressing both fee-shifting and forum selection provisions in the 2015 amendments to

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[41]*ATP Tour, Inc.* 91 A.3d at 554. This case dealt with a non-stock corporation; however, as many observed, the reasoning applied equally to stock corporations.

[42]*E.g.*, Boilermakers Local 154 Re. Fund, 73 A.3d, at 940.

[43]8 *Del. C.* § 109(b).

[44]Lisa A. Rickard, *Delaware Flirts With Encouraging Shareholder Lawsuits*, WALL ST. J. (Nov. 14, 2014), http://tinyurl.com/WSJ-DE-14xi14.

the DGCL, enacted as Senate Bill 75 (S.B. 75). Pursuant to this legislation, stock corporations may not include fee-shifting provisions in their governing documents.[45] Forum selection provisions are specifically authorized, but only if they allow litigation to be filed and proceed in Delaware.[46] Thus, if a corporation wishes to confine litigation to a single state, S.B. 75 requires that it choose Delaware.

The addition of these two new mandatory rules appears inconsistent with Delaware's typically "flexible and enabling"[47] approach to corporate law. As *ATP Tours*, *Boilermakers*, and *First Citizens* demonstrate, Delaware generally views the relationship between shareholders and the board through a contractual lens and, as such, tends to favor private ordering. At least one prominent scholar has argued that the legislation is bad public policy and was enacted for the benefit Delaware's politically powerful bar.[48] While there can be no doubt that the bar played a major role in the passage of S.B. 75 and that its members stand to benefit from it, focusing on the public choice dimension omits several important points relating to the benefits that arise out of having corporate disputes adjudicated in Delaware courts. In the following two Sections, I explore these benefits and the impact that widespread adoption of fee-shifting and non-Delaware forum selection provisions would have on their ongoing generation.

III. THE INFORMATIONAL BENEFITS OF SHAREHOLDER LITIGATION

This Section explores the informational benefits generated by having corporate disputes that involve Delaware corporations adjudicated in Delaware courts. This litigation produces a variety of information, whose ongoing generation contributes to many of the traditionally cited advantages to Delaware incorporation. Importantly,

[45]8 *Del. C.* § 102(f) (prohibiting fee-shifting provisions in certificates of incorporation); *see also* 8 *Del. C.* § 109(b) (barring fee-shifting provisions in bylaws).

[46]8 *Del. C.* § 115 ("The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State.").

[47]Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan and Kamar's Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1257, 1258 (2001).

[48]Bainbridge, *supra* note 9, at 875; *See also* Cox, *supra* note 10, at 257 ("[T]he legislature gave managers something they wanted, a way to deal with the scourge of multi-forum litigation, while pacifying the local bar that feared lucrative shareholder litigation would disappear . . . .").

these informational benefits accrue to a wide variety of people and entities, not only the parties to a particular litigation.

Information generated by shareholder litigation can be divided (roughly) into two categories: legal information, which relates to the legal rules of principles that govern a particular situation, and factual information, relating to the underlying facts and circumstances that led to the dispute. Ongoing availability of this information is important to many of the advantages to incorporating in Delaware: it allows Delaware corporations to plan transactions and other corporate actions more easily and with more certainty. It allows their advisors to build expertise across transactions and cases. The generation of this information also informs the individuals responsible for drafting and considering annual amendments to the DGCL. Ultimately, the ongoing generation of information about the current state of Delaware law enhances the flexibility afforded to management by providing them with guidance on the most reliable way to achieve a desired end.

The generation of factual information plays an additional role in enabling the flexibility for which Delaware law is known by enabling extra-legal constraints on the behavior of corporate fiduciaries. The threat of market-based and reputational sanctions aligns the incentives of corporate fiduciaries and shareholders, and in so doing, reduces the need for corporate law to provide for more extensive, *ex ante* constraints on the behavior of fiduciaries.[49] But these systems require information to function – there can be no reputational consequences for bad behavior if no one apart from the actor and perhaps a few others know about it. Insofar as these systems function more effectively on account of the factual information generated by Delaware shareholder litigation, the ongoing generation of information helps to maintain Delaware's flexible approach to corporate law. The remainder of this Section addresses the benefits that result from the information that is generated by Delaware shareholder litigation and its significance for corporations organized there.

[49]STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS §1.5 37 (2002) ("Corporate managers operate within a pervasive web of accountability mechanisms . . . ."); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 4 (1991) ("There is therefore a limit on managers' efforts to enrich themselves at investors' expense. Managers may do their best to take advantage of their investors, but they find that the dynamics of the market drive them to act as if they had investors' interests at heart.").

A. *Benefits Arising out of Legal Information*

1. Delaware Case Law and Its Importance to Corporate Governance

Legal information generated by shareholder litigation most commonly takes the form of written opinions issued by the Delaware courts, primarily the Delaware Court of Chancery. This case law and its ongoing development allow Delaware corporations to plan transactions and other activities. It also contributes the creation of other network benefits that assist Delaware corporations in various ways. In this Section, I explore the benefits that arise out of the generation of legal information as well as various features of Delaware law that makes access to case law particularly valuable for the state's corporations.

The benefits that arise out of access to Delaware's extensive body of case law are well-documented. The case law "provides a pool of handy precedents, and the basis for obtaining almost instantaneously a legal opinion on any issue of Delaware law. These features of stability and predictability are desired by managers who need quick opinions on proposed activities."[50] With access to this case law and to counsel who is already well-versed in it, directors and officers operate under less uncertainty and are better able to plan transactions or any other corporate activity that could be subject to shareholder challenge.

The benefits that arise out of the public availability of Delaware case-law are both backward- and forward-looking. The body of precedent that already exists at the time of a firm's incorporation (or reincorporation in Delaware) helps corporations and their constituents assess the legal rules and standards that will govern the relationship when they enter into it. However, Delaware corporations can also count on a "future flow" of relevant case-law on account of the widespread standardization of the governance terms that are applicable to Delaware corporations.[51] Professor Klausner famously borrowed from network economics to analyze some of the benefits that arise out of a future flow of precedent relevant to widely-adopted corporate governance terms.[52]

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[50]Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON. & ORG. 225, 274 (1985); *see also* Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1345 (2013) ("An obvious source of value is the volume of Delaware case law, and the expectation that this volume will continue to grow. A high volume of case law, which admittedly is difficult to separate fully from the quality of case law, can reduce legal uncertainty and thereby enhance firm value. The value of Delaware incorporation may come as well from lawyers' familiarity with Delaware law and the ease with which they can provide reliable legal advice.").

[51]Klausner, *supra* note 50, at 1330.

[52]*See* Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995). Professor Klausner identifies network benefits as potentially leading

These network benefits increase with the number of firms who share a particular term (or are governed by the same rule or standard in a given situation) because the more firms there are that are governed by that term, the more likely future litigation will arise and lead to judicial interpretations that are applicable (and available) to all firms subject to that term or rule.[53] As the number of judicial interpretations grow, uncertainty is reduced (generally, at least, even if not with regard to a particular opinion at a particular moment in time).[54]

Additional network benefits arise as a result of widespread standardization and the development of case law interpreting standardized terms. Advisors assist in developing business practices to implement a term (or comply with a rule or standard) and help to reduce uncertainty for members of the network by giving them options that have been tested in the past.[55] Legal services are also affected by network effects – members of the bar with accumulated experience in relation to these terms are better able to provide legal services or may be able to provide them more cheaply than other lawyers who are not.[56] Participants in capital markets also enjoy network benefits insofar as institutional investors and other informational intermediaries are better able to assess terms they are already familiar with.[57]

Prominent scholars have argued that access to this publicly available information about the state of Delaware law leads to lower transaction costs for Delaware corporations.[58] According to this view, Delaware's well-developed body of case-law and the benefits that arise out of it make it cheaper for corporations to operate under Delaware law.[59] This theory makes intuitive sense, but is hard to verify. By their

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Delaware law to be suboptimal. According to his view, it is possible that the advantages that arise out of network benefits outweigh disadvantages resulting from suboptimal features of Delaware law. I do not take a position as to whether network benefits compensate for suboptimal features of Delaware law; this may or may not be the case. Regardless, once those benefits are acknowledged as real and as forming part of the value of Delaware law, the impact of measures that would affect those benefits is an important consideration for Delaware corporations and their constituents.

[53]Klausner, *supra* note 52, at 776.

[54]*Id.* at 775-79.

[55]*Id.* at 780-82.

[56]*Id.* at 782-84.

[57]Klausner, *supra* note 52, at 785.

[58]*See, e.g.*, Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 735-36 (1987).

[59]*See, e.g.*, *Id.* at 723 ("[T]he large number of firms makes it more likely that any particular issue will be litigated and decided in Delaware, providing a sound basis for corporate planning. This attracts even more firms for the more responsive a state and the more settled its law, the cheaper it is for a firm to operate under that legal regime.").

nature, transaction costs are difficult, if not impossible to quantify with any degree of certainty.[60]

Certain features of Delaware law and its judiciary's approach to adjudication of shareholder litigation make the informational benefits of the state's case law particularly important for Delaware corporations. Unlike other states whose corporation statutes are based on the Model Business Corporations Act, the Delaware General Corporation Law includes few bright-line rules.[61] Delaware "has preferred to state its statutory standards in more general terms, leaving counsel and courts to fill in the interstices."[62] Accordingly, and as discussed throughout the remainder of this Section, judge-made law plays an especially important role for Delaware corporations. In the course of filling out these interstices, Delaware's judges regularly provide guidance where there are ambiguities in the law, give advance notice of legal developments that are on the horizon, and attempt to shape future behavior by explaining how similarly situated parties should proceed in the future to avoid intrusive judicial review of an action.[63] In this regard, dictum is a powerful, and often-used tool. The currently commonplace special committee had its genesis in a footnote of dicta of that appeared in *Weinberger v. UOP, Inc.* in which the Court suggested that the outcome could have been different if a special committee had been utilized.[64] The unique approach of Delaware's judiciary has led prominent commentators to argue that the state's judicial lawmaking is similar to a legislative[65] or regulatory process.[66] The value of this information is

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[60]OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 22 (1985). For this reason, transaction costs "are always assessed in a comparative institutional way, in which one mode of contracting is compared with another. Accordingly, it is the difference between rather than the absolute magnitude of transaction costs that matters. . . . Empirical research on transaction cost matters almost never attempts to measure such costs directly." *Id.*

[61]*See* William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 57 (2009) (comparing the Model Business Corporation Act with the DGCL and arguing that "[t]he Model Act has made an effort to provide greater clarity for a variety of transactions through bright line rules and safe harbors" and "has favored bright line rules and well defined property rights over an ex post judicial consideration of where rights and duties lie.").

[62]Michael P. Dooley & Michael D. Goldman, *Some Comparisons Between the Model Business Corporation Act and the Delaware General Corporation Law*, 56 Bus. Law. 737, 764-65 (2001).

[63]Mohsen Manesh, *Dictum in alternative entity jurisprudence and the expansion of judicial power in Delaware*, in RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS, AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 336, 337-41 (Robert W. Hillman & Mark J. Loewenstein, eds., 2015) (exploring the role that dictum plays in the Delaware courts' corporate jurisprudence).

[64]Weinberger v. UOP, Inc., 457 A.2d 701, 709 n. 7 (Del. 1983).

[65]Jill E. Fisch, 68 U. Cin. L. Rev. 1061, 1077-78 (2000). In support of this position, Professor Fisch looks to the "flexibility and responsiveness" of the state's case law, which is in

further enhanced by the fact that there is a high concentration of large, publicly traded corporations incorporated in Delaware.[67] When the network's members (Delaware corporations) are homogenous with respect to one or more normatively significant characteristics (*e.g.*, a large number of Delaware corporations are publicly traded), legal questions and issues that arise in one case are more likely to be relevant to other members of the network not involved in that particular case. When the members of a network display some level of homogeneity, case law generated in the future is more likely to be broadly relevant. Similarly, advisors are more likely to have acquired relevant experience on account of having worked through similar issues and situations previously.[68]

Delaware's reliance on case law is not without its detractors. Commentators have questioned its value to Delaware corporations on account of its indeterminacy and the resulting frequency of litigation.[69] Professors Kahan and Kamar identify various features of Delaware law as increasing indeterminacy, including its typically fact-intensive, standards-based approach, ambiguity as to which standard will apply, and "narrow breadth" of its precedents.[70] According to these commentators, the indeterminacy of Delaware law limits its value because it prevents the elimination of uncertainty.[71] It is not clear, however, that Delaware is significantly more indeterminate than other

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large part driven by the courts' willingness to "distinguish or overrule a precedent without regard to considerations of stare decisis"; the Delaware Supreme Court's "unanimity norm"; the degree to which Delaware judges control their agenda; and the willingness of Delaware's judges to announce prospective legal principles to guide future decision-making.

