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## Limiting Frivolous Shareholder Lawsuits Via Fee-Shifting Bylaws: A Call for Delaware to Overturn and Revise Its Fee-Shifting Bylaw Statute

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# LIMITING FRIVOLOUS SHAREHOLDER LAWSUITS VIA FEE-SHIFTING BYLAWS: A CALL FOR DELAWARE TO OVERTURN AND REVISE ITS FEE-SHIFTING BYLAW STATUTE

**Abstract:** Shareholder lawsuits have become an epidemic, with lawsuits being filed after almost every merger or acquisition, costing corporations and shareholders billions of dollars. With little substantive and successful reform measures at the federal and state level, corporations have begun to take matters into their own hands, including adopting corporate bylaws to deter these lawsuits. This Note examines the Delaware Supreme Court's controversial decision in 2014, *ATP Tour, Inc. v. Deutscher Tennis Bund*, in which the court approved the adoption of fee-shifting bylaws by corporations. It further examines the Delaware State Legislature's subsequent prohibition of fee-shifting provisions and explores the possibility that ambiguity in the legislation may allow fee-shifting bylaws in securities class action lawsuits. This Note argues that corporations should be statutorily allowed to adopt fee-shifting bylaws subject to shareholder approval and a maximum relief standard. With minimal chance that the Delaware legislature will immediately overturn its legislation, it argues alternatively that the Delaware courts should narrowly interpret the current statute so as not to not apply to securities class action lawsuits.

## INTRODUCTION

Mergers and acquisitions (“M&A”) are a central part of the current economic marketplace.<sup>1</sup> In recent years, however, these transactions have come under attack through an increasingly popular legal device: shareholder lawsuits.<sup>2</sup> This growing trend has exploded in recent years, with 93% of all mer-

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<sup>1</sup> See *Mergers & Acquisition Review – Full Year*, THOMSON REUTERS (Jan. 9, 2015), <http://blog.thomsonreuters.com/index.php/mergers-acquisition-review-full-year/> [<http://perma.cc/N26V-F5CA>] (finding that the worldwide value of mergers and acquisitions in 2014 totaled \$3.5 trillion); Dan Primack, *2014 Was a Huge Year for M&A and Private Equity*, FORTUNE (Jan. 5, 2015), <http://fortune.com/2015/01/05/2014-was-a-huge-year-for-ma-and-private-equity/> [<http://perma.cc/4ZNW-7S3V>] (noting that in 2014 the value of acquisitions in the United States was \$1.3 trillion).

<sup>2</sup> See OLGA KOUMRIAN, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2013 M&A LITIGATION 1 (2014), <https://www.cornerstone.com/GetAttachment/73882c85-ea7b-4b3c-a75f-40830eab34b6/-Shareholder-Litigation-Involving-M-and-A-2013-Filings.pdf> [<http://perma.cc/434E-QDG6>] (finding that on average in 2013, M&A deals resulted in more than five lawsuits, and 62% of M&A deals were litigated in more than one jurisdiction); Dionne Searcey & Ashby Jones, *First, the Merger; Then the Lawsuit*, WALL ST. J. (Jan. 10,

gers and acquisitions in 2013 being subject to at least one shareholder lawsuit.<sup>3</sup> Although one would hope that a large majority of these lawsuits result in monetary benefits for the shareholders, this is unfortunately not the case.<sup>4</sup> It has been estimated that shareholders lose \$39 billion annually because of these lawsuits, compared to an average of \$5 billion that investors receive as a result of lawsuit settlements.<sup>5</sup> With an annual loss of \$34 billion to shareholders, there is a need for legal reform in this area to curtail the abuse of frivolous shareholder lawsuits.<sup>6</sup>

Unexpectedly, in May 2014, in *ATP Tour Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court provided a potential solution to this problem when the court affirmed a corporation's right to adopt fee-shifting bylaws.<sup>7</sup> By affirming this right, a Delaware corporation could now adopt a corporate by-law allowing it to shift all costs of litigation to any shareholder who brought an unsuccessful lawsuit against it.<sup>8</sup> Just over a year later, however, the Delaware State Legislature ultimately decided to do away with this potential solution.<sup>9</sup> In

2011), <http://www.wsj.com/articles/SB10001424052748704482704576072050216781160> [<http://perma.cc/HQ89-9DDH>] (discussing how statistics show that investors are filing a growing number of lawsuits against corporations engaging in deals).

<sup>3</sup> See KOUMRIAN, *supra* note 2, at 1 (charting the percentage of deals valued over \$100 million challenged by shareholders between 2007 and 2013).

<sup>4</sup> See Matthew D. Cain & Steven M. Davidoff, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 479 (2015) (finding that only 4.8% of merger litigation provided a monetary benefit to shareholders); Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 566 (2014) (explaining that few cases result in a pecuniary recovery for shareholders).

<sup>5</sup> See MUKESH BAJAJ ET AL., U.S. CHAMBER INST. FOR LEGAL REFORM, ECONOMIC CONSEQUENCES: THE REAL COSTS OF U.S. SECURITIES CLASS ACTION LITIGATION 1, 3 (Feb. 2014), [http://www.instituteforlegalreform.com/uploads/sites/1/EconomicConsequences\\_Web.pdf](http://www.instituteforlegalreform.com/uploads/sites/1/EconomicConsequences_Web.pdf) [<http://perma.cc/8M9P-UBGS>] (finding that shareholders lose \$39 billion annually upon the announcement of shareholder lawsuits, compared to the average of \$5 billion, after attorney's fees, that investors receive as a result of settlements).

<sup>6</sup> See *id.*; see also Patrick M. Garry et al., *The Irrationality of Shareholder Class Action Lawsuits: A Proposal for Reform*, 49 S.D. L. REV. 275, 303–09 (2004) (proposing to limit frivolous shareholder class action lawsuits through a notice-and-demand feature); Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 37–59 (2015) (proposing to limit frivolous shareholder lawsuits by reforming the corporate benefit doctrine).

<sup>7</sup> See *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 556 (Del. 2014).

<sup>8</sup> See *id.*; Micah Hauptman, *A Delaware Court Decision Threatens Effective Enforcement of Our Nation's Securities Laws, While the SEC Stands Idly By*, HUFFINGTON POST (Nov. 12, 2014, 11:23 AM), [http://www.huffingtonpost.com/micah-hauptman/a-delaware-court-decision\\_b\\_6145982.html](http://www.huffingtonpost.com/micah-hauptman/a-delaware-court-decision_b_6145982.html) [<http://perma.cc/G5TH-PKV3>] (describing how a corporation could amend its bylaws to include a provision that would make a plaintiff shareholder liable for all litigation expenses in an unsuccessful lawsuit); Gretchen Morgenson, *Shareholders, Disarmed by a Court*, N.Y. TIMES (Oct. 25, 2014), <http://www.nytimes.com/2014/10/26/business/shareholders-disarmed-by-a-delaware-court.html> [<http://perma.cc/VL4Q-97MW>] (explaining that a company could now adopt fee-shifting bylaws that require shareholders who bring unsuccessful lawsuits to pay the company's litigation fees).

<sup>9</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b) (West 2015).

June 2015, the Governor of Delaware Jack Markell signed into law a prohibition against fee-shifting bylaws for stock corporations.<sup>10</sup> With this new law in place, Delaware corporations once again have minimal protection against frivolous shareholder lawsuits.<sup>11</sup>

This Note argues that Delaware should amend its fee-shifting prohibition and, barring that, Delaware courts should read the statute narrowly and not apply it to securities class action lawsuits.<sup>12</sup> Part I of this Note discusses corporate governance structures and describes the use, and possible abuse, of shareholder derivative lawsuits and shareholder class action lawsuits as well as reform measures by the federal government and several states.<sup>13</sup> Part II examines attempts at shareholder lawsuit reform in Delaware and then reviews the Delaware Supreme Court's approval of fee-shifting bylaws in *ATP Tour*.<sup>14</sup> Part III focuses on the Delaware State Legislature's response to the *ATP Tour* decision, including the legislature's subsequent prohibition of fee-shifting bylaws for stock corporations.<sup>15</sup> Finally, Part IV proposes two solutions that Delaware could take to limit the negative effects of shareholder lawsuits.<sup>16</sup> First, it proposes that the Delaware State Legislature should amend its corporate laws to allow corporations to adopt fee-shifting bylaws.<sup>17</sup> Alternatively, recognizing that the Delaware State Legislature is unlikely to immediately reverse course, Part IV also proposes that Delaware courts should read the statute prohibiting fee-shifting bylaws narrowly so that it does not apply to securities class action lawsuits.<sup>18</sup>

## I. CORPORATE GOVERNANCE AND SHAREHOLDER LITIGATION: AN INCREASING TREND TOWARDS SHAREHOLDER CLASS ACTION LAWSUITS FOLLOWING MERGERS AND ACQUISITIONS

This Part provides an overview of the corporate governance structure, explores two legal devices—shareholder derivative lawsuits and class action lawsuits—that provide shareholders with the ability to police corporate governance decisions, and discusses legislative shareholder reform measures at both the federal and state level.<sup>19</sup> Section A reviews the corporate governance structure and the formation of shareholder derivative and class action lawsuits.<sup>20</sup>

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<sup>10</sup> See *id.*

<sup>11</sup> See *infra* notes 190–247 and accompanying text.

<sup>12</sup> See *infra* notes 190–247 and accompanying text.

<sup>13</sup> See *infra* notes 19–104 and accompanying text.

<sup>14</sup> See *infra* notes 105–154 and accompanying text.

<sup>15</sup> See *infra* notes 155–189 and accompanying text.

<sup>16</sup> See *infra* notes 190–247 and accompanying text.

<sup>17</sup> See *infra* notes 193–220 and accompanying text.

<sup>18</sup> See *infra* notes 221–247 and accompanying text.

<sup>19</sup> See *infra* notes 19–104 and accompanying text.

<sup>20</sup> See *infra* notes 25–35 and accompanying text.

Section B discusses the characteristics and typical outcomes of shareholder derivative lawsuits.<sup>21</sup> Section C describes the recent trend away from derivative lawsuits and towards shareholder class actions lawsuits.<sup>22</sup> Section C also examines the nature of these shareholder class action lawsuits, in particular how they are now brought following almost every merger or acquisition.<sup>23</sup> Lastly, Section D discusses past and current legislative shareholder lawsuit reform measures taken by the federal government, as well as the state legislatures of New Jersey and Oklahoma.<sup>24</sup>

### *A. The Corporate Governance Structure*

The governance of a corporation consists of three actors: shareholders, directors, and officers.<sup>25</sup> Shareholders are “owners” of the corporation, directors are responsible for managing and supervising the corporation, and officers are the corporate employees who are responsible for running the corporation’s day-to-day business.<sup>26</sup> Elected by the shareholders, directors owe duties to act on behalf of and represent the interests of the corporation.<sup>27</sup> As such, the directors also owe fiduciary duties to the corporation’s shareholders.<sup>28</sup>

The fiduciary duties that directors owe to the corporation and its shareholders are the duty of care and the duty of loyalty.<sup>29</sup> The duty of care requires directors to exercise good business judgment during their decision-making

<sup>21</sup> See *infra* notes 36–53 and accompanying text.

<sup>22</sup> See *infra* notes 54–81 and accompanying text.

<sup>23</sup> See *infra* notes 54–81 and accompanying text.

<sup>24</sup> See *infra* notes 82–104 and accompanying text.

<sup>25</sup> See ALAN PALMITER & FRANK PARTNOY, *CORPORATIONS* 33–34 (2d ed. 2010) (explaining that within the governance of a corporation there are three categories of actors: shareholders, directors and officers).

<sup>26</sup> See *id.*; DEL. CODE ANN. tit. 8, § 141(a) (2011) (explaining that the business and affairs of a Delaware corporation are managed by or under its board of directors).

<sup>27</sup> See *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (explaining that directors owe fiduciary duties to the corporation and its shareholders); PALMITER & PARTNOY, *supra* note 25, at 34; Randy J. Holland, *Delaware Directors’ Fiduciary Duties: The Focus on Loyalty*, 11 J. BUS. L. 675, 681 (2013), <http://scholarship.law.upenn.edu/jbl/vol11/iss3/4> [<http://perma.cc/BY8E-NHEJ>] (explaining that directors have a fiduciary duty to the corporations on whose boards they serve); William M. Lafferty et al., *A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law*, 116 PENN ST. L. REV. 837, 841 (explaining that directors are required to protect the interests of the corporation).

<sup>28</sup> See *Francis v. United Jersey Bank*, 432 A.2d 814, 824 (Del. 1981) (stating that a director has a fiduciary relationship to the stockholders); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. Ch. 1939) (describing how the directors of a corporation have a fiduciary relationship with its shareholders); Lafferty et al., *supra* note 27, at 841 (explaining that directors are charged with a fiduciary duty to the corporation’s shareholders).

<sup>29</sup> See PALMITER & PARTNOY, *supra* note 25, at 38; Holland, *supra* note 27, at 679 (explaining that directors are fiduciaries who are obligated to fulfill the duties of care and loyalty); Lafferty et al., *supra* note 27, at 841 (stating that directors, to satisfy their fiduciary obligations to the corporation and its shareholders, must satisfy the duties of care and loyalty).

processes, and act as a reasonably prudent person in their position would act.<sup>30</sup> The duty of loyalty forces directors to place the corporation's interests before their own.<sup>31</sup> This duty imposes a legal obligation on a corporation's directors to act in good faith and make decisions that are solely in the best interests of the corporation and its shareholders, rather than advancing their own personal interests.<sup>32</sup> If directors breach their fiduciary duties, they can be held liable for any resulting corporate losses.<sup>33</sup>

Because directors control the corporation's decision making, and thus cannot be trusted to sue themselves, two legal devices have been formed to provide shareholders with the ability to enforce a director's liability for breach of fiduciary duty.<sup>34</sup> These devices are the shareholder derivative lawsuit and the shareholder class action lawsuit.<sup>35</sup>

### B. Shareholder Derivative Lawsuits

Shareholder derivative lawsuits involve intracompany litigation brought by one or more shareholders on behalf of the corporation in which they own

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<sup>30</sup> See *Smith*, 488 A.2d at 872–73 (noting that under the duty of care, a director has a duty to exercise an informed business judgment); PALMITER & PARTNOY, *supra* note 25, at 38 (explaining how the duty of care requires managers to be prudent and attentive when making decisions); Holland, *supra* note 27, at 691 (describing how before directors vote on a transaction, they are required by the duty of care to apprise themselves of “all material information that is reasonably available” to them).

<sup>31</sup> See *Guth*, 5 A.2d at 510 (explaining that directors and officers cannot use their positions to further their private interests); PALMITER & PARTNOY, *supra* note 25, at 521 (describing the duty of loyalty as a duty to avoid self-dealing); Lafferty et al., *supra* note 27, at 844–45 (describing the duty of loyalty as one that requires a director to put the interests of the corporation ahead of his or her own).

<sup>32</sup> See *Stone v. Ritter*, 911 A.2d 362, 369–70 (Del. 2006) (holding that a director's failure to act in good faith can result in a breach of the duty of loyalty); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (explaining that the duty of loyalty requires the corporation's best interests to take priority over those of any director or officer); *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (explaining that the duty of loyalty mandates that a director “acts in the good faith belief that [their] actions are in the corporation's best interest”).

<sup>33</sup> See PALMITER & PARTNOY, *supra* note 25, at 39.

<sup>34</sup> See *id.*; see also *Koster v. (Am.) Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 522 (1947) (explaining that directors and officers accused of wrongdoing generally have the ability to limit the corporation's efforts to remedy their wrongs); Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 81 (2008) (discussing the structure of derivative lawsuits and observing that corporate officers are often the subject of the alleged misconduct underlying the derivative lawsuit).

<sup>35</sup> See Erickson, *supra* note 34, at 76 (explaining that securities class actions and derivative suits are the primary means by which shareholders enforce the legal duties of corporations and their managers); Stephen P. Ferris et al., *Derivative Lawsuits as a Corporate Governance Mechanism: Empirical Evidence on Board Changes Surrounding Filings*, 42 J. FIN. & QUANTITATIVE ANALYSIS 143, 146 (2007) (explaining that the law allows shareholders to bring two types of legal proceedings to vindicate their rights: direct suits or derivative suits).

stock.<sup>36</sup> Because the shareholder is suing on behalf of the corporation, the corporation is both the “functional plaintiff” and the nominal defendant.<sup>37</sup> In a shareholder derivative lawsuit, shareholders have the ability to bring suit in a representative capacity on behalf of the corporation in order to remedy or prevent a wrong to the corporation.<sup>38</sup> This is because corporate directors may be involved in the wrongdoing and are therefore unlikely to make a neutral decision regarding whether to file suit.<sup>39</sup> Typically, these lawsuits allege a breach of fiduciary duty by the corporation’s board of directors and seek to recover losses sustained by the corporation due to the board’s harmful actions.<sup>40</sup> A claim of corporate waste or claims that a corporation’s officers or directors breached their fiduciary duty by making false or misleading public statements often bring rise to shareholders derivative lawsuits.<sup>41</sup>

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<sup>36</sup> See *Koster*, 330 U.S. at 522 (explaining that in a derivative lawsuit the plaintiffs bring the corporation’s cause of action before the court, not their own); *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) (explaining that the derivative action was established to allow shareholders to sue in the corporation’s name); PALMITER & PARTNOY, *supra* note 25, at 39.

