"Not Your Average Fee-Shifting Provision"[[1]](#footnote-1):

Setting Reasonable Restrictions on Fee-Shifting Bylaws Post-*ATP Tour*

# INTRODUCTION

 In May 2014, theDelaware Supreme Court held that a fee-shifting bylaw unilaterally adopted by a nonprofit corporation's board of directors was facially valid, even if it were adopted for the purpose of deterring shareholder litigation.[[2]](#footnote-2) The Court's opinion, issued in response to a set of certified questions from the federal district court for the District of Delaware, sparked a debate over the legal and policy implications of enabling corporate boards to impose liability for the corporation's legal fees onto plaintiff shareholders.[[3]](#footnote-3)

Those alarmed by the prospect of fee-shifting bylaws argue that they are an unfair and unprecedented imposition of liability on shareholders that will prevent shareholders from taking action against board misconduct.[[4]](#footnote-4) Others argue that fee-shifting bylaws can help corporations deter excessive and frivolous transaction-related litigation.[[5]](#footnote-5) In evaluating these concerns, it is helpful to examine the Court’s opinion in *ATP Tour* as well as related Delaware jurisprudence, including the Delaware Court of Chancery's 2013 opinion upholding forum selection bylaws in *Boilermakers Local 154 Retirement Fund v. Chevron Corp*.[[6]](#footnote-6)

This Note argues that fee-shifting bylaws should be available to Delaware corporations in a way that limits the potential negative impact on plaintiff shareholders. Part II discusses Delaware's approach to bylaws generally and the Court's apparent endorsement of fee-shifting bylaws in *ATP Tour*. [[7]](#footnote-7) Part III presents both sides of the debate over fee-shifting bylaws, including the concerns raised by such bylaws that might justify legislative action, and the arguments in support of a more hands-off approach.[[8]](#footnote-8) In Part IV, this Note considers several solutions that seek to address the concerns of both corporations and their stockholders.[[9]](#footnote-9) Action may not be necessary to the extent that shareholders can limit the adoption of fee-shifting bylaws.[[10]](#footnote-10) Also, courts may be able to successfully prevent their abuse.[[11]](#footnote-11) There are, however, multiple approaches that can be taken alone or in concert to allow some corporations to utilize fee shifting while limiting the potential chill to legitimate shareholder litigation.[[12]](#footnote-12)

# BACKGROUND

The Delaware General Corporation Law ("DGCL") provides that "bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."[[13]](#footnote-13) Valid subject matter for bylaws include "the rules by which the corporate board conducts its business,"[[14]](#footnote-14) "how stockholders may exercise their rights,"[[15]](#footnote-15) and, per *ATP Tour*,the "allocat[ion of] risk among parties in intra-corporate litigation."[[16]](#footnote-16)

Delaware courts treat a corporation's governing documents collectively as a contract.[[17]](#footnote-17) The contract is fluid in that its provisions can be amended, repealed, or added to by the shareholders or the directors at any time.[[18]](#footnote-18) Where the corporation grants directors the power to change bylaws, the board may lawfully do so without shareholder consent.[[19]](#footnote-19) Any bylaw validly adopted by the board is then deemed agreed to by the shareholders and is therefore "contractually binding."[[20]](#footnote-20) Therefore, unlike most contracts, bylaws are subject to unilateral change by either party.[[21]](#footnote-21) Investors are charged with knowledge of this possibility merely by the fact of having bought shares of stock in a Delaware corporation.[[22]](#footnote-22) As former Chancellor Strine stated, "[S]tockholders assent to not having to assent to board-adopted bylaws."[[23]](#footnote-23)

In *ATP Tour*, the Delaware Supreme Court considered fee-shifting bylaws for the first time and concluded that a nonprofit Delaware corporation's bylaw that required an unsuccessful shareholder plaintiff to reimburse the corporation for litigation expenses[[24]](#footnote-24) was facially valid.[[25]](#footnote-25) The Court noted that the bylaw did not conflict with Delaware law and "relate[d] to the business of the corporation" as required by 8 *Del. C.* § 109(b).[[26]](#footnote-26) In addition, the corporation's charter allowed such a bylaw "implicitly by silence."[[27]](#footnote-27) Acknowledging the contractual nature of bylaws, the Court noted that the common law allows contracting parties to depart from the usual American Rule and opt for a loser-pays approach to litigation expenses.[[28]](#footnote-28) The Court considered the bylaw in response to certified questions from the District Court for the District of Delaware.[[29]](#footnote-29) Accordingly, it did not have sufficient facts to address the enforceability of ATP Tour's particular bylaw.[[30]](#footnote-30) The Court emphasized, however, that "[l]egally permissible bylaws adopted for an improper purpose are unenforceable in equity."[[31]](#footnote-31) The Court also advised that deterring litigation would not necessarily be an improper purpose.[[32]](#footnote-32) Should the bylaw be enforceable in equity, the Court noted that it would likewise be enforceable against shareholders who purchased their shares prior to the adoption of the amendment.[[33]](#footnote-33)

In response to *ATP Tour*, in 2014 the Delaware General Assembly ("DGA") considered an amendment to the DGCL that would limit *ATP Tour*'s holding to nonprofit corporations.[[34]](#footnote-34) However, some members of the business community mounted vocal opposition to the amendment.[[35]](#footnote-35) The DGA shelved the proposed amendment and resumed debate on a potential response to the Court's opinion in January 2015.[[36]](#footnote-36) After revisiting the issue, the Corporation Law Section of the Delaware State Bar Association crafted an amendment that would bar corporations from including provisions in their bylaws or certificate of incorporation imposing liability on stockholders for the corporation’s expenses arising from intracorporate litigation.[[37]](#footnote-37) The proposed legislation also includes an amendment allowing forum selection provisions.[[38]](#footnote-38) The Delaware State Senate passed the amendment by a 16 to five vote on May 12, 2015. The Delaware House of Representatives is expected to vote on it in early June.

 In the meantime, corporate boards have taken notice of the Court's apparent endorsement of fee-shifting bylaws, with a handful adopting provisions similar to those held facially valid in *ATP Tour*.[[39]](#footnote-39) Other corporations have quietly adopted a fee-shifting provision before an initial public offering.[[40]](#footnote-40)

The first challenges to fee-shifting bylaws have begun trickling into the Court of Chancery. The first major issue arose when the board of Hemispherx Biopharma, Inc., ("Hemispherx"), while defending a derivative challenge to $2.5 million in executive bonuses, adopted a fee-shifting bylaw just over one year into the litigation.[[41]](#footnote-41) This bylaw was retroactive in that it could be interpreted as effective against any shareholder who "maintains or continues" a lawsuit against the corporation.[[42]](#footnote-42) Shortly after the plaintiffs received notice of the fee-shifting provision, they filed a motion to invalidate the provision or, in the alternative, voluntarily dismiss the action.[[43]](#footnote-43) After full briefing on the issue, Hemispherx notified the court that the corporation would not seek to apply the fee-shifting provision to the pending litigation.[[44]](#footnote-44) Accordingly, the Court of Chancery never ruled on the validity of the Hemispherx bylaw.

More recently, in *Struogo v. Hollander*,a minority shareholder of First Aviation Services, Inc. filed an amended complaint in the Court of Chancery on September 24, 2014.[[45]](#footnote-45) The complaint, as amended, alleged a freeze out of the minority stockholders by way of a reverse share split.[[46]](#footnote-46) In addition, the plaintiff sought invalidation of a fee-shifting bylaw the board quietly adopted in the wake of the disputed transaction.[[47]](#footnote-47) In an opinion on the plaintiff’s motion for partial summary judgment, Chancellor Bouchard held that the bylaw could not be applied to the plaintiff.[[48]](#footnote-48) Rather than addressing the validity of such bylaws generally, the Chancellor focused on the timing of First Aviation’s adoption of the bylaw.[[49]](#footnote-49) Because First Aviation’s Board adopted the bylaw after the plaintiff no longer held shares in the company, it could not bind the plaintiff, both as a matter of contract law and Delaware corporate law.[[50]](#footnote-50) However, the Chancellor did note the potentially troublesome nature of fee-shifting bylaws:

As a practical matter, therefore, applying the Bylaw in this case would have the effect of immunizing the Reverse Stock Split from judicial review because, in my view, no rational stockholder—and no rational plaintiff's lawyer—would risk having to pay the Defendants' uncapped attorneys' fees to vindicate the rights of the Company's minority stockholders, even though the Reverse Stock Split appears to be precisely the type of transaction that should be subject to Delaware's most exacting standard of review to protect against fiduciary misconduct. This reality demonstrates the serious policy questions implicated by fee-shifting bylaws in general, including whether it would be statutorily permissible and/or equitable to adopt bylaws that functionally deprive stockholders of an important right: the right to sue to vindicate their interests as stockholders.[[51]](#footnote-51)

Although dicta, the Chancellor’s comments may provide insight on how the Court of Chancery might view enforceability of fee-shifting bylaws for future cases, in the event that the current legislative effort is unsuccessful.