[66]William Savitt, *The Genius of the Modern Chancery System*, 2012 COLUM. BUS. L. REV. 570, 570 (2012) ("The thesis of this Essay is that the Delaware Court of Chancery has developed over the past two decades an innovative form of corporate transactional jurisprudence that blends the oldest traditions of equitable judging with a modern regulatory sensibility.").

[67]*See* Jens Dammann, *Homogeneity Effects in Corporate Law*, 46 ARIZ. ST. L.J. 1103 (2014).

[68]Dammann, *supra* note 67, at 1108.

[69]*See, e.g.*, Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1233 (2001).

[70]*Id.*

[71]*See also* Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85 (1990); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987). To explain Delaware's continued success, these scholars look to the rational ignorance of lawyers, William J. Carney, George B. Shepherd, Joanna Shepherd Bailey, *Lawyers, Ignorance, and the Dominance of Delaware Corporate Law*, 2 HARV. BUS. L. REV. 123 (2012), as well as herding effects and path dependency. *See* Robert Anderson & Jeffrey Manns, *The Delaware Delusion*, 93 N.C. L. REV. 1049 (2015).

jurisdictions.[72] Indeterminacy may be a feature of corporate law generally, not Delaware corporate law.[73] Focusing on indeterminacy also risks ignoring the trade-off between reducing indeterminacy with the implementation of *ex ante*, mandatory rules and maintaining the freedom and flexibility for which Delaware law is known. Though based on a statute, Delaware corporate law is "largely enabling and provides a wide realm for private ordering."[74] If Delaware law were comprised more fully of rigid, *ex ante* rules (which are likely to be more determinate), the state's corporations would enjoy less freedom for private ordering. For Chief Justice Leo Strine (then Vice-Chancellor), the level of indeterminacy reflected in Delaware law is a positive feature for precisely this reason. It facilitates the flexibility for which Delaware law is known and valued.[75]

2. An Illustration – The Case Law Governing Controlling Shareholder Transactions

The body of Delaware case law addressing transactions between a corporation and its controlling shareholders illustrates the importance of the development of case law to the ability of the management of Delaware corporations to plan and achieve business objectives. In two early controlling shareholder cases, *Weinberger v. UOP, Inc.* ("*Weinberger*")[76] (decided in 1983) and *Rosenblatt v. Getty Oil Co.* ("*Rosenblatt*")[77] (decided in 1985), the Delaware Supreme Court established that mergers of a corporation and its controlling shareholder are evaluated under the entire fairness standard with the burden of proving fairness allocated to the controlling shareholder.[78] These cases

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[72]William B. Chandler III & Anthony A. Rickey, *Manufacturing Mystery: A Response to Professors Carney and Shepherd's "The Mystery of Delaware Law's Continuing Success,"* 2009 UNIV. ILL. L. REV. 95, 103 (2009).

[73]Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 UNIV. ILL. L. REV. 131, 135 (2009).

[74]Strine, *supra* note 47, at 1260.

[75]Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1782-83 (2006) ("Delaware's corporate laws are by no means a blank check for private ordering. On the other hand, and like the Model Business Corporations Act and most other state statutes, the DGCL establishes default rules on central matters, such as economic rights and voting rights of stock, which can be changed by private agreement almost without limit. There has been a strong tendency in Delaware corporate policymaking to broaden that rule for private ordering."); *see also* Fisch, *supra* note 69, at 1082 (noting that indeterminacy "avoid[s] the hardship or unfairness associated with the application of a crystalline rule without destroying the applicable doctrinal structure.").

[76]*Weinberger*, 457 A.2d at 701.

[77]Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985).

[78]When the court applies this standard, it evaluates both the substantive and procedural fairness of the transaction. Ordinarily, the defendant will bear the burden of proving that the

also established that a fully informed vote of a majority of the minority shareholders in favor of a merger between the corporation and its controlling shareholder shift the burden onto the plaintiff-shareholders to establish unfairness.[79] *Weinberger* included a crucially important piece of dictum intended to guide future behavior. In a footnote, the Delaware Supreme Court, explained that the case might have come out differently "if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length" because "a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness."[80]

Over time, the *Weinberger* footnote has given rise to widespread use of special committees of disinterested directors empowered to negotiate on behalf of minority shareholders. As use of the special committee grew in the context of controlling shareholder mergers, questions arose as to its effect on the applicable standard of review and the allocation of the burden of proof. Some decisions refused to stray from the entire-fairness-with-shifted-burden approach outlined in *Weinberger* and *Rosenblatt,* even with an additional procedural protection of negotiation and approval by a committee of disinterested directors.[81] Other post-*Rosenblatt* decisions indicated that negotiation and approval by a committee of disinterested directors should trigger the

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transaction was fair. However, under certain circumstances, the burden will shift, and plaintiffs will bear the burden of proving that the transaction was unfair.

[79] *Weinberger*, 457 A.2d at 703 ("The Chancellor also held that even though the ultimate burden of proof is on the majority shareholder to show by a preponderance of the evidence that the transaction is fair, it is first the burden of the plaintiff attacking the merger to demonstrate some basis for invoking the fairness obligation. We agree with that principle. *However, where corporate action has been approved by an informed vote of a majority of the minority shareholders, we conclude that the burden entirely shifts to the plaintiff to show that the burden entirely shifts to the plaintiff to show that the transaction was unfair to the minority.*") (emphasis added); *See also Rosenblatt*, 493 A.2d at 937 ("[A]pproval of a merger, as here, by an informed vote of a majority of the minority shareholders, while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs.").

[80] *Weinberger*, 457 A.2d at 709 n.7.

[81] *See, e.g.*, Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990) ("Consequently, in a merger between the corporation and its controlling stockholder—even one negotiated by disinterested, independent directors—no court could be certain whether the transaction terms fully approximate what truly independent parties would have achieved in an arm's length negotiation. Given that uncertainty, a court might well conclude that even minority shareholders who have ratified a parent-subsidiary merger need procedural protections beyond those afforded by full disclosure of all material facts. One way to provide such protections would be to adhere to the more stringent entire fairness standard of judicial review.").

business judgment rule.[82] It was not until a 1994 decision in *Kahn v. Lynch Communication Systems, Inc. ("Lynch")* that the Delaware Supreme Court resolved this split[83] by holding that approval by an independent committee of disinterested directors *or* by an informed majority of minority shareholders would shift the burden onto the plaintiff-shareholders to prove unfairness, but would not trigger the business judgment rule.[84] In the years following *Lynch*, the Delaware courts gave guidance as to when attempts to shift the burden would and would not be successful.[85]

Post-*Lynch*, however, the question remained whether controlling shareholder transactions conditioned on *both* procedural protections (special committee *and* majority of minority shareholder approval) would continue to be evaluated under entire fairness (albeit with a burden shift in place) or would receive the business judgment rule's presumption of validity.[86] The development of this line of case law recently culminated with opinions issued by the Delaware Chancery Court and Delaware Supreme Court in litigation challenging a going private merger of M&F Worldwide into its controlling shareholder.[87] The controlling shareholder conditioned the transaction on both approval by a majority of the minority shareholders and the negotiation and approval of the transaction by a special committee comprised of independent directors.[88] In the trial court opinion, the Court of Chancery

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[82]*In re* Trans World Airlines, Inc. Shareholders Litig., 1988 WL 111271, at *7 (Del. Ch. 1988) ("Both the device of the special negotiating committee of disinterested directors and the device of a merger provision requiring approval by a majority of disinterested shareholders, when properly employed, have the judicial effect of making the substantive law aspect of the business judgment rule applicable and, procedurally, of shifting back to plaintiffs the burden of demonstrating that such a transaction infringes upon rights of minority shareholders.").

[83]*See* Kahn v. Lynch Comm. Sys., Inc., 638 A.2d 1110 (Del. 1994).

[84]*Id.* at 1117.

[85]*Compare In re* Cysive, Inc. Shareholders Litig., 836 A.2d 531, 553-55 (Del. 2003) (holding that the Special Committee's negotiation process was sufficient to shift the burden under *Lynch* notwithstanding the CFO's failure to turn over certain financial information to the Committee), *with In re* Southern Peru Copper Corp. Shareholder Deriv. Litig., 52 A.3d 761, 798 (Del. Ch. 2011) (holding that the Special Committee's involvement was insufficient to shift the burden because it "fell victim to a controlled mindset and allowed Grupo Mexico [the controlling shareholder] to dictate the terms and structure of the merger"). The *Southern Peru* case is also instructive on the factual circumstances in which a majority of the minority shareholder vote will not shift the burden. In this case, the shareholder vote was not fully informed on account of material omissions in the Proxy Statement related to both the negotiation process and the methodology used by outside advisors to reach an opinion of fairness. *Id.* at 794-95.

[86]*See, e.g.*, *In re* Southern Peru Copper Corp., 52 A.3d at 787 n.70 (raising the question itself and listing other cases in which the question has been raised).

[87]*In re* MFW Shareholders Litig., 67 A.3d 496, 499 (Del. Ch. 2013).

[88]*Id.*

addressed the "novel question of law"[89] of whether the business judgment rule apply as a result of the double procedural protections and ultimately held that "when a controlling stockholder merger has, from the time of the controller's first overture, been subject to (i) negotiation and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors, the business judgment rule standard of review applies."[90] The Delaware Supreme Court affirmed the Chancery Court's opinion and adopted its reasoning. In the Supreme Court's opinion (captioned *Kahn v. M&F Worldwide ("M&F")*[91]), the unanimous Court further fleshed out the standard and enumerated of the necessary conditions for application of the business judgment rule to controlling shareholder transactions:

> To summarize our holding, in controller buyouts, the business judgment standard of review will be applied if and only if: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority shareholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[92]

Since *M&F*, the Chancery Court has had the opportunity to develop this doctrine further through the evaluation of various attempts to comply with the conditions required to change the standard of review from entire fairness to the business judgment rule. *In re Dole Food Co., Inc. Stockholder Litigation ("Dole Food")*[93] concerned a going-private transaction in which Dole merged into an entity wholly-owned (indirectly) by Dole's controlling shareholder (also CEO). Despite attempts to mimic the transactional structure that activated the business judgment rule in *M&F*, the Chancery Court did not depart from entire fairness and did not even shift the burden within fairness review because the transaction did not adhere to *M&F* in substance.[94] The Court found

[89] *Id.* at 502.
[90] *In re MFW Shareholders Litig.*, 67 A.3d at 502.
[91] Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).
[92] *Id.* at 645.
[93] *In re* Dole Food Co., Inc. Stockholder Litig., 2015 WL 5052214 (Del. Ch. Aug. 27, 2015).
[94] *Id.* at *38.

the CEO and his "right-hand man" prevented the special committee from functioning in the way required by *M&F*.[95] The Chancery Court therefore refused to depart from the entire fairness standard without a burden shift and held the defendants liable for over $140 million.[96] With his detailed account of the transaction and the negotiations leading up to its consummation, Vice Chancellor Laster gives additional insight into how the new *M&F* standard will be applied. His opinion also establishes that extraordinary and somewhat successful efforts of a special committee will not insulate otherwise defective procedure.[97]

With a sophisticated understanding of this line of case law, parties considering a controlling shareholder transaction and their counsel can consider the structure of the transaction and its implications for how the court will review the transaction if it is challenged. The starting point will be entire fairness and the possibility for burden shifting created by *Weinberger*, *Rosenblatt*, and later *Lynch*. If application of the more deferential business judgment rule is desirable, the parties now know that they can design a transaction that is consistent with *M&F* (and which stays far away from *Dole Foods*) to achieve that aim. This is obviously an over-simplification. There is a lot of grey area, and the circumstances surrounding any particular transaction will affect whether the parties perceive a need to mimic the *M&F* structure and how closely they are able to duplicate it. Notwithstanding the lack of any perfectly clear answers, the availability of this case law will be helpful to those who are able to call upon it when structuring a transaction, particularly those who are able to either avoid litigation altogether or avoid an entire fairness review. A recent shareholder action filed to challenge the going-private merger of Books-A-Million, Inc. illustrates the significance of this case law to directors, officers, controlling shareholders, and their advisors. After finding that "the complaint ha[d] not pled grounds to take the transaction outside of the *M&F Worldwide* framework,"[98] the Chancery Court applied the business judgment rule and dismissed the complaint.

