

Scholarly Commons @ UNLV Boyd Law

Scholarly Works

Faculty Scholarship

2019

Crafting Fee-Shifting Policy

Benjamin P. Edwards

University of Nevada, Las Vegas -- William S. Boyd School of Law

Follow this and additional works at: <https://scholars.law.unlv.edu/facpub>



Part of the [Organizations Law Commons](#)

Recommended Citation

Edwards, Benjamin P., "Crafting Fee-Shifting Policy" (2019). *Scholarly Works*. 1261.

<https://scholars.law.unlv.edu/facpub/1261>

This Article is brought to you by the Scholarly Commons @ UNLV Boyd Law, an institutional repository administered by the Wiener-Rogers Law Library at the William S. Boyd School of Law. For more information, please contact youngwoo.ban@unlv.edu.

CRAFTING FEE-SHIFTING POLICY

Benjamin P. Edwards*

ABSTRACT

The controversy over emerging fee-shifting corporate bylaw and charter provisions presents multiple policy choices. Delaware's decision to ban the provisions offers an opportunity for: (i) states to offer a meaningful alternative to Delaware; and (ii) the generation of useful information for evaluating whether particular bylaws or charter provisions enhance shareholder wealth.

TABLE OF CONTENTS

INTRODUCTION.....	934
I. THE GOALS OF CORPORATE LAW.....	938
A. COORDINATED ACTIVITY AND WEALTH CREATION	938
B. SHAREHOLDER WEALTH MAXIMIZATION	940
C. PRIVATE ORDERING AND TRANSACTION COST REDUCTION.....	941
D. STATE REVENUE.....	942
II. EMERGING FEE-SHIFTING PROVISIONS.....	942
A. CORPORATE LITIGATION EXPANDS BEYOND THE REALM OF REASON.....	942
B. THE DELAWARE CONTROVERSY.....	945
C. OKLAHOMA'S AMENDMENT.....	947
D. NEVADA'S OPPORTUNITY	947
III. TESTING GOVERNANCE PACKAGES.....	949
A. CLEARING AWAY CONFOUNDING FACTORS	950
B. TESTING CONSISTENT PACKAGES	951
C. SUNSET PROVISIONS.....	952
D. FUNDING REVIEW.....	953
E. CONSIDERATIONS FOR FRAMING A FEE-SHIFTING PACKAGE	953
F. INACTION, A LEGISLATIVE ALTERNATIVE	956
CONCLUSION.....	957

* Associate Professor, University of Nevada, Las Vegas, William S. Boyd School of Law; J.D., Columbia Law School. For helpful comments and conversations, special thanks to Lori Johnson, Elizabeth Manriquez and participants of the Business Law Conference at the University of Tennessee and the Rocky Mountain Junior Scholars Forum.

INTRODUCTION

Scholars often characterize Delaware as having won a competition over gathering the most state corporate charters.¹ With the victory came spoils. One recent estimate projected that Delaware would collect almost a billion dollars in 2018 from corporate charter and other business entity fees.² These revenues provide significant financial support for state operations, but they do not establish that Delaware got everything right.

Observers explain Delaware's dominance with different theories. Some contend that Delaware enjoys a massive network effect and its dominance continues simply because there are benefits to joining the larger corporate paradigm—even when the law might not be optimal for a corporation.³ Others argue that Delaware maintains its dominance because it offers access to high-quality Chancery courts, specialized in resolving business disputes.⁴ Many believe that states decide against challenging Delaware because Delaware could always simply amend its laws to copy any innovation delivered by a successful challenger.⁵

Despite its current dominance, Delaware's place may be more

¹ See J. Haskell Murray, *The Social Enterprise Law Market*, 75 MD. L. REV. 541, 567 (2016) (“professors Bruce Kobayashi and Larry Ribstein concluded that Delaware has won the competition for LLCs for many of the same reasons Delaware has won the competition for corporate charters, and that most other states seem more interested in retaining local LLCs than fighting for LLCs from outside their state”).

² See Financial Overview, Delaware, <https://budget.delaware.gov/budget/fy2018/documents/operating/financial-overview.pdf> (“DEFAC estimates (after refunds) for these categories are \$975.0 million for Fiscal Year 2017 and \$992.6 million for Fiscal Year 2018”).

³ See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 852 (1995) (“Second, the possibility that network externalities are significant in the corporate charter market implies that the products produced in that market may be suboptimal. Delaware’s dominance may have resulted in too much uniformity in state laws.”).

⁴ See Lynn M. LoPucki, *Corporate Charter Competition*, 102 MINN. L. REV. 2101, 2102–03 (2018) (“Delaware’s competitive strategy is principally judicial, not legislative. . . . Delaware Chancery Court has struggled to attract cases and, as a result, some believe that Delaware’s strategy has begun to unravel”).

⁵ See Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 557 (2002) (“even if a rival were to identify some substantial set of changes that could significantly benefit both shareholders and management, . . . [t]he substantial amount of time that would be required for the challenger to adopt changes and for firms to respond to them would provide Delaware with ample opportunity to react.”).

precarious than many recognize.⁶ In particular, Delaware's vaunted judiciary may wield less influence now than in years past because many shareholder plaintiffs have begun filing suits outside Delaware for strategic reasons.⁷ Delaware may also be less nimble in its responses to rival states for two reasons: (i) significant changes in Delaware law may draw federal intervention, limiting Delaware's ability to swiftly respond;⁸ and (ii) powerful interest groups within Delaware, namely Delaware lawyers that benefit from corporate litigation, may block changes that affect their interests and reduce litigation.⁹

Given the strategic terrain, state corporate law may soon diverge from Delaware on important issues. Most notably, Delaware's controversial decision to ban most fee-shifting bylaws and charter provisions provides an ideal opening.¹⁰ After the Delaware Supreme Court approved the use of a fee-shifting bylaw for a non-stock corporation in *ATP Tour, Inc. v. Deutscher Tennis Bund*. (ATP), many stock

⁶ LoPucki, *supra* note 4, at 2103.

⁷ *Id.*

⁸ See Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 600 (2003) ("Federal chartering is the most obvious means of preempting state corporate law. But even were there no prospect of federal chartering--as is the situation today-- federal authorities could still make corporate law, as they indeed do. In doing so, they deeply affect the state-to-state race").

⁹ See Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 873 (2016) ("The basic problem was that S.B. 75 presented an unprecedented conflict between the interests of the State and those of Delaware lawyers, the interest group that dominates corporate lawmaking in Delaware"); Larry E. Ribstein, *Delaware, Lawyers, and Contractual Choice of Law*, 19 DEL. J. CORP. L. 999, 1009-10 (1994) ("Delaware lawyers, in essence, are the Delaware legislature, at least insofar as corporate law is concerned." "[L]egislators are likely to rely on lawyers to supply sophisticated commercial and business legislation. As a result, virtually all of Delaware corporate law is proposed by the Delaware bar, and the bar's proposals invariably pass through the legislature").

