PAVING THE DELAWARE WAY: LEGISLATIVE AND EQUITABLE LIMITS ON BYLAWS AFTER *ATP*

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ABSTRACT

In ATP Tour, Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court held that a private company's fee-shifting bylaw was facially valid. And before that decision, Delaware courts similarly upheld companies' use of forum-selection bylaws requiring that intra-corporate disputes be litigated in a single designated forum. Many interpreted these holdings as broad endoresements of bylaws that could regulate the litigation process itself and a move by the Delaware courts to curtail shareholder litigation. Indeed, the Delaware legislature itself responded to* ATP*, amending the state's corporate law to explicitly prohibit Delaware companies from adopting fee-shifting bylaws for shareholder litigation. But the legislature simultaneously allowed Delaware companies to adopt forum-selection bylaws.*

In this Article, we show that ATP *and caselaw related to forum-selection bylaws will not result in calamity for investors or provide a silver bullet for companies to end shareholder and securities litigation. Rather, when carefully and fairly read, these decisions simply reaffirm the Delaware Way, under which corporate managers are vested with broad legal authority, but that authority is tempered by principles of equity. Using* ATP *and fee-shifting bylaws as a point of departure, we provide a template for equitable analysis of not only fee-shifting bylaws, but also forum-selection bylaws and other bylaws relating to litigation. Furthermore, as we argue in this Article, had equitable principles been properly applied to fee-shifting bylaws, equitable principles would have likely prevented fee-shifting bylaws from extinguishing meritorious shareholder or securities litigation anyway. In fact, the only kind of fee-shifting bylaw that would likely have survived equitable scrutiny is one*

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that already exists under Delaware's Rule 11—one that provides that a neutral arbiter can approve of two-way shifting of reasonable fees in response to frivolous litigation. Ultimately, perhaps the most compelling case for legislation barring fee-shifting bylaws in other states that follow the Delaware Way is that doing so may spare litigants and the system the lengthy, common-law process that will likely arrive at the state of the law already in place.

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I. INTRODUCTION

In *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court held that a private company's fee-shifting bylaw was facially valid.[1] That bylaw was especially wide-reaching. It applied to current shareholders, former shareholders, and anybody who assisted them in investigating or suing on their claim.[2] It required fee shifting in any case where the plaintiffs obtained anything short of a full judgment in their favor or that differed from the relief initially sought in the complaint.[3] And it shifted not just lawyers' fees but costs of every kind.[4]

Many have interpreted *ATP* as a broad endorsement of fee-shifting bylaws and a move by the Delaware courts to curtail shareholder litigation.[5] Commentators have warned or celebrated (depending on their point of view) that *ATP* would permit public companies to adopt similar fee-shifting bylaws for all sorts of shareholder and securities lawsuits.[6]

The prospect that companies organized in Delaware and elsewhere would race to adopt fee-shifting bylaws that apply to shareholder and securities litigation caused alarm. According to some, fee-shifting bylaws leave shareholder and securities litigation on the precipice of becoming "an empty threat"[7] and "eviscerate[] investor rights."[8] According to others, fee-shifting bylaws "chill[] the assertion of meritless claims"[9] and represent a "new weapon [in] . . . the corporate arsenal to deter shareholder litigation."[10]

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1. 91 A.3d 554, 558 (Del. 2014).
2. *Id.* at 556.
3. *Id.*
4. *Id.*
5. *See* discussion *infra* Part II.
6. *See* discussion *infra* Part II.
7. Press Release, U.S. Senator Richard Blumenthal, Blumenthal Calls on SEC to Protect Critical Check on Corporate Malfeasance (Oct. 30, 2014), *available at* http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-sec-to-protect-critical-check-on-corporate-malfeasance, *archived at* http://perma.cc/E7MX-B24L (providing the text of a letter from Senator Blumenthal to Mary Jo White, Chairwoman of the SEC, regarding private citizen suits).
8. Hazel Bradford, *Institutional Investors Team Up Against Delaware Court Ruling on Legal Fees*, PENSIONS & INVESTMENTS (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 (quoting a letter sent to Delaware Governor Jack Markell by the National Conference on Public Employee Retirement Systems and eight unions representing public- and private-sector workers).
9. Herbert F. Kozlov & Lawrence J. Reina, *Delaware Supreme Court Approves Fee-Shifting Bylaw for Non-Stock Corporations*, BUS. L. TODAY (June 2014), http://www.americanbar.org/content/dam/aba/publications/blt/2014/06/keeping-current-kozlov-201406.authcheckdam.pdf.
10. Gail O'Gradney, *Let Us Let Bylaws Be Bylaws*, 32 FLETCHER CORP. L. ADVISER, no. 7, July 2014, at 3.

In response to these concerns, the Delaware legislature amended its corporate law to explicitly provide that "[t]he certificate of incorporation [or 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 . . . ."[11] At the same time, the Delaware legislature also made clear that Delaware companies may adopt forum-selection bylaws.[12]

In this Article, we show that the Delaware legislature's decision to prohibit fee-shifting bylaws and to allow forum-selection bylaws is consistent with the equitable limits placed on any such bylaw under Delaware case law, including those articulated by *ATP* itself. *ATP*—when carefully and fairly read—simply reaffirms the "Delaware Way."[13] Under the Delaware Way, corporate managers are vested with broad legal authority, but that authority is tempered by principles of equity.[14] Likewise, in *ATP*, the Delaware Supreme Court held that even if fee-shifting bylaws are facially valid, principles of equity limit their application.[15] Those same principles of equity also limit the use of forum-

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11. DEL. CODE ANN. tit. 8, §§ 102(f), 109(b) (2015). An "internal corporate claim" includes claims "in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." *Id.* § 115.

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

13. For purposes of this Article, we assume that *ATP*'s "bylaws as contracts" theory for public companies holds true, see ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014), that *ATP*'s holding may be extended to non-stock companies, and that federal law would not preempt the fee-shifting bylaw. These assumptions are significant as every one of them is an open question. *See* J. Robert Brown, Jr., *Shifting Back the Focus: Fee Shifting Bylaws and a Need to Return to Legislative Intent*, 53 BANK & CORP. GOVERNANCE L. REP. 2015, *available at* http://ssrn.com/abstract=2547094 (arguing that bylaws of public companies are not contracts); John C. Coffee, Jr., *Fee-Shifting Bylaw and Charter Provisions: Can They Apply in Federal Court?—The Case for Preemption* (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 498, 2014), *available at* http://ssrn.com/abstract=2508973 (making the case for federal preemption of fee-shifting bylaws in shareholder litigation); Hon. Henry duPont Ridgely, J., Sup. Ct. of Del., Keynote Address at the 22nd Annual SMU Corporate Counsel Symposium: The Emerging Role of Bylaws in Corporate Governance 19 (Oct. 31, 2014), *available at* http://www.delawarelitigation.com/files/2014/11/The_Emerging_Role_of_Bylaws_in_Corporate_Governance-copy.pdf (stating that whether *ATP* applies to for-profit companies is an "open question"); William K. Sjostrom, Jr., *The Intersection of Fee-Shifting Bylaws and Securities Fraud Litigation*, 93 WASH. U. L. REV. (forthcoming 2015) (making a case for federal preemption of fee-shifting bylaws in securities cases).

14. *See* discussion *infra* Part III.

15. *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014) (stating that bylaws, even though legally permissible, may not be enforceable depending on how they are adopted and invoked).

selection bylaws, despite the fact that the Delaware legislature has made explicit their facial validity.[16]

Using *ATP* and fee-shifting bylaws as a point of departure, we provide a template for equitable analysis of not only fee-shifting bylaws, but also forum-selection bylaws and other bylaws relating to litigation. Further, as we argue in this Article, when equitable principles are properly applied, they will likely preclude the use of such bylaws to extinguish meritorious shareholder or securities litigation. As we demonstrate, before any court—including those states that follow Delaware's corporate law—will enforce a fee-shifting or forum-selection bylaw, the board of directors must meet its burden of proving that adopting and implementing that bylaw comports with its fiduciary duties of care and loyalty. Specifically, the only kind of fee-shifting bylaw that is likely to survive equitable scrutiny by any court following the Delaware Way is one that is balanced, or "proportionate"—one that provides that a neutral arbiter can approve of two-way shifting of reasonable fees in response to frivolous litigation.

Moreover, we find that the fee-shifting bylaws that will survive equitable review simply duplicate the existing mechanism for patrolling frivolous litigation: Rule 11. That Rule also provides for a neutral arbiter to approve of two-way shifting of reasonable fees in response to frivolous litigation. Ultimately, we demonstrate that the Delaware legislature's decision to prohibit fee-shifting bylaws on their face avoids years of litigation surrounding fee-shifting to arrive at the state of the law already in place. Perhaps the most compelling reason for legislative intervention was to spare litigants and the system the lengthy, common-law process that would have gotten us to a world that already exists.

II. PERCEIVING *ATP* AS PART OF THE JUDICIAL RESPONSE TO THE EXPLOSION OF DEAL LITIGATION

There is nothing inherently objectionable about corporate deals.[17] Yet lately, shareholder plaintiffs have challenged nearly every deal in court,[18]

16. *See* discussion *infra* Part III.

17. *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 10 (2010) (stating that mergers have the potential to "generate significant efficiencies," "enhance the merged firm's ability and incentive to compete," "lower prices," "improve[] quality," "enhance[] service," and create "new products").

18. *See, e.g.*, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2013 M&A LITIGATION 1 (2014), *available at* https://www.cornerstone.com/CMSPages/GetFile.aspx?guid=73882c85-ea7b-4b3c-a75f-40830eab34b6 (documenting the jump in the percentage of deals subject to lawsuits).

claiming that the board sold the company for too little, refused to sell at a premium, or did something to affect the price adversely.[19] Deal litigation is now so common that it has amounted to what some call "a feeding frenzy."[20] The number of deal challenges lends credence to this criticism. Specifically, in 2005, shareholders challenged only about half of all $100-million deals in court, yet by 2010, shareholders were claiming that more than 90% of these deals were, in some way, unfair.[21] A columnist for the New York Times reports that deal litigation is "a big issue these days because once you've announced a deal, you are likely to get sued. Really."[22]

The near-automatic litigation that accompanies deals has led to skepticism among academics and members of the bar concerning the worth of these lawsuits.[23] Likewise, the Delaware judiciary has questioned

19. Deal litigation usually takes the form of a class action, and the fundamental claim in deal litigation is that the deal is, in some way, unfair because the board breached a fiduciary duty of care, good faith, or loyalty when it sold the company for too little, refused to sell at a premium, or did something that adversely affected price. *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (defining substantive fairness as involving issues of process and price); 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, 564 (2015); Randall S. Thomas, *What Should We Do About Multijurisdictional Litigation in M&A Deals?*, 66 VAND. L. REV. 1925, 1929 (2013).

20. *See* Steven Davidoff Solomon, *Debating the Merits of the Boom in Merger Lawsuits*, N.Y. TIMES (Mar. 8, 2013, 3:50 PM), http://dealbook.nytimes.com/2013/03/08/debating-the-merits-of-the-boom-in-merger-lawsuits/?_r=3; *see also* Phillip R. Sumpter, *Adjusting Attorneys' Fee Awards: The Delaware Court of Chancery's Answer to Incentivizing Meritorious Disclosure-Only Settlements*, 15 U. PA. J. BUS. L. 669, 673 (2013) (describing the rise in deal litigation as "meteoric").

21. *See, e.g.*, Matthew D. Cain & Steven Davidoff Solomon, Takeover Litigation in 2014 2 (Feb. 20, 2015) (unpublished manuscript), *available at* http://ssrn.com/abstract=2567902 (finding that "[f]or the fourth year in a row over 90% of transactions experienced a lawsuit"); *see also* CORNERSTONE RESEARCH, *supra* note 18, at 1 (finding similar statistics); Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2013* 2 (Ohio State Univ. Moritz Coll. of Law Pub. Law & Legal Theory Working Paper Series, No. 236, 2014), *available at* http://ssrn.com/abstract=2377001 (demonstrating that in 2013, all but two of the large mergers studied were subject to litigation).

22. Solomon, *supra* note 20. Professor Thomas posits three reasons for the increase in multijurisdictional litigation: (i) Supreme Court precedent that calls for the enforcement of a settlement in one state to bind other jurisdictions; (ii) the ability of new, small firms to bring cases without investing large amounts of resources; and (iii) other states acting more favorably by deferring more to the parties' settlement numbers. *See* Thomas, *supra* note 19, at 1935–41; *see also* Brian Cheffins et al., *Delaware Corporate Litigation and the Fragmentation of the Plaintiffs' Bar*, 2012 COLUM. BUS. L. REV. 427, 431–33 (contending that the rise in deal litigation and the fact that deals are often subject to suit in multiple jurisdictions is the result of increasing competition among plaintiffs' lawyers specializing in shareholder litigation over the past 15 years); John C. Coffee Jr., *'Loser Pays': Who Will Be the Biggest Loser?*, 252 N.Y.L.J. 5, 7 (2014) (implicitly supporting the notion that new, smaller firms are driving the rise in deal litigation by stating that deal challenges "are generally not brought by the elite plaintiff firms (i.e., the larger ones), but by their fly-by-night competitors").

23. Fisch et al., *supra* note 19, at 559–60.

the value of such frequent merger litigation.[24] In fact, Delaware judges have taken a number of steps to address the concerns of deal-litigation critics.

First, critics contend that deal litigation is brought not by concerned shareholders, but by shareholders who are little more than pawns of plaintiffs' firms.[25] Critics observe that these shareholders often hold just a few shares and, presumably, stand to gain, at most, a few dollars from any successful challenge.[26] In short, these are not truly aggrieved investors, but figurehead plaintiffs for lawyer-driven lawsuits.

Reacting to these criticisms, Delaware courts moved away from legal rules that facilitated lawyer-driven deal challenges.[27] For example, Delaware courts abandoned the first-to-file approach to appointing a lead plaintiff (and thus lead counsel), instead announcing a number of factors to consider in appointing the lead plaintiff, including, among other things, the economic stake of the plaintiffs, the absence of any conflicts, and the competence of counsel.[28] Moreover, there is at least one example of a Delaware judge invoking Delaware Rule 23's typicality requirement to conduct a more searching inquiry into whether the shareholder plaintiff has actual, legitimate gripes, such that the shareholder was "typical" of the investor class.[29]

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24. *See, e.g.*, Dias v. Purches, No. 7199VCG, 2012 WL 4503174, at *5 (Del. Ch. Oct. 1, 2012) (stating that after a merger announcement, litigation "typically follow[s] like mushrooms follow the rain" and disclosure-only settlements "obviously create[] a risk of excessive merger litigation, where the costs to stockholders exceed the benefits"); *In re* Cox Commc'ns S'holders Litig., 879 A.2d 604, 605–06 (Del. Ch. 2005) (characterizing disclosure-only settlements as "non-meritorious, premature suits attacking negotiable, going-private proposals" in which plaintiffs' lawyers win "sizable fees . . . by settling at the same level that the special committee achieved").

25. *See, e.g.*, Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1822, 1855–56 (2004) (examining 104 merger class actions filed in Delaware between 1999 and 2001 and finding that merger litigation is lawyer driven, often lacking "real" plaintiffs).

26. *See, e.g.*, Solomon, *supra* note 20.