<sup>37</sup> See *Liddy v. Urbanek*, 707 F.2d 1222, 1224 (11th Cir. 1983); Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749, 1756 (2010) (explaining that the corporation is the “functional plaintiff”). Because the corporation is the party who actually benefits from a successful suit, the plaintiff is “at best the nominal plaintiff.” See *Liddy*, 707 F.2d at 1224. However, the corporation is initially named as a defendant to ensure they are a party to the lawsuit. See *id.*

<sup>38</sup> See *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1264 (Del. 2012) (explaining that a derivative suit enables a shareholder to bring a lawsuit on the corporation’s behalf, for harm done to it); *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1245 (Del. 1999) (explaining that a derivative claim is brought by a shareholder on the corporation’s behalf, to remedy harm inflicted on the corporation).

<sup>39</sup> See *Koster*, 330 U.S. at 522 (explaining that directors and officers accused of wrongdoing generally have the ability to suppress any effort by the corporation to remedy their wrongs); *Aronson*, 473 A.2d at 811 (explaining that derivative lawsuits were developed to enable shareholders to sue when corporate directors refused to bring a claim for harm done to the corporation); Erickson, *supra* note 34, at 81 (stating that officers and directors may be involved in misconduct and therefore may not be willing to act in the corporation’s best interests by filing a suit that may implicate themselves).

<sup>40</sup> See *Koster*, 330 U.S. at 522 (describing how the derivative lawsuit was invented to remedy breaches of fiduciary duty by corporate managers); Erickson, *supra* note 34, at 82 (explaining that in derivative lawsuits, shareholders often claim a breach of fiduciary duty by the officers or directors).

<sup>41</sup> See *Katz v. Halperin*, No. 13811, 1996 WL 66006, at \*4 (Del. Ch. 1996) (explaining that corporate waste claims are brought as derivative actions); Erickson, *supra* note 34, at 82 (noting that shareholder allegations that “officers or directors breached their fiduciary duty to the corporation by making . . . false or misleading public statements” are common in derivative lawsuits); Griffith, *supra* note 6, at 9 (stating that claims of corporate waste are a classic example of a derivative lawsuit); see also Kevin LaCroix, *Target Directors and Officers Hit with Derivative Suits Based on Data Breach*, D&O DIARY (Feb. 3, 2014), <http://www.dandodiary.com/2014/02/articles/cyber-liability/target-directors-and-officers-hit-with-derivative-suits-based-on-data-breach/> [<http://perma.cc/9RAC-EAWY>] (describing multiple shareholder derivative suits that were brought against Target, alleging breach of fiduciary duty and waste of corporate assets, as a result of a data breach).

Any amount a shareholder derivative lawsuit recovers belongs to the corporation and will be paid into the corporation's treasury.<sup>42</sup> As such, the plaintiff who brings suit does not receive any direct financial benefit.<sup>43</sup> At most, shareholders may receive an indirect benefit from the suit, such as an increase in stock price.<sup>44</sup> Monetary recovery for shareholders is generally either non-existent or minimal.<sup>45</sup> Indeed, the vast majority of shareholder derivative lawsuits end in dismissal or settlement, in which the only results are changes to the corporation's governance structure or mechanisms.<sup>46</sup>

These cases often settle for two reasons.<sup>47</sup> First, because of the minimal financial incentives for shareholders, derivative lawsuits are typically brought by aggressive plaintiffs' firms on behalf of insignificant shareholders.<sup>48</sup> With minimal pressure to obtain a substantive result for shareholders, the plaintiffs' firm's primary goal in these suits is to recover substantial legal fees and expenses.<sup>49</sup> Thus, these firms often choose to settle to ensure they recover their

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<sup>42</sup> See *Kramer v. W. Pac. Indus.*, 546 A.2d 348, 351 (Del. 1988) (explaining that in a derivative suit, any damages recovered are paid to the corporation); Erickson, *supra* note 37, at 1756 (noting that in a derivative suit, any recovery is given to the corporation); Griffith, *supra* note 6, at 8 (explaining that any recovery made by the shareholders is actually a recovery by the corporation and thus is paid into the corporation's treasury).

<sup>43</sup> See *Ams. Mining Corp.*, 51 A.3d at 1264 (noting that the corporation must receive any recovery from the suit); Erickson, *supra* note 34, at 81 (explaining that shareholders do not receive any direct financial benefit from a derivative suit).

<sup>44</sup> See Erickson, *supra* note 34, at 81 (explaining that because of their stock ownership, shareholders may receive an indirect financial benefit); Alison Frankel, *Ugly-Duckling Shareholder Derivative Suits Are Poised for Swandom*, REUTERS (Jan. 2, 2015), <http://blogs.reuters.com/alison-frankel/2015/01/02/ugly-duckling-shareholder-derivative-suits-are-poised-for-swandom/> [<http://perma.cc/57U7-NHCF>] (describing how shareholders benefit only indirectly from settled derivative lawsuits, such as through an increase in share price).

<sup>45</sup> See Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1775 (2004) (finding that in Delaware derivative suits filed in 1999 and 2000, out of fifty-seven lead cases resolved, only six resulted in monetary recovery).

<sup>46</sup> See Cain & Davidoff, *supra* note 4, at 469 (reporting that although only 39.3% of transactions attracted litigation in 2005, the frequency of litigation had risen to 92.1% by 2011); Erickson, *supra* note 34, at 96–97 (finding evidence that many settlements are largely nominal and only consist of the corporation agreeing “to implement small-scale corporate governance reforms”).

<sup>47</sup> See Ferris et al., *supra* note 35, at 146.

<sup>48</sup> See *Lewis v. Curtis*, 671 F.2d 779, 788 (3d Cir. 1982) (rejecting defendant's argument that the claim should be dismissed because the plaintiff, who owned only 100 out of 8 million outstanding shares, could not fairly and adequately represent the interests of other shareholders); *Ohio-Sealy Mattress Mfg. v. Kaplan*, 90 F.R.D. 21, 25 (N.D. Ill. 1980) (holding that plaintiffs who owned only 0.7% of the corporation's outstanding shares could adequately represent the corporation in their suit); Erickson, *supra* note 34, at 100 (collecting sources).

<sup>49</sup> See *Joy v. North*, 692 F.2d 880, 887 (2d Cir. 1982) (describing the real incentive behind derivative actions as the hope of plaintiffs' attorneys to recover large fees); John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 318 (1981) (describing the economic interest of plaintiffs' lawyers as being focused on a large award of attorney's fees, not in a large recovery for shareholders); Erickson, *supra* note 34, at 101 (stating that plaintiffs' attorneys typically receive between 20–30% of the lawsuits' recovery); Rodney Yap et al., *Merger Suits Often Mean Cash for Lawyers, Zero for Investors*,



fees, rather than risk losing the case and recovering no fees at all.<sup>50</sup> Second, the corporation's management also has strong incentives to settle in order to minimize the corporation's legal fees and because of the nature of most corporate insurance policies.<sup>51</sup>

Due to the actions of these plaintiffs' firms, legislative and judicial systems, at both the state and federal level, have developed numerous legal hurdles to curb the abuse of shareholder derivative lawsuits.<sup>52</sup> These include the contemporaneous ownership requirement, the demand requirement, and the formation of special litigation committees.<sup>53</sup>

### C. *The Costly Trend of Shareholder Class Action Lawsuits Following a Merger or Acquisition*

With the development of procedural hurdles in shareholder derivative lawsuits, shareholder class action suits have become an increasingly popular alternative, particularly those that target corporate mergers and acquisitions.<sup>54</sup>

BLOOMBERG (Feb. 16, 2012, 1:59 PM), <http://www.bloomberg.com/news/articles/2012-02-16/lawyers-cash-in-while-investor-clients-get-nothing-in-merger-lawsuit-deals> [<http://perma.cc/BMJ3-MWBC>] (finding that in forty cases in which no money was generated for shareholders, overall, lawyers obtained \$32.4 million in fees for themselves).

<sup>50</sup> See Ferris et al., *supra* note 35, at 146 (explaining that plaintiffs' lawyers often prefer to settle so that they can earn substantial fees without having to risk losing the case later).

<sup>51</sup> See *id.* (observing that because most insurance policies do not cover judgments where there is a determination of management dishonesty or intentional misconduct, management will structure the settlement in a way in which they do not admit dishonesty, and thus, are able to retain insurance coverage).

<sup>52</sup> See Griffith, *supra* note 6, at 10 (explaining that many procedural obstacles have been developed to prevent the abuse of derivative suits); Seth Aronson et al., *Shareholder Derivative Actions: From Cradle to Grave*, O'MELVENY & MYERS, LLP (June 2009), <http://www.mondaq.com/pdf/clients/87654.pdf> [<http://perma.cc/GV4B-TMKJ>] (examining many of the federal and state legal hurdles for derivative suits).

<sup>53</sup> See Griffith, *supra* note 6, at 10; see, e.g., DEL. CODE ANN. tit. 8, § 327 (2011) (requiring a plaintiff who brings a derivative suit to be a shareholder of the corporation at the time of the transaction of which the shareholder complains); WIS. STAT. § 180.0744 (2015) (permitting board of directors to appoint a special litigation committee to recommend whether the corporation should proceed with a derivative action); DEL. CH. CT. R. 23.1 (a) (requiring that the plaintiff "allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors . . . and the reasons for the plaintiff's failure to obtain the action or the grounds for not making the effort").

<sup>54</sup> See Adam B. Badawi, *Merger Class Actions in Delaware and the Symptoms of Multi-Jurisdictional Litigation*, 90 WASH. U. L. REV. 965, 972 (2013) (stating that, of the 1048 cases filed in the Chancery Court that involved fiduciary duty claims against public companies during 1999 and 2000, 77.6% were related to acquisitions and, of the 77.6%, 94.9% were class actions); Erickson, *supra* note 37, at 1756 (explaining that derivative lawsuits were "once the cornerstone of corporate law," but have been replaced by more modern means of policing corporate misconduct "such as . . . securities class actions").

Shareholder class action lawsuits face none of the additional procedural requirements placed on shareholder derivative lawsuits.<sup>55</sup>

In shareholder class action lawsuits, unlike derivative lawsuits, shareholders are the direct plaintiffs.<sup>56</sup> Therefore, they sue directly on their own behalf to defend their individual rights and those of similarly situated shareholders.<sup>57</sup> These suits almost always allege that a corporation and its directors violated federal securities laws by making false or misleading public statements, so that the defendants in the class action are the corporation and its current or former directors.<sup>58</sup> Any recovery goes not to the corporation, but rather to its shareholders.<sup>59</sup>

The percentage of transactions targeted by class action lawsuits has grown rapidly over the past few years.<sup>60</sup> Only 44% of mergers and acquisitions over \$100 million were challenged by shareholder class actions in 2007, compared to 94% in 2013.<sup>61</sup> These lawsuits have had substantial financial impacts on corporations and their investors.<sup>62</sup> Plaintiffs in merger litigation generally ask for equitable relief, often seeking an injunction to prevent the merger transaction or to revise its terms.<sup>63</sup> The potentially disastrous impact of such

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<sup>55</sup> See Garry et al., *supra* note 6, at 280 (noting that shareholder class actions are not subject to the procedural requirements of derivative suits); Griffith, *supra* note 6, at 10 (explaining that shareholder class actions do not need to satisfy the procedural hurdles that derivative suits do).

<sup>56</sup> See Kahn v. Kaskel, 367 F. Supp. 784, 788–89 (S.D.N.Y. 1973) (explaining that a shareholder class action is based upon individual rights belonging to each shareholder).

<sup>57</sup> See *id.*; Garry et al., *supra* note 6, at 279–80 (noting that shareholder class actions are brought by shareholders for harm done to themselves or a collection of shareholders).

<sup>58</sup> See Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 498 (2007) (finding that 93% of securities class actions allege violations of Rule 10b-5, which prohibits corporations or other persons from making false or misleading statements in connection with the purchase or sale of a security); Erickson, *supra* note 34, at 80 (explaining that plaintiffs in securities class actions allege that the corporation and its officers and directors “made false or misleading public statements” in violation of federal securities laws).

<sup>59</sup> See Erickson, *supra* note 37, at 1756 (explaining that any recovery in a class action lawsuit goes to the shareholders); Ferris et al., *supra* note 35, at 146 (describing how in class action lawsuits, any monetary recovery will go directly to the shareholders involved); see also Arrington v. Merrill Lynch, Pierce, Fenner & Smith, 651 F.2d 615, 621 (9th Cir. 1981) (stating that under the general rule, shareholders in a securities class action “may recover the difference between the value of the consideration paid and the value of the securities received, plus consequential damages that can be proven with reasonable certainty”).

<sup>60</sup> See KOUMRIAN, *supra* note 2, at 1 (charting the percentage of deals challenged by shareholders between 2007 and 2013); see also Searcey & Jones, *supra* note 2 (stating that investors have been filing a growing number of lawsuits against corporations that commence major deals).

<sup>61</sup> See KOUMRIAN, *supra* note 2, at 1.

<sup>62</sup> See BAJAJ ET AL., *supra* note 5, at 3 (finding that shareholders lose \$39 billion annually upon the announcement of these lawsuits, compared to the average of \$5 billion, after attorney’s fees, that investors receive as a result of lawsuit settlements).

<sup>63</sup> See Fisch et al., *supra* note 4, at 565 (explaining that plaintiffs frequently ask for equitable relief, such as an injunction stopping the transaction or a significant revision to the deal terms); Yap et al., *supra* note 49 (noting that these lawsuits often seek to halt the transaction).

relief forces corporations to settle class action litigation a large majority of the time, as corporations often cannot complete the merger or acquisition until they reach a settlement.<sup>64</sup> Additionally, corporations settle to limit the massive legal fees they would incur through prolonged merger litigation involving multiple class action lawsuits brought in numerous jurisdictions.<sup>65</sup>

Few of these class action lawsuits result in any monetary award for the actual shareholders.<sup>66</sup> Often, the only result of the lawsuit is that the corporation is required to disclose more information about why they entered into the merger or acquisition in the merger proxy.<sup>67</sup> Other common forms of non-monetary relief involve amendments to the merger agreement, usually the deal protection terms.<sup>68</sup>

The prevalence of these “disclosure only” settlements is largely due to the makeup of the shareholder plaintiffs and attorneys that bring these class action lawsuits.<sup>69</sup> A small number of plaintiffs’ firms specialize in shareholder class action lawsuits and bring most of these claims.<sup>70</sup> When there is a merger or acquisition, these plaintiffs’ firms will immediately begin to recruit plaintiffs

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<sup>64</sup> See Fisch et al., *supra* note 4, at 565–66 (explaining that corporations are often forced to resolve claims before the merger is consummated because claims that are not resolved prior to consummation may create significant ongoing liabilities); see also KOURMIAN, *supra* note 2, at 1 (finding that in 75% of deals, litigation was over before the deal was closed); Cain & Davidoff, *supra* note 4, at 477 (finding that 71.6% of transaction litigation results in some type of settlement).

<sup>65</sup> See KOURMIAN, *supra* note 2, at 1, 3 (finding that on average in 2013, M&A deals attracted more than five lawsuits per deal and 62% of M&A deals were litigated in more than one jurisdiction).

<sup>66</sup> See Cain & Davidoff, *supra* note 4, at 479 (finding that only 4.8% of merger litigation provided a monetary benefit to shareholders); Fisch et al., *supra* note 4, at 566 (explaining that few cases result in plaintiffs receiving a monetary recovery).

<sup>67</sup> See Cain & Davidoff, *supra* note 4, at 479 (finding that 55.1% of all merger litigation settlements required only additional disclosures); Fisch et al., *supra* note 4, at 566 (explaining that a large majority of settlements result only in supplemental disclosures through additional information in the merger proxy statement); Steven Davidoff Solomon, *Corporate Takeover? In 2013, a Lawsuit Almost Always Followed*, N.Y. TIMES (Jan. 10, 2014), <http://dealbook.nytimes.com/2014/01/10/corporate-takeover-in-2013-a-lawsuit-almost-always-followed/> [<http://perma.cc/V4TG-V3EY>] (explaining that disclosure-only settlements typically result only in additional disclosures in the corporation’s proxy statement).

<sup>68</sup> See Cain & Davidoff, *supra* note 4, at 479 (finding that 12.3% of settlements result in amendments to a deal’s transaction terms, most commonly as a termination fee decrease); Fisch et al., *supra* note 4, at 610 (explaining that amendments to a merger agreement are often to its “deal protection” provisions).

<sup>69</sup> See Ferris et al., *supra* note 35, at 146 (explaining that derivative lawsuits are brought due to incentives for plaintiffs’ counsel, not shareholders); Fisch et al., *supra* note 4, at 567 (noting that disclosure-only settlements are a result of America’s “financial structure” of shareholder lawsuits, where plaintiffs’ lawyers have their fees paid by the corporation if the suit achieves a “corporate benefit”).

