The Delaware Supreme Court’s May 8, 2014 Opinion in ATP Tour, Inc. v. Deutscher Tennis Bund (“ATP”) marked a sudden and potentially transformative moment in the relationship among corporate boards, their stockholders, and the Delaware legal system. This article observes that failure to legislatively override the ATP precedent is likely to eliminate all but the most unusual types of stockholder litigation. The authors juxtapose the evolution of the pertinent jurisprudence with the backdrop of an increase in the volume of deal-related stockholder litigation. Notably, on March 6, 2015, the Delaware Corporation Law Council proposed a recommended amendment to the DGCL to legislatively overrule ATP, to the extent it would apply to public companies. The Council’s proposal is generally consistent with the core conclusion of this article, which consolidates the legal and policy reasons for Delaware legislators and pertinent commentators to support the proposal, particularly in the face of immediate efforts by the U.S. Chamber of Commerce and others to dilute or defeat it.

The article asserts that the “nuclear option” of allowing boards of public companies to employ fee-shifting bylaws against stockholders whose interests they are supposed to represent is poor policy and departs from well-established legal principles. Moreover, such a draconian use of corporate power is not needed to curtail the problem of frivolous lawsuits that achieve no material benefit for stockholders while providing corporate defendants with broad releases. In opposing fee-shifting bylaws, the authors provide legal and policy reasons not to permit bylaws or charter provisions to be used to impede fundamental stockholder rights, including the right to enforce fiduciary duties through litigation. The authors observe that Delaware Supreme Court precedent previously distinguished “process-focused,” bylaws, from substantive bylaws. The process versus substance distinction flows naturally from the statutory treatment of charter provisions, under Section 102 of the Delaware General Corporation Law (“DGCL”), versus that of bylaws, under Section 109. By allowing director-adopted bylaws to regulate substantive and personal stockholder rights, however, the ATP Court applied a more restrictive legal standard to stockholder-adopted bylaws that touches on the functions of directors, than the more deferential standard applied in ATP to assess the validity of director-adopted bylaws that undermine core stockholder rights. The ATP Court also undermined the basis for calling bylaws a standalone
corporate “contract,” because a contract that can be materially modified without consideration or an opportunity to rescind is no contract at all. Most fundamentally, whether discussing bylaws or charter provisions, if the law really views corporate foundational documents as a fully binding contract, then a fee shifting provision is an interested transaction governed by section 144 of the DGCL. Such contracts are voidable absent specific stockholder approval by a disinterested, uncoerced and fully informed majority of disinterested stockholders, approval by disinterested and independent directors, or a judicial determination that the transaction is fair to the company and its stockholders. Finally, Delaware’s hands-off approach to director-imposed fee shifting is also irreconcilable with Rule 11 of the procedural rules, and raises questions of preemption due to conflict with the federal securities laws (thus posing a significant threat to Delaware’s prominence as the leader in establishing corporate law and policy). In sum, for a variety of policy and legal reasons, ATP should be legislatively overruled. The judiciary’s hands are tied by respect for stare decisis and the damage from a failure to prevent unilateral fee shifting will be swift and severe.

Finally, the authors propose an alternative to fee shifting to reduce the number of cases that provide no material benefit to stockholders and put a strain on corporations and the judiciary. Expanding upon the logic that underlies then-Chancellor Strine’s rejection of a settlement in the Medicis litigation, the authors propose a two part test that would eliminate the weakest two-thirds of all stockholder litigation. Under the proposed test, before “disclosure-only settlements” are approved, the Court would affirmatively determine that: (1) the disclosures providing the purported consideration to stockholders are, in fact, material, and (2) subject to judicial discretion to approve a broader release for good cause shown, the release is limited to the benefit of the disclosures obtained, so as to ensure that meritorious claims that were not properly vetted by counsel are not inadvertently or thoughtlessly released. While corporate actors would lose their access to overbroad litigation releases, they could still obtain protection from future suit for conduct that was genuinely vetted through the litigation process. Most important, by applying the above-proposed rule, the number of frivolous suits will decrease, the increasingly hostile criticism of stockholder litigation in the merger context will lose its basis, the societal burden posed by meritless suits will be curtailed, and core stockholder rights and the societal benefit of meaningful stockholder litigation will be preserved.
I. INTRODUCTION

"Private enforcement of [state corporation] law and … federal securities laws is imperfect. No one has written more law journal articles saying that there are imperfections with securities class actions than I. But there’s a strong argument with a very simple theme: You don’t throw the baby out with the bathwater. We… are going to create chaos."

Too much has been said and written about perceived problems in the world of deal-related stockholder litigation. True, it is troubling that a majority of public corporation mergers results in a lawsuit. While the volume of litigation grabs headlines, the real problem is the percentage of these stockholder lawsuits that achieve little, if anything, for stockholders while giving away overbroad liability releases for corporate defendants and paying both plaintiffs’ and defendants’ lawyers. We believe that reducing the incentives to
bring the weakest lawsuits in the first place is beneficial, both for corporate actors looking to pursue a deal in good faith, for investors generally, and for the judiciary. However, those seeking to empower senior executives and directors without limit, such as the U.S. Chamber of Commerce, are using the sheer number of merger-related lawsuits to urge “solutions” that would immunize corporate executives and directors from accountability for all wrongdoing, regardless of how egregious their misconduct.\(^4\) We believe it is critical that purported solutions not throw out the proverbial baby with the bathwater.

The rhetoric surrounding problems in the stockholder litigation field has become overblown. Recent court rulings and legislative acts have endorsed measures that seemed unthinkable less than a year ago.\(^5\) Before the Delaware Supreme Court decided *ATP Tour, Inc. v. Deutscher Tennis Bund*,\(^6\) no one publicly advocated the idea of allowing boards to unilaterally impose bylaws that immunize them from representative litigation to hold them accountable for self-dealing or other corporate misconduct. While the *ATP* Opinion itself expressly applies only to non-stock member corporations, the
Opinion arguably has a broader reach. In the wake of *ATP*, over 50 public companies adopted fee-shifting bylaws.

This article examines the *ATP* ruling from legal and policy precedent perspectives. Finding that *ATP* is inconsistent with various well established common law and statutory protections for stockholders, we find that it is likely to eliminate all stockholder litigation, irrespective of merit. The inability of fee-shifting bylaws to differentiate between meritorious and frivolous suits while impairing fundamental stockholder rights is a fundamental flaw with the entire concept, whether or not *ATP* could somehow be read to conform to Delaware law. Accordingly, the authors support the March 6, 2015 proposal from the Delaware Corporation Law Council to legislatively prohibit the use of fee-shifting provisions in the public company context. Rather than simply criticize *ATP* and support the legislative proposal, we propose a carefully tailored answer to frivolous litigation, which mitigates abuses, conforms to longstanding legal principles, and preserves the benefits of board accountability and meritorious stockholder litigation.

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

In Parts IV and V, we detail the policy and legal problems with the concept of allowing directors to impose fee shifting bylaws, putting in question the relationship between stockholders and boards that forms the foundation of the modern public corporation. If *ATP* applies to public corporations, the Delaware Supreme Court, *sub silentio*, reversed several bedrock principles of Delaware corporate

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7 A new Section 102(f) is proposed to read as follows: "The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys’ fees or expenses of the corporation or any other party in connection with an intracorporate claim, as defined in § 115 of this title." Moreover, a new sentence is proposed to be added to section 109(b) that will prohibit corporations from putting such provisions in the bylaws. Section 115 defines intracorporate claims as follows: "Intracorporate claims' means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery."

Proposed Amendments to 8 Del. C. §§102, 109, and 115.

law and upset the balance of powers between stockholders and boards that has been in existence for decades. No longer will boards have to stay in their proverbial “lane,” and avoid impairing their stockholders’ core personal rights and powers. 9 Statutory distinctions between the substantive rights and powers set forth in a corporate charter and the procedural rules set forth in bylaws are rendered irrelevant if directors have free reign to rewrite substantive stockholder rights as they see fit. Moreover, director imposed bylaws that impair substantive stockholder rights, including the right to sue, do not fit the standard definition of an enforceable contract. Centuries of contract law makes clear that contracts cannot be materially changed without consideration or the ability to rescind. Further, if bylaws – standing alone – are contracts, then fee-shifting provisions in corporate documents are plainly related-party transactions that are void or voidable pursuant to DGCL § 144, absent one of three statutory safe harbors: (1) approval by disinterested and independent directors of the company; (2) approval by a disinterested and fully informed stockholder majority; or (3) judicial determination that the transaction was entirely fair to the company and its stockholders.10 Such director-adopted fee-shifting bylaws also conflict with Rule 11, pertaining to frivolous litigation filings. Moreover, since the federal securities laws generally preempt any state law or agreement that would absolve individuals governed by federal disclosure law of liability for violations, Delaware potentially risks ceding its leadership position to federal law if it allows corporate directors to effectively block stockholder suits regardless of their merit.

In Part VI, we offer an alternative to fee shifting bylaws that reduces the incentive to pursue cases that offer little benefits to stockholders while giving broad releases to corporate defendants,

9 CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 239 (Del. 2008) (characterizing bylaw that stockholders proposed to adopt as an “internal governance contract” and holding it to be an impermissible limitation on directors’ obligation to exercise fiduciary duties); Datapoint Corp. v. Plaza Securities Co., 496 A.2d 1031, 1036 (Del. 1985) (affirming preliminary injunction against enforcement of bylaw that “is so pervasive as to intrude upon fundamental stockholder rights guaranteed by statute.”).