27. *See, e.g.*, John Armour et al., *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1380 (2012) (observing, among other things, that Delaware courts have retreated from the first-to-file custom in choosing lead counsel and that this has caused litigators to file cases outside of Delaware); Cheffins et al., *supra* note 22, at 482–84 (documenting Delaware's "de-emphasis of first-to-file as an ordering principle").

28. *See, e.g.*, Hirt v. U.S. Timberlands Serv. Co., No. CIV. A. 19575, 2002 WL 1558342, at *2 (Del. Ch. July 3, 2002); TCW Tech. Ltd. P'ship v. Intermedia Commc'ns, Inc., No. 18336, 2000 WL 1654504, at *4 (Del. Ch. Oct. 17, 2000); *see also* David H. Webber, *Private Policing of Mergers and Acquisitions: An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions*, 38 DEL. J. CORP. L. 907, 916 (2014) (finding that "the 'great weight' accorded to the relative economic stakes of the contestants has ushered in a period of substantial participation of institutional-investor lead plaintiffs in Delaware, in some ways paralleling the increased participation of these investors in federal securities fraud class actions").

29. *See In re* Transatlantic Holdings Inc. S'holders Litig., C.A. No. 6574-CS, 2013 WL 1191738,

Second, critics argue that plaintiffs' lawyers bring deal challenges in several jurisdictions, which wastes everyone's time and money and benefits only the plaintiffs' lawyer.[30] Multijurisdictional deal litigation is possible because of the nature of the legal claim and the corporate defendant. Shareholder litigation is, by its nature, representative. In other words, a shareholder sues on behalf of a class of shareholders (shareholder class actions) or on behalf of the company (shareholder derivative litigation). In representative litigation, more than one shareholder can claim to represent the company or shareholders, and thus more than one shareholder can sue.[31] Additionally, defendants in deal litigation are always corporate entities. When suing a corporation, shareholders can bring claims in any forum that has jurisdiction over that corporation, usually the state in which the company is incorporated and in which the company keeps its principal place of business.[32] Thus, identical deal challenges are often filed, not just in Delaware, but other states as well.[33] But the waste, inefficiencies, and dangers of inconsistent outcomes attendant with litigating the same suit in multiple places are obvious.[34]

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at *2–3 (Del. Ch. Mar. 8, 2013) (refusing to grant a joint motion to approve a disclosure-only settlement for attorneys' fees because the settlement "achieved nothing substantial for the class" and the plaintiffs, one of whom held only two shares and the other who did not vote on the merger, were not proper representatives of the class). Litigators have pointed to *Transatlantic* as solid precedent through which to challenge the adequacy and typicality of class representatives in Delaware. *See, e.g.*, Dwight W. Stone II et al., *Dealing with the Inevitable: Practical Considerations in Defending Merger Objection Lawsuits*, DRI: FOR THE DEFENSE, Oct. 2013, at 56.

30. *See, e.g.*, John C. Coffee, Jr., *Foreword: The Delaware Court of Chancery: Change, Continuity—and Competition*, 2012 COLUM. BUS. L. REV. 387, 388 (noting the increase in multijurisdictional deal litigation); Fisch et al., *supra* note 19, at 605 (same); Minor Myers, *Fixing Multi-Forum Shareholder Litigation*, 2014 U. ILL. L. REV. 467, 469 (same); Donald F. Parsons, Jr. & Jason S. Tyler, *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, 70 WASH. & LEE L. REV. 473, 506 (2013) (same); Thomas, *supra* note 19, at 1926, 1934 (same).

31. *See* Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multijurisdictional Litigation*, 106 NW. U. L. REV. 1753, 1768 (2012) ("[T]here is more than one possible representative for a shareholder group and [plaintiffs' firms] likely will be competing with other plaintiffs' firms to become the lead lawyer.").

32. *See, e.g.*, Hertz Corp. v. Friend, 559 U.S. 77, 85, 93 (2010) (holding that a corporation is a citizen of the state in which it is incorporated and houses its "nerve center").

33. Armour et al., *supra* note 27, at 1358 ("[W]hile it used to be common for suits in cases arising from large M&A transactions to be filed *only* in Delaware, this has become rare."); John Armour et al., *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605, 605 (2012) (documenting a trend in which legal challenges to large mergers and acquisitions as well as leveraged buy-outs are filed outside Delaware and in multiple jurisdictions); Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 476 (2015) (finding that in 2011, there was a mean of about 5 lawsuits per deal, more than half of them being multi-state claims).

34. *See, e.g.*, *In re* Allion Healthcare Inc. S'holders Litig., No. 5022-CC, 2011 WL 1135016, at *4 (Del. Ch. Mar. 29, 2011) (stating that duplicating litigation risks "the possibility that two judges

In response, Delaware courts upheld intra-corporate forum-selection bylaws, which allow companies to adopt charter provisions selecting an exclusive forum for intra-entity disputes.[35] In *In re Revlon, Inc. Shareholders Litigation*,[36] Vice Chancellor Laster suggested that companies could adopt these provisions, but said that the issue had to await resolution in the proper case. The proper case presented itself in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,[37] where then-Chancellor (now Chief Justice) Leo E. Strine upheld the facial validity of bylaws requiring that intra-corporate disputes be litigated exclusively in Delaware courts. Since *Boilermakers*, courts across the country have adopted this position[38] and extended its holding to uphold as facially valid forum-selection bylaws that select venues other than Delaware.[39] After *Boilermakers*, private and publicly-traded firms, both in and out of Delaware, rushed to adopt exclusive-forum bylaws.[40] The effect of this judicial counter has been significant. Initial filing numbers suggest that

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would apply the law differently or otherwise reach different outcomes"); Settlement Hearing and Rulings of the Court at 54, *In re* Burlington N. Santa Fe S'holder Litig., C.A. No. 5043-VCL (Del. Ch. Oct. 28, 2010) (recognizing that duplicative litigation presents "a conflict between individual rationality, where plaintiffs logically benefit from filing multiple actions, and group rationality, where efficiency calls for a single forum"); *see also* Armour et al., *Delaware's Balancing Act*, *supra* note 27, at 1368–69 (recognizing that duplicative litigation may invite forum shopping to, among other things, maximize a fee award or avoid scrutiny of a proposed settlement); Edward B. Micheletti & Jenness E. Parker, *Multi-Jurisdictional Litigation: Who Caused This Problem, and Can It Be Fixed?*, 37 DEL. J. CORP. L. 1, 12 (2012) (recognizing that duplicative litigation increases costs for defendants, forcing them to "consider settling deal litigation that . . . defendants might otherwise have moved to dismiss").

35. *See, e.g.*, Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751, 757 (2015) ("Exclusive forum bylaws are intended to help Delaware corporations address forum shopping and the related phenomenon of plaintiffs' attorneys filing lawsuits arising out of the same facts in multiple jurisdictions, often with a view toward obtaining attorneys' fees.").

36. 990 A.2d 940, 960 & n.8 (Del. Ch. 2010).

37. 73 A.3d 934, 963 (Del. Ch. 2013).

38. *See, e.g.*, North v. McNamara, 47 F. Supp. 3d 635, 644 (S.D. Ohio 2014); Groen v. Safeway Inc., No. RG14716641, 2014 WL 3405752, at *2 (Cal. Super. Ct. May 14, 2014) (trial order); Hemg Inc. v. Aspen Univ., No. 650457/13, 2013 WL 5958388, at *3 (N.Y. Sup. Ct. Nov. 4, 2013) (same).

39. *See, e.g.*, City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 235 (Del. Ch. 2014) (upholding a forum-selection bylaw that designated North Carolina as the exclusive forum for intra-corporate disputes).

40. *See, e.g.*, Allen, *supra* note 35, at 760 n.47 ("Following *Boilermakers*, public companies once again began to adopt exclusive forum bylaws, with 105 Delaware corporations and 30 non-Delaware corporations and trusts adopting exclusive forum bylaws between June 25 and October 31, 2013."); Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 326 (2013) (observing that "[t]hree hundred publicly traded entities have adopted [intra-corporate forum selection] provisions as of September 30, 2012"); *see also* CLAUDIA H. ALLEN, TRENDS IN EXCLUSIVE FORUM BYLAWS (2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2411715&download=yes (summarizing Delaware and non-Delaware companies with forum-selection bylaws).

after *Boilermakers* and its progeny, multi-state litigation has trended downward.[41]

Third, critics contend that settlements in deal cases yield little to no value for investors. Deal litigation settles for money, an amendment to the terms of the deal, an increase in consideration, supplemental disclosures in the proxy statement, or some combination of those.[42] In most deal litigation, the litigation settles before the deal closes,[43] and most often, companies settle by agreeing to make additional disclosures about the terms of the deal.[44]

Troubling critics is the fact that, in most deal litigation, the lawyers receive fees while investors receive additional disclosures that just do not seem to matter to the deal.[45] To be sure, supplemental disclosures can

41. Cain & Solomon, Takeover Litigation in 2014, *supra* note 21, at 2–3 (finding that in 2012, multi-state claims were 52.7%; in 2013, multi-state claims were 41.8%; and in 2014, multi-state claims were 33.8%, and stating that the decrease "may be due to the effectiveness and increasing use of forum selection by-laws, but remains to be explored further").

42. *See, e.g.*, Fisch et al., *supra* note 19, at 566 (describing the types of recovery for the plaintiff class, including monetary recovery, amendments to the merger agreement, and supplemental disclosures in the form of additional information in the merger proxy statement); *see also* Cain & Solomon, *supra* note 33, at 478 (same).

43. *See, e.g.*, CORNERSTONE RESEARCH, *supra* note 18, at 4 ("As in prior years, litigation for the majority of deals [in 2013] was resolved before the deal was closed—75 percent of 2013 deals. . . . Of the 2013 deals resolved before the deal closed, 88 percent were settled, 9 percent withdrawn by plaintiffs, and 3 percent dismissed by courts."); Fisch et al., *supra* note 19, at 566 ("Empirical studies confirm . . . incentives [for defendants to resolve merger challenges before the deal closes], finding that nearly 70% of merger claims settle while the rest are dismissed.").

44. *See, e.g.*, CORNERSTONE RESEARCH, SETTLEMENTS OF SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2013 M&A LITIGATION 1 (2014), *available at* https://www.cornerstone.com/GetAttachment/7bd80347-124b-4b69-add5-575e33c3f61b/Settlements-of-M-and-A-Shareholder-Litigation.pdf ("Settlements for additional disclosures, or additional disclosures plus other terms, remained prevalent. Nearly 92 percent of settlements reached in 2013 included such deal terms."); Cain & Solomon, *supra* note 33, at 478 (stating that settlements requiring only disclosure of additional information are the "most common type of settlement"); Fisch et al., *supra* note 19, at 572 (footnote omitted) ("[P]laintiffs negotiate, and courts approve, corrective disclosure in more than 60% of all transactions. It is implausible to think that 60% of all mergers (or 80% in the last several years) with public company targets and a transaction value of more than $100 million, deals that are staffed by top quality lawyers and investment bankers, involve materially deficient disclosures.").

45. *See, e.g.*, Settlement Hearing at 21, Masucci v. Fibernet Telecom Grp., C.A. No. 4680-VCS (Del. Ch. Nov. 25, 2009) ("[T]here seems to be a repeated pattern of essentially hidden hope disclosure claims, where we're going to nitpick disclosures which, frankly, if you compare the quality and substance of the disclosures that are given today to those given even ten years ago, there's no comparison."); *see also* Thomas, *supra* note 19, at 1934 (quoting Vice Chancellor Laster as saying "[t]he increase in disclosure-only settlements is troubling. Disclosure claims can be settled cheaply and easily, creating a cycle of supplementation that confers minimal, if any, benefits on the class"); Steven Davidoff Solomon, *Corporate Takeover? In 2013, A Lawsuit Almost Always Followed*, N.Y. TIMES (Jan. 10, 2014, 12:20 PM), http://dealbook.nytimes.com/2014/01/10/corporate-takeover-in-2013-a-lawsuit-almost-always-followed/?_r=0 ("[D]isclosure-only settlements have been criticized for being

provide meaningful information, such as revealing that managers are genuinely conflicted with respect to the transaction.[46] But the criticism is that most of these supplemental disclosures are not beneficial to investors. For one thing, disclosing information already contained in the proxy, correcting typographical errors, or adding useless or otherwise immaterial details are just a few examples of suggested disclosures used to extract attorneys' fees.[47] Further, a regression analysis of disclosure-only settlements by Professors Fisch, Griffith, and Solomon has found no consistent relationship between supplemental disclosures and shareholder voting on the deal, and they rightly observe, "if the disclosure does not affect the shareholder vote, it is difficult to see how shareholders benefit from it."[48] They go on to summarize their findings, and, bottom line, "[t]he benefit produced by disclosure-only settlements is anything but substantial. Indeed, it would be closer to the truth to say that it is imaginary."[49] If the shareholders are not receiving money or material disclosures, what do they gain?[50]

What is most problematic, critics say, is that defendants are motivated to settle these lawsuits quickly lest the deal be upended.[51] Plaintiffs can

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'cheap' settlements that benefit only plaintiffs' lawyers and only further encourage litigation without merit.").

46. *See* Tandycrafts, Inc. v. Initio Partners, 562 A.2d 1162, 1165 (Del. 1989) ("[A] heightened level of corporate disclosure, if attributable to the filing of a meritorious suit, may justify an award of counsel fees.").

47. *See, e.g.*, *In re* Sauer-Danfoss Inc. S'holders Litig., 65 A.3d 1116, 1136 (Del. Ch. 2011) ("All supplemental disclosures are not equal."); *In re* BEA Sys., Inc. S'holders Litig., C.A. No. 3298-VCL, 2009 WL 1931641, at *1 (Del. Ch. June 24, 2009) (noting that supplemental disclosures that consisted of correcting an analyst's name and a press-release date were "unmistakably modest").

48. Fisch et al., *supra* note 19, at 588–89.

49. *Id.* at 601.

50. Proponents respond that shareholder litigation, even if it does achieve just meager additional disclosures, is worthwhile for several reasons. First, deal litigation has resulted in a "marked improvement" in disclosure generally, and now, all companies withhold or later disclose tangential information. *See* Sumpter, *supra* note 20, at 686–88. Second, deal litigation and resulting settlement enables buyers of companies to obtain valuable releases that accompany settlement, meaning they do not have to worry about new claims popping up from shareholders. *See* Sean J. Griffith & Alexandra D. Lahav, *The Market for Preclusion in Merger Litigation*, 66 VAND. L. REV. 1053, 1057–59, 1075–86 (2013). Third, even the rare frivolous lawsuit is acceptable in the grand scheme of things as it funds the war chests of private attorneys general to pursue other, actual frauds or breaches of fiduciary duties. *See* Solomon, *supra* note 20.