<sup>70</sup> See Garry et al., *supra* note 6, at 284 (explaining that shareholder class actions have become a “cottage industry for attorneys who specialize in class action litigation,” and that merger class action lawsuits are generally filed by an “identifiable, small group of lawyers”); Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 894 (2003) (observing that sixteen firms filed more than 75% of Delaware fiduciary duty class actions).

on whose behalf they can bring a class action lawsuit.<sup>71</sup> In a large number of class actions, they will solicit any and all shareholders of the corporation, hoping to find a poorly informed shareholder to agree to serve as plaintiff.<sup>72</sup> Alternatively, they may recruit “professional” plaintiffs.<sup>73</sup> These professional plaintiffs own a few shares of stock in many companies for the purpose of bringing these lawsuits.<sup>74</sup>

In many cases, plaintiffs have preexisting relationships with the lawyers bringing the lawsuit and sometimes plaintiffs receive “bounty payments” or “bonuses” for their services.<sup>75</sup> With plaintiffs serving as figureheads, class action lawsuits are primarily lawyer-driven.<sup>76</sup> Consequently, the shareholder plaintiffs, who have a minimal stake in the litigation, rarely object when their lawyers decide to settle in order to ensure that the legal fees will be paid by the defendant corporation.<sup>77</sup>

The staggering amount of disclosure-only settlements is also a result of the fact that plaintiffs’ lawyers in shareholder litigation can have their fees paid

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<sup>71</sup> See John C. Coffee, Jr., *Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 682 (1986) (explaining that once an attorney decides to bring suit, identifying and securing a client is rarely a significant hurdle); Garry et al., *supra* note 6, at 283 (explaining that a plaintiffs’ lawyer will typically first find a promising lawsuit and then search for a client); Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2060 (1995) (finding that plaintiffs’ attorneys recruit most of the investors on whose behalf they bring the class actions).

<sup>72</sup> See Weiss & Beckerman, *supra* note 71, at 2060 (explaining that in many class actions, plaintiffs lack information about the facts and theories of their case, or are financially illiterate).

<sup>73</sup> See Garry et al., *supra* note 6, at 281, 285 (stating that law firms still use “professional plaintiffs”); John F. Olson et al., *Pleading Reform, Plaintiff Qualification and Discovery Stays Under the Reform Act*, 51 BUS. LAW. 1101, 1105 (1996) (describing how plaintiffs’ counsel generally has a number of “professional plaintiffs” on whose behalf it can bring suit).

<sup>74</sup> See Coffee, *supra* note 71, at 682 (explaining that there are well-known individuals who have broad securities portfolios and have been lead plaintiff in numerous other class actions); R. Chris Heck, *Conflict and Aggregation: Appointing Institutional Investors as Sole Lead Plaintiffs Under the PSLRA*, 66 U. CHI. L. REV. 1199, 1202 (1999) (stating that professional plaintiffs often own a few shares in a large number of companies); Olson et al., *supra* note 73, at 1105 (explaining that professional plaintiffs regularly buy stock in troubled companies in order to bring a lawsuit).

<sup>75</sup> See Olson et al., *supra* note 73, at 1105 (explaining that professional plaintiffs often receive “bounty payments or bonuses”); Weiss & Beckerman, *supra* note 71, at 2060 (noting that plaintiffs in many class actions have a close relationship to the lawyer or firm representing them).

<sup>76</sup> See Ferris et al., *supra* note 35, at 147 (explaining that shareholders can easily become “figurehead plaintiffs”); Garry et al., *supra* note 6, at 283–84 (explaining that shareholder class actions are commonly criticized as being “lawyer-driven”); Jeffrey Michael Smith, Note, *The Role of the Attorney in Protecting (and Impairing) Shareholder Interests: Incentives and Disincentives to Maximize Corporate Wealth*, 47 DUKE L.J. 161, 176 (1997) (explaining that throughout the suit the attorney makes the decisions while the plaintiff is a “mere figurehead”).

<sup>77</sup> See Garry et al., *supra* note 6, at 284, 286 (observing that shareholders rarely object to settlements due to their minimal stake in the litigation); Weiss & Beckerman, *supra* note 71, at 2064–65 (explaining that due to the plaintiff’s limited financial interest in the class action he or she is not likely to monitor their attorney’s settlement of the suit).

directly by the defendant corporation if the litigation results in a “corporate benefit.”<sup>78</sup> Under this doctrine, Delaware law allows courts to award plaintiffs’ lawyers their fees, payable directly by the defendant corporation, when litigation results in non-monetary relief that will result in a benefit to the corporation and its shareholders.<sup>79</sup> This benefit, however, does not need to be monetary; rather, it can be a purely informational benefit.<sup>80</sup> Consequently, plaintiffs’ lawyers pursue settlement agreements that characterize their disclosure-only settlements as a “corporate benefit,” thereby ensuring they will be awarded substantial fees for their representation.<sup>81</sup>

#### *D. Shareholder Lawsuit Reform: Past and Present Reform Measures*

The rapid growth in the number of shareholder lawsuits has led to many calls for the implementation of government reform.<sup>82</sup> With the passage of the Private Securities Litigation Reform Act (“PSLRA”) in 1995, the federal government enacted legislative measures seeking to limit frivolous or unwarranted lawsuits.<sup>83</sup> The PSLRA’s inability to effectively reform shareholder litigation abuses has consequently led multiple states, including New Jersey and Oklahoma, to enact fee-shifting legislative measures in an attempt to curb the abuses.<sup>84</sup>

<sup>78</sup> See Fisch et al., *supra* note 4, at 567 (explaining that plaintiffs’ counsel must portray the settlement relief as a corporate benefit to recover their fees); Griffith, *supra* note 6, at 2 (explaining that under the “corporate benefit” doctrine, a plaintiffs’ attorney who achieves only non-pecuniary relief may still be awarded their legal fees).

<sup>79</sup> See Fisch et al., *supra* note 4, at 560 (explaining that Delaware acknowledges the potential benefits of non-monetary relief by awarding fees to plaintiffs’ attorneys if the relief results in a corporate benefit).

<sup>80</sup> See *id.* at 566 (explaining that a large majority of settlements result only in supplemental disclosures in the merger proxy statement); Solomon, *supra* note 67 (explaining that disclosure-only settlements typically result in an amendment to the company’s proxy statement).

<sup>81</sup> See Fisch et al., *supra* note 4, at 567 (stating that plaintiffs’ counsel must portray the settlement relief as a corporate benefit to recover their fees); see also Cain & Davidoff, *supra* note 4, at 479 (noting that an attorney receives an average of \$749,000 in fees for disclosure-only settlements); Erickson, *supra* note 34, at 101 (explaining that plaintiffs’ attorneys generally receive between 20–30% of a plaintiff’s recovery); Yap et al., *supra* note 49 (stating that in forty cases in which shareholders received no monetary payout, overall, lawyers received \$32.4 million in fees).

<sup>82</sup> See Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 101, 109 Stat. 737, 737–749 (codified in scattered sections of 15 U.S.C.); N.J. STAT. ANN. § 14A:3-6.7 (West 2003); OKLA. STAT. tit. 18, § 1126 (2012).

<sup>83</sup> See Private Securities Litigation Reform Act § 101 (the Act sought to limit frivolous lawsuits by imposing a heightened pleading standard and procedural hurdles).

<sup>84</sup> See N.J. STAT. ANN. § 14A:3-6.7 (permitting courts to require a shareholder to pay the corporation’s legal expenses if the court determines that the plaintiffs commenced a derivative or class action lawsuit “without reasonable cause or for an improper purpose”); OKLA. STAT. tit. 18, § 1126 (requiring fee-shifting in all derivative lawsuits).

## 1. The Private Securities Litigation Reform Act

The last set of major federal reforms in the area of shareholder lawsuits came in 1995, with the passage of the PSLRA.<sup>85</sup> The first substantial reform of federal securities laws since the New Deal, the PSLRA was enacted despite a veto by President Bill Clinton.<sup>86</sup> Congress designed the PSLRA to limit frivolous or unwarranted lawsuits by imposing new rules on securities class action lawsuits.<sup>87</sup> Despite this goal, the Act has failed to reduce the frequency of these lawsuits.<sup>88</sup> In fact, after passage of the PSLRA, the number of shareholder class action lawsuits actually increased.<sup>89</sup>

Without a substantive and effective federal reform for meritless shareholder lawsuits, states and corporations have begun to take matters into their own hands.<sup>90</sup> In the past, states and corporations have tried to deter frivolous shareholder lawsuits through heightened pleading or demand requirements, or

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<sup>85</sup> See Private Securities Litigation Reform Act § 101.

<sup>86</sup> See *id.*; James A. Kassis, *The Private Securities Litigation Reform Act of 1995: A Review of Its Key Provisions and an Assessment of Its Effects at the Close of 2001*, 26 SETON HALL LEGIS. J. 119, 135–36 (2001) (detailing the legislative history of the PSLRA).

<sup>87</sup> See Private Securities Litigation Reform Act § 101; Garry et al., *supra* note 6, at 293 (explaining that the purpose of the PSLRA was to restrict “abusive” and “frivolous” securities litigation). The most notable provisions of the PSLRA included a heightened pleading standard that required plaintiffs to specifically identify any allegations of fraud, as well as the imposition of a stay of all discovery before a ruling on a motion to dismiss. See Private Securities Litigation Reform Act § 101; Kassis, *supra* note 86, at 121. The heightened pleading standard requires plaintiffs alleging that the defendant misrepresented or omitted a material fact to specify the supposedly misleading statements and explain why they are misleading. See Private Securities Litigation Reform Act § 101; Kassis, *supra* note 86, at 141. Furthermore, where the plaintiff is required to prove that the defendant acted with “a particular state of mind,” the complaint must state specific facts that support a “strong inference” that the defendant acted with the required state of mind. See Private Securities Litigation Reform Act § 101; Kassis, *supra* note 86, at 141. A complaint that fails to satisfy either requirement is subject to dismissal. See Private Securities Litigation Reform Act § 101; Kassis, *supra* note 86, at 141. In addition, the PSLRA provides judges with the authority to determine the lead plaintiffs in a suit, and mandates that judges impose appropriate sanctions on attorneys or parties who filed frivolous claims. See Private Securities Litigation Reform Act § 101; Kassis, *supra* note 86, at 142–46.

<sup>88</sup> See Garry et al., *supra* note 6, at 295–96 (noting that critics claim that the PSLRA has failed to create procedural hurdles that make it more difficult to bring and maintain frivolous securities cases); Kassis, *supra* note 86, at 148–49 (stating that the PSLRA has not fulfilled its goal of reducing securities litigation).

<sup>89</sup> See Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 930 (finding an increase in lawsuits, from 183.4 annually in the five years before passage of the Act, to 241.5 lawsuits annually in the first six years following passage of the Act; a 32% increase in the number of lawsuits per year).

<sup>90</sup> See N.J. STAT. ANN. § 14A:3-6.7 (permitting courts to require a shareholder to pay the corporation’s legal expenses if the court determines that the plaintiffs commenced a derivative or class action lawsuit “without reasonable cause or for an improper purpose”); OKLA. STAT. tit. 18, § 1126 (requiring fee-shifting in all derivative lawsuits); *ATP Tour*, 91 A.3d at 556 (upholding a corporation’s fee-shifting bylaw); *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 942 (Del. Ch. 2013) (upholding a corporation’s exclusive forum bylaw).

by clarifying ownership requirements.<sup>91</sup> Recent developments have focused on the enactment of fee-shifting legislation and bylaws.<sup>92</sup>

## 2. New Jersey and Oklahoma Enact Fee-Shifting Legislation

Historically, corporate law has been a state issue.<sup>93</sup> Rooted in the American principle of federalism, which gives states the autonomy to serve as “laboratories of democracy,” states have generally been free to enact corporate laws as they see fit, with certain areas requiring federal laws and oversight.<sup>94</sup> In light of the PSLRA’s inability to properly limit frivolous or unwarranted lawsuits, states have begun enacting dramatic measures to curb such suits.<sup>95</sup> Two notable examples of these measures are the fee-shifting laws passed in both New Jersey and Oklahoma.<sup>96</sup>

In 2013, New Jersey enacted new, comprehensive statutory provisions regarding shareholder derivative and class action lawsuits.<sup>97</sup> The laws include a fee-shifting provision, under which a court may require a shareholder to pay the corporation’s legal expenses if the court determines that the plaintiff commenced the proceeding without “reasonable cause” or for an “improper purpose.”<sup>98</sup> Although the provisions permit fee-shifting to plaintiffs, the provisions do not require it.<sup>99</sup>

<sup>91</sup> See e.g., DEL. CODE ANN., tit. 8, § 327 (requiring a plaintiff to own stock at the time the challenged transaction occurred); N.Y. BUS. CORP. L. § 626(b) (2007) (requiring plaintiffs to own stock at the time they commence the lawsuit); N.Y. BUS. CORP. L. § 626(c) (requiring plaintiffs to specifically detail the efforts they made to demand action of the board or the reasons they did not make these efforts); DEL. CH. CT. R. 23.1 (requiring a plaintiff to detail in their complaint the efforts they made to obtain their desired action from the board).

<sup>92</sup> See N.J. STAT. ANN. § 14A:3-6.7; OKLA. STAT. tit. 18, § 1126; *ATP Tour*, 91 A.3d at 556; *Boilermakers Local 154*, 73 A.3d at 942.

<sup>93</sup> See PALMITER & PARTNOY, *supra* note 25, at 58–62; Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 709 (1987) (describing corporate law as “the domain of the states”).

<sup>94</sup> Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 209, 214 (2006) (explaining that corporate law is based on principles of federalism and is “encapsulated [by] the metaphor of the ‘states as a laboratory’”); see PALMITER & PARTNOY, *supra* note 25, at 58–62.

<sup>95</sup> See N.J. STAT. ANN. § 14A:3-6.7; OKLA. STAT. tit. 18, § 1126; see also Kassis, *supra* note 86, at 148–49 (arguing that the PSLRA has not achieved its goal of limiting the filing of meritless class action lawsuits).

<sup>96</sup> See N.J. STAT. ANN. § 14A:3-6.7 (permitting courts to require a shareholder to pay the corporation’s legal expenses if the court finds the plaintiff’s commenced a derivative or class action lawsuit “without reasonable cause or for an improper purpose”); OKLA. STAT. tit. 18, § 1126 (requiring fee-shifting in all derivative lawsuits).

<sup>97</sup> See N.J. STAT. ANN. § 14A:3-6.7.

<sup>98</sup> See *id.* The statute states:

On termination of a derivative proceeding or a shareholder class action the court may: (1) order the corporation to pay the plaintiff’s expenses incurred in the proceeding if it finds that the proceeding has resulted in a substantial benefit to the corporation; (2) or-

Similarly, on May 23, 2014, the Oklahoma State Legislature enacted a fee-shifting amendment to the Oklahoma General Corporation Act that applied to all derivative lawsuits.<sup>100</sup> Unlike the fee-shifting provision in New Jersey, however, this amendment requires fee-shifting in all derivative lawsuits.<sup>101</sup> It also applies to all derivative suits brought in Oklahoma, whether against a domestic or foreign corporation.<sup>102</sup> Furthermore, upon final judgment, courts will impose fee-shifting against the non-prevailing party, whether or not the lawsuit was reasonable and proper.<sup>103</sup> This provides a degree of balance to the provision, as it also applies to the defendants, not just non-prevailing plaintiffs, and thereby allows successful plaintiffs the right to recover their fees and costs.<sup>104</sup>

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der the plaintiff to pay any defendant's expenses incurred in defending the proceeding if it finds that the proceeding was commenced or maintained without the exercise of reasonable diligence by the plaintiff or without reasonable cause or for an improper purpose; or (3) order a party to pay an opposing party's expenses incurred because of the filing of a pleading, motion or other paper, if it finds that the pleading, motion or other paper was not well grounded in fact, after reasonable inquiry, or warranted by existing law or a good faith argument for the extension, modification or reversal of existing law and was interposed for an improper purpose, such as to harass or cause unnecessary delay or needlessly increase the cost of litigation.

*Id.*

<sup>99</sup> *See id.* The statutory language states that courts "may" impose fee-shifting. *See id.*

<sup>100</sup> *See* OKLA. STAT. tit. 18, § 1126. The law states:

In any derivative action instituted by a shareholder of a domestic or foreign corporation, the court having jurisdiction, upon final judgment, shall require the non-prevailing party or parties to pay the prevailing party or parties the reasonable expenses, including attorney fees, taxable as costs, incurred as a result of such action.

*Id.*

<sup>101</sup> *Compare id.* ("the court . . . shall require the non-prevailing party or parties to pay the prevailing party or parties the reasonable expenses") (emphasis added), *with* N.J. STAT. ANN. § 14A:3-6.7 ("the court may . . .") (emphasis added).

<sup>102</sup> *See* OKLA. STAT. tit. 18, § 1126; Kevin LaCroix, *Oklahoma Legislature Adopts Derivative Litigation Fee-Shifting Provision*, D&O DIARY (Sept. 25, 2014), <http://www.dandodiary.com/2014/09/articles/corporate-governance/oklahoma-legislature-adopts-derivative-litigation-fee-shifting-provision/> [<http://perma.cc/D548-A7FQ>] (stating that the Oklahoma legislation applies to any derivative action in the state, even if the company involved is not an Oklahoma corporation).

<sup>103</sup> *See* OKLA. STAT. tit. 18, § 1126 ("shall require the non-prevailing party or parties to pay the prevailing party or parties the reasonable expenses . . . incurred").