10 DEL. CODE ANN. tit. 8, § 144(b)(1), (2), (3). See also, e.g., In re Cox Commc’ns, Inc. S’holdres Litig., 879 A.2d 604, 614 (Del. Ch. 2005) (“In the absence of [a ratification by a majority of disinterested directors or by a shareholder vote] the transaction is presumed voidable absent a demonstration…that the transaction is fair”); See also Nagy v. Bistrice, 770 A.2d 43, 54 n.21 (Del. Ch. 2000) (“[a] self-dealing transaction that falls within the statute’s reach is voidable unless, at minimum, one of the statutory categories that creates an exception to voidability is satisfied”).

6
without eliminating meritorious stockholder litigation. Our proposal is simple: (1) legislatively prohibit public corporations from imposing fee shifting against stockholders as proposed by the Delaware Corporate Law Council; and (2) apply and modestly expand the holdings of Vice Chancellor Laster’s application of the materiality standard in In re Sauer-Danfoss Inc., S’holders Litig., and then-Chancellor Strine’s rejection of a “disclosure only” settlement in In re Medicis Pharm. Corp. In a disclosure-only settlement, stockholder-plaintiffs should show that the consideration for settling their claims – supplemental disclosures – is material as a matter of law. A disclosure that is not material as a matter of law is not consideration as a matter of fact. Without consideration, there should be no settlement. Defendants seeking a release in a “disclosure only” settlement should show that the release is limited in scope to the disclosures being used as consideration for that release, rather than serving as virtually unfettered insurance protection against a future suit for claims that were never vetted. We believe that a limited availability of a broad release in the disclosure-only settlement context is good policy, in part because corporate boards are required by both federal and state law to make material disclosures whether or not they obtain a personal release. Nevertheless, we recognize that there are instances when a genuinely adversarial and thorough litigation process both leads to a disclosure-only settlement and gives the judicial system comfort that a broader release is not likely to be immunizing serious misconduct that remains hidden because of a lack of diligence on the part of counsel. Thus, courts should retain discretion to permit a broader release when defendants show “good cause.”

A modified application of the holdings of In re Sauer-Danfoss and In re Medicis would strike a far more effective balance of stockholder rights versus director powers than applying the ATP decision to public corporations. As shown by the Chamber of Commerce’s immediate opposition to the Delaware Corporate Law Council proposal, however, this modest idea will find vigorous resistance because under our proposal, corporate directors who engage in disloyal or bad faith conduct remain accountable to the stockholders whose assets they manage and oversee.

11 In re Medicis Pharm. Corp. S’holders Litig., C.A. No. 7857-CS, 2014 WL 1614336 (Del. Ch. Feb. 26, 2014) (rejecting settlement, finding “it looks like there was no “there” there for any claims at all, but we’re giving a release. And if something comes about -- and this is getting to where I just don’t see enough value here that it’s worth the release.”).
12 See Davidoff Solomon, Fisch & Griffith, supra note 4 (summarizing the debate about stockholder litigation).
II. ATP: ALLOWING DIRECTORS TO USE BYLAWS AS A WEAPON AGAINST THEIR STOCKHOLDERS TO AVOID ACCOUNTABILITY

A. THE RIGHT TO SUE IS A PERSONAL STOCKHOLDER RIGHT

One of the fundamental principles of Delaware corporate law is that the business affairs of a corporation are managed by or under the direction of its board of directors. The grant of that power over another person’s property only works because it is constrained by the existence (and enforcement) of fiduciary duties.

Stockholders’ right to enforce management’s breach of fiduciary duty and contractual rights – either directly or derivatively – is a personal property right. When someone buys stock, she personally acquires a bundle of property rights, which includes the right to sue corporate fiduciaries for breach of duty. Courts have recognized that the stockholders’ ability to exercise this right is a core part of Delaware’s governance system and essential to constrain board and management overreach. For example, in In re Anderson Clayton Shareholders Litigation, then-Chancellor Allen noted “the significant institutional role of class and derivative actions in the enforcement of the fiduciary duties assumed by corporate officers and directors.” Similarly, the Delaware Supreme Court has expressly affirmed the importance of the stockholders’ right to hold fiduciaries accountable

13 DEL. CODE ANN. tit. 8, § 141(a) (2014); Quickturn Design Sys., Inc v. Shapiro, 721 A.2d 1281, 1291-92 (Del.1998) (“One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation…. Section 141(a) … confers upon any newly elected board of directors full power to manage and direct the business and affairs of a Delaware corporation.”).

14 See Logan v. Zimmerman Brush Co., 455 U.S. 422, 428 (1982) (considering it “settled” that “a cause of action is a species of property”). Indeed, the right of suit has been treated as a personal property right going back to Greek and Roman law. See Jeremy A. Blumenthal, Legal Claims as Private Property: Implications for Eminent Domain, 36 HASTINGS CONST. L.Q. 373, 373-374 (2009) ("Historically, claims of action, choses in action, rights of suit, and lawsuits themselves have been treated as personal and inalienable.").

15 Aronson v. Lewis, 473 A.2d at *811;Sun Equities Corp. v. Computer Memories Inc., 1988 WL 13565, at *3 (Del. Ch. Feb. 16, 1988) (“The law does recognize that [shareholder actions] are an important part of the overall mechanism of corporate governance.”).

16 1988 WL 97480, at *5 (Del. Ch. 1988); See also Seinfeld v. Coker, 847 A.2d 330, 333 (Del. Ch. 2000) (“It is important for shareholders to bring derivative suits because these suits, filed after the alleged wrongdoing, operate as an ex post check on corporate behavior…. When shareholder plaintiffs bring meritorious lawsuits, they deter improper behavior by similarly situated directors and managers, who want to avoid the expense of being sued and the sometimes larger reputational expense of losing in court”).
through litigation, stating that “[t]he machinery of corporate
democracy and the derivative suit are potent tools to redress the
conduct of a torpid and unfaithful management.”

Until the Delaware Supreme Court’s opinion in ATP, the judiciary
seemed to fairly balance the important powers of directors with the
substantive rights of stockholders. As applied to corporate bylaws,
that meant that director-adopted bylaws had to be equitable to be
valid. Moreover, a board using a bylaw to unilaterally strip
stockholders of substantive rights would presumably overstep its
authority. While the statutory provisions of the DGCL give little
express guidance on bylaws, its structure is informative as to
treatment of stockholders' substantive rights: to sell, vote, and sue.
Textual analysis and the interplay of DGCL sections 102(a)(4) and
109 of the DGCL show that the DGCL permits the regulation of
procedural stockholder rights through bylaws while requiring that
substantive limitations on stockholder rights appear in charter
provisions. Specifically, Section 102(a)(4), in conjunction with
Section 151(a), requires that limitations on the "powers, preferences
and rights" appurtenant to stock ownership must be set forth in a
corporate charter. This contrasts with the language of Section
109(b), which provides that bylaws cannot be inconsistent with the
law or the corporate charter, and which does not trump the
requirements of Sections 102(a)(4) and 151(a). This statutory

17 Rales v. Blasband, 634 A.2d 927, 933 (Del. 1993) (quoting Aronson v. Lewis,

18 ATP, 91 A.3d at 560 (“Legally permissible bylaws adopted for an improper
purpose are unenforceable in equity”); Datapoint Corp. v. Plaza Sec. Co., 496
A.2d 1031, 1036 (Del. 1985) (invalidating board-adopted bylaw amendments
because the “underlying intent” behind them was “to give management an
opportunity distribute ‘opposing solicitation material’ “ to challenge written
(holding that despite the fact that management’s attempt to deprive stockholders
from their franchise rights was legally permissible, the board’s action was
inequitable and therefore void);

19 See, e.g., In re Osteopathic Hosp. Ass’n of Del., 191 A.2d 333, 336 (Del. Ch.
1963), aff’d, 195 A.2d 759 (Del. 1963) (invalidating a membership bylaw because
a “change of so fundamental a character” to the “structure of this rather unique
organization” was improper without the consent of “the group whose interests are
adversely affected,” i.e., the association’s members).

20 Quadrant Structured Products Company, Ltd. v. Vincent Vertin, et al., C.A.
No. 6990-VCL (Del. Ch. Oct. 28, 2014). When a court addresses the question of
whether corporate action conforms with the corporate contract, it examines
whether the action complies with all higher levels of the "corporate contract,
comprising (i) the Delaware General Corporation Law, (ii) the corporation's
charter, (iii) its bylaws, and (iv) other entity-specific contractual agreements, such
as a stock option plan, other equity compensation plan, or, as to the parties to it, a
stockholder agreement.”
hierarchy requires interpreting Section 109(b) as permitting bylaws that "relate to" the rights or powers of stockholders so long as such bylaws do not impair substantive powers, preferences and rights.

This interpretation is consistent with judicial precedent. The law clearly prevents stockholders from using bylaws to override the core powers of directors. In CA, Inc. v. AFSCME Emps. Pension Plan ("AFSCME"), stockholders sought to exercise their statutory right to adopt a bylaw requiring the company to pay the fees of stockholder sponsored proxy solicitations if they enjoyed some measure of success. In invalidating this stockholder-sponsored bylaw, the Delaware Supreme Court recognized the power of stockholders to adopt bylaws under Section 109 of the DGCL, but insisted that the bylaw was facially invalid because, as written, the court could conceive of hypothetical situations in which the bylaw would conflict with the board’s core right to exercise its business judgment in managing the company’s affairs. Until ATP, one would reasonably expect the same judicial skepticism and level of scrutiny if a board were to adopt a bylaw that would conflict with the stockholders’ core rights to vote, nominate, sell shares and bring suit.

