Optimal Fee-Shifting Bylaws

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Abstract

A fee-shifting bylaw provision requires the plaintiff-shareholder to reimburse the litigation expenses of the defendant-corporation when the plaintiff is not successful in litigation. After the Delaware Supreme Court ruled that the provision is enforceable in 2014, a number of corporations adopted fee-shifting provisions, utilizing the directors' right to amend bylaws without express shareholder approval. In 2015, the Delaware legislature responded by amending the Delaware General Corporation Law to prohibit fee-shifting. This paper argues that the optimal fee-shifting arrangement lies somewhere between the version adopted by the corporations and no fee-shifting mandated by the Delaware legislature. A more balanced fee-shifting provision will do better in achieving the goal of encouraging meritorious lawsuits and discouraging frivolous ones, especially with respect to direct shareholder lawsuits. For derivative lawsuits, a balanced fee-shifting rule will impose a higher threshold on the merits than the traditional, no-fee-shifting rule. The paper also examines the fee-shifting provisions that are used in commercial agreements, notably stock purchase agreements and bond indentures, that employ more balanced fee-shifting arrangements but with variation. The paper finally argues that, given that there is unlikely one fee-shifting provision that is optimal for all corporations and for all types of litigation, the courts should consider applying the "proper or equitable purpose" requirement more vigorously to maintain flexibility while prohibiting undue restriction on shareholders' legitimate right to sue.

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Introduction

After the financial crisis of 2008, there was an explosion of lawsuits by shareholders against their corporations, particularly in mergers and acquisitions transactions.[1] Partly in response to this "flood" of litigation, a number of corporations began devising strategies to deter shareholder lawsuits. One strategy was the fee-shifting bylaw, which would obligate the plaintiff-shareholder to reimburse the corporation's expenses (including attorneys' fees and other costs)[2] when the plaintiff is unsuccessful in litigation. Initially, whether the bylaw—adopted unilaterally by the directors and without express shareholder consent—would be honored by the court was uncertain. But that uncertainty was resolved, at least in Delaware, through the case of *ATP Tour, Inc. v. Deutscher Tennis Bund* ("ATP Tour").[3] In the case, the Delaware Supreme Court upheld the fee-shifting bylaw adopted by the directors of ATP Tour, Inc., largely by applying the contractarian principle. According to the Court, charters and bylaws constitute a contract between a corporation and its shareholders,[4] and the directors can amend the bylaws by adopting a fee-shifting provision when the amendment right is granted to them in the corporation's charter.[5] The case generated a substantial amount of controversy, but a number of corporations promptly took advantage of this newly validated right. Only a year later, however, the Delaware legislature took away that right by amending the Delaware General Corporation Law to prohibit altogether fee-shifting provisions, either in the charter or the bylaws.[6]

[1] Matthew D. Cain and Steven M. Davidoff, Takeover Litigation in 2013 (The Ohio State Univ. Mortiz Coll. of Law Pub. Law & Legal Theory Working Paper Series, No. 236, 2014). See also Robert M. Daines and Olga Koumrian, Cornerstone Research, Shareholder Litigation Involving Mergers and Acquisitions: Review of 2012 M&A Litigation (2013). By 2014, the percentage of M&A deals that were subject to litigation has reached 95%. By 2015, however, the rate substantially decreased to 22%. At least according to Professor Davidoff, the primary reasons behind the sharp decline are: (1) adoption of forum selection bylaws that required intra-corporate suits to be brought only in Delaware, thereby curtailing or eliminating multi-jurisdictional litigation; and (2) Delaware courts' strong skepticism against, and refusal to approve, disclosure-only settlements, as evidenced, for instance, by the case of In re Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. Ch. 2016). See Steven Davidoff, Why the Surge in Merger Litigation Fizzled, the New York Times August 22, 2016. The story suggests that fee-shifting provisions might have played only a marginal role in curtailing M&A related litigation. The legislative amendment prohibiting fee-shifting bylaws, however, can have a much wider implications across all corporate law-related litigation. There are two important differences between M&A litigation and other lawsuits by shareholders. First, in an M&A litigation, the stakes tend to be quite asymmetric. When the plaintiff-shareholder successfully enjoins the pending deal, the possible loss that the merging companies suffer can greatly exceed any gain for the plaintiff-shareholder. Second, M&A lawsuit involves not only the defendant corporation but also the counter party in the contract. When the target company's shareholders bring breach of fiduciary duty suit (seeking injunction), this implicates not just the target company but also the purchasing company, who basically has nothing to gain by letting the lawsuit proceed and drag on. Both of these reasons will create a large amount of pressure on the target and the purchaser to settle the lawsuit as soon as practicable.

[2] Courts and the relevant statutes sometimes make a distinction between the "fees" that are charged by attorneys and other "expenses" that are incurred by the litigants. We will not, however, strictly adhere to this distinction and use the terms, fees, expenses, and costs, somewhat more interchangeably throughout the paper.

[3] 91 A.3d 554 (Del. 2014).

[4] According to the Court, "corporate bylaws are 'contracts among a corporation's shareholders'…" Id. at 558.

[5] In Delaware, the directors have the right to amend the bylaws only when such right is granted to them in the corporation's charter. However, granting such right to the directors is not deemed to diminish the shareholders' right to amend bylaws. See DGCL §109.

[6] S. 75, 148th Gen. Assemb. (Del. 2015), amending Del. Code Ann. tit. 8, §§102, 109 (2015).

This rocky history has left an important question unanswered: as a matter of corporate law policy, should the directors of a corporation be allowed to incorporate a fee-shifting provision through a unilateral bylaw amendment?[7] A small number of scholars have analyzed related issues on fee-shifting bylaws, such as: whether all corporate law matters must be subject to private ordering under the contractarian principle; how bylaws and charters are similar or different from contracts; whether we can impute a meaningful consent by shareholders when directors unilaterally change the bylaws; whether corporate directors are breaching their fiduciary duty by shifting the defense costs onto plaintiff-shareholders; and whether the Delaware legislature is beholden to the plaintiffs' bar.[8] This paper, in comparison, takes a more normative approach to the question of whether fee-shifting bylaws are desirable at all and, if so, in what form. In analyzing this problem, the paper links the corporate law literature on charters and bylaws with the law and economics literature on fee-shifting rules in litigation. The paper foremost argues that neither the adopters of fee-shifting bylaws nor the Delaware legislature is correct, and the optimal fee-shifting rule lies somewhere in between. When we first examine the actual bylaw provisions employed by the corporations prior to the 2015 legislative amendment, they are broad and one-sided, hence posing the danger of discouraging even the meritorious suits

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[7] When we compare bylaw amendments to contracts, granting the directors the right to amend the bylaws (through the charter) and the directors exercising such right is akin to giving one party to a contract the right to unilaterally amend (or modify) the contract. Such unilateral amendment provisions are prevalent particularly in consumer and employment contracts, including credit card agreements and end user license agreements (EULAs). Under contract law, the unilateral right to amend raises at least three issues: (1) whether the right is so open-ended so as to make the contract illusory; (2) whether the right grants too much power to one party so as to make the term unconscionable; and (3) in case the right is exercised, whether it is done in "good faith." Courts have required a (different) combination of (1) a notice provision, which obligates the amending party to notify the counter party about the proposed amendment several days prior; (2) a termination or opt-out right, which allows the counter party to terminate the agreement if she does not agree with the proposed amendment; and (3) non-retroactive application provision. See, e.g., Badie v. Bank of America, 67 Ca. App. 4th 779 (Cal. App. 1998) (applying the implied covenant of good faith and fair dealing principle to unilateral insertion of arbitration clause in credit card agreements); and In re Halliburton Co., 80 S.W.3d 566 (Texas 2002) (imposing opt out right and prohibiting retroactive application). Unilateral bylaw amendments are similar in the sense that, at least with respect to publicly traded corporations, they have to notify the shareholders through an 8-K filing and the shareholders can "terminate" their relationship with the corporation by selling their shares, if they do not agree with the amendment. See SEC 8-K Disclosure Requirements. The notice and termination rights are different in two important dimensions, however. First, unlike contract amendments, bylaw amendments are ex-post: that is, by the time the notice is given to the shareholders, the amendments are already effective. Second, and more importantly, when a shareholder sells her shares in response to the bylaw amendment, the corporation does not incur a loss, at least not immediately, whereas in a contract setting, the amending party will lose the contractual surplus that the party expected to realize when the counter party terminates the agreement.

[8] See, e.g., James Cox, Corporate Law and the Limits of Private Ordering, 93 Wash. U. L. Rev. 257 (2015) (questioning the validity of contractarian approach to corporate law); Deborah DeMott, Forum-Selection Bylaws Refracted through an Agency Lens, 57 Ariz. L. Rev. 269 (2015) (examining the issue from the agency law perspective and doubting that there is meaningful "consent" from the shareholders); Ann Lipton, Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws, 104 Geo. L.J. 583 (2016) (examining mandatory arbitration bylaws); and Stephen Bainbridge, Fee Shifting: Delaware's Self-Inflicted Wound, 40 Del. J. Corp. L. 851 (2016) (arguing that the Delaware legislature undermined its own interest by catering to the Delaware bar who would have suffered from less corporate litigation in case fee-shifting is allowed). See also Sean Griffith, Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees, 56 BC L. Rev. 1 (2015) (arguing that the courts should limit the scope of "substantial corporate benefit" doctrine to battle frivolous litigation); and Roberta Romano and Sarath Sanga, The Private Ordering Solution to Multiforum Shareholder Litigation (2016) (finding, among others, that companies that adopt exclusive forum bylaws have no worse corporate governance features than the ones that do not).

(those with high probability of success) from being filed and proceeding.[9] On the other side of the spectrum, the legislative amendment that bans all fee-shifting provisions errs on the opposite end by not sufficiently encouraging the meritorious suits and discouraging the frivolous ones.[10]

By referencing the law and economics literature on fee-shifting and litigation, the paper first makes an analytical argument that fee-shifting provisions can be optimal (unlike the view taken by the Delaware legislature) and the optimal fee-shifting provision employs a more symmetric shifting of the expenses (unlike the version used in ATP Tour and subsequent corporations). The optimal, symmetric fee-shifting provision encourages meritorious lawsuits while discouraging frivolous ones. The reasoning is straightforward. When a plaintiff has a meritorious claim (a claim with high probability of success), under the optimal fee-shifting regime, the plaintiff knows that she is unlikely to bear the cost of prosecution, since the defendant will have to reimburse her for the expenses in the likely prosecutorial success. This, in turn, makes her more like to proceed with the lawsuit, compared to the regime where she needs to worry about her litigation expenses. On the other hand, if she has a frivolous claim (a claim with very low probability of success), under the optimal fee-shifting rule, she knows that not only is she unlikely to get any recovery from the corporation-defendant, but she also will likely have to reimburse the defendant's litigation expenses. This makes her less likely to proceed with the claim, compared to the standard regime under which she needs not worry about having to reimburse the defendant for the expenses in the case of loss. In short, the optimal fee-shifting rule will magnify the positive return for the plaintiff with a meritorious claim and further depress the return for the plaintiff with a frivolous one, thereby providing a more effective screening function.