<sup>104</sup> *See id.*; J. Robert Brown, Jr., *Fee Shifting in Derivative Suits and the Oklahoma Legislature*, RACE TO THE BOTTOM (Sept. 24, 2014, 6:00 AM), <http://www.theracetothetbottom.org/home/fee-shifting-in-derivative-suits-and-the-oklahoma-legislatur.html> [<http://perma.cc/MXA7-QZ2R>] (explaining that there is some balance to the statute because successful shareholders are guaranteed to have their expenses paid by the opposing party).



## II. SHAREHOLDER LAWSUIT REFORM: THE USE OF CORPORATE FEE-SHIFTING BYLAWS TO DETER SHAREHOLDER LAWSUITS

This Part examines shareholder lawsuit reform measures, focusing on the use and implications of allowing fee-shifting bylaws.<sup>105</sup> Section A discusses the recent trend of corporations adopting or amending their bylaws in order to deter future shareholder lawsuits.<sup>106</sup> Section B examines the Delaware Supreme Court's approval of fee-shifting bylaws in *ATP Tour, Inc. v. Deutscher Tennis Bund*.<sup>107</sup> Section B then analyzes the implications of the court's decision in *ATP Tour* and considers whether it may be applicable to stock corporations.<sup>108</sup>

### A. Adopting and Amending Corporate Bylaws to Deter Shareholder Lawsuits

The lack of uniform and substantive shareholder lawsuit reform has forced corporations themselves to take drastic measures to limit and control shareholder lawsuits.<sup>109</sup> One recent trend has been for corporations to amend their corporate bylaws in order to limit these lawsuits.<sup>110</sup>

Corporate bylaws set out the governing details of a corporation.<sup>111</sup> Bylaws vary widely, but typically include the powers of directors, the procedures for director elections, and the procedures for holding shareholder meetings.<sup>112</sup> Under Delaware law, the power to adopt, amend, or repeal corporate bylaws is given to the shareholders.<sup>113</sup> Nevertheless, any corporation may grant this power to its directors in its certificate of incorporation.<sup>114</sup> Delaware courts have ruled that corporate bylaws are a binding part of the contract between a

<sup>105</sup> See *infra* notes 105–154 and accompanying text.

<sup>106</sup> See *infra* notes 109–120 and accompanying text.

<sup>107</sup> See *infra* notes 121–135 and accompanying text.

<sup>108</sup> See *infra* notes 136–154 and accompanying text.

<sup>109</sup> See *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 556 (Del. 2014) (upholding a corporation's fee-shifting bylaw); *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 942 (Del. Ch. 2013) (upholding a corporation's exclusive forum bylaw).

<sup>110</sup> See *ATP Tour*, 91 A.3d at 556; *Boilermakers Local 154*, 73 A.3d at 942.

<sup>111</sup> See DEL. CODE ANN. tit. 8, § 109(b) (West 2015) (“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>112</sup> See *id.*

<sup>113</sup> *Id.* § 109(a) (“After a corporation other than a nonstock corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote.”).

<sup>114</sup> *Id.* (“Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors or, in the case of a nonstock corporation, upon its governing body.”).

Delaware corporation and its shareholders.<sup>115</sup> Therefore, if this power is conferred in a corporation's certificate of incorporation, shareholders are on notice that the corporation's board may act unilaterally to adopt bylaws addressing lawful subject matters.<sup>116</sup>

Possessing such unilateral authority, the boards of some Delaware corporations have taken shareholder lawsuit reform into their own hands by adopting or amending their bylaws to discourage and limit shareholder suits.<sup>117</sup> The first major instance of this occurred when the boards of Chevron and FedEx, both stock companies, adopted bylaws providing that litigation relating to their internal affairs must be conducted in Delaware.<sup>118</sup> Shareholders immediately challenged the bylaws, claiming they went beyond the board's authority under the Delaware General Corporation Law ("DGCL").<sup>119</sup> In 2013, in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, the Delaware Court of Chancery upheld the forum-selection bylaws, finding them both statutorily and contractually valid.<sup>120</sup>

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<sup>115</sup> See *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010) (stating "corporate charters and bylaws are contracts among a corporation's shareholders"); *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) (stating that "corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply").

<sup>116</sup> See *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 492 (Del. Ch. 1995) (explaining that a certificate of incorporation can provide directors with the power to unilaterally amend bylaws without obtaining shareholder approval).

<sup>117</sup> See *ATP Tour*, 91 A.3d at 556 (upholding a corporation's fee-shifting bylaw); *Boilermakers Local 154*, 73 A.3d at 942 (upholding a corporation's exclusive forum bylaw).

<sup>118</sup> See *Boilermakers Local 154*, 73 A.3d at 942. Chevron and FedEx adopted identical bylaws that provided:

Unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this [bylaw].

*Id.*

<sup>119</sup> See *id.* The shareholders argued that the bylaw was statutorily invalid because it was beyond the board's authority under section 109(b) of the Delaware Code to regulate an "external" matter of corporate governance rather than an "internal" matter. See *id.*; see also DEL. CODE ANN. tit. 8, § 109(b).

<sup>120</sup> See *Boilermakers Local 154*, 73 A.3d at 942. The court upheld the bylaws, reasoning that the bylaws were statutorily valid because they govern the "rights . . . of the stockholders" and "the conduct of [the corporations'] affairs." See *id.* at 952, 954. Furthermore, the court reasoned that the bylaws were contractually valid because the shareholders, by purchasing stock, had agreed to be bound by the contractual framework outlined in the company's certificates of incorporation and bylaws. See

## B. The Delaware Supreme Court Validates Fee-Shifting Bylaws for Non-Stock Corporations

Shortly after that decision, in June 2014, in *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court upheld another corporate bylaw that sought to limit the effects of frivolous shareholder litigation through a fee-shifting provision.<sup>121</sup> This section examines the Delaware Supreme Court's ruling.<sup>122</sup> Subsection 1 provides an overview of the procedural history of the case and the court's ruling.<sup>123</sup> Subsection 2 examines the dramatic implications of the ruling, including its chilling effect on both frivolous and meritorious lawsuits and its probable applicability to stock corporations.<sup>124</sup>

### 1. *ATP Tour*: Background and Ruling

In 2006, the board of ATP Tour, Inc. ("ATP"), a Delaware non-stock corporation, amended its bylaws to add a fee-shifting provision that required a non-prevailing plaintiff in an intra-corporate dispute to reimburse the corporation for all fees and expenses the defendant(s) incurred as a result of the action.<sup>125</sup> The provision applied in any circumstance in which the plaintiff did not "obtain a judgment on the merits that substantially achieved, in substance

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*id.* at 954–56. Those bylaws explicitly provided that shareholders would be bound by the bylaws adopted by the respective boards of directors. *See id.*

<sup>121</sup> *See ATP Tour*, 91 A.3d 557–60.

<sup>122</sup> *See infra* notes 123–154 and accompanying text.

<sup>123</sup> *See infra* notes 125–135 and accompanying text.

<sup>124</sup> *See infra* notes 136–154 and accompanying text.

<sup>125</sup> *See ATP Tour*, 91 A.3d at 556. ATP Tour, Inc. ("ATP") operates a global professional men's tennis tour. *Id.* The Tour's members include both professional tennis players and organizations that own and operate professional tennis tournaments worldwide. *Id.* at 555. When two of those organizations joined the ATP they agreed "to be bound by ATP's Bylaws, as amended from time to time." *Id.* at 556 (quoting Certification of Questions of Law at 4, *Deutscher Tennis Bund v. ATP Tour, Inc.*, No. 07-178 (D. Del. Oct. 3, 2013)). The fee-shifting provision applies to any current or prior league member or owner who brings suit against the ATP. *See id.* The amendment language, found in Article 23.3(a), states:

In the event that (i) any [current or prior member or Owner or anyone on their behalf ("Claiming Party")] initiates or asserts any [claim or counterclaim ("Claim")] or joins, offers substantial assistance to or has a direct financial interest in any Claim against the League or any member or Owner (including any Claim purportedly filed on behalf of the League or any member), and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the League and any such member or Owners for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorney's fees and other litigation expenses) (collectively, "Litigation Costs") that the parties may incur in connection with such Claim.

and amount, the full remedy sought.”<sup>126</sup> Subsequently, two members brought suit against ATP alleging both federal antitrust claims and breach of fiduciary duty claims.<sup>127</sup> After the U.S. District Court for the District of Delaware entered judgment in ATP’s favor, ATP moved to recover its legal fees under their fee-shifting bylaw.<sup>128</sup> After making its way through the federal appeals process, the case eventually came before the Delaware Supreme Court, which on May 8, 2014, sitting en banc, unanimously held that ATP’s fee-shifting bylaw was enforceable because it was both facially valid and not in conflict with Delaware common law.<sup>129</sup>

The court found the bylaw lawful, explaining that corporate bylaws are presumed to be facially valid as long as they are authorized by Delaware Gen-

<sup>126</sup> *Id.*

<sup>127</sup> *See id.* at 555–56. In 2007, the board of ATP voted to change the tour’s schedule. *Id.* at 556. As a result of this change, the tournament in Hamburg, Germany was demoted from the highest tournament tier to the second-highest, along with a schedule change from the spring to the summer. *Id.* Consequently, two tournament entities, Deutscher Tennis Bund and Qatar Tennis Federation, brought suit against ATP and six of its board members in the U.S. District Court for the District of Delaware. *Id.* ATP was successful in its breach of fiduciary duty and antitrust claims, being granted a motion for judgment as a matter of law and winning the jury trial. *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *See id.* at 556–57, 560. Originally, the district court denied ATP’s motion, finding that federal law preempted Article 23.3(a), because the law prevents fee-shifting agreements in antitrust claims. *Id.* at 556. On appeal, the U.S. Court of Appeals for the Third Circuit vacated the district court’s order, finding that the district court should not have decided the federal preemption issue, but instead, determined whether Article 23.3(a) was enforceable under Delaware law. *Id.* at 556–57. On remand, finding that the validity of the bylaw was an open question under Delaware law, the U.S. District Court for the District of Delaware certified four questions for the Delaware Supreme Court concerning the validity of a fee-shifting provision in a Delaware non-stock corporation’s bylaws. *Id.* at 557. The four certified questions of law were:

1. May the Board of a Delaware non-stock corporation lawfully adopt a bylaw (i) that applies in the event that a member brings a claim against another member, a member sues the corporation, or the corporation sues a member (ii) pursuant to which the claimant is obligated to pay for ‘all fees, costs, and expenses of every kind and description (including, but not limited to, all reasonable attorneys’ fees and other litigation expenses)’ of the party against which the claim is made in the event that the claimant does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought?
2. May such a bylaw be lawfully enforced against a member that obtains no relief at all on its claims against the corporation, even if the bylaw might be unenforceable in a different situation where the member obtains some relief?
3. Is such a bylaw rendered unenforceable as a matter of law if one or more Board members subjectively intended the adoption of the bylaw to deter legal challenges by members to other potential corporate action then under consideration?
4. Is such a bylaw enforceable against a member if it was adopted after the member had joined the corporation, but where the member had agreed to be bound by the corporation’s rules ‘that may be adopted and/or amended from time to time’ by the corporation’s Board, and where the member was a member at the time that it commenced the lawsuit against the corporation?

*Id.* (footnotes omitted).

eral Corporation Law, are consistent with a corporation's certificate of incorporation, and are not otherwise prohibited.<sup>130</sup> Finding that ATP's fee-shifting bylaw met all of these requirements, the court held the bylaw to be facially valid.<sup>131</sup> Additionally, the court found the bylaw was not in conflict with Delaware common law because, although under the "American Rule" litigants must typically pay their own legal fees, parties have always been able to contractually agree to modify the American Rule so that the losing party pays the prevailing party's attorney's fees and costs.<sup>132</sup> Thus, because Delaware treats corporate bylaws as "contracts among a corporation's shareholders," a fee-shifting bylaw falls within the contractual exception to the American Rule.<sup>133</sup>

Although the court sanctioned corporate fee-shifting bylaws in general, it warned that such bylaws would not be enforced if adopted or used for an inequitable purpose.<sup>134</sup> Ruling that the bylaw was not rendered unenforceable because it was adopted with the intention of deterring legal challenges by shareholders, the decision provides little guidance on what factors may cause a Del-

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<sup>130</sup> See *id.* at 557–58; see also DEL. CODE ANN. tit. 8, § 109(b) ("The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation . . ."); *Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 398 (Del. 2010) (explaining that if a bylaw is inconsistent with the DGCL, it is void); *Frantz Mfg. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985) (explaining that corporate bylaws are presumed to be valid).

<sup>131</sup> See *ATP Tour*, 91 A.3d at 558. The court explained that the enactment of fee-shifting bylaws is not prohibited by the DGCL or other Delaware statutes. *Id.* Additionally, the court found that fee-shifting bylaws also meet the DGCL's requirement that bylaws must "relate to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." *Id.* Lastly, the court explained fee-shifting bylaws could be consistent with a corporation's certificate of incorporation, as the charter could permit fee-shifting provisions, "either explicitly or implicitly by silence." *Id.*; see also DEL. CODE ANN. tit. 8, § 102(a) (2011) (does not require that fee-shifting provisions be included in a corporate charter).

<sup>132</sup> See *ATP Tour*, 91 A.3d at 558; *Sternberg v. Nanticoke Mem'l Hosp., Inc.*, 62 A.3d 1212, 1218 (Del. 2013) (stating that the American Rule is not absolute and explaining that if contract litigation involves a fee-shifting provision, a judge may award all litigation costs to the prevailing party); *Hauptman*, *supra* note 8 (explaining that parties can contractually agree to make the losing party pay the prevailing party's fees).

<sup>133</sup> See *ATP Tour*, 91 A.3d at 558; see also *Airgas, Inc.*, 8 A.3d at 1188 (stating that a corporation's shareholders are contractually bound by corporate charters and bylaws); *Centaur Partners, IV*, 582 A.2d at 928 (explaining that the rules of contract interpretation apply to corporate charters and bylaws because they are contracts among a corporation's shareholders).

<sup>134</sup> See *ATP Tour*, 91 A.3d at 558; see also *Schnell v. Chris-Craft Indus.*, 285 A.2d 437, 438–39 (Del. 1971) (refusing to enforce a board-adopted bylaw amendment moving up the date of an annual shareholder meeting a month earlier than originally scheduled because the board adopted the bylaw for the inequitable "purpose of obstructing the legitimate efforts of dissident stockholders . . . to undertake a proxy contest against management"); *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1080, 1155 (Del. Ch. 2004) (finding that bylaw amendments enacted by a controlling shareholder that, among other changes, required a unanimous vote from the board to act on matters of importance, were clearly adopted for an inequitable purpose).

aware court to rule that a corporation adopted a fee-shifting bylaw for improper purposes.<sup>135</sup>

## 2. *ATP Tour*: Implications of the Ruling

The *ATP Tour* decision had the potential to impact American corporate law dramatically because it occurred in Delaware.<sup>136</sup> With approximately two-thirds of the Fortune 500 list and over half of all U.S. public companies incorporated in the state, Delaware is essentially the source of the United States' "de facto national corporate law."<sup>137</sup> Delaware has assumed this role as America's corporate law leader through its historic tradition of being at the forefront of corporate law, its perceived management-friendly laws, and its specialized corporate law judicial system.<sup>138</sup>

If not later overruled by the Delaware State Legislature, the ruling in *ATP Tour* could have had many significant future implications on shareholder lawsuits for Delaware corporations.<sup>139</sup> Primarily, it likely would have had a severe

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<sup>135</sup> See *ATP Tour*, 91 A.3d at 559–60. The court reasoned that trying to deter litigation is not always an improper purpose because fee-shifting provisions, intrinsically, deter litigation. *Id.* at 560. Therefore, because fee-shifting bylaws are not "per se invalid," the intent to deter litigation does not automatically make the bylaw unenforceable. *Id.* Although the court provided examples of past rulings in which facially valid bylaws were ruled ineffective and unenforceable because they were enacted for improper and inequitable purposes, the court was not able to analyze specifically whether ATP's bylaw was adopted for a proper purpose thus making it enforceable. See *id.* at 558–59. This is because the certified questions only addressed principles of law, preventing the court from reviewing and ruling on the factual background of the case. See *id.* at 559.

<sup>136</sup> See Hauptman, *supra* note 8 (explaining that Delaware courts create and apply standards that will be binding on a large number of publicly traded companies because so many of them are Delaware corporations).

<sup>137</sup> See John Armour et al., *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1397 (2012), <http://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=11027&context=ilj> [<http://perma.cc/GTB5-PTA2>] (describing Delaware courts as the source of a "de facto national corporate law" and discussing how possible shifts in venue could affect the development of corporate law); Liz Hoffman, *Dole and Other Companies Sour on Delaware as Corporate Haven*, WALL ST. J. (Aug. 2, 2015), <http://www.wsj.com/articles/dole-and-other-companies-sour-on-delaware-as-corporate-haven-1438569507> [<http://perma.cc/P6G7-CUHL>] [hereinafter Hoffman, *Dole*] (finding that Delaware is the legal home of 54% of public companies); Liz Hoffman, *Shareholder Suits May Prove Costly*, WALL ST. J. (May 18, 2014), <http://www.wsj.com/articles/SB10001424052702304908304579565850165670972> [<http://perma.cc/T9B9-C9L8>] [hereinafter Hoffman, *Shareholder Suits*] (describing how approximately two-thirds of the Fortune 500 and greater than half of all U.S. public companies are Delaware corporations); Lisa A. Rickard, *Delaware Flirts with Encouraging Shareholder Lawsuits*, WALL ST. J. (Nov. 14, 2014), <http://www.wsj.com/articles/lisa-rickard-delaware-flirts-with-encouraging-shareholder-lawsuits-1416005328?tesla=y&mg=reno64-wsj> [<http://perma.cc/R7AT-TG2Y>] (noting that about two-thirds of Fortune 500 companies are Delaware corporations).