¹⁰ Bainbridge, *supra* note 9, at 871 (explaining that the ban "is especially likely to trigger a migration away from Delaware because it is one of those rare corporate law changes that directly affects the potential personal liability of corporate officers and directors"); John C. Coffee, Jr., *Fee-Shifting and the SEC: Does It Still Believe in Private Enforcement?*, CLS BLUE SKY BLOG (Oct. 14, 2014), archived at <https://perma.cc/QD6P-N9TX> ("[T]he permissibility of automatic fee-shifting is a major difference that will fuel interjurisdictional competition because it protects corporate managers and directors from potential personal liability").

corporations adopted similar provisions as part of their corporate bylaws or charters.¹¹ Corporations began adopting these provisions as a response to increased litigation around mergers and acquisitions transactions.¹² Within about a year and over howls of protest, the Delaware legislature banned most fee-shifting provisions at the prompting of the Delaware state bar.¹³ Because fee-shifting provisions threatened to reduce corporate litigation volume, Delaware's corporate lawyers had significant, self-interested reasons to support the ban.¹⁴

Many, possibly pretextual, arguments over fee-shifting provisions claimed that the provisions would be good or bad for shareholders. Opponents argued that fee-shifting provisions would hurt shareholders because management would use them to insulate themselves from challenge. In this entrenchment narrative, unfaithful managers would loot corporate assets while secure in the knowledge that few plaintiffs would sue. A fee-shifting provision would chill meritorious litigation because few shareholders would voluntarily expose themselves to liability for staggering corporate litigation fees. Presumably, corporations with such provisions would be worth less to shareholders because they would have less freedom to challenge management and a greater expectation that management would steal. Moreover, rational shareholders holding these views would sell on the news that a corporation adopted a fee-shifting provision. Supporters, on the other hand, argued that the provisions responded to value-destroying shareholder litigation, benefiting shareholders by reducing litigation costs and making more money available for investment or dividends. In theory, rational investors concerned about excessive litigation costs would prefer to buy shares in a company likely to have lower litigation expenses.

These questions need not go unanswered. A state could pass legislation designed to attract corporate incorporations and simultaneously gather information useful for further amending and promoting its corporate law. Access to favored governance innovations may draw public corporations to reincorporate or announce the

¹¹ *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 555 (Del. 2014) (“we hold that fee-shifting provisions in a non-stock corporation’s bylaws can be valid and enforceable under Delaware law”).

¹² See Albert H. Choi, *Fee-Shifting and Shareholder Litigation*, 104 VA. L. REV. 59, 62 (2018) (“generated a substantial amount of controversy, but a number of corporations promptly took advantage of this newly validated right”).

¹³ See Bainbridge, *supra* note 9, at 853–54.

¹⁴ Even transactional lawyers might support a ban because litigation risk often drives the decision to invest in expensive transactional processes.

enactment of fee-shifting provisions, opening the door for market reactions to provide useful information about the provisions' impact. If stocks tended to fall on these announcements, a state might conclude that the provisions destroyed wealth and harmed shareholders. This evidence would support following Delaware and banning the provisions. On the other hand, if stocks reliably rise when corporations announce or propose these changes, the experiment would indicate that the state's law generated wealth for shareholders. This result might accelerate any shift in market share toward a state endorsing fee-shifting provisions because it would make a corporation more valuable.

In any event, some corporations chartered outside of Delaware will continue to adopt fee-shifting provisions until judicial decisions or legislation invalidate the governance rule. Indeed, a good number of corporations chartered outside of Delaware have already done so despite the uncertainty around whether courts will enforce these provisions. Legislation offers a way to thoughtfully shape how these provisions emerge instead of leaving the decision entirely to corporate managers and courts.

Ultimately, state competition on this front seems inevitable simply because of potential revenues available from even small inroads into Delaware's near billion-dollar revenue stream. Despite past lassitude, some states have launched challenges attempting to capture increased incorporation market share.¹⁵ Notably, Nevada began to compete more aggressively in the market for corporate incorporations when it raised its taxes on corporate charters in 2003.¹⁶ Although Nevada has not yet captured sizeable market share, it has had some success in drawing out-of-state incorporations, ranking a distant second behind Delaware.¹⁷

¹⁵ See Bebchuk & Hamdani, *supra* note 5, at 555 ("the alleged vigorous race among states vying for incorporations, we argue, simply does not exist. We present evidence that Delaware's dominant position is far stronger, and thus that the competitive threat that it faces is far weaker, than has been previously recognized.").

¹⁶ See Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 940 (2012) ("Nevada has capitalized on this opportunity by offering, and aggressively marketing, a unique product—a no-liability corporate law—that has proven attractive to a subset of American companies.").

¹⁷ LoPucki, *supra* note 4, at 2112 ("Compustat data on 7061 public-company incorporations show that, as compared with a hypothetical regulatory scheme that would require companies to incorporate in their headquarters states, Delaware gains 3879 corporations (fifty-five percent of the 7061). Only four other states gain at all. Nevada gains 282 corporations (four percent)").

This essay suggests an intermediate path for states overseeing emerging fee-shifting provisions. The public securities markets produce valuable information useful for evaluating the significance of new information. States should move to deliberately harness the market's information-generating power as they revise their corporate laws. If well-executed, the end result would be more efficient corporate law rules and greater prosperity.

This essay proceeds in three short parts. Part I provides a brief discussion of the nature of corporate law and its goals. Part II discusses the controversy over fee-shifting provisions as an ideal opportunity for thoughtful exploration. Part III discusses mechanisms for legislation to harness the market's information-generating power.

I. THE GOALS OF CORPORATE LAW

A robust, long-running debate over corporate law's purpose continues between scholars.¹⁸ Although a universally accepted consensus will likely never emerge, some common and widely held views about the purposes served by corporate law suggest metrics for evaluating and considerations for crafting new corporate law.¹⁹ This Part briefly reviews a few, but not all, common positions.

A. Coordinated Activity and Wealth Creation

Many view corporate law's chief and least controversial purpose as creating social wealth by facilitating economic investment and development. One scholar framed the view as "corporate law should

¹⁸ See, e.g., E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1154 (1932) ("My conception of it is this: That there are three groups of people who have an interest in that institution. One is the group of fifty-odd thousand people who have put their capital in the company, namely, its stockholders. Another is a group of well toward one hundred thousand people who are putting their labor and their lives into the business of the company. The third group is of customers and the general public."); Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 435 (2013) ("Beyond positive law and theory addressing corporate purpose, the normative debate has gone on for decades and shows no signs of abating"); Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59, 71 (2010) ("Over the course of the past century, the famous debate between Adolph Berle and Merrick Dodd in the Harvard Law Review over the nature and purpose of the corporation has been traced and retraced in a pendulum swing between two fundamental positions.").