# FEE-SHIFTING BYLAWS: POTENTIAL PROBLEMS AND BENEFITS

Although the corporation in *ATP Tour* was a nonprofit, *ATP Tour*'s holding likely applies to profit corporations. First, the Court did not say anything to the contrary in its opinion.[[52]](#footnote-52) Second, the Court relied on profit corporation statutes and case law in its reasoning and in its discussion of proper motives behind bylaws generally.[[53]](#footnote-53) However, because Justice Berger, who authored the opinion in *ATP Tour*, Justice Ridgely, and Justice Jacobs have since resigned, only two of the five Justices who decided the case *en banc* remain with the Court. Accordingly, the Court's analysis in *ATP Tour* may be less predictive than previously thought.

For the sake of this analysis, however, this Note will assume that the current Court would apply its holding in *ATP Tour* to profit corporations and consider: (1) the concerns raised by fee-shifting bylaws; (2) the reasons why corporations may seek to adopt them; and (3) potential support for and against such bylaws in common and statutory law.

## Concerns Raised by Fee-Shifting Bylaws

As discussed above,[[54]](#footnote-54) the negative response to *ATP Tour* has been strong and swift. The two main arguments against the Court's decision have been (1) the potential chill to meritorious litigation and (2) the exposure of stockholders to liability without their express consent.

First, fee-shifting bylaws may expose plaintiff stockholders to such a high risk of liability that no stockholder would be willing to bring even legitimate claims.[[55]](#footnote-55) Where stockholders have already brought suit against a corporation, the board might adopt such a bylaw in order to gain leverage over the plaintiffs.[[56]](#footnote-56) In order for plaintiffs to avoid being responsible for the corporation's legal expenses, such bylaws require that the plaintiff stockholders "obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought."[[57]](#footnote-57) A strict reading of this provision leads to frightening results. As the Third Circuit noted in an opinion in the *ATP Tour* litigation:

This is not your average fee-shifting provision. Its language seems to suggest that a plaintiff would have to pay the defendant's fees even if the plaintiff receives a favorable settlement, because the plaintiff in such a case failed to 'obtain a judgment on the merits.' . . . [I]f a plaintiff prevailed at trial and won $10,000,000, but sought $20,000,000, this by-law theoretically could require the plaintiff to pay the defendant's fees . . . .[[58]](#footnote-58)

Meanwhile, a judgment on the merits for all but one of the plaintiff's claims would be meaningless or even detrimental. These potential and foreseeable outcomes may prevent stockholders from filing suit—no matter how strong their claims.[[59]](#footnote-59)

Suppression of litigation is cause for concern beyond the immediate impact on plaintiff stockholders. All investors benefit when Delaware stockholders bring management misconduct to the courts' attention by filing suit.[[60]](#footnote-60) Investors would likewise lose out if stockholders are deterred from "fulfilling their important role in policing the board's and the corporation's conduct . . . ."[[61]](#footnote-61) Stifling corporate litigation could also be bad business for Delaware. A decrease in corporate lawsuits would curb the progression of case law that has made Delaware a popular home for so many corporations.[[62]](#footnote-62) Allowing fee-shifting bylaws is arguably inconsistent with maintaining Delaware's reputation for providing courts capable of acting as "sophisticated and fair arbiters that help promote investor confidence and thereby reduce the cost of capital."[[63]](#footnote-63)

This degree of risk to stockholders is especially burdensome considering that a bylaw imposing legal fees on stockholders can be adopted without their approval.[[64]](#footnote-64) Recall that corporate bylaws are contracts, the terms of which can be changed unilaterally by the board.[[65]](#footnote-65) Unlike other bylaws, however, fee-shifting provisions have the potential to impose monetary liability on stockholders, which is contrary to the concept of limited liability.[[66]](#footnote-66) The Chamber of Commerce's Institute for Legal Reform ("ILR"), which supports free use of fee-shifting bylaws, has argued that no liability results unless the shareholder takes "an affirmative act . . . [by] instituting a losing claim and thereby inflicting unjustified costs on all shareholders."[[67]](#footnote-67) However, this argument overstates the degree of certainty any plaintiff has over the likely success of its claims. Even those claims likely to win are susceptible to failure depending on factors that are not necessarily predictable. Singling out for punishment those shareholders who complain about potential management misconduct is especially troubling, especially given the lack of a corresponding obligation on the part of the corporation in the event that the plaintiff is successful.[[68]](#footnote-68) To some, the concept of requiring shareholders to reimburse the company in which they own stock without their express authorization is simply unpalatable.[[69]](#footnote-69)

The 2014 amendment would have precluded corporations from adopting bylaws that impose liability on shareholders purely on the basis of their status as a shareholder.[[70]](#footnote-70) The draft of the recently proposed amendment more directly confronts the issue by providing that neither the certificate of incorporation nor the bylaws may "impose liability on a stockholder for the attorneys’ fees or expenses of the corporation or any other party in connection with an intracorporate claim . . . ."[[71]](#footnote-71) This rule offers clarity and predictability, values which Delaware corporate law has long supported.[[72]](#footnote-72) However, it also removes what opponents of the amendment believe is a valuable tool to address the sharp rise in shareholder litigation, discussed below.[[73]](#footnote-73)

## The Problem of Excessive Litigation

Boards adopt fee-shifting bylaws in part to deter litigation.[[74]](#footnote-74) Shareholder litigation has been on the rise, especially with regard to transactions.[[75]](#footnote-75) The frequency of merger-related lawsuits has caught the attention of the judiciary, with Vice Chancellor Glasscock of the Court of Chancery noting:

For better or worse, after the announcement of a merger or acquisition, stockholder class action suits typically follow like mushrooms follow the rain. [. . .] The fact that merger litigation has gone from common to ubiquitous in just a few years suggests that the current balance of incentives is flawed.[[76]](#footnote-76)

Some of these suits offer minimal or no monetary compensation to stockholders while an average of $500,000 could be awarded to the plaintiff's lawyers under the corporate benefit doctrine.[[77]](#footnote-77) Critics warn of the potential for an industry supported solely by such lawsuits, in which the corporations generally settle and agree to pay the plaintiffs' lawyers as part of the settlement agreement.[[78]](#footnote-78) Because of the costs involved in defending these actions, corporations are motivated, therefore, to use the tools within their power to reduce this litigation.

A potential advantage of fee-shifting bylaws is that, when drafted properly, they can focus deterrence on the weakest claims, such as frivolous lawsuits that are filed only to obtain a quick settlement.[[79]](#footnote-79) Theoretically, a group of stockholders with evidence of a legitimate claim would be undeterred by a fee-shifting bylaw because they would be confident of their ability to win at trial. Plaintiffs filing suit merely to get the attention of the corporation for the purpose of a so-called "peppercorn settlement,"[[80]](#footnote-80) meanwhile, would be unwilling to accept the risk of having to reimburse the corporation for legal fees. Therefore, rather than punish shareholders who sue, fee-shifting bylaws protect all shareholders from having their investment squandered on settlements of illegitimate claims.[[81]](#footnote-81)

The problem, of course, is that these bylaws are not crafted in such a way that they would only impact frivolous claims.[[82]](#footnote-82) As the Third Circuit pointed out, ATP Tour's fee-shifting provision sweeps in meritorious and frivolous claims alike.[[83]](#footnote-83) The standard required by the bylaw is so demanding that as a practical matter few plaintiffs would be likely to meet it, effectively disenfranchising them from judicial remedy for board misconduct.[[84]](#footnote-84) Indeed, many feel that fee-shifting bylaws are one step too far: "Delaware courts have granted [those in favor of fee-shifting bylaws] ample tools to deal with shareholder litigation[,] and chipping away at limited liability might be a cure that is worse than the disease."[[85]](#footnote-85) Limits may be necessary in order to balance deterrence of frivolous litigation with reasonable access to judicial review of board conduct.[[86]](#footnote-86)

Given the legitimate interest of corporations and their shareholders in limiting unnecessary litigation expenses, anyone who hopes to prohibit fee-shifting bylaws should be prepared to offer alternative solutions to the excessive litigation problem.[[87]](#footnote-87) At the same time, there are valid concerns raised by fee-shifting bylaws, as discussed above,[[88]](#footnote-88) so the legal support for such bylaws must be clear if they are to be a legitimate tool for corporations seeking to deter frivolous litigation. Potential support can be found in the Court of Chancery's endorsement of forum selection bylaws, explored in Part III.C., below.