<sup>138</sup> See Hoffman, *Dole*, *supra* note 137 (explaining that businesses frequently incorporate in Delaware due to the state's management-friendly laws and a court system that has unmatched corporate law expertise).

<sup>139</sup> See Herbert Kozlov & Lawrence Reina, *Delaware Supreme Court Approves Fee-Shifting Bylaw for Non-Stock Corporations*, BUS. L. TODAY (Jun. 2014), <http://www.americanbar.org/publications/>

limiting effect on future shareholder lawsuits, for plaintiffs would have been less likely to bring such suits if they could be liable for legal fees and expenses incurred by the corporation should the suits prove unsuccessful.<sup>140</sup> Furthermore, although ATP was a non-stock corporation, the court's reasoning in upholding the bylaw implied that the ruling was likely applicable to stock corporations, providing public companies with the option to also adopt fee-shifting bylaws.<sup>141</sup>

The scope of the bylaw upheld in *ATP Tour* would have further limited the likelihood of shareholder lawsuits.<sup>142</sup> ATP's bylaw imposed fee-shifting on any claimant that "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought."<sup>143</sup> The court did not clearly rule on how the "substantially achieves . . . the full remedy sought" standard should be applied.<sup>144</sup> With no definite explanation as to what fulfills this burdensome standard, many shareholders would have been greatly deterred from bringing lawsuits out of fear that they could be liable for all fees if they obtain some or most of the remedies sought but fail to recover all of them.<sup>145</sup>

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blt/2014/06/keeping\_current\_kozlov.html [http://perma.cc/GM6Z-3VS6]; Morgenson, *supra* note 8; Jonathan Starkey, *Delaware Lawyers Fight Fee-shifting in Legislation*, DEL. ONLINE (June 10, 2014, 12:30 PM), <http://www.delawareonline.com/story/news/local/2014/06/09/delaware-lawyers-push-bill-protect-legal-fees/10260555/> [http://perma.cc/P3LC-4F6V].

<sup>140</sup> See Morgenson, *supra* note 8 (calling the fee-shifting bylaw a "nuclear weapon against shareholders"); Starkey, *supra* note 139 (explaining that shareholders would be unlikely to bring litigation in Delaware because of the risk of a large legal bill due to fee-shifting).

<sup>141</sup> See Kozlov & Reina, *supra* note 139 (noting that the *ATP Tour* decision references case law and relevant DGCL provisions that deal with bylaws of stock corporations); Ronald O. Mueller et al., *Gibson Dunn Discusses Supreme Court of Delaware Case Upholding Fee-Shifting Bylaws*, CLS BLUE SKY BLOG (May 16, 2014), <http://clsbluesky.law.columbia.edu/2014/05/16/gibson-dunn-discusses-supreme-court-of-delaware-case-upholding-fee-shifting-bylaws/> [http://perma.cc/7G95-KJVC] (explaining that the *ATP Tour* decision should apply to non-stock and stock corporations because the DGCL cited in the case governs bylaws for both types of corporations).

<sup>142</sup> See *ATP Tour*, 91 A.3d at 556; Hauptman, *supra* note 8 (stating that "no reasonable shareholder" would bring suit under this standard because even if they are successful in court and are awarded damages, if the damages are "substantially" less than the amount they sought they could be liable for the corporation's fees); Starkey, *supra* note 139 (explaining that shareholders would be unlikely to bring litigation in Delaware because of the risk a large legal bill due to fee-shifting).

<sup>143</sup> *ATP Tour*, 91 A.3d at 556.

<sup>144</sup> See *id.*; *Deutscher Tennis Bund v. ATP Tour Inc.*, 480 F. App'x 124, 127 n.4 (3d Cir. 2012) (observing that a plaintiff who succeeds at trial and wins half of the remedy sought may still be liable for the defendant's fees because the judgment arguably did not "substantially achieve[ ] . . . the full remedy sought"); Hauptman, *supra* note 8 (explaining that it is uncertain when plaintiffs will be "substantially successful" in their suits).

<sup>145</sup> See *Deutscher Tennis Bund*, 480 F. App'x at 127 n.4. In a footnote, the court explained that the language of the fee-shifting provision seemed to suggest that even if a plaintiff receives a favorable settlement, they may be liable for the defendant's fees because they failed to "obtain a judgment on the merits." *Id.* The court went on to observe that "if a plaintiff prevailed at trial and won \$10,000,000, but sought \$20,000,000," the plaintiff could be liable for the defendant's fees because the defendant could argue that the plaintiff "did not 'substantially achieve[ ]', in substance and amount,

The court's ruling, when analyzed solely on the facts of the case, was limited to the enforceability of fee-shifting bylaws within the context of a non-stock corporation.<sup>146</sup> Some scholars and commentators, however, believed the ruling would also enable stock corporations to enact valid fee-shifting bylaws.<sup>147</sup> They noted that the court's reasoning focused on Delaware case law addressing Delaware stock corporations, and the well-established theory that bylaws are a contract between a corporation and its shareholders.<sup>148</sup> All of these factors were equally applicable to both Delaware stock and non-stock corporations.<sup>149</sup> Focusing on Delaware General Corporation Law, the court made it clear that the law applied equally to both stock and non-stock corporations, even explicitly stating in a footnote to the case that under DGCL section 114, all DGCL provisions that speak in terms of shareholders apply equally to non-stock corporations.<sup>150</sup> Furthermore, the court relied on case law addressing stock corporations to explain that facially valid bylaws can be unenforceable if adopted or used for an improper purpose, and to explain that fee-shifting bylaws are not per se improper because deterring litigation is a legitimate purpose.<sup>151</sup>

The deterrence effect of the ruling in *ATP Tour* was likely to have an even greater impact on shareholders of stock corporations, compared to its effects on shareholders of non-stock corporations, because non-stock members are often sophisticated parties who have the necessary financial resources to risk

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the full remedy sought.” *Id.*; see also Hauptman, *supra* note 8 (explaining why “no reasonable shareholder” would bring suit under this standard).

<sup>146</sup> See *ATP Tour*, 91 A.3d at 555.

<sup>147</sup> See Mueller et al., *supra* note 141 (outlining how the *ATP Tour* decision should apply to non-stock and stock corporations because the DGCL equally governs bylaws for both types of corporations); Delaware Supreme Court Endorses “Fee-Shifting” Bylaw in *Certified Question of Law*, WILSON SONSINI GOODRICH & ROSATI (May 12, 2014), <https://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert-fee-shifting.htm> [<http://perma.cc/ZJ27-KWQH>] (explaining that the court's analysis in *ATP Tour* also seems to apply to stock corporations).

<sup>148</sup> See Kozlov & Reina, *supra* note 139 (observing that the court in *ATP Tour* used case law and DGCL provisions relating to bylaws of stock corporations to arrive at a decision); see also *Airgas, Inc.*, 8 A.3d at 1188 (stating “corporate charters and bylaws are contracts among a corporation's shareholders”).

<sup>149</sup> See Kozlov & Reina, *supra* note 139; Mueller et al., *supra* note 141 (explaining that none of the statutes and cases the court cited apply only to non-stock corporations).

<sup>150</sup> See DEL. CODE ANN. tit. 8, § 114 (2011); *ATP Tour*, 91 A.3d at 557 n.10 (“Under 8 Del. C. § 114, the provisions of the Delaware General Corporation Law, including § 109(b), apply to non-stock corporations and all references to the stockholders of a corporation are deemed to apply to the members of a non-stock corporation.”).

<sup>151</sup> See *ATP Tour*, 91 A.3d at 558–59; *Schnell*, 285 A.2d at 438–39 (refusing to enforce a board-adopted bylaw amendment in a stock corporation because the bylaw was adopted for an inequitable purpose); *Hollinger Int'l*, 844 A.2d at 1080, 1155 (holding that bylaw amendments for a stock corporation were ineffective because they were clearly adopted for an inequitable purpose).



bringing a lawsuit despite the possibility of fee-shifting.<sup>152</sup> Alternatively, shareholders in stock corporations, who are more likely to be unsophisticated parties with minor financial interests, are less likely to bring a lawsuit in light of a fee-shifting provision.<sup>153</sup> They would not want to risk the potentially large financial expense of paying the defendant corporation's legal fees and expenses in order to recover a minimal financial return.<sup>154</sup>

### III. THE DELAWARE STATE LEGISLATURE'S RESPONSE TO *ATP TOUR, INC. v. DEUTSCHER TENNIS BUND*: STATUTORY PROHIBITION OF FEE-SHIFTING BYLAWS FOR STOCK CORPORATIONS

This Part explores the Delaware State Legislature's response to the Delaware Supreme Court's 2014 ruling in *ATP Tour, Inc. v. Deutscher Tennis Bund*, along with the legislature's subsequent statutory prohibition of fee-shifting bylaws for Delaware stock corporations.<sup>155</sup> Section A reviews the support and opposition of different interest groups to the *ATP Tour* ruling.<sup>156</sup> Section B provides an overview of the legislative history leading to the Delaware State Legislature's approval of the fee-shifting bylaw prohibition.<sup>157</sup> Section C examines the ambiguity of the statutory language of the fee-shifting prohibition and whether the prohibition is applicable to securities class actions.<sup>158</sup>

#### A. Support and Opposition to the *ATP Tour* Decision

The Delaware Supreme Court's ruling in *ATP Tour* immediately generated a great deal of outspoken support and opposition.<sup>159</sup> Corporations, corporate

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<sup>152</sup> See *ATP Tour*, 91 A.3d at 556–60. This was the case in *ATP Tour*, where Deutscher Tennis Bund and Qatar Tennis Federation's large financial interests, and great sophistication and financial resources, allowed them to bring suit despite their knowledge of the possibility of having to pay ATP's fees if they were unsuccessful. See *id.*; see also William J. Sushon et al., *Shifting Sands: Practical Advice on Delaware Fee-Shifting Bylaws*, N.Y. L.J., Aug. 11, 2014, at 8, 9 (describing how the parties in *ATP Tour* were likely not deterred by the fee-shifting provision because they were "substantial entities").

<sup>153</sup> See Morgenson, *supra* note 8 (describing how shareholders lacking financial resources might be discouraged from bringing lawsuits if they know they will have to pay their opponents' legal fees if the suit is unsuccessful).

<sup>154</sup> See *id.*; Sushon et al., *supra* note 152, at 8–9 (arguing that the fear of fee-shifting liability would preclude many shareholders in stock corporations from bringing a lawsuit); Hoffman, *Shareholder Suits*, *supra* note 137 (stating that a plaintiff who owns only 1% of a corporation's stock could receive 1% of any recovery if their suit is successful, but could be liable for 100% of the defendant's costs if the suit is unsuccessful).

<sup>155</sup> See *infra* notes 156–189 and accompanying text.

<sup>156</sup> See *infra* notes 159–165 and accompanying text.

<sup>157</sup> See *infra* notes 166–175 and accompanying text.

<sup>158</sup> See *infra* notes 176–189 and accompanying text.

<sup>159</sup> See *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 556 (Del. 2014); Alison Frankel, *Big Pension Funds Mobilize Against Delaware Fee-Shifting Clauses*, REUTERS (Nov. 26, 2014), <http://blogs.reuters.com/alison-frankel/2014/11/26/big-pension-funds-mobilize-against-delaware-fee->

interest groups, and even legal reform groups were particularly supportive of the ruling.<sup>160</sup> Corporations showed their support by adopting fee-shifting bylaws, as more than forty companies adopted similar bylaws by the end of 2014.<sup>161</sup> In addition, interest groups expressed their support by sending letters to the Delaware General Assembly, arguing that fee-shifting bylaws protect shareholders against the significant costs of frivolous and abusive litigation.<sup>162</sup>

At the same time, the ruling also generated a great deal of opposition, primarily from large institutional investors, pension funds, and the interest groups that represent them.<sup>163</sup> These interest groups strongly lobbied the Delaware State Legislature and sent letters to Delaware Governor Jack Markell, urging him to support legislative action to keep corporations from adopting fee-shifting bylaws.<sup>164</sup> These interest groups also reached out to proxy adviso-

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shifting-clauses/ [<http://perma.cc/73FM-EKRX>] (detailing both support and opposition by various interest groups to the *ATP Tour* decision); Kevin LaCroix, *Battle Builds in Delaware Over Fee-Shifting Bylaws*, D&O DIARY (Dec. 1, 2014), <http://www.dandodiary.com/2014/12/articles/director-and-officer-liability/battle-builds-in-delaware-over-fee-shifting-bylaws/> [<http://perma.cc/UBC7-G53F>] (further describing support and opposition to the *ATP Tour* decision); Francis Pileggi, *Delaware Proposes New Fee-Shifting and Forum Selection Legislation*, DEL. CORP. & COMM. LITIG. BLOG (Mar. 6, 2015), <http://www.delawarelitigation.com/2015/03/articles/commentary/delaware-proposes-new-fee-shifting-and-forum-selection-legislation/> [<http://perma.cc/59RZ-CDGA>] (explaining that the Delaware legislation faced “powerful lobbyists” representing both sides of the issue).

<sup>160</sup> See Liz Hoffman, *Delaware Fight Over Corporate Legal Bills on Hold*, WALL ST. J. L. BLOG (June 18, 2014), <http://blogs.wsj.com/law/2014/06/18/delaware-fight-over-corporate-legal-bills-on-hold/> [<http://perma.cc/47D8-N6B5>] (reporting that Dole Food Co. has expressed support for the decision); LaCroix, *supra* note 159 (stating that the U.S. Chamber Institute for Legal Reform supports the ruling); Jonathan Starkey, *Chamber Forces Delay on Fee-shifting Legislation*, DEL. ONLINE (June 10, 2014, 1:52 PM), <http://www.delawareonline.com/story/firststatepolitics/2014/06/10/fee-shifting-bill/10280791/> [<http://perma.cc/32TE-NSKA>] (describing how support for the ruling has also come from the U.S. Chamber of Commerce).

<sup>161</sup> See Lee Rudy, *Litigation Bylaws*, COUNCIL OF INSTITUTIONAL INV'RS (Nov. 19, 2014), [http://www.cii.org/files/issues\\_and\\_advocacy/legal\\_issues/Litigation%20Bylaws.pdf](http://www.cii.org/files/issues_and_advocacy/legal_issues/Litigation%20Bylaws.pdf) [<http://perma.cc/83PY-W5FG>] (providing a list of stock corporations that have already adopted fee-shifting bylaws).

<sup>162</sup> See Letter from Lisa A. Rickard, President, U.S. Chamber Inst. for Legal Reform, to Members of the Del. Gen. Assembly (June 9, 2014), <https://www.documentcloud.org/documents/1184978-chamber-letter-to-lawmakers.html> [<http://perma.cc/55RX-QSRL>]; Letter from Andrew Wynne, Dir., State Legislative Affairs, U.S. Chamber Inst. for Legal Reform, to Bryan Townsend, Senator, Del. State Legislature (June 5, 2014), <https://www.documentcloud.org/documents/1184979-chamber-letter-to-townsend.html> [<http://perma.cc/ET2Q-G9BY>].

<sup>163</sup> See Frankel, *supra* note 159 (detailing the opposition efforts of institutional investors); Michael Greene, *Investor Group Joins Chorus Against Fee-Shifting Bylaws, Asks Del. Bar to Act*, BLOOMBERG BNA (Dec. 1, 2014), <http://www.bna.com/investor-group-joins-n17179917697/> [<http://perma.cc/7WEM-RLV3>] (describing opposition efforts by the Council of Institutional Investors); *Investors Try to Undo Damage in Delaware, as Eager Companies Shift Costs of Lawsuits to Plaintiffs*, BERMAN DEVALERIO (Nov. 2014), <http://www.bermandevalerio.com/9-news/recent-developments/243-investors-try-to-undo-damage-in-delaware-as-eager-companies-shift-costs-of-lawsuits-to-plaintiffs> [<http://perma.cc/ESY7-UWYK>] [hereinafter BERMAN DEVALERIO] (detailing the opposition of institutional investors to the *ATP Tour* decision).