B. THE ATP DECISION

ATP arose in an unusual manner. The board of the ATP Tour, a Delaware non-stock, membership corporation, sought to enforce a bylaw imposing fee-shifting on any current or former members if the claim did not achieve “substantially the full remedy sought” in the complaint. The plaintiff members brought suit against ATP and six of its seven board members in the U.S. District Court for the District of Delaware, asserting federal antitrust and breach of fiduciary duty

22 Id. at 246 (“The certified questions, however, request a determination of the validity of the [CA’s] Bylaw in the abstract. Therefore, in response to the second question, we must necessarily consider any possible circumstance under which a board of directors might be required to act. Under at least one such hypothetical, the board of directors would breach their fiduciary duties if they complied with the Bylaw.”) The analysis of the AFSCME court was similar to the application of judicial scrutiny under the First Amendment when the government imposes content-based restrictions on speech. Applying “strict scrutiny,” such restrictions are invalid for “overbreadth” if a regulation that bans unprotected speech also prohibits or chills protected speech in the process. See Ashcroft v. Free Speech Coalition 535 U.S. 234, 255 (2002). Thus, the government faces a heavy presumption against exercising its power to broadly regulate speech. Id. In AFSCME, the Delaware Supreme Court similarly presumed that a stockholder adopted bylaw should be invalidated if it indirectly implicated matters of business judgment.
claims. After ATP obtained a favorable trial verdict, it moved to recover $17 million in legal fees pursuant to its fee-shifting bylaw. The district court held that federal antitrust law preempted the corporate bylaw and denied the motion. On appeal, the Third Circuit Court of Appeals reversed and vacated the lower court's order, holding that the court should first address the validity of the bylaw before considering federal preemption. While both the Third Circuit and the district court made clear their expectation that Delaware law would invalidate a fee-shifting bylaw, the district court certified the question of the fee-shifting bylaw's enforceability to the Delaware Supreme Court.

On May 8, 2014, the Delaware Supreme Court held that boards of non-stock membership corporations can unilaterally adopt a fee-shifting bylaw. Never citing or acknowledging its own AFSCME ruling, the ATP Court treated director-approved bylaws touching upon core stockholder rights very different from its treatment of stockholder-approved bylaws affecting core director rights. While in AFSCME, the Court had conceived of hypothetical ways in which a stockholder adopted bylaw might affect core director powers and would therefore be facially invalid, the ATP court held that as long as it could conceive of a hypothetical situation in which the bylaw did not violate Delaware law, it would be upheld – leaving it to the members of the corporation to challenge the bylaw in a future “as-applied” circumstance. The court never assessed whether fee-shifting bylaws conflict with core stockholder property rights.

An easy way to explain the ATP ruling is to conclude that it is limited to the context of non-stock member corporations. Such a reading is difficult to extract from the plain words of the Opinion. To the contrary, the court’s reasoning seemed to go out of its way to imply that bylaws, even those which are unilaterally adopted by board of directors, must be treated in every way as an independent contract – separate and apart from the Charter and the DGCL –

26 Perhaps because it involved a non-stock corporation or because it began in federal court, there is no indication that anybody in the corporate governance field identified the case as one that could be of interest, much less fundamentally alter the corporate governance litigation landscape.
27 ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 562 (Del. 2014) ("That, under some circumstances, a bylaw might conflict with a statute, or operate unlawfully, is not a ground for finding it facially invalid.").
between the corporation and its stockholders.\textsuperscript{28} Since bylaws are independent contracts, the reasoning went, and fee-shifting provisions are permissible in contracts, directors could unilaterally impose fee-shifting bylaws on stockholders.\textsuperscript{29} The Court also made clear that fee shifting bylaws would bind stockholders who joined the non-public corporation after the bylaw was adopted, and that fee-shifting was viable even if the plaintiff was largely successful in litigation.\textsuperscript{30}

The anti-stockholder litigation tone of the opinion is hard to ignore. Indeed, in giving an example of how a board-adopted fee-shifting bylaw would be held enforceable, the Court stated that “deterring litigation” – with no condition that the litigation is “frivolous” – would generally be a proper corporate purpose.\textsuperscript{31}

Within days of the \textit{ATP} opinion, prominent corporate law firms issued client alerts suggesting that boards of public stockholder corporations consider adopting similar bylaws. As of March 1, 2015, boards of over 50 public entities adopted fee-shifting provisions. As explained herein, a widespread expansion of fee shifting provisions would be tantamount to giving corporate directors and officers immunity against all claims, regardless of merit.\textsuperscript{32}

\textsuperscript{28} ATP, 91 A.3d at 558.
\textsuperscript{29} Id. (“Because corporate bylaws are “contracts among a corporation’s shareholders,” a fee-shifting provision contained in a non-stock corporation’s validly-enacted bylaw would fall within the contractual exception to the American Rule.”).
\textsuperscript{30} The bylaw at issue in the ATP case stated that “In the event that (i) any [current or prior member or Owner or anyone on their behalf (“Claiming Party”)] initiates or asserts any [claim or counterclaim (“Claim”)]… against the League or any member or Owner… and (ii) the Claiming Party… does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the League and any such member or Owners for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys’ fees and other litigation expenses) (collectively, “Litigation Costs”) that the parties may incur in connection with such Claim.” Certification of Questions of Law from the United States District Court for the District of Delaware (Oct. 4, 2013).
\textsuperscript{31} Id. at 560.
\textsuperscript{32} Robert Strougo v. Aaron P. Hollander, et al., C.A. No. 9770-CB, (Del. Ch. Mar. 10, 2015) (TRANSCRIPT) (pointing out that given the stakes, adopting a fee shifting provision would deter an average stockholder from bringing a suit against the company's directors). Another way to effectively immunize all but the most egregious misconduct comes from a concerning recent trend of "minimum-stake-to-sue" bylaws that require a potential plaintiff to deliver written consent from the owners of at least a certain percent of the company’s outstanding shares in order to bring a class action or derivative suit. \textit{See} Alison Frankel, \textit{Shareholder challenges minimum-stake-to-sue bylaw}, Reuters, Jun. 21, 2015,
If ATP is applied to public corporations, the message is clear: stockholders cannot amend bylaws to preemptively dictate how proxy costs will be allocated (i.e., the bylaw invalidated in AFSCME), but directors can unilaterally amend the bylaws to preemptively allocate litigation costs to stockholders, even for claims that are largely vindicated (i.e., the bylaw upheld in ATP). This disparate treatment creates an imbalance in the law. When considering a facial bylaw challenge, courts should not ignore the nature of the bylaw and the rights affected. Analogizing bylaws to Acts of Congress can be helpful in this regard. Traditionally, when a citizen brings a facial challenge to an Act of Congress, the government merely has to show a rational basis for the legislation. However, the Government’s burden increases significantly when legislation infringes upon a fundamental right, such as the free speech and association rights protected by the First Amendment. In that case, courts will strike down the legislation if the government cannot show that the legislation is narrowly tailored to achieve a compelling governmental interest.

Under Delaware law, as well as most other jurisdictions, stockholders have three core substantive rights: nominating and voting for directors, selling their shares, and suing those who violate their fiduciary, securities laws, and contractual duties. Put differently, the stockholders’ rights to vote, nominate, sell shares and bring suit for misconduct can be viewed as the corporate equivalent to fundamental citizens’ rights guaranteed by the U.S. Constitution. When directors impair the stockholders’ ability to exercise their substantive rights, skeptical judicial scrutiny is warranted. The standard for directors who act for the principal purpose of preventing stockholders from exercising their fundamental right to elect a majority of new directors was set forth in the seminal case of Blasius, where then-Chancellor Allen crafted a stringent test that permitted a board to so act if the board could show a compelling

http://blogs.reuters.com/alison-frankel/2015/01/21/shareholder-challenges-over-minimum-stake-to-sue-bylaw/ (report of a stockholders suit against a company and its directors that adopted a minimum-stake-to-sue bylaw without stockholders consent, seeking an injunction against enforcement of the provision).

35 See e.g., ROBERT C. CLARK, CORPORATE LAW §3.1, at 93–105 (1986) (discussing the extent of these rights); see also WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 96 (4th ed. 2012) (“[The default powers of shareholders [are] three: the right to vote, the right to sell, and the right to sue.”);
justification for its decision. Likewise, enhanced judicial scrutiny applies when directors prevent the company's stockholders from deciding to sell their shares. Delaware authorities and sound corporate governance principles strongly suggest that courts should apply a similarly stringent test to assess director actions that impinge on the stockholders substantive right to bring a suit for director misconduct.

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

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

A. BEFORE ATP, BYLAWS WERE THE “PROCESS-BASED” PART OF THE BROADER CONTRACT BETWEEN COMPANIES AND STOCKHOLDERS

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

56. 564 A.2d 651, 661-662 (Del. Ch. 1988).
57. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 92 (Del. Ch. 2011) (reviewing board’s maintenance of the company’s stockholders rights plan in the face of an unfriendly cash tender offer the board determined was inadequate under an enhanced scrutiny that was set forth in the Delaware Supreme Court’s 1985 decision in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985))
59. See, eg, Chevron; Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010) (stating that “charters and bylaws are contracts among a corporation’s shareholders”); Kidsco Inc. v. Dinsmore, 674 A.2d 483 (Del. Ch. 1995) (“the plaintiffs claim that they had an enforceable contract right to proceed under the then existing by-law, and the directors lacked any power to amend it. The difficulty with the argument is that its “vested right” premise is wrong…although the by-laws are a contract between the corporation and its stockholders (Centaur Partners), the contract was subject to the board’s power to amend the by-laws unilaterally.”)
Read together, Sections 102(a)(4) and 109 of the DGCL make clear that bylaws can be used to change procedural stockholder rights but not substantive stockholder rights, which require stockholder approval in the form of a charter amendment. Specifically, section 102(a)(4) of the DGCL, provides that “powers, preferences and rights, and the qualifications thereof, which are permitted by [DGCL] § 151” with respect to stock of a public corporation “shall” be set forth in the certificate of incorporation. Thus, qualifications on the “right to sue” inherent in stock of a public corporation must be included in the charter.40

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

Decades of case law came to the same conclusion.41 In 1933, the Court of Chancery noted:

as the charter is an instrument in which the broad and general aspects of the corporate entity’s existence and nature are defined, so the by-laws are generally regarded as the proper place for the self-imposed rules and regulations deemed expedient for its convenient functioning to be laid down.42

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

Traditionally, the bylaws have been the corporate instrument used to set forth the rules by which the corporate board conducts its business. To this end, the

40 Notably, section 102(a)(4) of the DGCL further makes clear that this provision does not apply to non-stock corporations, such as the one at issue in the ATP decision.