The analysis also reveals that symmetric fee-shifting is more effective in achieving the screening function with respect to direct lawsuits compared to derivative lawsuits. This is because derivative lawsuits already incorporate partial fee-shifting by allowing the plaintiff's

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[9] Under the reasoning of ATP Tour, discouraging even the meritorious suits can potentially constitute an "proper purpose" behind adopting a fee-shifting provision through a unilateral amendment of the bylaws. See infra section III-C for more analysis. An important puzzle is why the directors would adopt a bylaw that would harm the corporation and reduce firm value and why some firms adopt such bylaws while others do not. The most straightforward answer lies in private benefits that the directors (and the officers) could enjoy. Imagine a situation where the directors, by amending the bylaws, can capture B amount of private benefits while reducing the firm (equity) value by V, where $V > B$ so that the new bylaw is inefficient (in Kaldor-Hicks sense). If the directors' alignment with the shareholders' interest is given by $\beta \in (0,1)$ so that the directors will privately suffer a loss of βV, then the directors will amend the bylaw so long as $B > \beta V$. When β is sufficiently small, even though $V > B$, we will have $B > \beta V$ and the directors will adopt an inefficient bylaw. This also produces a comparative statics result: when the directors' (and officers') incentive alignment is strong (β is high) or the private benefits are small (a small B), the directors will not adopt an inefficient bylaw. Of course, there also is the third possibility that the bylaw amendment is actually efficient. See generally Albert Choi, Costs and Benefits of Concentrated Ownership and Control (2016) for an analysis of how a controlling shareholder, who owns less than 100% of the outstanding stock, will have an incentive to extract private benefits of control even though the extraction is inefficient (cost to the corporation as a whole is larger than the benefit to the controlling shareholder).

[10] According to Professor Bainbridge, the plaintiffs' bar in Delaware vigorously lobbied the Delaware legislature for the prohibition of fee-shifting bylaws (and charter provisions), and the legislature responded in accordance. If we think the legislative amendment to be also inefficient, this may be due to a possible capture by a well-organized interest group and a political failure. This is a political economy story as to why a representative legislature would enact a welfare-reducing law. See Bainbridge, supra note 8. See generally, Jonathan Macey and Geoffrey Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 Tex. L. Rev. 469 (1987).

attorney to recover fees from the corporation if she is successful.[11] A more balanced fee-shifting provision, on the other hand, will impose a higher threshold on the merits of the lawsuit (probability of success) for the plaintiff's attorney to bring litigation. The paper also empirically supports the claim by examining two other, important areas where fee-shifting provisions are frequently used.[12] The first area is stock purchase agreements (among commercially sophisticated parties), which allow the winner (of a contract dispute) to collect litigation expenses from the loser, often without involving the court to determine the merits of the lawsuit. The second area is indentures for publicly issued bonds, contracts that govern the relationship between the bondholders and the borrowing corporations (along with the indenture trustees). With respect to the indentures, the federal Trust Indenture Act, as a default rule, expressly allows the court to shift expenses to the loser on a case-by-case basis. Unlike the stock purchase agreement scenario, fee-shifting under the Trust Indenture Act depends on the court's determination of the merits of the claim.[13] These two sets of examples offer us useful modules for devising the optimal fee-shifting regime for corporate litigation. Given that not all commercial contracts utilize a fee-shifting provision and that the adopted provisions vary (as exemplified by the two modules), the paper argues that there is no single fee-shifting provision that will work for all types of cases. To allow for flexibility while making sure that there is no undue restriction on the shareholders' right to bring lawsuit, the paper suggests that the courts should consider a more vigorous application of the "proper or equitable purpose" review.

The paper is organized as follows. Section I briefly reviews Delaware's recent history with respect to fee-shifting bylaws, focusing mostly on the ATP Tour case and the subsequent legislative amendment. The section, in particular, will analyze the fee-shifting clause used by the directors of ATP Tour (and subsequent corporations) and highlight the problems associated with the provision. Section II presents an economics-based analysis of fee-shifting rules. Building on the existing law and economics literature, the section first analyzes screening effects under three different regimes: (1) the ATP Tour regime; (2) the traditional, no fee-shifting (amended DGCL) regime; and (3) the more "balanced" fee-shifting regime. The section then extends the analysis to show how fee-shifting works with respect to lawyer's incentive to bring suit and also in derivative litigation (where recovery flows back to the corporation and the lawyer's compensation is determined by court). The section concludes by laying out the potential downsides of adopting a fee-shifting provision. Section III presents examples from actual commercial contracts—in particular, stock purchase agreements and bond contracts

[11] This is subject to the court's finding of "common fund" or "substantial benefit" to the corporation. See Griffith, supra note 7, for more detailed analysis. See also infra section II-C.

[12] In a recent study, Professors Eisenberg and Miller examine more than 2,000 commercial contracts and show that in about 60% of them, contracting entities opt out of American fee-shifting rule. Theodore Eisenberg & Geoffrey Miller, The English versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts, 93 Cornell L. Rev. 327 (2013). The contracts they studied included bond indentures, merger agreements, employment agreements, securities purchase agreements, among others. By comparison, in this paper, I examine two types of commercial contracts (bond indentures and stock purchase agreements) more in depth to examine how their fee-shifting provisions are structured.

[13] Furthermore, in most civil litigation, courts are given the discretion to sanction (including by shifting the litigation expenses), in particular, plaintiffs or their attorneys for bringing frivolous claims. See Federal Rules of Civil Procedure Rule 11 and Rules of the Chancery Court in Delaware Rule 11. Similar to the Trust Indenture provision, fee-shifting rules in the civil procedure rules are meant to be the default rule which can be "contracted around" with, for instance, bylaws or charters or contracts. See also Federal Rules of Civil Procedure Rule 54 (allowing prevailing party to seek attorney's fees and other costs from the other).

(indentures)—that use fee-shifting provisions to support the argument that even the commercially sophisticated parties would voluntarily utilize fee-shifting (at the time of contract formation), albeit with some variation. Section IV combines the results from Sections II and III to suggest that, to maintain the flexibility with respect to fee-shifting provisions while prohibiting the directors' undue restriction on shareholders' right to sue, more stringent judicial review (for instance, in terms of applying the "proper" or "equitable" purpose standard in Delaware) can be beneficial. The final section summarizes and concludes, with some thoughts for future research.

I. A Tumultuous History of Fee-Shifting Bylaws in Delaware: from ATP Tour to Delaware's Legislative Response

ATP Tour, Inc. is a Delaware, non-stock, membership corporation that operates a global men's tennis tour. The case of *ATP Tour, Inc. v. Deutscher Tennis Bund*[14] arose out of a dispute between the non-stock corporation and two of its members, Deutscher Tennis Bund and Qatar Tennis Federation, when ATP Tour's board downgraded the Hamburg tennis tournament (owned and operated by the two members) from the highest tier to the second highest tier of tournaments and moved the tournament from the spring to the summer season. Displeased by the changes, the two members brought suit against the directors of ATP Tour in federal court, making both federal antitrust claims and Delaware fiduciary duty claims. The plaintiffs were unsuccessful with respect to both claims, but that did not end the matter. Now, ATP Tour moved to recover its litigation expenses (including attorney's fees) from the member-plaintiffs, in accordance with the ATP Tour's bylaws. As amended by the corporation's directors back in 2006, the bylaws allowed for such recovery when a member-plaintiff does not "obtain a judgment on the merits that substantially achieves…the full remedy sought."[15] The question of whether such a bylaw provision would be enforceable under Delaware law was certified to the Delaware Supreme Court, which the Court accepted.

In a relatively short opinion, the Delaware Supreme Court upheld the enforceability of fee-shifting bylaws under Delaware corporate law, largely by resorting to the contractarian (or the "private ordering") principle.[16] According to the Court, while Delaware follows the American Rule that makes litigants bear their own expenses, they can, through a contract, modify this rule and obligate the losing party to bear the cost of the winning party.[17] More importantly, "because corporate bylaws are 'contracts among a corporation's shareholders,' a fee-shifting provision contained in a non-stock corporation's validly-enacted bylaw would fall

[14] 91 A.3d 554 (Del. 2014).
[15] Id. at 556. According to an experienced corporate and securities litigator, in practice, obtaining judgments that "substantially achieves…the full remedy sought" is quite difficult. See Mark Lebovitch, Why Expanding Director Power over Corporate Bylaws Could Undermine Core Stockholder Rights: Comments on Three Scary Predictions of the Future, 57 Ariz. L. Rev. 299, 300 (2015) (stating that "for anyone who has ever litigated a corporate-law case, even the largest courtroom successes rarely achieve this level of victory").
[16] See also Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010) (stating that "charters and bylaws are contracts among a corporation's shareholders"). This contractarian principle is rooted in the long-standing idea that a corporation can be thought of as a "nexus of contracts," that governs the rights of shareholders, creditors and other investors, and employees and suppliers. See generally Frank Easterbrook & Daniel Fischel, The Corporate Contract, 89 Colum. L. Rev. 1416 (1989).
[17] Id. at 558.

within the contractual exception to the American Rule."[18] On the issue of whether the directors can unilaterally amend the bylaws and adopt a fee-shifting provision, foremost, bylaws can be amended by the directors when the amendment when the amendment right is granted to the directors in the corporation's charter and so long as the amendment is not done for "improper purpose."[19] The Court went on to determine that adopting the fee-shifting provision for the purpose of deterring litigation is not done for an "improper purpose."[20] The Court's analysis closely followed another important case in Delaware, *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,[21] which similarly upheld a forum selection bylaw provision that prohibited shareholders from bringing lawsuits in states (or forums) other than Delaware.[22]

The ATP Tour decision must have come as welcome news for many corporations. Within the span of about a year,[23] until the Delaware legislature's statutory amendment, about 40 corporations adopted a fee-shifting provision, mostly in their bylaws.[24] The bylaw at issue in ATP Tour served as the template for the later adopters, but with a slight variation because, unlike ATP Tour, the later adopters were mostly for-profit, stock corporations.[25] Here is a sample fee-shifting bylaw provision, almost identical to that in ATP Tour, adopted by the directors of Echo Therapeutics:[26]

> 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

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[18] Id.

[19] Id. at 557—559. According to the Court, while not all bylaw amendments would be valid, an amendment would be valid "if adopted by the appropriate corporate procedures and for a proper corporate purpose." Id. at 559. Delaware is not alone in allowing the shareholders to grant the right to amend bylaws to the directors. See, e.g., MBCA §10.20. Currently, 24 states follow the Model Business Corporation Act. See Eastland, Survey of Fee-Shifting Bylaws Suggests DGCL Amendments Won't End Debate, The CLS Blue Sky Blog, June 24, 2015.

[20] Id. at 560.

[21] 73 A.3d 934 (Del. Ch. 2013).