51. *See, e.g.*, Coffee, Jr., *supra* note 30, at 392 (stating that deal litigation is likely to settle because "target management (and the bidder as well) are under time pressure to close a deal"); Fisch et al., *supra* note 19, at 565 ("Plaintiffs in merger litigation typically ask for equitable relief—most often in the form of an injunction barring consummation of the transaction or requiring a substantial revision of its terms, such as a higher price."); Steven M. Haas, *Little Deals, Big Fees? Addressing Attorneys' Fee Awards in Small-Cap M&A Litigation*, 17 M&A LAW. 3, 6 (2013) (explaining that "'[d]eal litigation' [is] expensive because it typically proceeds on an expedited basis, involves electronic

make a settlement palatable—even attractive—by seeking superficial changes to the deal, requesting reasonable fees,[52] and agreeing to broad releases of liability.[53] A settlement seeking only cosmetic changes is easy to swallow for defendants who are eager to consummate the deal, aware that insurance typically foots the bill for plaintiffs' attorneys' fees, and receptive to the benefits provided by a broad release of liability.[54] Parties to the dispute then present the settlement jointly to the court. With no red flags to pique a judge's interest, a court will have to raise objections on its own, something that it is unlikely to do.[55]

To counter this dynamic and to ensure that settlements in deal cases actually provide something for investors and not just their lawyers, Delaware courts have more closely scrutinized settlements—outright rejecting them if the disclosures did not materially change the total mix of

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discovery and depositions of directors, officers, and financial advisors and requires the defendants to defend against a motion for a preliminary injunction or a temporary restraining order").

52. From 2005 to 2013, the mean attorneys' fees for disclosure-only settlements ranged from about $400,000 on the low end to about $1.1 million on the high end. Cain & Davidoff, *Takeover Litigation in 2013*, *supra* note 21, at 4. Fees for 2014 observed a slight uptick with the mean attorneys' fee going from $489,000 in 2013, to $531,000 in 2014. Cain & Solomon, Takeover Litigation in 2014, *supra* note 21, at 3–4. Nevertheless, attorneys' fees do not appear so high that they will derail a $500-million deal.

53. *See, e.g.*, Stone, *supra* note 29, at 61 ("Fortunately for defendants that wish to reach an early settlement, the plaintiffs' bar agrees! Parties can often meet this goal by entering into a[] [Memorandum of Understanding] that outlines fair, reasonable, and adequate supplemental disclosures in exchange for a sufficiently broad release of liability for defendants."); Sumpter, *supra* note 20, at 681–82 (explaining that defendants are motivated to settle deal challenges "since they can . . . obtain a broad release of all potential deal-related claims").

54. *See, e.g.*, Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 16–18, 25–26 (2015) (explaining that defendants are attracted to broad releases from liability they can obtain cheaply in a disclosure-only settlement); *see generally* Doug Clark, *Why Merger Cases Settle*, BOARDMEMBER.COM (June 6, 2013), https://www.wsgr.com/publications/PDFsearch/clark-0613.pdf (outlining why companies settle deal challenges even if the challenge is meritless); Anthony Tatum, *Securing D&O For Attorneys' Fees in Securities Cases*, LAW360 (May 28, 2013, 11:57 AM), http://www.law360.com/articles/444555/securing-d-o-for-attorneys-fees-in-securities-cases, *archived at* http://perma.cc/PHU3-KBT6 (explaining that D&O insurance often covers attorneys' fees in deal litigation).

55. *See* Fisch et al., *supra* note 19, at 569 (recognizing that a court's task in reviewing and approving disclosure-only settlements in deal litigation is complicated by the fact that "the settlement hearing is likely to be nonadversarial in nature"); Griffith, *supra* note 54, at 20–21 (explaining that judges are loathe to determine a settlement has no value because doing so may "condemn the defendant to further rounds of non-meritorious litigation that may ultimately cost the defendant more than the settlement itself"); Christopher R. Leslie, *A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation*, 49 UCLA L. REV. 991, 1053 (2002) (footnote omitted) ("Despite their authority to reject settlements and the inherent problems of coupon-based settlements in class action litigation, courts routinely approve such settlements. This is not surprising given that for many class action settlements, court approval is a mere formality. For a variety of systemic and case-specific reasons, courts are loathe to reject proposed settlements in class action litigation.").

information available to stockholders.[56] Even when Delaware courts are not rejecting settlements outright, they have cut fees where the benefit achieved only minimal value for investors.[57] According to some scholars, Delaware courts started this trend in 2001, gradually conducting a more incisive inquiry into whether the settlement produced any benefit for shareholders.[58]

This is not to criticize Delaware courts as unthinking or reactionary. To the contrary, these developments have been gradual, measured responses to specific threats. Nevertheless, it is easy to lump these responses under a broad umbrella of hostility to shareholder litigation generally. And once that level of abstraction is reached, given the Delaware judiciary's

56. *See, e.g.*, Settlement Hearing and the Court's Ruling, *In re* Medicis Pharm. Corp. S'holders Litig., No. 7857-CS (Del. Ch. Feb. 26, 2014), 2014 WL 1614336 (rejecting settlement to deal challenge that provided for supplemental disclosure and $400,000 in attorneys' fees because the disclosures did not "materially change[] the informational mix"); *In re* Transatlantic Holdings Inc. S'holders Litig., C.A. No. 6574-CS, 2013 WL 1191738, at *2–3 (Del. Ch. Mar. 8, 2013) (rejecting settlement to deal challenge that provided for supplemental disclosure and attorneys' fees because the court had serious doubts about the usefulness of the agreed-upon disclosures).

57. *See* Sumpter, *supra* note 20, at 714–15, 729 (surveying court scrutiny of disclosure-only settlements and finding that the Delaware Court of Chancery "is not approving disclosure-only settlements without first looking closely at the plaintiff's counsel's fee award. . . . [and] adjust[ing] its award of attorneys' fees to either encourage or discourage similar future litigation" and is likely to reduce attorneys' fees where disclosures are too meager, claims are weak at the outset, the plaintiffs' claimed work was inflated, or the case settled early).

58. *See, e.g.*, Armour et al., *supra* note 33, at 643–44; *see also* Settlement Hearing & Rulings of the Court at 11–18, *In re* The Talbots, Inc. S'holders Litig., C.A. No. 7513-CS (Del. Ch. Dec. 16, 2013) (stating that attorneys' fees do not automatically start with $400,000 or $500,000 for disclosure-only settlements and then awarding attorneys $237,000 in fees); Hearing on Plaintiffs' Application for Award of Attorneys' Fees and Expenses & Rulings of the Court at 11, 60, *In re* Complete Genomics, Inc. S'holder Litig., C.A. No. 7888-VCL (Del. Ch. Oct. 2, 2013) (denying request for $1.4 million in fees and awarding $315,000 instead); Settlement Hearing & Rulings of the Court at 47–49, *In re* Gen-Probe Inc., S'holders Litig., No. 7495-VCL (Del. Ch. Apr. 10, 2013) (denying request for $450,000 in fees and awarding $100,000 instead); Settlement Hearing at 39, *In re* Craftmade Int'l, Inc., S'holders Litig., C.A. No. 6950-VCL (Del. Ch. Jan. 10, 2013) (denying request for attorneys' fees and awarding $650,000 instead); Settlement Hearing at 55, *In re* Access to Money, Inc. S'holders Litig., C.A. No. 6816-VCN (Del. Ch. May 31, 2012) (denying request for $400,000 in fees and awarding $275,000 instead); Final Order & Judgment, *In re* Icagen, Inc. S'holders Litig., No. 6692-CS (Del. Ch. Apr. 5, 2012), 2012 WL 1144994 (denying request for $1.25 million in fees and awarding $350,000 instead); Order & Final Judgment, *In re* Inspire Pharm. Inc. S'holders Litig., No. 6378-VCP, 2012 WL 275115 (Del. Ch. Jan. 30, 2012) (trial order) (refusing to award $500,000 in requested attorneys' fees and awarding $300,000 instead because benefits of disclosures were relatively meager); Settlement Hearing at 36, Roffe v. Eagle Rock Energy GP, L.P., No. 5258-VCL (Del. Ch. Oct. 28, 2010) (refusing to award $535,000 in requested attorneys' fees and awarding $200,000 instead because the disclosures were otherwise unimpressive); Settlement Hearing & Rulings of the Court at 63, Jeffrey Benison IRA v. Critical Therapeutics, Inc., C.A. No. 4039-VCL (Del. Ch. Feb. 26, 2009) (denying request for $450,000 in attorneys' fees and awarding $175,000 instead); *In re* Nat'l City Corp. S'holders Litig., No. 4123-CC, 2009 WL 2425389, at *6 (Del. Ch. July 31, 2009) (refusing to award $1.2 million in requested attorneys' fees and awarding $400,000 instead because the disclosures were too "meager" to be included on the company's proxy statement).

criticism of deal litigation, it is easy to see why many read *ATP* as a sign that Delaware was working to further stymy deal litigation. Thus, commentators have interpreted *ATP* as encouragement for public companies to adopt similar fee-shifting bylaws.[59] In fact, after *ATP*, several (mostly small-cap) companies adopted bylaws that purport to shift litigation expenses in shareholder and securities lawsuits.[60] Similar to the broad bylaws upheld in *ATP*, these bylaws do not simply require plaintiffs to pay legal expenses if they lose, but they target a broad range of actors and require them to pay all costs if they do not "substantially achieve[], in substance and amount, the full remedy sought."[61]

Institutional investors warn that *ATP* poses a serious threat to investors' ability to sue. They wrote letters to Delaware's governor, the chair of the Delaware Bar Association's Section of Corporate Law, and several others.[62] They said that fee-shifting bylaws would "foreclos[e] stockholders' access to courts" and "effectively make corporate directors and officers unaccountable for serious wrongdoing."[63] Moreover, in another correspondence, the investors said that "[i]f corporations adopt fee-shifting bylaws in large numbers, the judiciary will be relegated to the sidelines."[64] The upshot, institutional investors claim, is that *ATP*'s

59. *See, e.g.*, Anthony J. Rospert & Thomas M. Ritzert, *Limiting Shareholder Suits in Mergers & Acquisitions: Potential Corporate Governance Solutions*, THE DEAL (Dec. 11, 2014), http://www.thompsonhine.com/uploads/1137/doc/Thompson_Hine_Article_2LimitingShareholder_FINAL.pdf ("The Delaware Supreme Court's recent opinion in ATP Tour, Inc. v. Deutscher Tennis Bund, though issued in the context of a fee-shifting provision adopted by a non-stock corporation, suggests that this may be a viable approach for public companies seeking to curb merger objection litigation.").

60. *See, e.g.*, Lee Rudy, *Litigation Bylaws*, CII (Nov. 19, 2014), http://www.cii.org/files/issues_and_advocacy/legal_issues/Litigation%20Bylaws.pdf (listing 42 companies that adopted fee-shifting bylaws as of November 2014); J. Robert Brown Jr., *Fee Shifting Bylaws and the Reaction of Institutional Investors (Part 1)*, THERACETOTHEBOTTOM.ORG (Dec. 11, 2014, 6:00 AM), http://www.theracetothebottom.org/home/2014/12/11/fee-shifting-bylaws-and-the-reaction-of-institutional-invest.html (reporting similarly that after *ATP*, "the number of companies adopting [fee-shifting bylaws] proliferated"). Notably, however, no large cap companies have adopted fee-shifting bylaws. Claudia H. Allen, *Fee-Shifting Bylaws: Where Are We Now?*, BLOOMBERG LAW (Feb. 2, 2015), http://www.bna.com/feeshifting-bylaws-n17179922685/.

61. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 556 (Del. 2014); *see also* Coffee, *supra* note 22, at 5–7.

62. *See, e.g.*, Brown, *supra* note 60.

63. Letter from Institutional Investors to the Honorable Jack Markell, Governor (Nov. 24, 2014), *available at* http://www.law.du.edu/documents/corporate-governance/legislation/letters-2014/Letter-to-The-Honorable-Jack-Markell-Office-of-the-Governor-from-Institutional-Investors-Re-Fee-Shifting-Bylaws-Nov-24-2014.pdf.

64. Letter from Institutional Investors to Robert McCormick, Chief Policy Officer, Glass, Lewis & Co., LLC (Nov. 24, 2014), *available at* http://www.law.du.edu/documents/corporate-governance/legislation/letters-2014/Letter-to-Robert-McCormick-Chief-Policy-Officer-Glass-Lewis-Company-LLC-from-Institutional-Investors-Re-Fee-Shifting-Bylaws-Nov-24-2014.pdf.

consequences would be "severe and detrimental to the integrity of the capital markets."[65]

Shortly after *ATP*, the Delaware Corporate Council proposed a statute that would forbid any charter or bylaw of a Delaware stock company from imposing monetary liability, or responsibility for any debts of the company, on any corporate stockholder.[66] But by June 2015, the Delaware legislature postponed any action, sending the matter back to the Delaware Bar to examine the issue.[67] The Delaware Bar then proposed legislation that would prohibit Delaware companies from adopting, in the certificate of incorporation or bylaws, any provision that "impose[s] liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an intracorporate claim."[68] In June 2015, the Delaware legislature adopted that approach to fee-shifting bylaws, while also refusing to render forum-selection bylaws facially invalid.[69]

III. UNDERSTANDING *ATP* AS PART OF THE DELAWARE WAY

ATP, however, was not a shareholder or deal case at all, and it is not part of the Delaware judiciary's response to the explosion of deal litigation. Rather, it represents the Delaware Supreme Court's commitment to the "Delaware Way." The Delaware Way is to empower corporate boards with broad legal authority to manage the business of the company, and to check the exercise of that power through mandatory shareholder voting and review of board action under equitable principles.[70] In *ATP*, the Delaware Supreme Court held that corporate boards of non-stock companies had the legal authority to adopt fee-shifting bylaws, but

65. *Id.*

66. S. 236, 147th Gen. Assemb., Reg. Sess. (Del. 2014) (proposing to limit *ATP* to non-stock companies).

67. S.J. Res. 12, 147th Gen. Assemb., Reg. Sess. (Del. 2014).

68. *See* DEL. CORP. LAW COUNCIL, AN ACT TO AMEND TITLE 8 OF THE DELAWARE CODE RELATING TO THE GENERAL CORPORATION LAW §§ 2, 3 (2015) (proposing legislation), *available at* http://www.delawarelitigation.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-U01245103.doc.

69. DEL. CODE ANN. tit. 8, §§ 102(f), 114(b), 115 (2015).

70. *See, e.g.*, Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 675–76 (2005); *see also* Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of* Schnell v. Chris-Craft, 60 BUS. LAW. 877, 877 (2005) (defining "The Delaware Way" as "Invest[ing] Broad Legal Authority in Directors, but Subject[ing] Their Use of That Authority to Equitable Oversight"). As applied to fee shifting, to paraphrase Theodore Mirvis and William Savitt, *ATP* vests Delaware courts with the ability "to do what they have always done: to distinguish the reasonable from the unreasonable, the legitimate from the illegitimate." Theodore N. Mirvis & William Savitt, *Shifting the Focus: Let the Courts Decide*, 53 BANK & CORP. GOVERNANCE L. REP. 8, 11 (2015).

that the adoption and enforcement of those bylaws must be equitable under the circumstances.[71] This Part outlines the Delaware Way of corporate governance and explains how *ATP* is consistent with that model.

A. The Delaware Way

Before his appointment to Delaware's Supreme Court, Chief Justice Strine explained his view of the Delaware Way.[72] It consists of two features: a broad grant of legal authority to corporate boards, but curtailing that broad grant of legal authority by protecting fundamental shareholder rights and policing managerial abuse with equitable principles, such as the fiduciary duties of care, good faith, and loyalty.[73]

First, Delaware corporation law was intentionally designed to be efficient and flexible. It enables company-specific procedures and provides corporate planners flexibility to accomplish legitimate corporate ends.[74] In fact, the Delaware General Corporate Law ("DGCL") explicitly accepts the notion that shareholders may delegate to the board of directors legal authority to manage the corporation, providing that a corporation's "business and affairs . . . shall be managed by or under the direction of a board of directors,"[75] and bylaws can regulate anything "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."[76] Delaware courts reinforce this structure, presuming that director actions in accordance with the corporation's business judgment will be left undisturbed.[77]

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71. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014).