<sup>164</sup> BERMAN DEVALERIO, *supra* note 163 (stating that “20 institutional investors with nearly \$2 trillion in assets under management wrote Delaware Gov. Jack Markell” asking him to take action

ry services ISS and Glass Lewis and urged them to adopt policies opposing corporate adoption of fee-shifting bylaws or charters.<sup>165</sup>

### *B. Prohibition of Fee-Shifting Bylaws: Legislative History and Approval*

The Delaware Corporate Law Council, in conjunction with the Delaware State Legislature, agreed with those who sought to limit or overrule *ATP Tour* and began working on an amendment to the Delaware General Corporation Law (“DGCL”) immediately after the *ATP Tour* decision.<sup>166</sup> On May 22, 2014, the Delaware Corporate Law Council proposed an amendment to the Delaware General Corporation Laws that would restrict the *ATP Tour* ruling to its specific facts by only allowing non-stock corporations, not stock corporations, to adopt fee-shifting bylaws.<sup>167</sup> After direct opposition from lobbying groups including the U.S. Chamber of Commerce and the U.S. Chamber Institute for Legal Reform, however, the legislature ultimately decided to table the bill until the 2015 legislative session.<sup>168</sup> This decision was made in order to provide the representatives of the Delaware State Bar with more time to study the use of

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against fee-shifting bylaws); see Letter from Jeff Mahoney, Gen. Counsel, Council of Inst. Inv’rs, to Norman Monhait, Chairman, Section of Corp. Law Del. State Bar Ass’n (Nov. 25, 2014), [http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2014/11\\_25\\_14\\_CII\\_letter\\_DCC.pdf](http://www.cii.org/files/issues_and_advocacy/correspondence/2014/11_25_14_CII_letter_DCC.pdf) [<http://perma.cc/U3KN-3D76>]; see also Hazel Bradford, *Institutional Investors Team up Against Delaware Court Ruling on Legal Fees*, PENSIONS & INVS. (Dec. 3, 2014, 3:39 PM), <http://www.pionline.com/article/20141203/ONLINE/141209953/institutional-investors-team-up-against-delaware-court-ruling-on-legal-fees> [<http://perma.cc/68XV-4A9X>] (describing a letter that the National Conference on Public Employee Retirement Systems and eight unions sent to Governor Markell expressing their opposition to fee-shifting bylaws). Opposition to fee-shifting bylaws came from both national and international institutional investors; “state pension funds of California, Colorado, Connecticut, Florida, Massachusetts, New York, North Carolina and Oregon, city pension funds in Houston, New York and San Diego, the Middlesex County Retirement System and three Dutch asset managers” were among the twenty institutional investors that cosigned the letter to the Governor. See BERMAN DEVALERIO, *supra* note 163.

<sup>165</sup> See BERMAN DEVALERIO, *supra* note 163 (noting that these letters asked the proxy advisory services to oppose bylaw or charter provisions that exposed shareholders to liability for the corporation’s legal expenses).

<sup>166</sup> See S.B. 236, 147th Gen. Assemb. (Del. 2014); Starkey, *supra* note 139 (stating that lawyers immediately began drafting legislation to overrule the *ATP Tour* decision).

<sup>167</sup> See S.B. 236. The proposed amendment, section 331, “Monetary Liability of Stockholders,” stated, “Notwithstanding any other provision of this chapter, neither the certificate of incorporation nor the bylaws of any corporation may impose monetary liability, or responsibility for any debts of the corporation, on any stockholder of the corporation, except to the extent permitted by Sections 102(b)(6) and 202 of this title.” *Id.*

<sup>168</sup> See Hoffman, *supra* note 160 (detailing how the Delaware legislature postponed legislative action until early 2015); Kevin LaCroix, *Delaware Legislative Proposal to Restrict Fee-Shifting Bylaws Held Over to Next Year*, D&O DIARY (June 23, 2014), <http://www.dandodiary.com/2014/06/articles/corporate-governance/delaware-legislative-proposal-to-restrict-fee-shifting-bylaws-held-over-to-next-year/> [<http://perma.cc/YV7V-7RDP>] (detailing the legislative decision to postpone legislative action on fee-shifting bylaws until 2015).

fee-shifting bylaws and to allow supporting and opposing sides the ability to further study and present their arguments.<sup>169</sup>

This delay had little effect: at the start of the 2015 legislative session the legislature once again sided with opponents of fee-shifting and approved a statutory prohibition against fee-shifting bylaws.<sup>170</sup> After receiving near unanimous approval in the Delaware legislature, on June 24, 2015, Governor Markell signed the statutory prohibition against fee-shifting bylaws for stock corporations into law.<sup>171</sup> Although the law does not explicitly overrule the *ATP Tour* decision, it does prohibit Delaware stock corporations from adopting fee-shifting bylaws or certificate of incorporation provisions.<sup>172</sup> The prohibition amends sections 102 and 109 of the DGCL to provide that a Delaware corporation's certificate of incorporation and bylaws "may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim."<sup>173</sup> The law applies only to Delaware stock corporations, so that the *ATP Tour* decision is still applicable to non-stock corporations.<sup>174</sup> Furthermore,

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<sup>169</sup> See Peter A. Atkins et al., *Fee-Shifting Bylaws: The Current State of Play*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES (June 20, 2014), [http://www.skadden.com/news/letters/Fee-Shifting\\_Bylaws\\_The\\_Current\\_State\\_of\\_Play.pdf](http://www.skadden.com/news/letters/Fee-Shifting_Bylaws_The_Current_State_of_Play.pdf) [<http://perma.cc/7N66-DHEA>] (explaining that the legislature urged parties to continue to study use of fee-shifting bylaws and alternative solutions); LaCroix, *supra* note 168 (explaining that the legislature called upon "the Delaware State Bar Association, its Corporation Law Section, and the Council of that Section" to continue to examine whether fee-shifting legislation should be adopted in 2015).

<sup>170</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b) (West 2015); A.W. Chip Phinney III, *Delaware Bans Corporate Fee-Shifting Bylaws and Authorizes Delaware-Only Forum Requirement for Intra-Corporate Litigation*, NAT'L L. REV. (July 6, 2015), <http://www.natlawreview.com/article/delaware-bans-corporate-fee-shifting-bylaws-and-authorizes-delaware-only-forum-requi> [<http://perma.cc/UH5K-N4MP>] (detailing Delaware's approval of the fee-shifting prohibition).

<sup>171</sup> See DEL. CODE ANN. tit. 8, § 102(f) (West 2015); *id.* § 109(b). The Delaware Senate passed the bill with sixteen "yes" votes and five "no" votes. *SB 75, Delaware Senate Bill, An Act to Amend Title 8 of the Delaware Code Relating to the General Corporation Law*, OPENSTATES.ORG, <http://openstates.org/de/bills/148/SB75/> [<http://perma.cc/BAS9-EP84>] The Delaware House of Representatives unanimously passed the bill. See *id.*

<sup>172</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b).

<sup>173</sup> See *id.* § 102(f) ("The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title."); *id.* § 109(b) ("The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title.").

<sup>174</sup> See *id.* §§ 102(f), 109(b); see also Matthew M. Greenberg et al., *Delaware Legislature Prohibits Fee Shifting and Authorizes Exclusive Forum Selection*, PEPPER HAMILTON LLP (July 29, 2015), <http://www.pepperlaw.com/publications/delaware-legislature-prohibits-fee-shifting-and-authorizes-exclusive-forum-selection-2015-07-29/> [<http://perma.cc/44QV-8AT8>] (explaining that the new legislation limits the *ATP Tour* ruling to non-stock corporations); Kevin M. LaCroix, *Delaware Legislature Passes Fee-Shifting Bylaw Prohibition—What Questions Remain?*, D&O DIARY (June 14, 2015), <http://www.dandodiatry.com/2015/06/articles/shareholders-derivative-litigation/delaware-legislature->

the law does not forbid fee-shifting terms in shareholder agreements or other private agreements between corporations and shareholders.<sup>175</sup>

### C. Uncertainty Surrounding “Internal Corporate Claims” and Securities Class Action Lawsuits

Despite passage of Delaware’s fee-shifting bylaw prohibition, uncertainty still remains as to the scope of the prohibition, specifically whether the prohibition applies to securities class action lawsuits.<sup>176</sup> This uncertainty stems from the fact that the statutory language prohibits fee-shifting specifically “in connection with an internal corporate claim.”<sup>177</sup> Section 115 of the DGCL defines “internal corporate claims” to mean “claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity . . . .”<sup>178</sup>

This definition may not encompass securities class actions, which are not required to claim a breach of fiduciary duty.<sup>179</sup> Rather, they often allege only a material misstatement or omission by a director or officer, without asserting a

passes-fee-shifting-by-law-prohibition-what-questions-remain/ [http://perma.cc/9RBW-WZYN] (noting that the new legislative restrictions will not apply to non-stock corporations).

<sup>175</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b); see also Greenberg, *supra* note 174 (explaining that the legislation will not prevent fee-shifting in “stockholder agreements or other private agreements between stockholders and corporations”).

<sup>176</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b); John C. Coffee, Jr., *Update on “Loser Pays” Fee Shifting*, CLS BLUE SKY BLOG (May 27, 2015), <http://clsbluesky.law.columbia.edu/2015/05/27/update-on-loser-pays-fee-shifting/> [http://perma.cc/AX2L-63KH] (arguing that the fee-shifting prohibition may not cover securities class action lawsuits); Neil J. Cohen, *Does Delaware Bill 75 Cover Fee Shifting in Securities Cases?*, BANK & CORP. GOVERNANCE L. REP., June 2015, at 7, 7–10 (explaining that it is possible for the fee-shifting prohibition to be interpreted so as not to apply to securities class actions); Lawrence A. Hamermesh & Norman M. Monhait, *Fee-Shifting Bylaws: A Study in Federalism*, INST. DEL. CORP. & BUS. L. (June 29, 2015), <http://blogs.law.widener.edu/delcorp/2015/06/29/fee-shifting-bylaws-a-study-in-federalism/#sthash.WTx3qqji.MWrWpZaX.dpbs> [http://perma.cc/ASR5-9KEQ] (arguing that the legislation does not address the validity of fee-shifting bylaws in securities class actions).

<sup>177</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b), 115; Coffee, *supra* note 176 (explaining that the definition of “internal corporate claims” in section 115 does not clearly cover securities class actions); Cohen, *supra* note 176, at 7 (explaining that plaintiffs are likely to question whether section 115, which defines “internal corporate claim,” exempts securities class actions).

<sup>178</sup> See DEL. CODE ANN. tit. 8, § 115; Coffee, *supra* note 176. This definition covers “derivative actions, merger class actions based on the Delaware Supreme Court’s 1983 decision in *Weinberger* or similar breach of fiduciary duty claims, and appraisal actions.” See Coffee, *supra* note 176; see also *Weinberger v. UOP, Inc.*, 457 A. 2d 701, 711 (Del. 1983) (establishing that when there is a controlling shareholder who consummates a merger or acquisition, the concept of fairness involves fair dealing and fair price).

<sup>179</sup> See DEL. CODE ANN. tit. 8, § 115; J. Robert Brown, Jr., *Staying in the Delaware Corporate Governance Lane: Fee Shifting Bylaws and a Legislative Reaffirmation of the Rules of the Road*, BANK & CORP. GOVERNANCE L. REP., June 2015, at 12, 12–13 (explaining that securities class action claims are not always based on a breach of duty by directors and officers); Coffee, *supra* note 176 (explaining that federal securities class actions assert a material misstatement or omission claim, but are not required to bring a breach of fiduciary duty claim).

breach of fiduciary duty claim.<sup>180</sup> Thus, without a claim “based upon a violation of a duty,” it is possible that a Delaware court could interpret the statutory language to allow fee-shifting bylaws that cover securities class actions.<sup>181</sup>

Some commentators acknowledge this statutory ambiguity, but they argue that a closer reading of the statutory language shows that the new fee-shifting prohibition does cover securities class actions.<sup>182</sup> These commentators emphasize that the statute defines “internal corporate claims” as “claims, *including* claims in the right of the corporation, (i) that are *based upon* a violation of a duty . . . .”<sup>183</sup> They argue that if securities class actions were meant to be specifically excluded from the fee-shifting prohibition, the statute would have defined internal corporate claims as “claims in the right of the corporation.”<sup>184</sup> Instead, by broadly defining claims as “*including* claims in the right of the corporation,” these commentators believe that the statute implicitly covers securities class actions.<sup>185</sup> Second, these commentators note that the statute’s language is not restricted to claims alleging “a violation of a duty,” but instead covers claims “*based upon* a violation of a duty.”<sup>186</sup> Therefore, they argue the statute covers securities fraud class actions because, although such claims are not a direct violation of a duty, they are based upon a violation of a director’s or officer’s duty of loyalty not to violate the law.<sup>187</sup> Lastly, because the lan-

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<sup>180</sup> See John C. Coffee, Jr., *Delaware Throws a Curveball*, CLS BLUE SKY BLOG (Mar. 16, 2015), <http://clsbluesky.law.columbia.edu/2015/03/16/delaware-throws-a-curveball> [<http://perma.cc/T27U-UHZC>] (explaining that federal securities class actions must allege a material misstatement or omission but do not need to allege a violation of a duty); Hamermesh & Monhait, *supra* note 176 (explaining that securities class actions based on § 10(b) of the Securities Exchange Act, the most common type of suit, generally involve allegations of a material misstatement or omission by directors or officers, which do not arise from their duty to the corporation and its shareholders).

<sup>181</sup> See Brown, *supra* note 179, at 13–14 (arguing that the fee-shifting prohibition does cover securities class actions because it is preempted by federal law); Coffee, *supra* note 176 (arguing that ambiguity of the “internal corporate claims” definition could lead to securities class actions being exempt from the fee-shifting prohibition); Coffee, *supra* note 180 (explaining that fee-shifting bylaws in a federal securities class action might not be prohibited if the action does not claim a “violation of a duty” by officers or directors).

<sup>182</sup> See Cohen, *supra* note 176, at 7–10 (arguing that the statutory language should be interpreted broadly so as to include securities class actions).

<sup>183</sup> See DEL. CODE ANN. tit. 8, § 115 (emphasis added).

<sup>184</sup> See *id.*; Cohen, *supra* note 176, at 8 (arguing that section 115 was not designed to exclude securities lawsuits because it did not define internal corporate claims as exclusively “claims in the right of the corporation”).

<sup>185</sup> See DEL. CODE ANN. tit. 8, § 115 (emphasis added); Cohen, *supra* note 176, at 8 (arguing that because the definition uses the language “*including* claims in the right of the corporation,” the drafter purposefully left room for securities class actions to be covered).

<sup>186</sup> See DEL. CODE ANN. tit. 8, § 115 (emphasis added); Cohen, *supra* note 176, at 8 (explaining that the language of section 115 is “not restricted to claims alleging ‘a violation of a duty’; rather, it includes claims ‘based on a violation of a duty’”).

<sup>187</sup> See DEL. CODE ANN. tit. 8, § 115; Cohen, *supra* note 176, at 8–9 (arguing that securities class actions fit within the definition in section 115 because they are “based on a violation of a corporate officer’s duty to loyally obey the law on behalf of his employer”).

guage does not limit the prohibition to claims under Delaware law, the definition could have been drafted to provide Delaware courts with the flexibility to find that federal securities class actions are covered by the statutory prohibition.<sup>188</sup>

Despite these contrasting beliefs on whether the law covers securities class actions there is a general consensus that unless the statutory language is amended, the issue of whether the fee-shifting prohibition applies to securities class actions will have to be decided by the Delaware courts.<sup>189</sup>

#### IV. ALLOWING FEE-SHIFTING BYLAWS WITH LIMITATIONS THAT PROTECT BOTH SHAREHOLDERS AND CORPORATIONS

Given the negative impact of shareholder lawsuits, Delaware's legislature and judiciary should strive to limit the number of frivolous shareholder claims, in particular, securities class action claims.<sup>190</sup> Section A proposes that Delaware amend the statute that prohibits fee-shifting bylaws to allow stock corporations to adopt fee-shifting bylaws subject to two key limitations.<sup>191</sup> Section B argues that courts should read the existing statute narrowly so that it does not apply to securities class action lawsuits, and argues that the legislature should ultimately amend the statute so that it does not apply to securities class action lawsuits.<sup>192</sup>

##### *A. Allowing Stock Corporations to Adopt Fee-Shifting Bylaws*

The Delaware State Legislature should amend its fee-shifting prohibition to explicitly allow stock corporations to adopt fee-shifting bylaws.<sup>193</sup> The abusive and costly trend of lawsuits following a merger or acquisition must be

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<sup>188</sup> See DEL. CODE ANN. tit. 8, § 115; Cohen, *supra* note 176, at 9 (arguing that because section 115 does not limit claims under Delaware law, it "could have been deliberately worded to leave enough room for the Delaware courts to find that securities fraud cases are covered").

<sup>189</sup> See Coffee, *supra* note 176 (explaining that it is probable that the Delaware courts will soon have to determine whether the fee-shifting prohibition applies to securities class actions); Cohen, *supra* note 175, at 9–10 (explaining that the outlook for the fee-shifting prohibition likely involves Delaware courts deciding whether the prohibition applies to securities class actions).

<sup>190</sup> See *infra* notes 191–247 and accompanying text.

<sup>191</sup> See *infra* notes 193–220 and accompanying text.

<sup>192</sup> See *infra* notes 221–247 and accompanying text.