## Fee Shifting vs. Forum Selection

Forum selection bylaws reflect an earlier attempt by corporate boards to decrease litigation expenses.[[89]](#footnote-89) In *Boilermakers*, the Delaware Court of Chancery upheld the facial validity of a forum selection bylaw as adopted by Chevron Corporation and FedEx Corporation.[[90]](#footnote-90) Although the claims against Chevron and FedEx never made it to the Delaware Supreme Court for review, the Court did indicate support for *Boilermakers* by favorably citing to itin *ATP Tour*.[[91]](#footnote-91) The Court in *ATP Tour* also echoed concepts articulated in *Boilermakers*, andmuch of the reasoning used in then-Chancellor Strine's analysis of forum selection bylaws can be directly applied to the concept of fee-shifting bylaws.[[92]](#footnote-92)

The *Boilermakers* opinion emphasized the contractual nature of bylaws[[93]](#footnote-93) to support its holding that the bylaws were contractually binding against shareholders even though they were unilaterally adopted by the board.[[94]](#footnote-94) The court explained:

[T]he bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the DGCL. This contract is, by design, flexible and subject to change in the manner that the DGCL spells out and that investors know about when they purchase stock in a Delaware corporation.[[95]](#footnote-95)

Shareholders are therefore considered to be on notice of any potential change in bylaws by the board of directors, without their consent, when they choose to invest.[[96]](#footnote-96) *ATP Tour* confirms that a board may unilaterally adopt fee-shifting bylaws.[[97]](#footnote-97)

Admittedly, fee-shifting bylaws are a novelty, so there is a certain amount of unfairness in expecting stockholders to look for them.[[98]](#footnote-98) However, as the Supreme Court articulated in *Unocal*, "[O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs."[[99]](#footnote-99) Given the fluid nature of Delaware corporate law, it seems reasonable to charge at least some stockholders, such as institutional investors, with responsibility for keeping abreast of developments such as fee-shifting bylaws.

As noted by then-Chancellor Strine in *Boilermakers*, "[T]he boards of Delaware corporations have the flexibility to respond to changing dynamics in ways that are authorized by our statutory law."[[100]](#footnote-100) In enacting fee-shifting bylaws, corporations are responding to a sharp rise in litigation.[[101]](#footnote-101) Just as the boards of Chevron and FedEx were allowed to address multijurisdictional litigation by enacting forum selection bylaws to "protect against what they claim is a threat to their corporations and stockholders,"[[102]](#footnote-102) so should corporations be able to deter frivolous litigation via reasonable fee-shifting bylaws.[[103]](#footnote-103)

Forum-selection bylaws, however, are arguably of a different nature than fee-shifting bylaws. Instead of trying to deter litigation generally, a board adopting a forum-selection provision merely seeks to limit claims related to a transaction to one jurisdiction.[[104]](#footnote-104) Doing so avoids duplicative filings in multiple forums that create unnecessary expenses for the corporation and, therefore, the shareholders.[[105]](#footnote-105) Forum selection provisions, therefore, have a more clear benefit to shareholders than fee-shifting provisions. In addition, fee-shifting bylaws are more likely to deter potential plaintiffs than forum-selection bylaws.[[106]](#footnote-106) For these reasons, there is a need for mechanisms to limit their impact, especially on vulnerable groups such as minority shareholders in privately held corporations.

# TOWARD A COMPROMISE POSITION

As discussed above, there are legitimate concerns on both sides of the debate over fee-shifting bylaws. While those concerned about the negative consequences of fee shifting have pushed for an outright prohibition on their use as to profit corporations,[[107]](#footnote-107) corporate boards have maintained that the bylaws are a necessary response to excessive merger-related litigation.[[108]](#footnote-108) This Part will explore whether action in response to *ATP Tour* is in fact necessary, including a discussion of what might result if the enforceability of fee-shifting bylaws is left to the courts. Finally, this Part offers several suggestions for compromise solutions.

## Legislative Response May Not be Needed

First, the most logical response may be to do nothing. As discussed below, the natural negative consequences of adopting fee-shifting bylaws may prevent boards from adopting them.[[109]](#footnote-109) If they do, then shareholders who are unhappy with the board's decision will likely find sufficient recourse by exercising their corporate democratic rights.[[110]](#footnote-110)

Fee-shifting bylaws can backfire in a way that may limit a board's interest in adopting them. First, because the bylaws require plaintiffs to achieve judgment on the merits, stockholders who are brave enough to sue will have a strong motivation to go to trial. Accordingly, corporations with fee-shifting bylaws will lose the possibility of an early and relatively low-cost settlement, unless the corporation is willing and able to waive fee shifting in the settlement agreement. [[111]](#footnote-111) Second, companies who choose a fee-shifting provision will attract the attention of "[s]hareholder activists," potentially resulting in a net gain in lawsuits filed against the corporation. [[112]](#footnote-112) Finally, courts could hold that fee-shifting bylaws are not valid for certain federal claims, such as federal securities litigation[[113]](#footnote-113) or antitrust claims,[[114]](#footnote-114) "particularly given the expense of prosecuting such claims."[[115]](#footnote-115) A shrewd plaintiff's lawyer would therefore be more likely to plead any colorable federal claim against the corporation in addition to the state law claim, leading to more complex (and therefore more expensive) litigation. For these reasons, corporations may hesitate to adopt fee-shifting bylaws.[[116]](#footnote-116)

Where boards do choose to adopt fee-shifting bylaws, most unhappy shareholders will be able to find remedy "through the procedures of corporate democracy."[[117]](#footnote-117) Indeed, "stockholders have powerful rights they can use to protect themselves . . . ."[[118]](#footnote-118) First, they can vote the offending directors out of their positions[[119]](#footnote-119) and elect a new board in its place with a more shareholder-friendly attitude.[[120]](#footnote-120) Institutional investors may be more willing and able to take this approach.[[121]](#footnote-121) Second, a majority of the stockholders can vote to repeal the bylaw.[[122]](#footnote-122) Their right to do so is "legally sacrosanct; *i.e.*, the power cannot be non-consensually eliminated or limited by anyone other than the legislature itself."[[123]](#footnote-123) Third, if the above two options are unsuccessful, most stockholders can simply sell their shares and invest their money elsewhere.[[124]](#footnote-124) If enough stockholders sell, the company's share price will fall, thereby adding a disincentive to adopting fee-shifting bylaws in the first place.

The problem with corporate democratic rights, of course, is that a majority or more of the stockholder vote is required to implement them. Therefore, minority shareholders may be unable to take advantage of these remedies, especially where there is no ready market for their shares (such as in a close corporation). Doing nothing to limit fee-shifting bylaws, therefore, will not be sufficient to protect the interests of such stockholders. One could argue that those who purchase a minority interest in a corporation with no ready market for its stock do so knowing that they may be unable to sell their shares. Nevertheless, the disparate impact of fee-shifting on such stockholders warrants legislative action to act to protect this discrete group of investors.[[125]](#footnote-125)

## Judicial Oversight

To what extent can or should Delaware courts provide judicial remedies for shareholders who are unhappy with a board's adoption of a fee-shifting bylaw? This subpart discusses (1) the potential for allowing Delaware courts to evaluate fee-shifting bylaws without legislative guidance and (2) under what circumstances the courts are likely to declare a bylaw unenforceable.

As the Court cautioned in *ATP Tour*, mere facial validity does not an enforceable bylaw make; instead, courts must consider equitable limitations as well.[[126]](#footnote-126) In crafting the DGCL, the Delaware legislature decided to allow broad authority to directors and then utilize judicial oversight to both deter and correct abuse of that authority.[[127]](#footnote-127) Delaware corporate law therefore relies on the Court of Chancery "to ensure that corporate directors do not use the wide authority granted to them by statute for ends that are inimical to the best interests of the corporations they serve."[[128]](#footnote-128) A legislative mandate prohibiting directors from using fee-shifting bylaws would disrupt this system by prematurely stripping directors of a power whose implications are not yet known. Doing so would be a drastic measure in light of corporate boards' otherwise "capacious authority to pursue business advantage by a wide variety of means."[[129]](#footnote-129) The more prudent approach might be to allow this issue to be addressed by Delaware courts in fact-specific situations as they arise, thereby developing a body of case law to address this problem as Delaware courts have done in other areas.