[22] The two cases, ATP Tour and Chevron, have led to an opposite response from the Delaware legislature. While prohibiting fee-shifting bylaws, the amended Delaware General Corporation Law now expressly authorizes forum selection bylaws so long as the selected forum is Delaware. S. 75, 148th Gen. Assemb. (Del. 2015), adding Del. Code Ann. tit. 8, §115 (2015).

[23] The case was decided on May 8, 2014 while the legislative amendment became effective on June 24, 2015.

[24] See Claudia Allen, Fee-Shifting Bylaws: Where Are We Now? Bloomberg BNA (2015) (reporting that 39 firms have adopted a fee-shifting bylaw since ATP Tour). See also, Eastland, supra note 4 and Lebovitch and Kwawegen, Of Babies and Bathwater: Deterring Frivolous Stockholder Suits without Closing the Courthouse Doors to Legitimate Claims, 40 Del. J. Corp. L. 1, 12 (2016) (stating that "within days of the ATP opinion, prominent corporate law firms issued client alerts suggesting that boards of public stockholder corporations consider adopting similar bylaws.")

[25] Id. For the ATP Tour fee-shifting provision, see ATP Tour, Inc. at 556.

[26] Echo Therapeutics, Current Report (Form 8-K, Ex. 3.2) (July 29, 2014), http://www.sec.gov/Archives/edgar/data/1031927/000141588914002261/ex3-2.htm.

> 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.

While there are many parts of this provision that are worthy of more detailed examination, two aspects of the provision are salient for our purposes. First, the provision covers a very broad range of lawsuits and litigants. The latter includes not only the plaintiff-shareholder, but also the attorneys who offer "substantial assistance to" the plaintiff and even the investors that lend financial assistance to the lawsuit. More relevant for our analysis is the fact that the provision covers both derivative and direct suits by shareholders. In a derivative lawsuit, if there is any monetary recovery, the recovery will go to the corporation (and not to the shareholder-plaintiffs or their attorneys); and, perhaps more importantly, the amount of expenses that the plaintiff's attorney can recover will be determined by the court. In a direct suit, by contrast, the recovery will flow back to the plaintiff-shareholders and the amount of expenses that the plaintiffs' attorneys get will depend, foremost, on the contractual arrangement between the plaintiff-shareholders and the attorneys. The convention is that the plaintiff-shareholders are contractually obligated to pay the attorneys a stipulated percentage (as a contingency fee) of what they recover from the defendant.

Second, in any given case, fee-shifting applies in broad circumstances and in only one direction, from the defendant to the plaintiff. The provision shifts the defendant's litigation expenses to the plaintiff when the plaintiff "does not obtain a judgment on the merits that substantially achieves…the full remedy sought." So, for instance, if a plaintiff were to seek $1 million in remedy but receives only $500,000 in judgment, under the provision, the plaintiff (with his/her lawyer and jointly and severally) will have to pay for the defendant's litigation expenses. Furthermore, the provision has no mention of what will happen when the plaintiff does receive the "full remedy sought." Presumably, in such a case, the default arrangement will apply and, in the case of a direct lawsuit, even though the plaintiff has been fully successful in the merits and the remedy, the defendant will not pay for the plaintiff's litigation expenses. If the plaintiff brought a derivative claim, on the other hand, the plaintiff can de facto shift the fees, not onto the defendant, but onto the corporation. Under the Delaware jurisprudence, either using the common fund doctrine or the substantial corporate benefit doctrine, the court will allow the plaintiff's attorney to recover fees from the corporation under the theory that the corporation either has recovered a "common fund" from the defendant or has received substantial benefit from the litigation.

The Delaware legislature, possibly in acceding to the influence of the Delaware plaintiffs' bar,[27] responded by amending sections 102 and 109 of the Delaware General Corporation Law

[27] See, e.g., Lebovitch and Kwawegen, supra note 13 (arguing that the ATP Tour rule would "likely eliminate all stockholder litigation, irrespective of merit" and that the dramatic rise of deal-related litigation and disclosure-only settlement can be better dealt with a rule that (1) requires more substantive disclosure; and (2) limits the release of claims that relate to the disclosure). See also Bainbridge, supra note 8. Another influential group that spoke out against the fee-shifting bylaws is the proxy advisory firms, including Glass Lewis and Institutional Investor Services. See Glass Lewis & Co., Proxy Paper Guidelines: 2016 Proxy Season 38 (2016), available at

("DGCL").[28] The amended section 102 deals with charters and section 109, with bylaws. According to the legislative synopsis, the amendments were done to "preserve the efficacy of the enforcement of fiduciary duties in stock corporation."[29] The new DGCL §102(f) states that: "the certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in §115 of this title." Similarly, the newly inserted second sentence in DGCL §109(b) now states that, "the bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in §115 of this title." DGCL §115 defines "internal corporate claims" as "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." In short, DGCL sections 102 and 109 now prohibit the corporation from having a provision either in its charter or the bylaws that shifts the litigation expenses (of the corporation or other defendant) onto the plaintiff-shareholder when she brings a corporate law based claim, such as a breach of fiduciary duty claim.[30] As far as fee-shifting is

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http://www.glasslewis.com/wp-content/uploads/2016/01/2016_Guidelines_United_States.pdf ("Glass Lewis therefore strongly opposes the adoption of such fee-shifting bylaws and, if adopted without shareholder approval, will recommend voting against the governance committee."); Institutional Investor Services, U.S. Proxy Voting Guideline Updates: 2015 Benchmark Policy Recommendations 7 (Nov. 6, 2014), available at http://www.issgovernance.com/file/policy/2015USPolicyUpdates.pdf ("Generally vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits.").

[28] S. 75, 148th Gen. Assemb. (Del. 2015), amending Del. Code Ann. tit. 8, §§102, 109 (2015). The legislature's initial attempt to over-turn the decision failed putatively due to a "significant backlash from business groups supporting such [fee-shifting] bylaws." See Bainbridge, supra note 8, at 3. As a compromise, the legislature requested the Corporate Law Council of the Delaware State Bar Association to study the problem and report back in time for the 2015 legislative session. In March 2015, the Corporate Law Council proposed legislation that would limit the availability of fee-shifting bylaws to non-profit organizations and the bill was introduced as Senate Bill 75. It passed the Delaware Senate on May 12, 2015 and was approved by the Delaware House on June 11, 2015. The law was signed by Governor Jack Markell on June 24, 2015. Id. Although the legislative amendment deals with both bylaws and charters, the paper's focus is on bylaws because the bylaws can be unilaterally amended by the directors without shareholder approval. Id. By contrast, a charter amendment requires a shareholder approval in Delaware. See DGCL §242. Although the shareholders can simply vote against any charter amendment proposal that attempts to impose inefficient fee-shifting, scholars have noted that such midstream charter amendments are also fraught with various dangers, including collective action problem, rational apathy, and lack of information. See, e.g., Lucian Bebchuk, Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments, 102 Harv. L. Rev. 1820 (1989). Even in the modern day of shareholder activism and institutional ownership, there are various means that the managers and the directors can employ in denying what the shareholders seek through charter amendment. See Geeyoung Min, Activated Charters (Virginia Law and Economics Research Paper No. 7, 2016), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2738961 (describing how directors at many publicly traded companies "preempt" shareholder proposals to amend the charter by implementing their own proposals that are less shareholder-friendly).

[29] S. 75, 148th Gen. Assemb. 80 Del. Laws, c. 40, §2 (2015). Apart from a brief legislative synopsis, there seems to be no publicly available record on the legislative history behind the amendment.

[30] Although the corporations are still free to have a provision in their charters or bylaws reimbursing the plaintiff's expenses, presumably, it is not in their interest to do so. There are also exceptions to the prohibition. First, sections 102 and 109 only prohibit such fee-shifting clauses from being present in either the charter or the bylaws, but not other corporate documents. So, if the shareholders were to execute a similar fee-shifting provision in an agreement amongst themselves, presumably, such an agreement would be upheld by court. See S. 75, 148th Gen. Assemb. 80 Del. Laws, c. 40, §2 (2015) (stating that the amendments are not intended to prevent the application of fee-shifting "pursuant to a stockholders agreement and other writing signed by the stockholder against whom the provision is to be enforced"). Second, as intended by the Delaware legislature, the prohibition applies only to stock corporations,

concerned, at least with respect to direct suits, Delaware corporate law mandates the traditional, bear-your-own-cost rule: the American Rule.[31]

II. An Analysis of Fee-Shifting Rules: Screening Benefits and Potential Costs

There exists a line of law and economics scholarship that demonstrates how a fee-shifting provision can facilitate the screening function: encouraging meritorious lawsuits while discouraging frivolous ones.[32] We can apply the existing theory to fee-shifting bylaws but with three important modifications: first is to allow for possible fee-shifting when the plaintiff does not receive full recovery (or "does not achieve…full remedy sought"); second is to consider ATP Tour style fee-shifting that is asymmetric and pro-defendant; and third is to consider fee-shifting in the case of a derivative litigation, where the recovery goes back to the corporation and not the plaintiff-shareholders (or their attorneys) and the attorneys expect to recover compensation from the corporation as determined by the court. While the law and economics literature on fee-shifting rules also covers a number of other issues, the focus of the analysis in this paper is the issue of credibility and screening: that fee-shifting provisions can increase the returns of meritorious lawsuits credible while depressing the returns of frivolous lawsuits. We will informally discuss some of the other issues, such as settlement, asymmetric information, and expending more resources at trial, at the end of this section.

To make the analysis more concrete, let's think about a simple numerical setup. Suppose a plaintiff (shareholder) contemplates bringing a direct lawsuit against a single defendant

leaving the holding of ATP Tour valid for non-stock corporations (including ATP Tour). Id. Finally, since fee-shifting bylaws relate to the issues based on Delaware corporate law, they do not apply in the cases where shareholders bring a non-corporate claim, such as a claim based on federal securities laws that does not allege a violation of duty. See John C. Coffee, Delaware Throws a Curveball, The CLS Blue Sky Blog (Mar. 16, 2015), available at http://clsbluesky.law.columbia.edu/2015/03/16/delaware-throws-a-curveball/ (showing that the amendments do not cover claims brought under the federal securities laws and arguing that even if a corporate counsel were to adopt a fee-shifting provision against securities actions, it is likely preempted by the federal Private Securities Litigation Reform Act).

[31] While the Delaware Legislature has prohibited fee-shifting bylaws, the status of fee-shifting is less clear in other states. At least one state, Oklahoma, has taken the opposite stance. Under the Oklahoma statute, with respect to derivative litigation, the court is required to shift reasonable expenses to the non-prevailing party. According to the statute, passed in September 2014, "in any derivative action instituted by a shareholder of a domestic or foreign corporation, the court having jurisdiction, upon final judgment, *shall require* the non-prevailing party or parties to pay the prevailing party or parties the reasonable expenses, including attorney fees, taxable as costs, incurred as a result of such action." (italics added) 18 Okl. St. §1126(c). Professor Bainbridge has argued that this is an attempt to compete away those corporations currently incorporated in Delaware. See Bainbridge, supra note 8, at 15—16. Under the Model Business Corporation Act, a court may order fee shifting when a plaintiff brings a lawsuit "without reasonable cause or for an improper purpose." Model Bus. Corp. Act. §7.46(2) (2011). Other jurisdictions grant discretion to the court with respect to fee-shifting, similar to the civil procedure rules under the Federal Rules and the Delaware Chancery Court rules, without expressly stating whether fee-shifting bylaws would be upheld by court.

