

# *Bank and Corporate Governance Law Reporter*

## **Round Table on Fee-Shifting Bylaws**

### **Publisher's Introduction**

by

Neil J. Cohen

This discussion begins with an article by Theodore Mirvis and William Savitt at Wachtell Lipton Rosen & Katz LLP who argue that a legislative response to ATP Tours is unnecessary because it is still an open question whether the decision applies to public corporations. Moreover, they say the Chancery courts have discretion to prevent any inequitable effects of the bylaws as they are applied.

Their thesis is contested by Neil Cohen, the publisher of the Bank and Corporate Governance Law Reporter who, reading between the lines of the ATP decision, says the Delaware Supreme Court apparently issued the decision to “violently push back against the explosive growth of merger-related class and derivative actions designed primarily for a quick settlement, a broad release, and attorneys’ fees.” Unfortunately, the potential scope of the ruling “encourages suspect corporate actors to insulate themselves from scrutiny” and imposes devastating financial risk on plaintiff firms.

The author believes that because the Supreme Court’s ATP decision and Delaware jurisprudence demand judicial deference to the Board, the Chancery Courts do not actually have the discretion to trump the bylaws with equitable principles—except in extreme situations. To encourage legislative action, he submits statutory language that would allow courts the nuanced discretion to order total or partial fee shifting against either party; require a shareholder vote; and bar fee-shifting against plaintiffs who both survive a motion to dismiss and achieve a significant remedy.

He states, “Defendants won’t like this language because it weakens the purpose of the bylaws. Plaintiffs won’t like it because they still could be liable for a judicially determined percent or all of the defendant’s fees. In short, it’s a compromise—but one that discourages frivolous lawsuits without bankrupting plaintiff firms; reduces the likelihood that bad actors will escape responsibility; honors the shareholders with a democratic vote; and enables the courts to craft a nuanced result for each factual construct.”

The debate is furthered by three law professors. First, Professor John Coffee focuses on the SEC because fee-shifting bylaws are a national problem. Moreover, securities class actions cases take place in federal court where the bylaws may run afoul of Federal Rule

11 and preemption by securities laws. After citing several precedents on how federal judges might decide these issues, he concludes that the SEC should play a determinative role by reasserting its position that private litigation is necessary to enforcement and declaring now that “it will challenge fee-shifting provisions.”

The next piece is a review of Professor Larry Hamermesh’s article entitled “Consent in Corporate Law,” which will soon appear in the *Business Lawyer*. He focuses on the ATP case where the Delaware Supreme Court implied that a broad fee-shifting provision adopted by a public company would be enforceable, because shareholders implicitly consent to bylaws adopted for the legitimate purpose of “detering litigation.” He concludes that the Delaware legislature should preclude broad bylaws adopted after shareholders have invested because those shareholders did not “consent” and the bylaws contravene traditional shareholder expectations that there are no overwhelming barriers to enforcing fiduciary obligations in the Delaware courts.

Professor Jay Brown agrees with Professor Hamermesh that the reasoning behind the ATP Tours decision is wrongly based on contract law; in addition, he says the decision will prevent plaintiffs’ attorneys from bringing meritorious derivative suits, appraisal challenges and federal securities cases. Because sanctions under Rule 11 and for bad faith litigation already exist, he argues that the legislature must overturn the incorrect decision.

The final submission is by former SEC Chairman Harvey Pitt who states that although the SEC used its “persuasive powers” to discourage compulsory arbitration bylaws, he thinks that fee-shifting bylaws should be the exclusive province of the state legislature and the Board. In his view, the Delaware legislature should require the Board of Directors to appoint a Special Committee to weigh ten factors, with the help of experts, to arrive at fair bylaws. At a minimum, the Board must require a shareholder vote and an appraisal remedy for shareholders whose stockholdings predated the adoption of the bylaw. He concludes that “One-sided fee-shifting bylaw provisions should be proscribed.”

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## Shifting the Focus: Let the Courts Decide

Theodore N. Mirvis & William Savitt

*Wachtell, Lipton, Rosen & Katz*

The frenzy over fee-shifting bylaws and charter provisions is no surprise. Anything that addresses the economics of the game so directly is cause for either alarm or implementation, depending on the side of the caption. And in a world where intracorporate litigation is ubiquitous, and very profitable even though far more derivative and class suits lose than win, no change in substantive law would have quite the bite. In our view, however, the calls to resolve the fee-shifting debate by legislative fiat are misguided. The Delaware courts should be allowed to do what only they can: address the propriety of fee-shifting provisions carefully, contextually, and incrementally.

It is somewhat surprising that the Delaware Supreme Court's decision in *ATP v. Deutscher Tennis Bund* spawned the present kerfuffle. The case, decided on May 8, 2014, involved a non-stock non-public membership organization of professional men's tennis tournaments. Two of the member tournaments objected to being downgraded and so sued. They lost. The corporation sought to recover the expenses of defense under a bylaw that called for fee-shifting if one of the members brought suit and did not substantially prevail. The logic of the bylaw was pure: if a club member chose to go to court and lost, why should the other members be made to pay for the defense?

Enforcing the bylaw, the Supreme Court's opinion emphasized that it had before it a non-stock corporation. It made the point three times in just its opening paragraph. To be sure, the Court was called upon to address the broad language of DGCL § 109 (requiring that bylaws "relat[e] to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers or powers of its stockholders, directors, officers or employees"), and that statutory language is applicable to public company bylaws as well. Some on the defense side of the bar saw the decision as a welcome mat for public corporation fee-shifting, some going so far as to issue client alerts urging corporations to consider implementing such bylaws. By ignoring the non-stock character of the corporate defendant and the peculiarities of the facts before the Court, this reaction went out on a limb that the Court's opinion did not appear support.

Then the empire struck back. And fast. By the end of May 2014, the Delaware Corporate Council came up with a proposed bill to present to the Delaware legislature seeking to overrule *ATP* on the ground that the decision violated the most elemental of all corporate law principles—the principle of limited liability. The proposed statute expressly forbade any charter or bylaw of a stock corporation from "impos[ing] monetary liability, or responsibility

for any debts of the corporation, on any stockholder of the corporation.” The proponents of the legislation argued that the Delaware Supreme Court in *ATP* had suggested that a corporation could “expose stockholders to a wide variety of liabilities, including substantially greater liability than the cost of their investments.” Perhaps revealing a broader agenda, the proponents warned menacingly that *ATP*’s “extension of the contract theory of corporate constitutional documents” could have “unforeseen consequences on capital formation.” Yet, pulling a punch, the proponents simultaneously acknowledged that the Court’s decision “made clear that enforcing such a bylaw would require equitable scrutiny, leaving a significant question as to the viability of such provisions if widely adopted.”

Both the speed and the theory of that proposal was odd. It is an important part of the Delaware genius and DNA that resort to legislation is a sparingly used tool. It is reserved, typically, for relatively non-controversial fine tuning of the purposefully flexible and enabling corporation statute under which room for private ordering is a significant value. Even during the height of the takeover period, Delaware acted cautiously and eventually enacted legislation that left most of the heavy lifting to private ordering and judicial review. Likewise the legislative fix to the *Van Gorkom* decision (authorizing exculpation charter provisions) took some time even though the D&O insurance crisis triggered by the decision created by that decision was far more acute than the (phantom?) threat of *ATP*.

Pressing the legislative panic button should, at the least, be preceded by robust debate and sober recognition that legislative medicine may be more harmful than the illness, and much more difficult to undo. Turning over corporate law issues to a political process is risky business. Politics and corporate law don’t always mix well. For some, Dodd-Frank might be exhibit A for the point. For others, the PSLRA.

Speed and process aside, those on the stockholder rights team who would rush to seek solution in the legislature might recall that nearly forty state legislatures have seen fit to pass constituent statutes permitting directors to base decisions on concerns other than, and in some instances inimical to, stockholder value. These legislatures understand that the privilege of limited liability is bestowed by the state not only for one interest group—stockholders—but for the common good. And they also understand that the high-sounding rhetoric of stockholder rights and synergies and efficient use of assets masks an unattractive economic and political objective, not so easily squared with that common good: the loss of jobs.

Beyond that, the proposed legislation’s premise of preserving limited liability is forced and unpersuasive. Fee-shifting bylaws may be many things but they do not impinge on that principle. What they do is disable one stockholder who has caused the corporation to incur costs from imposing those costs on all the other stockholders. It was rather ironic for

proponents of stockholder-centric corporate governance to disenfranchise even their fellow stockholders from deciding to adopt any form of fee-shifting on the perplexing theory that fee-shifting violates stockholder immunity. Perhaps that theory was necessary as an excuse to prevent any private ordering, or to overcome the natural Delaware prejudice against the idea that in no circumstances can directors (or stockholders) do something not forbidden on its face by the corporate law.

Moreover, the push for that legislation was seen in many quarters as a thinly veiled attack on the “contract theory” of bylaws and charters, and hence an effort to limit the rights of Delaware directors and stockholders to corporate self-governance. And the effort to start down the road of one-size-fits-all was properly challenged by some as antithetical to a central premise of the Delaware long game: that Delaware with its enabling statute and special judiciary is able to address legitimate concerns in a contextual fact-specific way without resort to mandatory rules of prohibition or affirmation.

In all events, the proposed legislation died a sudden death. By the second week of June, action on the bill was postponed. The episode had the unfortunate consequence of nourishing press reports of corporate lawyers and plaintiffs’ lawyer uniting to protect the “franchise” of unimpeded stockholder litigation in the Delaware courts. The Delaware legislature ultimately sent the matter back to the Delaware bar with a request that it examine not only fee-shifting but more generally the use of charter or bylaw provisions to affect “the conduct and the forum for litigation.”

As part of the fallout, the usual governista suspects have put forward all manner of proposed legislative fixes. Proposals have been advanced to limit fee-shifting to post-IPO stockholder-approved provisions or to cut off the fee-shift at the motion to dismiss stage (with survival of the motion eliminating the risk). The mix-and-match possibilities are endless. No fee-shifting if a plaintiffs folds early (demonstrating restraint). No fee-shifting if a plaintiffs persists through discovery (demonstrating diligence). No fee-shifting if a plaintiff agrees to mediation (demonstrating realism). No fee-shifting for low fees (demonstrating parsimony). No fee-shifting on the Sabbath (demonstrating piety)?

The SEC has even been blamed. The Alibaba IPO, the largest in years (albeit under Cayman law, not Delaware), came with an embedded fee-shifter in the corporate charter with no mention in the registration statement, and yet the SEC did nothing. Professor Coffee deemed this miss “equivalent to the Las Vegas bookies missing that one side in the Super Bowl had invoked a rule under which no penalties could be called against it.” The Professor’s conclusion: “The SEC’s continuing passivity adds to the growing sense that it is not the agency it once was.” (Presumably the Professor thinks that is a bad thing.) The

Professor's solution: the SEC should announce that it will challenge "onerous fee-shifting provisions" as a step that will "chill interstate charter competition (and might even be welcomed in Delaware)." Indeed.

Big Money has weighed in. CII and a range of institutional investors have urged that Delaware adopt legislation to overturn or narrow *ATP* across the board, albeit without specifics. Warming up, the CII letter made the point that since 2011, 18 of 20 corporations in which management has proposed exclusive forum bylaws have seen stockholder approval, with the prospect being that fee-shifting will diminish the role of the Delaware judiciary. (No faith in the same judiciary to address the fee-shifting issue was visible.) Overheating, the institutional investor letter stated that not only Delaware's continued preeminence is at stake but also "the very underpinning of our publicly traded financial markets."

In our view, legislation is a bad idea whatever one thinks of the merits or demerits of any kind of fee-shifting. In addition to the concerns rehearsed above, legislation is a blunt instrument. It cannot distinguish good from bad or good from worse. There are doubtless untold, unknown variations on the fee-shifting theme. Left to develop over time, we think it certain that some species of fee-shifting will prove optimizing and be sustained and other species will prove welfare-destroying and be stricken. The only practical way to continue the tradition of private ordering, and incremental and contextual decision-making, is to trust the Delaware courts to do what they have always done: to distinguish the reasonable from the unreasonable, the legitimate from the illegitimate. This is the genius of the common law, and quite especially the genius of the Delaware courts.