¹⁹ See Tamara Belinfanti & Lynn Stout, *Contested Visions: The Value of Systems Theory for Corporate Law*, 166 U. PA. L. REV. 579, 606 (2018) ("Multiple purposes are the rule, not the exception, in systems. Indeed, it is hard to think of any designed system whose designer would not have had more than one goal in mind").

facilitate corporate attempts to maximize productive output (and hence wealth) in a competitive economy, encouraging long-term investment at the lowest cost of capital, subject to exterior regulations that control externalities.”²⁰ Notably, this view does not mean that corporations should focus on creating wealth exclusively for shareholders or that the wealth generated should be distributed in any particular way.²¹

This view remains consistent with the influential team production model for corporate law.²² Under this view, corporate directors serve the interests of the corporation, understood as the interests of the corporation’s diverse stakeholders that have made investments of some kind in the corporation, and not purely the interests of the corporation’s shareholders.²³ It accepts that although shareholders have special rights in some circumstances, corporate law insulates directors from direct shareholder control.²⁴

²⁰ William W. Bratton, *Framing A Purpose for Corporate Law*, 39 J. CORP. L. 713, 723 (2014).

²¹ *Id.* at 720 (“There is no place for shareholder primacy in a statement of the corporate purpose that aspires to general acceptance. The shareholder maximization norm follows from a particular conception of the optimal incentive alignment within the firm, a conception contestable in theory”).

²² See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 285 (1999) (“The mediating hierarchy model consequently suggests that the public corporation can be viewed most usefully not as a nexus of implicit and explicit contracts, but as a nexus of firm-specific investments made by many and varied individuals who give up control over those resources to a [decision-making] process in hopes of sharing in the benefits that can flow from team production”).

²³ *Id.* at 288 (“Corporate law does not treat directors as shareholders’ agents but as something quite different: independent hierarchs who are charged not with serving shareholders’ interests alone, but with serving the interests of the legal entity known as the “corporation.” The interests of the corporation, in turn, can be understood as a joint welfare function of all the individuals who make firm-specific investments and agree to participate in the extracontractual, internal mediation process within the firm.”).

²⁴ *Id.* at 288–89 (“we argue that public corporation law encourages directors to serve the joint interests of all stakeholders who comprise the corporate “team” by generally insulating them from the demands of any single stakeholder group, including the shareholders.” “Shareholders enjoy special legal rights not because they have some unique claim on directors, but because they often are in the best position to represent the interests of the coalition that comprises the firm.”).

B. *Shareholder Wealth Maximization*

Although not universally accepted, the most widely-taught corporate law norm and conventional wisdom is that corporate law and corporations both serve to maximize shareholder wealth.²⁵ This means that a corporation's board of directors should generally act in good faith to maximize shareholder wealth.²⁶ This view holds that:

[U]ltimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance; noncontrolling shareholders should receive strong protection from exploitation at the hands of controlling shareholders; and the market value of the publicly traded corporation's shares is the principal measure of its shareholders' interests.²⁷

Much of the shareholder primacy framework draws from an agency model of corporate law. In this model, the shareholders are the principals in the relationship and the corporation's directors, officers, and employees all serve as agents. A corporation's stock price provides a constant referendum on agent performance.²⁸ Embracing stock price

²⁵ Lynn A. Stout, *On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)*, 36 SEATTLE U. L. REV. 1169, 1177 (2013) ("[C]ombined enthusiasm for shareholder primacy ideology among academics, hedge funds, policy entrepreneurs, executives, and journalists, goes a long way toward explaining how shareholder primacy managed so swiftly to mature from provocative academic theory to conventional wisdom.").

²⁶ See Leo E. Strine, Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155 (2012) ("[C]orporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders.").

²⁷ Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440–41 (2001).

²⁸ Lynn A. Stout, *supra* note 25, at 1177 ("[S]hareholder primacy ideology led to a number of individually modest but collectively significant changes in corporate law and practice that had the practical effect of driving directors and executives in public corporations to focus on share price as their guiding star.").

reactions as a metric to measure corporate law itself may link corporate law more closely to shareholder wealth maximization.

Of course, many states now explicitly authorize directors to consider other interests with constituency statutes. For example, Nevada's statute allows a corporate board to consider a variety of constituencies, including the "interests of the corporation's employees, suppliers, creditors or customers" as well as the community's interest, the State or Nation's interest, and the short-term or long-term interests of shareholders.²⁹

C. *Private Ordering and Transaction Cost Reduction*

Corporate law also serves to provide default rules and reduce transaction costs for persons forming corporate entities.³⁰ In the contractarian view, corporate law should provide the sorts of default rules that stakeholders would have arrived at if they had bargained over how to structure the terms of their relationships.³¹ Outside of the default rules, contractarians expect managers and shareholders to arrive at deals that maximize the value of corporate entities and tend to defer to the parties' choices.³² Some believe that market pressure will encourage corporations to enact governance provisions that maximize firm value.³³

²⁹ Nev. Rev. Stat. Ann. § 78.138 (West 2017).

³⁰ See William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1400 (1993) ("Corporate law is seen as a way to provide a standard set of instructions for the operation of such a governance structure. In the corporate charter much of this standard set can be replaced by terms better suited to the perceived needs of the parties involved, if that is efficient and desired, but the cheaper, "off-the-rack" terms set forth in the corporate statute will often serve well enough.").

³¹ FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 15 (1991) ("The normative thesis of the book is that corporate law should contain the terms people would have negotiated, were the costs of negotiating at arm's length for every contingency sufficiently low. The positive thesis is that corporate law almost always conforms to this model.").

³² Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1328 (2013) ("The contractarian theory brought economics into the analysis of corporate governance and corporate law, and in doing so it provided a fresh start based on simple assumptions and straightforward economic logic. In the absence of transaction costs, economic theory implies that managers will customize the terms of their relationship with shareholders to maximize firm value.").

³³ See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 767 (1995) ("In the contractarian paradigm, firm managers are conceptualized

D. State Revenue

Corporate law also serves the interests of the state by providing franchise taxes, fees, and increased economic activity. States may make changes to their corporate law or supporting infrastructure with this financial objective in mind.³⁴

Notably, investor interests and the threat of federal intervention theoretically constrain state competition.³⁵ For example, if a state offered one-sided terms favoring corporate managers over investors, corporations organized under the law of that state would, in theory, attract fewer investors.