[32] See Steven Shavell, Suit, Settlement, and Trial: A Theoretical Analysis under Alternative Methods for the Allocation of Legal Costs, 11 J. Legal Stud. 55 (1982); David Rosenberg & Steven Shavell, A Model in which Suits are Brought for Their Nuisance Value, 5 Int. R. of L. and Econ. 3 (1985); Avery Katz, Measuring the Demand for Litigation: Is the English Rule Really Cheaper?, 3 J. L. Econ. & Org. 143 (1987); and Avery Katz, The Effect of Frivolous Lawsuits on the Settlement of Litigation, 10 Int. R. of L. and Econ. 3 (1990). See Avery Katz & Chris Sanchirico, Fee Shifting in Litigation, in Procedural Law & Economics, Encyclopedia of Law and Economics 271 (Chris Sanchirico ed., 2d ed. 2012) for an excellent survey.

(corporation).[33] Let's assume for now that the plaintiff-attorney pair tries to maximize their expected joint return from the lawsuit or, alternatively, an attorney is not involved. If the parties proceed to trial, there are three possible outcomes: full, partial, or no recovery for the plaintiff. No recovery is equivalent to the plaintiff losing at the trial, while partial recovery can be thought of as the court granting the plaintiff less than the full remedy sought. In terms of monetary (or monetized, in the case that the remedy sought is not damages) values, let's assume that full recovery is given by D, partial recovery by αD, where $\alpha \in (0,1)$, and no recovery by 0. In terms of the respective probabilities, full recovery takes place with probability p, partial recovery with probability q, and no recovery with probability $1 - p - q$. Finally, let's assume that both the plaintiff and the defendant expect to incur a (monetized) litigation cost of C each.

With these parameters, under the traditional, no-fee-shifting rule, the plaintiff's expected return is $pD + q\alpha D - C$.[34] Regardless of the outcome, the plaintiff incurs the cost of C but does not reimburse the expenses for the defendant, nor does she get reimbursed by the defendant for her expenses. Note that this is also the expected return under the rule mandated by the amended corporate law in Delaware ("Amended DGCL Rule"). If $pD + q\alpha D - C > 0$, the plaintiff has a credible threat to go to trial (or a credible lawsuit) and, with a credible threat, the plaintiff will also be able to extract a positive settlement from the defendant. That is, the defendant won't refuse to settle given that the plaintiff's threat to go to trial is credible and, if there is a trial, the defendant expects to lose $pD + q\alpha D + C > 0$. When $pD + q\alpha D - C > 0$, therefore, they will settle the case at some value between $pD + q\alpha D - C$ and $pD + q\alpha D + C$.[35] At the same time, when the potential recovery (D) is relatively small, even if the plaintiff has a high probability of winning, given the cost of litigation, the plaintiff will decide not to file the lawsuit. For instance, even if p is close to 1 (and q is close to zero), so that the plaintiff has a very high likelihood of

[33] There are a couple of important aspects about the lawsuit that is not being explicitly modeled here. First, the plaintiff may remain as a shareholder of the corporation. In the case of a direct suit against the corporation, when the plaintiff recovers from the corporation, the plaintiff also indirectly suffers because the firm value will decrease. In the case of a derivative suit against a third party defendant, the plaintiff will indirectly gain when there is recovery against the third party since the firm value will likely increase (assuming that the size of the recovery is larger than the expenses that the corporation has to incur). See Albert Choi & Kathy Spier, Taking a Financial Position in Your Opponent in Litigation (2016) for a more detailed examination of this issue. Second, when shareholders bring lawsuit against the directors and officers, this is akin to a principal suing an agent, unlike a lawsuit between two parties who are in an arm's-length relationship. Presumably, there are other devices, such as incentive schemes, that a principal can deploy in controlling the agency problem. This raises an issue of how shareholder lawsuits fit into the grander scheme of minimizing the agency problem. To the extent that other devices are imperfect, shareholder lawsuits can still play an important role. See Albert Choi & George Triantis, Completing Contracts in the Shadow of Costly Verficiation, 37 J. Legal Stud. 503 (2008) (analyzing how incentive structure can be used together with costly lawsuits).

[34] We are assuming here, for simplicity, that the court is not exercising its discretion, under the procedural rules, to shift the fees to either party. See, e.g., supra note 12, for a discussion of judicial discretion under both the federal and Delaware procedural rules.

[35] Although settlement is not expressly modeled here, under the assumption of symmetric information, we can easily employ the Nash bargaining solution that allows the plaintiff (or the defendant) to capture a larger (or smaller) share of the surplus depending on the relative bargaining strength. The potential surplus from settlement is given by the combined costs of litigation, $2C$. With symmetric information, the parties will always settle (an application of the Coase theorem). As is well known in the literature, the parties may fail to settle when (1) one plaintiff has sufficiently more optimistic belief about the trial outcome than the defendant (non-convergent priors setting); or (2) one party has private information that is not shared by the other (asymmetric information setup).

receiving full recovery at trial, if $C > D$, the plaintiff's expected return is negative and she will not bring the lawsuit against the defendant.

Now suppose the litigants are subject to the same fee-shifting provision as in ATP Tour ("ATP Tour Rule"). Recall from the previous discussion, there are two important aspects about the ATP Tour's fee-shifting provision: (1) with respect to direct suits by plaintiff-shareholders against the corporation, even if the plaintiff were to receive the full remedy sought, the defendant does not reimburse the plaintiff's litigation expenses; and (2) the plaintiff has to reimburse the defendant's expenses even when the plaintiff receives only partial recovery ("does not achieve…full remedy sought").[36] Under the ATP Tour Rule, the plaintiff's expected return from trial becomes $p(D - C) + q(\alpha D - 2C) - (1 - p - q)2C$. The first term $p(D - C)$ represents the fact that the plaintiff still has to bear her own litigation expenses when she receives full recovery. The expression $2C$ in the second and the third terms represents the fact that, if the plaintiff either receives partial or no recovery, the plaintiff has to bear both parties' litigation expenses. For ease of comparison, this expected return can be re-written as $pD + q\alpha D - C - (1 - p)C$. When we compare this to the plaintiff's expected return from the traditional rule (Amended DGCL Rule), we see that $pD + q\alpha D - C > pD + q\alpha D - C - (1 - p)C$ unless $p = 1$ (or, equivalently, $q = 1 - p - q = 0$). The difference between the expected returns is represented by $(1 - p)C$, which is the expected loss from having to reimburse the defendant's expenses when the plaintiff does not get the full recovery. In other words, with the ATP Tour Rule, the plaintiff is strictly worse off compared to the Amended DGCL Rule unless the plaintiff is certain (with probability one) to get full recovery. And, even when the plaintiff is certain to get full recovery, the plaintiff is no better off under the ATP Tour Rule than under the Amended DGCL Rule. Table 1 lays out the respective expected returns under the Amended DGCL Rule and the ATP Tour Rule.

ATP Tour v. Amended DGCL Provisions	Plaintiff-Attorney's Joint Expected Return from Direct Litigation
Amended DGCL Rule (traditional, no fee-shifting)	$pD + q\alpha D - C$
ATP Tour Rule (non-symmetric and pro-defendant fee-shifting)	$pD + q\alpha D - C - (1 - p)C$

Table 1: Comparison between ATP Tour and amended DGCL Fee-Shifting Provisions

An implication of this comparison is that, under the ATP Tour Rule, the plaintiff is less likely to bring suit against the defendant-corporation even in the case that the lawsuit is meritorious, i.e., a case with a high probability of success ($p + q$ close to 1 or p close to 1). Especially when the chances of getting a partial recovery are substantial (probability q is large), the plaintiff may not file suit, even though the plaintiff has a credible claim under the traditional rule. If we were to use a numerical example, suppose that $D = \$1{,}000$, and $p = q = \alpha = 0.5$. In this case, the plaintiff is certain to receive some, either full or partial, recovery at trial. We

[36] One issue related to the partial recovery exception is that it can lead the potential plaintiff to strategically reduce the size or type of remedy sought in order to increase the chances of receiving the full recovery sought and to avoid having to reimburse the defendant's expenses. This may be especially true in derivative litigation or class actions since the plaintiff's attorney may be able to get all of their expenses reimbursed by the corporation. Such a strategic claim will further worsen the "token" settlement problem.

can think of this as the plaintiff having a relatively strong, meritorious case against the defendant. Under the Amended DGCL Rule, given that the expected recovery is \$750 ($= (0.5)(\$1{,}000) + (0.5)(0.5)(\$1{,}000)$), so long as the plaintiff's litigation expenses are not bigger than \$750, the plaintiff will bring suit. Under the ATP Tour Rule, on the other hand, the plaintiff's expected return is smaller by $(1-p)C$. Hence, when $p = 0.5$ and $C = \$750$, the plaintiff no longer has a credible threat. Under the ATP Tour rule, the litigation expenses have to be less than \$500 ($C \leq \$500$) for the plaintiff to have a credible lawsuit.

A. Symmetric Fee-Shifting Rules and the Benefits of Screening

An important reason for the difference is that the ATP Tour Rule is asymmetric: with respect to direct suits, the plaintiff has to reimburse the defendant for the expenses when the defendant wins the case, but the same does not apply to the defendant if the plaintiff wins at trial. What if we were to apply a more symmetric fee-shifting rule? Foremost, a symmetric rule would require that, when the plaintiff receives full recovery, the defendant will reimburse the plaintiff's expenses; and, when the plaintiff gets no recovery (e.g., when the defendant gets fully vindicated at trial), the plaintiff will reimburse the defendant for the defendant's litigation expenses. Symmetry, however, does not dictate what should happen if the plaintiff gets only partial recovery. In such cases, we can think of three possible variations: (1) each party bears her own litigation cost (as in the traditional, no-fee-shifting rule); (2) the plaintiff bears all the expenses (pro-defendant rule); and (3) the defendant bears all the expenses (pro-plaintiff rule).[37] Although allowing for partial recovery for the plaintiff creates some complexity in terms of devising the fee-shifting rule, calculating the expected return for the plaintiff is fairly straight-forward. The following table shows the respective returns for the plaintiff under the three rules. While the expressions are somewhat messy, they are written so that the first three terms, $pD + q\alpha D - C$, represent the plaintiff's expected return under the traditional, no-fee-shifting rule (Amended DGCL Rule).