There are certainly forms of fee-shifting that should not be worrisome and cannot fairly be thought to threaten the republic. Now that the validity of exclusive forum bylaws has been established, there is no legitimate reason that the cost of having a suit brought in derogation of such a bylaw should be borne by all the stockholders. A fee-shifting bylaw might provide that the unsuccessful plaintiff be reimbursed if the stockholders voted to do so at the next annual meeting. Perhaps fee-shifting could be in order when a would-be derivative plaintiff meritlessly alleges demand futility without even seeking recourse to books-and-records. No doubt other plainly abusive litigation can be and will be identified with sufficient precision to provide fair warning to would-be plaintiffs and their counsel and fair protection to stockholder from the needless cost of needless litigation.

There can be no doubt that the Delaware courts will be able to draft appropriate tools by which to measure fee-shifting bylaws and separate the good, the bad and the ugly. Doubtless the courts will give great weight to the potential input of any form of fee-shifting on stockholder access to the courts. *ATP* itself—as the proponents of the ill-fated initial legislative

gambit recognized—full well recognized that equitable scrutiny is inherently a part of the analysis. Equitable scrutiny fits the task at hand in a way that legislative fiat cannot.

Nor do we perceive much force in the argument that no plaintiff lawyer could even bring suit to challenge a fee-shifting bylaw, lest the cost of defeat include the corporation's cost of defense (as if that were immutably a violation of the laws of physics). The courts can be trusted to prevent that Catch-22. Or a fee-shifting bylaw can provide that it does not apply to a suit challenging its efficacy (provided, of course, the suit is in the Delaware courts, and one test case is enough). Similarly, there is no real reason to fear provisions that fee shift unless the plaintiff is “substantially” successful; the courts certainly can prevent inequitable fee-shifting where the stockholder-plaintiff achieved a real result even if not everything prayed for.

In the final analysis, the poets seems to have it about right:

*“You can’t always get what you want*

*But if you try sometime you just might find*

*You get what you need.”*

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**Who Should Oversee Fee-Shifting Bylaws:  
the Shareholders, the Courts, the Legislature, or All Three?**

By

Neil J. Cohen, Publisher

Fee-shifting bylaws are designed to dramatically reduce the growth of class action and derivative suits. According to Cornerstone Research, shareholders challenged 94% of U.S. mergers last year—up from 44% in 2007. Moreover, the average deal faces five lawsuits, usually in different state and federal courts. Corporations first responded to the problem with forum selection bylaws in an attempt to herd the class action bar into Delaware courts. Now some corporations seek a more drastic remedy, the fee-shifting bylaw that could eliminate the problem altogether by making federal securities class actions and derivative suits too financially risky to file. The Delaware Supreme Court approved such a bylaw in *ATP Tours v. Deutscher Tennis Bund*, holding that the partnership's bylaw was a facially valid attempt to “discourage litigation.” Reading between the lines, it appears the Delaware Supreme Court issued the decision to violently push back against the explosive growth of

merger-related class and derivative actions designed primarily for a quick settlement, a broad release, and attorneys' fees. Unfortunately, the potential scope of the ruling encourages suspect corporate actors to insulate themselves from scrutiny and imposes devastating financial risk on plaintiff firms.

As the date approaches for the Delaware legislature to address fee-shifting bylaws, authors Mirvis and Savitt maintain that the issue is best left to the courts which, they say, could ban all fee-shifting bylaws *for public companies* or, at least, distinguish between especially stringent bylaws that are facially invalid and more reasonable bylaws. They also maintain that nuanced judicial determinations are more likely to fit the specific factual situations than an inflexible statutory rule. The implied purpose of their article is to convince the public legislature that it should not pass legislation—even though a fee-shifting bylaw is just as inflexible as a statute. Although we agree with the authors that the courts are best suited to oversee these bylaws, the legislature must do something to limit the precedential impact of *ATP Tours* and make it possible for shareholders and trial judges to participate with the Board to make the ultimate fee-shifting decisions.

If the legislature does nothing, defense lawyers will probably win the argument that *ATP Tours* is binding on the facial validity of public company bylaws because the same purpose, discouraging litigation, applies equally to bylaws enacted by public companies as partnerships.

Moreover, applying Delaware precedent that non-conflicted Board actions are entitled to great deference, the defense would argue—and courts could well decide—that the only narrow issue is whether the Board was required to waive the bylaw in the particular circumstances. That was the analysis of Chancellor Parsons in *AB Value Partners v. Kreisher Manufacturing*, a recent case (published in this issue) challenging the as-applied validity of an advance notice bylaw. The plaintiff hedge fund argued that although it missed the deadline to propose an alternative slate, it should be given extra time because the Board implemented changes in executive compensation between the time it notified shareholders of the date of the election and the due date for submitting alternative proxies. The court refused, holding that “compelling circumstances must exist before the equitable powers . . . will be applied” to require Board waiver of the bylaw. Acknowledging the facial validity of such bylaws the court explained that even where the sacrosanct shareholder vote is at issue, a challenge to the bylaw

should be reserved for those instances that threaten the fabric of the law, or which by an improper manipulation of the law, would deprive a person of a clear right. . . . [T]he Court of Chancery's equitable powers can only be roused under *Schnell* where compelling circumstances suggest that the



company unfairly manipulated the voting process in such a serious way as to constitute an evident or grave incursion into the fabric of the corporate law. *Accipiter Life Scis. Fund, L.P. v. Helfer*, 905 A.2d 115, 127 (Del. Ch. 2006).

Even when a fee-shifting bylaw is enacted in response to pending litigation, it would take a brave plaintiff's lawyer to challenge it after the Delaware Supreme Court's recent decision in *United Technologies Corp. v. Treppel*, No. 127, 2014 (Del. Dec. 23, 2014) (en banc) holding that a forum selection bylaw was valid even though it was enacted during the pendency of Section 220 litigation. Assuming the same deference to Board action that Chancellor Parsons applied *AB Value*, the plaintiff's lawyer would be hard pressed to convince the court that a failure to waive the fee-shifting bylaw would result in "an evident or grave incursion into the fabric of the corporate law."

Advocates of fee-shifting bylaws correctly point out that class actions and derivative suits often result in a quick settlement with no bump in the merger price. Does that mean shareholders received no benefits? No, because a screening process by expert practitioners has unquantifiable prophylactic benefits and occasionally uncovers a massive breach of duty or securities fraud that results in a huge shareholder recovery. We should not effectively ban a process that provides that check and balance at the relatively small cost of liability insurance payouts.

The challenge is how to strike a balance between the Board's interest in passing a bylaw that discourages strike suits and the shareholders' interest in encouraging class action lawyers to take meritorious cases? Allowing the courts to freely decide fee-shifting questions would incentivize corporate lawyers to limit the breadth of fee-shifting bylaws to increase the chances that the courts would honor them. The legislation would also discourage plaintiffs' lawyers from bringing frivolous suits. But in meritorious cases, the statute would enable a court to eliminate any fee shifting despite the bylaw, or even make the defendants responsible for plaintiffs' unnecessary costs.

The legislature must recognize that officers of corporations with something to hide will be quick to recommend that their Boards pass fee-shifting bylaws. Surely the legislature does not want the full responsibility of allowing the next Enron to escape discovery and responsibility. For that reason, the Board's proposed bylaw should be submitted to a shareholder vote and, in the case of a controlled corporation, a vote of the majority of the minority. Even if the shareholders approve, to encourage plaintiff lawyers to investigate possible criminal acts, the legislature should not allow fee shifting for contested discovery motions or after plaintiffs survive a motion to dismiss and achieve a significant financial or corporate governance remedy.

Moreover, the legislature should allow for more than one fee ruling in the same case; that can be done by allowing the court to make preliminary decisions on who pays a simple oral ruling from the bench, while the final determination on liability and the amount due would require detailed briefing. This procedure would discourage both sides from making superfluous arguments.

To start the discussion, we submit the following draft language:

All fee-shifting bylaw proposals must be submitted to a 51% shareholder vote and, in the case of a controlled corporation, by a majority of the minority voters. No bylaw may provide fee-shifting against the plaintiff in contested discovery motions or suits that both survive a motion to dismiss and achieve, in trial judge's view, a significant financial or corporate governance remedy.

Notwithstanding any fee-shifting bylaw, the Delaware courts shall have the ultimate authority, after deciding any motion or other proceeding, to make a preliminary equitable allocation of fees and costs for that proceeding. Said determinations may be made without briefing by an oral bench ruling. Subsequent decisions on liability and amount due shall be briefed and determined in the usual manner for determining fees and costs.

Defendants won't like this language because it weakens the purpose of the bylaws. Plaintiffs won't like it because the risk still exists that they will be liable for all or part of the defendant's fees. In short, it's a compromise—but one that discourages frivolous lawsuits without bankrupting plaintiff firms; reduces the likelihood that bad actors will escape responsibility; honors the shareholders with a democratic vote; and enables the courts to craft a nuanced result for each factual construct.”

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### **Fee-Shifting and the SEC: Does It Still Believe in Private Enforcement?**

John C. Coffee, Jr.\*

Corporate law normally moves at a glacial pace, but sometimes there are periods of rapid change, much of it invisible to the ordinary observer. 2014 may be witnessing such a period of rapid, low-visibility change. Between May 29 and September 29, 2014, some 24 public companies adopted either bylaws or charter provisions mandating that an “unsuccessful” plaintiff in shareholder litigation (whether in state or federal court or arbitration) must pay the fees and expenses of all defendants. This list includes high profile examples, such as the recent Alibaba IPO.<sup>1</sup> Generally, “reporting” companies accomplish this result

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through a board-adopted bylaw, while IPO companies place this provision in their charter before they go public. The fee-shifting thereby mandated is considerably tougher than the British “loser pays” rule because many of these provisions deem a plaintiff who is not entirely successful on all claims and requested forms of relief to have been unsuccessful and thus required to reimburse.<sup>2</sup> Also, unlike the British rule, this approach is one-sided; that is, a defendant who loses does not pay the successful plaintiff’s fees and expenses. Although 24 companies is not a large number, the trend is accelerating, and it resembles the first trickle of water through a leak in a dam. Soon the dam breaks, and a cascade descends upon those below. By the end of September, adoption of fee-shifting provisions was occurring on a virtually daily basis. Moreover, many of the most prestigious law firms in the country were helping their clients clear registration statements containing such provisions with the SEC. This could quickly become part of the standard IPO game plan.

York.

<sup>1</sup> For the Alibaba example, see Section 173 (“Claims Against the Corporation”) of the Amended and Restated Memorandum and Articles of Association of Alibaba Group Holding Limited, which is incorporated in the Cayman Islands (available at <http://www.sec.gov/Archives/edgar/data/1577552/000119312514333674/d709111dex32.htm>).

<sup>2</sup> For an example of how sweeping some of the bylaws can be, see Article Sixteenth of the Second Amended and Restated Certificate of Incorporation of Smart & Final Stores, Inc., which may have been the first company to adopt this approach in its IPO (available at [http://www.sec.gov/Archives/edgar/data/1563407/000104746914007436/a2221270zex-3\\_1.htm](http://www.sec.gov/Archives/edgar/data/1563407/000104746914007436/a2221270zex-3_1.htm)). The company is a West Coast food and supply chain, which is incorporated in Delaware. Article Sixteenth reads as follows:

Notwithstanding anything in this Certificate of Incorporation to the contrary, to the fullest extent permitted by law, in the event that (i) any current or prior stockholder or anyone on their behalf (a “*Claiming Party*”) initiates any action, suit or proceeding, whether civil, criminal, administrative, or investigative, or asserts any claim or counterclaim (each, a “*Claim*”) or joins, offers substantial assistance to or has a direct financial interest in any Claim against the Corporation (including any Claim purportedly filed on behalf of any other stockholder) and/or any director, officer, employee or affiliate thereof (each, a “*Company Party*”), 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 applicable Company Party 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 applicable Company Party may incur in connection with such Claim. If any provision (or any part thereof) of this Article SIXTEENTH shall be held to be invalid, illegal or unenforceable facially or as applied to any circumstance for any reason whatsoever: (1) the validity, legality and enforceability of such provision (or part thereof) in any other circumstance and of the remaining provisions of this Article SIXTEENTH (including, without limitation, each portion of any subsection of this Article SIXTEENTH containing any such provision (or part thereof) held to be invalid, illegal or unenforceable that is not itself held to be invalid, illegal or unenforceable) shall not in any way be affected or impaired thereby, and (2) to the fullest extent permitted by law, the provisions of this Article SIXTEENTH (including, without limitation, each such portion containing any such provisions (or part thereof) held to be invalid, illegal or unenforceable) shall be construed for the benefit of the Corporation to the fullest extent permitted by law so as to (a) give effect to the intent manifested by the provision (or part thereof) held invalid, illegal, or unenforceable, and (b) permit the Corporation to protect its directors, officers, employees and agents from personal liability in respect of their good faith service. Any person or entity purchasing or otherwise acquiring any interest in the shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this Article SIXTEENTH.