72. *See* Strine, *The Delaware Way*, *supra* note 70, at 674–79.

73. *Id.* at 674–77, 686 ("[Delaware does] not tie down all boards with a prescriptive set of procedural mandates. We do not create a thousand boxes to check. Instead, we give managers broad flexibility to chart the course that they believe is best for their corporations, using the stockholder franchise and the potency of fiduciary duty review to ensure managerial fidelity.").

74. *Id.* at 674–75; *see also* Strine, *If Corporate Action is Lawful*, *supra* note 70, at 879.

75. DEL. CODE ANN. tit. 8, § 141(a) (2015); *see also* Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (citing DEL. CODE ANN. tit. 8, § 141(a)) ("A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation."), *overruled by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

76. DEL. CODE ANN. tit. 8, § 109(b) (2015).

77. *See, e.g.*, *Aronson*, 473 A.2d at 812 (stating that the business judgment rule acknowledges "the managerial prerogatives of Delaware directors under Section 141(a)" by presuming that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company," and thus, "[a]bsent an abuse of discretion, that judgment will be respected by the courts").

In essence, the DGCL is enabling, providing managers "an enormous amount of leeway to act."[78] This flexible design was intended to benefit not just the interests of corporate managers, but also to give stockholders the freedom to construct charter and bylaw provisions that address company-specific needs.[79] This principle has been echoed by the Delaware courts.[80]

Second, Delaware also recognizes that managers can use their broad power for inimical ends or purposes that may align with managers' but not shareholders' interests. Therefore, Delaware overlays two mechanisms to safeguard against abuse: shareholders' fundamental rights and equitable review.[81] This means that, even if the board of directors has the common-

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78. Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 501 (2002); *see also id.* at 501 ("[The DGCL] is broadly enabling, and thus permits corporations to engage in virtually any otherwise lawful act, subject generally only to the requirement that the acts be accomplished in the manner specified by the statute."); Jill E. Fisch, *Leave It to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 DEL. J. CORP. L. 731, 742 (2013) ("Delaware's corporate law is largely enabling rather than mandatory."); Strine, *If Corporate Action Is Lawful*, *supra* note 70, at 879 ("[The DGCL] is an enabling statute that provides corporate directors with capacious authority to pursue business advantage by a wide variety of means."); Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1257, 1260 (2001) (describing the "Delaware Model" as "largely enabling and provid[ing] a wide realm for private ordering").

79. Strine, *The Delaware Way*, *supra* note 70, at 675.

80. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985) ("[O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs. Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited."); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1351 (Del. 1985) (quoting *Unocal*'s language); *see also* Shintom Co. v. Audiovox Corp., 888 A.2d 225, 227 (Del. 2005) ("The Delaware General Corporation Law is an enabling statute that provides great flexibility for creating the capital structure of a Delaware corporation."); Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 939 (Del. 2003) (Veasey, C.J., dissenting) ("The beauty of the Delaware corporation law, and the reason it has worked so well for stockholders, directors and officers, is that the framework is based on an enabling statute with the Court of Chancery and the Supreme Court applying principles of fiduciary duty in a common law mode on a case-by-case basis.").

81. *See, e.g.*, Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1988) ("In discharging this function [of governance], the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders."); Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 633 (2010) ("[The DGCL] is broadly enabling, in the sense that it gives directors capacious authority to undertake lawful actions of various kinds in the pursuit of profit, subject to two important constraints: (1) a discrete set of mandatory statutory rules, such as requirements for director elections and stockholder votes and (2) the requirement that director actions authorized by law be undertaken in conformity with equity."); Strine, *Delaware's Corporate-Law System*, *supra* note 78, at 1260 ("[T]he Delaware Model is premised on a statute, that statute provides corporate boards with a substantial amount of leeway to govern their corporations as they see fit. Aside from the corporate electoral process mandated by the Delaware statute, the ultimate protection provided to investors by Delaware law is the guarantee that its courts will hold directors responsible for living up to their fundamental fiduciary duties of care and loyalty.");

law, contractual authority to exercise its business judgment, the Delaware courts will enjoin board action where it interferes with the fundamental rights of shareholders or where it is inequitable under the circumstances.

In terms of fundamental rights, Delaware gives shareholders the power to vote, sell, and sue.[82] Indeed, Delaware law explicitly demands that stockholders meet once a year to exercise their right to vote, and subjects certain transactions to stockholder approval.[83]

In addition, Delaware polices managerial abuse with courts of equity.[84] As Chief Justice Strine explained, the Delaware legislature made a policy choice to deploy Delaware courts "to guarantee the integrity of our corporate law through the articulation of common law principles of equitable behavior for [our] corporate fiduciaries."[85] In this sense,

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Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1782–83 (2006) (noting that "the DGCL establishes default rules on central matters, such as economic rights and voting rights of stock," but also that these rules "can be changed by private agreement almost without limit," except to the extent that they "alter fundamental aspects of the system, such as judicial enforcement of fiduciary duties or the allocation of control as between directors and stockholders").

82. *See* DEL. CODE ANN. tit. 8, § 211(b) (establishing stockholder right to vote to elect directors); *id.* § 242(b)(2) (entitling stockholders to vote on charter amendments); *id.* § 251(c) (requiring stockholder vote for merger); *id.* § 271(a) (requiring stockholder vote for sale of "all or substantially all" of company's assets); *id.* § 327 (creating stockholder's right to initiate a lawsuit on behalf of a corporation); *see also* Strougo v. Hollander, 111 A.3d 590, 595 n.21 (Del. Ch. 2015) ("Modern corporate law recognizes that stockholders have three fundamental, substantive rights: to vote, to sell, and to sue.").

83. *See, e.g.*, Strine, *The Delaware Way*, *supra* note 70, at 675–76.

84. *See, e.g.*, Sample v. Morgan, 914 A.2d 647, 664 (Del. Ch. 2007) ("An essential aspect of our form of corporate law is the balance between law (in the form of statute and contract, including the contracts governing the internal affairs of corporations, such as charters and bylaws) and equity (in the form of concepts of fiduciary duty). Stockholders can entrust directors with broad legal authority precisely because they know that that authority must be exercised consistently with equitable principles of fiduciary duty."); Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1078 (Del. Ch. 2004) ("The DGCL is intentionally designed to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation. That capacious grant of power is policed in large part by the common law of equity, in the form of fiduciary duty principles."); Strine, *The Delaware Way*, *supra* note 70, at 676; *see also* Strine, *If Corporate Action Is Lawful*, *supra* note 70, at 880 (stating that Delaware uses a court of equity "to ensure that corporate directors do not use the wide authority granted to them by statute for ends that are inimical to the best interests of the corporations they serve"); Strine, *The Inescapably Empirical Foundation*, *supra* note 78, at 501 ("Delaware's enabling statute is premised on its use within a system of corporate law that uses the common law of fiduciary duties as an additional restraint on director action.").

85. Strine, *If Corporate Action Is Lawful*, *supra* note 70, at 879; *see also* William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1289 (2001) (footnote omitted) ("Over the course of the twentieth century, the mandatory features of the statutory law gradually decreased. Statutes became increasingly elegant and flexible, continuously moving away from a mandatory or prescriptive model and ever closer to a pure contractual or enabling model. As a consequence, what emerged as a counterpoint to the evolution of the enabling model of corporation law was the second key function of the law of corporations: the *ex*

equitable principles of fiduciary duty overlay and constrain the statutory powers of directors.[86]

The Delaware Way, Chief Justice Strine says, is perfectly captured by *Schnell v. Chris-Craft Industries, Inc.*,[87] where the Delaware Supreme Court "emphatically rejected the proposition that compliance with the DGCL was all that was required of directors to satisfy their obligations to the corporation and its stockholders."[88] *Schnell* plainly articulated the separate roles of law and equity when it stated, "inequitable action does not become permissible simply because it is legally possible."[89] Per Chief Justice Strine, under the Delaware Way, when a judge in equity is confronted with corporate action alleged to be dangerous to shareholders, that judge must ask two questions: "(1) is that action authorized by statute and by the corporation's governing instruments? and (2) if so, is it equitable in the circumstances? These are separate inquiries."[90]

B. ATP *as Part of the Delaware Way*

In *ATP*, the Delaware Supreme Court upheld the facial validity of a bylaw that demanded that members of a non-stock company pay the company's litigation costs where that member brings an unsuccessful intracorporate lawsuit.[91] *ATP* came to the Delaware Supreme Court on certified questions of law.[92] In the course of answering the district court's

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post judicial review of the actions of corporate officers and directors, measured by fiduciary principles.").

86. *See* Lawrence A. Hamermesh, *Consent in Corporate Law*, 70 BUS. LAW. 161, 171 (2014) ("[I]t is a fundamental premise of Delaware corporate law that the governing statute is broadly enabling and confers enormous and essentially exclusive managerial powers on the board of directors—BUT—subject at all times to the potential for oversight by the courts to police inequitable use of those powers."); Strine, *If Corporate Action Is Lawful*, *supra* note 70, at 882; Strine, *The Inescapably Empirical Foundation*, *supra* note 78, at 501 ("Delaware's enabling statute is premised on its use within a system of corporate law that uses the common law of fiduciary duties as an additional restraint on director action. This fiduciary restraint enables stockholders to benefit safely from the flexibility of the DGCL's enabling approach because the common law limits the ability of directors to abuse that flexibility for their own self-interest at the stockholders' expense.").

87. 285 A.2d 437 (Del. 1971).

88. Strine, *If Corporate Action Is Lawful*, *supra* note 70, at 881.

89. *Schnell*, 285 A.2d at 439.

90. Strine, *If Corporate Action Is Lawful*, *supra* note 70, at 880.

91. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (Del. 2014).

92. The Association of Tennis Professionals ("ATP") is a non-stock company. Its members are various tournament operators. As a condition of their membership, the tournament operators agreed to be bound by ATP's bylaws, as amended from time to time. In 2006, ATP's board of directors amended the bylaws and adopted a fee-shifting provision that required plaintiffs to bear all fees, costs, and expenses that ATP incurred in unsuccessful intra-corporate litigation. *Id.* at 555–56.

To revitalize its popularity with other sporting events, ATP reorganized its professional tennis circuit. Under this reorganization, two tournament operators were downgraded, effectively making

four certified questions, the Delaware Supreme Court (with the recently appointed Chief Justice Strine) held as follows. First, fee-shifting bylaws are not prohibited by Delaware law.[93] Second, Delaware law does not prohibit a fee-shifting bylaw even if it purports to apply to members who join the company before the board of directors adopted that bylaw.[94] Third, a fee-shifting bylaw is unenforceable if the board of directors adopts or invokes it for an improper purpose or adopting or implementing it would be inconsistent with fiduciary obligations under the circumstances.[95]

The bylaw upheld in *ATP* was incredibly wide-reaching. First, it applied to current and former members of the company as well as to any entity who offered "substantial assistance" to those members in pressing their claim.[96] The bylaw could reach plaintiffs' lawyers, their expert witnesses, investigators, and witnesses. Second, the bylaw required fee shifting in any case short of a clear victory. The bylaw provided for fee shifting in the event that the company's members failed to "obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought."[97] Last, the fees shifted included all costs "of every kind and description," including "reasonable attorneys' fees and other litigation expenses."[98]

Nevertheless, although the bylaw upheld as facially valid was very broad, *ATP* reiterated that what is legal is not always permissible under Delaware law. Thus, *ATP* illustrates the Delaware Supreme Court's commitment to the Delaware Way, providing broad power to management

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their tournaments less prestigious. *Id.* at 556. These two tour operators sued, claiming that the downgrade was an antitrust violation and a breach of fiduciary duties of care, loyalty, and good faith. *Id.* The two tour operators lost a jury trial. *Id.* ATP then sought attorneys' fees, invoking its fee-shifting bylaw. *Id.* The federal court refused to enforce it, stating that fee shifting was contrary to the federal antitrust laws' policy of encouraging private rights of action. Deutscher Tennis Bund v. ATP Tour, Inc., No. 07-178, 2009 WL 3367041, at *4 (D. Del. Oct. 19, 2009), *vacated*, 480 F. App'x 124 (3d Cir. 2012). ATP appealed, however, and the Third Circuit vacated the district court's order, noting that the district court should have first decided whether ATP's fee-shifting bylaw was enforceable as a matter of Delaware law. Deutscher Tennis Bund v. ATP Tour Inc., 480 F. App'x 124, 128 n.5 (3d Cir. 2012). On remand, the district court decided that whether the fee-shifting bylaw was enforceable was a matter best decided by the Delaware courts and certified four questions for review. Deutscher Tennis Bund v. ATP Tour, Inc., No. 07-178, 2013 WL 4478033, at *1 n.1 (D. Del. Aug. 20, 2013).

93. *ATP*, 91 A.3d at 557–59. Related to the question of whether the fee-shifting bylaw was facially valid, the court also confronted whether a bylaw could be lawfully enforced against a member that obtained no relief at all on its claim against the company, even if the bylaw might be unenforceable in a different situation. *Id.* at 558. This question is inextricably bound up with the first.

94. *Id*. at 560.

95. *Id.*

96. *Id.* at 556.

97. *Id.*

98. *Id.*

under Delaware corporate law, but emphasizing that while legal, such bylaws are still subject to equitable review.

First, *ATP* plainly held that the board of a non-stock company had the legal authority to adopt a fee-shifting bylaw. It observed that fee-shifting bylaws were consistent with (or not inconsistent with) the common law, the company's charter, and Delaware law.[99] With respect to Delaware law, the *ATP* court held that fee-shifting bylaws were allowed under the DGCL because neither that law nor any other Delaware law forbid fee-shifting bylaws. Additionally, the court explained that "allocat[ing] risk among parties in intra-corporate litigation . . . 'relat[es] to the business of the corporation, the conduct of its affairs,'" and the rights of the company's shareholders or managers.[100]

It is important to emphasize the limited nature of *ATP*'s holding. *ATP* upheld only the facial validity of fee-shifting bylaws.[101] By addressing a facial challenge, *ATP* analyzed only whether in *all* cases, the bylaw would operate inconsistent with Delaware law.[102] Facial invalidity is a tough standard to meet, one that requires fee shifting to be contrary to Delaware law in *every* conceivable circumstance.[103] If there is but one legitimate, conceivable way in which the fee-shifting bylaw could operate consistent with Delaware law, then that bylaw is facially valid.[104] Thus, in the context of a facial challenge, it is unsurprising that *ATP* concluded that corporate managers had the legal authority to adopt a fee-shifting bylaw that might, in the right case, apply permissibly.

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99. *See id.* at 558 ("Neither the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws. . . . [A] fee-shifting bylaw would not be prohibited under Delaware common law.").

100. *Id.* (quoting DEL. CODE ANN. tit. 8, § 109(b)).

101. *See id.* at 555 ("[W]e cannot directly address the bylaw at issue . . . ."); *id.* at 558 ("A fee-shifting bylaw, like the one described . . . is facially valid."). *ATP* specifically refrained from assessing whether the bylaw at issue in the case was adopted for a proper or improper purpose. *See id.* at 559 ("The Certification does not provide the stipulated facts necessary to determine whether the ATP bylaw was enacted for a proper purpose or properly applied.").