Symmetric Fee Shifting Rules	Plaintiff-Attorney's Joint Expected Return from Direct Litigation
Symmetric Fee-Shifting Rule with Each Party bearing Own Cost when Partial Recovery	$pD + q\alpha D - C + pC - (1-p-q)C$
Symmetric Fee-Shifting Rule with Plaintiff bearing both costs when Partial Recovery	$pD + q\alpha D - C + pC - (1-p)C$
Symmetric Fee-Shifting Rule with Defendant bearing both costs when Partial Recovery	$pD + q\alpha D - C + (p+q)C - (1-p-q)C$

Table 2: Three Versions of "Symmetric" Fee-Shifting Bylaws

When we compare the plaintiff's expected returns under the three different symmetric, fee-shifting rules, we see that the return is the highest when the defendant bears all costs; the

[37] One could argue that a truly symmetric fee-shifting provision requires each party to bear her own expenses if the plaintiff gets a partial recovery. If we allocate the expenses either to the plaintiff or the defendant in the case of partial recovery, the rule would no longer be "symmetric." This, however, depends on our perception of what partial recovery entails. If we think of partial recovery as the plaintiff's "win," it may make more sense to allocate the expenses on the defendant; whereas if we treat it as the plaintiff's "loss," making the plaintiff to reimburse the defendant may make more sense.

next highest when each party bears own cost; and the lowest when the plaintiff bears all costs. This result is not surprising. The more important comparison, however, is between the returns under the symmetric fee shifting rule and the traditional, no-fee-shifting rule (Amended DGCL Rule). Under the traditional rule, recall that the plaintiff's expected return is given by $pD + q\alpha D - C$. For ease of comparison, let's focus on the symmetric, fee-shifting rule, under which the defendant bears all costs if the plaintiff gets only partial recovery (the third variation). When we compare the respective returns, we see that compared to the traditional rule, the returns differ by $(p+q)C - (1-p-q)C$, which may be either positive or negative. More precisely, the plaintiff's expected return will be higher when $p+q$ is bigger than $1/2$: $(p+q)C - (1-p-q)C > 0$ when $p+q > 1/2$.[38] When the plaintiff has a relatively high chance of receiving either full or partial recovery, the plaintiff is more likely to have a credible lawsuit under the symmetric fee-shifting rule than under the traditional rule: $pD + q\alpha D - C + (p+q)C - (1-p-q)C > pD + q\alpha D - C$ when $p+q > 1/2$.

Conversely, when the chances of winning recovery, either full or partial, are low, in which case the suit would be more likely to be frivolous, the plaintiff's expected return under the symmetric fee-shifting rule is likely to be lower than that under the traditional rule: $pD + q\alpha D - C + (p+q)C - (1-p-q)C < pD + q\alpha D - C$ when $p+q < 1/2$. In short, compared to the traditional, no-fee-shifting rule, the symmetric fee-shifting rule will be better at screening meritorious from non-meritorious lawsuits.[39] Furthermore, when we examine the ATP Tour Rule, because the rule depresses the plaintiff's expected return across the board, the rule will discourage all types of lawsuits, whether meritorious or not.[40] Table 3 summarizes the results.[41]

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[38] The reason why the cutoff is at $\frac{1}{2}$ is due to the fact that we have assumed that both the plaintiff and the defendant have the same litigation cost of C. More generally, if we let C_p to stand for the plaintiff's litigation cost and C_d for the defendant's, the threshold will be given by the ratio of $\frac{C_d}{C_p+C_d}$. As the defendant's litigation cost of C_d gets larger compared to the plaintiff's, the ratio will get closer to one, implying that the plaintiff will need a stronger case to proceed than before. The opposite will happen as C_d gets smaller. This is sensible since the plaintiff will become more (or less) worried about having to reimburse larger (or smaller) expenses incurred by the defendant.

[39] Although evidence on how fee-shifting rules affect litigation is not extensive, at least according to one important study, Florida's implementation of a fee-shifting rule with respect to medical malpractice claims from 1980 through 1985 shows that the fee-shifting increased plaintiff success rates at trial, average jury awards, and out-of-court settlements, which support the conclusion that the overall quality of the claims reaching the latter stage of litigation improved. This is consistent with the screening function provided by the fee-shifting rule. See James Hughes & Edward Snyder, Litigation and Settlement under the English and American Rules: Theory and Evidence, 38 J. L. & Econ. 225 (1995).

[40] If the sole objective is to reduce or eliminate shareholder litigation altogether, then among the rules compared here, the ATP Tour Rule does this the best. There is, however, some "screening effect" built into the ATP Tour Rule. When compared to the traditional, no-fee-shifting rule (Amended DGCL Rule), the ATP Tour Rule does less worse when p is relatively high than when p is relatively low. But, the plaintiff's expected return under the ATP Tour Rule will always be lower (unless $p = 1$) than that under the traditional, no-fee-shifting rule. Directors' denying, through a bylaw amendment, even the meritorious lawsuits by shareholders from proceeding can constitute an amendment done with "improper" or "inequitable" purpose. See infra part IV for more on this analysis.

[41] There are three knife-edge situations where the expected returns are equal. First, when $p + q = 1/2$, both Amended DGCL and Symmetric Fee-Shifting Rules produce the same expected returns. Second, when $p = 1$ and $q = 0$, Amended DGCL and ATP Tour Rules produce the same expected return, while the return from symmetric fee-shifting rule is strictly higher. Third, when $p = q = 0$, all three rules produce the same expected return.

Likelihood of Plaintiff (Partial and Full) Success	Ranking of Plaintiff's Expected Returns
$p + q > \frac{1}{2}$	Symmetric Fee-Shifting Rule > Amended DGCL Rule > ATP Tour Rule
$p + q < \frac{1}{2}$	Amended DGCL Rule > Symmetric Fee-Shifting Rule > ATP Tour Rule

Table 3: Comparison among Three Fee-Shifting Rules

To better see the screening function performed by the symmetric, fee-shifting rule, let's engage in a simple thought experiment. Suppose we vary the plaintiff's aggregate chances of partial or full recovery $(p + q)$ from (near) zero to one. And, as we vary the combined probability, we keep the plaintiff's expected return under the Amended DGCL Rule at zero: $pD + q\alpha D - C = 0$. We can do this, for instance, by varying damages (D) or the cost (C). In this setting, under the traditional rule, the plaintiff should be just indifferent between filing and not filing suit. When we examine the expected returns from either the symmetric fee-shifting rule or the ATP Tour Rule, however, the expected returns will no longer be equal to zero. First, because the ATP Tour Rule always produces a worse expected return than the Amended DGCL Rule, the expected return from the ATP Tour Rule will always be negative: $pD + q\alpha D - C - (1 - p)C < 0$. This implies that under the ATP Tour Rule, the plaintiff will never file suit, even if the chances of receiving recovery is quite high: when $p + q$ is close to one. By contrast, if we were to apply the symmetric fee-shifting rule, given that the expected return from the Amended DGCL Rule is kept at zero, the expected return will be strictly positive when the aggregate chances are high and strictly negative when the aggregate chances are low: $pD + q\alpha D - C + (p + q)C - (1 - p - q)C > 0$ when $p + q > 1/2$ and $pD + q\alpha D - C + (p + q)C - (1 - p - q)C < 0$ when $p + q < 1/2$. That is, under the symmetric fee-shifting rule, the plaintiff will definitely file suit if the chances of recovery are relatively high but will not file suit if the chances are low. In sum, compared to the traditional, no-fee-shifting rule, symmetric fee-shifting rule encourages more meritorious lawsuits while discouraging frivolous ones, while the ATP Tour Rule discourages all types of lawsuits.

Figure 1 graphically represents this thought experiment, with the assumption that the probability is partial recovery is positive $(q > 0)$ when $p + q > 0$. The vertical axis measures the plaintiff's expected return from trial. The horizontal axis represents the plaintiff's aggregate chances of winning at trial $(p + q)$, which starts at (near) zero and goes up to one. On top of the horizontal axis, we have the plaintiff's expected return under the traditional, no fee-shifting rule, which is kept at zero. The upward sloping, dashed line, which lies strictly below the horizontal axis, represents the plaintiff's expected return under the ATP Tour Rule, with the assumption that the chances of partial recovery is positive $(q > 0)$. The upward sloping, solid line that cuts the horizontal axis from below represents the plaintiff's expected return under the symmetric fee-shifting rule. As the figure shows, when the plaintiff's expected return under the traditional, no fee-shifting rule is set at zero, while the plaintiff will never file suit under the ATP Tour Rule, under the symmetric fee-shifting rule, only the plaintiff with a relatively high chance of securing (either partial or full) recovery will file suit.

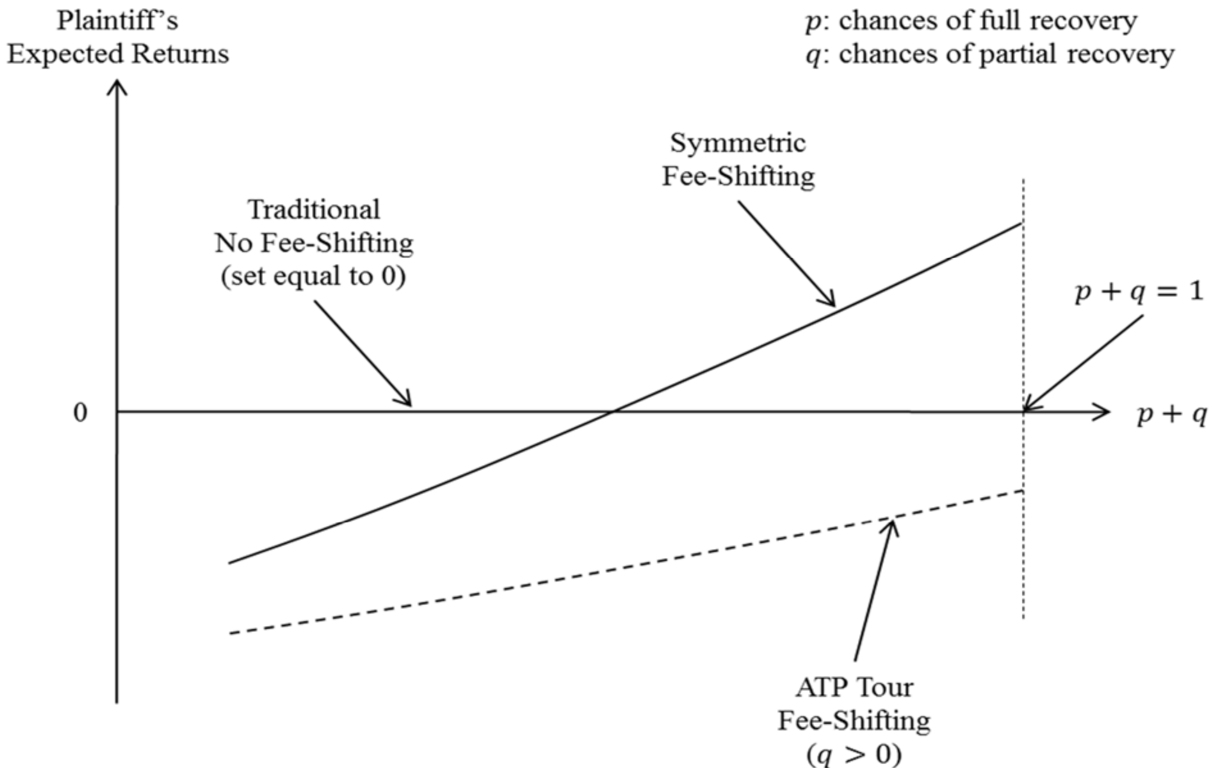

Figure 1: Plaintiff's Expected Return under Three Fee-Shifting Rules

What about in terms of choosing among the three symmetric, fee-shifting rules? When we compare among the three rules, we see that while all three can provide the screening function, their efficacy differs. The third rule is most effective in screening when the added probability of $p + q$ rises or falls together. The second rule, under which the plaintiff has to reimburse the defendant's expenses in the case of partial recovery, looks only at how the probability of full recovery (p) changes. Meanwhile, the first rule, under which each party will bear her own litigation expenses when the plaintiff gets partial recovery, depends on both p and q, but relies more on the former than the latter. As mentioned in the previous paragraph, the plaintiff's expected return is the highest with respect to the third, second highest with the first, and the lowest with respect to the second. Therefore, which rule should be adopted can depend on whether we want to encourage or discourage such suits across the board, while maintaining the screening function provided by fee-shifting. It should also depend on our perception of what partial recovery means. If we think of plaintiff's partial recovery as the plaintiff's near complete vindication of her right, we should treat partial recovery more like full recovery and move toward adopting the third rule. On the opposite end, if partial recovery by plaintiff should be thought of mostly as the defendant's victory, shifting the expenses to the plaintiff (under the second rule) would make more sense. And finally, if partial victory should be thought of as neither side having a complete upper-hand, the first rule using the traditional allocation mechanism would be more desirable.