Obviously, this provision goes beyond a “loser pays” rule and is in effect “a-less-than-100%-successful-plaintiff-pays” rule.

The timing of this sudden burst of new bylaws is not surprising. They all follow a decision in May 2014—*ATP Tour Inc. v. Deutscher Tennis Bund*<sup>3</sup>—in which the Delaware Supreme Court held that a very punitive fee-shifting bylaw was “facially valid” and could be enforced against shareholder/plaintiffs who acquired their shares both before and after its adoption—unless the shareholder could show that the bylaw was adopted for an “improper purpose.”<sup>4</sup> But here the Delaware Supreme Court added that “the intent to deter litigation...is not invariably an improper purpose.”<sup>5</sup>

One cloud on the horizon remains the attitude of Delaware. Last June, the Corporate Law Section of the Delaware State Bar Association proposed legislation to overturn *ATP Tour* by prohibiting charter or bylaw provisions from containing any provision that would impose monetary liability on a shareholder. That legislation was blocked, but is being re-fashioned. At hearings before the SEC Investor Advisory Committee last week, Professor Lawrence Hamermesh, who is involved in that process, predicted that something might emerge in early 2015, but offered no clues on the likely shape of new legislation. Delaware is uniquely conflicted on this issue, because *ATP Tour* could imply a significant decline in Delaware-based litigation, but such a decline would greatly benefit management and directors of Delaware corporations. Never before have the interests of the Delaware bar and its clients clashed so directly. Still, even if Delaware were to act, the issue would still not disappear for three distinct reasons: (1) Delaware might only modestly limit the use of such bylaws, still permitting a substantial chill on securities class actions; (2) Corporations incorporated in other jurisdictions may adopt similar provisions (and the prestige of the Delaware Supreme Court may lead other courts to accept its ruling, even if the Delaware legislature were to reverse or amend it); and (3) Corrective action by Delaware might fuel an interjurisdictional competition, as other, more conservative states (think, Texas) might seek to lure companies to reincorporate there to exploit their tolerance for such provisions.

Still, the even larger question then is what will the SEC do—if anything at all. To date, it has been standing passively on the sidelines. Indeed, in the Alibaba IPO, its staff missed the forest for the trees, requiring no disclosure of the impact or scope of Alibaba’s charter provision shifting fees to unsuccessful plaintiffs.

<sup>3</sup> 91 A. 3d 554 (2014). This decision is fully consistent with other recent Delaware decisions upholding board-adopted bylaws containing forum selection clauses requiring intracorporate litigation to be brought in Delaware. See *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A. 3d 934 (2013) and *City of Providence v. First Citizens Bankshares, Inc.*, 2014 Del. Ch. LEXIS 168 (Del. Ch. Sept. 8, 2014). State court decisions in Louisiana, New York, Illinois and elsewhere have recently upheld and enforced Delaware forum selection clauses.

<sup>4</sup> This “improper purpose” requirement dates back to *Schnell v. Chris-Craft Industries*, 285 A. 2d 437 (Del. 1971), which essentially holds that powers legitimately possessed may not be used for an inequitable purpose.

<sup>5</sup> 91 A.3d at 560.

## I. Fee-Shifting Provisions in Federal Court

What then is the status of such a board-adopted bylaw in federal court? Here, it is important to note that the *ATP Tour* case was in fact brought in federal court in Delaware. The plaintiff lost at trial,<sup>6</sup> and the defendant moved for its costs pursuant to the bylaw. The District Court denied this motion, effectively ruling that federal law preempts the enforcement of fee-shifting agreements when antitrust claims are involved.<sup>7</sup> But the Third Circuit reversed the District Court's order, ruling that before addressing federal preemption issues, the District Court should have first determined whether the bylaw was enforceable under state law.<sup>8</sup> In fact, the Third Circuit expressed skepticism that the bylaw was enforceable under Delaware law.<sup>9</sup> On remand, the District Court certified this question of the bylaw's enforceability under Delaware law to the Delaware Supreme Court.

With that initial question thus resolved, the focus now shifts back to the preemption issue. In general, federal courts have refused to enforce state law penalties intended to deter frivolous litigation. In a leading case, *Burlington Northern Railroad Company v. Woods*,<sup>10</sup> a tort action was removed by the defendant from Alabama state court to federal court, where the defendant lost at trial and then appealed, posting a mandatory bond to stay the judgment. On affirmance of the decision below, the Eleventh Circuit granted plaintiff's motion for a mandatory penalty of 10% of the judgment amount, based on an Alabama statute that sought to deter frivolous appeals by imposing an automatic 10% penalty. The Supreme Court reversed, finding that the Alabama statute had no application to a case in federal court (even when removed to federal court based on diversity jurisdiction). Following its leading precedent of *Hanna v. Plumer*,<sup>11</sup> the Supreme Court held that federal procedural rules applied in federal court. Further, it noted a conflict between the Federal Rules of Civil Procedure (which permit a court in its discretion to impose a penalty for a frivolous appeal) and the Alabama statute (which made the penalty mandatory, whether the appeal was frivolous or not).

If we assume *Burlington Northern* to govern, the same conflict arguably exists between mandatory fee-shifting under a bylaw and the discretionary sanctions authorized

<sup>6</sup> For the treatment of the substantive claims, see *Deutscher Tennis Bund v. ATP Tour, Inc.*, 610 F.3d 820 (3d Cir. 2010).

<sup>7</sup> See *Deutscher Tennis Bund v. ATP Tour, Inc.*, 2009 U.S. Dist. LEXIS 97851, 2009 WL 3367041 at \*4 (D. Del. Oct. 19, 2009).

<sup>8</sup> See *Deutscher Tennis Bund v. ATP Tour, Inc.*, 480 Fed. Appx. 124, 126 (3d Cir. 2012).

<sup>9</sup> *Id.* at 127 (“Indeed, we have doubts that Delaware courts would conclude that Article 23.3 imposes a legally enforceable burden on Deutscher and Qatar.”). Apparently, it guessed wrong.

<sup>10</sup> 480 U.S. 1 (1987).

<sup>11</sup> 380 U.S. 460 (1965).

for frivolous litigation by Federal Rule of Civil Procedure 11. Yet, other decisions have applied state law requirements that amount in substance to fee-shifting in federal court.<sup>12</sup> In any event, before one concludes that federal law should preempt state law on this issue, one must focus on a critical difference between *Burlington Northern* and the case of a fee-shifting bylaw. Fee-shifting under *ATP Tour* is not based on a state statute, but on a contract among the shareholders. Indeed, the Delaware statute authorizing broad bylaws is no different from that of any other state jurisdiction. Rather, under standard “black letter” corporate law, bylaws set forth a contract among the shareholders. From this perspective, the fee-shifting bylaw is the same as an indemnification provision in which one party by contract agreed to pay the other’s legal expenses (at least under certain circumstances). In fact, the *ATP Tour* decision emphasizes that contractual agreements are an exception to the usual American rule on fee-shifting (under which each side bears its own legal expenses) that Delaware normally follows.

Hence, the Supreme Court’s standard position that federal procedural rules apply in federal court (and state procedural rules do not) might be sidestepped here if we view the bylaw as simply a contract among the parties. But again one cannot stop at this point either—for at least two reasons. First, federal courts have held that some contracts for indemnification are unenforceable because they conflict with the policies underlying specific federal statutes. The leading such decision is *Globus v. Law Research Service, Inc.*,<sup>13</sup> in which the Second Circuit denied indemnification to an underwriter who had knowledge of the misstatement because, it said, such indemnification would be contrary to the policies underlying the federal securities laws. Second, in *Atlantic Marine Construction Co., Inc. v. United States District Court for the Western District of Texas*,<sup>14</sup> the Supreme Court held in 2013 that contractual provisions among the parties do not supercede the Federal Rules of Civil Procedure but must be interpreted in a manner consistent with them. In

<sup>12</sup> The case most favorable to enforcing a fee-shifting bylaw is probably *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), which upheld the application of a state mandatory security-for-expense bond requirement in federal court. The Supreme Court concluded that this statute was not truly procedural because its real intent was to deter frivolous litigation, not regulate procedure. Such an argument could also be made for fee-shifting bylaws, which similarly levy costs against the losing plaintiff. But Cohen was enforcing a substantive state policy intended to regulate corporate governance (which is traditionally left to state law). In this sense, *Cohen* is easily distinguishable. First, Delaware has no substantive policy favoring fee-shifting (but rather generally follows the American Rule and leaves departures from that rule to private ordering at present). Second, while the security-for-expense bond in *Cohen* applied only to derivative actions (which are principally brought in state court), the fee-shifting bylaw here at issue will apply to federal securities class actions (which cannot be brought in state court, at least in the case of Rule 10b-5, because federal courts have exclusive subject matter jurisdiction). Hence, it is arguable that Delaware lacks any legitimate interest in regulating actions that can exclusively be filed in federal court.

<sup>13</sup> 418 F. 2d 1276 (2d Cir. 1969). *Globus* does not stand alone and has been widely followed. See, e.g., *Heizer Corp. v. Ross*, 601 F. 2d 330, 334 (7th Cir. 1979); *DeHaas v. Empire Petroleum Co.*, 286 F. Supp. 809, 815 (D. Colo. 1968), aff’d in relevant part, 435 F. 2d 1223 (10th Cir. 1970).

<sup>14</sup> 134 S. Ct. 568 (2013).

*Atlantic Marine*, the parties had agreed to a forum-selection clause providing that all disputes would be litigated in Virginia. Yet, when a dispute arose, the plaintiff sued in Texas, and the defendant sought to have the case either dismissed or, in the alternative, transferred to federal court in Virginia. Both the district court and the Fifth Circuit refused to do either, ruling that 28 U.S.C. §1404(a) was the exclusive mechanism for enforcing a forum-selection clause. Both further concluded that the district court had to undertake a balancing-of-interests analysis. On appeal, the Supreme Court partially disagreed. Although it found that Section 1404 (and not the contract, itself) governed, it held that the District Court’s analysis improperly placed the burden on the defendant to prove that the requested transfer was appropriate. Instead, it said the burden was on the plaintiff, as the party “flouting” its contractual obligations, to show that public-interest factors overwhelmingly disfavored the requested transfer to Virginia: “Only under extraordinary circumstances unrelated to the convenience of the parties should a §1404(a) motion be denied.”<sup>15</sup>

Because there was no preemption issue in *Atlantic Marine*, its relevance is limited, but it does have two implications: (1) contracts governing litigation are not necessarily enforced as written but must be interpreted through the prism of the Federal Rules of Civil Procedure; and (2) public policy questions may retain some modest relevance, even when there is no federal statute involved. On this basis, a forum selection bylaw requiring federal securities class actions to be brought in a preferred federal forum (for example, federal district court in Delaware) is likely enforceable, but will have to be implemented by means of Section 1404.

## **II. Is One-Sided Fee-Shifting Inconsistent With the Policies Underlying the Federal Securities Laws?**

To ask this question is not to answer it. Indeed, the likely answer is probably: sometimes yes, sometimes no. The specific provision needs to be considered to determine the extent of the burden it imposes. Most such provisions will presumably require a losing shareholder who sued the company unsuccessfully to pay all the defendants’ expenses, but many go even further and require the plaintiff to be completely successful on all its claims and obtain most of the relief sought—or face fee-shifting.<sup>16</sup> Thus, if a plaintiff sued for \$100 million and obtained only \$40 million (a notable victory by any realistic standard), it may not have been sufficiently successful to escape fee-shifting. Most (if not all) such

<sup>15</sup> 134 S. Ct. at 581.