The controlling shareholder merger cases also demonstrate the importance of having a high concentration of firms that are homogenous with respect to one or more normatively significant characteristics. Without a sufficient number of corporations that share these characteristics (*e.g.*, publicly traded corporations with controlling shareholders who are interested in taking the company private), the development of this line of cases would not have been possible. If there

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[95] *Id.* at *1-2.
[96] *Id.* at *47.
[97] *In re Dole Food Co., Inc.*, 2015 WL 5052214, at *45.
[98] *In re Books-A-Million, Inc.*, 2016 WL 5874974, at *1 (Del. Ch. Oct. 10, 2016).

were fewer corporations with these characteristics organized in Delaware, there would be fewer similar transactions and ultimately fewer opinions to guide parties who wish to undertake such transactions in the future.

3. Facilitating Amendments to the DGCL

Another commonly cited advantage to Delaware incorporation that is impacted significantly by informational benefits is the legislature's regular updates to the DGCL in response to the needs of the business community. The state's reliance on corporate franchise taxes for revenue[99] represents a public commitment of the legislature to be responsive to Delaware corporations.[100] Various institutional features, including Delaware's constitutional provision requiring a supermajority of both legislative houses to revise the corporation code, make it difficult to renege on that commitment.[101] Reliance on regular amendments may also explain the widespread standardization of corporate organizational documents - adoption of default terms (as opposed to customized terms) is a way for managers and shareholders to delegate to the government responsibility for adjusting their relationship over time in response to changing circumstances.[102]

Amendments to the DGCL are typically considered annually.[103] As a practical matter, the Delaware legislature is not heavily involved in their drafting. Instead, the Corporation Law Section of the Delaware State Bar Association and its governing body, the Council, play the primary role in the drafting of amendments.[104] Comprised of prominent practitioners of Delaware corporate law,[105] the Council meets monthly between legislative sessions to discuss and draft potential

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[99]Romano, *supra* note 50.

[100]*See, e.g.*, Roberta Romano, THE GENIUS OF AMERICAN CORPORATE LAW 37-38 (The AEI Press 1993).

[101]Delaware Constitution, Article IX, section 1. ("No general incorporation law, nor any special act of incorporation, shall be enacted without the concurrence of two-thirds of all the members elected to each House of the General Assembly.").

[102]Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 2 (2006).

[103]*See, e.g.*, Romano, *supra* note 100, at 37-38; Hamermesh, *supra* note 105, at 1754 (2006) ("[W]hen proposed amendments to the DGCL are presented for legislative consideration, as they are essentially every year, they are promptly brought to a vote before the appropriate committee and the floor of both houses.").

[104]Hamermesh, *supra* note 75, at 1755-56; *see also* About the Section of Corporation Law, http://tinyurl.com/DSBA-Corp (last accessed Nov. 8, 2015).

[105]Professor Hamermesh explains that the Council includes both litigators and transactional attorneys as well as practitioners who typically represent both plaintiffs and defendants. Hamermesh, *supra* note 105, at 1755-56.

amendments.[106] These discussions are private, although members of the Council receive and filter suggestions from clients and non-Delaware co-counsel,[107] calling upon their collective experience and the views of Delaware's judiciary when available.[108] Amendments require approval of the full Corporation Law Section and the Executive Committee of the Delaware Bar Association before they are presented to the Delaware legislature.[109] Amendments generally receive quick legislative attention and tend to pass unanimously.[110]

The regular generation of case law and the information it contains assists this annual process by disseminating information about the state of Delaware law to participants in the process. According to two prominent Delaware jurists, ongoing availability of case law is important to the amendment process because it "provides feedback to policymakers that stimulates later amendments to the rules."[111] The 2016 amendments provide a helpful illustration. In recent years, appraisal arbitrage has been on the rise,[112] fueled largely by Delaware's statutory interest rate of 5% over the Federal Reserve discount rate (compounded quarterly) that is payable on judgments entered in appraisal actions.[113] With recent cases noting both the increase in appraisal actions and the fact that they are often filed by hedge funds or other institutional investors who purchased shares with the intention of seeking appraisal, the 2016 amendments to the DGCL added a provision to Section 262 that allows the surviving corporation to pay, prior to final judgment, an amount to the shareholders seeking appraisal and, in so doing, terminate the accrual of interest on that amount.[114]

B. *Benefits Resulting from Generation of Factual Information*

Benefits also result from the ongoing generation of information related to the facts and circumstances underlying shareholder litigations. Like legal information, the ongoing generation of factual information benefits Delaware corporations as a group. First, factual information

[106] *Id.* at 1755-56.
[107] *Id.*
[108] *Id.*
[109] Hamermesh, *supra* note 75, at 1755-56.
[110] *Id.*
[111] William B. Chandler, III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 982 (2003).
[112] *See, e.g.*, Merion Capital LP v. BMC Software, Inc., 2015 WL 67586 (Jan. 5, 2015).
[113] 8 *DEL. C.* § 262(h).
[114] 8 *DEL. C.* § 262(h).

helps to illustrate the applicable legal principles and standards. By doing so, it enhances the value and usefulness of the information pertaining to Delaware law. The generation of factual information also facilitates non-legal mechanisms for holding corporate actors accountable. This, in turn, leads to increased levels of flexibility.

1. Illustrating Legal Principles and Standards

Opinions issued by Delaware's judges are known for their "fact-specific, narrative quality."[115] Detailed descriptions of both the circumstances leading to litigation and the conduct of directors, mangers, and a variety of other corporate actors are common, and not only when the Court acts as a finder of fact.[116] The Chancery Court's "distinctively narrative process" provides "a set of parables – instructive tales – of good managers and bad managers, of good lawyers and bad lawyers, that, in combination, fill out the normative job description of these critical players."[117] Delaware's judges use this narrative process to shame misbehaving corporate actors,[118] even when not holding them liable.[119] Conversely, virtuous actors receive judicial praise, and the Court holds out their behavior as worthy of emulation by others.[120]

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[115]Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1017 (1997).

[116]*See, e.g.*, *In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959 (Del. 1996) (motion for settlement approval); *See, e.g.*, *In re* Oracle Corp. Deriv. Litig., 824 A.2d 917 (Del. Ch. 2003) (motion to dismiss on recommendation of Special Litigation Committee). For an example of the Chancery Court acting as a finder of fact, see Vice Chancellor Laster's recent opinion in *In re* Dole Food Co., Inc. Stockholder Litig., 2015 WL 5052214 (Del. Ch. Aug. 27, 2015) in which he resolved claims arising out of the going private transaction in which Dole Food CEO David H. Murdock acquired all of the outstanding Dole Food common stock that he did not already own. The majority of the opinion consists of the Factual Background.

[117]Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016 (1997).

[118]David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1865 (2001).

[119]*See, e.g.*, *In re* Walt Disney Co. Deriv. Litig., 907 A.2d 693, 762-63 (Del. Ch. 2005) ("In light of this knowledge, I cannot find that plaintiffs have demonstrated by a preponderance of the evidence that Eisner failed to inform himself of all material information reasonably available or that he acted in a grossly negligent manner. Notwithstanding the foregoing, Eisner's actions in connection with Ovitz's hiring should not serve as a model for fellow executives and fiduciaries to follow. His lapses were many . . . To my mind, these actions fall far short of what shareholders expect and demand from those entrusted with a fiduciary position. Eisner's failure to better involve the board in the process of Ovitz's hiring, usurping that role for himself, although not in violation of law, does not comport with how fiduciaries of Delaware corporations are expected to act.").

[120]*See, e.g.*, *In re Dole Food Co., Inc.*, 2015 WL 5052214, at *1 ("The record at trial, however, demonstrated that the Committee carried out its task with integrity. The Committee was assisted in this effort by expert legal counsel and an investment bank – Lazard Frères &

These factually rich descriptions of underlying conduct and circumstances enhance the benefits that flow from the generation of information about Delaware law by giving meaning to the generalized standards that govern the actions of the directors and officers of Delaware corporations.[121] By relying on these open-ended standards, judges are "relatively free to select the facts and create a version of the events that they deem most relevant."[122] The factual descriptions "serve as guidance for future officers and directors" by providing them with examples of conduct and an assessment of whether that conduct met the applicable standard.[123] Studying the opinion can yield "lessons of what not to do"[124] or, in the case of opinions that identify characterize conduct favorably, provide models that can be duplicated. Here, the line between benefits arising out of factual information and those arising out of information relating to the state of Delaware law becomes blurry. As discussed below, however, it is useful and important to recognize that the generation of factual information alongside the information relating to legal standards enhance the network and other benefits discussed above in Section III.B.1.

Both the *M&F* and *Dole Foods* cases demonstrate the importance of having access to relevant factual information alongside information about the applicable rule or standard. In *M&F* the Court not only established the legal rule that conditioning a controlling shareholder merger on both the negotiation and approval by a special committee of disinterested directors and a majority of the minority shareholder vote will bring the transaction within the business judgment rule.[125] The Court also explained and illustrated its new legal rule with factual descriptions of how the procedural mechanisms functioned in the case and an explanation of why they were sufficient to trigger the business judgment rule.[126] As the Chancery Court's recent opinion in the action

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Co. LLC ("Lazard") – that likewise acted with integrity. In contrast to a string of decisions that have criticized financial advisors for flawed and outcome-driven analyses, this opinion can praise and rely on Lazard's thorough and balanced work product.").

[121]Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1017 (1997) (arguing that "the process that leads to reasonably precise standards proceeds through the elaboration of the concepts of independence, good faith, and due care through richly detailed narratives of good and bad behavior, of positive and negative examples, that are not reducible to rules or algorithms").

[122]Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1, 45 (2015).

[123]*In re Walt Disney*, 907 A.2d at 698.

[124]*Id.* at 760.

[125]Kahn v. M&F Worldwide Corp., 88 A.3d 635, 645 (Del. 2014).

[126]*Id.* at 647-54. Over the course of approximately seven pages, the Supreme Court delves into whether or not members of the Special Committee were independent of the controlling shareholder, which involved discussion and consideration of various personal,

challenging the going private merger of Books-A-Million, Inc. demonstrates, the *M&F* opinion is a manual on structuring a controlling shareholder transaction in a way that will trigger the business judgment rule.

Dole Food, on the other hand, provides instruction on when, despite an attempt to mimic *M&F*, a Special Committee will not be considered sufficiently well-functioning to activate the business judgment rule.[127] The Chancery Court's approach to issues such as the scope of the Committee's authority, selection of the Committee's advisors, the Committee's ability to say no to the transaction, and access to information will assist transactional participants and advisors in future attempts to structure a controlling-shareholder transaction in a way that brings it within the business judgment rule.[128] One major law firm has labeled the case "A Going-Private Primer"[129] on account of its

> instructive insight into a number of conflicted-party transaction issues, including assessing controlling shareholder status; identifying the appropriate standard of judicial review; the composition and functioning of special committees; the application of the entire fairness standard to facts at hand; assigning value to contingent future events for transaction valuation and damages assessment purposes; and

business, economic and academic relationships. *Id.* at 647-48. It also examines the powers delegated to the Special Committee, including its ability to hire advisors, negotiate, and "say no." *Id.* at 650-51. The decision also provides extensive detail about the Special Committee's procedures and conduct in connection with negotiation of the deal, including discussions of the forecasts the Special Committee considered and the results of the various valuation methods utilized. *Id.* at 651-52. With regard to the majority of the minority shareholder approval condition, the Court discussed the contents of the proxy statement and emphasized that the 65% vote in favor of the transaction occurred after stockholders were informed of "the background of the Special Committee's work, of Evercore's valuation ranges and of the analyses supporting Evercore's fairness opinion . . . ." *Id.* at 653-54.

[127]*In re Dole Food Co., Inc.*, 2015 WL 5052214, at *31-32 (Del. Ch. Aug. 27, 2015). The Chancery Court provides a long-list of issues including provision of false projections to the Special Committee, attempts to limit the Committee's mandate, improper sharing of information on the part of a member of management, and attempts to limit the Committee's ability to hire advisors of its own choosing.

[128]Karen Brunton Bloom, Evelyn Cruz Sroufe & Luis R. Mejia, *Lessons from the $148 Million Fraud by Dole's GC and CEO*, CORPORATE COUNSEL (Oct. 14, 2015), http://tinyurl.com/CC-Dole-14x15.