B. Attorney's Expected Return under Different Fee-Shifting Rules

So far, we have assumed that the shareholder-plaintiff is initiating a direct lawsuit against the corporation and have focused on the plaintiff-attorney's joint expected return. In reality, of course, the arrangements are more complex when a shareholder brings suit, either directly or derivatively, against the corporation or any third party. But the previous analysis is robust enough to reflect more complex settings. We consider two important variations in turn: (1) expected return from the attorney's perspective; and (2) the plaintiff's and the attorney's expected return in the case of a derivative lawsuit, where the plaintiff is bringing suit on behalf of the corporation against a third-party defendant, including the directors and officers of the corporation. The first variation reflects the reality that, especially in class action settings, it is the plaintiff's attorney who is the main driver behind a lawsuit. The second variation reflects the fact that, in a derivative lawsuit, the recovery will flow back to the corporation and the attorney's compensation will be subject to more stringent judicial oversight.

Fee-Shifting Rules	Attorney's Expected Return from Direct Litigation
Amended DGCL Rule (traditional, no fee-shifting)	$\theta(pD + q\alpha D) - C$
ATP Tour Rule (non-symmetric and pro-defendant fee-shifting)	$\theta(pD + q\alpha D) - C - (1 - p)C$
Symmetric Fee-Shifting Rule with Defendant bearing both costs when Partial Recovery	$\theta(pD + q\alpha D) - C + (p + q)C$ $-(1 - p - q)C$

Table 4: Plaintiff's Lawyer's Expected Return in Direct Litigation under Different Fee-Shifting Rules

When a plaintiff-shareholder brings a direct suit against the corporation, just like any other civil suits, the matter of attorney compensation will depend on the retainer agreement entered into between the plaintiff and the attorney. This is true whether the direct suit is brought only on behalf of the plaintiff or on behalf of the entire shareholder class as a class action.[42] Let's start with the conventional assumption that it is the attorney who incurs all the litigation expenses and the attorney gets paid a percentage ($\theta \in (0,1)$) of the recovery for the plaintiff (or plaintiff class). One additional assumption we need is with respect to the issue of who will bear the defendant's expenses when they are shifted to the plaintiff. Under the ATP Tour Rule, for instance, the claiming party, which is broadly defined to include the plaintiff's attorney, will become jointly and severally liable for the defendant's expenses. Given that, especially in class actions, it is the attorney who initiates and manages the suit, when the fee-shifting rule is applicable, it would be reasonable to assume that the attorney will reimburse the plaintiff-shareholder, through an agreement for the (defendant's) expenses that the plaintiff becomes liable for.[43] Table 4 represents the expected returns for the attorney under different fee-shifting

[42] An important caveat is that, with respect to class action litigation, the court gets more involved with attorney compensation. Although the initial arrangement (contingency fee) with the plaintiff class still have influence on how the court will approve compensation, the court does not have to follow that arrangement and instead decide to use other methods, such as the lodestar method, to determine appropriate compensation.

[43] This assumption may be unrealistic in certain circumstances, particularly when the plaintiff-shareholder owns a substantial fraction of the outstanding stock. But the necessary modifications can be made fairly easily. In many cases, given that it is the plaintiff's attorney who initiates a lawsuit, a single shareholder would be unwilling to become the plaintiff if she has to bear the defendant's expenses when there is fee-shifting. It would be reasonable to

rules. For the sake of simplicity, the table uses only the symmetric fee-shifting rule with defendant bearing both costs in the case of partial recovery.

At the same time, under the assumptions, the fee-shifting rule will no longer affect the plaintiff-shareholder's expected return: her return will stay constant at $(1-\theta)(pD+q\alpha D)$ across all five different fee-shifting rules. The results, therefore, imply that when the attorney is entitled to a fraction of the recovery but bears the full cost of litigation, the general conclusions from the previous analysis hold. Symmetric fee-shifting rules will still play a screening role when the main decision maker of the lawsuit is the attorney, while the rules will have no effect against the plaintiff-shareholder since her return gets unaffected by the rule. The attorney's incentive to file and prosecute suit gets attenuated since she gets only a fraction of the recovery. One could deduce from this result that the ATP Tour Rule is targeted at plaintiffs' attorneys with the aim of reducing lawsuits against the corporations and their directors and officers.

C. Fee-Shifting Rules in Derivative Lawsuits

In contrast to a direct lawsuit, when a plaintiff-shareholder (with the help of, or at the instigation of, an attorney) brings a derivative claim on behalf of the corporation against a third party (e.g., the directors or the officers of the corporation), the plaintiff-shareholder no longer receives any direct recovery if the prosecution is successful. Given that the initial claim belongs to the corporation, any recovery (to the extent that there is any) will flow back to the corporation rather than to the plaintiff-shareholder.[44] Furthermore, given that the attorney who represents the plaintiff-shareholder does not have a compensation or retainer agreement directly with the corporation, the issue of attorney compensation becomes a matter of judicial determination: the judge gets to decide whether the attorney should be compensated and, if so, how much.[45] At the same time, since the plaintiff's attorney receives compensation from the corporation and not from the plaintiff-shareholder, a partial fee-shifting rule is already built into the regime from the attorney's perspective.[46] That is, if the derivative prosecution is successful, the attorney's litigation expenses are shifted onto the corporation.

In terms of determining the amount of compensation that the plaintiff-shareholder's attorney must receive, at least in theory, if the attorney were to receive exactly the amount of

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assume that such a plaintiff would demand indemnification from the attorney, as part of the retainer agreement. See George Geis, Shareholder Derivative Litigation and the Preclusion Problem, 100 Va. L. Rev. 261, 311 (2014).

[44] Of course, to the extent that the plaintiff remains a shareholder of the corporation, the plaintiff can receive an indirect benefit when the value of the corporation rises from the recovery.

[45] In assessing attorney compensation, in Delaware, courts apply what's known as the Sugarland factors, which include the results achieved, the time and effort of the attorney, the relative complexities of the litigation, any contingency factor, and the standing and ability of the attorney. See Sugarland Indus., Inc. v. Thomas, 420 A.2d 143 (Del. 1980).

[46] In determining whether the plaintiff's attorney should be compensated by the corporation, courts determine whether there is a "common fund" (corporation's recovery) out of which the compensation can be paid or, particularly in the case of no monetary recovery for the corporation, whether the corporation has received a "substantial benefit" from the outcome of the litigation. See Sean Griffith, Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees, 56 BC L. Rev. 1 (2015) for more detailed analysis. Professor Griffith also argues that the courts have been too lenient in finding that there is a "substantial benefit" to the corporation particularly, in M&A litigation, when the parties settle the case with an obligation on the corporation to make seemingly minor, additional disclosure.

expenditure that she has spent on litigation when the lawsuit is successful and none otherwise, a derivative lawsuit will always be of negative expected value and therefore unattractive from the attorney's perspective.[47] Hence, it may be reasonable to assume that, if the plaintiff prevails in a derivative litigation, the attorney receives compensation that includes a certain amount of rent (extra compensation).[48] To reflect this possibility, as a variation of the previous analysis, let's assume that, in the case that the plaintiff prevails, the attorney receives a compensation of $(1+\delta)C$ where $\delta > 0$ represents a measure of extra compensation.[49] Another necessary assumption has to do with what happens when the plaintiff is only partially successful. Foremost, each version of the symmetric fee-shifting rule stipulates whether the attorney should be compensated in the case of partial recovery. Second, under the traditional, no fee-shifting rule, it is reasonable to assume that the attorney still gets to receive $(1+\delta)C$ as compensation in the case of partial recovery.[50] Finally, under the ATP Tour Rule, the plaintiff (with the attorney) is obligated to reimburse the corporation for "all fees, costs and expenses of every kind," if the plaintiff does not receive the full remedy sought. Hence, it is reasonable to assume that the rule dictates no compensation for the attorney in the case of partial recovery. Table 5 summarizes the attorney's expected return under three fee-shifting regimes.

Fee-Shifting Rules	Attorney's Expected Return from Derivative Litigation
Amended DGCL Rule (traditional, no fee-shifting)	$(p+q)(1+\delta)C - C$
ATP Tour Rule (non-symmetric and pro-defendant fee-shifting)	$p(1+\delta)C - C - (1-p)C$
Symmetric Fee-Shifting Rule with Defendant bearing both costs when Partial Recovery	$(p+q)(1+\delta)C - C - (1-p-q)C$

Table 5: Plaintiff's Lawyer's Expected Return in Derivative Litigation under Different Fee-Shifting Rules

A few points are salient from the table. First, we can see that the attorney's expected return is the highest under the traditional, no fee-shifting rule (Amended DGCL Rule), and lowest under the ATP Tour Rule. When the symmetric fee-shifting rule is imposed, the attorney's expected return is lower than in the case of traditional, no fee-shifting regime. This is in contrast to the result from direct lawsuits. This is not surprising. Under the Amended DGCL Rule, because the attorney receives compensation from the corporation when the lawsuit is successful but does not need to reimburse the corporation's expenses when the lawsuit is unsuccessful, the Amended DGCL Rule has a built-in asymmetric fee-shifting feature in favor of

[47] More precisely, suppose the attorney has to expend C to prosecute a derivative claim but recovers exactly C only when she succeeds at trial, which happens with probability p. When $p < 1$, $pC - C < 0$: the expected return for the attorney is negative and the suit is not worthwhile pursuing. With a negative expected value (NEV) suit, presumably it is also difficult for the attorney to secure a profitable settlement against the defendant.