<sup>193</sup> See DEL. CODE ANN. tit. 8, § 102(f), 109(b), 115 (West 2015); see also Stephen Bainbridge, *The Case for Allowing Fee Shifting Bylaws as a Privately Ordered Solution to the Shareholder Litigation Epidemic*, PROFESSORBAINBRIDGE.COM (Nov. 17, 2014), <http://www.professorbainbridge.com/professorbainbridgecom/2014/11/the-case-for-allowing-fee-shifting-bylaws-as-a-privately-ordered-solution-to-the-shareholder-litigat.html> [<http://perma.cc/R7F4-9Z9B>] (arguing that the Delaware legislature should not ban fee-shifting bylaws); John O. McGinnis, *Let Corporations Shift Fees in Shareholder Suits*, LIBR. OF L. & LIBERTY (Oct. 28, 2014), <http://www.libertylawsite.org/2014/10/28/let-corporations-shift-fees-in-shareholder-suits/> [<http://perma.cc/3HWD-Y9HH>] (arguing that fee-shifting bylaws should not be prohibited); Rickard, *supra* note 137 (arguing that, at a minimum, corporations should have the option to adopt fee-shifting bylaws).

stopped.<sup>194</sup> The current Delaware fee-shifting legislation does little, if anything, to curtail this practice.<sup>195</sup> By prohibiting stock corporations from adopting fee-shifting bylaws for internal corporate claims, and possibly for securities class actions, the Delaware legislature is allowing this harmful trend to continue.<sup>196</sup>

The legislature should allow the use of fee-shifting bylaws, but it should impose two important limits on this practice by requiring shareholder approval for fee-shifting bylaws and imposing a maximum relief standard.<sup>197</sup> Requiring shareholder approval would address concerns that fee-shifting bylaws are inequitable, for the Delaware judicial system has a long-standing tradition of finding that shareholder approval via informed voting overcomes any allegations of a board or corporation's misconduct.<sup>198</sup> Although such a requirement would transfer considerable power to the proxy advisory services, which generally have reacted negatively to the adoption of bylaws that could potentially limit shareholder rights, this risk must be born by the corporation for the sake of fair-

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<sup>194</sup> See BAJAJ ET AL., *supra* note 5, at 3 (finding that shareholders lose \$34 billion annually when class action lawsuits are announced); KOUMRIAN, *supra* note 2, at 1 (finding that in 2013, 94% of deals over \$100 million were challenged by at least one lawsuit).

<sup>195</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b); see also Benjamin Horney, *Delaware's 2015 Dominated by Fee-Shifting Fervor*, LAW360 (July 1, 2015, 4:25 PM), <http://www.law360.com/articles/673991/delaware-s-2015-dominated-by-fee-shifting-fervor> [<http://perma.cc/X2MC-GXN3>] (discussing a Delaware lawyer's belief that the fee-shifting bylaw legislation will not resolve the problem of frivolous shareholder lawsuits); Letter from Lisa A. Rickard, President, U.S. Chamber Inst. for Legal Reform, to Norman Monhait, Chairman, Section of Corp. Law Dela. State Bar Ass'n (Apr. 8, 2015), [http://www.instituteforlegalreform.com/uploads/sites/1/de-bar-letter-4\\_8\\_2015.pdf](http://www.instituteforlegalreform.com/uploads/sites/1/de-bar-letter-4_8_2015.pdf) [<http://perma.cc/DZ3Z-WTZG>] (explaining that the fee-shifting bill "does little to address the well-documented, longstanding problem of abusive merger-and-acquisition litigation in Delaware," and "removes a useful tool for protecting innocent shareholders against these frivolous lawsuits").

<sup>196</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b); Horney, *supra* note 195 (discussing a Delaware lawyer's belief that the fee-shifting bylaw legislation simply returned Delaware to where it was prior to the *ATP Tour, Inc. v. Deutscher Tennis Bund* decision, "when shareholder suits ran rampant").

<sup>197</sup> See John C. Coffee, Jr., "Loser Pays": *Who Will Be the Biggest Loser?*, CLS BLUE SKY BLOG (Nov. 24, 2014), <http://clsbluesky.law.columbia.edu/2014/11/24/loser-pays-who-will-be-the-biggest-loser/> [<http://perma.cc/ZE5W-3N3G>] (suggesting that Delaware could allow fee-shifting provisions to be adopted only after they are approved by shareholder vote); Neil J. Cohen, *Who Should Oversee Fee-Shifting Bylaws: The Shareholders, the Courts, the Legislature, or All Three?*, 38 SEC. REFORM ACT LITIG. REP. 22, 25 (2015), <http://www.lawreporters.com/jan15sra.pdf> [<http://perma.cc/YH3F-LEQ9>] (suggesting that proposed fee-shifting bylaws should be submitted to a shareholder vote); Theodore N. Mirvis & William Savitt, *Shifting the Focus: Let the Courts Decide*, 38 SEC. REFORM ACT LITIG. REP. 11, 13 (2015), <http://www.lawreporters.com/jan15sra.pdf> [<http://perma.cc/YH3F-LEQ9>] (explaining that proposed maximum relief standards could include a corporation being unable to impose fee-shifting liability if a plaintiff survives a motion to dismiss or if the plaintiff continues through discovery); Starkey, *supra* note 139 (explaining that the burdensome fee-shifting language approved in *ATP Tour* could force shareholders not to bring lawsuits in Delaware due to a large risk of liability); Sushon et al., *supra* note 152, at 9 (suggesting that boards submit fee-shifting bylaws to a shareholder vote).

<sup>198</sup> See Sushon et al., *supra* note 152, at 9. This tradition is premised on the simple fact that it is extremely difficult for a shareholder to argue that a bylaw is inequitable if the majority of the corporation's shareholders approved it. See *id.*



ness.<sup>199</sup> Moreover, shareholders might approve fee-shifting bylaws because they may recognize that the net benefit of deterring many frivolous shareholder lawsuits is worth any potential chilling effect that such bylaws may have on a small number of meritorious lawsuits.<sup>200</sup>

The Delaware State Legislature should prohibit corporations from using language similar to “does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought.”<sup>201</sup> As previously discussed, this harsh language could essentially require a claimant to achieve the full remedy sought in order to avoid liability for the defendant’s fees.<sup>202</sup> Thus, even if the claimant wins the lawsuit and a large portion of the remedy sought, they could still be liable for the defendant’s fees because it was not the “full remedy sought.”<sup>203</sup>

Instead, the Delaware legislature should create a maximum standard that corporations can impose on claimants in order for them to avoid liability for the defendant corporation’s fees.<sup>204</sup> Significantly lower than *ATP Tour, Inc. v.*

<sup>199</sup> See Ariel J. Deckelbaum et al., *ISS and Glass Lewis Issue 2015 Proxy Voting Policies*, PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP (Nov. 11, 2014), <http://www.paulweiss.com/media/2703532/11oct14alert.pdf> [<http://perma.cc/VDL7-AGH8>] (explaining that both ISS and Glass Lewis added policies against boards unilaterally adopting fee-shifting bylaws); see also James Woolery, *Boards Should Minimize the Role of Proxy Advisors*, HARVARD L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 31, 2015), <http://corpgov.law.harvard.edu/2013/10/31/boards-should-minimize-the-role-of-proxy-advisors/> [<http://perma.cc/2MV4-TMP5>] (explaining that ISS and Glass Lewis, the two primary proxy advisors, influence approximately 38% of shareholder votes at U.S. public company meetings). Although there is a possibility that shareholders will just follow the recommendations of the proxy advisory services to reject the fee-shifting provisions, there is also a possibility that this vote will bring to light the rampant abuse and extreme costs of shareholder lawsuits. See BAJAJ ET AL., *supra* note 5, at 7 (describing the extreme costs of shareholder lawsuits, including a study finding that 1456 settled securities class action cases, filed over an eighteen-year period from December 1995 through January 2014, resulted in an estimated \$262 billion in shareholder losses).

<sup>200</sup> See BAJAJ ET AL., *supra* note 5, at 3 (finding that shareholders lose \$39 billion annually when these lawsuits are announced, compared to the average of \$5 billion—after attorney’s fees—that investors receive as a result of lawsuit settlements).

<sup>201</sup> See *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 556 (Del. 2014); Starkey, *supra* note 139 (explaining that the burdensome fee-shifting language approved in *ATP Tour* could force shareholders not to bring lawsuits in Delaware due to the large risk of liability).

<sup>202</sup> See *Deutscher Tennis Bund v. ATP Tour Inc.*, 480 F. App’x 124, 127 n.4 (3d Cir. 2012); Hauptman, *supra* note 8 (explaining that “no reasonable shareholder[s]” would bring suit under this standard because even if they are successful in court and are awarded damages, if the damages are “substantially” less than the amount they sought, they could be liable for the corporation’s fees).

<sup>203</sup> See *Deutscher Tennis Bund*, 480 F. App’x at 127 n.4 (explaining that “if a plaintiff prevailed at trial and won \$10,000,000, but sought \$20,000,000, this by-law theoretically could require the plaintiff to pay the defendant’s fees because the judgment the plaintiff received arguably did not ‘substantially’ achieve . . . the full remedy sought”); Hauptman, *supra* note 8 (explaining that a plaintiff who wins “one out of three claims, or obtain[s] a judgment for \$1 million out of \$3 million sought” might still be liable for fee-shifting because the plaintiff was not “substantially” successful).

<sup>204</sup> See *Deutscher Tennis Bund*, 480 F. App’x at 128; Cohen, *supra* note 197, at 24 (arguing that the legislature should not allow fee-shifting if a plaintiff survives a motion to dismiss or achieves “a significant financial or corporate governance remedy”); Mirvis & Savitt, *supra* note 197, at 13 (ex-

*Deutscher Tennis Bund*'s "full remedy sought" standard, the standard should state that if a claimant is able to achieve any relief that is greater than minimal disclosures then they are not subject to liability for the defendant's legal fees.<sup>205</sup> The traditional "American Rule" would then apply and all parties involved would pay their own legal fees and expenses.<sup>206</sup> This modified application of the American Rule will not discourage legitimate claims by shareholders because the "corporate benefit" doctrine will still apply.<sup>207</sup> Thus, by receiving relief that is greater than minimal disclosures, the defendant corporation would pay its own attorney's fees even without monetary relief.<sup>208</sup>

This standard should be greater than minimal disclosures, so as to deter frivolous lawsuits whose only purpose often is to receive minimal disclosures from the corporation.<sup>209</sup> This is because doing so still allows the plaintiff's attorneys to achieve a "corporate benefit" and thus have their fees paid directly by the defendant corporation.<sup>210</sup> Determining what relief is greater than minimum disclosures should be left to the judiciary to determine on a case-by-case basis.<sup>211</sup> Additionally, this standard should also be applied to settlements.<sup>212</sup>

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plaining that proposed maximum relief standards include a corporation being unable to impose fee-shifting liability if a plaintiff survives a motion to dismiss or if the plaintiff continues through discovery).

<sup>205</sup> See *ATP Tour*, 91 A.3d at 556.

<sup>206</sup> See *Mahani v. Edix Media Grp., Inc.*, 935 A.2d 242, 245 (Del. 2007) (explaining that under the American Rule litigants pay their own litigation costs).

<sup>207</sup> See *Fisch et al.*, *supra* note 4, at 567 (noting that plaintiffs' counsel must portray the settlement relief as a corporate benefit in order to recover their fees).

<sup>208</sup> See *id.* at 560 (explaining that Delaware acknowledges the potential benefits of non-monetary relief by awarding fees to plaintiffs' attorneys if the relief results in a corporate benefit); Griffith, *supra* note 6, at 2 (describing how under the "corporate benefit" doctrine, a plaintiffs' attorney may recover their fees even if they only achieve non-pecuniary relief).

<sup>209</sup> See *Fisch et al.*, *supra* note 4, at 567 (stating that Delaware law incentivizes "litigants to generate, and judges to reward, throwaway disclosures" that are unimportant to shareholders and whose only purpose is to end litigation); Solomon, *supra* note 67 (explaining that in 2012, approximately 85% of settlements were solely disclosures).

<sup>210</sup> See *Fisch et al.*, *supra* note 4, at 567 (explaining that plaintiffs' counsel must portray the settlement relief as a corporate benefit in order to recover their fees); Griffith, *supra* note 6, at 2 (describing how under the "corporate benefit" doctrine, a plaintiffs' attorney who only achieves non-pecuniary relief may still be awarded their legal fees).

<sup>211</sup> See *Fisch et al.*, *supra* note 4, at 591–604 (proposing that Delaware courts reject arguments that disclosure-only settlements provide a "corporate benefit," thus preventing the award of attorney's fees); Mirvis & Savitt, *supra* note 197, at 15 (explaining that if the validity of fee-shifting provisions were left up to the Delaware courts, the courts would be able to prevent unfair fee-shifting by determining when the plaintiff achieved a meaningful result, even if it was not the full remedy the plaintiff had sought).

<sup>212</sup> See *Fisch et al.*, *supra* note 4, at 562 (explaining that settlements often consist of only "throwaway disclosures"). Courts must approve the termination of a merger class action lawsuit by settlement. See *id.* at 568; FED. R. CIV. P. 23(e) (requiring judicial approval for compromise of a class action). The court's primary role at a settlement hearing is to determine whether the settlement is fair and reasonable and to determine the fees to be awarded to plaintiff's counsel. See *Fisch et al.*, *supra* note 4, at 558. In order to deter frivolous lawsuits properly, it is imperative that fee-shifting provisions

This lower standard is primarily justified for two reasons.<sup>213</sup> First, and most importantly, the standard will continue to provide shareholders with incentives to bring meritorious lawsuits against corporations.<sup>214</sup> Shareholders will still be incentivized because meritorious suits have, at the very least, a high probability that they will achieve relief that is greater than minimal disclosures.<sup>215</sup> Thus, in a large majority of meritorious cases, if not all, the shareholders will not be subject to fee-shifting.<sup>216</sup>

Second, it is extremely hard for a claimant to achieve the full remedy sought.<sup>217</sup> Generally, even when claimants decisively win a lawsuit, they will not receive the entirety of the remedy sought.<sup>218</sup> If the “full remedy sought” standard were used, then claimants may be inclined to seek less than the actual amount of damages they incurred to ensure a greater likelihood of meeting this difficult standard.<sup>219</sup> In a judicial system based upon the theory of restitution, discouraging claimants from seeking to recover the entirety of their actual damages is not good judicial policy.<sup>220</sup>

are applied to settlement agreements because a large majority of shareholder lawsuits end with disclosure-only settlements. See KOUMRIAN, *supra* note 2, at 4 (finding that in 88% of merger cases filed in 2013, the settlement only resulted in disclosures); Cain & Davidoff, *supra* note 4, at 477 (finding that 71.6% of transaction litigations result in some type of settlement). By ensuring that these settlements end with more than just minimal disclosures, it will prevent plaintiffs’ lawyers from developing the potential loophole of bringing frivolous lawsuits just to settle them and recover their fees. See *Joy v. North*, 692 F.2d 880, 887 (2d Cir. 1982) (stating that the true motivators behind derivative actions are plaintiffs’ attorneys who hope to recover large fees).

<sup>213</sup> See *Deutscher Tennis Bund*, 480 F. App’x at 127 n.4; John C. Coffee, Jr., *Fee-Shifting and the SEC: Does It Still Believe in Private Enforcement?*, CLS BLUE SKY BLOG (Oct. 14, 2014), <http://clsbluesky.law.columbia.edu/2014/10/14/fee-shifting-and-the-sec-does-it-still-believe-in-private-enforcement/> [<http://perma.cc/38X3-C2NG>] (explaining that it is rare for plaintiffs to win every claim, making it highly unlikely that they could achieve the full remedy sought).

<sup>214</sup> See Starkey, *supra* note 139 (explaining that the burdensome language of the bylaw in *ATP Tour* could lead shareholders to avoid bringing suit in Delaware due to the risk of liability for attorney’s fees if their suit is unsuccessful).

<sup>215</sup> See Cohen, *supra* note 197, at 24 (arguing that the legislature should not allow fee-shifting if a plaintiff survives a motion to dismiss or achieves “a significant financial or corporate governance remedy”); Fisch et al., *supra* note 4, at 560 (stating that Delaware acknowledges the possible benefits of non-pecuniary relief); Mirvis & Savitt, *supra* note 197, at 15 (dismissing the argument that plaintiffs’ lawyers would not bring a lawsuit if the corporation had a fee-shifting provision).

<sup>216</sup> See Fisch et al., *supra* note 4, at 560.

<sup>217</sup> See *Deutscher Tennis Bund*, 480 F. App’x at 127 n.4; Coffee, *supra* note 213 (explaining that plaintiffs rarely win on every claim, thus it is highly unlikely for them to achieve the full remedy they seek).

<sup>218</sup> See *Deutscher Tennis Bund*, 480 F. App’x at 127 n.4; Coffee, *supra* note 213.

<sup>219</sup> See *Deutscher Tennis Bund*, 480 F. App’x at 127 n.4; Coffee, *supra* note 213.