In an article discussing *Schnell v. Chris Craft*, Chief Justice Leo Strine explained the difference between legal and equitable conduct on the part of corporate fiduciaries.[[130]](#footnote-130) A court considering the enforceability of a fee-shifting bylaw would first determine whether the bylaw is lawful and then whether it is equitable.[[131]](#footnote-131) However, Delaware courts are limited from taking broad action against a board in several ways: the business judgment rule, respect for the legislature's prerogative in setting policy, and respect for precedent.[[132]](#footnote-132) Therefore, it seems unlikely that a Delaware court would make a sweeping rule invalidating all fee-shifting bylaws as inequitable.[[133]](#footnote-133)

Because enforcement of fee-shifting bylaws requires an affirmative act of the corporation (namely, a motion for attorney's fees), the provision will inevitably be subject to judicial review before any liability for expenses is imposed.[[134]](#footnote-134) Because Delaware courts have experience limiting corporate managers from acting unfairly to the detriment of stockholders,[[135]](#footnote-135) there is reason to believe that a court would not grant a motion to award attorney's fees in unfair circumstances. However, the question remains: what board action would be sufficiently inequitable that a court would refuse to shift the corporation's legal fees onto a shareholder plaintiff?

The Court in *ATP Tour* offered some guidance on this point.[[136]](#footnote-136) Enforceability "depends on the manner in which [the bylaw] was adopted and the circumstances under which it was invoked. Bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose."[[137]](#footnote-137) To illustrate, the Court discussed several cases that set forth parameters on bylaw enforceability.[[138]](#footnote-138) For example, in *Hollinger International, Inc. v. Black*, bylaws passed by a majority shareholder "were clearly adopted for an inequitable purpose and have an inequitable effect"[[139]](#footnote-139) where they "complete[d] a course of contractual and fiduciary improprieties."[[140]](#footnote-140) In *Schnell v. Chris-Craft Industries*, the Supreme Court invalidated a board-adopted bylaw amendment that the board passed to "'perpetuat[e] itself in office' and to 'obstruct[] the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management.'"[[141]](#footnote-141) Doing so was "contrary to established principles of corporate democracy."[[142]](#footnote-142) Finally, in *Frantz Manufacturing Co. v. EAC Industries*, the Court acknowledged, "when a board acts for the sole or primary purpose of perpetuating its own control, this improper motive overrides the ordinary protection of the business judgment rule."[[143]](#footnote-143) However, in *Frantz* the Court held that a bylaw amended by a controlling shareholder's written consent was "not inequitable under the circumstances"[[144]](#footnote-144) where the shareholder merely sought to "avoid its disenfranchisement as a majority shareholder."[[145]](#footnote-145) Although fee-shifting bylaws are uncharted judicial territory, a stockholder seeking to challenge a fee-shifting bylaw in a Delaware court can look to these cases for guidance.

A plaintiff shareholder does face a substantial burden, however, since corporate bylaws benefit from a presumption of validity.[[146]](#footnote-146) Before striking an improper bylaw, Delaware courts will attempt to interpret the bylaw "in a manner consistent with the law."[[147]](#footnote-147) Accordingly, a bylaw can only be invalidated one of two ways: (1) if the bylaw is "inconsistent with any statute or rule of common law" and therefore facially invalid or (2) if the bylaw is unreasonable in a given circumstance.[[148]](#footnote-148)

When challenging a bylaw as facially invalid, the plaintiff "must show that the bylaws cannot operate lawfully or equitably *under any circumstances*."[[149]](#footnote-149) The plaintiff "cannot evade this burden by conjuring up imagined future situations where the bylaws might operate unreasonably."[[150]](#footnote-150) Instead, there must be actual abuse; a plaintiff shareholder who provides only hypothetical situations in which a board could misuse the bylaw will not be successful, because the court will give the board a "reasonable opportunity to interpret [an] otherwise valid by-law in a fair and proper manner."[[151]](#footnote-151) Indeed, "every valid by-law is always susceptible to potential misuse."[[152]](#footnote-152) Where a shareholder is unable to show that a bylaw is invalid as a matter of law, the challenge must be based on an actual controversy.[[153]](#footnote-153)

Because the Court in *ATP Tour* held that fee-shifting bylaws are facially valid,[[154]](#footnote-154) plaintiff shareholders seeking to contest a board-adopted fee-shifting bylaw will have to show actual abuse by the board in order to prevail.[[155]](#footnote-155) Such challenges are just beginning to appear in the Court of Chancery.[[156]](#footnote-156) The Court of Chancery has not yet stated whether it will address the question only when considering a corporation's motion for attorneys' fees, or if it is sufficient for the plaintiff to seek invalidation of the bylaws prior to moving forward in prosecuting a lawsuit against the corporation.[[157]](#footnote-157) If having an actual controversy requires that the plaintiff has already sued and lost and would therefore be subject to liability if the court finds the bylaw valid, then the deterrent effect of a fee-shifting bylaw would be much more powerful.[[158]](#footnote-158) Indeed, the deterrent effect could be so powerful that challenges will never be filed.[[159]](#footnote-159)

Given the risk of a *de facto* bar on shareholder challenges to corporate acts, some kind of protection for shareholders may be necessary. If so, the Delaware Court of Chancery has the power in equity to declare bylaws unenforceable in certain circumstances. However, plaintiffs have a significant burden to overcome, and they may be unwilling to attempt to do so in the face of a fee-shifting provision. These risks may require legislative action. Accordingly, several options for limiting the negative impact of fee-shifting bylaws are discussed in the next subpart.

## Exploring the Middle Ground

In addressing the concerns outlined above, the legislature should explore solutions that will address excessive litigation, including allowing corporations to reasonably deter frivolous lawsuits, while limiting the unfair consequences of fee-shifting bylaws. In the event that the current legislative effort fails, there are several ways to limit fee-shifting bylaws while not eliminating them entirely.

First, the legislature could amend 8 *Del. C.* § 102(b) to require that a fee-shifting provision in the Articles of Incorporation or bylaws must be bilateral or truly "loser pays." Instead of only deterring stockholders from suing, the provision would also deter the corporate board from behaving unfairly toward shareholders, since they too could be exposed to liability for legal expenses beyond their own. In addition, a majority of shareholders would be more likely to disfavor fee shifting due to the risk of corporate exposure to liability for a plaintiff's legal fees. Fewer corporations would be willing to adopt fee-shifting bylaws. Meanwhile, plaintiff stockholders with dubious claims would still be deterred from suing.

Second, the legislature could protect minority shareholders by limiting fee shifting to publicly traded corporations, or at least prohibiting their application to close corporations. Doing so would recognize that investors in companies with a ready market for their shares are capable of selling their shares and moving on if they do not have sufficient influence to exercise their corporate democratic rights. At the same time, those stockholders whose companies are not publicly traded and do not have a large enough ownership share to interest potential buyers would be protected since their company would not have the ability to legally adopt fee-shifting bylaws. Taking this course, however, disregards that stock illiquidity is a natural consequence of the minority shareholder's ownership interest in a close corporation.

Third, to address concerns that boards are able to adopt fee-shifting bylaws unilaterally, it may be helpful for the legislature to prohibit corporations from adopting retroactive fee-shifting bylaws. For example, in the Hemispherx litigation, the plaintiffs expressed concern that the board adopted fee-shifting bylaws after the plaintiffs filed their complaint.[[160]](#footnote-160) The legislature could require that fee-shifting provisions be prospective only to prevent boards from using fee shifting as leverage against existing plaintiffs.

 Fourth, one way to balance the interests of shareholders in not being exposed to liability without their consent[[161]](#footnote-161) with the interest of corporations in deterring frivolous litigation[[162]](#footnote-162) would be to require that any provision imposing liability for corporate legal fees be placed in the Articles of Incorporation in order to be enforceable.[[163]](#footnote-163) Because an amendment to the Articles requires a shareholder vote,[[164]](#footnote-164) any fee-shifting provision that a board seeks to impose would have to be submitted to the shareholders and affirmatively agreed to by a majority of them. In addition, placing the fee-shifting provision in the Articles provides effective notice to potential investors. Investors would know to look for them there, especially in the wake of *ATP Tour* when discussion of fee-shifting bylaws has become widespread. Once a company has enacted a fee-shifting provision, investors may be less likely to buy shares, bringing the share price down and thereby discouraging the use of fee shifting.

 This solution is certainly not perfect. The board or the shareholders can amend bylaws unilaterally, but amending the Articles requires a board resolution and a shareholder vote. Accordingly, although a fee-shifting provision is more difficult to enact if it must be in the Articles, it would also be more difficult for the shareholders to undo without cooperation from the board.[[165]](#footnote-165) This tradeoff may be worth the additional protection provided by ensuring that fee-shifting provisions cannot be thrust upon a corporation's shareholders without their consent.