II. EMERGING FEE-SHIFTING PROVISIONS

Delaware's decision to ban fee-shifting corporate bylaws and charter provisions provides a rare opportunity for states to offer an attractive alternative to Delaware because Delaware's legislature stripped the freedom to adopt fee-shifting provisions from Delaware corporate law. This part briefly traces that controversy and overviews recent research.

A. Corporate Litigation Expands Beyond the Realm of Reason

For some time, deal litigation has increased, driving significant costs for shareholders.³⁶ One relatively recent study found that as of 2013, "97.5% of deals over \$100 million were challenged through litigation, and each transaction triggered an average of seven separate lawsuits."³⁷ It seems unlikely that corporate malfeasance in merger deals

as selecting a set of charter terms that capital markets price and that investors, in effect, purchase when they purchase a firm's securities. Because they have incentives to obtain the highest value for their firm's shares, managers attempt to offer terms that maximize share values by minimizing agency costs and signaling to investors valuable information about the firm.").

³⁴ For example, a state might invest in improved customer service by appropriating additional funding for the state agency charged with administering ministerial corporate law.

³⁵ See, e.g., Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporate Law*, 76 NW. U. L. REV. 913, 919–20 (1982) (claiming that Delaware "has achieved its prominent position because its permissive corporation law maximizes, rather than minimizes, shareholders' welfare.").

³⁶ See Jill E. Fisch et. al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and A Proposal for Reform*, 93 TEX. L. REV. 557, 558 (2015) ("[T]he frequency of merger litigation has risen sharply over the last several years.").

³⁷ *Id.* at 559 (citing Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2013*

has become so widespread as to justify this volume of litigation.³⁸

Much securities and derivative litigation suffers from an agency cost problem. In essence, plaintiffs' counsel face a continual economic incentive to press securities and derivative litigation when litigation remains profitable for their firms—even if overly aggressive private enforcement reduces shareholder welfare.³⁹ In many instances, plaintiffs' counsel have received hundreds of thousands in fees paid by the corporation while the shareholder class receives mere additional disclosure about the deal.⁴⁰

The disclosure-settlement problem may even weaken incentives to actually deal with conflicts when putting deals together. Leading academic experts have critiqued the litigation in strong terms:

At the root of the crisis in shareholder litigation is the absence of meaningful incentives on either side to protect shareholder rights. Plaintiffs' lawyers seeking disclosure settlements happily trade litigation rights into which they have invested little, if any, real investigative effort. Meanwhile, defense counsel, who also collect fees ultimately funded by shareholders, set up the settlements that result in the abandonment of shareholder rights. The disclosure settlement dynamic may also lead defense counsel to take a more cavalier approach to potentially

1-2 & tbl. A (Moritz Coll. of Law Ctr. for Interdisciplinary Law & Policy Studies, Pub. Law & Legal Theory Working Paper Series No. 236, 2014), <http://ssrn.com/abstract=2377001> [<http://perma.cc/XP2B-8C8B>]).

³⁸ See Bainbridge, *supra* note 9, at 861 (reviewing evidence “suggesting that the pervasive problem in this area is not breaches of duty by directors and officers but rather strike suits filed by the plaintiffs’ bar.”).

³⁹ See Benjamin P. Edwards, *Disaggregated Classes*, 9 VA. L. & BUS. REV. 305, 319 (2015) (“Agency cost problems may also drive over-enforcement of the securities laws. Over-enforcement issues arise when the plaintiffs’ counsel would litigate to secure fees and payment even though the litigation would not be in the plaintiffs’ long-term interest.”).

⁴⁰ Courts now recognize that these disclosure-only settlements provide, at best, dubious value to shareholders. See Matthew D. Cain et. al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 605 (2018) (“In several decisions, judges openly questioned the value of so-called disclosure-only merger litigation settlements in which the only relief provided to the plaintiff class was additional disclosure by the takeover parties.”).

serious conflicts or other complications.⁴¹

Delaware's Chancery courts now recognize that they have struggled to control the litigation, with one leading jurist opining that Delaware courts' history of approving "disclosure settlements of marginal value [to shareholders] and to routinely grant broad releases to defendants and six-figure fees to plaintiffs' counsel . . . caused deal litigation to explode in the United States beyond the realm of reason."⁴²

Excessive deal litigation also has broader consequences. The excessive securities and derivative litigation has also been linked to concerns about the competitiveness of American capital markets.⁴³ The Supreme Court echoed this concern in *Stoneridge Investment Partners v. Scientific Atlanta* when it decided against expanding Rule 10b-5 liability.⁴⁴ In essence, firms considering whether to offer their securities to the public may shy away from American capital markets if the litigation environment will interfere with their operations and create additional costs.

Investors have good reasons to be skeptical about securities litigation. For many shareholders, securities litigation may be value destroying.⁴⁵ To attract quality directors, corporations must purchase insurance to protect the directors from personal liability—otherwise, few directors would be willing to serve. When shareholder litigation settles, the funds for defense costs and plaintiffs' fees often come from either the corporation or the insurance policy. If the funds come from the corporation, those funds cannot be paid out in dividends or reinvested into economic activities. If the funds come from insurance policies, insurance companies react by charging corporations larger premiums for insurance. In either instance, shareholders make less money.

⁴¹ Dan Awrey et. al., *Resolving the Crisis in U.S. Merger Regulation: A Transatlantic Alternative to the Perpetual Litigation Machine*, 35 YALE J. ON REG. 1, 14 (2018).

⁴² *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884, 894 (Del. Ch. 2016).

⁴³ See Bainbridge, *supra* note 9, at 865–66 (reviewing evidence that excessive shareholder litigation creates "a substantial drag on the economy as a whole").

⁴⁴ *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta*, 552 U.S. 148, 164 (2008) ("Overseas firms with no other exposure to our securities laws could be deterred from doing business here This, in turn, may raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets." (internal citation omitted)).

⁴⁵ See Edwards, *supra* note 39, at 317 ("[M]ost compensation paid [in securities litigation] is essentially circular and wasteful.").

B. The Delaware Controversy

Against the backdrop of expanding shareholder litigation, the Delaware Supreme Court decided *ATP Tour, Inc. v. Deutscher Tennis Bund*.⁴⁶ The case upheld a controversial bylaw provision that allowed ATP Tour to shift its litigation costs to the plaintiff if the plaintiff did not succeed on substantially all claims pressed in its litigation.⁴⁷ The decision signaled that the Delaware Supreme Court might approve private attempts to alter the attorney-fee regime for shareholder derivative litigation.