[48] For instance, the attorney can successfully claim the complexity of the case or the attorney's ability to receive higher compensation. See the Sugarland factors in supra note 19.

[49] When δ is close to zero, again the derivative suit will have a negative expected value from the attorney's perspective. So, we'll assume that δ is sufficiently large and is bounded away from zero.

[50] The court may not allow the plaintiff's attorney to recover expenses, for instance, if the court determines that the corporation did not receive a "substantial benefit" from partial recovery, particularly when the partial recovery amount is small (α is small). See Griffith, supra note 6, for more detailed analysis.

the plaintiff's attorney. Both the ATP Tour Rule and the symmetric fee-shifting rule correct this asymmetry by making the plaintiff's attorney bear the corporation's expenses when the lawsuit is not successful. The ATP Tour Rule, compared to the symmetric fee-shifting rule, does so more by shifting the corporation's expenses even in the case that the plaintiff-shareholder is partially successful.

More importantly, unlike the case with direct lawsuits, the symmetric fee-shifting rule is somewhat weaker in its screening function. For instance, when we compare the traditional rule with the symmetric fee-shifting rule, as the probability of success $(p + q)$ rises, attorney's expected return in both cases will rise. But, unlike the case with direct suits, the expected return under Amended DGCL Rule will always be higher than that under the symmetric fee-shifting rule. That is, $(p + q)(1 + \delta)C - C > (p + q)(1 + \delta)C - C - (1 - p - q)C$ for all $(p + q) < 1$. Both of these results (again) have to do with the fact that, for a derivative suit, even under the traditional rule, partial fee-shifting, under which the attorney gets to recover expenses from the corporation if the suit is successful, has already been built in. Hence, the symmetric fee-shifting rule will only worsen the attorney's expected return by forcing the attorney to reimburse the corporation's expenses in the case of loss. While the Amended DGCL Rule has the upside of fee-shifting (from the attorney's perspective), symmetric fee-shifting rule also creates the downside. Because of this downside, symmetric fee-shifting rule, when compared to the traditional rule, requires the case to be stronger ($p + q$ to be larger) for the attorney to pursue the case. It, therefore, imposes a higher threshold for a derivative suit to be brought.

D. The Costs of Adopting Fee-Shifting Rules

The foregoing analysis focused primarily on the benefits of using a symmetric fee-shifting provision: encouraging meritorious suits while discouraging frivolous ones. The analysis, however, is not meant to argue that fee-shifting provisions are always beneficial or efficient. As the next section will show, while many sophisticated contracting parties will often adopt a fee-shifting rule in their contracts, others do not. This provides an empirical support to the argument that the fee-shifting rule is not always optimal. The law and economics scholars have noted (primarily through theoretical analyses) at least two potential costs of using a fee-shifting rule: (1) encouraging spending more resources at trial; and (2) discouraging settlement when the parties are not symmetrically informed (e.g., when one party has better information about either the liability or the remedy in the case than the other). While an exhaustive analysis of these concerns will require much more economic analysis and, therefore, is beyond the scope of this paper, this sub-section will informally review these two arguments and possible mitigating factors.[51]

Fee-shifting rules can encourage the litigants to spend more resources if they were to proceed to trial, which can lead to over-spending by the litigants. The reasons are two-fold.[52] First, because there is a chance that a litigant can get all of her expenses reimbursed by the counter-party when she prevails, the marginal cost of spending additional dollar is lower than under the no-fee-shifting (each-side-bears-own-cost) rule. For instance, if a litigant is contemplating spending additional $1,000 at trial, but knows that, with 40% probability, the cost

[51] See Katz & Sanchirico (2012), supra note at 18, for a more detailed analysis and a comprehensive overview.
[52] See Katz (1987) at supra note at 18, for a more detailed presentation of the arguments.

will be born by the counter-party, the expected additional cost of spending $1,000 goes down to $600. Second, because the prevailing litigant also gets to recover the expenses, this makes the stakes of the case larger. If we assume that the amount of resources spent by both parties, without the fee-shifting rule, is (near) optimal, encouraging both parties to spend more at trial will be inefficient. At the same time, however, bigger expenditures by both parties (assuming that there is one) do not necessarily mean that the inefficiency will always realize. A larger aggregate expenditure at trial implies a bigger surplus from settlement, which leads to a bigger incentive for the parties to settle (to save on the larger litigation expenses). When the rate of settlement thus increases, some of the inefficiency will not materialize. In fact, if the increase in the rate settlement is sufficiently strong, large expected expenditure at trial can actually be efficiency-enhancing.

The second possible downside of using a fee-shifting rule is that the rule can discourage settlement when the litigants are not symmetrically informed about (i.e., do not have the same information with respect to) the merits of the litigation. Briefly, when the parties do not share the same belief (information) about the merits of the case, fee-shifting tends to increase the difference between the reservation values (the amount willing to pay to settle) of parties with favorable private information and high trial costs and parties with unfavorable information and low trial costs. As an example, imagine that there are two types of defendants: one ("innocent" type) who knows (correctly) that she will win for certain and the other ("guilty" type) who knows (again, correctly) that she will lose for certain. Let's also suppose that both the plaintiff and the defendant expect to spend $500 at trial. If the damages are set at $2,000, without fee-shifting, the innocent defendant is expected to lose $500, while the guilty one to lose $2,500, at trial. But, with fee-shifting, now, the innocent defendant knows that she will lose nothing while the guilty one knows that she'll lose $3,000 from trial: the difference in expected losses between the two types of defendants has gotten larger. When the plaintiff is unaware of which type of defendant she is facing, the guilty defendant has a bigger incentive to mimic the innocent one, since her gains are larger than before. The plaintiff should, in turn, become more skeptical of the defendant's representation and become more willing to reject a settlement offer from the defendant.[53]

At the same time, the analysis assumes that credibility is not affected by the fee-shifting rule. To the extent that the fee-shifting rule worsens the returns of non-meritorious lawsuits, while increasing the returns of meritorious ones, the (potential) decrease in the rate of settlement

[53] See Mitch Polinsky & Daniel Rubinfeld, Does the English Rule Discourage Low-Probability-of-Prevailing Plaintiffs?, 27 J. Legal Stud. 519 (1998). In their analysis, plaintiffs have private information about the probability of prevailing at trial and uninformed defendant makes a take-it-or-leave-it settlement offer. They assume, however, the fee-shifting rule will have no effect on the filing rate; and if the defendant were to make a positive settlement offer, all plaintiffs (even those with negative expected values) will file suit. Hence, credibility is not a concern, either. Another line of analysis, that examines litigation and settlement under different fee-shifting rules, assumes the litigants have different beliefs about the possibility of prevailing at trial and, even though the differences are known to each other, their beliefs do not converge. For instance, suppose the defendant believes that the chance of her prevailing at trial is 70% while the plaintiff believes that the chances of his prevailing at trial are 50%, so that the beliefs are inconsistent. Even if they know each other's belief, they could insist on their own beliefs. This setting is known as the non-convergent priors assumption. When both parties are more optimistic, relative to the other's belief, fee-shifting can again reduce the chances of settlement. The reason is that, with fee-shifting, each party believes that she is more likely to not bear the cost of trial, which leads her to demand more in settlement. See Shavell (1982), supra note, at 18.

can be offset by the decrease in the rate of filing and through the selection effect. Using the same numbers from above, suppose, while the defendant knows the culpability for certain, the plaintiff believes that there is 25% chance that she is facing a guilty defendant and 75% chance of facing an innocent one. Given the relatively low probability of winning, this case is a bit of a "long-shot" from the plaintiff's perspective. Assuming that the plaintiff will also spend $500 at trial, without fee-shifting, the plaintiff's expected return is $0 ($= (0.25)(\$2{,}000 - \$500) + (0.75)(-\$500)$). That is, the plaintiff would be just indifferent between filing and not filing the lawsuit. If we were to apply the fee-shifting rule, on the other hand, because the probability of losing is substantial, the plaintiff will no longer want to pursue the case. Her expected return becomes –$250 ($= (0.25)(\$2{,}000) + (0.75)(-\$1{,}000)$). When the case thus becomes non-credible, the defendant would refuse to settle, expecting the plaintiff to drop the case when the settlement negotiations fail.[54] Conversely, when more meritorious lawsuits proceed, the defendant would be more willing to settle with the plaintiff, thereby increasing the rate of settlement.[55] In short, when the screening effect and the settlement failure effect are combined, it is likely that the inefficiency from the latter will be mitigated by the former. Finally, even when credibility is not an issue or when fee-shifting plays a minor role because the size of the expenses is relatively small compared to the damages, the effect of fee-shifting rule amplifying the difference in reservation values among different types of defendants (and thereby reducing the rate of settlement) becomes smaller.

III. Fee-Shifting Provisions Used in Commercial Contracts

To the extent that the Delaware courts have been using the contractarian principle in analyzing charters and bylaws, drawing some lessons from actual commercial contracts (in non-shareholder-director context) would be instructive. In this section, we examine fee-shifting provisions in two different types of contracts: stock purchase agreements and bond indentures. The first example demonstrates how commercial entities, in an arms-length negotiation, would agree on a fee-shifting provision and in what form. The second example shows us how dispersed, public investors agree on a fee-shifting provision with a corporate borrower. With respect to the second example, we also have the federal Trust Indenture Act that provides further guidance on fee-shifting provisions. Both examples demonstrate both the incidence and the symmetry of fee-shifting provisions in commercial contexts while offering some further guidance on issues, such as the contractually-stipulated level of ex-post judicial involvement and specific exceptions to which fee-shifting would not apply.

A. Fee-Shifting Provisions in Stock Purchase Agreements

[54] We can make this statement more general. Suppose the probability of plaintiff's winning (or the defendant being found liable) is distributed between zero and one; and while the defendant knows the probability for certain, the plaintiff only knows the distribution. When both parties expect to spend the same amount of resources in litigation, for instance, the plaintiff's expected return will pivot at probability one-half, when symmetric fee-shifting rule is applied. That is, if the probability of winning is larger (less) than one-half, the plaintiff's expected return will increase (decrease), when fee-shifting rule applies. If the distribution is skewed to the left (more mass below one-half), the ex ante expected return will decrease, whereas if the distribution is skewed to the right, the ex ante expected return will increase. In the numerical example, 75% of the probability is below one-half, thereby reducing the expected return from the fee-shifting rule.

[55] Of course, if the plaintiff knows that the defendant is willing to settle for a generous amount, more plaintiff types (even the ones with frivolous claims) would become willing to file. Hence, the effect will have to take this into consideration along with the possible cost of filing suit. See Katz (1990), supra note at 18.