In addition, this solution only requires consent from shareholders of existing public corporations. Some corporations planning initial public offerings have quietly included fee-shifting provisions in their governing documents.[[166]](#footnote-166) Investors therefore may not have sufficient notice of the provision to create meaningful consent. However, investors who are able to participate in an IPO (such as institutional investors) are likely sufficiently sophisticated to closely scrutinize charter documents for any provision that may be detrimental to shareholders, especially now that the corporate world has taken notice of fee-shifting bylaws post-*ATP Tour*.[[167]](#footnote-167) Moreover, addressing this concern may be more appropriately within the domain of the Securities and Exchange Commission, which has the power to mandate IPO disclosure requirements.[[168]](#footnote-168)

As the Delaware legislature continues to work toward a solution that can please both sides of the fee-shifting debate, its members will likely consider these and many other viable options. If the current legislative effort fails, then a compromise approach may be required that combines aspects of these various solutions. Of course, if the current legislation passes the Delaware House, then fee-shifting bylaws will be facially invalid as contrary to Delaware law. Accordingly, further limits on the use of these bylaws will not be necessary. Market actors will then focus on developing other mechanisms for reining in excessive litigation.

# CONCLUSION

The current effort to legislate away fee-shifting bylaws is to be applauded for attempting to combine strong protection of shareholder interests with an acknowledgement of corporate concerns in the legitimization of forum selection bylaws. If it passes, then those concerned about excessive litigation will no doubt develop another tool for deterring frivolous shareholder lawsuits. If it does not pass, then one way to generate broad support could be to adopt one or more of the moderate approaches described here. These proposals seek to balance the legitimate interests of plaintiff shareholders with those of the corporations in which they invest. Moving forward, any legislation that seeks to protect shareholders must keep in mind the business community's concern over excessive litigation. Likewise, proponents of fee-shifting bylaws must be willing to agree to reasonable limitations that soften their negative impact on plaintiff shareholders, especially those without a ready market for their shares. As with most policy debates, the answer likely lies somewhere in the middle ground.

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1. Deutscher Tennis Bund v. ATP Tour, Inc., 480 F.App'x 124, n.4 (3d Cir. 2012). [↑](#footnote-ref-1)
2. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (Del. 2014). [↑](#footnote-ref-2)
3. *See infra* notes 24-33 and accompanying text. [↑](#footnote-ref-3)
4. *See infra* Part III.A. [↑](#footnote-ref-4)
5. *See infra* Part III.B. [↑](#footnote-ref-5)
6. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013). [↑](#footnote-ref-6)
7. *See infra* Part II. [↑](#footnote-ref-7)
8. *See infra* Part III. [↑](#footnote-ref-8)
9. *See infra* Part IV. [↑](#footnote-ref-9)
10. *See infra* Part IV.A. [↑](#footnote-ref-10)
11. *See infra* Part IV.B. [↑](#footnote-ref-11)
12. *See infra* Part IV.C. [↑](#footnote-ref-12)
13. 8 *Del. C.* § 109(b). [↑](#footnote-ref-13)
14. Hollinger Intern., Inc. v. Black, 844 A.2d 1022, 1078 (Del. Ch. 2004). [↑](#footnote-ref-14)
15. *Boilermakers*, 73 A.3d at 952. [↑](#footnote-ref-15)
16. *ATP Tour*, 91 A.3d at 558. [↑](#footnote-ref-16)
17. *See, e.g.*,Centaur Partners, IV v. Nat'l Intergroup, Inc., 582 A.2d 923, 928 (Del. 1990); Airgas, Inc. v. Air Prods. and Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010). [↑](#footnote-ref-17)
18. 8 *Del. C.* § 109(a) ("[T]he power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote. . . . Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors . . . . The fact that such power has been so conferred upon the directors . . . shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws."). [↑](#footnote-ref-18)
19. Kidsco Inc. v. Dinsmore, 674 A.2d 483, 492 (Del. Ch. 1995). [↑](#footnote-ref-19)
20. *Boilermakers*, 73 A.3d at 958. [↑](#footnote-ref-20)
21. *Kidsco*, 674 A.2d at 492. [↑](#footnote-ref-21)
22. *Boilermakers*, 73 A.3d at 939. [↑](#footnote-ref-22)
23. *Id.* at 956. [↑](#footnote-ref-23)
24. ATP Tour's bylaws as stated by the Court in *ATP Tour* included the following provision: "(a) In the event that (i) any [current or prior member or Owner or anyone on their behalf ('Claiming Party')] initiates or asserts any [claim or counterclaim ('Claim')] or joins, offers substantial assistance to or has a direct financial interest in any Claim against the League or any member or Owner (including any Claim purportedly filed on behalf of the League or any member), and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the League and any such member or Owners for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) (collectively, 'Litigation Costs') that the parties may incur in connection with such Claim." *ATP Tour*, 91 A.3d at 556. For the purposes of this Note, ATP Tour's fee-shifting bylaw will be considered representative of fee-shifting bylaws generally. [↑](#footnote-ref-24)
25. *Id*. at 558. [↑](#footnote-ref-25)
26. *Id.* (*quoting* 8 *Del. C.* § 109(b)). [↑](#footnote-ref-26)
27. *Id.* [↑](#footnote-ref-27)
28. *ATP Tour,* 91 A.3d at 558. [↑](#footnote-ref-28)
29. *Id.* at 557. [↑](#footnote-ref-29)
30. *Id.* at 559. [↑](#footnote-ref-30)
31. *Id.* at 560. [↑](#footnote-ref-31)
32. *ATP Tour,* 91 A.3d at 560. [↑](#footnote-ref-32)
33. *Id.* (*citing* Boilermakers, 73 A.3d at 956). [↑](#footnote-ref-33)
34. S.B. 236, Del. State S., 147th Gen. Assemb. (Del. 2014), *available at* http://legis.delaware.gov/LIS/

LIS147.NSF/vwLegislation/SB+236?Opendocument. This effort was led by Senator Bryan Townsend, with support from the Delaware State Bar Association's Council on Corporate Law. Daniel Fisher, *Is Delaware Law a Favor to Plaintiff Lawyers, Or Shareholder Protection?*, Forbes.com (Jun. 10, 2014, 12:22 PM), http://www.forbes.com/

sites/danielfisher/2014/06/10/is-delaware-law-a-favor-to-plaintiff-lawyers-or-protection-for-capitalists/. The proposed amendment had widespread support among the Delaware Bar, including corporate attorneys for both plaintiffs and defendants. Liz Hoffman, *Delaware to Weigh Who Pays Legal Fees in Corporate Litigation*, WSJ.com (Jun. 10, 2014, 10:09 AM), http://blogs.wsj.com/law/2014/06/10/delaware-to-weigh-who-pays-legal-fees-in-corporate-litigation/. Indeed, almost 100% of the Council on Corporate Law voted in favor of it. Fisher. [↑](#footnote-ref-34)
35. This opposition came mainly from the U.S. Chamber of Commerce's Institute for Legal Reform ("ILR"). *See* Hoffman, *supra* note 34. However, corporations such as Dole Foods and E.I. du Pont de Nemours & Co. also expressed their disapproval of the proposed amendment. Jennifer L. Vergilii & Brian Mielcusny, *The Delaware Supreme Court's 'ATP Tour' Decision: Most Observers Overstating Potential Impact on Fee-Shifting Bylaws*, Bloomberg BNA Corporate Law & Accountability Report (Aug. 8, 2014), http://www.bna.com/

delaware-supreme-courts-n17179894367/. According to the ILR, the amendment takes away a tool that corporations can use to "protect their shareholders" from frivolous and "abusive litigation" by other shareholders. Fisher, *supra* note 34. The argument goes that this protection is necessary because of the high expense to the corporation involved in either defending against the claim or paying off the plaintiff shareholder in order to have certainty that the transaction involved can move forward. Jonathan Starkey, *Delaware Lawyers Fight Fee-Shifting in Legislature*, The News J. (Jun. 10, 2014, 12:30 PM), http://www.delawareonline.com/story/news/local/2014/06/