Notably, shareholder derivative litigation already has a unique fee structure. In most litigation under the “American Rule,” each party bears its own fees and costs regardless of the outcome.⁴⁸ This differs from the English Rule, where the loser pays the winner’s legal fees. Shareholder litigation proceeds a bit differently because the corporation normally pays the fees for the successful plaintiff’s lawyers under the common benefit doctrine after a settlement resolving the litigation is approved.⁴⁹

This dynamic generates multiple consequences. Attorneys may take cases from shareholders with small individual recoveries if they will be able to receive fees for a benefit, even a benefit of dubious value, that is conferred on all shareholders. This creates an incentive to represent dispersed shareholders and gives shareholders a meaningful way to protect their rights. On the downside, the possibility of lush attorney fees for disclosure-only settlements seemingly motivates litigation profitable to the attorney, even if it is not necessarily in the best interest of shareholders.

Controversy erupted in 2014 as some ordinary Delaware corporations quickly began to adopt fee-shifting provisions as a means to

⁴⁶ *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 555 (Del. 2014) (“[W]e hold that fee-shifting provisions in a non-stock corporation’s bylaws can be valid and enforceable under Delaware law.”).

⁴⁷ *Id.*

⁴⁸ *Id.* at 558 (“Delaware follows the American Rule, under which parties to litigation generally must pay their own attorneys’ fees and costs.”).

⁴⁹ See Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 37–38 (2015) (“In spite of famously declining to follow English doctrine on fee-shifting, American courts did adopt the practice of English courts of equity in ordering the sharing of fees among all beneficiaries of a fund recovered for the ‘common benefit.’” (citation omitted)).

deter litigation.⁵⁰ Plaintiffs' lawyers lobbied the legislature to ban fee-shifting provisions, and the legislature delayed action after the business community protested.⁵¹

The debate over fee-shifting provisions for intercorporate litigation has significant implications for shareholders, corporate managers, and attorneys. On the self-interested front, some attorneys may oppose it because it will reduce the profitability and demand for legal services.⁵² Corporate managers and directors may favor it simply because it may reduce their exposure to litigation. These personal stakes may color how many evaluate fee-shifting provisions.

Personal stakes to the side, proponents and opponents framed their arguments in terms of shareholder and public interests. Opponents argued that fee-shifting provisions would unduly insulate management and allow them to self-deal and take advantage of shareholders too afraid to litigate for fear of crushing attorney's fees.⁵³ They also argued that by reducing intra-corporate litigation volume, fee-shifting provisions would remove judicial oversight of corporate law, potentially weakening investor confidence over time.⁵⁴ Supporters countered these arguments by pointing out that intra-corporate litigation had over-expanded under the current incentive system and, on balance, resulted in more harm than

⁵⁰ See Bainbridge, *supra* note 9, at 858 ("Anticipating such a result, over fifty Delaware corporations adopted fee-shifting bylaws by April 2015.").

⁵¹ See Lisa A. Rickard, *Delaware Flirts With Encouraging Shareholder Lawsuits*, WALL ST. J., Nov. 14, 2014, <http://www.wsj.com/articles/lisa-rickard-delaware-flirts-with-encouraging-shareholder-lawsuits-1416005328> ("Loud protests from national, state and local business groups, as well as individual companies caused the legislature to rethink its approach.").

⁵² Cf. Jonathan R. Macey, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 472 (1987) ("the rules that Delaware supplies often can be viewed as attempts to maximize revenues to the bar, and more particularly to an elite cadre of Wilmington lawyers who practice corporate law in the state.").

⁵³ See CORP. LAW COUNCIL, EXPLANATION OF COUNCIL LEGISLATIVE PROPOSAL 4 (2015) [hereinafter COUNCIL EXPLANATION], <http://www.corporatedefensedisputes.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.pdf> (finding that faced with fee-shifting provisions "few stockholders will rationally be able to accept the risk of exposure to millions of dollars in attorneys' fees to attempt to rectify a perceived corporate wrong, no matter how egregious").

⁵⁴ *Id.* at 6 ("If investors were to perceive over time that statutory rights and fiduciary obligation had become hollow concepts, investors' confidence could diminish, and capital formation could be adversely affected").

good to shareholders. Supporters conceded that even if fee-shifting provisions might deter some potentially successful suits, the net result would improve shareholder welfare. On balance, it might be better to allow some risk of bad behavior than to perpetuate a system that consumes corporate resources in endless disputes.

Ultimately, the faction opposing fee-shifting provisions prevailed, and the Delaware legislature banned fee-shifting provisions.⁵⁵ In the aftermath, many corporate managers expressed dissatisfaction with the legislation and Delaware's failure to reign in excessive litigation.⁵⁶

C. *Oklahoma's Amendment*

While Delaware debated fee-shifting provisions, Oklahoma moved swiftly to change its corporate law to make fee-shifting mandatory for all derivative disputes.⁵⁷ Oklahoma's statute is notable because it changed the law for Oklahoma corporations instead of simply authorizing Oklahoma corporations to adopt fee-shifting provisions if they deemed them appropriate.

D. *Nevada's Opportunity*

Although Oklahoma already explicitly embraced fee-shifting, other states now face a choice between three options: (i) some form of legislative adoption and authorization; (ii) inaction pushing the issue onto courts; or (iii) following Delaware and banning these provisions.

⁵⁵ See generally 2015 Delaware S.B. 75.

⁵⁶ Liz Hoffman, *Dole and Other Companies Sour on Delaware as Corporate Haven*, WALL ST. J., Aug. 2, 2015, <https://www.wsj.com/articles/dole-and-other-companies-sour-on-delaware-as-corporate-haven-1438569507> ("Executives of Dole, DuPont Co., Ancestry.com Inc. and other Delaware companies have publicly and privately appealed to state officials to find ways to curb lawsuits."). Notably, the legislation banning fee-shifting provisions also authorized corporations to make Delaware the exclusive forum for resolving any internal corporate claims. From an interest-group analysis perspective, this might be viewed as an effort to secure additional fees for Delaware lawyers. See DEL. CODE ANN. tit. 8, § 115 (West) ("The certificate of incorporation or the bylaws may require . . . that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State").

⁵⁷ OKLA. STAT. ANN. tit. 18, § 1126 (West) ("In any derivative action instituted by a shareholder of a domestic or foreign corporation, the court having jurisdiction, upon final judgment, shall require the nonprevailing party or parties to pay the prevailing party or parties the reasonable expenses, including attorney fees, taxable as costs, incurred as a result of such action").