102. *See* BLACK'S LAW DICTIONARY 261 (9th ed. 2009) (defining a facial challenge as a "claim that a statute is unconstitutional on its face — that is, that it always operates unconstitutionally").

103. *See, e.g.*, Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 940 (Del. Ch. 2013) (footnote omitted) ("By challenging the facial statutory and contractual validity of the forum selection bylaws, the plaintiffs took on the stringent task of showing that the bylaws cannot operate validly in any conceivable circumstance. The plaintiffs cannot evade this burden by conjuring up imagined future situations where the bylaws might operate unreasonably, especially when they acknowledge that in most internal affairs cases the bylaws will not operate in an unreasonable manner.").

104. *Id.* at 948 (citing Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407 (Del. 1985)) ("[T]he plaintiffs' burden on this motion challenging the facial statutory and contractual validity of the bylaws is a difficult one: they must show that the bylaws cannot operate lawfully or equitably *under any circumstances*.").

In the absence of an explicit limit on that authority ultimately enacted by the Delaware legislature, the court's conclusion that management has broad power to adopt fee-shifting bylaws was consistent with the Delaware Way, and unremarkable. In fact, it would have been surprising if the court in *ATP* had found that adopting the bylaw was beyond the power assigned to the board of directors. Delaware statutory law imposes precious few limits on director power—authorizing the issuance of shares for less than par value, which is really an obsolete limit in light of the DGCL's authorization of the issuance of no-par stock;[105] authorizing dividends to shareholders in the context of insolvency, which is subject to strong reliance defenses;[106] and deciding to cause the corporation to indemnify directors from a judgment entered against them, but even that patent self-dealing is not unlawful if done with the approval of the Court of Chancery.[107]

Second, *ATP* held that adopting and enforcing a legally permissible bylaw would still be policed by courts of equity to ensure that the adoption and invocation of that bylaw was consistent with the directors' fiduciary obligations—the other component of the Delaware Way.[108] And this means that the Delaware courts must craft the appropriate tools by which to measure fee-shifting bylaws and "separate the good, the bad and the ugly."[109]

ATP went out of its way to remind us that a fee-shifting bylaw, and indeed any bylaw—even if lawful on its face under Delaware corporate law—must nonetheless be enjoined as invalid if it was adopted for an improper purpose, invoked for an improper purpose, adopted in a way that was not equitable under the circumstances, or invoked in a way that was not equitable under the circumstances. *ATP* said that "[w]hether the specific . . . fee-shifting bylaw is enforceable . . . depends on the manner in which it was adopted and the circumstances under which it was invoked. Bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose."[110]

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105. DEL. CODE ANN. tit. 8, § 151(a) (2015).

106. *Id.* §§ 141(e), 172.

107. *Id.* § 145(b).

108. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014); *see also* Coffee, *supra* note 22, at 5 ("The Delaware courts have a long history of holding that powers legitimately possessed by the corporation may still not be used for an improper purpose."); Mirvis & Savitt, *supra* note 70, at 12 ("*ATP* itself . . . full well recognized that equitable scrutiny is inherently a part of the analysis.").

109. Mirvis & Savitt, *supra* note 70, at 12.

110. *ATP*, 91 A.3d at 558; *see also id.* at 560 ("Legally permissible bylaws adopted for an improper purpose are unenforceable in equity."); Boilermakers Local 154 Ret. Fund v. Chevron Corp.,

In this critical language, *ATP* cited the precise passage from *Schnell* that, as Chief Justice Strine wrote nearly ten years earlier, captured the essence of the Delaware Way[111]—a broad grant of legal authority is constrained by shareholders' fundamental rights and principles of equity.[112] *ATP* stated that the enforceability of a fee-shifting bylaw will "turn on the circumstances surrounding its adoption and use."[113] This critical language incorporated by reference the body of settled Delaware case law providing a template for the judicial analysis of board action in just these kinds of circumstances. Under that case law, a board's decisions to adopt or invoke a fee-shifting bylaw cannot be enforced unless the board establishes that those decisions satisfied its fiduciary duties.

IV. FEE-SHIFTING BYLAWS UNDER THE DELAWARE WAY AND A TEMPLATE FOR EQUITABLE LIMITS ON BYLAWS GENERALLY

To illustrate the equitable limits on bylaws generally, we consider what kind of bylaw would be consistent with equitable principles and adopted and used for a proper purpose. We think the only kind of bylaw that is likely to survive such scrutiny is one that is proportionate. In the particular context of fee-shifting bylaws, a proportionate bylaw is one that provides a mechanism for a neutral arbiter to award two-way shifting of reasonable fees in response to frivolous litigation tactics.

A. *The* Unocal *Standard of Review Governs Bylaws Tainted by the Omnipresent Specter of Self-Interest*

At the threshold, bylaws enacted in circumstances where the board of directors is inherently self-interested should be governed by the *Unocal*

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73 A.3d 934, 949 (Del. Ch. 2013) ("The answer to the possibility that a statutorily and contractually valid bylaw may operate inequitably in a particular scenario is for the party facing a concrete situation to challenge the case-specific application of the bylaw, as in the landmark case of *Schnell v. Chris–Craft Industries*.").

111. Strine, *If Corporate Action Is Lawful*, *supra* note 70, at 881.

112. *ATP* cited examples of bylaws found not enforceable because they were adopted to perpetuate directors in office or disenfranchise members, otherwise inequitable purposes. *ATP*, 91 A.3d at 557–59. The court cited Schnell v. Chris-Craft Industries, 285 A.2d 437 (Del. 1971), which refused to enforce a bylaw adopted by the board of directors that would block shareholder voting and perpetuate directors in office. Next, the court cited Hollinger International, Inc. v. Black, 844 A.2d 1022 (Del. Ch. 2004), which refused to enforce a bylaw adopted by the board of directors that would have the practical effect of disenfranchising other stockholders. Finally, the court cited Frantz Mfg. Co. v. EAC Industries, 501 A.2d 401 (Del. 1985), which enforced a bylaw because it would avoid disenfranchising shareholders.

113. *ATP*, 91 A.3d at 559.

standard of review, which is an exception to the traditional business judgment rule. So too with fee-shifting bylaws.

Equitable review examines whether managers complied with their fiduciary obligations, including the duty of care and the duty of loyalty.[114] If the company's managers' conduct breaches of either duty, then the Chancery Court can enjoin that conduct.[115] When reviewing the actions of directors, Delaware courts traditionally employ the business judgment rule. Under that rule, a Delaware court will presume that the board's business decisions are informed, made in good faith, and made "in the honest belief that the action taken was in the best interests of the company."[116]

But in *Unocal Corp. v. Mesa Petroleum Co.*,[117] the Delaware Supreme Court recognized that certain scenarios in which a board exercises its judgment present an "omnipresent specter that [the] board may be acting primarily in its own interests." In cases where board members have this kind of an inherent conflict, "there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."[118] In *Unocal*, the Delaware Supreme Court developed the framework for this threshold judicial examination. Under that framework, a board of directors must show that: (1) it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed"; and (2) the "defensive measure" adopted in response was "reasonable in relation to the threat posed."[119] *Unocal* involved defensive measures adopted to counter a hostile takeover, but the

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114. *See, e.g.*, Allen et al., *supra* note 85, at 1289–91 (describing the duties of care and loyalty and the three categories of cases in which these concepts have been primarily used); Grundfest & Savelle, *supra* note 40, at 400 (stating that Delaware courts must consider whether a forum-selection bylaw would "violate the fiduciary duties that the board owes to stockholders and to the corporation" under the facts and circumstances of the case).

115. *See, e.g.*, E.I. duPont de Nemours & Co. v. Am. Potash & Chem. Corp., 200 A.2d 428, 432 (Del. Ch. 1964) (stating that it is "well-recognized" that "equity will enjoin a threatened breach of fiduciary duty").

116. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citations omitted).

117. 493 A.2d 946, 954 (Del. 1985). Although Delaware law allows directors to limit monetary liability for breaches of the duty of care, Delaware law does not extend those limits to breaches of the duty of loyalty or to requests for injunctive relief. DEL. CODE ANN. tit. 8, § 102(b)(7); *see also In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 752 (Del. Ch. 2005) (citing Malpiede v. Townson, 780 A.2d 1075, 1095 (Del. 2001)) ("The existence of an exculpation provision authorized by § 102(b)(7) does not, however, eliminate a director's fiduciary duty of care, because a court may still grant injunctive relief for violations of that duty.").

118. *Unocal*, 493 A.2d at 954.

119. *Id.* at 955–56 (citations omitted); *see also* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356 (Del. 1985).

Delaware courts have extended this framework to all defensive measures adopted where managers risk losing control of the company.[120]

Adopting and invoking fee-shifting bylaws presents such a circumstance where the omnipresent specter of self-interest taints the board's action and thus must satisfy the test from *Unocal*. The board has three inherent interests in stemming all shareholder litigation, merited or not.[121] First, managers have an inherent interest in retaining control of their seats on the board or their positions in the company. If claims or evidence of misconduct emerge against managers, then these claims or that evidence may threaten their positions within the company—forcing resignation or emboldening rivals in a challenge for power.[122] Second, directors have an inherent fiscal interest in avoiding shareholder litigation. Board members typically have an equitable stake in the company.[123] Shareholder and derivative lawsuits, which themselves often follow a drop in the company's stock price, usually trigger a further dip in the

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120. *See, e.g.*, Stroud v. Grace, 606 A.2d 75, 82 (Del. 1992) (quoting Gilbert v. El Paso Co., 575 A.2d 1131, 1144 (Del. 1990)) (stating that *Unocal* applies to any defensive measure "touch[ing] upon issues of control"); Chesapeake Corp. v. Shore, 771 A.2d 293, 320 (Del. Ch. 2000) (footnote omitted) ("[I]n *Stroud v. Grace*, the Delaware Supreme Court held that *Unocal* must be applied to any defensive measure touching upon issues of control, regardless of whether that measure also implicates voting rights.").

121. Others have characterized the "conflict of interest that comes with allowing directors to adopt bylaws that insulate their own behavior from legal challenge" as "obvious." Brown, *supra* note 13, at 21. And some law firms have warned clients that just by adopting those bylaws, directors could expose themselves to a lawsuit for breach of the duty of loyalty. *See* Corporate Alert, Nicholas O'Keefe & Natasha Y. Hsieh, Kaye Scholer LLP, 2015 Proxy Season: Should Companies Propose Exclusive Forum and Fee-Shifting Charter Amendments at Their 2015 Annual Shareholder Meetings? (Dec. 18, 2014), *available at* http://www.kayescholer.com/in-the-market/publications/client_alerts/20141218-corporate-alert-2015-proxy-season-should-companies-propose-exclusive-forum-and-fee-shifting-charter-amendments-at-their-2015-annual-shareholder-meetings/_res/id=sa_File1/Corporate%20Alert_2015%20Proxy%20Season_Should%20Companies%20Propose%20Exclusive%20Forum%20and%20Fee-Shifting%20Charter%20Amendments.pdf ("Adoption of [fee-shifting provisions] could be viewed as a breach of the duty of loyalty, given the possibility that the provisions may immunize questionable board conduct from challenge by plaintiffs' lawyers.").

122. *See, e.g.*, *In re* China Agritech, Inc. S'holder Derivative Litig., C.A. No. 7163−VCL, 2013 WL 2181514, at *1 (Del. Ch. May 21, 2013) (observing that six outside directors and two senior officers resigned after claims of mismanagement surfaced); Edgewater Growth Capital Partners LP v. H.I.G. Capital, Inc., 68 A.3d 197, 207 (Del. Ch. 2013) (observing that because of claims of mismanagement, senior leaders "drew a line in the sand," refusing further funding unless certain directors resigned).

123. *See, e.g.*, Katherine M. Brown, *New Demands, Better Boards: Rethinking Director Compensation in an Era of Heightened Corporate Governance*, 82 N.Y.U. L. REV. 1102, 1122 & n.128 (2007) (citing NAT'L ASS'N OF CORPORATE DIRS. BLUE RIBBON COMM'N, DIRECTOR COMPENSATION: PURPOSES, PRINCIPLES, AND BEST PRACTICES vii (2001), and observing that "[n]early all of the largest companies in the United States use equity in the company as some part of their directors' compensation package").

company's stock price.[124] Third, by avoiding litigation, managers keep their reputations unsullied. Shareholder and derivative litigation calls managers' performance or judgment into question. Certainly, managers wish to avoid all claims of mismanagement—merited or not.[125]

B. *Under* Unocal*, The Bylaw Must Be Proportionate and Reasonable in Relation to a Legitimate Threat to Corporate Welfare*

Under *Unocal*, a defensive measure must be a proportional response to a legitimate threat to corporate or shareholder welfare.[126] This inquiry has two aspects: (1) a legitimate threat; and (2) proportionality and reasonableness—both of which limit the application of a company's bylaws.

1. A Legitimate Threat

Turning to the first limit on bylaws, there must be a legitimate threat, not to the directors' ability to control the company, but to corporate or

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124. *See, e.g.*, Stephen P. Ferris & A.C. Pritchard, *Stock Price Reactions to Securities Fraud Class Actions Under the Private Securities Litigation Reform Act* 3 (Univ. of Mich. John M. Olin Ctr. for Law & Econ., Paper No. 01-009, 2001), *available at* http://www.law.umich.edu/centersandprograms/lawandeconomics/abstracts/2001/documents/pritchard01-09.pdf (finding a "strong negative price reaction of approximately 25% around the revelation date of the bad news spawning the lawsuit. The reaction to the subsequent event, the notice of suit filing is much smaller, but remains statistically significant").

125. *See, e.g.*, Seinfeld v. Coker, 847 A.2d 330, 333 (Del. Ch. 2000) (recognizing the importance of shareholder litigation as a mechanism to deter improper behavior by directors and managers "who want to avoid the expense of being sued and the sometimes larger reputational expense of losing in court"); Barbara Black, *Reputational Damages in Securities Litigation*, 35 J. CORP. L. 169, 174–75 (2009) (discussing how challenges to a company's internal controls and its managers' reputation for integrity "can have a profound effect on future cash flows"); 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, 718 (1986) (noting that directors fear damaged reputations from shareholder derivative litigation); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 35 (1991) ("Directors usually own some stock in their corporations and are interested in preserving their reputational capital by not being associated with firms that perform poorly.").

126. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955–56 (Del. 1985) (citing Cheff v. Mathes, 199 A.2d 548, 554–55 (Del. 1964)) ("The standard of proof . . . is designed to ensure that a defensive measure to thwart or impede a takeover is indeed motivated by a good faith concern for the welfare of the corporation and its stockholders, which in all circumstances must be free of any fraud or other misconduct. . . . A further aspect is the element of balance. If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed.").

shareholder welfare.[127] Thus, a bylaw that does not target a legitimate threat to corporate or shareholder welfare is invalid.