[129]BakerHostetler, *In re Dole Food Co., Inc.: A Going-Private Primer* (Sept. 11, 2015), http://tinyurl.com/Baker-Primer.

the distinctions between evaluating transactional fairness and individual exposure to liability.[130]

2. Facilitating Non-Legal Accountability Mechanisms

The factual information generated by Delaware shareholder litigation also plays a role in the functioning of non-legal accountability mechanisms, such as reputational sanctions and market pressures. For decades, critical commentators have been exploring the modern corporation's structural features that undermine management accountability.[131] Many features of corporate law, such as the business judgment rule,[132] the ability of Delaware corporations to exonerate directors for breaches of the duty of care,[133] corporate indemnification,[134] and the widespread availability of insurance to cover the liabilities of directors and officers all arguably insulate corporate fiduciaries from the consequences of bad decisions, potentially even dishonest, decisions. A dominant justification for this state of affairs is the "web of accountability mechanisms" that exists outside the firm.[135] A variety of forces, including the markets for capital, employment, products, and corporate control, constrain the extent to which corporate fiduciaries are able to enrich themselves.[136] Similarly, reputational sanctions impact the fiduciary's standing in a community as information about the fiduciary's

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[130] *Id. See also* Cadwalader, Wickersham & Taft LLP, *Delaware Court Finds Dole Executives Personally Liable for Millions in Damages for Defrauding Stockholders in Buy-Out and Undermining Special Committee Process* (Aug. 28, 2015), http://tinyurl.com/CAD-Dole.

[131] *See, e.g.*, ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 121 (William S. Hein & Co., Inc. 2000) ("But have we any justification for assuming that those in control of a modern corporation will also choose to operate it in the interests of the owners? The answer to this question will depend on the degree to which the self-interest of those in control may run parallel to the interests of ownership, and, insofar as they differ, on the checks on the use of power which may be established by political, economic, or social conditions.").

[132] Citron v. Fairchild Camera and Instrument Corp., 569 A.2d 53, 64 (Del. 1989) ("The business judgment rule is an extension of the fundamental principle that the business and affairs of a corporation are managed by and under the direction of its board. The rule operates as both a procedural guide for litigants and a substantive rule of law. As a rule of evidence, it creates a presumption that in making a business decision, the directors of a corporation acted on an informed basis i.e., with due care, in good faith and in the honest belief that the action taken was in the best interest of the company. The presumption initially attaches to a director-approved transaction within a board's conferred or apparent authority in the absence of any evidence of fraud, bad faith, or self-dealing in the usual sense of personal profit or betterment.") (internal citations and quotations omitted).

[133] 8 *DEL. C.* § 102(b)(7).

[134] *See* 8 *Del. C.* § 145.

[135] BAINBRIDGE, *supra* note 49, at 37.

[136] EASTERBROOK & FISCHEL, *supra* note 49, at 4; BAINBRIDGE, *supra* note 49, at 37.

conduct is revealed and disseminated.[137] When these forces exert their pressure on corporate fiduciaries, there is simply less work for corporate law to do. Other, more immediate concerns (like maintaining a competitive position in one or more competitive markets) provide corporate fiduciaries with strong incentives to act in the best interest of shareholders. But, these non-legal mechanisms all require information. To the extent that Delaware's flexible and enabling approach to corporate law is made possible by the disciplinary effects that other, non-legal accountability mechanisms have on corporate fiduciaries, reductions in the flow of information could impact the degree to which Delaware can maintain its traditionally enabling approach.

Factual information about the behavior of management is generated throughout the litigation process.[138] Provided a complaint survives a motion to dismiss, discovery ensures that plaintiff-shareholders and their representatives will have access to a wide variety of information about the actions of management, much of which will be come public in the course of litigation. But, Delaware law facilitates the generation of information even before litigation is commenced: Delaware includes a specific, pre-suit discovery mechanism under Section 220 of the DGCL that allows shareholders who are seeking to file litigation access to certain information that will likely be relevant to the threshold issues implicated by the demand requirement and presumption in favor of the business judgment rule.[139]

Judicial opinions also play a significant role in the ability of market-based and reputational sanctions to discipline corporate fiduciaries. Although much of the factual information included in issued opinions is usually old (insofar as it has already been revealed publicly at some point in the litigation process), judges affect how that information is interpreted and how it impacts non-legal disciplinary mechanisms by editing it, weaving it into a narrative, and expounding on its significance.[140] Even when the judge does not ultimately sanction an actor with liability, the factual information about that actor's behavior can have reputational consequences, especially if the actor receives judicial rebuke. It can also have a rehabilitative effect on the reputation of defendants by contextualizing their conduct and describing it with nuance.[141]

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[137]Shapira, *supra* note 122, at 1.

[138]Shapira, *supra* note 122, at 11. Erica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story about the "Genius of American Corporate Law,"* 63 EMORY L.J. 1383, 1383-84 (2014).

[139]8 *DEL. C.* § 220.

[140]Shapira, *supra* note 122, at 44-45.

[141]*Id.* at 23-24.

The *Dole Food* decision is a potent example of the Chancery Court's role as a channel for factual information relevant to non-legal accountability mechanisms. The factual information resulting from the case (particularly the information relating to the conduct of Murdock and Carter) is fodder for both market and reputation based accountability mechanisms. Particularly in the case of Carter (who, as a lawyer for the company, was subject to more rigorous ethical constraints), the case serves as a well-developed instructional manual for other in-house attorneys on what not to do.[142]

David Murdock (the controlling shareholder, CEO, and Chairman of Dole's board) and his deputy C. Michael Carter (director and President, COO, and General Counsel) received harsh criticism throughout. Murdock is described as "an old-school, my-way-or-the-highway controller, fixated on his authority and the power and privileges that came with it."[143] In the course of rejecting the relevance of Murdock's charitable activities, the Court criticizes his personality and chastises him for his behavior at trial:

> Murdock tried out three different personas during his testimony . . . Both during his deposition and on the first day of trial, many of Murdock's assertions were not credible or plainly wrong. To rehabilitate him, the defendants tried to portray him as a confused 91-year-old man, but it was clear that Murdock's intellect remains sharp. Murdock's problem was different. By dint of his prodigious wealth and power, he has grown accustomed to deference and fallen into the habit of characterizing events however he wants. That habit serves a witness poorly when he faces a skilled cross-examiner who has contrary documents and testimony at his disposal . . . In addition to offering the "confused old man" theory, the defendants sought to blunt the cumulative effect of Murdock's testimony, demeanor, and actions by citing his philanthropy, which is commendable. But it does not inoculate his business dealings. Tycoons like Vanderbilt, Carnegie, and Rockefeller built great fortunes as aggressive businessmen, then devoted substantial portions of their wealth to the betterment of all. More recently, Bill Gates led a company that was prosecuted successfully for antitrust violations, yet his foundation appears (at least to me) to be a

[142] *See* Alison Frankel, *How Dole's ex-general counsel cost his boss (and himself) $148 million*, REUTERS (Aug. 28, 2015), http://tinyurl.com/AF-28viii15.

[143] *In re Dole Food Co., Inc.*, 2015 WL 5052214, at *5.

> force for good. The ultimate balancing is for posterity and the divine.[144]

The Court similarly chastises Carter. His testimony is "false"[145] and "not credible."[146] The Court refers to his actions as "Carter's fraud" and quotes *Weinberger* when concluding that he committed "fraud, misrepresentation, self-dealing, [and] gross and palpable overreaching."[147] Ultimately, the Court holds Carter and Murdock personally liable for over $148 million.[148] In addition to these significant legal consequences, other sanctions for Murdock and Carter have almost certainly resulted from the Chancery Court's findings. Criminal prosecution and, in the case of Carter, bar disciplinary proceedings also seem to be potential consequences of the opinion. It is impossible to know what Carter's prospects for future employment, but it seems unlikely that he will be able to secure a position that is as lucrative or prestigious as his position at Dole.

As to the special committee and its advisors, on the other hand, the Court offers praise for its efforts in the face of Murdock's and Carter's obstruction. The Committee "carried out its task with integrity."[149] Through the "diligence of [the Committee's] members and their advisors, the Committee overcame most of Murdock and Carter's machinations."[150] For these individuals, the opinion is likely to have positive reputational ramifications. The directors who were able to maintain their independence in the face of Murdock's and Carter's actions and who were praised by the Court have now had their integrity and skill praised by the most prestigious business court in the country in a decision that was covered in business and mainstream news sources. Their reputation in the business community has almost certainly been enhanced. Similarly, advisors will also enjoy reputational benefits as uniquely qualified to represent special committees – they will likely be considered for future engagements as a result.

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[144] *In re Dole Food Co., Inc.*, 2015 WL 5052214, at *5 n.6.
[145] *Id.* at *19.
[146] *Id.* at *5 n.10.
[147] *Id.* at *38 (quoting *Weinberger*, 457 A.2d at 714).
[148] *In re Dole Food Co., Inc.*, 2015 WL 5052214, at *39.
[149] *Id.* at *1.
[150] *Id.* at *2.

IV. THE CONSEQUENCES OF WIDESPREAD ADOPTION OF FEE-SHIFTING AND NON-DELAWARE FORUM SELECTION PROVISIONS

This Section explores the impact that widespread adoption of fee-shifting and forum selection bylaws would have on the ongoing generation of information and the benefits that result from it. In Part A, I argue that wide-spread adoption of fee-shifting provisions would likely chill shareholder litigation to the point of negatively impacting the informational benefits that result from Delaware shareholder litigation. Part B addresses the consequences of widespread adoption of forum selection provisions that designate a non-Delaware forum (courts in a different state or arbitration) as the exclusive forum for shareholder-initiated litigation. I argue that these provisions threaten many of the benefits that result from Delaware's courts adjudicate the intra-corporate disputes of the state's corporations.

A. *Fee-Shifting Provisions*

Fee-shifting provisions are intended to alter the economic incentives applicable to plaintiffs' attorneys in shareholder suits. Provisions styled after the one upheld in *ATP Tour* target the peppercorn settlement phenomenon by requiring the plaintiff to pay all litigation fees in the event he or she does not achieve substantial success on the merits. A settlement would be insufficient for the plaintiff to escape this obligation. The intention is to deter the filing of frivolous strike suits that settle for no meaningful relief and then form the basis of a fee award under the corporate benefit doctrine. However, as demonstrated below, the deterrent effect of fee-shifting provisions would be much broader. Almost all litigation – including meritorious litigation – would be deterred by these broad and draconian provisions. This over-deterrence carries the threat of negatively impacting many of the benefits that come with a Delaware incorporation.

Corporate fee-shifting provisions – including the one at issue in *ATP*[151] – did not simply impose a higher burden on plaintiffs seeking to have the corporation pay their fees. Instead, they eliminated the

[151] *ATP Tour, Inc.*, 91 A.3d at 556. The bylaw at issue in *ATP* provided that if the plaintiff (Claiming Party) "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 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) . . . that the parties may incur in connection with such Claim."

corporate benefit doctrine (under which a plaintiff can secure a fee award if the action results in a benefit to the corporation)[152] and, in its place, imposed a non-mutual fee-shifting rule that required the plaintiff to pay its own *and* the defendants' costs and expenses whenever the plaintiff did not meet a specified level of success on the merits of the claim.[153] The *ATP* bylaw, for example, required plaintiffs to pay the defendants' costs and expenses unless plaintiffs obtain "a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought . . . ."[154] Imposition of such drastic consequences in the absence of substantial success on the merits is clearly intended to increase the economic risk involved in filing any claim.

Fee-shifting bylaws like the one upheld in *ATP* would be problematic primarily for two reasons. *First,* as Professor Griffith has demonstrated, the adjustment of economic incentives in the shareholder litigation context is particularly troubling because "it would force *representative* litigants to bear *individual* responsibility for the full cost of an unsuccessful suit."[155] The plaintiff stands to receive only a fraction of the benefit of any recovery but bears all of the risk created by a fee-shifting bylaw.[156] A potential answer to this, of course, would be for the plaintiffs' attorneys to agree to indemnify the plaintiffs for any amount for which the plaintiff is liable pursuant to a fee-shifting bylaw.[157] But, with such an arrangement, the potential for a significant divergence of interest between the attorneys and the plaintiffs would become even greater than it is currently.

Second, they were one-way insofar as there was no corresponding requirement that the defendants pay the plaintiff's fees in the event the

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[152] *See supra* Part I.B.

[153] Griffith, *supra* note 33, at 1; Stephen M. Bainbridge, *The Case for Allowing Fee Shifting Bylaws as a Privately Ordered Solution to the Shareholder Litigation Epidemic* 5 J. OF L. (4 THE POST) 105, 105-106 (2015).

[154] *ATP Tour, Inc.*, 91 A.3d at 556.

[155] Griffith, *supra* note 33, at 29.

[156] *Id.* at 3.