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

42 Gow v. Consolidated Coppermines Corp., 165 A. 136, 140 (Del. Ch. 1933)
DGCL is replete with specific provisions authorizing the bylaws to establish the procedures through which board and committee action is taken. There is a general consensus that bylaws that regulate the process by which the board acts are statutorily authorized.43

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

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

B. **HOW THE REASONING IN SUPPORT OF FORUM SELECTION WAS STRETCHED TO ENDORSE FEE SHIFTING**

The doctrinal arc that ends with *ATP* started with a more modest discussion about the problem of identical lawsuits in multiple fora. Over the past decade, stockholders have increasingly filed identical lawsuits in multiple fora, in particular in the M&A context. Without bothering to actually quantify or objectively assess the true societal cost from multiple forum litigations (no doubt because in almost every instance of multi-forum parallel litigations, only one action in one court was actively litigated while the remainder were stayed and additional cost from parallel litigation was marginal, at best), the corporate community determined that multi-forum litigation was a plague that must be squashed.

As a proposed solution to this supposed “epidemic,” in the spring of 2007, a prominent corporate attorney suggested that Delaware corporations select Delaware as the exclusive forum for intra-

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corporate litigation in their bylaws.\textsuperscript{44} Notably, that article advocated that directors could unilaterally amend the contract without the consent of the stockholders and without either consideration or an opportunity to rescind.

Delaware courts did not initially embrace the author’s suggestion that bylaws were a proper means to select a judicial forum. Most notably, in his opinion in \textit{In re Revlon, Inc. Shareholder Litigation}, Vice Chancellor Laster noted that “if board of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free [pursuant to section 102(b)(1) of the DGCL] to respond with charter provisions selecting an exclusive forum for intra-entity disputes.”\textsuperscript{45} The Vice Chancellor spoke specifically of charters, which require stockholder approval, and never suggested that companies could achieve forum selection through a bylaw alone. Perhaps recognizing that stockholders are not losing too much sleep about the purported (but never objectively quantified) costs of multi-forum litigation and might be opposed to giving up their choice of forum, Delaware companies were initially reluctant to adopt exclusive forum provisions in their charters. Of the 430 Delaware companies filing for an IPO during 2010, only 21 (4.9\%) included an exclusive forum selection provision in the charter.\textsuperscript{46}

In 2013, then-Chancellor Strine’s decision in \textit{Chevron} squarely empowered boards to unilaterally select forum for intra-corporate litigation.\textsuperscript{47} The court ruled that director-adopted forum selection bylaws are facially valid under Delaware law.\textsuperscript{48} True to prior precedent, the court held that a corporation’s bylaws are part of a

\textsuperscript{44} Theodore N. Mirvis, \textit{Anywhere But Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions}, 7 M&A J. 17 (May 2007).

\textsuperscript{45} \textit{In re Revlon, Inc. S'holder Litig.}, 990 A.2d 940, 960 (Del. Ch. 2010) (emphasis added).

\textsuperscript{46} Brian J.M. Quinn, \textit{Shareholder Lawsuits, Status Quo Bias and Adoption of the Exclusive Forum Provision}, 45 U.C. Davis L. Rev. 137, 171-72 (Nov. 2011); See also, John C. Coffee, \textit{The Delaware Court of Chancery: Change, Continuity – and Competition}, 2012 Colum. B. L. Rev. 387, at *401 (2012) (“Four explanations for their caution seem plausible: (1) legal uncertainty deters some issuers, particularly in view of pending litigation; (2) for other issuers, apathy still reigns, as the prospect of M&A litigation is not sufficiently material to them to justify an advance response; (3) more corporations appear to fear that proxy advisors will resist such a proposed charter amendment and cause institutional investors to vote it down; and (4) some corporations may actually want multi-forum litigation because it reduces the likely settlement they will have to pay in the event of a future M&A transactions in which they are the target”).

\textsuperscript{47} \textit{Boilermakers Local 154 Retirement Fund v. Chevron Corp}, 73 A.3d 934, 939 (Del. Ch. 2013).

\textsuperscript{48} \textit{Id.}
larger, binding contract among directors and stockholders under the rubric of the Delaware General Corporation Law, which permits a corporation, through its charter, to grant directors the power to adopt and amend bylaws unilaterally. In other words, the court held that when stockholders acquire stock, they consent to the directors’ power to amend bylaws. As long as the proper subject matter for bylaws remained constrained, however, this aspect of the ruling did not portend a fundamental change in the delicate balance of power within the public corporation.

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

Notably, the pending legislative proposal from the Delaware Corporate Law Council addresses both forum selection and fee shifting, statutorily enshrining the former while invalidating the latter. This different treatment is consistent with the arguments made herein, and reflects a balanced approach between the board’s ability to decide procedural issues through bylaws while preserving core stockholder rights. Besides falling on the process side of the line set by AFSCME, forum selection bylaws serve the additional

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49 Id. at 957.
50 A new Section 102(f) is proposed to read as follows: "The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an intracorporate claim, as defined in § 115 of this title." Moreover, a new sentence is proposed to be added to section 109(b) that will prohibit corporations from putting such provisions in the bylaws. Section 115 defines intracorporate claims as follows: "Intracorporate claims' means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." Proposed Amendments to 8 Del. C. §§102, 109, and 115.
purpose of preserving Delaware’s ability to develop its corporate common law through its own judicial system.

C. COMMONWEALTH REIT: FROM SELECTING FORUM TO DICTATING THE TERMS ON WHICH STOCKHOLDERS BRING SUIT

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

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

IV. THE REAL WORLD IMPLICATIONS OF APPLYING ATP TO PUBLIC CORPORATIONS

In the wake of the ATP decision, prominent national law firms, including at least two law firms counting former members of the

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52Although not decided under Delaware law, the Commonwealth case oversteps the dividing line set up by AFSCME with respect to bylaws. Whereas a forum selection provision is arguably “process-based” and only determines where the stockholder can bring claims, the arbitration provision at issue in Commonwealth REIT also altered substantive stockholder rights, including a prohibition on fee awards and fee shifting through indemnification. For its part, ATP did not cite AFSCME. As explained herein, if ATP applies to public corporations, it appears to have overruled AFSCME’s process versus substance distinction sub silentio.
Delaware Court of Chancery as partners, publicly issued statements suggesting that their current and potential board clients “seriously consider adopting fee-shifting bylaws of their own.” Although decided in the context of a non-stock corporation, lobbyists and lawyers representing the interest in entrenched directors of public corporations were urging their clients to use a broad reading of *ATP* to immunize their conduct from judicial oversight by imposing liability for associated fees and expenses directly on stockholders.

By the end of 2014, over 50 public companies, including multi-billion dollar companies, adopted either bylaws or charter provisions requiring a stockholder who is not completely successful in litigation to pay the legal fees of corporate defendants. Indeed, reflecting an aggressive but predictable response to the *ATP* decision, and the ambiguity created by the Delaware legislature’s delay in a statutory clarification or correction, some corporations adopted bylaws similar to or even more extreme than those approved in *ATP*.

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55 http://www.ncpers.org/files/Conference%20Docs/Legislative%20Conf/2015%20Presentations/Darren%20Check%20and%20Lee%20Rudy.pdf (noting that 53 public stock companies have adopted fee-shifting bylaws since the *ATP* decision).

56 This bylaw provision, adopted by American Spectrum Realty, Inc. on July 25, 2014, is typical:

To the fullest extent permitted by law, in the event that (i) any current or prior stockholder of the Corporation or anyone on their behalf, in the capacity of a stockholder of the Corporation (“Claiming Party”) initiates or asserts any claim or counterclaim against the Corporation (“Claim”) or joins, offers substantial assistance to or has a direct financial interest in any Claim against the Corporation and/or any director, officer, employee or affiliate (including any claim filed derivatively on behalf of the
Fee-shifting provisions undermine all representative stockholder litigation, regardless of merit. In traditional stockholder litigation, stockholder-plaintiffs seek to correct misconduct for the benefit of all stockholders. Hence, under the ruling in *ATP*, stockholders face a dilemma of recovering only part of any damage award if they win, while paying the full defense fee if they obtain a partial win.  

In this context, no matter how strong a case, and irrespective of whether a stockholder is willing to bear the cost of paying for its own counsel or chooses to pursue claims through contingency counsel, few, if any, stockholders could initiate or support an action in which the stockholder’s personal liability for the company’s defense costs is completely out of the stockholder’s control and will rise exponentially the longer a case continues. Indeed, it will be difficult for even the largest institutional investors to take the risk of paying millions, or tens of millions, of dollars in defense attorneys’ fees to correct corporate misconduct when their individual, pro rata share of the potential benefit or recovery created by the litigation will only be a fraction of the total benefit sought, and when achieving a “full remedy” is not possible absent lengthy proceedings.  