Three examples—cited by *ATP*—illustrate this principle. *Schnell v. Chris-Craft Industries, Inc.*[128] is the first example of a legal but equitably improper bylaw. In *Schnell*, the board of directors adopted a bylaw advancing the date of an annual stockholder meeting. The bylaw was not aimed at any threat to corporate or shareholder welfare, but was instead aimed at "obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management" and to "perpetuat[e]" managers in office.[129]

Another example is *Hollinger International, Inc. v. Black*,[130] where a controlling shareholder enacted a bylaw that prevented the board of directors from acting "on any matter of significance except by unanimous vote" and set the board's quorum requirement at 80%. Just as in *Schnell*, there was no threat to the company's welfare that justified such a defensive measure by the controlling shareholder, and thus the bylaw was invalid.[131]

The third example illustrates the converse of this principle: a bylaw aimed at a legitimate threat will not be overturned judicially. In *Frantz Manufacturing Co. v. EAC Industries*, the Delaware Supreme Court upheld a bylaw that limited anti-takeover maneuvering after a majority stockholder gained control of the company. That bylaw *was* aimed at a legitimate threat to shareholder welfare: an "attempt to avoid . . . disenfranchisement as a majority shareholder."[132]

Forum-selection bylaws provide a more recent example of bylaws with a valid corporate purpose. Forum-selection bylaws aim to solve the issue of multi-forum litigation, which is detrimental to the plaintiff class, defendants, and the judicial system. No court—Delaware or otherwise—has found this to be an improper purpose.[133]

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127. Legitimate threats to corporate welfare include, for example, derailing the company's long-term strategy, losing the opportunity to formulate or present a potentially superior alternative, inadequacy of consideration offered to shareholders, or the risk of shareholder confusion or coercion. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1989); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 107–08 (Del. Ch. 2011).

128. 285 A.2d 437 (Del. 1971).

129. *Id*. at 439.

130. 844 A.2d 1022, 1077 (Del. Ch. 2004).

131. *Id*. at 1081–82.

132. 501 A.2d 401, 407 (Del. 1985).

133. *See, e.g.*, City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 239–41 (Del. Ch. 2014) (observing that forum-selection bylaws spare courts from the need to divine the appropriate forum and do not advance directors' self-interest by having claims in a single forum); North v. McNamara, 47 F. Supp. 3d 635, 645 (S.D. Ohio 2014) (stating that forum-selection bylaws achieve

2. *Reasonableness and Proportionality*

Turning to the second limit on bylaws tainted by the omnipresent specter of self-interest, not only must the bylaw target a legitimate threat, but it must also be a reasonable and proportionate comeback to that threat. A defensive measure is disproportionate if it is "draconian (coercive or preclusive) or falls outside a range of reasonable responses."[134]

Again, forum-selection bylaws provide a recent example of a bylaw that is reasonable and proportional to the identified threat to corporate welfare. Forum-selection bylaws are designed to avoid the inefficiencies and waste that accompany litigating the same case in several courts. Forum-selection bylaws that designate a single forum in which to sue are reasonable and proportional measures to that threat because these bylaws merely regulate "*where* stockholders may file suit, not *whether* the stockholder may file suit or the kind of remedy that the stockholder may obtain" if the stockholder does sue.[135]

C. Applying Unocal *to Fee-Shifting Bylaws*

How then does *Unocal* affect fee-shifting bylaws? We think that under a *Unocal* standard, as applied by the many courts outside of Delaware that follow Delaware corporate law, the universe in which fee-shifting bylaws would be consistent with settled equitable principles is, in fact, quite limited. In our view, a proportionate and reasonable fee-shifting bylaw that responds to a legitimate threat to corporate welfare is one that provides for two-way shifting of reasonable fees for frivolous litigation as determined by a neutral arbiter. Accordingly, in those states that rely upon Delaware corporate law, the courts will apply the Delaware Way and refuse to enforce any fee-shifting bylaw that does not provide for two-way shifting of reasonable fees for frivolous litigation as determined by a neutral arbiter.

1. *Frivolous Litigation*

To start, fee-shifting bylaws will likely survive equitable scrutiny only where they target frivolous litigation. A fee-shifting bylaw that shifts fees

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"cost and efficiency benefits that inure to the corporation and its shareholders by streamlining litigation into a single forum").

134. Allen et al., *supra* note 85, at 1309.

135. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 952 (Del. Ch. 2013).

in merited cases is likely either disproportionate or not aimed at a legitimate threat.

Fee-shifting bylaws must distinguish between legitimate and frivolous shareholder suits.[136] As a rule, fee-shifting bylaws must respond to a legitimate threat to corporate or shareholder welfare. Fee-shifting bylaws are often advanced as responses to the threat shareholder lawsuits present to corporate coffers.[137] But not all litigation poses a threat to corporate or shareholder welfare. In fact, by enabling equitable review of managers' actions, shareholder litigation gives shareholders a powerful tool to protect their welfare and, as the Delaware Way recognizes, constrain the broad legal authority Delaware law invests in managers.[138] Only frivolous litigation causes the company to expend money when it should not. This kind of litigation wastes management's time and diverts resources from the company's business activities.[139]

ATP itself did not endorse fee shifting in every case. Apart from resolving a mere facial challenge,[140] *ATP* did not say that deterring litigation is always proper. In a confusing double negative, *ATP* said only that deterring litigation is not "invariably" improper.[141] Put differently, *ATP* said that there could be instances when deterring litigation is permissible, but also instances when deterring litigation is not.[142]

Practically speaking, however, directors will almost always justify fee-shifting bylaws as counters to frivolous litigation only, not *all* shareholder

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136. *See* Harvey L. Pitt, *Reducing Litigation Perils Fairly*, 53 BANK & CORP. GOVERNANCE L. REP. 22, 26, 28 (2014) ("Ideally, any by-law provision adopted should distinguish between frivolous litigation and frivolous litigation practices, on the one hand, and meritorious claims.").

137. *See, e.g.*, *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, *archived at* http://perma.cc/55SE-A24Y.

138. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) ("The machinery of corporate democracy and the derivative suit are potent tools to redress the conduct of a torpid and unfaithful management."), *overruled by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000); *accord* Rales v. Blasband, 634 A.2d 927, 933 (Del. 1993) (quoting *Aronson*'s language).

139. *See* Griffith, *supra* note 54, at 30 ("The problem with current fee-shifting proposals is not that they deter shareholder litigation, but that they deter it indiscriminately. The extreme loser-pays position of current bylaw proposals takes no account of the merits of the underlying claim . . . ."); Pitt, *supra* note 136, at 28 (similar).

140. *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 559–60 (Del. 2014).

141. *See id.* at 560 ("The intent to deter litigation . . . is not invariably [read, in every case or on every occasion] an improper purpose."). Many overread this point and contend that *ATP* says that deterring litigation of any kind is always permissible. *See, e.g.*, Robert W. Gaffey et al., *Break Point? Delaware Supreme Court Upholds Validity of Fee-Shifting Bylaw*, 18 WALL ST. LAW. 16, 17 (2014) ("Importantly, the court noted that the intent to deter litigation is not, standing alone, an improper purpose.").

142. *ATP Tour, Inc.*, 91 A.3d at 560.

litigation. The reason being, if the board of directors' primary purpose for adopting or invoking a fee-shifting bylaw is to impair or impede legitimate shareholder litigation, then the bylaw is most certainly doomed, as the board must offer a compelling justification for it. Delaware courts have recognized that the burden of showing a compelling justification is "quite onerous,"[143] and its application "comes close to being outcome-determinative in and of itself."[144]

To explain why a bylaw that indiscriminately targets litigation would require a compelling justification, under Delaware case law, when the board of directors uses defensive measures primarily to interfere with fundamental shareholder rights, such as the voting franchise, then the board's justification for that defensive measure must be compelling.[145] In *Schnell*, for instance, the Delaware Supreme Court held that a board's rescheduling of an annual meeting, although consistent with the letter of Delaware law, was done to "perpetuat[e] [directors] . . . in office" and "for the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management."[146] These, the court said, "are inequitable purposes."[147]

Just as board action primarily used to interfere with fundamental shareholder rights (e.g., shareholder voting) requires a compelling justification, so too should board action primarily used to interfere with equitable review of board action. Shareholders' rights are but one of the Delaware Way's two constraints on the broad grant of authority given to

143. Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996).

144. Chesapeake Corp. v. Shore, 771 A.2d 293, 320 (Del. Ch. 2000).

145. *See, e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988); Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del. 1992) (citations omitted) ("A board's unilateral decision to adopt a defensive measure touching 'upon issues of control' that purposefully disenfranchises its shareholders is strongly suspect under *Unocal*, and cannot be sustained without a 'compelling justification.'"); *see also* MM Companies, Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1132 (Del. 2003) (citing *Stroud*, 606 A.2d at 92 n.3) ("When the *primary purpose* of a board of directors' defensive measure is to interfere with or impede the effective exercise of the shareholder franchise in a contested election for directors, the board must first demonstrate a compelling justification for such action as a condition precedent to any judicial consideration of reasonableness and proportionately [sic]."); Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1378 (Del. 1995) (citing Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 42 n.11 (1994)) (stating that Delaware "has been and remains assiduous in its concern about defensive actions designed to thwart the essence of corporate democracy by disenfranchising shareholders"); *Chesapeake*, 771 A.2d at 323 ("[I]t may be optimal simply for Delaware courts to infuse our *Unocal* analyses with the spirit animating *Blasius* and not hesitate to use our remedial powers where an inequitable distortion of corporate democracy has occurred.").

146. Schnell v. Chris-Craft Indus., 285 A.2d 437, 439 (Del. 1971).

147. *Id.*; *see also* State v. Jessup & Moore Paper Co., 77 A. 16, 19–20 (Del. 1910) (striking down a bylaw that would "take from the stockholder the right to have the court pass upon the question whether he is entitled to the inspection" by forcing the stockholder to make "his first and final appeal to the board of directors").

managers of a company, and equitable review of board action is the other.[148] Plainly, fee-shifting bylaws that indiscriminately target shareholder litigation present a real impediment to equitable review. Before fee shifting can be found inequitable, there must be a case in controversy, which itself requires that a claim be brought; but fee-shifting bylaws operate to deter claims from ever being brought to begin with.[149] Indeed, other Delaware jurists have suggested that bylaws that impede a shareholder's right to sue by, for example, eliminating legal standing, may be "per se" inequitable.[150]

Unocal's second prong—reasonableness and proportionality—likewise implicitly limits the kinds of cases in which a fee-shifting bylaw may apply to only frivolous cases. Not only must fee-shifting bylaws target a legitimate threat (i.e., frivolous litigation), they must also be reasonable and proportionate responses to that threat. These limits likely foreclose any bylaw that demands complete success by the plaintiff.[151] Plainly, if the defendant obtains a small victory on one issue, but the plaintiff otherwise prevails, requiring fee shifting for a minor loss is unjustly severe. In fact, the Third Circuit already recognized that a bylaw that shifts fees in circumstances where the plaintiff does not "substantially achieve" the full remedy sought would likely be draconian—"unconscionab[le] or [invalid under] public policy considerations."[152]

2. *Reasonable Fees*

Along with proportionality, the next constraint on fee-shifting bylaws is reasonableness. To that end, a bylaw that transfers anything other than "reasonable" fees is not a reasonable response to any legitimate threat that frivolous litigation poses to the corporation.

As an initial matter, limiting fees to reasonable fees is consistent with general contract law. In cases of contractual fee shifting, which, according

148. *See* EMAK Worldwide, Inc. v. Kurz, 50 A.3d 429, 433 (Del. 2012) (describing shareholder voting rights as "sacrosanct" in the context of director elections and describing them as a "fundamental governance right"); Lonergan v. EPE Holdings LLC, 5 A.3d 1008, 1018 (Del. Ch. 2010) (stating that "[f]iduciary duty review empowers courts to determine how a governance scheme should operate"); Rales v. Blasband, 634 A.2d 927, 932 (Del. 1993) ("The stockholder derivative suit is an important and unique feature of corporate governance.").

149. Griffith, *supra* note 54, at 35.

150. Ridgely, *supra* note 13, at 23.

151. *See* Coffee, *supra* note 22, at 5 ("[E]ven if attempting to discourage frivolous litigation seems fair enough, the analysis changes when a bylaw or charter provision demands complete success. Then, it seemingly moves beyond a proper purpose and intentionally seeks to discourage meritorious litigation.").

152. Deutscher Tennis Bund v. ATP Tour Inc., 480 F. App'x 124, 127 n.4 (3d Cir. 2012).

to *ATP* is the species of fee shifting contained in a company's bylaws, the fees and costs shifted must be reasonable.[153] To assess a fee's reasonableness, case law directs a judge to consider several factors, including customary fees for similar legal services and the results obtained.[154]

A component of reasonableness is that the bylaw is a proportional countermeasure, which means it must not be either preclusive or coercive.[155] To avoid precluding shareholder litigation or coercing an unfair settlement, the fees that can be shifted must be tailored to the specific threat identified (i.e., the threat of frivolous litigation) and shift only those fees actually caused by the need to respond to that threat (i.e., the frivolous claims).

Turning to the first aspect, to avoid over-deterrence, fee-shifting bylaws should distinguish between representative and non-representative litigation. To explain, *ATP* was non-representative litigation; the plaintiffs were suing on behalf of themselves alone.[156] In contrast, shareholder litigation is representative litigation. In representative litigation, the plaintiffs are a diversified group and many have no connection to the business of the company other than their equity stake. Indiscriminate fee shifting, however, would impose liability on an individual litigant for representative cases. And without some reasonable cap on fee shifting for the named plaintiff, fee shifting forces the plaintiff to shoulder the entire cost of representative litigation or forgo a potentially merited challenge.[157] This is particularly glaring for shareholders since their personal liability for monetary losses is generally limited to the amount of their investment in the corporation.[158] There is near unanimous recognition that no rational person would put "half-a-million dollars at risk . . . when their own gain will be relatively small"—even if they believe the corporation acted improperly.[159] Requiring a representative litigant to bear individually the

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153. *See* Sternberg v. Nanticoke Mem'l Hosp., Inc., 62 A.3d 1212, 1220–21 (Del. 2013).

154. *See, e.g.*, Mahani v. Edix Media Grp., Inc., 935 A.2d 242, 247–48 (Del. 2007).

155. *See, e.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1367 (Del. 1995).

156. In fact, the company that adopted a fee-shifting bylaw in that case was more akin to a partnership: ATP operated a professional tennis tour and its members were those who owned and operated tennis tournaments.

157. *See* 4 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 23:6 (3d ed. 2014) (quoting *In re* Gen. Motors Class H S'holders Litig., 734 A.2d 611, 621 (Del. Ch. 1999)) (stating that coercion is "when the shareholder is forced into 'a choice between a new position and a compromised position for reasons other than those related to the economic merits of the decision'").

158. DEL. CODE ANN. tit. 8, § 102(b)(6).

159. Jeff Mordock, *Delaware Legislation Could Bar Litigation Fee-Shifting Bylaws*, DEL. BUS. CT. INSIDER, June 2014, at 1, 1 (quoting Professor Lawrence A. Hamermesh as stating, "[w]hy would

risk and cost of an unsuccessful suit "almost certainly will kill shareholder litigation."[160] The problem indiscriminate fees pose is further illustrated when one considers how the risk of those fees would influence the motives of lead plaintiffs and lead counsel at settlement. Lead plaintiffs and lead counsel would face enormous pressure to settle rather than take the risk of any loss, effectively placing their interests in conflict with the class they purport to serve.[161]

Turning to the second aspect, fee-shifting bylaws must limit fees shifted to those actually caused by the need to defend against frivolous claims. Suppose the plaintiff files three claims, and the first claim is frivolous while the other two have merit. Also assume that the defendant spent $250,000 in fees to dismiss quickly the first claim at the pleading stage, but then incurs $1,000,000 in additional fees to successfully litigate the remaining two claims at trial. Theoretically, only $250,000 of the defendants' fees were actually caused by the existence of the frivolous claim. The additional $1,000,000, however, appear unrelated to the frivolous claim, and that portion of the fees then is unrelated to any threat posed by that claim. To require the plaintiff to pay all of the defendants' fees in that situation is simply to give the defendants a windfall and provide a disproportionate response to any legitimate threat from frivolous litigation.