[157] A creative plaintiffs' firm could attempt to find an insolvent shareholder to act as lead plaintiff in the suit so as to make the threat of fee-shifting meaningless. An attempt to do so would likely be met with opposition when the court determines who will be appointed lead plaintiff. *See, e.g.*, King v. VeriFone Holdings, Inc., 12 A.3d 1140, 1151 (Del. 2011) (discussing potential denial of lead plaintiff status in the event an action is filed prematurely in race to the courthouse). Both Delaware and federal courts consider a wide variety of factors when determining who will act as the lead plaintiff. *See, e.g.*, Hirt v. U.S. Timberlands Serv. Co., 2002 WL 1558342 (Del. Ch. July 9, 2002) (listing six factors). Some of these factors, such as the economic stake of the plaintiff, and the general preference in favor of naming large, institutional shareholders lead plaintiffs whenever no conflict exists between them and smaller shareholders, make such a strategy unlikely to succeed. *See, e.g.*, TCW Tech. Ltd. P'ship v. Intermed. Comm. Inc., 2000 WL 1654504 (Del. Ch. Oct. 17, 2000).

plaintiff prevails. Although a successful plaintiff would be able to look to a common fund or corporate benefit for fees, the defendants themselves do not bear the risk of having to cover them. Fee-shifting provisions were drafted to allocate the risk created by uncertainty entirely on the plaintiffs.

The literature on fee-shifting has generally identified three types of incentives that are impacted by fee-shifting: those relating to initiation of claims, the investment in claims, and the settlement of claims.[158] On the claim-filing front, fee-shifting encourages the filing of claims that present a high probability of success at the filing stage, even if recovery would be low. It discourages suits that present a low probability of success, even if recovery would be high.[159] Fee-shifting's effect on the incentives that impact investment in claims can actually lead to an *increase* in the overall expenditures in legal fees because the parties discount their fees by their perceived probability of success. In the case of *ATP*-style fee-shifting provisions, defendants would have an incentive to spend increased amounts with respect to claims they think they can win because by doing so, they can discourage potential future plaintiffs.[160]

As to the effect of fee-shifting on settlement, it is important to take into account that the fee-shifting bylaws go further than the traditional "loser-pays," English rule by *automatically* shifting the fees onto the plaintiff even if the suit resolves in settlement. (Recall the *ATP* bylaw that imposes fee-shifting on the plaintiff he secures "a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought . . . ."[161]) For the plaintiff, any acceptable settlement amount would need to be high enough to take into account his obligation to pay the defendants' fees (or involve a waiver of any fee payment by defendants). In cases where the defendants are confident in their chances of succeeding at trial, the defendants would have little incentive to agree

[158] Griffith, *supra* note 33, at 28.

[159] *See, e.g.*, Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55, 59-60 (1982) ("[T]he frequency of suit will be greater under the British system when the plaintiff believes the likelihood of prevailing is sufficiently high – above a 'critical' level – and the frequency will be greater under the American system when the likelihood is below the critical level. This is so because when the plaintiff is relatively optimistic about prevailing, his expected legal costs will be relatively low under the British system – he will be thinking about the possibility of not having to pay any such costs – whereas under the American system he must bear his own costs with certainty. Thus he will be likely to find suit a more attractive prospect under the British system. But when the plaintiff is not optimistic, converse reasoning explains why he would be expected to sue more often under the American system.")

[160] Griffith, *supra* note 33, at 29.

[161] *ATP Tour, Inc.*, 91 A.3d at 556.

to a settlement, much less a settlement that would be palatable to the plaintiff.[162] Given that these provisions were intended to target the settlement-driven practices of the plaintiffs' bar, it is no surprise that they would be designed in a way that would significantly diminish plaintiff's bargaining power with respect to settlement negotiations.

While deterrence of frivolous litigation is hardly objectionable, the effect that corporate fee-shifting bylaws would have on litigants' risk and incentives would deter litigation "indiscriminately."[163] Plaintiffs would need to factor in their increased risk when choosing to file a claim and throughout the course of the litigation, but there would be no corresponding check on defendants' incentives to litigate to trial. Many cases in which plaintiffs could prevail (or secure a meaningful and valuable settlement) would never be brought, particularly if plaintiffs are forced to make the initial filing decision with limited information, which is almost always the case. Borderline cases (including those in which plaintiffs ultimately lose but which were brought with a reasonable, good faith belief that success on the merits was a possible outcome) would be particularly vulnerable to the deterrent effect of these bylaws.

The problem with this broad deterrence is that many of the informational benefits associated with Delaware law arise out of the types of cases that would simply be too risky to bring. This is not to argue that frivolous strike suits contribute to the generation of information and should therefore not be the proper object of deterrence. Rather, because the deterrence effect of fee-shifting bylaws is over-inclusive, they would keep many cases that would contribute to the generation of valuable information from ever being brought.

Ultimately meritorious cases are the most obvious class of claims that contribute to the generation of useful information and which could be deterred by fee shifting bylaws. *Dole Food*, for example, is a meritorious case that may not have been brought had the corporation's bylaws included a fee-shifting provision. Given the attempt to mimic the *M&F* structure, the Special Committee's ability to nudge the price higher into the arguable bounds of fairness, and the fact that some of the most

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[162] In reality, the corporation's directors' and officers' liability insurer is likely to be financing the defense and, under the doctrine of subrogation, would likely be entitled to receive any amounts recovered from the plaintiff pursuant to the fee-shifting bylaw.

[163] Griffith, *supra* note 33, at 29. *See also* J. Robert Brown, Jr. *Shifting Back the Focus: Fee Shifting Bylaws and a Need to Return to Legislative Intent*, 13-14 (University of Denver Sturm College of Law Legal Research Paper Series, Working Paper No. 14-65 2015); Verity Winship, *Shareholder Litigation by Contract*, 94 B.U. L. REV. 485, 486 (2016)(discussing deterrent effect of fee-shifting bylaws and exploring predominately negative reaction of proxy advisory firms and institutional investors to fee-shifting bylaws); Mark Lebovitch & Jeroen Van Kwawegen, *Of Babies and Bathwater: Deterring Frivolous Stockholder Suits Without Closing the Courthouse Doors to Legitimate Claims*, 40 DEL. J. CORP. L. 491, 491-92 (2015).

troublesome aspects of Murdock's and Carter's behavior were not known to plaintiffs prior to discovery,[164] it is not difficult to imagine that a bylaw requiring the plaintiff to succeed at trial to avoid fee-shifting would have made it too risky for a plaintiff to file the claim initially.

Not all cases in which the plaintiff-shareholder loses are frivolous. Many were initially filed with a reasonable and good-faith belief that the plaintiff had a significant chance to prevail. Many of these cases yield valuable informational benefits insofar as they lead the resolution of outstanding questions of law that arose out of reasonable disagreement. Take for example, *M&F*, the precursor to *Dole Food*. It was in *M&F* that the Chancery Court and eventually the Delaware Supreme Court first articulated that controlling-shareholder transactions conditioned on both negotiation and approval by a Special Committee of disinterested directors and approval by a majority of minority shareholders would fall within the business judgment rule.[165] The plaintiffs in this case were not meritorious – in fact, as a result of applying the business judgment rule, the Chancery Court entered summary judgment in favor of the defendants,[166] and the Delaware Supreme Court affirmed.[167] Notwithstanding the fact that this case is one in which the plaintiff shareholder did not prevail, it is difficult to overstate its significance and importance insofar as it gives management (*i.e.*, potential defendants) and their advisors a guide to structuring a controlling-shareholder transaction in a way that will trigger application of the business judgment rule rather than a mere burden shift within entire fairness review.[168]

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[164] *In re Dole Food Co.*, 2015 WL 5052214, at *20 (Del. Ch. Aug. 27, 2015) ("But until this litigation, the Committee and its advisors never knew that BAML, Scotiabank, Wells Fargo, Paul Hastings, and Griswold had also attended the Lender Meeting, or that Murdock's advisors had the opportunity to meet in person with and question Dole's international management.").

[165] *M&F Worldwide Corp.*, 88 A.3d at 644.

[166] *In re M&F Shareholders Litig.*, 67 A.3d 496, 536 (Del. 2013) ("When all these factors are considered, the court believes that the approach most consistent with Delaware's corporate law tradition is the one best for investors in Delaware corporations, which is the application of the business judgment rule. That approach will provide a strong incentive for the wide employment of a transactional structure highly beneficial to minority investors, a benefit that seems to far exceed any cost to investors, given the conditions a controller must meet in order to qualify for business judgment rule protection. Obviously, rational minds can disagree about this question, and our Supreme Court will be able to bring its own judgment to bear if the plaintiffs appeal. But, this court determines that on the conditions employed in connection with MacAndrews & Forbes's acquisition by merger of MFW, the business judgment rule applies and summary judgment is therefore entered for the defendants on all counts.").

[167] *M&F Worldwide Corp.*, 88 A.3d at 654.

[168] Some commentators argue that there are equitable reasons for relaxing fee-shifting, such as plaintiffs' loss establishing new law. *See, e.g.*, Thomas D. Rowe, Jr., *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 DUKE L. J. 651, 655 (1982) (noting that

Similarly, *Stone v. Ritter*,[169] one of the major oversight cases that defines the board's duty to oversee and monitor the corporation and its employees, was decided on a meritorious motion to dismiss for plaintiff's failure to satisfy the demand requirement. Notwithstanding the very preliminary stage at which it was resolved in favor of the defendants, this case determined several important issues of Delaware corporate law including whether good faith is an independent duty or falls under the duty of loyalty, the standard of conduct applicable to oversight claims, and the availability of exculpation for oversight claims.[170]

Even cases that settle often yield informational benefits in the course of securing Chancery Court approval for the settlement. Take, for example, *In re Caremark International Inc. Derivative Litigation,* the case that gave birth to the modern compliance department by establishing directors "duty to attempt in good faith to assure that a corporate information and reporting system . . . exists."[171] *Caremark* arose on a motion for settlement approval, and based on the Court's assessment of the plaintiff's case, the claims being settled appeared to be very weak.[172] Nevertheless, with this case, the Delaware Supreme Court articulated the board's duties of oversight and monitoring and gave basic instruction as to how a board can discharge those duties.[173] Together, *Caremark* and *Stone v. Ritter* are the seminal cases on the duty of Delaware directors to oversee and monitor the corporation, and neither one was decided in favor of the plaintiffs.

B. *Forum Selection Provisions*

Delaware's new restriction on forum-selection provisions prohibits any provision that would bar shareholders from filing litigation in the Delaware courts. Thus, provisions designating courts in another jurisdiction as the exclusive forum as well as provisions requiring arbitration are forbidden.[174] In this section, I consider the effects that widespread adoption of both varieties of non-Delaware forum selection provisions would have on the ongoing generation of information and

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in a "loser-pays" setting, the "loser in a test case making unexpected new law" would have a strong equitable argument against having to pay fees).

[169]Stone v. Rotter, 911 A.2d 362, 373 (2006).

[170]*Id.* at 364.

[171]*In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 970 (Del. 1996).

[172]*Id.* at 971 ("Nonetheless, given the weakness of the plaintiffs' claims the proposed settlement appears to be an adequate, reasonable, and beneficial outcome for all of the parties.").

[173]*Id.* at 967-68.

[174]The statutory language bars any provision that would "prohibit bringing such claims in the courts of this State." 8 *Del. C.* § 115.

argue that, as with fee-shifting bylaws, the result would be the destruction of many of the benefits identified above in Section II.

1. Non-Delaware Forum Selection Provisions

Pursuant to the newly enacted DGCL § 115, Delaware corporations may not designate the courts of another jurisdiction as the exclusive forum for resolving shareholder-initiated litigation. In this regard, Section 115 is a clear repudiation of *First Citizens*, which upheld a bylaw requiring that litigation be brought exclusively in North Carolina.[175] As demonstrated by *First Citizens*,[176] non-Delaware forum selection provisions are likely to be adopted by firms that are headquartered outside of Delaware and whose managers or controllers perceive some advantage to requiring shareholders to file litigation outside of Delaware. In *First Citizens*, the bylaw was adopted by a Delaware corporation that was headquartered in North Carolina at the same time the company entered into a merger agreement with a corporation under common control.[177]

Widespread migration of shareholder litigation involving Delaware corporations to other states would diminish the value of the information they include by diluting the body of Delaware case law.[178] While non-Delaware courts would be expected to attempt to apply pre-existing Delaware case law, uniform application across jurisdictions is unlikely to ever be the reality. Inconsistent results would be especially likely when courts in different states begin to reach issues of first impression. Without a centralized appellate court to harmonize conflicting decisions,[179] it would become increasingly difficult to determine the legal principle applicable to any particular situation.