<sup>16</sup> For example, the actual bylaw in the *ATP Tour* case was even more sweeping (and was still upheld by the Delaware Supreme Court) in that it required the plaintiff to reimburse the other side’s expenses if it did “not obtain a judgment on the merits that substantially achieves, in substance and in amount, the full remedy sought.” 91 A. 3d at 555. Wow! Plaintiffs rarely win on everything and so could achieve a 95% victory and still face fee-shifting. See also the bylaw set forth supra in Note 2.

bylaws will not pay the successful plaintiff's fees or expenses.<sup>17</sup> Thus, without more, such provisions have two key faults: (1) they are one-sided in that they reimburse successful defendants, but not successful plaintiffs (thus, they are unlike the English Rule which shifts fees both ways evenly); and (2) they require fee-shifting even in cases that were reasonable or even meritorious (but lost on a technical legal defense or were largely, but not entirely, successful).

But there is even more objectionable about many of these provisions. Some of these provisions are drafted so broadly that they expressly apply to “investigations” as well as to legal actions, and some also purport to require anyone who assists a plaintiff in such litigation to also share liability for fee shifting. Thus, a shareholder/whistleblower could be arguably held liable for the corporation's fees and expenses in defending a civil or criminal investigation by regulators—at least if not all the charges raised by the whistleblower were fully confirmed. In a given case, this could be inconsistent with federal whistleblower protections. Also, efforts to cover those who assist the shareholder plaintiff might even apply to expert witnesses and attorneys who assist the litigation (at least if they own shares).

Since at least *J. I. Case Co. v. Borak* in 1964,<sup>18</sup> federal decisions and the SEC have asserted that private enforcement of law is a “necessary supplement” to public enforcement by the SEC and the Department of Justice.<sup>19</sup> Although the Supreme Court's attitude may be more equivocal today on this point (and clearly it will no longer imply a federal private cause of action, absent clear legislative direction), the Court has still shown itself unwilling to dismantle Rule 10b-5 class actions.<sup>20</sup> The SEC has not formally retreated from its support for private enforcement, but it is currently on the sidelines, and this issue will put its resolve to the test.

The incentives created by an automatic “loser pays” rule seem particularly perverse. A reckless or incompetent attorney who files a half-baked complaint will face only a modest to moderate sanction when the action is dismissed on a motion to dismiss (because the defendant will not yet have incurred substantial legal expenses). But if the action is more meritorious and survives the motion to dismiss, it will proceed into the discovery stage. Now, the expenses really begin to mount (and can easily exceed several million dollars a

<sup>17</sup> The successful plaintiff's attorney can seek a court-awarded fee from the class's recovery, but under the American rule defendants are not usually liable for the plaintiff's attorney fees, even if the facts were overwhelmingly in the plaintiff's favor. Thus, the plaintiff's fees comes from its successful clients' recovery, not from the defendants.

<sup>18</sup> 377 U.S. 426 (1964).

<sup>19</sup> *Id.* at 432.

<sup>20</sup> See *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014) (upholding “fraud on the market” doctrine).



year). The harder and longer the plaintiff's attorney works to prepare the case, the greater the potential sanction he faces. As a result, the incentive effect here is to encourage early (and probably premature) settlement before the facts are really developed. If the plaintiff's attorney loses (at trial, summary judgment, or whenever), the plaintiff's attorney has a strong incentive to negotiate a deal under which the attorney waives the right to appeal in return for defendants' waiver of fee-shifting. As a result, little appellate law may be made.

These outcomes seem inconsistent with Congress's attitude towards fee-shifting in securities class actions. Preemption seems especially justified here because Congress struck a special balance in this area. That balance recognizes that fee-shifting against the losing side may sometimes be appropriate, but it is conditioned on judicial oversight and applies to both sides. Under Section 21D(c)(3) of the Securities Exchange Act of 1934 (which provision was added by the Private Securities Litigation Reform Act of 1995), a presumption in favor of fee-shifting is created if any motion or pleading fails to comply with Rule 11(b) of the Federal Rules of Civil Procedure. This two-sided approach is equally punitive to both sides in making full fee-shifting (rather than a lesser financial sanction) the presumptive penalty, but it requires the court to find a violation of Rule 11. Because this approach is tougher and more punitive than the normal approach under Rule 11 of the Federal Rules (which would typically involve lesser financial sanctions), it represents a carefully balanced federal policy, but one that is in sharp conflict with automatic and one-sided fee-shifting without any role for judicial discretion. Effectively, board-adopted bylaws can turn a Congressionally-mandated system of two-sided fee shifting that is dependent on judicial discretion into an automatic system of one-way fee-shifting.

What standard for preemption does the caselaw suggest? On a number of occasions, federal courts have heard challenges by takeover bidders asserting that state anti-takeover provisions were so preclusive as to be preempted by the Williams Act. Most of these cases have converged on a test known as the "meaningful opportunity for success" standard.<sup>21</sup> Under this test, if a takeover is wholly precluded by the state statute, the statute is preempted. Correspondingly, under an analogous test applicable to securities class actions, it would be possible to impose some penalty on an unsuccessful litigant, but not one so punitive as to be preclusive.

### III. What Should the SEC Do?

The SEC could take a number of steps, all consistent with past practice. First, the SEC could assert the case for preemption selectively as an *amicus curiae* in cases where no

<sup>21</sup> See *City Capital Associates v. Interco, Inc.*, 696 F. Supp. 1551 (D. Del. 1988); *West Point-Pepperell v. Farley, Inc.*, 711 F. Supp. 1102 (N.D. Ga. 1989); *RP Acquisition Corp. v. Staley Cont'l Inc.*, 686 F. Supp. 476, 482 (D. Del. 1988); *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 469 (D. Del. 1988).

violation of Rule 11 seemed present. This should require some careful case analysis by the SEC and should not be an automatic response. Alternatively, the SEC might assert that automatic fee-shifting is always in violation of the Securities Exchange Act, unless it is predicated on a judicial finding that Rule 11 was violated. This would be a riskier approach, and it might force the SEC to defend a less-than-attractive plaintiff's attorney.

Second, the SEC has in a closely related area refused to accelerate registration statements where the company's certificate of incorporation or bylaws contained a mandatory arbitration clause. This threat seems to have been effective, and companies that have considered challenging the SEC have ultimately backed down.<sup>22</sup> Yet, the SEC has not held up registration statements with fee-shifting provisions. This is inconsistent. Functionally, the two cases are equivalent, because both provisions effectively bar private enforcement.

Third, the SEC could require registrants to state in their registration statements that they understand that the SEC believes that the federal securities laws are inconsistent with fee-shifting bylaws. Such a statement is already specified in Forms S-1 and S-3 with respect to indemnification provisions.<sup>23</sup> This at least imposes an embarrassment cost on the issuer and alerts courts to the SEC's views without the need for an SEC amicus position.

Fourth, the SEC could focus disclosure on such provisions, thereby raising the "embarrassment cost" to the issuer. In the case of IPOs that involve such provisions, the SEC could require these terms to be disclosed up front as a major "risk factor." In contrast, in the Alibaba IPO, no disclosure focused on the impact of its fee-shifting charter provision. Although the SEC's staff appears to have missed the forest for the trees here, it must be stressed that enhanced disclosure alone is not an adequate remedy. Corporations will still use such provisions, even if they modestly impact the IPO price. Investors cannot adequately price the impact of a provision denying them the ability to enforce their legal rights because they do not know how likely it is that the corporate insiders will breach their duties.

Finally, the SEC is uniquely positioned to gather relevant data. In assessing the impact of fee-shifting bylaws, it would be useful to know what the average costs are that defendant firms incur on such litigation and that they would seek to shift. The impact on the

<sup>22</sup> In 2012, the Carlyle Group inserted a mandatory arbitration provision into its governance documents as it was preparing its IPO, but quickly dropped it under regulatory and investor pressure. See Note, *In a Bind: Mandatory Arbitration Clauses in the Corporate Derivative Context*, 28 Ohio St. J. on Disp. Resol. 737, 745 (2013).

<sup>23</sup> See Form S-3 at Item 13 ("Disclosure for Securities Act Liabilities"). This Item requires the registrant to provide the information required by Item 510 of at Regulation S-K (17 C.F.R. 229.510), which requires the registrant (if indemnification is authorized) to state that it has "been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed by the Act and is therefore unenforceable."

typical plaintiff's firm could also be evaluated empirically. Similarly, the SEC could assess whether insurance could alleviate this problem (if it were available) and at what cost. If Delaware were to impose partial curbs (permitting only some limited fee shifting), the SEC could assess the likely empirical impact of such a modified fee-shifting bylaw.

### Conclusion

The impact of fee-shifting provisions could be decisive on the future of private enforcement of the securities laws. The defendant's expenses in a securities class action can easily exceed \$10 million, and this amount would bankrupt many smaller plaintiff's law firms. It is questionable (and certainly unresolved) whether plaintiff's law firms could obtain liability insurance to cover these amounts. Even if a bold plaintiff's law firm did sue, it would likely have to agree to indemnify the class representative from fee-shifting, and some class representatives might decline the position, fearing that the plaintiff's firm could not fully protect them.

As the case proceeded, the defendant's expenses will progressively mount, increasing the potential penalty. This will predictably force cheaper settlements, thereby injuring the class. If fee-shifting bylaws are upheld, defendant issuers should logically regard them as a riskless move that has little downside. Probably, proxy advisors would object to such board-adopted bylaws,<sup>24</sup> but this is not the kind of board action that could easily fuel a proxy contest or be easily overturned by a shareholder vote.<sup>25</sup> As a result, such provisions, unless challenged by the SEC, will predictably become prevalent.

The full impact of bylaw and charter provisions are potentially even more far-reaching. Potentially, not only litigation, but proxy contests could be deterred. If a bylaw can require shareholder plaintiffs to reimburse the other side, it is arguable that it could also require proxy insurgents to do so, unless they were "completely" successful.

*Bottom Line:* For the short-term, the ball is still in Delaware's court while its legislature considers possible curbs. That process will not likely be resolved until 2015. Although the SEC need not oppose all fee-shifting provisions adopted through board or shareholder action, it must be prepared to take on open-ended and more sweeping provisions—or

<sup>24</sup> Indeed, Institutional Shareholder Services has also objected to board-adopted forum selection bylaws and supported an effort to repeal Chevron's bylaw to this effect.

<sup>25</sup> Activists could seek passage of an advisory shareholder vote recommending the repeal of the bylaw, but such a vote (presumably pursuant to SEC Rule 14a-8) will likely have to be precatory only. See *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A. 2d 227 (Del. 2008) (holding that a bylaw mandating reimbursement of expenses in proxy contests must be subject to a "fiduciary out," meaning that the board can refuse to accept the shareholders' position). In administering Rule 14a-8, the SEC will generally permit issuers to exclude shareholder resolutions that are not simply precatory. With respect to the possibility of a proxy contest, the passage of a fee-shifting bylaw will hardly reduce the corporation's value and thus will not make it a candidate for hedge fund activism (which usually is aimed at increasing share value over the short-term). No one else is likely to undertake the high costs of a proxy contest.

concede the decline of private enforcement. At present, the SEC seems to be ducking this issue. At last week's hearings, SEC staffers observed that although mandatory arbitration provisions in corporate charters would not be accelerated, they were not yet certain that fee-shifting provisions were equally preclusive. Continued irresolution will only further injure the SEC's already damaged reputation.

*Final Thought:* If Delaware does act to restrain fee-shifting through bylaws, the potential for a "race to the bottom" arises. Other states of a more conservative bent (consider, for example, Texas) might accept or even endorse fee-shifting provisions. At this point, some corporate lawyers will predictably advise their clients to reincorporate in Texas, and many IPO issuers might prefer to incorporate in Texas initially. Even if small changes in corporate law will not produce a migration into or away from Delaware, the permissibility of automatic fee-shifting is a major difference that will fuel interjurisdictional competition because it protects corporate managers and directors from potential personal liability. In this light, an SEC announcement that it will challenge onerous fee-shifting provisions would chill interstate charter competition (and might even be welcomed in Delaware). Delaware alone cannot solve this problem.