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a rational person put half-a-million dollars at risk in corporate litigation when their own gain will be relatively small? Even if you thought a corporation acted improperly, what if you were wrong? You would get hammered with legal fees."); *see also* Brown, *supra* note 13, at 24 ("[S]hareholders have little incentive to step forward where they also bear the risk of liability for the fees incurred by the company and its directors."); Griffith, *supra* note 54, at 3 (observing that fee-shifting imposed on representative litigants makes representative litigation "economically irrational, even in cases involving potentially significant recoveries"); Hamermesh, *supra* note 86, at 171 ("[S]uch a bylaw is one that is essentially self-enforcing: even if there were some evidence that its adoption was improperly motivated, a lawsuit challenging it would likely be too risky for any stockholder to undertake because anything less than total success in that litigation would result in the stockholder having to pay the corporation's costs of defense."); Strougo v. Hollander, 111 A.3d 590, 595 (Del. Ch. 2015) ("[I]n my view, no rational stockholder—and no rational plaintiff's lawyer—would risk having to pay the Defendants' uncapped attorneys' fees to vindicate the rights of the Company's minority stockholders, even though the Reverse Stock Split appears to be precisely the type of transaction that should be subject to Delaware's most exacting standard of review to protect against fiduciary misconduct.").

160. Griffith, *supra* note 54, at 29 ("Whatever the effects of a move to fee-shifting may be in other contexts, it almost certainly will kill shareholder litigation because it would force *representative* litigants to bear *individual* responsibility for the full cost of an unsuccessful suit.").

161. *See, e.g.*, Marc I. Gross, *Loser-Pays—Or Whose "Fault" Is It Anyway: A Response to Hensler-Rowe's "Beyond 'It Just Ain't Worth It,'"* 64 LAW & CONTEMP. PROBS. 163, 168 (2001) (discussing this dynamic in the context of fee-shifting in securities litigation).

3. Two-Way Fee Shifting

Not only must fee shifting be limited to the transfer of reasonable fees and only for frivolous litigation tactics, but fee shifting should also be bilateral.[162] Otherwise, a bylaw that shifts fees one way may not be a reasonable retort to the threat posed.

If the threat posed to the company is the threat of incurring costs of frivolous litigation, then the bylaw should target *all* sources of frivolous litigation. A one-way bylaw prevents frivolous litigation by only the shareholder plaintiff. But we know that corporate directors may raise frivolous defenses or engage in frivolous litigation tactics just as easily.[163] Two-way fee shifting tempers both sides' expenses on legal fees and discourages each side from taking questionable legal stands.

4. Neutral Arbiter

Equally important to the limits on fee-shifting bylaws of frivolousness and reasonableness is who decides whether the fees shifted (to either party) are reasonable or the litigation frivolous. Allowing the board of directors to decide the amount of fees and whether a legal challenge is frivolous seems to prove the maxim that no man ought to be the judge in his own case.[164] Certainly, Delaware law generally avoids that approach, requiring instead that "[t]he key to upholding an interested transaction is the approval of some neutral decision-making body."[165]

Delaware law suggests four potential neutral arbiters: independent directors, a committee with some independent directors, independent

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162. *See* Pitt, *supra* note 136, at 28 (recommending that "fee-shifting should be two-sided, [not] one-sided, permitting plaintiffs' fees and expenses to be borne by the Company in the event of untoward litigation postures taken on the Company's behalf or at its behest").

163. *See* Richard L. Marcus, *Reassessing the Magnetic Pull of Megacases on Procedure*, 51 DEPAUL L. REV. 457, 470 (2001) (observing that "defendants [may] use 'dump truck' discovery responses as methods of overwhelming their adversaries," and that businesses in litigation may stake out aggressive litigation positions and pursue similarly aggressive litigation tactics); Linda S. Mullenix, *Discovery in Disarray: The Pervasive Myth of Pervasive Discovery Abuse and the Consequences for Unfounded Rulemaking*, 46 STAN. L. REV. 1393, 1401–02 (1994) (stating that corporate defendants sometimes "withhold necessary evidence or inundate requesting plaintiffs with thousands of documents (in either instance, imposing extra cost, harassment, and delay on requesting plaintiffs)," and that "[w]hen discovery abuse occurs, it seems equally likely to be an attempt by a corporate defendant to bankrupt a plaintiff and to induce abandonment of the lawsuit as a plaintiff's attempt to harass a defendant").

164. *See* Dr. Bonham's Case, (1610) 77 Eng. Rep. 638 (C.P.) 646, 652; 8 Co. Rep. 107 a, 114 a, 118 a.

165. Williams v. Geier, 671 A.2d 1368, 1379 n.23 (Del. 1996) (quoting Oberly v. Kirby, 592 A.2d 445, 467 (Del. 1991)).

shareholders, or a court. For instance, to ratify corporate transactions in which directors are interested, that decision must be ratified by a majority of independent directors, a committee of at least two independent directors, or a vote of the majority of shares held by independent shareholders.[166] Additionally, Delaware law allows the board of directors to adopt a bylaw indemnifying itself—even in cases where the board is found liable for some wrongdoing against the company—but before the board may be indemnified, the Court of Chancery or the court in which the action is pending must deem it proper.[167]

For fee-shifting bylaws, the only arbiter that is reliably neutral would be a court. For reasons explained, directors are inherently interested in stemming shareholder litigation, and hence those directors, or a committee consisting of some of those directors, cannot ratify the decision—independent directors do not exist in that situation. For shareholders, apart from the logistical challenge in coordinating shareholders to determine frivolousness and the reasonableness of fees, there is also the challenge that shareholders may never be disinterested in cases of two-way fee shifting. In cases with two-way fee shifting, existing shareholders would always want to shift fees away from the company to protect their investment. If those existing shareholders were also plaintiffs, then they would always want to shift fees to management out of their own self-interest. Thus, the board, a committee consisting of board members, and shareholders will generally lack the neutrality required. Accordingly, as is true of the decision whether the corporation should indemnify its own directors for expenses incurred by them when they lose a lawsuit to their own corporation, the only legitimate disinterested arbiter of fee shifting would be the court.

V. EQUITABLY APPROPRIATE FEE-SHIFTING BYLAWS AND FEE SHIFTING UNDER DELAWARE RULE 11

As we have shown, the only equitably appropriate fee-shifting bylaws are those that provide for two-way shifting of reasonable fees in response

166. DEL. CODE ANN. tit. 8, § 144.

167. *Id.* § 145(b); *see also* Carlson v. Hallinan, 925 A.2d 506, 542 n.240 (Del. Ch. 2006) (recognizing that the board of directors may authorize indemnification for itself in cases of "wrongdoing and liability" with court approval, but denying approval in that case); Active Asset Recovery, Inc. v. Real Estate Asset Recovery Servs., Inc., No. Civ.A. 15478, 1999 WL 743479, at *19 (Del. Ch. Sept. 10, 1999) (citing DEL. CODE ANN. tit. 8, § 145(b)) (acknowledging the "strict[] conditions" placed on the right of the board to indemnify itself when it has been held liable to the company).

to frivolous litigation as determined by a neutral arbiter. And, it turns out, Delaware law, and the law of every state, already provides for just this sort of mechanism. Rule of Procedure 11 in Delaware, and virtually identical provisions in the procedural rules of the federal courts and many states, provides a neutral mechanism for two-way shifting of reasonable fees as a response to frivolous litigation tactics as determined by a neutral arbiter.[168] Delaware Rule 11 overlaps with the three key features of equitably appropriate fee-shifting bylaws.

First, just as fee-shifting bylaws are limited to instances of frivolous litigation, so too are sanctions under Rule 11 permissible only in cases of frivolous litigation.[169] Sanctions are only appropriate after a finding that one has violated Rule 11.[170] Explicit in Rule 11 is that by signing a pleading and submitting it to the court, the attorney certifies that it is not presented for an improper purpose, the legal claims are warranted, and the factual allegations have evidentiary support.[171]

Second, just as fee-shifting bylaws shift only reasonable fees, so too does Rule 11 allow courts to impose only reasonable sanctions. For example, Delaware Rule 11 specifies that sanctions may consist of "some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation."[172] That rule also explicitly limits sanctions "to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated."[173] Indeed, the federal Rule 11 specifically contemplates limiting fees and expenses that can be shifted to

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168. John B. Oakley, *A Fresh Look at the Federal Rules in State Courts*, 3 NEV. L.J. 354, 379 (2002/2003) ("Delaware has separate but substantially identical rules of civil procedure for each of its three principal systems of courts: the Court of Chancery, the Superior Court, and the inferior civil court of non-equitable jurisdiction, the Court of Common Pleas.").

169. *See, e.g.*, Anderson v. State, 21 A.3d 52, 62 (Del. 2011) (citing *In re* Appeal of Infotechnology, Inc., 582 A.2d 215, 221 (Del.1990)) ("Rule 11 sanctions are appropriate to deter and punish the bringing of frivolous or meritless claims."); Fairthorne Maint. Corp. v. Ramunno, C.A. No. 2124–VCS, 2007 WL 2214318, at *9 (Del. Ch. July 20, 2007) ("[F]ee-shifting awards may be merited in exceptional cases in order to deter abusive litigation, avoid harassment, and protect the integrity of the judicial process."); *see also* Jonathan T. Molot, *Fee Shifting and the Free Market*, 66 VAND. L. REV. 1807, 1816 (2013) (describing Rule 11 as the American system's mechanism for discouraging meritless positions in all types of cases).

170. FED. R. CIV. P. 11(c)(1) ("If . . . the court [first] determines that Rule 11(b) has been violated, [then] the court may impose an appropriate sanction . . . .").

171. *Id.* at 11(b); DEL. CT. C.P.R. 11(b).

172. DEL. CT. C.P.R. 11(c)(2); *see also* FED. R. CIV. P. 11(c)(4) (stating that sanctions "must be limited to what suffices to deter repetition of the conduct or comparable conduct by others similarly situated").

173. DEL. CT. C.P.R. 11(c)(2); *see also* FED. R. CIV. P. 11 advisory committee's note (1993 Amendment) (recognizing that a sanctions award for a Rule 11 violation need not be the full amount of the other side's attorneys' fees and that "partial reimbursement of fees may constitute a sufficient deterrent with respect to violations by persons having modest financial resources").

those “directly and unavoidably caused” by just the frivolous aspect of the case.[174]

Third, just as fee-shifting bylaws must allow for two-way fee shifting, so too does Rule 11 provide for two-way fee shifting. Rule 11 targets all parties, not just plaintiffs. Rule 11 allows for fee shifting, not just for plaintiffs or shareholders who bring frivolous suits, but also against defendants when they unnecessarily require additional litigation, delay it, or assert frivolous motions.[175]

As a method of deterring frivolous litigation, Rule 11 retains two features that may make it more desirable than fee-shifting bylaws. First, Rule 11 is the result of years of serious study by respected thinkers on the appropriate deterrent for frivolous litigation.[176] Congress, too, has recognized that the inquiry under Rule 11 provides adequate safeguards against frivolous litigation. Significantly, before Congress passed the Private Securities Litigation Reform Act (“PSLRA”), Congress heard testimony about the perceived weakness of Rule 11 in curbing frivolous securities lawsuits.[177] It responded to that perception by making a post-judgment Rule 11 inquiry mandatory in all private securities cases, but, importantly, chose not to alter the essential limits on fee shifting imposed by Rule 11: frivolousness, reasonableness, and bilateral application.[178]

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174. FED. R. CIV. P. 11 advisory committee’s note (1993 Amendment) (“If, for example, a wholly unsupportable count were included in a multi-count complaint or counterclaim for the purpose of needlessly increasing the cost of litigation to an impecunious adversary, any award of expenses should be limited to those directly caused by inclusion of the improper count, and not those resulting from the filing of the complaint or answer itself.”); *see also* Adams v. Buck-Luce, No. 04 Civ. 1485 (JSR), 2005 WL 822910, at *2 (S.D.N.Y. Apr. 8, 2005) (holding that under the Private Securities Litigation Reform Act (“PSLRA”), in multi-count complaints, the amount of fees shifted are limited to those associated with the frivolous counts only).

175. *See, e.g.*, Fairthorne Maint. Corp. v. Ramunno, C.A. No. 2124–VCS, 2007 WL 2214318, at *9 (Del. Ch. July 20, 2007).

176. *See, e.g.*, Karen Kessler Cain, Comment, *Frivolous Litigation, Discretionary Sanctioning and a Safe Harbor: The 1993 Revision of Rule 11*, 43 U. KAN. L. REV. 207, 216 (1994) (observing that the 1993 amendment to Rule 11 “was enacted after three years of discussion, drafting and debate by all facets of the legal community”); *see also* Nathan R. Sellers, Note, *Defending the Formal Federal Civil Rulemaking Process: Why the Court Should Not Amend Procedural Rules Through Judicial Interpretation*, 42 LOY. U. CHI. L.J. 327, 328–29 (2011) (explaining that a key feature of the Federal Rules is that that they are derived from “public input from a diverse set of constituencies including judges, attorneys, legal publications, law schools, professors, and bar associations” and are approved by multiple governing bodies).

177. *See* S. REP. NO. 104-98, at 13 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 692 (“Many believe that Rule 11 has not been an effective tool in limiting abusive litigation. Complaints about the current system include the high cost of making a Rule 11 motion, and the unwillingness of courts to impose sanctions, even when the rule is violated.”).

178. 15 U.S.C. § 78u-4(c)(2) (2014) (importing Rule 11 into the PSLRA); *see also* Citibank Global Mkts., Inc. v. Rodriguez Santana, 573 F.3d 17, 32 (1st Cir. 2009) (“[T]he PSLRA . . . does not alter the standards used to judge compliance with Rule 11.”); Simon DeBartolo Grp., L.P. v. Richard

Congress not only refused to alter Rule 11's traditional limits on fee shifting; Congress imported those same limits into the PSLRA. For instance, the PSLRA tells courts to presume that attorneys' fees should be shifted when the court finds a violation of Rule 11(b), which defines frivolousness.[179] And the PSLRA explicitly calls for reasonableness and proportionality in its sanctions.[180] Moreover, the PSLRA dictates that attorneys' fees are appropriate sanctions, not only for plaintiffs' conduct (e.g., filing a complaint that substantially violates Rule 11(b)), but also for defendants' conduct (e.g., filing responsive pleadings or dispositive motions that violate the Rule).[181]

In addition, two other equitable limitations on fee-shifting bylaws are not present under Rule 11: (1) courts may refuse to enforce any bylaw because of the manner in which the board of directors adopted or invoked it; and (2) bylaws apply only to those shareholders who "consent" to them. These additional equitable limits also apply to all other bylaws that are tainted by the specter of self-interest.