Nevada may be well situated to continue differentiating itself from Delaware in the market for corporate incorporations.⁵⁸ Nevada now ranks a distant second behind Delaware in attracting public company corporate charters.⁵⁹ Nevada's success may be attributed to changes in its corporate law designed to reduce managerial liability.⁶⁰ Firms concerned about the high governance costs associated with derivative litigation might prefer to reincorporate into Nevada to take shelter under Nevada's protections. Moreover, Nevada has attracted attention as a jurisdiction that might compete with Delaware.⁶¹

Nevada has steadily embraced a strategy to "differentiate itself from Delaware by providing its corporations with minimal liability exposure."⁶² Nevada's distinct approach has even been marketed by its Secretary of State.⁶³ Thus far, the effort has had some success at attracting corporate charters. Some firms openly declare that they selected Nevada law because of the liability environment. For example, one firm released a proxy statement advocating for a change to Nevada because "reincorporation in Nevada may help us attract and retain qualified management by reducing the risk of lawsuits being filed against the Company and its directors."⁶⁴

Current research about the impact of Nevada law on shareholder

⁵⁸ See LoPucki, *supra* note 4, at 2126 ("At present, Nevada, Maryland, Oklahoma, Connecticut, North Dakota, South Dakota, and Wyoming are either actively competing or preparing to do so.").

⁵⁹ *Id.* at 2112.

⁶⁰ Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 940 (2012) ("Nevada has capitalized on this opportunity by offering, and aggressively marketing, a unique product--a no-liability corporate law--that has proven attractive to a subset of American companies.").

⁶¹ See generally Kevin LaCroix, *Should Nevada Be the New Preferred Forum? (That's Right, Nevada.)*, THE D&O DIARY, Aug. 12, 2015, <https://www.dandodiary.com/2015/08/articles/corporate-governance/should-nevada-be-the-new-preferred-forum-thats-right-nevada/>.

⁶² Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. 131, 168–69 (2018).

⁶³ *Id.* ("Nevada has been marketing its services by highlighting the greater protections afforded to managers, directors and officers under Nevada law.").

⁶⁴ Cleantech Solutions International, Inc., Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, May 22, 2012, https://www.sec.gov/Archives/edgar/data/819926/000121390012002971/def14a0512_cleantech.htm.

value paints an inconclusive picture.⁶⁵ Many of Nevada's public companies trade only over-the-counter (OTC), making it difficult to acquire clear stock price information.⁶⁶ Adding to the difficulty, reincorporation from Delaware to Nevada occurs infrequently. One reincorporation event study examining a single firm did not find any significant evidence that shareholders cared one way or another about a decision to reincorporate to Nevada.⁶⁷

Although not definitive, some evidence tends to show that Nevada's approach might be right for some firms. One recent study, forthcoming in the *Journal of Law & Economics*, found no evidence that Nevada's corporate law harms shareholders.⁶⁸ Rather, it found that evidence suggested "that Nevada's pro-managerial system is conducive to the value of the firms that choose to incorporate in Nevada."⁶⁹ The evidence supports the view that "strong shareholder monitoring and stringent fiduciary norms are not necessarily conducive to shareholder welfare."⁷⁰

III. PROVISIONAL GOVERNANCE PACKAGES

A provisional, limited approach may help states decide how to proceed. Importantly, shifting stock market prices for public companies provide information.⁷¹ Reasonably efficient securities markets swiftly

⁶⁵ See Barzuza, *supra* note 62, at 173 ("Despite what one might expect given Nevada firms' high ratios of reporting irregularities, our study did not find conclusive evidence that firms in Nevada were traded in a lower value relative to firms in other states").

⁶⁶ *Id.* at 174 ("Nevada firms come disproportionately from OTC, which provides only thin trading data").

⁶⁷ Bruce H. Kobayashi, Larry E. Ribstein, *Nevada and the Market for Corporate Law*, 35 SEATTLE U. L. REV. 1165, 1186 (2012) ("We could not reject the null hypothesis that shareholders were unaffected by the decision to reincorporate, as there is no evidence of statistically significant negative or positive abnormal returns generated by the announcement of the firm's decision to reincorporate under Nevada law").

⁶⁸ Ofer Eldar, *Can Lax Corporate Law Increase Shareholder Value? Evidence from Nevada*, 62 J. OF L. & ECON. (forthcoming 2019) (on file with author).

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ See Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1543 (2007) ("stock prices have become more informative[,] . . . individual stock price movements . . . became increasingly decoupled from overall market movements, meaning that firm-specific

react to new public information and impound that information into a stock's price. If shareholders, on balance, believe that a change will harm the corporation in the long run, many may opt to sell their shares, driving the price down. In contrast, news reflecting a higher probability of a more prosperous future causes prices to increase as more investors purchase the stock.

Although imperfect markets do not provide perfect predictions, event studies focused on market reactions can provide useful information about how investors view particular changes.⁷² This part sketches a rough outline for how a state legislature might deliberately craft its corporate law to facilitate using event studies to evaluate market reactions to new laws.

A. Clearing Away Confounding Factors

Event studies often suffer from imprecision when confounding factors make it difficult to assess an event or statement's impact.⁷³ This often happens when a company releases more than one piece of information at a time. An event study may be able to see the market reacting to new information in the aggregate, not whether a particular piece of information drove the change.⁷⁴ Consider a stock price reacting in the wake of a corporation announcing two facts at the same time: (i) corporate earnings significantly exceeded analyst expectations for the quarter; and (ii) a promising and previously-hyped research initiative had failed. If the stock moves upward after the corporation makes both announcements, disentangling the impact each statement had on the stock

factors became increasingly influential. This greater firm-specific return variation is best explained, in the United States, in terms of increasingly informative stock prices.”).

⁷² For a description of an event study, see Jill E. Fisch et. al., *The Logic and Limits of Event Studies in Securities Fraud Litigation*, 96 TEX. L. REV. 553, 570 (2018) (“In its simplest form, an event study compares a stock’s return on a day when news of interest hits the market to the range of returns typically observed for that stock, taking account of what would have been expected given general changes in the overall market on that day.”).

⁷³ Alon Brav & J.B. Heaton, *Event Studies in Securities Litigation: Low Power, Confounding Effects, and Bias*, 93 WASH. U.L. REV. 583, 605 (2015) (“Causes of price impacts unrelated to the event under study are “confounding effects.” “Sometimes confounding effects are apparent, such as when, in an event study of dividend omissions, a firm simultaneously announces bad earnings, which makes it more difficult to determine how much of the observed price impact resulted from the dividend omission and how much from the negative earnings announcement”) (citation omitted).