09/delaware-lawyers-push-bill-protect-legal-fees/10260555/. [↑](#footnote-ref-35)
36. Bloomberg BNA Corporate Counsel Weekly, *Del. Legislature Delays Vote on Fee-Shifting Bylaws Ban*, 29 CCW 202 (Jul. 2, 2014). Apparently the amendment was delayed at least in part to the comments from ILR. Fisher, *supra* note 34. The ILR plans to use this time to "continue to staunchly oppose this legislation, as well as to educate lawmakers on the negative impact this bill would have on Delaware's business climate." *Delaware Legislature Delays Anti-Fee-Shifting Legislation*, U.S. Chamber Institute for Legal Reform (June 20, 2014), http://www.instituteforlegalreform.com/resource/delaware-legislature-delays-anti-fee-shifting-legislation/. [↑](#footnote-ref-36)
37. *See* S.B. 75, Del. State S., 148th Gen. Assemb. (Del. 2015), *available at* http://legis.delaware.gov/LIS/

lis148.nsf/vwLegislation/SB+75/$file/legis.html?open. [↑](#footnote-ref-37)
38. *See id.* [↑](#footnote-ref-38)
39. *See* *Delaware Judge Wants More Briefing Before Ruling on New Fee-Shifting Bylaw*, 30 Westlaw J. Corp. Officers & Directors Liability 10 (Sep. 8, 2014) (noting that these corporations are "mostly small biotechnology firms" and that most companies appear to be holding off "to see how investors react"). [↑](#footnote-ref-39)
40. *See* Alison Frankel, *Sneaky New Trend in IPOs: Make Shareholders Pay if They Sue and Lose*, 30 Westlaw J. Corp. Officers & Directors Liability 12 (Oct. 20, 2014) (discussing the quiet adoption of fee-shifting bylaws by Alibaba and other corporations with recent IPOs and calling on the SEC to review the impact of potentially insufficient notice on stockholder rights). [↑](#footnote-ref-40)
41. *See* Kastis v. Carter, Plaintiffs' Motion to Invalidate Retroactive Fee-Shifting and Surety Bylaw or, in the Alternative, to Dismiss and Withdraw Counsel, No. 8657 (Del. Ch. Jul. 21, 2014). [↑](#footnote-ref-41)
42. *Id.* [↑](#footnote-ref-42)
43. *Id.* [↑](#footnote-ref-43)
44. Kastis v. Carter, Letter from Counsel for Defendants to Chancellor Andre G. Bouchard, No. 8657 (Del. Ch. Sep. 16, 2014). [↑](#footnote-ref-44)
45. Strougo v. Hollander, Verified Amended Class Action Complaint, No. 9770 (Del. Ch. Sep. 24, 2014). [↑](#footnote-ref-45)
46. *Id.*, at ¶ 1. [↑](#footnote-ref-46)
47. *Id.*, at ¶ 2. [↑](#footnote-ref-47)
48. Strougo v. Hollander, 2015 WL 1189610, \*1 (Del. Ch. Mar. 16, 2015). [↑](#footnote-ref-48)
49. *Id.* at \*7. [↑](#footnote-ref-49)
50. *Id.* at \*5 ("[T]he Bylaw does not apply here for two related reasons: (i) the Board adopted the Bylaw after Plaintiff's interest in the Company was eliminated in the Reverse Stock Split; and (ii) Delaware law does not authorize a bylaw that regulates the rights or powers of former stockholders who were no longer stockholders when the bylaw was adopted."). [↑](#footnote-ref-50)
51. *Id.* at \*4 (internal citations omitted). [↑](#footnote-ref-51)
52. Lawrence A. Hamermesh, *Consent in Corporate Law*, 70 Bus. Law. 161, 167 (2015). [↑](#footnote-ref-52)
53. Noam Noked, *Delaware Court Endorses "Fee-Shifting" Bylaw*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. Blog (May 14, 2014, 9:01 AM), http://blogs.law.harvard.edu/corpgov/2014/05/14/delaware-court-endorses-fee-shifting-bylaw/; William J. Sushon, Samantha A. Brutlag, & Edward N. Moss, *Shifting Sands: Practical Advice on Delaware Fee-Shifting Bylaws*, N.Y.L.J. (Aug. 11, 2014), http://www.newyorklawjournal.com/

id=1202666097449/Shifting-Sands-Practical-Advice-on-Delaware-FeeShifting-Bylaws?slreturn=20140929171418. [↑](#footnote-ref-53)
54. *See supra* notes 35-36 and accompanying text. [↑](#footnote-ref-54)
55. *See, e.g.*, Starkey, *supra* note 35; *see also* Kastis v. Carter, Plaintiffs' Motion to Invalidate Retroactive Fee-Shifting and Surety Bylaw or, in the Alternative, to Dismiss and Withdraw Counsel, at 8-9, No. 8657 (Del. Ch. Jul. 21, 2014) ("By enacting this draconian Bylaw, the Board imposed a risk that neither Plaintiffs, their counsel, nor any economically rational stockholder or lawyer, could accept"). [↑](#footnote-ref-55)
56. Sushon, Brutlag, & Moss, *supra* note 53. Indeed, in the Hemispherx litigation, the Hemispherx board adopted a fee-shifting bylaw over a year into the litigation; shortly after announcing the new bylaw, the corporation notified the plaintiffs that it planned to take advantage of the bylaw in the litigation and warned that the plaintiffs could be liable for the corporations' legal fees if they continued to prosecute their claim. *See* Kastis v. Carter, Plaintiffs' Motion to Invalidate Retroactive Fee-Shifting and Surety Bylaw or, in the Alternative, to Dismiss and Withdraw Counsel, at 2-5, No. 8657 (Del. Ch. Jul. 21, 2014). [↑](#footnote-ref-56)
57. *ATP Tour*, 91 A.3d at 556. [↑](#footnote-ref-57)
58. *Deutscher Tennis Bund*, 480 F.App'x at 127, n.4 (suggesting that Delaware courts might not enforce the provision based on "unconscionability or public policy considerations"). [↑](#footnote-ref-58)
59. *But see* Sushon, Brutlag, & Moss, *supra* note 53 (suggesting that institutional investors may have sufficient resources to be beyond deterrence). [↑](#footnote-ref-59)
60. *See* Hamermesh, *supra* note 52, at 171. [↑](#footnote-ref-60)
61. Sushon, Brutlag, & Moss, *supra* note 53. [↑](#footnote-ref-61)
62. Starkey, *supra* note 35 (noting also that Delaware collects over $1 billion from such corporations each year). [↑](#footnote-ref-62)
63. Hamermesh, *supra* note 52, at 171. [↑](#footnote-ref-63)
64. This tension between fee shifting and shareholder consent is the an essay by Professor Lawrence A. Hamermesh that explores the limits of what he calls the "doctrine of corporate consent." *See* Hamermesh, *supra* note 50. [↑](#footnote-ref-64)
65. *See supra* notes 17-23 and accompanying text. [↑](#footnote-ref-65)
66. Hamermesh, *supra* note 52, at 167. [↑](#footnote-ref-66)
67. Fisher, *supra* note 34. [↑](#footnote-ref-67)
68. Hamermesh, *supra* note 52, at 166. [↑](#footnote-ref-68)
69. *See id.* at 167. [↑](#footnote-ref-69)
70. S.B. 236, Del. State S., 147th Gen. Assemb. (Del. 2014), *available at* http://legis.delaware.gov/LIS/lis147.nsf/vwlegislation/6FC0ACD6AA8A7AB885257CEC004EE4E5. [↑](#footnote-ref-70)
71. *See* Draft Legis., Nov. 8, 2013 (on file with author). [↑](#footnote-ref-71)
72. *See, e.g.,* Williams v. Geier, 671 A.2d 1368, 1385 n.36 (Del. 1996). [↑](#footnote-ref-72)
73. The draft amendment currently being circulated also includes a provision specifically permitting corporations to include forum-selection provisions in their bylaws and certificates of incorporation, reflecting a more balanced approach to the problem. *See* Draft Legis., Nov. 8, 2013 (on file with author). [↑](#footnote-ref-73)
74. Per the Court in *ATP Tour*, deterring litigation is "not invariably an improper purpose." ATP Tour, 91 A.3d at 560. [↑](#footnote-ref-74)
75. Steven M. Davidoff, Jill Fisch, & Sean J. Griffith, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 Tex. L. Rev. 557, 559 ("In 2013, . . . 97.5% of deals over $100 million were challenged through litigation, and each transaction triggered an average of seven separate lawsuits."). [↑](#footnote-ref-75)
76. Dias v. Purches, 2012 WL 4503174, at \*5 (Del. Ch. Oct. 1, 2012). In *Dias*, the Court elaborated on the balance of interests that has led to this development: "Rather than carefully considering what claims have merit, some plaintiffs file a broad and general complaint, taking a scattershot approach in the hopes that the case will be expedited. Those plaintiffs then rely on the Court to winnow their claims, determining which are meritorious and what value they confer upon the stockholders. This dynamic obviously creates a risk of excessive merger litigation, where the costs to stockholders exceed the benefits. On the other hand, the diffuse nature of corporate ownership means that, absent class actions, many wrongs would not be remedied. Class actions give any stockholder sufficiently interested the ability to act as an independent prosecutor and vindicate stockholders' rights. Class actions also give attorneys a reason to represent clients whose claims are individually worth little but in the aggregate are worth much more." *Id.* [↑](#footnote-ref-76)
77. Davidoff, Fisch, & Griffith, *supra* note 75, at 566-68 (discussing disclosure-only settlements). [↑](#footnote-ref-77)
78. Hoffman, *supra* note 34. [↑](#footnote-ref-78)
79. *Cf.* Sushon, Brutlag, & Moss, *supra* note 53 ("These statistics [showing the discrepancy between shareholder votes in favor of mergers and the increase in shareholder litigation] suggest that many shareholder lawsuits are not performing an important policing function at all, but instead are brought to generate plaintiffs' attorneys' fees."). [↑](#footnote-ref-79)
80. Davidoff, Fisch, & Griffith, *supra* note 75, at 558. [↑](#footnote-ref-80)
81. *See* *Dias*, 2012 WL 4503174, at \*7 (Del. Ch. Jul. 31, 2012) ("Stockholders ultimately pay for the defense of meritless expedited litigation, offsetting the benefits received by a stockholder class."). [↑](#footnote-ref-81)
82. For the purposes of this discussion, the ATP Tour bylaws as reproduced by the Court in *ATP Tour* are considered representative of all fee-shifting bylaws. Doing so makes sense in light of the similarity between ATP Tour's bylaws and those that have been adopted by Hemispherx, First Aviation, and other corporations since *ATP Tour* was decided. [↑](#footnote-ref-82)
83. *See supra* notes 55-59 and accompanying text. [↑](#footnote-ref-83)
84. *Cf.* Hamermesh, *supra* note 52, at 168 (suggesting that fee-shifting bylaws such as ATP Tour's significantly "impair the rights of investors"). [↑](#footnote-ref-84)
85. Fisher, *supra* note 34. [↑](#footnote-ref-85)
86. *See infra* Part IV.C. [↑](#footnote-ref-86)
87. The draft amendment appears to be an attempt to do so; the drafters included a provision that will specifically allow corporations to impose forum selection provisions on their shareholders. *See* Draft Legis., Nov. 8, 2013 (on file with author). Because such provisions have already been endorsed by the Court of Chancery in *Boilermakers*, discussed *infra*, those in favor of dampening shareholder litigation may not find this effort sufficient. [↑](#footnote-ref-87)
88. *See supra* Part III.A. [↑](#footnote-ref-88)
89. *See* Edward B. Micheletti & Jenness E. Parker, *Multi-Jurisdictional Litigation: Who Caused This Problem, and Can It Be Fixed?*, 37 Del. J. Corp. L. 1, 25 (2012). [↑](#footnote-ref-89)
90. *Boilermakers*, 73 A.3d at 939 ("[F]orum selection bylaws are not facially invalid as a matter of statutory law."). [↑](#footnote-ref-90)
91. *ATP Tour*, 91 A.3d at 560, n.38. [↑](#footnote-ref-91)
92. For a discussion of *Boilermakers* and *ATP Tour* in the context of the potential for corporate use of mandatory arbitration bylaws, see Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 Del. J. Corp. L. (forthcoming) (manuscript at 5-13) (*available at* http://papers.ssrn.com/sol3/papers.cfm?abstract\_