Corporation), and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the Corporation and any such director, officer, employee or affiliate for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys’ fees and other litigation expenses) that the parties may incur in connection with such Claim.

57 By threatening to impose defense counsel’s fees on a stockholder-plaintiff, fee-shifting bylaws strike at the very purpose and nature of class and derivative stockholder litigation. *See Noerr v. Greenwood*, No. 14320-NC, 2002 WL 31720734, at *2 (Del. Ch. Nov. 22, 2002) (“Class actions enable parties that have small individual stakes to overcome the often-prohibitive transactional costs of bringing a lawsuit, by suing on behalf of other parties who are similarly situated.”); John C. Coffee, Jr., *Litigation and Corporate Governance: An Essay on Steering Between Scylla and Charybdis*, 52 GEO. WASH. L. REV. 789, 812 n.54 (1984) (in addressing certain criticisms of corporate law, acknowledging that “so long as a contingent fee system is essential to the enforcement of derivative actions, the English rule of fee shifting would deter most plaintiffs from commencing such an action, because the nominal plaintiff stands to receive no portion of the recovery in a derivative action (if successful) and yet would be liable for the other side’s attorneys’ fees (if unsuccessful). Even if the lawyer could enforce the action himself (without the need for a client), a substantial asymmetry would remain because the defendants’ fees would typically exceed the expected fee award to the plaintiff”).

58 The fees at issue in *ATP*, for example, were $17,865,504.51.
counsel of CalPERS, the largest public pension fund in the United States, noted in the CommonWealth REIT case, CalPERS would not be able to justify stockholder litigation due to the fact that *pro rata* benefit of any class or derivative recovery to CalPERS itself would make up only a fraction of the expenses of litigation.\(^{59}\)

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

As a result, directors and officers will be largely insulated from accountability for breaches of fiduciary duty. Indeed, fee-shifting bylaws incentivize defendant-directors to use their ability to spend stockholder funds to retain numerous and expensive law firms as a weapon to deter and undermine even the most valid of stockholder claims. Without the realistic threat of representative stockholder litigation, there will be little to deter fiduciary misconduct. Thus, the enforcement and monitoring functions played by stockholder litigation will be lost. Without question, the temptation for boards of directors to adopt fee-shifting bylaws, under the guise of deterring purportedly “frivolous” litigation, will be overwhelming, given that stockholders’ only other recourses to hold their fiduciaries to account will be to vote them out of office or repeal the litigation limiting bylaw – themselves are not costless or seamless, and are a rarity.\(^{60}\)

In justifying the application of *ATP* to public companies, some corporate advocates have compared *ATP* style fee-shifting bylaws to fee shifting under the “*English Rule*” in which the “loser” in litigation pays the winners’ fees. Even a simple loser pays system leaves little or no room for investors to bring valid claims. In explaining why American courts “have generally resisted any movement” towards the English Rule, former U.S. Supreme Court Chief Justice Earl Warren noted that “since litigation is at best


\(^{60}\) Folk Report at 97 (referring to the “value, however, irritating at times and to some managements, of private, as distinguished from governmental, enforcement of fiduciary duties”).

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uncertain one should not be penalized for merely defending or prosecuting a lawsuit, and … the poor might be unjustly discouraged from instituting actions to vindicate their rights if the penalty for losing included the fees of their opponents’ counsel.\(^{61}\)

But ATP is not about “loser pays.” It is about “substantial winner” pays. Specifically, ATP-style fee-shifting bylaws go far beyond the English Rule, which merely requires the losing party to pay the winning party’s attorney’s fees without regard for the exact relief the winning party had requested.\(^{62}\) A partial victory by a defendant on one small issue would not result in the entire fee being shifted to the plaintiff under the English Rule. By contrast, following the Delaware Supreme Court’s ATP decision, boards can unilaterally adopt a bylaw requiring payment of legal fees by any plaintiff member who is not entirely successful on all her claims.\(^{63}\)

This rule chills almost all litigation. Even a plaintiff with a highly meritorious case knows that she will almost inevitably not get all of the relief sought.\(^{64}\) Thus, absent a legislative clarification or correction, ATP may well spell the end of stockholder litigation entirely, which in turn would eliminate the prospect of any form of governance of fiduciary misconduct, since there is no government regulator of fiduciary duties. All fiduciary oversight was left to stockholders, voting, selling or suing. ATP gives directors a weapon to override at least some, and perhaps even all, of these core stockholder rights.

V. THE SIGNIFICANT LEGAL FLAWS OF ATP

A. THE ATP VIEW OF BYLAW-AS-STANDALONE CONTRACT IS INCONSISTENT WITH BASIC CONTRACT LAW PRINCIPLES

Under basic contract law, modification of a contract between individuals requires mutual agreement and some form of consideration — i.e., some benefit in exchange for the agreement or (at least) an opportunity to rescind the agreement.\(^{65}\) Cases in which


\(^{62}\) Hensley v. Eckerhart, 461 U.S. 424, 443 (“[E]nglish rule”, under which the losing party, whether plaintiff or defendant, pays the winner’s fees”).

\(^{63}\) American Spectrum Realty, Inc. July 25, 2014 8-K; see also bylaw in ATP (“substantially all” relief).

\(^{64}\) To be sure, Delaware law is already so highly protective of corporate directors that it is hard to fathom any situation in which a plaintiff could confidently file suit with the expectation of obtaining all relief sought.

\(^{65}\) De Cecchis v. Evers, 174 A.2d 463 (Del. 1961).
Delaware courts have upheld fee-shifting provisions in other types of contracts are instructive. Courts have emphasized the fact that these provisions were included in the contract as part of a bargained-for exchange, such as in contracts for land or for goods or services, and have stated that the fee shifting agreements may have been part of the reason that people were induced to enter into the contracts in the first place.\(^{66}\) Further, while courts also allow such agreements in employment contracts, they are wary of the potential for disparities in bargaining power, and indicate that they might not always be enforceable.\(^{67}\) The ability to bargain for such a provision is paramount.

Board-adopted bylaws have neither of these attributes: stockholders neither specifically agree to the bylaw nor do they receive anything in return. This type of authorization for unilateral modification might raise a Corbin or Williston eyebrow and is virtually unheard of in any type of contract.\(^{68}\) Yet, the Delaware Supreme Court’s endorsement of blanket stockholder “consent” (while ignoring the lack of any consideration or ability to rescind) is being employed to potentially impose significant liability on stockholders for holding their fiduciaries to account for misconduct.\(^{69}\)

If boards of directors of public corporations are permitted to upend the economic and legal rights of stockholders through

\(^{66}\) Dittrick v. Chalfant, No. Civ.A. 2156-S, 2007 WL 1378346 (Del. Ch. 2007) (“In recognition that inclusion of such a clause may well have helped induce a party to sign an agreement, Delaware courts will ‘routinely enforce provisions of a contract allocating costs of legal actions arising from the breach of a contract.’”); See also Knight v. Grinnage, No. 14823, 1997 WL 633299, at *3 (Del. Ch. Oct. 7, 1997) (“The parties who enter into a contract have the opportunity during the course of their negotiations to add to the contract any provision appropriately bargained for which would place the responsibility for payment of attorney’s fees on any party who either breaches the contract or fails to perform in accordance with the terms of the contract.”).

\(^{67}\) Research & Trading Corp. v. Pfuhl, Civ. A. No. 12527, 1992 WL 345465, at *15 (Del. Ch. 1992) (“The special context of an employment contract may be thought to raise special concerns. Employees as a class may be thought to lack bargaining power vis a vis their employers and thus the enforcement of a provision shifting legal fees in an employment contract may, at least in some cases, offend the policy of the law that has sought to permit necessitous persons to avoid oppressive bargains that were forced upon them”); see also All Pro Maids, Inc. v. Layton, No. Civ.A. 058-N, 2004 WL 1878784 (Del. Ch. 2004).

\(^{68}\) Union Pac. R.R. v. Chi., Milwaukee, St. Paul & Pac. R.R., 549 F.2d 114, 118 (9th Cir. 1976) (“One party cannot unilaterally modify a contract without the consent of the other party…or without a consideration.”).

\(^{69}\) For example, $17,865,504.51 in attorneys’ fees was at issue in the ATP Tour case.
unilaterally-adopted bylaws, the notion of what it means to be a stockholder of a Delaware corporation will change radically. The effect of this opinion can be mitigated with a simple ruling: bylaws are “like” contracts, but cannot impair substantive investor rights. This rule of law can distinguish forum selection clauses (whether in charters or bylaws) from fee shifting provisions. Forum selection is arguably a simple part of the procedural way in which intra-corporate disputes are adjudicated, without actually changing any of the substantive rights of investors, companies or directors. Fee shifting, on the other hand, fundamentally impairs stockholders’ substantive rights, while undermining both the balance the law should strive to achieve and limiting the judiciary’s ability to ensure that the law evolves to maintain that balance as industry practices evolve.

B. BOARD-ADOPTED FEE SHIFTING PROVISIONS ARE RELATED-PARTY TRANSACTIONS THAT ARE VOID OR VOIDABLE

Delaware’s corporation law presumes that, in the normal course, boards conduct affairs with a focus on the best interests of the corporation.70 Embedded in the rule, however, is the notion that the directors must not let personal interests, which may diverge from those of the corporation, guide their exercise of their statutory authority.71 The law’s suspicion of interested transactions is also embedded in the statute. Specifically, section 144 of the DGCL provides that a transaction between a corporation and an officer or director in which the director or officer has a financial interest is void or voidable unless the contract or transaction is approved, after full disclosure, either by: 1) a majority of the disinterested and independent directors; 2) a good faith vote of the disinterested stockholders, or 3) judicial determination that the transaction is fair to the company and its stockholders.72

70 8 Del. C. § 141(a); See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (stating business judgment rule “is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in honest belief that the action taken was in the best interest of the company.”).