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## **Shifting Back the Focus: Fee Shifting Bylaws and a Need to Return to Legislative Intent**

J. Robert Brown, Jr.<sup>1</sup>

### **I. Introduction**

In advocating restraint against a legislative fix to the myriad problems created by the Delaware Supreme Court's decision in *ATP*, Messrs. Savitt and Mervis seek to "shift the focus" of the debate. Rather than favor a swift legislative solution, they propose to leave in the hands of management the ability to insulate their own misbehavior from legal challenge. In their vision, the very courts that gave directors this authority through a thorough misreading of the Delaware General Corporation Law would be assigned the task of policing these bylaws through the application of vague and boundless principles of equity. Everyone benefits except shareholders.

In *ATP*, the Delaware Supreme Court upheld as facially valid a bylaw that required owners in a non-stock corporation to pay all legal fees in any action against the entity, its

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members or owners, unless owners obtained substantially all the relief sought in the complaint.<sup>2</sup> While the Supreme Court has not yet expressly applied the analysis to public companies, the expansive breadth of its reasoning provided boards of “for profit” businesses with an immediate weapon that could be, and has been, used to prevent shareholders and investors from filing actions seeking to expose malfeasance by corporations and their directors. Unsurprisingly, these provisions have proved popular. By late December 2014, more than 50 public companies had the provisions in place, with the number growing daily.

The response by some has been to ignore the obvious conflict of interest that comes with allowing directors to adopt bylaws that insulate their own behavior from legal challenge and instead characterize any concern as an overstatement. Messrs. Mirvis and Savitt describe the matter as a mere “kerfuffle.” One Delaware Supreme Court justice who participated in the *ATP* decision called the application of the analysis to for profit companies an “open question,” as if to suggest that the Court might decide not to extend the analysis to these entities.<sup>3</sup>

In fact, the *ATP* decision represents a radical and unjustifiable shift in the nature of corporate law. The Court effectively dismantled a carefully crafted framework put in place by the Delaware legislature. The effect of the decision was to eliminate all meaningful limits in the DGCL on the purpose and content of bylaws adopted by directors and to give boards an effective veto over the filing of actions challenging their behavior. The decision imposed unacceptable financial risk on shareholders (and “prior” shareholders), put in place a framework for the creation of other types of bylaws antagonistic to the interests of shareholders, and provided the federal government with an incentive to intervene in the corporate governance process, further eroding Delaware’s historic leadership in the field.

## II. The Reasoning

The Court in *ATP* was asked to assess the facial validity of a fee shifting bylaw in the context of a non-stock company. In a brief and shockingly cursory discussion,<sup>4</sup> the Court overturned longstanding core principles of corporate law without any meaningful authority or analysis.<sup>5</sup> The Court noted the absence of any explicit limitation on fee shifting bylaws<sup>6</sup>

<sup>2</sup> *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014)

<sup>3</sup> The Honorable Henry duPont Ridgely, Justice, Supreme Court of Delaware, *The Emerging Role of Bylaws in Corporate Governance*, available at [http://www.delawarelitigation.com/files/2014/11/The\\_Emerging\\_Role\\_of\\_Bylaws\\_in\\_Corporate\\_Governance-copy.pdf](http://www.delawarelitigation.com/files/2014/11/The_Emerging_Role_of_Bylaws_in_Corporate_Governance-copy.pdf)

<sup>4</sup> The opinion consisted of a meager 2835 words. Compare that with the more recent decision in *C&J Energy*, a case in which the Court dedicated 13,706 words to an analysis of a board’s “Revlon duties.” The opinion is available here: <http://courts.delaware.gov/opinions/download.aspx?ID=216540>

<sup>5</sup> The operative analysis consisted of four sentences and two footnotes. The Court cited no cases, treatises, or other authority in the one paragraph discussion.

<sup>6</sup> See *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014) (“Neither the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws.”).

and concluded that the allocation of “risk among parties in intra-corporate litigation would . . . appear to satisfy” Section 109.<sup>7</sup> Moreover, by characterizing the bylaws as contracts, the Court determined that fee shifting bylaws were affirmatively permitted.<sup>8</sup>

The decision overturned a carefully constructed framework put in place by the Delaware legislature. First, bylaws have traditionally been used to regulate a corporation’s internal affairs, not the substantive and personal property rights of stockholders.<sup>9</sup> Such matters typically include the “number and qualifications of directors, board vacancies, board committees, quorum and notice requirement[s] for shareholder and board meetings, procedures for calling special shareholder and board meetings, any special voting procedures, any limits on the transferability of shares, and titles and duties of the corporation’s officers.”<sup>10</sup> Bylaws that effectively deny shareholders access to the court system do not implicate a corporation’s internal affairs.<sup>11</sup>

Second, the Delaware legislature made explicit that permissible provisions “limiting” the substantive rights and powers of shareholders were to be in the charter.<sup>12</sup> Section 102(b) provides that the certificate of incorporation may include any provision “limiting . . . the

<sup>7</sup> DGCL 109(b) (“The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.”).

<sup>8</sup> See *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014) (“But it is settled that contracting parties may agree to modify the American Rule and obligate the losing party to pay the prevailing party’s fees. Because corporate bylaws are ‘contracts among a corporation’s shareholders,’ a fee-shifting provision contained in a nonstock corporation’s validly-enacted bylaw would fall within the contractual exception to the American Rule.”).

<sup>9</sup> See Samuel Willison, *History of the Law of Business Corporations before 1800*, 2 Harv. L. Rev. 105, 122-23 (1888) (“But by the change in the conception of a corporation from an institution for special government to a simple instrumentality for carrying on a large business, the right to pass by-laws was restricted to regulations for the management of the corporate business.”); Judd F. Sneirson, *Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 Iowa L. Rev. 987, 996-97 (March 2009) (“Bylaws govern a corporation’s internal affairs.”); James D. Cox and Thomas Lee Hazen, *Treatise on The Law of Corporations*, 3d Ed. 2010 (“The bylaws establish rules for the internal governance of the corporation. Bylaws deal with such matters as how the corporation’s internal affairs are to be conducted by its officers, directors, and stockholders.”); see also Ridgely, *supra* note 3 (“As this early corporate history demonstrates, bylaws have long been needed to govern the manner in which an organization operates.”).

<sup>10</sup> See Judd F. Sneirson, *Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 Iowa L. Rev. 987, 997 (March 2009) (quoting Stephen M. Bainbridge, *Corporation Law and Economics* §2.3(B), at 43).

<sup>11</sup> Any attempt to reconcile the fee shifting bylaw at issue in *ATP* with the internal affairs doctrine would have been unsuccessful. First, they are not internal rules and regulations of the corporation. They affect access to the court system. Second, they are not limited to shareholders, officers, and managers (see *Vantagepoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005) (“The internal affairs doctrine applies to those matters that pertain to the relationships among or between the corporation and its officers, directors, and shareholders.”), but apply to “prior” shareholders and certain third parties. Third, they apply to all causes of action, even those that do not implicate the internal affairs of a corporation. Already at least one state has put in place a statutory requirement that regulates the practice of fee shifting in derivative suits not only for companies incorporate in the state but also for actions against foreign corporations brought in the state. See <https://www.sos.ok.gov/documents/legislation/54th/2014/2R/SB/1799.pdf>

<sup>12</sup> The failure of the Court to consider the impact of Section 102(b)(1) illustrates the analytical weakness of the decision. Limits permitted in the certificate would not, however, include fee shifting bylaws that restrict access to the courts. Instead, the language is logically read to apply to “limits” that involve the corporations internal affairs.

powers of the corporation, the directors, and the stockholders”<sup>13</sup> Yet without even citing the provision, the *ATP* decision allowed for the imposition of “limits” on shareholders through the unilateral adoption of bylaws by the board of directors, entirely rewriting the language of the statute.

Third, the bylaw allowed management to effectively eliminate or restrict inherent rights of ownership granted to shareholders by the Delaware legislature. To the extent applicable to inspection rights cases, fee shifting bylaws have the capacity to prevent shareholders from obtaining access to corporate books and records.<sup>14</sup> Likewise, to the extent applicable to suits seeking a judicial determination of fair value, fee shifting bylaws have the capacity to deny shareholders appraisal rights.<sup>15</sup>

Finally, the Court rewrote Section 109 by characterizing bylaws as contracts and then using contract law, rather than the intent of the legislature, to define the substantive content of bylaws. Bylaws in the public company arena are not contracts.<sup>16</sup> The board of Exxon-Mobil does not enter into a contract with almost 450,000 record owners every time it amends the bylaws.<sup>17</sup> Contracts require consent and consideration; bylaws do not.<sup>18</sup> Contracts are subject to a duty of good faith and fair dealing, bylaws are not.<sup>19</sup> Bylaws are reviewed under the duty of care and loyalty, contracts are not. Moreover, where the Delaware legislature wanted to use contract law as a substantive source of authority it did so explicitly.<sup>20</sup> The statute, not contract, determines the appropriate content and the appropriate limits of bylaws. After the *ATP* decision, this is apparently no longer the case.

<sup>13</sup> The Court was aware of the legislative mandate but chose to disregard it. *See ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014) (“The corporate charter could permit fee-shifting provisions, either explicitly or implicitly by silence.”).

<sup>14</sup> *See* DGCL 220.

<sup>15</sup> *See* DGCL 262.

<sup>16</sup> Delaware courts have sometimes used contract terminology when describing bylaws. They did so, however, not to expand the substantive content of bylaws but as a source of interpretative rules. Thus, *Airgas*, the only case cited by the *ATP* Court, referred to contract law in order to apply the “rules of contract interpretation”. *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del.2010) (“Corporate charters and bylaws are contracts among a corporation’s shareholders; therefore, our rules of contract interpretation apply.”). The cases cited by *Airgas* in turn were likewise designed to identify a source of interpretative guidance. *See Berlin v. Emerald Partners*, 552 A.2d at 488 (“In examining the provisions of a certificate of incorporation, courts apply the rules of contract interpretation.”); *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 342-43 (Del. 1983) (“Our analysis starts with the principle that the rules which are used to interpret statutes, contracts, and other written instruments are applicable when construing corporate charters and bylaws.”).

<sup>17</sup> *See* Current Report on Form 10-K, Exxon-Mobil, Feb. 16, 2014, at 39 (“At January 31, 2014, the registered shareholders of ExxonMobil common stock numbered 449,312.”), available at <http://www.sec.gov/Archives/edgar/data/34088/000003408814000012/xom10k2013.htm>.

<sup>18</sup> *See* § 17 Requirement of a Bargain, Restatement (Second) of Contracts (1981) (“the formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.”).

<sup>19</sup> *See* § 205 Duty of Good Faith and Fair Dealing, Restatement (Second) of Contracts (1981).

<sup>20</sup> *See* Del. Code § 18-1101(b) (“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.”).

### III. The Consequences

The ATP decision will have a pernicious impact on the ability of shareholders to challenge the malfeasance of directors and corporations. They apply to actions against officers or directors for breach of fiduciary duties, actions against corporations for committing fraud under the federal securities laws, and actions against acquirers in corporate takeovers that engage in wrongdoing or seek to pay less than fair value. Fee shifting bylaws threaten to impose a financial penalty on a shareholder initiating any of these actions.

Messrs. Savitt and Mervis address this concern with a fictitious assertion. They note that “we [do not] perceive much force in the argument that no plaintiff lawyer could even bring suit to challenge a fee-shifting bylaw, lest the cost of defeat include the corporation’s cost of defense (as if that were immutably a violation of the laws of physics).” They are right that the argument does not have “much force” because no one (except Messrs. Savitt and Mervis) makes it. The issue is not whether there will be “no plaintiff lawyer” who will bring an action but whether the bylaws will prevent meritorious litigation in a manner that insulates corporations and boards from wrongdoing. There is little doubt that it will.