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[175] City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 242 (Del. Ch. 2014).

[176] *Id.* at 235.

[177] *First Citizens BancShares*, 99 A.3d at 231-32, 237. Although the Chancery Court rejected their position, the plaintiffs argued that the defendants were hoping for more favorable treatment in the North Carolina courts than they would receive in Delaware. *Id.* at 237.

[178] Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L. J. 713, 749 (2009) ("Delaware corporate law doctrine regularly employs open-ended, highly fact-specific standard that are difficult to apply by any judge who does not regularly adjudicate corporate law disputes . . . As a result, any issue arising under Delaware corporate law where the correct outcome is not obvious is best decided by Delaware's judiciary.")

[179] As Posner and Landes explain, harmonizing conflicting precedent is an important function of appellate courts. There is no obvious method for achieving this in a system of adjudication by privately-retained, competitive judges. William A. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 239 (1979).

The line of controlling shareholder cases discussed in Section III.B.1. illustrates the importance of appellate courts' precedent-harmonizing function in the face of conflicting trial court outcomes. Prior to the Delaware Supreme Court's decision in *M&F* establishing the circumstances under which a controlling-shareholder transaction would receive the protection of the business judgment rule, Delaware's lower courts were split on relevant issues twice. It was not until *M&F* that these precedents were harmonized and a single rule established.[180] Corporations that have designated a non-Delaware court as the exclusive forum could always look to how that state's judges have applied Delaware law previously, but such an approach would significantly limit the size of the body of case law from which to draw. Furthermore, to the extent that new legal rules are developed over time and through a series of cases, the diffusion of cases into a variety of non-Delaware courts would have a negative effect on the consideration and development of new rules.

Diffusion of Delaware corporate litigation into non-Delaware courts would also have a negative impact on the value and effect of the factual information generated by shareholder litigation. Whether other states' judges can be expected to write with the same level of factual precision and detail as the Delaware Chancery Court, is doubtful (particularly when those judges' dockets will likely be relatively full and include a wide variety of cases). Additionally, given the complex factual background involved in many shareholder cases, courts that have not yet developed expertise in adjudicating complex business law issues will not have the same second-opinion effects as a court that is well-known for its

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[180] *See supra* Part III.A.2. After the Delaware Supreme Court's 1985 decision in *Rosenblatt*, confusion arose as to the effect that negotiation and approval of a controlling-shareholder merger by a special committee of disinterested directors would have on the standard of review and allocation of the burden of proof. Nine years later, in *Lynch*, the Delaware Supreme Court resolved this split and held that the effect of committee involvement would be a burden shift within the entire fairness standard. Subsequent to *Lynch*, questions arose as to the effect that conditioning the merger on both committee negotiation and approval of a majority of the minority shareholders; several years later in *M&F*, the Delaware Supreme Court ultimately established that the effect would be activation of the business judgment rule. In both of these instances, the appellate process "harmonized" divergent approaches and established a legal rule and the circumstances under which it would apply. For those planning a controlling-shareholder merger in the future, the ability to look to the lessons of *M&F* and structure the transaction in a way that will avoid fairness review is a considerable benefit. Without the appellate process to establish a uniform approach by issuing precedent that is binding on the lower courts, the applicable standard would depend on the identity of the particular adjudicator. It would be impossible to determine the applicable standard with any level of certainty prior to the litigation being filed and, from the perspective of the transactional planners, would call into question the value of including expensive procedural protections upfront.

specialized expertise.[181] And, finally, on a very practical level, significant dispersion of litigation into courts in other states would increase the costs of institutional investors that currently monitor Delaware litigation in real time.[182]

2. Arbitration Provisions

The possibility of using arbitration to resolve shareholder disputes is not a new idea.[183] At least one attempt to require arbitration of shareholder claims was made over two decades ago: a 1990 article in a prominent securities law publication details an unsuccessful attempt by the author's unnamed client to include an arbitration provision in its corporate charter when going public.[184] The SEC, however, refused to accelerate the company's registration statement on account of the arbitration provision,[185] putting an end to efforts by public-companies to mandate arbitration of shareholder actions.

Recent case law, however, has sparked renewed interest in the possibility. After *Boilermakers*, *First Citizens*, and the United States Supreme Court's pro-arbitration decision in *AT&T Mobility LLC v. Concepcion* (in which it held that the Federal Arbitration Act required enforcement of an arbitration clause prohibiting class-wide arbitration, even though that clause appeared in a standardized contract of adhesion),[186] mandatory arbitration of shareholder claims looked like a potentially viable option.[187] In fact, a Maryland court has already enforced an arbitration provision appearing in the bylaws of a publicly-traded Real Estate Investment Trust.[188]

Widespread adoption of mandatory arbitration provisions in corporate organizational documents would, like other non-Delaware

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[181]Shapira, *supra* note 122, at 15.

[182]*Id.* at 15 n.34.

[183]*See, e.g.*, C. Richard Shell, *Arbitration and Corporate Governance*, 67 N.C. L. REV. 517 (1989) (advocating the corporations experiment with arbitration as a method of resolving shareholder disputes).

[184]Carl W. Schneider, *Arbitration in Corporate Governance Documents: An Idea the SEC Refuses to Accelerate*, 4 INSIGHTS 21 (No. 5, May 1990).

[185]*Id.* at 22-23.

[186]AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 351 (2011).

[187]Whether or not the Federal Arbitration Act would preempt state laws (like Delaware's) prohibiting publicly traded corporations from adopting arbitration bylaws is a complicated question that is currently being debated. *Compare* Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEORGE. L. REV. 583 *with* Allen, *supra* note 38. Issues surrounding FAA preemption are outside the scope of this Article.

[188]Corvex Mgmt LP v. CommonWealth REIT, 2013 WL 1915769, at *2 (Md.Cir.Ct. 2013).

forum selection provisions, destroy many of the benefits identified above in Section II. However, as demonstrated below, the threat posed by arbitration is more significant on account of various practices that are commonly implemented in the course of arbitral proceedings.

That arbitration is a "creature of contract" is a regular, but important refrain.[189] Because arbitration is contractual, parties are generally free to tailor arbitration procedures to their liking. Best practices currently require that the parties have some input into the selection of arbitrators and are jointly responsible for the arbitrators' fees,[190] that arbitration proceedings be conducted confidentially,[191] and that the arbitrators' awards be both unappealable[192] and unreasoned (or "naked").[193]

As with non-Delaware forum selection provision, widespread adoption of arbitration provisions would significantly impede the future development of case law and cut-off the benefits that arise as a result of its public availability. In this regard, however, arbitration would present a much more serious threat because (1) arbitrators, unlike judges do not have the incentive to produce fully-reasoned opinions that are useful for purposes of assessing potential future action and resolving future disputes; (2) even if they did, there is no centralized appellate procedure available for harmonizing conflicting arbitration awards; and (3) even if mechanisms for producing and harmonizing precedent were to exist, arbitration is usually conducted confidentially.

Parties to an arbitration generally have input into the selection of arbitrators[194] and pay for the arbitrators' time (by the hour or day). These features are responsible, at least in part, for the general practice of

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[189] *See, e.g.*, United Steelworkers of Am. v. Am. Manuf. Co., 363 U.S. 564, 569 (1960) (noting that "arbitration is a creature of contract").

[190] *See, e.g.*, 2 DOMKE ON COMMERCIAL ARBITRATION §24:2, §24:3.

[191] 4 AM. JUR. 2D *Alternative Dispute Resolution* § 44 (2015) ("With some limited exceptions, contractual arbitrations are generally considered to be private and the arbitrators are expected to adhere to the ethical standards of confidentiality.").

[192] The Federal Arbitration Act provides a limited and narrow set of grounds for vacating an arbitration award. 9 U.S.C. § 10 (2012). Such grounds are primarily focused on wrongdoing or misconduct by the arbitrator(s).

[193] *See, e.g.*, American Arbitration Association, COMMERCIAL ARBITRATION RULES AND MEDIATION PROCEDURES R-46(b) (Oct. 2013) ("The arbitrator need not render a reasoned award unless the parties request such an award in writing prior to appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate.").

[194] This input can take various forms, including outright selection of one or more arbitrators or eliminating one or more arbitrators proposed by the organization conducting the arbitration. *See, e.g.*, Alan Scott Raum, *Integrity in Private Judging*, 38 S. TEX. L. REV. 485, 497 (1997); Luis M. Martinez, *The ICDR's Arbitrator Appointment Process – The Institutional Role and Available Options*, American Bar Association, Section of International Law, International Arbitration Committee, Volume 1, Issue 1 at 20 (2013).

issuing naked and unappealable awards. Parties paying for arbitrators' time are unlikely to want to pay for the time involved in the production of fully reasoned awards that explain the result in a way that primarily provides guidance for third parties the future.[195] For parties to an arbitration, resolution of the dispute is the primary objective. Arbitrators have every reason to comply (on account of their desire to maximize their reputation and secure future arbitral engagements)[196] and do not themselves have an incentive to spend the time producing detailed opinions if they are not being compensated for it.[197]

This dynamic is also responsible for the general lack of any arbitral appellate process – neither the parties to an arbitration nor the arbitrators have any reason to underwrite the costs of producing appellate precedent that will primarily benefit others.[198] Although the appellate process can also play an error-correction function, the need for error correction in arbitration is insufficient to require appellate procedures, in part, because the parties are able to reduce the potential for error by choosing reputable arbitrators with relevant experience. The arbitrators themselves have an economic incentive to avoid error that public judges do not have.[199] Whatever need there may be for an error-correcting mechanism is insufficient to justify the additional expenses that would be borne by the parties. And, in fact, the lack of an appellate process is perceived as one of arbitration's advantages. Without appellate courts to harmonize precedent and promulgate binding rules on arbitrators, any

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[195] Steven Shavell, *The Appeals Process as a Means of Error Correction*, 24 J. LEGAL STUD. 379, 424 (1995); Bruce L. Hay, et al., *Litigating BP's Contribution Claims in Publicly Subsidized Courts: Should Contracting Parties Pay Their Own Way*?, 64 VAND. L. REV. 1919, 1931–32 (2011) ("Even if arbitrators were as qualified as judges to make precedent, it is doubtful that the parties would be willing pay the price for comparable services. And that price would be quite steep, far higher than the cost of simply deciding the legal questions for the sole benefit of the present parties. To begin with, arbitrators would labor longer and more intensively to decide legal questions for the benefit of parties other than those financing the proceedings[.]"*Id.* at 1944-45.); Landes & Posner, *supra* note 179, at 238.

[196] Christopher A. Drahozal, *Judicial Incentives and the Appeals Process*, 51 S.M.U.L. REV. 469, 471 (1998). Because of their need to compete for engagements, arbitrators "aim for decisions which are pairwise Pareto efficient, which involves giving no weight to third parties." Robert Cooter, *The objectives of private and public judges*, 41 PUB. CHOICE 107, 130 (1983). For this reason, they will not give any weight to the need of third parties for precedent that will inform future actions. *See also* Landes & Posner, *supra* note 179, at 238. Raum, *supra* note 194, at 529 (noting that "the naked award [] is the norm in domestic commercial arbitration").

[197] Landes & Posner, *supra* note 179, at 238.

[198] *See* Drahozal, *supra* note 196, at 501-02.

[199] Shavell, *supra* note 195, at 423-24.

body of arbitral precedent would likely be highly inconsistent and have little, if any, predictive value.[200]

Given these common features of arbitration, it is likely that widespread adoption of arbitration provisions in corporate governing documents would diminish many of the benefits that arise out of both the generation of information relating to both the state of Delaware law and the facts underlying the claims. Unreasoned awards would be nearly useless when future parties attempt to plan a transaction that complies with Delaware law. Even if some awards were reasoned, the lack of any appellate tribunal to harmonize conflicting awards and establish binding rules of law would similarly make it difficult for parties to plan corporate actions and transactions with confidence. If it were somehow possible to overcome the system of incentives responsible for unreasoned, non-appealable awards, parties to arbitrations are unlikely to forgo confidentiality.[201]

Over time, the benefits arising out of Delaware's well-developed body of case law would shrink and potentially disappear. As the likelihood that future opinions that provide relevant guidance to similarly situated parties will become smaller, network benefits would dissipate. Legal and financial advisors would have fewer opportunities to study opinions issued in cases in which they were not involved. And, because arbitration does not have the same attorney admission requirements that are applicable to litigation in state and federal courts, the experience and expertise that is currently concentrated in the Delaware bar and a handful of large, corporate law firms that work alongside Delaware firms would likely be dispersed among a broader group of practitioners.[202] Less frequent retention of Delaware counsel would negatively impact the

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[200]Landes & Posner, *supra* note 179, at 239. Of course, if some corporations did not adopt mandatory arbitration provisions and continued to litigate disputes in the Delaware courts. However, the rate at which precedent is produced and rules are promulgated would decrease with the number of suits being litigated in the Delaware courts. Furthermore, as discussed more fully below in Section IV.A., the prospect of opting-out of litigation in Delaware court presents a collective action problem insofar as those firms who opt out would be free-riding on the benefits resulting from those firms who do not opt-out.