71 See Van Gorkom, 488 A.2d at 872–73 (“Since a director is vested with the responsibility for the management of the affairs of the corporation, he must execute that duty with the recognition that he acts on behalf of others. Such obligation does not tolerate faithlessness or self-dealing....Representation of the financial interests of others imposes on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information of the type and under the circumstances present here. Thus, a director’s duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty.”)

72 DEL. CODE ANN. tit. 8, § 144(b)(1), (2), (3).
Boards are inherently interested in and benefit from provisions that eliminate virtually all prospect of personal liability, regardless of the egregiousness of their conduct. Thus, even if bylaws are standalone contracts that can deny stockholders substantive rights, adoption of fee-shifting provisions without stockholder consent constitute self-interested transactions that are void or voidable pursuant to Section 144. By the same token, as many companies are held by controlling stockholders or groups, enforcement of a fee-shifting charter provision would require ratification of the disinterested majority, or at the very least, proof of entire fairness.

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

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

C. ATP RUNS COUNTER TO DELAWARE’S CAREFULLY BALANCED RULE 11 REGIME

Addressing the specific problem of frivolous litigation did not require the blunt and overbroad solution of fee-shifting bylaws. First, Delaware already has a rule in place to deter abusive litigation. Rule 11 of the Rules of Civil Procedure for the Superior Courts of

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Delaware, which is modeled after Rule 11 of the Federal Rules of Civil Procedure, does not permit fee-shifting merely because a claim is unsuccessful. To the contrary, the Rule allows fee shifting only after a specific judicial determination that the claim was not based on a non-frivolous argument for the extension, modification, reversal of law, or the establishment of new law. The sanction of fee shifting cannot be entered just because a party does not prevail.

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

As with the different standards applied to facial challenges of stockholder-adopted versus director-adopted bylaws, the divergence between the burden a stockholder faces to impose fee shifting on defendants under Rule 11 and the ease with which directors can unilaterally impose fee shifting under ATP is difficult to follow. Most recently, the Court of Chancery assessed a request for an award of fees for purportedly egregious discovery abuses and misrepresentations to the Court by an investment bank. In In re Rural Metro, the Court specifically found, as required to impose any fee shifting, a wide range of stunning misconduct by the defendant bank and its counsel. While the Court unequivocally found that affirmative misrepresentations to the Court and similar judicial misconduct was “egregious,” it did not rise to the level of being “glaringly egregious,” and thus did not support a significant shifting of fees. Regardless of what happens on appeal in the Rural Metro case, it is clear that directors and their advisors will know that they can take aggressive litigation positions without exposing themselves to fee shifting under Rule 11. Yet, under ATP, the directors can unilaterally expose stockholders to fee shifting even if the stockholder does nothing wrong, simply because the lawsuit is not completely successful.

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75 Id.
76 Ct. Civ. R. 11(c)(2) ("A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated").
78 Id.
D. **ATP Invites Federal Preemption**

The stark contrast between the effect of fee-shifting bylaws on the rights of stockholders to hold their fiduciaries accountable and the requirements of Rule 11 underscores how such bylaws impair substantive stockholder rights. Unlike fee-shifting bylaws, Rule 11 cannot impair substantive rights. The federal Rules Enabling Act prohibits the United States Supreme Court from promulgating any rule of procedure that abridges, enlarges or modifies any substantive right.79 Rule 11 therefore does not, and cannot, alter substantive law, or tip the balance in favor of or against any particular parties. As the drafters of Rule 11 acknowledged, a blanket fee shifting rule would have done just that.

Moreover, using state corporation law to undermine or insulate oneself from potential liability for all intra-corporate disputes (including disputes over the board’s duty of candor and related disclosure obligations) may invite Congressional action or judicial rulings harming Delaware’s prominent role in setting corporate law. Congress has, in recent years, shown little hesitancy to intervene in the corporate governance process, overturning state regulation, particularly when state law is perceived to inadequately protect the investing public. The two most prominent (but not exclusive) examples are the corporate governance related provisions of the Sarbanes-Oxley Act of 200280 and the Dodd-Frank Act of 2010.81 With respect to public companies, federal rather than state law now regulates the membership (and in many respects the functioning of) audit committees, provides a partial “say-on-pay” on executive compensation matters, and regulates certain financial relationships among corporations, and their directors and executive officers. Since ATP’s effects can clearly be felt in interstate (and international) commerce, it should be no surprise that some members of Congress have publicly advocated intervention on the matter.82

Federal courts and the Securities and Exchange Commission will face pressure to find that Delaware law and similar state laws

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permitting fee-shifting bylaws are preempted to the extent they interfere with protected rights under the federal securities laws.\footnote{While the Delaware courts have held that litigation limiting bylaws may only regulate stockholders’ ability to bring internal affairs claims, some publicly traded companies keep adopting bylaws provisions that purport to extend to any claim, including securities claim. See, e.g., Boilermakers Local 154 Retirement Fund v. Chevron Corp., 73 A.3d 934, 952 & n.78, 960 n. 129 (noting that matters of internal affairs were not appropriate subjects for corporate bylaws); ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014) (confining discussion to intra-corporate claims); Henry duPont Ridgely, The Emerging Role of Bylaws in Corporate Governance, http://www.delawarelitigation.com/files/2014/11/The_Emerging_Role_of_Bylaws_in_Corporate_Governance-copy.pdf, at 16 (affirming that the ATP holding was confined to internal affairs claims); Ann M. Lipton, Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws, 104 93 Geo. L. Rev. ___ (2015) (noting that the Delaware courts have acknowledged that litigation-limiting bylaws would have no application to securities claims).} Most fundamentally, while Rule 11 is itself a rule of procedure, not one of substance, the PSLRA arguably incorporates this procedural rule as a part of Congress’s substantive regulation of securities transactions, including those involving Delaware companies. Specifically, in the PSLRA, Congress established a heightened pleading standard for federal securities claims to deter the filing of frivolous suits. But Congress purposely went beyond the pleading standard. Under Section 21D(c)(3) of the Securities Exchange Act of 1934 (which is part of the PSLRA), a presumption in favor of fee-shifting is created if any motion or pleading fails to comply with Rule 11(b) of the Federal Rules of Civil Procedure. This two-sided and balanced approach is equally punitive to both sides in making fee-shifting (rather than some lesser financial sanction) the presumptive penalty. But before allowing fee shifting, Congress specifically required the federal court to actually find a violation of Rule 11. This aspect of substantive federal securities law almost certainly conflicts with automatic and one-sided fee-shifting that leaves no role for judicial review.

Moreover, both the Securities Act of 1933 and the Exchange Act of 1934 preempt provisions that cause persons to “waive compliance” with the requirements of these Acts.\footnote{See Section 29(a) of the Exchange Act and Section 14 of the 1933 Act.} Whether or not a fee-shifting bylaw is a means to “waive compliance” with federal law is, of course, a matter of perspective. But to the extent that fee shifting bylaws will effectively insulate directors from liability for their duty of candor and related disclosure obligations while private litigation under the federal securities laws is a well-established
component of our overall disclosure law framework, a failure to correct the effects of ATP in the public company context at least raises a credible question of preemption or inconsistency with the federal scheme.

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

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

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

A. REPRESENTATIVE LITIGATION PROVIDES SIGNIFICANT BENEFITS TO INVESTORS AND CORPORATIONS ALIKE

“So what,” readers of this article may be asking themselves, “Who cares if representative stockholder litigation goes by the wayside?” Everyone should care. Whatever problems exist in the stockholder litigation field, stockholders should never be stopped from pursuing


87 See Globus v. Law Research Service, the Second Circuit 418 F.2d 1276, 1289 (2d. Cir. 1969) (rejecting indemnification for an underwriter’s knowing misrepresentations).
credible claims for board misconduct, and society will be far worse off if stockholders are blocked from doing so.

Meritorious stockholder litigation not only can compensate aggrieved investors with a significant monetary recovery, it can achieve a deterrent to corporate executives who may have to contribute to the compensation and who want to avoid the “shaming effect” of adverse judicial rulings. Smart litigation also elicits judicial guidance regarding the propriety of corporate practices, thus providing boards and their legal and financial advisors acting in good faith critical information about how to conduct themselves when making critically important decisions affecting the corporation and its stockholders. In other words, smart stockholder litigation not only remedies wrongs from the past, but it creates value-enhancing benefits for the future.

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


90 Recent precedents like Southern Peru illustrate the substantive benefits generated for stockholders by prosecuting and monitoring corporate governance failures. See In re S. Peru Copper Corp. S’holder Derivative Litig., 52 A.3d 761 (Del. Ch. 2011), aff’d, Ams. Min. Corp. v. Theriault, 51 A.3d 1213 (Del. 2012) (merger litigation resulted in $1.347 million damages); see also In re Rural/Metro Corp. S’holder Litig., 102 A.3d 205 (Del. Ch. Oct. 10, 2014) (awarding $75.7 million to stockholders in a lawsuit stemming from a company buyout); In re News Corp. S’holder Derivative Litig., 2013 WL 3231515 (Del. Ch. June 26, 2013) (approving $139 million settlement of stockholders claims that the company’s managers turned a blind eye to illegal conducts at the company); In re Delphi Fin. Grp. S’holder Litig., C.A. No. 7144–VCG, 2012 WL 729232 (Del. Ch. March 6, 2012) (approving settlement under which merger target’s controlling stockholder
Del Monte, El Paso and Vivendi-Activision cases are illustrative of important monetary victories for stockholders and “teaching moments” for managers and directors.