The blunt reality is that fee shifting bylaws will result in the non-filing of many, if not most, derivative suits. With payouts going to the company, not the plaintiff, shareholders have little incentive to step forward where they also bear the risk of liability for the fees incurred by the company and its directors.<sup>21</sup> Similarly, almost half of all securities class action law suits are dismissed on motion.<sup>22</sup> It will be the rare investor who will want to incur a 50-50 risk of having to pay the company’s fees in the event of a dismissal, particularly given the “skyrocketing” rates charged by defense firms in securities cases.<sup>23</sup>

Nor is there any reason to believe that boards will not use the newly granted authority to adopt other types of bylaws that will further insulate misbehavior from challenge. Under the Court’s interpretation in *ATP*, bylaws need only relate to the “business of the corporation,” an almost unlimited mandate. There is nothing that prevents the shifting of fees to suits brought, for example, by employees, a category of persons specifically mentioned in Section 109(b). Nor is there anything that prevents boards from imposing other types of “limits” that interfere with shareholder suits.<sup>24</sup>

<sup>21</sup> See Transcript, *Kastis v. Carter*, No. 8657, Del. Ch., Aug. 22, 2014, at 17 (“if a bylaw may apply to these plaintiffs, they cannot—and virtually no stockholder can [maintain an action], particularly in a derivative case. You have no direct interest in any recovery and your indirect interest is going to be minimal.”). The transcript is available here: <http://www.law.du.edu/documents/corporate-governance/governance-cases/kastis/Transcript-Discussing-Amendment-to-Bylaw-Kastis-v-Carter-Case-No-8657-CB-Aug-15-2014.pdf>

<sup>22</sup> The statistics on dismissals are here: [http://www.nera.com/content/dam/nera/publications/archive2/PUB\\_2013\\_Year\\_End\\_Trends\\_1.2014.pdf](http://www.nera.com/content/dam/nera/publications/archive2/PUB_2013_Year_End_Trends_1.2014.pdf)

<sup>23</sup> For a discussion of “skyrocketing” defense costs in securities class action law suits, see <http://www.dandodiscourse.com/2014/09/09/the-root-cause-of-skyrocketing-securities-class-action-defense-costs/>

<sup>24</sup> One non-Delaware company has adopted a bylaw that limits derivative suits to 3% shareholders. See <http://>



Finally, the approach invites conflict with other states and inconsistent standards for corporations and shareholders.<sup>25</sup> Oklahoma has already adopted a statutory provision that requires fee shifting for both domestic and foreign companies in certain circumstances.<sup>26</sup> A Delaware corporation with a fee shifting bylaw that is named in a derivative action filed in Oklahoma could find itself subject to conflicting requirements. This would be exacerbated should a state adopt a provision that prohibits fee shifting bylaws and applies the prohibition to foreign companies operating in the state.

#### IV. The Solution

The approach taken in *ATP* should be legislatively overturned. The argument for federal intervention is strong. The bylaws directly interfere with actions brought under the federal securities laws. Moreover, while Congress could restrict board authority with respect to fee shifting bylaws,<sup>27</sup> the Securities and Exchange Commission already has the authority to do so.

Both the 1933 Act and the Exchange Act void provisions that cause persons to “waive compliance” with the requirements of these Acts.<sup>28</sup> The Commission has, in the past, invoked its authority to restrict practices by the board of directors. Companies going public must include in a registration statement of a legend stating that the Commission views “indemnification for liabilities arising under the Securities Act of 1933” for directors, officers or persons controlling” the company as “against public policy” and “therefore unenforceable.”<sup>29</sup> The Commission could also decline to accelerate a registration statement that included fee shifting bylaws.

The most obvious and effective solution would be for the Delaware legislature to intervene and reinstate the law as it was before the *ATP* decision. This is not the same as the response to the *Van Gorkom* decision when the legislature added Section 102(b)(7). In that instance, the legislature opted to effectively rewrite the common law to avoid the possibility of personal liability for breach of the duty of care.

[www.theracetothetbottom.org/home/delaware-and-the-consequences-of-an-excessively-management-f.html](http://www.theracetothetbottom.org/home/delaware-and-the-consequences-of-an-excessively-management-f.html)

<sup>25</sup> See *Vantagepoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1112-1113 (Del. 2005) (noting that internal affairs doctrine was intended to “prevent corporations from being subjected to inconsistent legal standards” by providing that a corporation’s internal affairs would be subject only to “the law of the state of incorporation”).

<sup>26</sup> The provision is here: <https://www.sos.ok.gov/documents/legislation/54th/2014/2R/SB/1799.pdf>

<sup>27</sup> See Letter from Senator Blumenthal to Chair White, Securities & Exchange Commission, Oct. 30, 2014, available at <http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-sec-to-protect-critical-check-on-corporate-malfeasance>

<sup>28</sup> See Section 29(a) of the Securities Exchange Act of 1934 (15 USC §78cc) and Section 14 of the Securities Act of 1933. 15 USC §77m.

<sup>29</sup> 17 CFR §229.510.

In these circumstances, the legislature would be overturning an incorrectly decided decision of the Delaware Supreme Court. Moreover, doing so would not eliminate existing tools available to prevent frivolous litigation. Courts already have the authority to impose sanctions under Rule 11 or award fees for litigation brought in bad faith.<sup>30</sup> Legislative intervention would, however, take away from boards the ability to reduce their own accountability and eliminate a serious impediment to meritorious litigation.

Whether the Delaware legislature will overturn the decision remains to be seen. As Messrs. Savitt and Mervis note, initial efforts to legislatively resolve the concerns raised by the *ATP* Court “died a sudden death.” Inaction will only cause long term harm to the role of Delaware in the corporate governance process. Confronting the decidedly unfriendly legal environment, shareholders will have an incentive to pressure companies to reincorporate to other jurisdictions,<sup>31</sup> to lobby other states to bar fee shifting bylaws,<sup>32</sup> to encourage further federal preemption, and to avoid litigation in the Delaware courts.<sup>33</sup>

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<sup>30</sup> See *In re SS&C Technologies, Inc. Shareholders Litigation*, 948 A.2d 1140, 1149-50 (Del. Ch. 2008) (“This court has broad discretion to award attorneys’ fees where litigation was brought in bad faith or where bad faith conduct by one of the parties increases the costs of the litigation. This serves to “deter abusive litigation in the future, thereby avoiding harassment and protecting the integrity of the judicial process.”).

<sup>31</sup> Shareholders have submitted proposals requesting boards to consider reincorporation and the SEC has declined to grant no action letters excluding them from the proxy statement. See OGE Energy (Feb. 21, 2013), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/geraldarmstrongoenergy022113-14a8.pdf>

<sup>32</sup> Data produced by Cornerstone suggests that, after Delaware, the most popular state for the filing of litigation challenging mergers between 2010 and 2013 was California (77) and New York (39). See *Shareholder Litigation Involving Mergers and Acquisitions*, Review of 2013 M&A Litigation, Cornerstone Research, at 3, available at <https://www.cornerstone.com/GetAttachment/73882c85-ea7b-4b3c-a75f-40830eab34b6/-Shareholder-Litigation-Involving-M-and-A-2013-Filings.pdf>

<sup>33</sup> States that do not apply fee shifting bylaws will also likely not enforce forum selection bylaws. Forum selection bylaws are not enforceable “as-applied” to the extent that they would result in unreasonable or unjust results. See *Boilermakers Local 154 Retirement Fund v. Chevron*, 73 A.3d 934 (Del. Ch. 2013). A foreign jurisdiction that did not favor fee shifting bylaws would likely find it unjust and unreasonable to enforce a bylaw that required a case to be litigated in a jurisdiction that did.

## **Do Broad Fee-Shifting Bylaws Comply with the Doctrine of Corporate Consent?**

What follows is our review of an article by Professor Lawrence A. Hamermesh, Ruby R. Vale Professor of Corporate and Business Law at the Widener University Delaware School of Law. *The complete article can be found at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2488209](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2488209)>.* It will also be published in a forthcoming issue of the *Business Lawyer*.

Professor Hamermesh knows whereof he speaks. He practiced law for many years as a partner in a large Wilmington law firm. In this article, he discusses why broad fee shifting bylaws exceed the limits of what he calls the “doctrine of corporate consent,” which treats stockholders as having implicitly consented to changes adopted by the Board. Mr. Hamermesh finds that a broad fee-shifting bylaw is a “rare example of a provision that contravenes what might be called the constitutional limits of corporate law, in that it is not an appropriate subject for private ordering, at least in publicly traded companies.”

Mr. Hamermesh lists four factors to be considered for identifying the legitimate limits of the corporate consent doctrine:

1. **The number and character of the investors**—meaningful consent is more appropriately assumed among a small group of experienced investors represented by counsel than when an investment is sold to a large number of unsophisticated investors;
2. **Whether the provision is in place before investors invest, or is adopted after investors have invested**—investors who choose to invest after a provision is in place can more easily be seen as having provided meaningful consent, unlike those who already own an investment at the time a change is adopted;
3. **Whether the likely impact of the changes are reasonably understandable to investors;** and
4. **Perhaps “most importantly, whether the provision impairs some strong and reasonable expectation on the part of investors, in light of other known elements of the so-called corporate contract.”**

Applying these factors, Mr. Hamermesh approves of the following examples of corporate consent: the clearly disclosed dual-class structure of Google and Facebook IPOs; a corporate merger, and a forum selection bylaw adopted by a board of directors. Similarly, he accepts LLC charters that reduce or eliminate fiduciary duties because a small number of sophisticated investors have agreed to them.

Mr. Hamermesh then turns to his final example, in which a board of directors unilaterally adopts a bylaw stating that, if a stockholder pursues the directors for breach of duties

and does not substantially achieve the full remedy sought, the member must reimburse all of the defendants' litigation fees and expenses. This provision is much more extreme than the English rule on attorneys' fees where the loser pays. As Mr. Hamermesh notes, under the terms of the fee-shifting bylaw "only the plaintiff has to pay the other side's costs—and it has to pay those costs not just if it loses, but even if it wins many of its claims but fails to get substantially all the relief it sought."

In *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), the Delaware Supreme Court nevertheless found such a bylaw to be facially valid, explaining:

[I]t is settled that contracting parties may agree to modify the American Rule and obligate the losing party to pay the prevailing party's fees." Because corporate bylaws are "contracts among a corporation's shareholders," a fee-shifting provision contained in a non-stock corporation's validly-enacted bylaw would fall within the contractual exception to the American Rule. Therefore, a fee-shifting bylaw would not be prohibited under Delaware common law.

While the company in that case was a non-stock corporation with a relatively small number of members, the Court's reasoning and application of the doctrine of corporate consent suggest that it would reach the same conclusion for publicly traded companies, 24 of which have since adopted similar bylaws. According to the Delaware Supreme Court, the only limitation on the bylaw is that it may not be enacted for an "improper purpose". Although the court did not provide any examples, a bylaw enacted in the middle of a lawsuit for the purpose of ending it would probably be considered improper. However, according to the court, a bylaw adopted earlier with "an intent to deter litigation would not necessarily render the bylaw unenforceable in equity."

Mr. Hamermesh considers the Court's decision "disconcerting":

Never before had I thought it possible that a shareholder whose shares were fully paid for could be compelled by a bylaw, to which he did specifically consent, to take on a monetary liability of any sort. Indeed, the concept seemed especially alien to me in a system of limited liability, in which shareholders of corporations understand that they cannot be made liable for monetary losses to any extent beyond the amount of their investment in the corporation.

He finds such bylaws "unacceptable" when such a provision is adopted after individuals have invested:

It satisfies none of the criteria I have proposed: it is not in essence an agreement negotiated by a small number of sophisticated investors; it is not in place before the investment occurs; there is no opportunity for an investor to assess its reasonableness and thereupon decide how to act, because it is adopted after

the investment occurs; and most of all, it contravenes what I believe are strongly and widely held expectations about the rights of stockholders of Delaware corporations.

Specifically, Delaware's corporate law system relies on the availability of court oversight to ensure that directors use their power appropriately. This type of bylaw not only "imposes intolerable risk on the stockholder's decision to sue directors for breach of fiduciary duty," it is also almost impossible to challenge: "it would likely be too risky for any stockholder to undertake [a lawsuit challenging it], because anything less than total success in that litigation would result in the stockholder having to pay the corporation's costs of defense." Even if this type of bylaw is in place before individuals invest, Mr. Hamermesh finds its appropriateness questionable "given the reliance on and prominence of judicial enforcement of fiduciary duties in the Delaware corporate system."

In light of this analysis, He suggests that it is important for those tasked with developing changes to Delaware's corporate statutes to consider how "to place legislative limits on the doctrine of corporate consent." Without such limits there is no end to what Directors may do; for example, they could require the losers in a corporate election to pay the costs if they do not garner a certain percent of the voting shares.