<sup>220</sup> See Eric G. Andersen, *The Restoration Interest and Damages for Breach of Contract*, 53 MD. L. REV. 1, 10 (1994) (noting that restitution is a major principle of American jurisprudence); George P. Roach, *Counter-Restitution for Monetary Remedies in Equity*, 68 WASH. & LEE L. REV. 1271, 1272 (2011) (arguing that receiving damages in current and future corporate litigation through the principle of restitution will offer significant benefits); Peggy M. Tobolowsky, *Restitution in the Federal Crimi-*

*B. Interpreting Delaware's Fee-Shifting Ban So That It Does Not Apply to Securities Class Action Lawsuits*

Recognizing that the Delaware State Legislature is unlikely to immediately reverse course and amend its statute to allow fee-shifting, Delaware courts should read the statute narrowly so that it does not apply to securities class action lawsuits.<sup>221</sup> Because of statutory ambiguity as to whether the fee-shifting prohibition will apply to securities class actions, many anticipate that the Delaware courts will soon have to rule on this matter.<sup>222</sup> It is possible that a plaintiff will bring a declaratory action in the Delaware Chancery Court seeking permission to file suit now that a defendant corporation's fee-shifting bylaw has been invalidated by the state's new statute.<sup>223</sup> Because of the significance of this issue, no matter the ruling in the Chancery Court, such a case would most likely make its way to the Delaware Supreme Court in order to provide a definitive and final answer.<sup>224</sup>

The Delaware courts should read the statute narrowly so that it does not apply to securities class action lawsuits because of the important policy considerations of deterring these lawsuits.<sup>225</sup> As previously discussed, securities class ac-

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*nal Justice System*, 77 JUDICATURE 90, 90 (1993) (explaining that Congress realized that restitution is vital to the criminal justice system).

<sup>221</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b); Coffee, *supra* note 176 (observing that Delaware courts may read the new statutes to allow fee-shifting in securities class actions); Cohen, *supra* note 176, at 10 (explaining that it is possible for Delaware courts to rule that the legislation does not apply to securities class actions).

<sup>222</sup> See John C. Coffee, Jr., *What Happens Next?*, BANK & CORP. GOVERNANCE L. REP., June 2015, at 11, 11–12 (explaining that the statute's ambiguity will likely lead Delaware courts to rule on whether the statute applies to securities class actions); Cohen, *supra* note 176, at 7 (stating that it is likely that plaintiffs will seek to use the new legislation to overturn the fee-shifting bylaws that have already been adopted by stock corporations).

<sup>223</sup> See Cohen, *supra* note 176, at 9 (noting that it is expected that plaintiffs' lawyers will file a declaratory judgment action in the Delaware Chancery Court to challenge the fee-shifting provision). There is a possibility that the fee-shifting bylaws could be challenged in a securities case in federal district court. See *id.*; see also Coffee, *supra* note 176. If challenged in federal court, the "court might stay the action and certify the issue of the proper construction of the Delaware statute to the Delaware Supreme Court." Coffee, *supra* note 176. Alternatively, the federal court may keep the case and rule on potential federal preemption issues. See *id.* Because a securities case in federal court could expose plaintiffs to fee-shifting liability if they are unsuccessful, they will likely bring the challenge in the Chancery Court. See *id.*; Cohen, *supra* note 176, at 9.

<sup>224</sup> See Coffee, *supra* note 176 (explaining that if a plaintiff brings a declaratory action in the Chancery Court, this process will likely "take longer []because the issue cannot be resolved authoritatively until the Delaware Supreme Court speaks").

<sup>225</sup> See Mike Chesney & Kye Parsons, *Updated: Delaware's Reputation as Corporate Haven Called into Question*, WBOC (Aug. 7, 2015, 8:38 AM), <http://www.wboc.com/story/29715615/delawares-reputation-as-corporate-haven-called-into-question> [<http://perma.cc/68TQ-HLDR>] (stating that "Delaware actively promotes itself as a business-friendly . . . state"); Benjamin Horney, *Fee-Shifting Bill Once Again Causes Divide in Delaware*, LAW360 (May 8, 2015), <http://www.law360.com/articles/631329/fee-shifting-bill-once-again-causes-divide-in-delaware> [<http://perma.cc/M2D6->

tion lawsuits have had a negative financial impact on both corporations and their shareholders.<sup>226</sup> With a large majority of these lawsuits resulting in “disclosure-only” settlements, the only true winners of these lawsuits are the plaintiffs’ attorneys.<sup>227</sup> To stop this harmful, growing trend, the Delaware courts, if given the opportunity, should clarify that the statute applies only to “internal corporate claims” and not to securities class actions.<sup>228</sup> This ruling would ensure that Delaware’s corporate policy goal of maintaining a proper balance between corporation and shareholder rights can continue.<sup>229</sup>

Corporations will be able to deter frivolous class actions through fee-shifting bylaws that are designed to ensure that plaintiffs will only bring actions that possess actual merit and are likely to result in a recovery.<sup>230</sup> Shareholders will still be able to bring meritorious securities class actions, in addition to internal corporate claims, without fear of fee-shifting liability.<sup>231</sup> There is a possibility that plaintiffs’ attorneys would just revise their claims to fall within the definition of “internal corporate claim” by claiming a “violation of a duty” by a director or officer.<sup>232</sup> In these instances, however, the Delaware judiciary must be vigilant to dismiss such meritless claims and not allow the law to be so easily circumvented.<sup>233</sup>

3UYF] (explaining that a “hallmark” of Delaware’s corporate law tradition has been its “commitment to maintaining [a] balanced legal system”).

<sup>226</sup> See BAJAJ ET AL., *supra* note 5, at 3 (finding that shareholders lose \$34 billion annually upon the announcement of class action lawsuits); Yap et al., *supra* note 49 (explaining that the filing of merger class action lawsuits is so probable that these associated legal fees have become a “transaction tax” that accompanies almost every merger or acquisition).

<sup>227</sup> See KOUMRIAN, *supra* note 2, at 4 (finding that in 88% of merger cases filed in 2013, the settlement only resulted in disclosures); Cain & Davidoff, *supra* note 4, at 479 (finding that the average attorney’s fees award for disclosure-only settlements is \$749,000).

<sup>228</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b); *see also* Coffee, *supra* note 176 (explaining that Delaware courts may read the new statutes to allow fee-shifting in securities class actions); Cohen, *supra* note 176, at 10 (describing how it is possible for Delaware courts to rule that the legislation does not apply to securities class actions).

<sup>229</sup> See Hoffman, *Dole*, *supra* note 137 (explaining that corporations choose to incorporate in Delaware because of its balanced corporate environment); Horney, *supra* note 225 (observing that the fee-shifting prohibition raises doubt about Delaware’s promise to preserve a “balanced legal system”).

<sup>230</sup> See Michael Greene, *Fee-Shifting Bylaws Prompt Myriad Reactions as Delaware Bill Looms*, BLOOMBERG BNA (Apr. 3, 2015), <http://www.bna.com/feeshifting-bylaws-prompt-n17179925005/> [<http://perma.cc/6MD7-TM94>] (referencing a law professor who has explained that fee-shifting bylaws are meant to deter meritless lawsuits rather than prevent meritorious ones); Letter from Lisa A. Rickard, *supra* note 195 (explaining that the use of fee-shifting bylaws provides corporations with a device to defend shareholders against the costs of frivolous litigation).

<sup>231</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b); Mirvis & Savitt, *supra* note 197, at 15 (dismissing the argument that plaintiffs’ lawyers would not bring a lawsuit if the corporation had a fee-shifting provision).

<sup>232</sup> See Coffee, *supra* note 180 (explaining that plaintiffs’ attorneys may attempt to come within the new legislation by revising their claims to assert a “violation of a duty” by officers or directors, “even though this does not legally strengthen their case”).

<sup>233</sup> See Fisch et al., *supra* note 4, at 602.

Additionally, the Delaware courts should interpret the statute narrowly, so as not to harm Delaware's status as America's corporate haven.<sup>234</sup> Recently many corporations that were initially attracted to the state's business-friendly reputation have expressed great displeasure with what they view as the state's growing hostility towards business.<sup>235</sup> One of the primary reasons cited for this negative development is Delaware's unwillingness to enact effective measures to combat the increasing trend of shareholder litigation.<sup>236</sup> At the same time, other states have made strong efforts to enact more business-friendly laws and develop specialized business courts to directly compete with Delaware.<sup>237</sup> Some corporations have even threatened to reincorporate in a different state due to Delaware's unwillingness to combat shareholder litigation.<sup>238</sup> Now that the Delaware State Legislature has passed its fee-shifting prohibition, some believe that it is only a matter of time before some corporations leave the state, which could

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<sup>234</sup> See Hoffman, *Dole*, *supra* note 137 (54% of public companies and 85% of U.S. companies that have gone public in the past two years have incorporated in Delaware); Hoffman, *Shareholder Suits*, *supra* note 137 (noting that two-thirds of Fortune 500 companies are Delaware corporations); U.S. Chamber Comments on Delaware State Senate Vote on "Fee Shifting" Bill, U.S. CHAMBER INST. FOR LEGAL REFORM (May 12, 2015), <http://www.instituteforlegalreform.com/resource/us-chamber-comments-on-delaware-state-senate-vote-on-fee-shifting-bill/> [<http://perma.cc/6WXS-TSQV>] (quoting the president of the U.S. Chamber Institute for Legal Reform as stating that the passage of the fee-shifting legislation "threatens Delaware's billion-dollar incorporation franchise").

<sup>235</sup> See Hoffman, *Dole*, *supra* note 137 (explaining that there are several companies, including Dole Food Co., that believe Delaware has become less welcoming to businesses); Jonathan Starkey, *Discord Tests Delaware's Corporate-Friendly Image*, DEL. ONLINE (Aug. 28, 2015), <http://www.delawareonline.com/story/news/local/2015/08/28/discord-tests-delawares-corporate-friendly-image/71319508/> [<http://perma.cc/UD2D-A8RM>] (describing how Delaware's corporate status has been subject to an "unusual level of public and political conflict" over the past year due in part to the state's inability to curtail shareholder suits).

<sup>236</sup> See Hoffman, *Dole*, *supra* note 137 (explaining that Delaware's inability to curb shareholder litigation has led companies to believe the state has become "less hospitable" towards business); Rickard, *supra* note 137 (explaining that Delaware's "reputation as a fair and hospitable business locale is at risk" because of the legislature's attempt to prohibit fee-shifting bylaws).

<sup>237</sup> See Hoffman, *Dole*, *supra* note 137 (explaining that other states are "angling for Delaware's business"); Benjamin Horney, *Del. Fee-Shifting Bill Won't Cause Corporate Exodus*, LAW360 (June 5, 2015), <http://www.law360.com/articles/660388/del-fee-shifting-bill-won-t-cause-corporate-exodus> [<http://perma.cc/D9JM-SSTD>] (naming Oklahoma and Connecticut as states that are trying to reinvent themselves as "safe havens" if corporations decide to leave Delaware). In May 2014, Oklahoma enacted a fee-shifting amendment covering all derivative lawsuits. See OKLA. STAT. tit. 18, § 1126 (2012); Horney, *supra*. Proposed legislation in Connecticut seeks to create a commission to develop a ten-year plan to "challenge and eventually overtake Delaware as the leading state in the country for businesses and corporations to locate, incorporate and do business." See Horney, *supra*. Similar to Delaware, Michigan and Texas have moved to establish separate business courts with judges steeped in corporate-law expertise. Hoffman, *Dole*, *supra* note 137.

<sup>238</sup> See Hoffman, *Dole*, *supra* note 137 (explaining that Dole Food Co. and First Citizens BancShares Inc. have threatened to move out of Delaware and reincorporate elsewhere due to the threat of frivolous shareholder lawsuits); Starkey, *supra* note 235 (describing how "name-brand corporations," including Ancestry.com, have been threatening to leave Delaware if the state does not act to limit shareholder lawsuits).

mark the beginning of a mass exodus of corporations out of Delaware.<sup>239</sup> With Delaware's economic well-being so heavily dependent on being America's corporate haven, the Delaware courts have a strong interest in authorizing fee-shifting in securities class actions to protect this status.<sup>240</sup> Doing so will help restore corporations' confidence in Delaware's business-friendly reputation and remove the growing doubt surrounding its future as the nation's corporate haven.<sup>241</sup>

Although the Delaware State Legislature is unlikely to immediately reverse course, it would be best if the legislature, not the courts, clarified that the fee-shifting prohibition does not apply to securities class action lawsuits.<sup>242</sup> The legislature could accomplish this by amending the statute to specifically exclude securities class action lawsuits.<sup>243</sup> First, this would provide more certainty for corporations, because even if the Delaware courts rule that the statute allows fee-shifting in securities class actions, there is always the possibility that courts will reverse or refuse to follow the precedent, without warning, in the future.<sup>244</sup> By having the legislature amend the statute, even if they were to reverse course in the future, the legislative process would provide warning and allow the corporations to have a

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<sup>239</sup> See Coffee, *supra* note 213 (describing how the fee-shifting prohibition could lead to "inter-jurisdictional competition" as other states might authorize fee-shifting to attract companies to reincorporate in their state); Hoffman, *Dole*, *supra* note 137 (explaining that some general counsels are talking about reincorporating in more "management-friendly states" because of the fee-shifting prohibition); Horney, *supra* note 225 (noting that, before passage of the fee-shifting prohibition, many feared that Delaware corporations would seek to reincorporate in other states if the bill was adopted).

<sup>240</sup> See Stephen Bainbridge, *Delaware's Decision: Viewing Fee Shifting Bylaws Through a Public Choice Lens*, PROFESSORBAINBRIDGE.COM (Nov. 18, 2014), <http://www.professorbainbridge.com/professorbainbridge.com/2014/11/delawares-decision-viewing-fee-shifting-bylaws-through-a-public-choice-lens.html> [<http://perma.cc/MGW3-URT7>] (explaining that because Delaware benefits so greatly from its corporate dominance, its government has a strong interest in preserving it); Chesney & Parsons, *supra* note 225 (stating that harm to Delaware's status as a corporate haven would be a real problem because it is vitally important to the state's economy, resulting in the employment of thousands of people and allowing Delaware to have no sales tax and low property taxes); Hoffman, *Dole*, *supra* note 137 (explaining that Delaware is projected to collect more than \$1 billion in corporate fees this year, which comprises 26% of its annual budget).

<sup>241</sup> See Hoffman, *Dole*, *supra* note 137; Rickard, *supra* note 137; Starkey, *supra* note 235 (reporting that Ancestry.com's chief legal officer questioned whether Delaware's corporate foundation remains strong); see also Judy Greenwald, *New Law Frustrates Efforts to Cut Shareholder Lawsuits*, BUS. INS. (July 19, 2015), <http://www.businessinsurance.com/article/20150719/NEWS06/307199970/new-delaware-law-frustrates-efforts-to-cut-shareholder-lawsuits?tags=%7C75%7C80%7C83%7C302> (explaining that the fee-shifting prohibition will encourage new companies to incorporate in other states besides Delaware).

<sup>242</sup> Cohen, *supra* note 197, at 23 (arguing that the Delaware State Legislature, not the judiciary, is best suited to resolve the fee-shifting issue).

<sup>243</sup> See DEL. CODE ANN. tit. 8, §§ 102(f), 109(b).

<sup>244</sup> See, e.g., *Beattie v. Beattie*, 630 A.2d 1096, 1101 (Del. 1993) (overruling prior precedent regarding the common law doctrine of interspousal immunity); *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 969–70 (Del. Ch. 1996) (refusing to follow the precedent established in *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125 (Del. 1963), in deciding if the board of directors had a duty to monitor).

democratic say in the process.<sup>245</sup> Second, a legislative amendment would help to reassure many corporations of Delaware's status as a state that is welcoming to business and management.<sup>246</sup> Lastly, having the legislature resolve this issue would be more efficient, as protracted litigation would impose high costs on parties without necessarily providing a definite resolution of the issue.<sup>247</sup>

#### CONCLUSION

Shareholder lawsuits have reached epidemic proportions. Lawsuits are filed after almost every merger and/or acquisition and result in legal fees that cost corporations billions of dollars. It is clear that there is a need for drastic and swift shareholder lawsuit reform. The Delaware legislature should explicitly allow stock corporations to adopt fee-shifting bylaws, subject to two limitations. First, before a corporation adopts a fee-shifting bylaw, it should be approved by a majority of the corporation's shareholders. Second, the legislature should create a maximum standard that corporations can impose on claimants in order for claimants to avoid liability for the defendant corporation's fees. Recognizing that the Delaware legislature is unlikely to immediately reverse course on this issue, alternatively, the Delaware courts should read the statute narrowly so as not to apply to securities class action lawsuits. This narrow reading will deter the harmful effects of frivolous shareholder class action lawsuits and will reaffirm Delaware's status as America's corporate haven. By taking either of these actions the state can strike a compromise between corporate and shareholder rights that will work to deter frivolous shareholder lawsuits, and in turn ensure that Delaware remains at the forefront of corporate law.

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<sup>245</sup> See LaCroix, *supra* note 159 (providing an example of the drawn-out timeframe of Delaware's legislative response to the *ATP Tour* decision and the fact that interested parties were able to express their opinions on the proposed legislation).

<sup>246</sup> See Bainbridge, *supra* note 240 (explaining that because Delaware benefits so greatly from its corporate dominance, its government has a strong interest in preserving it); Hoffman, *Dole*, *supra* note 137 (explaining that Delaware's inability to curb the growing trend of shareholder litigation is one of the reasons companies believe the state has become less hospitable towards business); Rickard, *supra* note 137 (explaining that Delaware's "reputation as a fair and hospitable business locale is at risk" because of the Delaware State Legislature's attempt to prohibit fee-shifting bylaws).

<sup>247</sup> See Coffee, *supra* note 176; Cohen, *supra* note 176, at 9.