⁷⁴ See Fisch, et al., *supra* note 72, at 614 (“When multiple sources of news are released at exactly the same time, however, no event study can by itself separate out the effects of the different news. The event study can only tell us whether the net effect of all the news was associated with an unusually large price drop or rise.”).

price may be impossible.

Carefully structured corporate enabling statutes may be able to clear away some confounding factors. States could reduce confounding factors by requiring corporations enacting new governance provisions to announce these changes individually instead of lumping them together with other pieces of news that might also impact the corporation's stock price.⁷⁵ Although efficient markets quickly incorporate new information, the effect is not instantaneous. To create a buffer around the release, a state might require announcements to occur midweek, during trading hours, and when no information had been announced for two days before. A well-crafted enabling statute might also require that the corporation certify it has no intention of making additional announcements that week.⁷⁶

This type of announcement protocol would facilitate efforts to evaluate governance announcements. Although it might be difficult to definitively assess how the market reacts after a single firm announces a change through this type of procedure, multi-firm event studies allow researchers to speak with much greater confidence about a governance rule's impact.⁷⁷ As more firms announce through this type of process, observers gain an incrementally stronger sense about a provision's impact.

B. Testing Consistent Packages

Effective evaluation of any provisional rule may require trimming away some of the traditional freedom offered by corporate law. In most instances, corporate law serves to enable, allowing lawyers to decide how to draft particular provisions or whether to copy language used elsewhere. This may result in corporations using different words to accomplish roughly the same results. In some instances, the different wording may matter because a reviewing court may see distinctions between differently worded provisions.

⁷⁵ Because of mandatory disclosure rules under the federal securities laws, this might require special board meetings where the issue could be resolved alone.

⁷⁶ Of course, events might require some corporate announcement during that week and a state could not prohibit a public company from complying with federal law.

⁷⁷ Brav & Heaton, *supra* note 73, at 586 (“[A]lmost all academic research event studies are multi-firm event studies (MFESs) that examine large samples of securities from multiple firms.”) (citation omitted).

Significant drafting freedom may also introduce additional confounding factors into any attempt to evaluate the impact of controversial corporate provisions. Markets may react differently to differently drafted provisions out of a belief that courts would interpret them differently or that the provisions might impose different obligations.

Conditioning access to provisional governance rules on the adoption of a uniform package of terms would reduce many of these concerns.⁷⁸ As others have noted, legislatures might also allow firms to simply opt-in to particular types of provisions instead of enabling them to craft their own.⁷⁹ Enabling packages of legislatively-crafted terms would reduce uncertainty and allow the legislature greater freedom in experimenting.

C. *Sunset Provisions*

Legislative bodies do not always function smoothly. There is always the risk that experimental provisions might remain law indefinitely—even if they produce pernicious effects. Future legislatures might have entirely different agendas to pursue and little interest in reviewing the outcome of an experiment.

Sunset provisions may serve to mitigate some of these risks.⁸⁰ The provisions specify that a particular law will go out of effect in the future unless the legislature affirmatively renews it.⁸¹ With a sunset provision in place, a future legislature would have to decide that the experiment had been a success and opt to authorize the provisions on a permanent basis.

Of course, including sunset provisions may increase risks for corporate entities. A corporation may hesitate to incur the cost and

⁷⁸ Cf. Barzuza, *supra* note 62, at 179 (“findings also lend support to a novel policy approach: creating a menu of minimal governance *packages* for firms to choose from. For example, if a firm chooses to incorporate in Nevada it should also have to adopt both proxy access and majority voting to ensure board accountability. So, a Nevada package will include a proxy access and a majority voting term.”).

⁷⁹ See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 840–41 (1995) (“This suggestion is not as radical or difficult to apply as it may appear. State legislatures would enact the menus just as they now enact default rules. They would be written to attract groups of firms with identifiable contractual needs, just as default rules are to be designed for the majority of firms”).

⁸⁰ See SUNSET LAW, Black’s Law Dictionary (10th ed. 2014) (“A statute under which a governmental agency or program automatically terminates at the end of a fixed period unless it is formally renewed”).

⁸¹ *Id.*

expense associated with reincorporation or adoption if the benefits would be available only fleetingly.

A decade might provide a reasonable amount of time to test a new corporate law package. The enabling legislation must allow enough time for the governance package to be thoroughly vetted. It would allow corporations to opt in to the experimental corporate package over time and time for the markets to learn how to evaluate these provisions. Much of that learning might only occur after slow-moving courts interpret the new provisions.

Importantly, sunset provisions only provide for an automatic end at a specific point in the future. They do not require a legislature to continue an experiment past the point where results become obvious. If a governance package proves to be value-destroying or otherwise unwise, the legislature could simply rescind its authorization for the package.

D. Funding Review

Corporate law also provides an ideal landscape for this sort of provisional authorization because corporate fees may be used to pay the costs associated with the process. In creating a provisional governance package, a state legislature might simply condition corporate adoption of particular provisions on the payment of specific, additional fees. These fees could be used for general state revenues, education, or for funding studies to review the impact of new governance provisions.

The market might react positively to experimental packages tied to funding provisions. These provisions would signal state commitment to optimizing corporate law and the development of useful information. They would also mitigate the fear that fee-shifting or other provisions might be enacted by a state eager to race to the bottom to maximize its own revenue.

In any event, modest additional fees would not be a sticking point for corporate actors. Corporations concerned about high governance costs would likely gladly pay an additional annual fee to participate. In many instances, a general counsel would enthusiastically recommend that a corporation pay an extra \$10,000 a year if it reduced the risk of paying millions in defense costs to defend against derivative litigation.

E. Considerations for Framing A Fee-Shifting Package

Fee-shifting provisions provide a novel opportunity for some provisional authorization. Despite Delaware's ban, fee-shifting provisions

also provide a reasonable response to excessive litigation. The provisions have a long history of use in the bond market which provides an analogous situation for two reasons: “(1) that both are investors to a corporation and (2) that dispersed ownership often leads to similar collective action problems.”⁸²

Not all fee-shifting provisions are alike. For example, the federal Trust Indenture Act explicitly authorizes fee-shifting at the discretion of the court.⁸³ In explaining the basis for authorizing fee-shifting, then SEC Commissioner, William O. Douglas, stated that the provision served “so as not to make too profitable just plain, ordinary strike suits, where suits are brought by irresponsible people merely in order to get a little money [through early settlement] from the trustees.”⁸⁴ Other contracts impose different terms. For example, the American Bar Association’s Model Stock Purchase Agreement makes fee shifting mandatory and symmetric:

10.12. ATTORNEYS’ FEES[.] In the event any Proceeding is brought in respect of this Agreement or any of the documents referred to in this Agreement, the prevailing party will be entitled to recover reasonable attorneys’ fees and other costs incurred in such Proceeding, in addition to any relief to which such party may be entitled.⁸⁵

The symmetrical approach embraced by the ABA’s Model Stock Purchase Agreement differs from the approach initially pursued by Delaware corporations.⁸⁶ For example, Echo Therapeutics adopted a broad fee-shifting bylaw that would push costs and fees onto plaintiffs whenever they achieved only a partial victory.⁸⁷

⁸² Albert H. Choi, *Fee-Shifting and Shareholder Litigation*, 104 VA. L. REV. 59, 98 (2018).