We applaud the article but believe these bylaw provisions are not aimed at shareholders but their attorneys. The plaintiffs' bar may be analogized to "sophisticated investors" who know or should know what they are getting into when they bring a lawsuit against a company with such a bylaw. The problem is not shareholder surprise-- it is lawsuit suppression. If all lawsuits are strike suits the Board is right to suppress them. But if some of them are legitimate, the question is how the Delaware legislature should draft bylaw limitations that distinguish between them. For a discussion of this question see Mr. Cohen's editorial, *infra*.

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## Reducing Litigation Perils Fairly

Harvey L. Pitt\*

I was recently reminded of the litigation malaise afflicting Americans when my twenty-five year old younger son, Rob, called with the sad news that a friend to whom he had entrusted his beloved cat, Toki, while moving to a new city, had been lost due to his friend's negligence. After commiserating with Rob, he surprised me by asking whether he had a cause of action against his friend, for negligently losing his cat! When I asked why he would even consider such a step, which would not bring back Toki, run huge costs, and have little impact on his impecunious former friend, Rob replied, "to teach my friend never to do something like this again." I suppose he has a point, but litigation against an impecunious friend to remedy irremediable wrongs strikes me as rubbing salt in one's own wounds! Needless to say, I was amazed to discover that there actually are precedents on which Rob could rely,<sup>1</sup> not to mention even more bizarre resorts to litigation.<sup>2</sup>

In our society, litigation far too often substitutes for reasoned discourse and sensible negotiations (or turning one's back on an insoluble problem and moving forward) when individuals or entities seek to remedy perceived or real injuries, or make some money tormenting their adversaries. In truth, the only persons who surely benefit from litigation are litigators!<sup>3</sup> Perhaps that goes too far—in our system, which generally (but not always) requires each side to bear its own litigation costs, win, lose or draw,<sup>4</sup> the only persons who are assured of benefitting from most litigation efforts are the litigators. In corporate litigation, the beneficiaries are not necessarily the litigants; rather, the only certain beneficiaries are defense lawyers (who are paid, win, lose or draw) and—if they prevail (in battle or by obtaining a settlement)—plaintiffs' lawyers. In almost all cases, corporations and their

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<sup>1</sup> See, e.g., C. Berry, "Legal Rights and Duties in Lost Pet Disputes," MICH. STATE UNIV. COLL. OF LAW ANIMAL LEGAL & HISTORICAL CTR. (2010), available at <https://www.animallaw.info/article/detailed-discussion-legal-rights-and-duties-lost-pet-disputes>.

<sup>2</sup> In 2007, for example, a small DC dry cleaner was sued for \$54 million because it allegedly lost a pair of the plaintiff's pants. The dry cleaner ultimately prevailed, but spent \$100,000 on legal fees. See, e.g., M. Gryphon, "Greater Justice, Lower Cost: How a 'Loser Pays' Rule Would Improve the American Legal System," MAN. INST. FOR POLICY RESEARCH CIVIL JUSTICE REPORT NO. 11 (Dec. 2008), available at [http://www.manhattan-institute.org/html/cjr\\_11.htm](http://www.manhattan-institute.org/html/cjr_11.htm).

<sup>3</sup> See, e.g., M. White, "Legal Complexity and Lawyers' Benefit from Litigation," 12 INT'L REV. OF LAW & ECON. 381 (1992), available at <http://econweb.ucsd.edu/~miwhite/complexity.pdf>.

<sup>4</sup> The "American Rule" provides that litigants generally are responsible for paying their own attorney's fees, irrespective of the outcome of the litigation. See, e.g., *Alyeska Pipeline Serv. Co. v. Wilderness Soc.*, 421 U.S. 240 (1975).

non-litigating shareholders are losers, even when the corporation prevails in the litigation.<sup>5</sup> It is small wonder then, that business enterprises have consistently sought ways to reduce the one-sided effect that can accompany shareholder litigation that turns out to be frivolous.

National legislative solutions have proved elusive, however; and, even when they succeed, they rarely achieve the aspirations of their sponsors and drafters,<sup>6</sup> compelling many corporations to engage in a search for a “silver bullet”—the elusive perfect solution that would spare well-managed companies forever from nuisance or frivolous shareholder litigation. Of course, there is a problem in attempting to discern which lawsuits are frivolous and which are not. Frivolousness, like beauty, is in the eye of the beholder. And, some cases said to be frivolous upon their institution turn out to be well-founded, while others, thought to be well-taken, turn out to be frivolous.<sup>7</sup>

Corporate efforts to fashion national legislative solutions are cyclical,<sup>8</sup> but have been given new impetus—as evidenced by the fact that at least twenty-four public companies have recently adopted some form of fee-shifting by-law provision—as a result of the recent Delaware Supreme Court decision in *ATP Tour Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. Sup. Ct. 2014) (“ATP”), broadly holding that a corporate by-law fee-shifting provision that forced unsuccessful shareholder plaintiffs to pay the winner’s legal fees is enforceable. Several facets of the by-law provision involved, and the case, are worth noting in this context:

<sup>5</sup> Most shareholder litigation is taken on a contingency fee basis, which means the plaintiff’s lawyers receive nothing if there is no recovery, but obtain a percentage of any recovery obtained for the plaintiff-shareholders. This is the reason that a great many shareholder lawsuits are resolved by settlement as opposed to litigation. The effect of this is that sued corporations always pay their own litigation costs, even when they prevail, and frequently pay the plaintiffs’ litigation costs as part of a settlement or as the result of an adverse judgment.

<sup>6</sup> A case in point is the Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737 (Dec. 22, 1995) (“PSLRA”), the only piece of legislation Congress passed over a President Clinton veto. Intended to stem the filing of frivolous securities lawsuits, the PSLRA increased the evidentiary requirements for plaintiffs in securities class action litigation, and provided greater judicial scrutiny of the class-action litigation milieu. In fact, however, since passage of the PSLRA, there has been an upsurge in class-action litigation, the size of recoveries, and a significant shift from individual plaintiffs to institutional investors, most notably public pension funds. See J. O’Brien, “Fee-shifting Could Impact Future of Securities Class Actions,” Legal Newsline Legal JI. (Oct. 28, 2014), available at <http://legalnewsline.com/issues/class-action/252785-fee-shifting-could-impact-future-of-securities-class-actions> (“From 1997-2012, 3,050 securities class actions have been filed and \$73.1 billion has been recovered. From 2012-13, public pension funds have been the lead plaintiff in 47 percent and 43 percent of cases, respectively”).

<sup>7</sup> See, e.g., R. Lee, “So Sue Me: The Intersection Between Law and Psychology; How to Deal with Litigious People and Frivolous Lawsuits,” PSYCHOLOGY TODAY (Jul. 28, 2014), available at <http://www.psychologytoday.com/blog/so-sue-me/201407/how-deal-litigious-people-and-frivolous-lawsuits>.

<sup>8</sup> In connection with past efforts at corporate self-help, the Securities and Exchange Commission (“SEC”) apparently has pressured companies to refrain from pursuing provisions discouraging traditional shareholder litigation, for example in favor of arbitration. See, e.g., C. Schneider, *Arbitration in Corporate Governance Documents: An Idea the SEC Refused To Accelerate*, 4 InSights 21, 24, (May 1990), discussed in “Arbitration Provisions in Corporate Governance Documents,” Harv. L. S. Forum on Corp. Gov. & Fin. Reg. (April 27, 2012), available at <http://blogs.law.harvard.edu/corpgov/2012/04/27/arbitration-provisions-in-corporate-governance-documents/#more-27513>.

- The company involved was a non-stock corporation, but most commenters and practitioners assume the same rule will apply to Delaware corporations, too;<sup>9</sup>
- The fee-shifting provision occurred as the result of the adoption of a by-law by the entity’s Board, without a shareholder vote;<sup>10</sup>
- The by-law in this case is often described as “one-way,” meaning that a loss or recovery of anything less than the original demand for relief by the plaintiff(s) requires them to pay their company’s legal fees, but a loss by the defendant(s) requires no such payment;<sup>11</sup>
- A significant settlement that provided material relief to plaintiffs would not technically obviate the fee-shifting obligation of the by-law;<sup>12</sup>
- While “an intent to deter litigation . . . would not necessarily render the bylaw unenforceable,” the corporation would be obligated to demonstrate that the by-laws were adopted by the appropriate corporate procedures and for a proper corporate purpose;<sup>13</sup>
- The by-law contained no provision for a Board waiver, for example in the case of a settlement of litigation;<sup>14</sup> and
- The by-law applied to *all* shareholders, including those who were already shareholders prior to the adoption of the fee-shifting by law.<sup>15</sup>

<sup>9</sup> See, e.g., N. Cook, “What Fiduciary Duties? Delaware Supreme Court Okays One-Way Fee-Shifting By-laws,” Grant & Eisenhofer P.A. Articles (2014) (“What Fiduciary Duties?”), available at <http://www.gelaw.com/articles/What-Fiduciary-Duties.pdf>.

<sup>10</sup> *ATP, supra*, 91 A.3d 554.

<sup>11</sup> See, e.g., *What Fiduciary Duties*, n. 7, *supra*.

<sup>12</sup> This concern might prove academic, but not necessarily so. A settling plaintiff could presumably obtain a waiver from the settling corporation of the plaintiff’s obligation to pay the legal fees of the corporation. If the by-law at issue does not permit a waiver, the defendant corporation could, presumably, exercise its business judgment in deciding to waive the recovery of legal fees. The issue would be whether this effort would be sufficient to prevent other shareholders from later seeking to hold those who approved the settlement liable for the loss of legal fees that were waived as part of the settlement. Since settlements of shareholder litigation require judicial approval, the court asked to approve the settlement could be asked to approve, specifically, the waiver of legal fees.

<sup>13</sup> *ATP, supra*, 91 A.3d 554.

<sup>14</sup> *Id.* As a general proposition, corporations that adopt these by-laws *without* giving themselves the ability to waive the requirement are being reckless, as well as poorly advised. Presumably, those who advocate rigid by-law terms may worry that, by exercising the ability to waive legal fees, the company involved may implicitly (or perhaps explicitly) be deemed to have expressed some acknowledgment of the merits of the lawsuit. In point of fact, however, that spurious logic has never impeded a corporation’s ability to settle class-action or derivative litigation (with or without fee-shifting by-law provisions in the picture).

<sup>15</sup> *ATP, supra*, 91 A.3d 554. While the Delaware Supreme Court held that “the fact that [the by-law] was adopted after [persons became shareholders] will not affect its enforceability [against those persons].” *Id.*

But, there is a significant difference between shareholders who become shareholders *after* a restrictive by-law has been adopted, and those who were existing shareholders *before* the restrictive by-law is adopted. In the former circumstance, those who become shareholders *after* restrictive provisions are in place may be presumed (assuming appropriate disclosure was made) to have purchased their interests with knowledge of



To consider what various judicial, legislative and regulatory authorities might do in response to the current situation, it is important to start with a number of fundamental premises that should guide the exercise—or non-exercise—of authority to deal with fee-shifting by-laws.

*Litigation-related provisions serve a variety of useful purposes.* It is impossible to catalogue all the potential ways in which litigation can be subject to restraints imposed by internal corporate documents, but among the various possibilities are

- Forum selection clauses;
- Choice of applicable law provisions;
- Arbitration provisions; and
- Fee-shifting provisions.

There is nothing new about these provisions, and there is an appreciable body of judicial decisions affirming the benefits that flow from provisions of this sort, when the motivation behind their imposition is free from doubt. For example, more than a decade ago, seven federal appellate courts confronted with the question of the binding nature of forum selection clauses and choice of applicable law provisions governing Lloyd’s of London, rejected challenges to such provisions based upon Section 29 (a) of the Securities Exchange Act.<sup>16</sup> Particularly in light of the fact that most U.S. corporations of size engage in activities across the U.S. and overseas as well, choice of law and choice of forum obligation for litigants ensures both an orderly and a consistent resolution of potential disputes.<sup>17</sup> In the Lloyd’s cases, the Lloyd’s Insurance Underwriting market encompassed over eighty countries, a substantial reason for requiring a single forum and a single choice of law to apply to all related market disputes.