[201]The ability to keep the proceedings, pleadings, etc. confidential is one of the most attractive features of arbitration. Delaware's short-lived Chancery arbitration program offered disputants the opportunity to have a member of the Court of Chancery act as an arbitrator. The confidentiality of the proceedings was one of its most attractive features.

[202]Currently, Delaware (like most jurisdictions) requires that counsel admitted in Delaware be engaged in connection with all proceedings taking place in its courts but allows attorneys admitted elsewhere to be admitted *pro hac vice* in connection with a single case. Delaware rejects, however, the phenomenon of "local counsel," in which the attorney admitted in the jurisdiction plays a primarily ministerial role. Delaware expects the Delaware attorneys to play an active role in the case and to monitor the behavior of counsel admitted *pro hac vice*. *See, e.g.*, James v. Nat. Fin. LLC, 2014 WL 68455600, at *12 (Del. Ch. Nov. 3, 2014).

Delaware bar's knowledge with regard to ongoing legal and business trends and reduce the network benefits that arise from having knowledge and experience concentrated within a relatively narrow group of practitioners.

Scholars of arbitration and dispute resolution have documented the effect that widespread adoption of arbitration clauses has had on the ongoing development of legal doctrine in other substantive areas.[203] Because "arbitration eliminates litigation in a public forum, precedent establishing decisions, and stare decisis,"[204] widespread migration of a particular type of case to arbitration halts the ongoing development of legal doctrine in that substantive area.[205] There is no reason to conclude that the result would be any different in the corporate context. There is, however, one significant difference between corporate law and many of the other substantive areas that face doctrinal disappearance on account of arbitration (*e.g.*, consumer protection, employment, antitrust) and that difference is the fact that corporations and their constituents pay for the benefits of incorporation in Delaware up front and on an ongoing basis. They are paying for the benefits that widespread fee-shifting and forum-selection provisions would put at risk. The implications of this opt-in decision are discussed more fully in Section V.A.

Additionally, widespread adoption of arbitration provisions would reduce the availability of factual information related to the behavior or corporate insiders and, in doing so, impede the functioning of non-legal accountability mechanisms. Because arbitration generally proceeds confidentially, much of the factual information generated in connection with it would never be released publicly and would not be available to institutional investors who currently monitor Chancery Court proceedings in real time. Unreasoned awards (even if publicly released in connection with a petition for confirmation) would not include nearly the level of factual information that regularly appears in judicial decisions. Arbitrators, concerned with the impact that including negative factual information would have on their prospects for future engagements, would have little incentive to include details related to misconduct. They would certainly be disinclined to shame bad actors

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[203] *See, e.g.*, Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 YALE L. J. 2804, 2836 (2015); Myriam Gilles, *The Day Doctrine Died: Private Arbitration and the End of Law*, 2016 U. Ill. L. Rev. 371 (2016).

[204] Richard Alderman, *Consumer Arbitration: The Destruction of the Common Law*, 2 J. AM. ARB. 1, 11 (2003).

[205] Gilles, *supra* note 203, at 47 ("[W]holesale removal of entire categories of cases from the public judicial system would arbitrarily freeze doctrinal development at the point of removal.").

who are not held liable if a reputation for doing so would lead to fewer engagements in the future.[206]

V. JUSTIFYING DELAWARE'S NEW RESTRICTIONS ON CORPORATE FEE-SHIFTING AND FORUM SELECTION PROVISIONS

In this Section, I explore justifications for Delaware's new limitations on fee-shifting and forum selection provisions. As discussed above, these new mandatory rules raise difficult questions in light of Delaware's generally enabling approach to corporate law. As the decisions in *ATP Tour, Boilermakers*, and *First Citizens* demonstrate, this approach views the relationship between the corporate constituents as a contractual one and emphasizes providing those parties with the flexibility and contractual freedom necessary to tailor their arrangement to their own needs. For normative contractarians, corporate codes, such as the DGCL, should generally supply default terms that parties can modify contractually, and only third party effects or market failures justify mandatory rules.[207]

In Section A, I argue that the mandatory rules are a response to the effect the widespread adoption of fee shifting and non-Delaware forum selection bylaws would have on the benefits that arise out of the generation of information that occurs as a result of having Delaware corporate cases primarily decided in Delaware. As discussed *infra*, maintenance of these benefits presents a collective action problem, and the effect that the destruction of these benefits would have on third parties is one justification for the new limitations. In Section B, I argue that Delaware's new mandatory rules can also be justified because they will foster broader freedom and flexibility in other, more substantive areas of corporate law. Finally, in Section C, I examine recent case law behind the recent decline in the peppercorn settlement phenomenon. I conclude that Delaware's limitations on fee-shifting and forum-selection provisions alongside its new approach to settlements and fee awards should be viewed as a comprehensive approach to the shareholder-litigation crisis that targets problematic practices without destroying the

[206]Cooter, *supra* note 196, at 125 ("Consequently, there must be a correspondence between the distribution of demands by disputants and the distribution of judges by reputations. For example, if most disputants agree to choose a private judge who enjoys a reputation for making moderate awards to a certain class of plaintiffs, but a few disputants agree to choose a judge who is generous to plaintiffs, but a few disputants agree to choose a judge who is generous to plaintiffs, then in competitive equilibrium most judges will make moderate awards and a few judges will make generous awards in that class of disputes.");

[207]*See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 49, at 22-26.

very valuable benefits that shareholder litigation generates for Delaware corporations.

A. *Cutting off the Flow of Information – A Collective Action Problem*

As discussed above in Section II, the legal information generated by shareholder litigation benefits Delaware corporations in a variety of ways. Insofar as this legal information is found in publicly available case law, it has the characteristics a public good.[208] Its production relies on having adjudications performed by an institution that is less vulnerable to the variety of economic disincentives involved in precedent production,[209] such as a government court system funded by a combination of fees paid by litigants and tax revenue. For Delaware corporations to continue benefiting from the flow of information, shareholder litigation involving Delaware corporations must result in decisions issued by the Delaware courts. Over-deterrence of litigation (as a result of fee-shifting provisions) or its dispersion into non-Delaware fora would negatively impact the generation of this public good.

In the case of corporate law, those who benefit most from "using" it pay a fee when first incorporating in the state and continue to do so annually with payment of Delaware's franchise tax. In exchange for these payments, Delaware corporations have the ability to "use" Delaware law (*e.g.*, by relying on its application to a transaction designed to comply with it), its court system, its infrastructure for corporate services, etc. Insofar as some of these benefits result from the information generated by the litigation that takes place in Delaware's courts and therefore depend on a stream of disputes being sent those courts for adjudication, it is possible to view fee-shifting and forum-selection provisions as presenting a potential free-rider problem.

The problem arises because, with regard to any particular litigation, the parties to it will pay almost all of the costs associated with generating the informational benefits, but those benefits will be enjoyed by all Delaware corporations (as well as a variety of corporate actors) who utilize that information at some point in the future. The disparity between those who pay the costs and those who enjoy the benefits gives individual corporations an incentive to attempt to constrain or eliminate those costs by adopting fee-shifting and forum selection provisions.

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[208] Roberta Romano, *The Shareholder Suit: Litigation without Foundation?*, 7 J. L. ECON. & ORG. 55, 85 (1991); *See generally* Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549 (1989); Landes & Posner, *supra* note 179, at 261.

[209] *See infra* Section II.B.2.

Firms who attempt to opt-out of having their own shareholder disputes resolved by the courts in Delaware (by either making it prohibitively risky to file any action or by designating another forum as the exclusive forum) but still take advantage of the benefits that arise from resolution of shareholder litigation against other corporations by the Delaware courts are free-riding on those Delaware corporations who continue to contribute their disputes to the Delaware courts. Eventually, if enough corporations opt-out, the flow of information will decrease, diminishing or eliminating many of the benefits that result from it.[210] Delaware's new restrictions on fee-shifting and non-Delaware forum provisions bar potential free-riders from opting out and destroying many of the benefits for which Delaware corporations pay on account of incorporating in the state.

Professor Jeffrey Gordon has previously offered a "public good hypothesis" as a justification for mandatory corporate law terms.[211] He has argued that it may be appropriate to restrict the ability of firms to deviate from the terms in a state's corporation code because "firms collectively are better off if the standard form is maintained."[212] If firms are allowed to deviate from the standard terms, they will be "tested less frequently," and the ultimate result will be "disintegration of the standard form."[213] Subsequent empirical research, however, has shown that this threat is less than Professor Gordon originally perceived it to be.[214] Delaware corporations seem to prefer to maintain the standard form without being forced to.[215] Nevertheless, his point that a public good conception of corporate law provides a potential justification for mandatory rules is helpful here.

More recently, two of Delaware's most prominent jurists have made similar arguments in favor of mandatory fiduciary duties in the

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[210]It is helpful to draw an analogy to the "tragedy of the commons," in individuals act in a way that is rational and in their individual self-interests but this behavior is also contrary to the best interests of a larger group to which they belong. In its traditional sense, the tragedy of the commons refers to the overuse of a resource or asset that is commonly owned. Here, the damage to the information benefits does not result from overuse, but, instead, results from the individual's rational self-interest in attempting to opt-out of the system that generates the benefits. It is not a perfect fit, but the fundamental issue—a conflict between the rational, self-interested behavior of individuals and the best interests of the group as a whole—is present here.

[211]Gordon, *supra* note **Error! Bookmark not defined.**, at 1567.

[212]*Id.*

[213]*Id.*

[214]Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 789 (2006) (surveying empirical evidence showing a lack of diversity with respect to terms appearing in corporate organizational documents).

[215]This may be because they perceive value in the nearly annual legislative updates to the standard form. Hansmann, *supra* note 102.

unincorporated business entities context (limited liability companies and limited partnerships). Delaware's policy of contractual freedom is even stronger in relation to these entities than it is in relation to corporations.[216] According to Chief Justice Strine and Vice Chancellor Laster, the widespread proliferation of customized terms in the governing documents of unincorporated business entities has led to "*ad hoc* judicial decisions interpreting specific provisions that do little to advance the development of common understandings among market participants."[217] This state of affairs is detrimental to both investors, who must either expend "material costs for legal advice" to understand the terms of their investments, and managers, who cannot "draw on market experiences and practices that have been generalized from other cases."[218] For these reasons, Chief Justice Strine and Vice Chancellor Laster call for imposition of a narrow set of mandatory terms to "promote investor confidence, create a predictable body of case law, and enable contract drafters to simplify the tangled web of provisions that currently attempts to substitute for traditional duty-of-loyalty analysis."[219]

The position adopted in this Article is similar to that of Gordon, Strine, and Laster insofar as it argues that maintaining the benefits that arise out of standardization is an acceptable justification for the imposition of mandatory terms. It is, however, materially different with regard to the type of mandatory term it advances. Rather than looking to the benefits of standardization and network effects as justification for mandatory terms related to the duties of corporate fiduciaries, it argues in favor of for mandatory terms relating to procedures by which shareholder disputes are addressed. The objective is not to maintain a standard form through imposition of mandatory substantive terms. Instead, the objective is to maintain a common dispute resolution mechanism that

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[216] *See Del. C.* § 18-1101(b) (2013) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."); *Del. C.* § 17-1101(c) (2013) ("It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.").

[217] Leo E. Strine & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, in RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS, AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 11, 12 (Robert W. Hillman & Mark J. Loewenstein, eds., 2015).

[218] *Id.* at 26-27.

[219] *Id.* at 13. Professors Merrill and Smith have made a similar argument in the context of justifying property law's recognition of a limited number of property interests. According to these commentators, the numerous clausus principle helps to achieve an optimal level of standardization that "minimize[s] the sum of measurement (and error costs), frustration costs, and administrative costs" that would arise if there were not constraints on parties' ability to devise novel issues. Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L. J. 1, 38 (2000).

generates a variety of benefits related to the development, meaning, and application of those terms, whatever they may be.