⁸³ 15 U.S.C.A. § 7700o(e) (West).

⁸⁴ Regulation of Sale of Securities: Hearing on S. 2344 Before the Subcomm. on Sec. & Exch. of the S. Comm. on Banking & Currency, 75th Cong. 69 (1937) (statement of William O. Douglas, Comm’r, Securities & Exchange Commission).

⁸⁵ Model Stock Purchase Agreement, § 12.15 (Am. Bar Ass’n 2010).

⁸⁶ See Choi, *supra* note 82, at 97-98 (“Under the ATP Tour bylaws, by contrast, when the plaintiff ‘does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, the plaintiff will still have to reimburse the defendant’s litigation expenses.’”) (citation omitted).

⁸⁷ *Id.* at 71 (explaining that with the Echo Therapeutics bylaw, “fee-shifting applies in only one direction, from the defendant to the plaintiff, and even when the plaintiff achieves a partial victory. The provision shifts the defendant’s litigation expenses to the plaintiff when the plaintiff ‘does not obtain a judgment on the merits that substantially

5.13. **Litigation Costs.** To the fullest extent permitted by law, in the event that (i) any current or prior stockholder 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 Corporation and/or any Director, Officer, Employee or Affiliate, 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, the greatest amount permitted by law of all fees, costs and expenses of every kind and description (including but not limited to, all reasonable attorney's fees and other litigation expenses) (collectively, “Litigation Costs”) that the parties may incur in connection with such Claim.⁸⁸

This type of broad bylaw drew substantial criticism as potentially overreaching because it seemingly covers both derivative and direct litigation. Derivative claims are claims that return money to the corporation—with the fees for plaintiffs’ attorneys determined by the court.⁸⁹ In contrast, direct claims return funds directly to shareholders and a plaintiff attorney’s recovery will ordinarily be governed by contract.⁹⁰ Before Delaware banned fee-shifting provisions, one Chancery Court jurist hinted that he would likely rule that these bylaw

achieves . . . the full remedy sought.”).

⁸⁸ Echo Therapeutics, Inc., Amended and Restated By-Laws of Echo Therapeutics, Inc. 9 (July 24, 2014), <http://www.sec.gov/Archives/edgar/data/1031927/000141588914002261/ex3-2.htm>.

⁸⁹ See Choi, *supra* note 82, at 71 (“In a derivative lawsuit, if there is any monetary recovery, the recovery will go to the corporation (and not to the plaintiff-shareholders); perhaps more importantly, the amount of expenses that the plaintiffs’ attorneys can recover will be determined by the court”).

⁹⁰ *Id.*

provisions could not reach direct claims.⁹¹

Putting precise linguistic framing to the side, legislatively authorizing a form of symmetrical fee-shifting for intracorporate litigation would likely provide significant benefits. Fee-shifting provisions would force plaintiffs' attorneys to consider the costs as well as their potential gains, driving them toward more judicious decisions about when to sue.⁹² In the aggregate, this type of provision might reduce governance costs for corporations with these bylaws.

Legislative authorization for fee-shifting allows the legislature to control the scope and severity of these provisions. A state with a well-functioning business court might opt to make fee-shifting discretionary at the option of the trial court. A state concerned about maximizing deterrence and minimizing governance costs might opt to make fee-shifting mandatory.

F. Inaction as a Policy Alternative

Importantly, legislative inaction does mean that corporations chartered in states other than Delaware will not successfully enact fee-shifting bylaws and charter provisions anyway. Consider Nevada for an example. There are now at least seven different Nevada-registered public corporations with fee-shifting provisions.⁹³

Substantial uncertainty remains about these provisions. For example, although these provisions have not yet been evaluated by Nevada courts, a Nevada court might follow *ATP Tour's* reasoning and uphold the provisions. This result would likely attract substantial publicity and lead other corporations to adopt similar provisions. As adoption expands, the opportunity to structure how corporations enact these provisions to foster better observations might pass. It might also become

⁹¹ See *In re Activision Blizzard, Inc. Stockholder Litigation*, C.A. No. 8885-VCL, at 50 (May 20, 2015), <https://courts.delaware.gov/opinions/download.aspx?ID=223710> ("A Rule 10b-5 claim under the federal securities laws is a personal claim akin to a tort claim for fraud. The right to bring a Rule 10b-5 claim is not a property right associated with shares, nor can it be invoked by those who simply hold shares of stock.").

⁹² See Choi, *supra* note 82, at 111 ("Th[is] Article has argued that a more even-handed, symmetric fee-shifting provision can lead to better screening of meritorious lawsuits from frivolous ones . . .").

⁹³ See, e.g., 10-K | EX-3.2, Lone Star Gold, Inc., CIK 0001464865, 000-54509, May 25, 2018, 5 page(s), Art. X ("In the event that any shareholder initiates or asserts a claim against the Corporation . . . and the shareholder does not obtain . . . the full remedy sought, then such shareholder shall be obligated . . . to reimburse the Corporation . . . for all fees, costs and expenses of every kind and description . . .").

increasingly difficult to enact limitations on fee-shifting provisions as more firms adopt the provisions and devote resources to defending the provisions.

CONCLUSION

States now face a range of choices between following Delaware and banning fee-shifting provisions, adopting an intermediate approach to cautiously test the provisions as outlined in this essay, and doing nothing. This essay makes the case for the intermediate approach and recognizes that fee-shifting provides an opportunity for thoughtful competition with Delaware.

Explicit legislative involvement offers real benefits. For corporate actors, legislative authorization would substantially reduce uncertainty about whether fee-shifting provisions would be enforceable. Diminished uncertainty would also make the provisions more effective at deterring strike suits and other extraordinarily low-probability litigation. For shareholder advocates concerned about preserving shareholder rights, legislative authorization provides a way to moderate the provisions enacted.

Importantly, the market-harnessing suggestions outlined here provide a framework for assessing fee-shifting's impact in the future. These provisions will remain controversial. A process that generates evidence showing that the provisions harm shareholders will likely check their expansion. On the other hand, if the provisions reduce governance costs without any significant ill effects, they will provide a valuable mechanism for checking excessive litigation.