Fee-shifting by-law provisions are justified if they provide a measure of protection to the corporation and its non-litigating shareholders against frivolous litigation. Frivolous these provisions, and be deemed implicitly to have accepted those provisions. Those who purchase their interests *before* a restrictive by-law has been put in place, especially without shareholder approval (although shareholder approval cannot cure acts of overreaching engaged in by those with fiduciary obligations), must be deemed to have implicitly given corporate management and the Board the power to perform a variety of detrimental acts for which there is little or no recourse. The implication of such authority does not seem to rest on any legitimate legal theory, although it apparently rests on prior Delaware precedent.

<sup>16</sup> Section 29(a), 15 U.S.C. §78cc(a) provides that “any condition, stipulation or provision binding any person to waive compliance with any provision of [the Securities Exchange Act] or of any rule or regulation thereunder, . . . shall be void.” See, e.g., *Stamm v. Barclays Bank of New York*, 153 F.3d 30, 45 (2d Cir., 1998), citing *Richards v. Lloyd’s of London*, 135 F.3d 1289, 1294 (9<sup>th</sup> Cir. 1998) (*en banc*) (collecting cases where other circuit courts have enforced the Choice Clauses).

<sup>17</sup> In the Lloyd’s cases, the provisions in question were contractual. But, the Delaware Courts have accorded the same deference to corporate Charter and Bylaw provisions. See, e.g., *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

litigation wastes management's and board members' time, diverts their focus from the essentials of the company's business activities and strategic plans, inflicts huge costs on the company in defending and disposing of the litigation, and often operates to curtail management's willingness to take sensible business risks to enhance shareholder value.

*Imposing litigation-related provisions by corporate fiat, without advance notice to shareholders, may render such provisions coercive, and undermine the valuable corporate purposes such provisions serve.* In light of the Delaware Supreme Court's *ATP* decision, we may be witnessing the corporate equivalent of the California Gold Rush.<sup>18</sup> There is nothing wrong with corporations seeking to take advantage of applicable legal interpretations, as long as they don't cross over into illegal conduct, and provided they remain faithful to their fiduciary obligations to corporate shareholders.

The easiest way to impose litigation-related provisions is during the incipient stages of incorporation. At that point, a general shareholder vote is not required, and therefore is not problematic, and there is no coercive effect resulting from the adoption of corporate charter provisions at the outset of a company's existence. Presumably, anyone purchasing the company's securities in that situation can fairly be assumed to have purchased stock cognizant of the litigation-related provisions.

The problem with effecting these restraints in IPOs, however, is that the IPO context leaves unaddressed the overwhelming number of companies that are already incorporated, with one or more outstanding classes of shareholders. For those companies, the logical vehicle for effecting the adoption of a corporate charter provision regarding fee-shifting is the annual proxy solicitation. Companies that wish to implement these fee-shifting provisions could avoid the problems that inhere in the unilateral imposition of the by-law by proposing a charter amendment for shareholder approval.

The prospect of a shareholder vote, however, may be perceived by many companies as daunting. Given the fact that most public companies today are principally owned by institutional shareholders,<sup>19</sup> and those shareholders may not support litigation-restraint charter or by-law provisions, many corporations may be reluctant to risk a shareholder vote.<sup>20</sup> Of

<sup>18</sup> Once word of the 1849 discovery of gold spread, the non-native population of San Francisco (and the surrounding area) increased more than 100-fold. See The History Channel, "*The Gold Rush of 1849*," available at <http://www.history.com/topics/gold-rush-of-1849>.

<sup>19</sup> Institutions own in excess of 75% of the equity shares of U.S. corporations. See, e.g., A. Kohn & J. Yip-Williams, "*The Separation of Ownership from Ownership: Concerns Arising from Institutional Investors as Intermediaries*," THE CONFERENCE BOARD DIRECTOR NOTES (Nov. 2013), available at [http://www.conference-board.org/retrievefile.cfm?filename=TCB\\_DN-V5N22-131.pdf&type=subsite](http://www.conference-board.org/retrievefile.cfm?filename=TCB_DN-V5N22-131.pdf&type=subsite),

<sup>20</sup> See, e.g., S. Solomon, "*A Ruling's Chilling Effect on Corporate Litigation*," NEW YORK TIMES DEALBOOK (May 23, 2014), available at [http://dealbook.nytimes.com/2014/05/23/a-rulings-chilling-effect-on-corporate-litigation/?\\_php=true&\\_type=blogs&\\_php=true&\\_type=blogs&\\_r=1](http://dealbook.nytimes.com/2014/05/23/a-rulings-chilling-effect-on-corporate-litigation/?_php=true&_type=blogs&_php=true&_type=blogs&_r=1).

course, even if a vote were taken, and the outcome supported the adoption of a fee-shifting charter amendment, pre-existing shareholders would still have an incentive to challenge the adoption of the charter amendment on the ground that it imposes a change in a fundamental shareholder right, and diminishes the value or desirability of continuing stock ownership. To avoid litigation, delay and expense, companies may wish to provide an escape mechanism for dissenting shareholders.<sup>21</sup>

Since Delaware law gives companies incorporated there the potential ability to amend their by-laws without a shareholder vote, and the *ATP* decision expressly holds that, in the absence of special facts and circumstances, litigation-restraint by-law provisions may validly be applied to previously-existing corporate shareholders, many Delaware-incorporated companies now seek to take advantage of this new-found opportunity. But, whatever the legality of the unilateral imposition on shareholders of fee-shifting by-law provisions by a corporation's board of directors, independent directors must be transparent in adopting litigation-restraint by-law provisions, and be certain they have fulfilled their fiduciary duties on behalf of the company and its shareholders in deciding whether to utilize the ability to adopt by-law provisions without a shareholder vote. This argues strongly in favor of caution before public companies jump on the fee-shifting by-law bandwagon.<sup>22</sup>

*One-sided fee-shifting by-law provisions are a potential trap for unwary directors.* As previously noted, the *ATP* decision was rendered in the context of a non-stock membership company, where fiduciary obligations may not be exactly the same as those applicable to public company directors.<sup>23</sup> To avoid unnecessary litigation and controversy, public company independent directors should seek independent advice regarding the possible adoption of a fee-splitting by-law provision.

Equally significant, careful consideration should be given to the process by which, and the terms of, any by-law provision a public company intends to impose unilaterally. Among other things, the following considerations may be helpful to keep in mind:

- Prior to developing and adopting a by-law provision, a special committee composed of outside directors should be considered to conduct due diligence and make recommendations to the full board.

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<sup>21</sup> This would take the form of an appraisal right, and would minimize the ex post facto nature of the imposed by-law changes.

<sup>22</sup> See, e.g., W. Savitt, "Ruling on Fee-Shifting Bylaws Raises Hackles," *The Nat'l L. J.* (June 2, 2014), available at <http://www.nationallawjournal.com/id=1202657437889/Ruling-on-FeeShifting-Bylaws-Raises-Hackles?slreturn=20140929033308>,

<sup>23</sup> *Id.* ("The decision whether to adopt a fee-shifting bylaw implicates a board's fiduciary responsibility and, in the public company context (and unlike in *ATP*), an inherent tension between the legitimate corporate goal of deterring litigation and the danger of self-interested director action").

- The special committee could be charged with developing an appropriate record for the board to consider in assigning reasons for the adoption of the by-law provision, providing empirical data (to the extent available and relevant), and considering the unique perspectives of the company as a potential justification for the adoption of a litigation-related by-law provision.
- Discussions should be had with significant institutional shareholders regarding the terms of and process by which any by-law provision will be adopted, soliciting ideas, recommendations and observations.
- An opinion of a qualified governance expert should be sought to ensure that the board has carefully considered the impact of the adoption of any litigation-related by-law.
- An effort should be made to align the proposed terms of any by-law provision with the stated rationales for the adoption of a litigation-related by-law provision. By definition, this means that any by-law that is adopted should not be one-sided.
- To the extent it is feasible, consideration should be given to adopting a comprehensive provision that not only deals with fee-shifting, but also deals with choice of law, choice for forum, choice of venue, etc.
- Ideally, any by-law provision adopted should distinguish between frivolous litigation and frivolous litigation practices, on the one hand, and meritorious claims.
- Any fee-shifting should be two-sided, rather than one-sided, permitting plaintiffs' fees and expenses to be borne by the Company in the event of untoward litigation postures taken on the Company's behalf or at its behest.
- The board should only adopt a by-law provision that permits the board to exercise its good faith business judgment to waive the provisions of the by-law whenever doing so would be conducive to securing a settlement of litigation.
- The test for fee-shifting should be whether the shareholder-litigant has substantially prevailed in establishing its claims of improper corporate behavior, or achieved a material benefit for shareholders (in a class action case) or the company (in derivative litigation).

In circumstances such as these, it is useful for directors to remember that the perfect is the enemy of the good.<sup>24</sup>

*Legislative codification of best practices would be appropriate and beneficial.* It is significant that Delaware's legislature is currently considering whether to adopt statutory

<sup>24</sup> Voltaire, "*La Begueule*," available at [http://fr.wikisource.org/wiki/La\\_B%C3%A9gueule](http://fr.wikisource.org/wiki/La_B%C3%A9gueule) (commencing with the observation that "The best is the enemy of the good").

provisions that might govern the ability of Delaware-incorporated companies to take advantage of the *ATP* decision.<sup>25</sup> Putting to one side, for the moment, whether there is (or should be) any federal preemption of the area, history suggests that a definitive legislative resolution of the issues—whether companies can adopt such by-law provisions unilaterally, how such by-law provisions should be adopted, and the substance of such by-law provisions—is preferable over permitting a “race to the bottom” regarding this subject.

Because appropriate restraints on litigation can benefit both corporations companies and their shareholders, permitting such by-laws should affirmatively be embraced, especially by the Delaware legislature.<sup>26</sup> But it would make sense to require that any fee-shifting by-law adopted conform to the ten criteria outlined above. In particular, a vote of shareholders should be mandatory, and an appraisal remedy should be available in the case of shareholders whose stock ownership predated the adoption of a fee-shifting by-law. One-sided fee-shifting by-law provisions should be proscribed.

*The application of the federal securities laws.* Although some academics have excoriated the SEC for failing to do whatever it can to block fee-shifting by-law provisions,<sup>27</sup> the rights of corporate shareholders are a matter of state law,<sup>28</sup> and should continue to be decided by state law. Notwithstanding the primacy of state law, there currently are regulatory provisions that require disclosures of litigation-related charter and by-law provisions,<sup>29</sup> and the SEC has used its “persuasive powers” to cause registrants to abandon litigation-related provisions with which the Agency did not approve.<sup>30</sup> Unless and until the primacy of state law governing shareholder rights and corporate governance is changed, however, the SEC has more than enough to keep itself occupied without attempting to assume a significant role in defining the rights of corporate shareholders.

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<sup>25</sup> See WSGR Alert, “*The Fate of Delaware ‘Fee-Shifting’ Bylaws*” (Jul. 11, 2014), available at <http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert-fee-shifting-0714.htm>.

<sup>26</sup> If the Delaware legislature were statutorily to prohibit fee-shifting by-law adoption, it is undoubtedly the case that other states would fill the vacuum. That is not, by itself, a justification for permitting these by-laws, but it is a practical reality of which the Delaware legislature should be aware.

<sup>27</sup> See, e.g., J. Coffee, “*Fee-Shifting and the SEC: Does it Still Believe in Private Enforcement?*,” THE METROPOLITAN CORPORATE COUNSEL (Oct. 22, 2014), available at <http://www.metrocorp counsel.com/articles/30473/fee-shifting-and-sec-does-it-still-believe-private-enforcement>.

<sup>28</sup> See, e.g., Prof. S. Bainbridge, “*The Scope of the SEC’s Authority over Shareholder Voting Rights*” (2007), available at <http://www.sec.gov/comments/4-537/4537-17.pdf>.

<sup>29</sup> See Coffee, *supra* n. 27, at n. 23, citing SEC Form S-3 at Item 13 (“Disclosure for Securities Act Liabilities”) (requiring registrants to disclose the SEC’s position that indemnification is against public policy and therefore unenforceable).

<sup>30</sup> *Id.*, at n. 22.

The *ATP* decision arose in a limited context, and provides—at best—only limited guidance on the ability of Delaware-incorporated companies to adopt fee-shifting by-law restraints. There is a real need for the Delaware legislature to address this subject directly, and provide the necessary content to make the ability of corporations to engage in this type of by-law creation one that is subject to the overarching principles of transparency, fairness and enhancement of shareholder values.

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