B. *Facilitating Freedom and Flexibility in Other Areas*

In this Section, I argue that Delaware's new restrictions on fee-shifting provisions will actually foster contractual freedom and flexibility in other areas of corporate law. This argument is less about information production than it is about the trade-off between *ex post* and *ex ante* mechanisms for ensuring that corporate fiduciaries act in the interests of shareholders and the impact those mechanisms have on the freedom and flexibility available under a corporate law regime. Professor John Coffee has previously observed the connection between contractual freedom and *ex post* judicial review in the corporate law context.[220] Because of the long-term, relational aspect of the arrangement between shareholders and management, it is not possible to negotiate and specify a complete set of terms *ex ante* (nor would it be desirable given the significant costs that this would involve). The solution is *ex post* adjudication pursuant to that broad fiduciary principles that provide the "rule[s] for completing incomplete bargains."[221] Readily available case law gives insight into how a court will apply these rules and allows management and their advisors to predict whether contemplated actions will comply with them. Without some meaningful guidance as a counterweight (even if it is not complete or perfectly clear), uncertainty is likely to have a chilling effect on many desirable actions or transactions.

Furthermore, the "feasibility" of the long-term arrangements between shareholders and management "probably depends upon the parties' ability to rely upon the courts" for *ex post* enforcement of fiduciary principles.[222] If shareholders do not have reliable recourse to *ex post* adjudication to challenge the way corporate fiduciaries have exercised their power and discretion, they are likely to demand more extensive *ex ante* limitations on the discretion given to management.[223]

[220]John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1621 (1989) ("[C]ontractual innovation can be reconciled with a stable mandatory core of corporate law if we recognize that what is most mandatory in corporate law is not the specific substantive content of any rule, but rather the institution of judicial oversight.").

[221]EASTERBROOK & FISCHEL, *supra* note 49, at 92.

[222]*See, e.g.*, Coffee, *supra* note 220, at 1620.

[223]Ribstein's work on unincorporated business associations is instructive insofar as he notes their substitution of accountability and disciplinary mechanisms that are put in place *ex ante* for *ex post* litigation pursuant to fiduciary principles. *See, e.g.*, Larry Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 165 (2009) ("[C]ustomizing or eliminating fiduciary duties[] may be best suited only to those firms that

Because of the impossibility of designing comprehensive arrangements, attempts to lay out more fulsome rules and procedures *ex ante* are likely to be poorly suited to address issues that arise under circumstances that were not present or anticipated at the time those rules are designed and implemented.

Chief Justice Strine has explored the relationship between flexibility, *ex ante* mandatory rules, and Delaware's reliance on litigation (an *ex post* mechanism) to constrain the conduct of corporate fiduciaries. He has argued that the flexibility for which Delaware law is known (and valued) results from its adoption of an "enabling paradigm."[224] This approach creates "room for economically useful innovation and creativity," but a consequence of this flexibility is "indeterminacy and litigation intensiveness."[225] If investors will push for more comprehensive *ex ante* rules in response to limitations on their ability to challenge actions *ex post*, a reduction in flexibility and "economically useful innovation and creativity"[226] will follow.

C. *Delaware Adjusts its Stance on Disclosure-Only Settlements and Fee Awards*

That there are strong justifications for Delaware's new restrictions on fee-shifting and forum selection provisions provides no solution for the problems created by the shareholder litigation explosion. As discussed above in Section I, these problematic trends arose largely as a result of efforts by multiple plaintiffs' attorneys to receive fee awards by filing duplicative litigation in multiple fora and settling in exchange for either minimal or no monetary relief. The obvious solution, of course, was for courts to adjust their standards for awarding fees to plaintiffs' attorneys, but the existence of competition amongst courts for litigation made this unlikely to do anything aside from driving litigation into more friendly fora.

State competition for shareholder litigation incentivizes states to create an environment that is attractive to plaintiffs and their attorneys. The most obvious way to do this is with a low rate of claim dismissals and a permissive stance toward fee awards. Cain and Solomon have

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can use uncorporate-type discipline instead of corporate-type monitoring."); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1477 (2006) (noting that publicly held partnerships often deploy "specific requirements to make distributions" and other "accountability devices [that] do not require ongoing supervision by courts or collective action by shareholders" instead of traditional fiduciary duty litigation).

224 Strine, *supra* note 47, at 1258.

225 *Id.*

226 *Id.* at 1258.

recently proffered a convincing account of state court competition for corporate litigation whereby plaintiffs' attorneys bring litigation in the forum that they conclude is most favorable based on prior decisions from that forum.[227] They argue from empirical evidence that "[a]ttorneys dynamically react to dismissals and the loss of attorneys' fee awards by shifting future case filings towards jurisdictions which make 'better' awards."[228] They find that while Delaware tends to have a higher dismissal rate than other jurisdictions, it reacts to attorney forum shopping by lowering that rate and "by paying more in attorneys' fees on average."[229]

Despite this competitive dynamic, the Delaware Chancery Court has recently gone in the opposite direction with regard to disclosure only settlements. The Chancery Court fired a shot across the bow with *In re Riverbed Technology Inc. Stockholders Litigation.*[230] In evaluating a proposed settlement, Vice Chancellor Glasscock found "the breadth of the release 'troubling'" when compared to the "peppercorn" of additional disclosures that the plaintiff shareholders would receive.[231] The Count indicated that it would have been inclined to reject the settlement were it not for the parties' reasonable reliance on its prior, permissive stance toward such settlements[232] and explained that the importance of the parties' reliance would be "diminished or eliminated going forward in light of this Memorandum Opinion."[233] Although the Court ultimately approved a fee award, it reduced the requested award by 40% (exclusive of expenses).[234] Reaction to *Riverbed Technology* was swift: several commentators and prominent Delaware law firms characterized it as the end of disclosure-only settlements,[235] a prediction which appears to be accurate in light of subsequent developments.

More recently, in *In re Trulia, Inc. Stockholder Litigation*, the Court of Chancery followed through with this warning and denied approval of a disclosure-only settlement because the disclosures were not

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[227]Cain & Solomon, *supra* note 14, at 468.

[228]*Id.* at 496.

[229]*Id.* at 497.

[230]*In re Riverbed*, 2015 WL 5458041. Other, contemporaneous opinions from the Court of Chancery take a similar approach. *See, e.g.*, *In re* Susser Holdings Corp. S'holder Litig., No. 9613 (Del. Ch. Sept. 15, 2015); Acevedo v. Aeroflex Holding Corp., No. 9730 (Del. Ch. Jul. 8, 2015); *In re* Intermune, Inc., S'holder Litig., No. 10086 (Del. Ch. Jul. 8, 2015).

[231]*In re Riverbed*, 2015 WL 5458041, at *6.

[232]*Id.*

[233]*Id.*

[234]*Id.* at *8.

[235]Chelsea Naso, *Del. Opinion Spells an End to Disclosure-Only Settlement*, LAW360 (Sept. 18, 2015), http://tinyurl.com/L360-18ix15.

material (or even helpful) and could not justify the grant of a release to defendants.[236] In a thorough discussion of recent trends in shareholder litigation, the Court attributed the dramatic increase in deal litigation to its "willingness in the past to approve disclosure settlements of marginal value and to routinely grant broad releases to defendants and six-figure fees to plaintiffs' counsel."[237] Going forward, the Court explained, disclosure settlements will be viewed with disfavor unless they "address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently."[238]

It would appear that the Delaware courts are acting against their own competitive interests in adopting a less permissive stance toward disclosure-only settlements and fee accompanying fee awards. But when this case law is considered alongside the restrictions on fee-shifting and forum selection provisions, the picture becomes more clear. Delaware corporations are able to adopt exclusive Delaware forum selection provisions and force plaintiffs' firms to file their claims in Delaware, even though they would rather attempt to escape the state's new approach to settlements and fee awards.[239] The Chancery Court makes this point explicitly in *Trulia*, reminding Delaware corporations worried about a migration of actions to other jurisdictions that it is within their power to enact such a provision.[240] Delaware cannot, however, opt-out of shareholder litigation in Delaware altogether.

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[236] *In re Trulia*, 129 A.3d at 887 ("[N]one of the supplemental disclosures were material or even helpful to Trulia's stockholders, and thus the proposed settlement does not afford them any meaningful consideration to warrant providing a release of claims to the defendants.").

[237] *Id.* at 894.

[238] *In re Trulia*, 129 A.3d at 898.

[239] This, of course, assumes that courts in other jurisdictions would enforce an exclusive Delaware forum-selection provision. While forum-selection provisions are generally enforceable, *see, e.g.*, Atlantic Marine Const. Co., Inc. v. U.S. Dist. Court for the W. Dist. of Tx., 134 S. Ct. 568, 581 (2013), there are several generally applicable exceptions, including one applicable when enforcing the forum-selection provision would be contrary to public policy. *See, e.g.*, M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 15 (1972) ("A contractual choice-of-forum clause should be held unenforceable if enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or by judicial decision."). It is not hard to imagine that a court sitting in the jurisdiction where a Delaware corporation is headquartered would be motivated to find a way to retain a suit filed there in contravention of an exclusive Delaware forum-selection bylaw or charter provision. This is particularly the case if the lead plaintiff or other large shareholder was a pension or retirement fund affiliated with an institution located in that state.

[240] *In re Trulia*, 129 A.3d at 899 ("Finally, some has expressed concern that enhanced judicial scrutiny of disclosure settlements could lead plaintiffs to sue fiduciaries of Delaware

So far, this approach seems to be working – filings are down significantly.[241] If the Chancery Court continues to follow through with its indications that disclosure-only settlements will no longer be approved and will no longer be the basis for generous fee awards, the number of frivolous filings should fall even further.[242] Meritorious claims and non-meritorious claims that offer a reasonable chance of recovery at the pleading stage should not be affected, and the informational benefits that arise out of having these claims prosecuted in Delaware courts will continue to accrue. However, in their justified efforts to escape strike-suits and other abusive practices, Delaware corporations cannot destroy these benefits by attempting to opt-out of almost all shareholder litigation (through fee-shifting provisions) or dispersing litigation into non-Delaware fora that they perceive to be more friendly to their interests.

VI. CONCLUSION

When initially enacted, Delaware's restrictions on corporate fee-shifting and non-Delaware forum-selection provisions appeared to be a politically-motivated departure from its general policy in favor of private ordering. S.B. 75's direct repudiation of the relatively straight-forward opinions *in ATP Tours* and *First Citizens* made the legislature's decision to adopt additional mandatory terms – it was not working on a blank slate. However, consideration of the effects that widespread adoption of fee-shifting and non-Delaware forum selection provisions would have on Delaware corporations collectively makes it possible to see S.B. 75 differently. When Delaware's courts adjudicate the intra-corporate disputes of the state's corporations, valuable information results. The ongoing generation of this information plays an important role in

corporations in other jurisdictions in the hope of finding a forum more hospitable to signing off on settlements of no genuine value. *It is within the power of a Delaware corporation to enact a forum selection bylaw to address this concern.*") (emphasis added).

[241]*See* CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2015 AND 1H 2016 M&A LITIGATION 1 (2016), https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-2016; *Matthew* D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2015* (Jan. 14, 2016), http://tinyurl.com/Cain-Solo (finding that the filing rate for completed and uncompleted transactions has fallen to 21.4% and that the percentage of transactions subject to multijurisdictional litigation has also fallen); Gregory A. Markel et al., *Delaware Judges Have Been Heard*, LAW360 (Feb. 2, 2016), http://tinyurl.com/L360-2ii16 ("[T]he number of lawsuits filed challenging public mergers dropped from 78 percent in the first nine months of 2015 to just 34 percent in the final quarter of 2015.").

[242]If fee awards for plaintiffs' attorneys are no longer a guarantee, the cost of financing litigation will be too high for any one shareholder to underwrite, particularly because any recovery would be shared amongst the class. Litigation consortiums or some other potential cost sharing solution present their own issues that would certainly be difficult to overcome.

maintaining many of the traditionally cited advantages of incorporating in Delaware, such as its extensive case law and generally flexible approach to corporate law. Delaware's new restrictions on private ordering serve as a solution to the problem that would result if a large number of individual Delaware corporations opted-out of litigating their intra-corporate disputes in Delaware courts. Alongside the Chancery Court's recently adopted policy disfavoring disclosure-only settlements, Delaware's limited restrictions on private ordering represent a well-balanced approach that provides the state's corporations a tool for combating abusive litigation without permitting them to erode the benefits that result from having Delaware's courts adjudicate their intra-corporate disputes. After all, these benefits are part of what these corporations (and their shareholders) pay for every year when the franchise tax is due.

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