The first such limitation on these bylaws is that a court may refuse to enforce them because of the manner in which they were adopted or invoked by the board. Under *Unocal,* the board of directors must show that it first adopted a fee-shifting bylaw after careful study, and when it later chose to invoke that bylaw, it had reasonable grounds for believing a danger to corporate policy and effectiveness existed.[182] In contrast, there is no such limit to fee shifting under Rule 11.

As an example, adopting or invoking a fee-shifting bylaw in the midst of litigation—on a so-called "cloudy day"—exposes the bylaw to equitable challenge as adopted or invoked without the proper time for study. This happened in *Roberts v. TriQuint Semiconductor, Inc.*,[183] where an Oregon court refused to enforce an exclusive-forum bylaw that was adopted at the same board meeting during which the board approved the

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E. Jacobs Grp., Inc., 186 F.3d 157, 167 (2d Cir. 1999) ("The PSLRA thus does not in any way purport to alter the substantive standards for finding a violation of Rule 11 . . . ."). Instead, the PSLRA altered the traditional process associated with imposing Rule 11 sanctions. First, the PSLRA makes findings on parties' compliance with Rule 11(b) mandatory upon the final adjudication of a securities-fraud case. Second, the PSLRA eliminates the 21-day grace period for correcting violations of Rule 11. MICHAEL J. KAUFMAN & JOHN M. WUNDERLICH, RULE 10B-5 PRIVATE SECURITIES FRAUD LITIGATION § 13:1 (2015).

179. 15 U.S.C. § 78u-4(c)(1); FED. R. CIV. P. 11(b)(1)-(4).

180. *Id.* § 78u-4(c)(3)(B)-(C) (allowing the district court to impose some sanction other than fee-shifting if awarding fees and costs would be unreasonable, unjust, or disproportionate).

181. KAUFMAN & WUNDERLICH, *supra* note 178, § 13:6.

182. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

183. No. 1402-02441, 2014 WL 4147465, at *4-5 (Or. Cir. Ct. Aug. 14, 2014).

merger that was subject to the underlying suit. The court suggested that it would have enforced the bylaw if "the board . . . adopted it prior to any of its alleged wrongdoing, and with ample time for the shareholders to accept or reject the change."[184] It is no surprise that even as litigators work through *ATP*'s meaning, lawyers advise that the board adopt such a bylaw on a clear day.[185]

The second equitable limit on fee-shifting bylaws—and bylaws generally—is that bylaws govern only those shareholders who "consent" to them. Rule 11, however, is not so limited. Under the Court of Chancery's Rule 11, the court may sanction the lawyers, the law firms, or the parties who violate Rule 11—whether they have consented to the possibility of fee shifting or not.[186]

Defensive tactics can be, and often are, taken solely on the authority of the board of directors, without prior approval by the company's shareholders.[187] But equitable considerations require proper notice and a proper procedure so shareholders have an opportunity to review and

184. *Id.* at *5. *But see* City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 241 (Del. Ch. 2014) (upholding fee-shifting bylaw adopted on an allegedly "'cloudy' day" because plaintiffs did not plead any allegations "demonstrating any impropriety in this timing").

185. *See, e.g.*, Alert Memorandum from Cleary Gottlieb, Muscular Bylaws: *ATP*'s Lessons of Continuing Relevance 2 (June 12, 2014), *available at* http://www.cgsh.com/files/News/e871a487-ad42-4c24-8bb0-47cecfb08be2/Presentation/NewsAttachment/e595815e-291f-4bf9-8d15-4e0a502489ea/Alert%20Memo%20(PDF%20Version)%202014-51.pdf ("It is surely better to adopt bylaw amendments on a 'clear day,' without the pressures and exigencies of the moment, and the concern that those pressures and exigencies will provide a basis for challenging the validity of those bylaws."); Alert from Wilson Sonsini Goodrich & Rosati, Delaware Supreme Court Endorses "Fee-Shifting" Bylaw in Certified Question of Law (May 12, 2014), *available at* https://www.wsgr.com/ WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert-fee-shifting.htm ("This sort of bylaw will be less susceptible to successful challenge if adopted on a 'clear day,' when a board is not facing threatened or pending derivative litigation."); Client Alert from Morrison Foerster, Paradigm Shift? The Delaware Supreme Court Allows Bylaw That Shifts Attorneys' Fees to Loser in Fiduciary Duty Litigation 3 (May 21, 2014), *available at* http://www.mofo.com/~/media/Files/ClientAlert/ 140521Paradigm Shift.pdf ("If the provision is adopted on a 'clear day'—well in advance of litigation or the event triggering litigation—there is a greater likelihood that the provision will be found to be enforceable."); Theodore N. Mirvis, *The Battle Against Multiforum Stockholder Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 25, 2014), http://blogs.law.harvard.edu/corpgov/2014/08/25/the-battle-against-multiforum-stockholder-litigation/ ("The Oregon rulings, which stray far from settled and binding Delaware authority, highlight the indefensible cost and procedural unfairness of duplicative multiforum corporate litigation. . . . In light of the *TriQuint* case and pending further elaboration and acceptance of the legal principles governing forum bylaws, however, boards should consider adopting such provisions on a 'clear day' in advance of any particular anticipated litigation.").

186. DEL. CT. C.P.R. 11(c). *See also* Bus. Guides, Inc. v. Chromatic Commc'ns Enters., 498 U.S. 533, 547–49 (1991) (holding that Rule 11 applies to parties and their attorneys).

187. 4 COX & HAZEN, *supra* note 157, § 23:5.

acquiesce to these terms.[188] As Professor Lawrence A. Hamermesh observes, a fee-shifting bylaw adopted by directors after public investors are already in place has several failings. As he points out, a bylaw unilaterally adopted by the board is not negotiated, nor is there a chance for investors to assess it and make an investment decision based on its presence.[189] Accordingly, while unilaterally adopting a fee-shifting bylaw may be a valid exercise of corporate power, enforcing a unilaterally adopted bylaw may be a different matter.[190]

For example, in *Galaviz v. Berg*,[191] a federal court in California refused to enforce a unilaterally-adopted exclusive-forum bylaw. The court refused to enforce it, observing that a unilaterally adopted forum provision was inconsistent with the general understanding of contract law. The court said that "[u]nder contract law, a party's consent to a written agreement may serve as consent to all the terms therein, whether or not all of them were specifically negotiated or even read, but it does not follow that a contracting party may thereafter unilaterally add or modify contractual provisions."[192]

Delaware law is admittedly broader than the holding in *Galaviz*. Delaware and other courts have rejected its approach, and held that once shareholders authorize the board of directors to "unilaterally adopt bylaws," bylaws may be valid even though the board does not obtain the "contemporaneous" consent of shareholders.[193]

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188. Pitt, *supra* note 136, at 26 (observing that failing to give shareholders proper notice of the board's adoption of a fee-shifting bylaw may "undermine the valuable corporate purposes such provisions serve").

189. Hamermesh, *supra* note 86, at 170–71.

190. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985) (emphasizing that while directors were protected by the business judgment rule when adopting a poison pill, "[t]he ultimate response to an actual takeover bid must be judged by the Directors' actions at that time").

191. 763 F. Supp. 2d 1170, 1174 (N.D. Cal. 2011). Notably, *ATP* upheld the facial validity of a bylaw against members who joined the company before the bylaw was adopted and agreed to be bound by bylaws set by the board afterward, bylaws that explicitly provided could be amended from time to time. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (Del. 2014).

192. *Galaviz*, 763 F. Supp. 2d at 1174. *Galaviz* may be limited by its facts. In that case, the directors already breached their fiduciary duties by the time they adopted the forum-selection bylaw and the court emphasized that this fact was relevant to its decision. *See id.* at 1171 (noting that "[p]articularly where, as here, the bylaw was adopted by the very individuals who are named as defendants, and after the alleged wrongdoing took place, there is no element of mutual consent" necessary to enforce a forum-selection bylaw). Nevertheless, some law firms advise that fee-shifting bylaws stand a better chance of success if they are approved by shareholders. *See, e.g.*, O'Keefe & Hsieh, *supra* note 121 (recommending that fee-shifting bylaws be ratified by shareholders).

193. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 956 (Del. Ch. 2013); *see also* Del. Cnty. Emps. Ret. Fund v. Portnoy, No. 13–10405–DJC, 2014 WL 1271528, at *12 (D. Mass. Mar. 26, 2014); Hemg Inc. v. Aspen Univ., No. 650457/13, 2013 WL 5958388, at *3 (N.Y. Sup. Ct. Nov. 4, 2013). Other courts, however, have recognized that adopting a forum-selection bylaw on a

Yet even under Delaware law, fee-shifting bylaws cannot be applied to former shareholders or third parties—people who otherwise do not "consent" to such a provision, as illustrated by the recent decision in *Strougo v. Hollander*.[194] In *Strougo*, the Delaware Chancery Court held that a fee-shifting bylaw adopted unilaterally that purported to apply to former shareholders could not apply to shareholders who stopped holding an equity stake in the company before that bylaw was adopted.[195] The court explained that bylaws are like contracts between shareholders and managers, and once stockholders buy into the company, they also agree to the terms set forth in the company's bylaws.[196] But if the shareholder's equity interest has been eliminated (either through sale or other means), then that shareholder is no longer part of that contract and terms changed afterward (such as adding a fee-shifting provision) do not apply.[197]

The corollary of *Strougo* is that bylaws also cannot apply to persons who were *never* shareholders. The implication of this is that fee-shifting bylaws cannot apply to those who provide substantial assistance to investigating or pursuing the litigation. The universe of those who fall into the category of providing substantial assistance to an investigation or litigation is exceptionally broad. It may include not just the plaintiffs' lawyer, but confidential witnesses, expert witnesses, private investigators, forensic accountants, and litigation financiers.[198] In terms of the company's fee shifting provision, while stockholders who hold stock at the time of the bylaw may be said to consent to the provision, parties who never own stock do not.[199]

One is likely to respond that a difference between Rule 11 and fee-shifting bylaws under *ATP* is that fee-shifting bylaws make the Rule 11 inquiry mandatory upon dismissals of frivolous cases, making *ATP*'s species of fee-shifting more like the PSLRA and less like traditional Rule

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stormy day coupled with allegations that show this timing was improper would be sufficient reason not to enforce the bylaw. *See, e.g.*, North v. McNamara, 47 F. Supp. 3d 635, 642–46 (S.D. Ohio 2014).

194. 111 A.3d 590 (Del. Ch. 2015).

195. *Id.* at 600.

196. *Id.* at 597–98.

197. *Id.* at 598.

198. *See* John C. Coffee, Jr., *Fee-Shifting and the SEC: Does It Still Believe in Private Enforcement?*, 53 BANK & CORP. GOVERNANCE L. REP. 10, 13 (2014) (stating that some bylaw provisions "are drafted so broadly that they expressly apply to 'investigations' as well as to legal actions, and some also purport to require anyone who assists a plaintiff in such litigation to also share liability for fee shifting," which could include "a shareholder/whistleblower").

199. *See Strougo*, 111 A.3d at 597–98; *see also* Am. Legacy Found. v. Lorillard Tobacco Co., 831 A.2d 335, 343 (Del. Ch. 2003) (stating that "only parties to a contract are bound by that contract").

11.[200] Managers' fiduciary obligations, again, likely preclude fee-shifting bylaws from operating in this manner. First, an automatic application of fee-shifting bylaws would mean that, in some instances, the provision would apply regardless of whether it was good or bad for the company. But under Delaware law, directors of companies cannot be contractually bound to violate their fiduciary duties.[201] A fee-shifting bylaw—a form of contract, says *ATP*—that requires enforcement in all cases may, in some cases, require directors to enforce it where enforcing it would breach their fiduciary duties.

Besides, if the board of directors does not have the ability to waive fee shifting, the board cannot exercise its business judgment to trade fee shifting for a reduced settlement.[202] Others have characterized fee-shifting bylaws that do not contain a provision for board waiver as "reckless."[203] In fact, in *Boilermakers*, where then-Chancellor Strine upheld the facial validity of a forum-selection bylaw, the court observed with approval that the bylaw could be waived in a particular circumstance, serving as a control against misuse.[204]

VI. CONCLUSION

ATP was never a dramatic judicial endorsement of fee-shifting bylaws. Rather, the decision represents a traditional application of the Delaware Way. That Way provides a settled path for the judicial scrutiny of all board behavior. The decision to adopt or invoke any bylaw is an important part of the board's obligation to manage the corporation. Delaware law

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200. Under the PSLRA, findings on a parties' compliance with Rule 11(b) are mandatory upon the final adjudication of a securities-fraud case, including when a case is dismissed with prejudice. 15 U.S.C. § 78u-4(c)(1); *see also* DeMarco v. Depotech Corp., 131 F. Supp. 2d 1185, 1187 (S.D. Cal. 2001).

201. *See, e.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003) (quoting Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 51 (Del. 1993)) ("'To the extent that a [merger] contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable.'").

202. *See, e.g.*, Pitt, *supra* note 136, at 29 ("The board should only adopt a by-law provision that permits the board to exercise its good faith business judgment to waive the provisions of the by-law whenever doing so would be conducive to securing a settlement of litigation.").

203. *Id.* at 22, 25 n.14.

204. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 963 (Del. Ch. 2013); *see also* Grundfest & Savelle, *supra* note 40, at 366, 369 (stating that the ability to waive a forum-selection bylaw "creates an option for the board later to act, consistent with its fiduciary duties, to petition a foreign court to dismiss the action in favor of proceedings in Delaware" and ensures that "[t]he board . . . always retains the discretion necessary to exercise its fiduciary obligations in connection with the decision of whether, when, where, how, and why to seek enforcement" of the forum-selection bylaw).

certainly grants the board a large reservoir of authority to manage the corporation, but in cases of inherent conflicts, it also demands careful judicial examination of board actions to ensure that those actions satisfy the board's equitable and fiduciary duties of care and loyalty. In particular, the board's decision to adopt or to invoke a fee-shifting bylaw—or any bylaw that raises the similar specter of self-interest—must be enjoined where that decision constitutes an improper purpose or is otherwise inequitable under the circumstances.

The Delaware Way requires particularly exacting judicial scrutiny of fee-shifting bylaws, under which most of these fee-shifting bylaws will not survive. Under *ATP* and the Delaware Way, as properly understood and followed by courts relying upon Delaware corporate law, the only fee-shifting bylaws that will survive equitable review are those that shift reasonable fees to the other party (be they plaintiffs or defendants) in cases of frivolous lawsuits or litigation tactics. Accordingly, the only fee-shifting bylaws that would have survived the equitable case-by-case scrutiny of the Delaware courts are those that simply mirror the inquiry already required by Delaware Rule 11. By overturning *ATP* legislatively, the Delaware legislature spared Delaware litigants and the system the lengthy decision-by-decision, common-law process.

Those states that look to Delaware law to guide them in their approach to fee-shifting bylaws have a choice to make. The courts in those states can follow the Delaware Way and impose, case by case, significant equitable limits on adopting or invoking fee-shifting bylaws. Over time, those decisions will preclude the use of any fee-shifting bylaw that does not mirror the state's version of Rule 11. In the end, however, do those states really want to spend the next several years—litigating, incurring costs for defendants, plaintiffs, and the courts—getting to a world that already exists? On the other hand, those states can follow the Delaware legislature's lead and render fee-shifting bylaws facially invalid.