id=2444771). [↑](#footnote-ref-92)
93. *E.g., Airgas*, 8 A.3d 1182, 1188 (Del. 2010) ("Corporate charters and bylaws are contracts among a corporation's shareholders: therefore, our rules of contract interpretation apply."); *Kidsco*, 674 A.2d at 492 (Del. Ch. 1995) (*aff'd* 1995 WL 715886 (Del. Supr.)) ("[A]lthough the by-laws are a contract between the corporation and its stockholders, the contract was subject to the board's power to amend the by-laws unilaterally."). [↑](#footnote-ref-93)
94. *Boilermakers*, 73 A.3d at 954-63. [↑](#footnote-ref-94)
95. *Id.* at 939. [↑](#footnote-ref-95)
96. *Id.* at 955-56 ("Stockholders are on notice that . . . the board itself may act unilaterally to adopt bylaws . . . ."). [↑](#footnote-ref-96)
97. *ATP Tour*, 91 A.3d at 560. [↑](#footnote-ref-97)
98. *See* Hamermesh, *supra* note 52, at 171. [↑](#footnote-ref-98)
99. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985). [↑](#footnote-ref-99)
100. *Boilermakers*, 73 A.3d at 954. [↑](#footnote-ref-100)
101. *See supra* Part II.B. [↑](#footnote-ref-101)
102. *Boilermakers*, 73 A.3d at 954. [↑](#footnote-ref-102)
103. *See* *ATP Tour*, 91 A.3d at 560 (noting that deterring litigation is "not invariably an improper purpose"). [↑](#footnote-ref-103)
104. *Boilermakers*, 73 A.3d at 944. [↑](#footnote-ref-104)
105. *Id.* ("[M]ultiforum litigation . . . to challenge a single corporate action, imposes high costs on the corporations and hurts investors by causing needless costs that are ultimately born [sic] by stockholders . . . ."). [↑](#footnote-ref-105)
106. Allen, *supra* note 92, at 12("On a spectrum, exclusive forum provisions would seem to have the most modest impact, since they affect the place where litigation proceeds and not whether it moves forward, while fee-shifting would have the strongest impact, as it creates the specter of significant, unknown expenses solely by virtue of unsuccessfully pursuing a case."). [↑](#footnote-ref-106)
107. *See supra* Part III.A. [↑](#footnote-ref-107)
108. *See supra* Part III.B. [↑](#footnote-ref-108)
109. *See infra* notes 111-16 and accompanying text. [↑](#footnote-ref-109)
110. *See infra* notes 117-24 and accompanying text. [↑](#footnote-ref-110)
111. *Cf.* *Boilermakers*, 73 A.3d at 954 (suggesting that boards can craft bylaws in such a way that would preserve the corporation's ability to "waive the corporation's rights under the bylaw in a particular circumstance"). [↑](#footnote-ref-111)
112. Fisher, *supra* note 34. [↑](#footnote-ref-112)
113. Vergilii & Mielcusny, *supra* note 35. [↑](#footnote-ref-113)
114. Noked, *supra* note 53. [↑](#footnote-ref-114)
115. Sushon, Brutlag, & Moss, *supra* note 53. [↑](#footnote-ref-115)
116. *See* Vergilii & Mielcusny, *supra* note 35 ("[T]he practical obstacles to adopting fee-shifting provisions in bylaws suggest that many of these responses [in opposition to *ATP Tour*] may have been overreaction."). [↑](#footnote-ref-116)
117. Citizens United v. Fed. Election Comm'n, 558 U.S. 310, 362 (U.S. 2010), *quoting* First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 794 (U.S. 1978). [↑](#footnote-ref-117)
118. *Boilermakers*, 73 A.3d at 957. [↑](#footnote-ref-118)
119. *Id.* ("[B]ecause the DGCL gives stockholders an annual opportunity to elect directors, stockholders have a potent tool to discipline boards . . . .") (citations omitted). [↑](#footnote-ref-119)
120. *See* Hamermesh, *supra* note 52, at 167. [↑](#footnote-ref-120)
121. *See* Vergilii & Mielcusny, *supra* note 35 ("Institutional investors and advisors would likely not approve of such provisions and could make efforts to rid the company of the directors responsible for its adoption."). [↑](#footnote-ref-121)
122. *See* 8 *Del. C.* § 109(a) ("[T]he power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote."). *See also* *Boilermakers*, 73 A.3d at 956 ("[E]ven though a board may . . . be granted authority to adopt by-laws, stockholders can check that authority by repealing board-adopted bylaws."); Noked, *supra* note 53. [↑](#footnote-ref-122)
123. *Boilermakers*, 73 A.3d at 956 (*quoting* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 232 (Del. 2008)). [↑](#footnote-ref-123)
124. Hamermesh, *supra* note 52, at 167. [↑](#footnote-ref-124)
125. *But see* *id.* at 168 (arguing for more extensive limitations on fee-shifting bylaws based on a theory that they fall under a category of "corporate actions that, while technically permissible and even properly motivated, so impair the rights of investors that we don't remit the shareholder to the corporate voting process for relief from such actions."). [↑](#footnote-ref-125)
126. *ATP Tour*, 91 A.3d at 558 ("Bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose."). [↑](#footnote-ref-126)
127. *See, e.g.*, *Hollinger*, 844 A.2d at 1078 ("The DGCL is intentionally designed to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation. That capacious grant of power is policed in large part by the common law of equity, in the form of fiduciary duty principles. The judiciary deploys its equitable powers cautiously to avoid intruding on the legitimate scope of action the DGCL leaves to directors and officers acting in good faith. The business judgment rule embodies that commitment to proper judicial restraint. At the same time, Delaware's public policy interest in vindicating the legitimate expectations stockholders have of their corporate fiduciaries requires its courts to act when statutory flexibility is exploited for inequitable ends."). [↑](#footnote-ref-127)
128. Leo E. Strine, Jr., *If Corporate Action is Lawful, Presumably There Are Circumstances in Which it is Equitable to Take That Action: The Implicit Corollary to the Rule of* Schnell v. Chris-Craft, 60 Bus. Law. 877, 880 (2005). [↑](#footnote-ref-128)
129. *Id.* at 879. [↑](#footnote-ref-129)
130. *See id.* at 880 ("[S]imply because an action is statutorily or contractually lawful, does not mean that it is equitable."). [↑](#footnote-ref-130)
131. *See id*. Presumably the answer to the legal question would be yes as to fee-shifting bylaws, unless the corporate charter prohibits them. *See ATP Tour*, 91 A.3d at 560. [↑](#footnote-ref-131)
132. Strine, *supra* note 128, at n.21. [↑](#footnote-ref-132)
133. *See* *id.* at 883 (noting that Delaware courts disfavor creation of "per se rules in equity" because creating such rules would "undermine the genius of the Delaware way, by narrowing the wide freedom of action our statute affords to directors"). [↑](#footnote-ref-133)
134. *Cf.* *Boilermakers*, 73 A.3d at 954 (noting that a board seeking enforcement of a forum selection bylaw "must *voluntarily* submit the forum selection clause to the scrutiny of the courts if a plaintiff does not comply with it") (emphasis in original). [↑](#footnote-ref-134)
135. *Hollinger*, 844 A.2d at 1078 ("Delaware's public policy interest in vindicating the legitimate expectations stockholders have of their corporate fiduciaries requires its courts to act when statutory flexibility is exploited for inequitable ends."). [↑](#footnote-ref-135)
136. *ATP Tour*, 91 A.3d at 558-59. [↑](#footnote-ref-136)
137. *Id.* at 558. [↑](#footnote-ref-137)
138. *Id.* at 558-59. [↑](#footnote-ref-138)
139. *Id.* at 559 (*quoting* *Hollinger*, 844 A.2d at 1080). [↑](#footnote-ref-139)