In the Southern Peru case, the Delaware Court of Chancery issued a post-trial opinion ruling in October 2011 that the stockholder class was entitled to recover damages of $2.1 billion, for breach of fiduciary duties in connection with an interested transaction. This award, coming despite the existence of a special committee and other standard indicia of process, sent the clear message that lawyers had to be mindful that a deal process not be a simple “check-the-box” exercise that looks fair, but that it should actually be fair. Indeed, besides the recovery for aggrieved investors, litigation also disciplines the conduct of directors and their advisors for the future.

Since the favorable ruling in the Del Monte case, which resulted in a settlement of $89.4 million, investment banks have drastically cut back on their practice of providing “staple financing,” in which they receive fees for advising a target board to sell, while they also receive fees for providing the buyer with the debt financing to complete the purchase. Besides providing a $110 million financial


92 In re Del Monte Foods Co. S’holders Litig., 25 A.3d 813 (Del. Ch. 2011); see Michael J. De La Merced, Del Monte and Barclays Settle Investor Lawsuit for $89.4 Million, NY Times, Oct. 6, 2011, http://dealbook.nytimes.com/2011/10/06/del-monte-and-barclays-settle-investor-lawsuit-for-89-4-million/?_php=true&_type=blogs&_r=0 (noting that banks have become reluctant to offer staple financing since the filing of the Del Monte lawsuit.); Jeffrey McCracken, Cristina Alesci and Zachary R. Mider, Barclays Leads LBO Financing Retreat After Del Monte Slap, Bloomberg News (Sep. 14, 2011), http://www.bloomberg.com/news/2011-09-14/barclays-leads-lbo-financing-retreat-after-del-monte-criticism.html (noting that since the Del Monte opinion, no firm has offered staple financing for a buyout over $1 billion, and at least nine major investment banks, including Barclays, had reviewed their lending practices.)
recovery, the plaintiffs in the *El Paso* case achieved a ruling that improved the way Wall Street banks review and uncover conflicts of interest with their advisory clients. And, most recently, when the CEO of Activision conditioned his support for an otherwise stockholder-beneficial transaction with Vivendi on his obtaining massive side benefits, the parties were compelled to pay $275 million to resolve the matter on the eve of trial. There are numerous other cases in which conflicted fiduciaries faced real consequences, providing valuable deterrents to repeat offenses by future boards.

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

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93 *In re El Paso S’holders Litig.*, 41 A.3d 432 (Del. Ch. 2012); see Gina Chon, Anupreeta Das, Goldman Reviewing Policies on Its Deal Makers' Conflicts; Other Wall Street Firms Also Weigh Providing More Information to Clients, Wall St. Journal (Mar. 16, 2012) http://online.wsj.com/articles/SB10001424052702304459804577285361058353548 (noting that Goldman Sachs, Barclays, Bank of America, and Citigroup were examining their processes for conflicts of interest in response to ruling in El Paso);

94 *In re Activision Blizzard, Inc. S’holder Litig.*, C.A. No-8885-VCL, stipulation (Del. Ch. Dec. 19, 2014) (a $275 pending settlement have been submitted for approval).

95 See, e.g., *In re ACS S’holder Litig.*, 4940-VCP (Del. Ch. 2010) (stockholder class action resulting in settlement of $69 million, including $12.8 million personally paid by controlling stockholder who had received over 50% more than other public stockholders in merger; significant corporate governance changes and stockholder voting rights also included in settlement); *In re Delphi Corp. Sec. Litig.*, 05-md-1725 (E.D.Md 2005) (stockholder class action resulting in $128.35 million in settlements for investors; company and its auditor had made materially false and misleading statements regarding the company’s earnings); *In re Rural/Metro Corp. S’holder Litig.*, 102 A.3d 205 (Del. Ch. Oct. 10, 2014) (finding the Royal Bank of Canada’s investment bank liable for about $76 million based on a claim that the investment bank aided and abetted wrongdoing – selling the company on the cheap – by the board of Rural/Metro Corporation. The Court held that RBC Capital Markets was conflicted, concealed its conflicts, and misled directors about company’s value in order to quickly sell the company, resulting in an inadequate sale price for investors); *In re Loral Space and Comm’ns Inc.*, C.A. Nos. 2808-VCS, 3022-VCS, 2008 WL 4293781 (Del. Ch. Sept. 19, 2008) (financing agreement between company and largest stockholder was unfair; Court reformed transaction by converting preferred stock issued in transaction into non-voting common stock at a price set by the Court).

96 A “proxy put” provision is a provision in a company’s debt agreement that defines the election of a majority of directors whose initial nomination arose from an actual or threatened proxy contest to be an event of default that triggers the lender’s right to accelerate - or “put back” - the debt.
provisions, which protect boards at the expense of the stockholder franchise, would become ubiquitous. As a result of stockholder litigation however, courts have made clear that dead hand proxy puts improperly interfere with stockholder voting rights.97

In a 2009 ruling in the **Amylin** case, the Delaware Court of Chancery issued a stern warning to directors and banks that such provisions could be subject to legal challenge for breach of duty. Notable to the ATP discussion, the **Amylin** plaintiff surely did not obtain “substantially all of the relief sought in its complaint.” However, the temptation to directors of insulating themselves from ouster proved too strong for boards to heed the court’s stern warning, and they continued to put in place dead hand proxy puts. In the recent **Healthways** litigation, the Court of Chancery made clear that boards are on notice of the **Amylin** decision and that stockholders now have viable claims for disloyalty and aiding and abetting breach of duty when boards and banks adopt “dead hand proxy puts” in debt agreements.98 The process was difficult, companies continue to use proxy puts at time, but the broad benefits for stockholders clear.

There are numerous other examples demonstrating the value of preserving the ability of stockholders to pursue claims to challenge corporate practices that may harm investor interests.99 Thus, unless

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97San Antonio Fire & Police Pension Fund v. Amylin Pharm., Inc., 983 A.2d 304, 307 (Del. Ch. 2009) (noting that proxy put provisions “can operate as improper entrenchment devices that coerce stockholders into voting only for persons approved by the incumbent board to serve as continuing directors,” the Court construed the provision to allow the Board to approve any person, whether nominated by the Board or by stockholders, as a continuing director, thus preventing an event of default under the provision.).

98 Transcript of Oral Argument at 75-77, Pontiac Gen. Emp. Ret. Sys. v. **Healthways**, C.A. No. 9789-VCL (Del. Ch. Oct. 14, 2014) (“There was ample precedent from this Court putting lenders on notice that these provisions were highly suspect and could potentially lead to a breach of duty on the part of the fiduciaries who were the counter-parties to a negotiation over the credit agreement. Given the facts here, as alleged, including that there was a historic credit agreement that had a proxy put but not a dead hand proxy put, and then that under pressure from stockholders, including the threat of a potential proxy contest, the debt agreements were modified so that the change-in-control provision now included a dead hand proxy put...I believe that...[the lender is] a party to an agreement containing an entrenching provision that creates a conflict of interest on the part of the fiduciaries on the other side of the negotiation.”)

99 See, e.g., Minneapolis Firefighters’ Relief Assoc. v. Ceridian Corp., C.A. No. 2996-CC (Del. Ch. 2007) (stockholder class action resulted in settlement eliminating standstill agreement and other merger agreement provisions limiting possibility of higher bidder emerging); *In re Ancestry.com Inc. S’holder Litig.*, Consol. C.A. No. 7988-CS (Del. Ch. Dec. 19, 2012) (granting preliminary injunction, enjoining merger pending disclosure of “don’t ask don’t waive” standstill agreements, and suggesting that failure to waive standstills prior to
one’s goal is to abolish accountability for corporate misconduct, any proposed solution for problematic practices in the stockholder litigation field requires an effort to fix identified problems without losing the value of the litigation process itself.

B. A PROPOSED “NON-NUCLEAR” METHOD TO CURTAIL THE TRULY PROBLEMATIC COSTS OF ABUSIVE LITIGATION

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

Yet, as we criticize those who rationalize eliminating all forms of stockholder litigation by ignoring its benefits and overstating its detriments, we would be remiss to ignore that some stockholder litigation confers such minimal benefits that its costs should be an institutional concern.¹⁰⁰ As such, we try to further the discussion by identifying the real problems in the field and proposing solutions. Consistent with the agency-based focus of the corporate form itself, a real solution should focus on limiting the incentives to pursue and settle weak claims in return for the release of good claims, while still permitting stockholders to bringing viable suits.

What are these “worthless lawsuits” anyway? Can we separate the wheat from the chaff? The answer is yes. While some strong suits will fail for reasons beyond the plaintiff’s or counsels’ control, and some seemingly meritless suits at the time of filing can occasionally uncover a corrupt process, a fair proxy for identifying weak claims are cases that result in a settlement providing only immaterial supplemental corporate disclosures.¹⁰¹ Although we believe that material disclosures can create substantial benefits for stockholders, we do not quibble with the notion that many lawsuits judicial review would support substantive injunctive relief. For an example of an unsuccessful stockholder challenge that nevertheless informs advisors of where the line will be drawn, see In re Gateway S’holders Litig., C.A. No. 3219-VCN (Del. Ch. Sept. 14, 2007) (noting that the top-up options at issue were “certainly not preclusive or coercive”).

¹⁰⁰ Stourbridge Invs., LLC. v. Bersoff, C.A. No. 7300-VCL (Del. Ch. Mar 13, 2012) (“[T]he increase in disclosure-only settlements is troubling. Disclosure claims can be settled cheaply and easily, creating a cycle of supplementation that confers minimal, if any, benefits on the class.”

¹⁰¹ See generally See Davidoff Solomon, Fisch & Griffith, supra note 4.
are settled for disclosures that are not material for stockholders while giving broad releases to defendants and paying the lawyers for all parties.

The hard question is: how can a legal system simultaneously encourage the policing of agents who manage and oversee large swaths of the nation’s assets and productivity, while reducing the incentives to pursue and settle lawsuits that will result, at best, in immaterial supplemental disclosures? The answer, we believe, lies in establishing a two-prong approval standard for settlement agreements that reduces the incentives for shareholder plaintiffs to pursue claims that will likely result in immaterial disclosures and for corporate defendants to settle such weak claims to obtain a broad release for claims that have not been presented or vetted. Notably, this simple proposal flows directly from existing Delaware precedent, including Vice Chancellor Laster’s application of the materiality standard in In re Sauer-Danfoss, and then-Chancellor Strine’s rejection of a settlement in In re Medicis.\textsuperscript{102}

Delaware law, like other states’ law, generally favors the voluntary resolution of disputes, including “disclosure only” settlements. Many suits are settled in the initial stages of litigation.\textsuperscript{103} As a result, courts in Delaware and elsewhere have until recently hesitated in scrutinizing “disclosure only” settlements and the scope of the proposed release. Instead, courts have begun to dramatically reduce fee awards for stockholder plaintiffs’ counsel who presented “disclosure only” settlements.\textsuperscript{104}


\textsuperscript{103} See Kahn v. Sullivan, 594 A.2d 48, 58 (Del. 1991) (“Delaware law, as a general proposition, favors the voluntary settlement of contested issues.”); Rome v. Archer, 197 A.2d 49 (Del. 1964).

\textsuperscript{104} Delaware courts have lowered attorneys’ fees awards dramatically for disclosure-only settlements. Matthew D. Cain & Stephen M. Davidoff, Takeover Litigation in 2013 (January 9, 2014), available at http://ssrn.com/abstract=2377001, at* 5 (noting that “Following the general decline in average attorneys’ fees across states after 2011, Delaware also awarded lower average attorneys’ fees of $450 million in 2013 compared to $650 million in 2012. This average also falls below the general sample average of $694 for all states”). For law firms that actually put effort into their litigation, settling cases on a disclosure only basis is not just a reputational harm, but it is economically unviable. For a discussion of the way some firms deliberately under-prosecute claims so they can make sure that a modest fee award is still profitable, see e.g., In re Revlon, Inc. S’holder Litig., 990 A.2d 940, 945-46 (Del. Ch. 2010) (describing this pattern in which “No One Litigates Anything”).
Notably, in several recent cases, the Delaware Court of Chancery seemed to signal application of both a materiality-based standard and concerns about the breadth of releases. In the spring of 2011, the Delaware Court of Chancery's opinion in Sauer-Danfoss signaled the beginning of a new era in regulating proposed settlements. In that case, Vice Chancellor Laster indicated that “disclosure only” settlements that provide no meaningful new information to stockholders would not be approved. Vice Chancellor Laster's opinion in Sauer-Danfoss thus started a trend (in Delaware and other jurisdictions, including New York) of more vigorous judicial scrutiny of disclosure only settlements, leading to the rejection of unmerited settlements and lowering fee awards.

We believe courts should be vigilant, not only of proposed settlements that offer no material benefits to stockholders, but also of settlements that “sell” a release where there has been insufficient

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105 See In re Medicis Pharm. Corp. S’holders Litig., Consol. C.A. No. 7857-CS, trans. ruling (Del. Ch. Feb. 26, 2014) (declining to approve a “disclosure-only” settlement as the supplemental disclosures did not support the release of claims being given by the stockholder class); See also In re Rural Metro Corp. S’holders Litig., 88 A.3d 54 (Del. Ch. 2014) (rejecting a “disclosure-only” settlement as inadequate).
107 See, e.g., In re Talbots, Inc. S’holders Litig., C.A. No. 7513-CS (Del. Ch. Dec. 16, 2013) (TRANSCRIPT) (emphasizing that materiality was key to whether the disclosure supported a fee award); In re Coventry S’holders Litig., C.A. No. 7905-CS (Del. Ch. Aug. 29, 2013) (TRANSCRIPT); In re Transatlantic Holdings Inc. S’holders Litig., C.A. No. 6574-CS (Del. Ch. Feb. 28, 2013) (TRANSCRIPT) (rejecting settlement and denying fee application, expressing serious doubts about the usefulness of the agreed upon supplemental disclosures); In re Theragenics Corp. S’holders Litig., C.A. No. 8790-VCL (Del. Ch. May 5, 2014) (TRANSCRIPT) (rejecting disclosure-only settlement, finding that several possible instances of wrongdoing had been left unexplored and that the benefits highlighted by counsel were illusory); In re Wilmington Trust Corp. S’holders Litig., C.A. No. 5989-VCL (Del. Ch. June 7, 2012) (refusing to approve settlement of a merger on basis of a weak package of supplemental disclosures) (TRANSCRIPT); In re SS&C Technologies, Inc., 2006 WL 3499748 (Del. Ch. 2006) (refusing to approve disclosure-only settlement, finding that the potential claims belonging to the class were adequately or diligently investigated or pursued); City Trading Fund v. Nye, Index No. 651668/14 (N.Y. Sup. Ct. Jan. 7, 2015) (rejecting settlement, finding that proposed supplemental disclosures that defendants would provide were immaterial as a matter of law); Gordon v. Verizon Communications, Inc., Index No. 653084/13 (N.Y. Sup. Ct. Dec. 19, 2014) (rejecting settlement, finding "Merely providing additional information—unless the additional information offers a contrary perspective on what has previously been disclosed—does not constitute material disclosure. . . . Even when the additional information goes to the sensitive details of a financial advisor’s fairness analysis, the information becomes material only when it corrects a valuation parameter or uncovers a conflict").
vetting of the record. Two recent examples highlight the institutional danger of issuing broad releases without sufficient inquiry. In 2008, Bank of America announced the acquisition of Merrill Lynch in a deal requiring the vote of the buyer’s stockholders. While lawyers challenged the deal on behalf of Merrill Lynch stockholders (a dubious proposition considering that Merrill was facing bankruptcy absent a deal), nobody brought suit on behalf of Bank of America stockholders. If such a suit was filed, and a “disclosure only” settlement was reached, the release included in such a settlement could have insulated Bank of America and its senior executives for very serious proxy violations. The federal securities class action brought after those losses and the resulting government bailout package were disclosed led to a $2.4 billion settlement. Delaware was arguably lucky that nobody filed suit on behalf of Bank of America stockholders and settled before closing in exchange for a broad release and modest disclosures.

In 2012, the Delaware Chancery Court was presented with a proposed settlement of stockholder claims arising from the acquisition of Rural Metro. After one of the stockholder plaintiffs objected to the proposed settlement, the court rejected the settlement and appointed new counsel. In 2014, the court awarded $76 million, and established important legal precedents. Most important, one may never know how many finally approved settlements provided broad releases for no value, only to later preclude meritorious claims.

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

108 See In re Hewlett-Packard Co S’holder Derivative Litig., No. 3:12-cv-06003-CRB, 2014 U.S. Dist. LEXIS 175578 (N.D. Cal. Dec. 19, 2014) (rejecting attempt for a settlement for a third time, explaining that the proposed settlement may not have been fair for stockholders because it would have released the defendants from liability for events unrelated to the present litigation.)

We believe the application of an actual materiality standard will eliminate the inherently collusive nature of the settlement process. This is because few advisors of corporate defendants will rush to argue that immaterial disclosures meet the applicable test because such precedents will then be used against their clients outside the settlement context. Many players in the M&A markets are “repeat players” and many more of the lawyers in the field fit that description. Thus, there should be an institutional and strategic hesitance to try selling the Court the proverbial bill of goods just to get a settlement in a single case knowing that it will be used to argue for an injunction or denial of a motion to dismiss in the future. Thus, turning settlement approval rulings into binding precedent on materiality should make it less likely that defendants support settlements on disclosures that are really immaterial.

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

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

VII. CONCLUSION

In this article, we have described the origins of the ATP decision and the profoundly harmful implications if that ruling is extended to public stockholder corporations. We believe extending the ATP decision to public corporations will eviscerate substantive stockholder property rights, significantly undermine director accountability for wrongdoing, and wreak doctrinal havoc. Moreover, we have described an alternative approach to addressing meritless representative litigation by requiring plaintiffs to show that a disclosure-only settlement provides material benefits to the class
and defendants that the scope of the release is appropriately tailored to the benefit of the disclosures obtained. But time is tight. While the judiciary can adopt a properly-tailored solution to frivolous or “disclosure-only” fiduciary litigation, the Pandora’s Box that was opened with ATP requires an immediate legislative fix. Too many self-interested corporate directors, officers and wolves in sheep’s clothing are prepared to make fee shifting provisions ubiquitous unless the legislature unequivocally shuts the door to their enforcement.

The Delaware Corporate Law Council has wisely proposed a prohibition on fee shifting provisions in the bylaws or charters of public corporations. As this article is being disseminated, the response of the Chamber of Commerce and other advocates of fee shifting is becoming clear. Notwithstanding the pressure brought to bear by corporate-side advocates who do not seek a legal balance, we firmly submit that the Delaware legislature should resolve the uncertainty surrounding ATP by prohibiting boards from imposing fee shifting provisions, and put the onus on companies to justify any future impediment to the enforcement of fiduciary duties.