140. *Hollinger*, 844 A.2d at 1081. [↑](#footnote-ref-140)
141. *ATP Tour*, 91 A.3d at 558 (*quoting* Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437, 439 (Del. 1971)). [↑](#footnote-ref-141)
142. *Schnell*, 285 A.2d at 439. [↑](#footnote-ref-142)
143. Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407 (Del. 1985). [↑](#footnote-ref-143)
144. *Id.* at 409. [↑](#footnote-ref-144)
145. *ATP Tour*, 91 A.3d at 559 (*quoting* *Frantz*, 501 A.2d at 409). [↑](#footnote-ref-145)
146. *E.g.*, *Frantz*, 501 A.2d at 407. [↑](#footnote-ref-146)
147. *Id*. [↑](#footnote-ref-147)
148. *Id*. [↑](#footnote-ref-148)
149. *Boilermakers*, 73 A.3d at 948 (*citing* *Frantz*, 501 A.2d at 407) (emphasis in original). [↑](#footnote-ref-149)
150. *Boilermakers*, 73 A.3d at 940. [↑](#footnote-ref-150)
151. Stroud v. Grace, 606 A.2d 75, 95 (Del. 1992). [↑](#footnote-ref-151)
152. *Id.* at 96. [↑](#footnote-ref-152)
153. *See Boilermakers*, 73 A.3d at 949, n.62 (explaining that there is a "judicial reticence to chill corporate freedom by condemning as invalid a bylaw that is consistent with the board's statutory and contractual authority, simply because it might be possible to imagine situations when the bylaw might operate unreasonably. . . . [S]uch as-applied challenges are to be raised later, when real-world circumstances give rise to a genuine, concrete dispute requiring judicial resolution."). *See also* *id.* at 954 (suggesting that a "real-world application of a forum selection bylaw can be challenged as an inequitable breach of fiduciary duty"). [↑](#footnote-ref-153)
154. *ATP Tour*, 91 A.3d at 560. [↑](#footnote-ref-154)
155. Although a shareholder could theoretically show that the bylaw "could not operate . . . equitably under any circumstances," *see* *supra* note 149, it is difficult to see how a plaintiff could meet this standard while being prohibited from hypothesizing over potential applications of the bylaw. Accordingly, an as applied challenge is the only viable alternative. [↑](#footnote-ref-155)
156. *See supra* notes 41-51 and accompanying text. [↑](#footnote-ref-156)
157. In the Hemispherx litigation, the plaintiffs articulated a plaintiff's dilemma over when a claim disputing the fee-shifting provision will be ripe: "In this case, Hemispherx is contending that Plaintiffs can only challenge the Bylaw by litigating the entire case and assuming liability for a six or seven figure amount of fees and expenses. Of course, even a small risk of such a devastating liability makes it financially irrational for Plaintiffs to proceed, so the reality is the Bylaw can never be challenged if the Court decides such a challenge can only come after the underlying case has been decided. Moreover, given the Bylaw’s requirement that Plaintiffs can only avoid liability by essentially achieving complete success on all claims, the risk of liability is extremely high." Kastis v. Carter, Plaintiffs’ Reply Brief in Response to Hemispherx Biopharma, Inc.’s Response to Plaintiffs’ Motion to Invalidate Retroactive Fee-Shifting and Surety Bylaw Or, in the Alternative, to Dismiss and Withdraw Counsel, No. 8657 (Del. Ch. Aug. 13, 2014). [↑](#footnote-ref-157)
158. *See id*. [↑](#footnote-ref-158)
159. *See* Hamermesh, *supra* note 52, at 171 ("[E]ven if there were some evidence that [a fee-shifting bylaw's] adoption was improperly motivated, a lawsuit challenging it would likely be too risky for any stockholder to undertake because anything less than total success in that litigation would result in the stockholder having to pay the corporation's costs of defense."). [↑](#footnote-ref-159)
160. Kastis v. Carter, Plaintiffs' Motion to Invalidate Retroactive Fee-Shifting and Surety Bylaw or, in the Alternative, to Dismiss and Withdraw Counsel, No. 8657 (Del. Ch. Jul. 21, 2014) ("The plain terms of the Bylaw and the Company’s July 18, 2014 letter demonstrate an intent to force Plaintiffs and their counsel to discontinue this litigation by threatening financial liability under the Bylaw. The Bylaw has had its intended effect. Plaintiffs and their counsel have concluded that, if the Bylaw is valid and enforceable, it would be economically irrational to continue this litigation."). [↑](#footnote-ref-160)
161. *See supra* Part III.A. [↑](#footnote-ref-161)
162. *See supra* Part III.B. [↑](#footnote-ref-162)
163. This mechanism for balancing director and corporation protection with shareholder interests would be similar to that employed in the waiver of directors' duty of care that corporations may adopt pursuant to 8 *Del. C.* § 102(b)(7). [↑](#footnote-ref-163)
164. *See* 8 *Del. C.* § 242(b)(1). [↑](#footnote-ref-164)
165. As the Court explained in *Boilermakers*, "[a]lthough the plaintiffs' argument suggests that a forum selection provision accomplished by a certificate amendment would be more legitimate in some normative sense because stockholders approved the amendment, the plaintiffs ignore that a certificate provision is harder for stockholders to reverse. *See* 8 Del. C. § 242(b)(1) (requiring a board resolution and stockholder vote for a proper amendment to the corporation's certificate of incorporation). By contrast, in the case of a board-adopted forum selection bylaw, the stockholders can act unilaterally to amend or repeal the provision. *Id.* § 109(a) ('After a corporation other than a nonstock corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote.'). For present purposes, however, the issue is not whether someone might deem it more legitimate in some sense to proceed by an amendment to the certificate of incorporation rather than by a bylaw. That decision was for the Chevron and FedEx boards in the first instance, and the stockholders have multiple tools to hold the boards accountable if the stockholders disagree with it." *Boilermakers*, 73 A.3d at 955, n.93. [↑](#footnote-ref-165)
166. *See* Frankel, *supra* note 40. [↑](#footnote-ref-166)
167. Indeed, institutional investors and the advisors they retain have begun reacting negatively to fee-shifting bylaws; Institutional Shareholder Services, a firm that advises institutional investors, recommends not only voting against fee-shifting bylaws that penalize shareholders who are only partially successful in litigation, but also encourages shareholders to vote against directors who engaged in pre-IPO adoption of bylaw and/or charter provisions. Institutional Shareholder Services, United States Proxy Voting Guideline Updates: 2015 Benchmark Policy Recommendations, at 3, 7 (Nov. 6, 2014), *available at* http://www.issgovernance.com/file/policy/

2015USPolicyUpdates.pdf. [↑](#footnote-ref-167)
168. *See* Frankel, *supra* note 40 (questioning why the Securities and Exchange Commission has not intervened to prevent the adoption of fee-shifting provisions without sufficient notice to investors); *see also* Letter from Sen. Richard Blumenthal to The Honorable Mary Jo White, Chairman of the Securities and Exchange Commission (Oct. 29, 2014), *available at* http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-sec-to-protect-critical-check-on-corporate-malfeasance (requesting that the Securities and Exchange Commission take action to protect investors from fee-shifting provisions). [↑](#footnote-ref-168)