In many commercial contracts, it is not unusual to find a fee-shifting provision that allows the winning party to recover litigation expenses from the losing party. Unlike fee-shifting bylaws that are unilaterally adopted by corporate directors against dispersed shareholders, fee-shifting provisions in commercial contracts are voluntarily adopted by sophisticated commercial entities at the time they enter into the underlying contract. The fact that the provision is agreed upon by sophisticated commercial parties at the time of entering into the contract provides support to the argument that such a fee-shifting provision is more likely to be optimal from the parties' perspectives. As an example, we focus on stock purchase agreements. In a typical stock purchase transaction, a buyer negotiates with a small number of shareholders of the target company to acquire the target stock.[56] Both the buyer and the target shareholders are sophisticated contracting parties and the negotiations are usually done on an arm's-length basis. Especially when the size of the target is sufficiently large, both parties are well represented by counsel and the stock purchase agreement is heavily negotiated.

The following fee-shifting provision from the Model Stock Purchase Agreement[57] by the American Bar Association is exemplary.

> 12.15. 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

[56] Privately negotiated stock acquisitions are used to acquire privately-held or closely-held target companies. This transactional form is in contrast to tender offers that are made to dispersed shareholders. While we are using stock purchase agreements as the main example in this subsection, fee-shifting provisions are prevalent in many other types of commercial contracts, including supply, manufacturing, licensing, and lease agreements. See, e.g., supply agreement by Green Mountain Coffee, at https://www.sec.gov/Archives/edgar/data/944136/000119312509140760/dex1031.htm; manufacturing agreement by NSA, Inc., at https://www.sec.gov/Archives/edgar/data/787253/000119312510032460/dex1051.htm; and lease agreement by NS Wells Acquisition LLC at https://www.sec.gov/Archives/edgar/data/1503802/000110465914024882/a14-9393_1ex10d1.htm. See also, ABA Model Merger Agreement section 7.3(a)(ii) (allowing the buyer to recover expenses, including attorneys' fees, if the merger is terminated for certain reasons). According to the official comment to the Model Merger Agreement, "a provision for the payment of fees and expenses is a common provision in acquisition transactions involving public companies." See also, Eisenberg & Miller, at supra note 12 (studying 2347 commercial contracts filed with the SEC by publicly traded companies and finding that in about 60% of the cases, contracting parties opt out of the American Rule).

[57] The stock purchase agreements used by contracting entities tend to rely heavily on the model agreement. As recent examples, see the stock purchase agreement used by Odyssey Marine Exploration, Inc. at https://www.sec.gov/Archives/edgar/data/798528/000119312509118417/dex101.htm; agreement used by Vertical V, Inc. at https://www.sec.gov/Archives/edgar/data/1532961/000119312513024365/d470124dex1015.htm; and agreement used by Soar Solutions, Inc. at https://www.sec.gov/Archives/edgar/data/1298978/000119312505054368/dex1012.htm. While the model stock purchase agreement allows the recovery of only the "reasonable" attorney fees, some contractual fee-shifting provisions do not include such a restriction. In such cases, some courts are unwilling to allow the winning party to recover all expenses and fees by imposing statute-based "reasonableness" requirement. See Mahani v. Edix Media Group, Inc., 935 A.2d 242 (2007) (Delaware Supreme Court imposing reasonableness requirement based on the Delaware Lawyers' Rule of Professional Conduct Rule 1.5(a) even though the contract in dispute allowed for recovery of "any and all loss."). But see Matsumura v. Benihana Nat. Corp., 2014 WL 1553638 (SDNY) (stating that "any entitled to attorneys' fees here arises exclusively from the language of the contract, and not from a statutory scheme").

> incurred in such Proceeding, in addition to any relief to which such party may be entitled.

The Model Agreement defines "Proceeding" as:

> any action, arbitration, mediation, audit, hearing, investigation, litigation, or suit (whether civil, criminal, administrative, judicial, or investigative) commenced, brought, conducted, or heard by or before, or otherwise involving, any Governmental Body or arbitrator

Hence, while the type of dispute resolution to which the fee-shifting provision is applicable is fairly broad, there are two important differences compared to the fee-shifting bylaws used in ATP Tour and other companies. First, the fee-shifting is symmetric. Unlike the ATP Tour bylaw, which does not allow the plaintiff to recover litigation expenses from the corporate defendant even when the plaintiff recovers the full remedy sought, the Model Agreement allows the prevailing party to recover litigation expenses from the losing party.

Second, the Model Agreement allows for fee-shifting in narrow circumstances by allowing the "prevailing party" to recover reasonable expenses ("attorneys' fees and other costs) from the losing party. Presumably, under the agreement, even if the plaintiff does not recover the full remedy sought, so long as the plaintiff "prevails" in litigation, the plaintiff will be entitled to get its litigation expenses reimbursed by the defendant. While the exact meaning of the word, "prevail," is not entirely clear, courts have ruled that, under New York law, "prevail" does not mean that the party has achieved the "complete relief" sought.[58] Similarly, under Delaware law, "prevailing" has been interpreted by courts to mean "predominance in litigation."[59] Even when recovery is less than complete, therefore, New York and Delaware courts let the winning party recover litigation expenses, including attorney's fees, from the losing party.[60] More generally, given that the fee-shifting clause envisions a contract dispute as the most likely scenario, when the plaintiff successfully proves in court that the defendant breached the contract, even though the plaintiff does not receive the full damages sought, it is likely that the plaintiff has "prevailed" in litigation.[61] Under the ATP Tour bylaws, by contrast, when the

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[58] See Matsumura v. Benihana Nat. Corp., 2014 WL 1553638 (SDNY). See also Chainani v. Lucchino, 94 A.D.3d 1492 at 1494 (N.Y. App. Div. 2012) (stating that to determine whether a party has prevailed, the fundamental consideration is whether that party has prevailed with respect to the "central claim sought").

[59] Comrie v. Enterasys Networks, Inc., 2004 Del. Ch. LEXIS 53 at 8 (Jan 22, 2014). In that case, even though the plaintiff was able to recover only 28% of the monetary damages sought ($1,309,991 out of $4,620,000), the Delaware Chancery court determined that the plaintiff was the prevailing party because the plaintiff was successful on the central issue dealing with the interpretation of a specific clause (option trigger clause) in the stock purchase agreement.

[60] Id. (citing Sykes v. RFD Third Ave. I Assocs., LLC, 833 N.Y.W.2d 76 that "to be considered a 'prevailing party,' one must simply prevail on the central claims advanced, and receive substantial relief in consequence thereof.")

[61] That is, the interpretation of the word "prevails" depends in part on the outcome of the litigation. In most contract litigation, the foremost question is whether a party has "breached" the contract and the secondary question is on proper measure of damages to compensate the innocent party. If, for instance, the plaintiff wins on the first issue by getting the judgment that the defendant "breached" the contract but receives less than the full remedy sought (e.g., receiving reliance damages rather than the full expectation damages), it is reasonable to conclude that the plaintiff "prevailed" in litigation. On the other hand, if the plaintiff does not get the full remedy sought because, even though the defendant breached the contract, the plaintiff was also at fault (did not mitigate the damages), then it is more

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.[62] In short, when compared to the fee-shifting provisions used in commercial contracts, the fee-shifting bylaw provisions adopted by corporations are more in favor of the defendant corporations (and their directors and affiliates).

B. Fee-Shifting Provision in Bond Indentures and under the Trust Indenture Act

Another important set of comparisons comes from the fee-shifting provisions that are used by bondholders. Just like shareholders, bondholders are investors to the corporation, and when the bond is issued to the public, it becomes likely that its ownership gets dispersed. Although the legal relationship that determines the rights and obligations of a public bondholder is different from that for a public shareholder, there are a few important aspects of the relationship that make the comparison relevant: that both are investors to a corporation and that dispersed ownership often leads to similar collective action problems. Furthermore, given that the Delaware courts have used the contract principle in interpreting charters and bylaws, the bond contract serves as a natural comparison. In addition to the fact that there is an express contract (an indenture) between bondholders and a corporation, another important difference is that when a corporation issues a bond to the public, it also has to satisfy the requirements under the Trust Indenture Act. An important, relevant provision from the Trust Indenture Act is the one that deals with fee-shifting when there is a legal dispute between bondholders and a corporation.[63] The fee-shifting provision is contained in section 315(e) of the Trust Indenture Act:[64]

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difficult to argue that the plaintiff "prevailed" in litigation. See, e.g., Comrie v. Enterasys Networks, Inc., at supra note 57.

[62] For instance, suppose a plaintiff-shareholder were to bring a breach of fiduciary duty suit against a director, and although the court determines that the defendant-director breached her fiduciary duty, the court does not grant the full remedy sought by the plaintiff. Under the ATP Tour fee-shifting rule, the plaintiff will have to reimburse the defendant-director and the corporation the litigation expenses. If we were to apply the fee-shifting rule used in the Stock Purchase Agreement, however, the plaintiff is likely the "prevailing party" and is entitled to recover expenses from the defendant. See, e.g., Comrie v. Enterasys Networks, Inc., at supra note 57.

[63] In addition to the Trust Indenture Act, fee shifting provisions are frequently found in other federal statutes. Examples include the Civil Rights Attorney's Fees Awards Act (one-way fee-shifting for attorneys in civil rights actions); the Privacy Act (one-way fee-shifting for attorneys successful in lawsuits against a federal agency); the Fair Debt Collection Act (automatic fee-shifting for successful plaintiff attorneys against creditors who engaged in "abusive and deceptive" conduct); the Age Discrimination in Employment Act (one-way fee-shifting for plaintiffs who successfully challenge discrimination based on age); and the Patent Act (two-way fee-shifting to prevailing parties in "exceptional [patent] cases"). With respect to civil rights statutes, see Sean Farhang, The Litigation State: Public Regulation and Private Lawsuits in the US (2010). With respect to the Patent Act, recently the US Supreme Court expanded the scope of fee-shifting by interpreting "exceptional" case to mean a case "that stands out from others with respect to the substantive strength of a party's litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated." Octane Fitness LLC v. ICON Health & Fitness, INC., 134 S. Ct. 1749, 1756 (Apr. 29, 2014). According to a couple of commentators, this expansion of fee-shifting will deter non-practicing patent entities ("patent trolls") and other "industry bullies" from asserting patent claims simply to get the "nuisance value settlements." Rudy Telscher & Kara R. Fussner, Patent Fee Shifting Stops Not Only Patent Trolls but Industry Bullies Too, IPWatchdog (September 16, 2016), available at: http://www.ipwatchdog.com/2015/09/16/patent-fee-shifting-stops-not-only-patent-trolls-but-industry-bullies-too/id=61575/.

[64] See also, the Trust Indenture Act §323(a) (fee-shifting in litigation involving false or misleading statements).

> Section 315(e). Undertaking for Costs. The indenture to be qualified shall automatically be deemed (unless it is expressly provided therein that any such provision is excluded) to contain provisions to the effect that all parties thereto, including the indenture security holders, agree that the court may in its discretion require, in any suit for the enforcement of any right or remedy under such indenture, or in any suit against the trustee for any action taken or omitted by it as trustee, the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys' fees, against any party litigant in such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant: Provided, that the provisions of this subsection shall not apply to any suit instituted by such trustee, to any suit instituted by any indenture security holder, or group of indenture security holders, holding in the aggregate more than 10 per centum in principal amount of the indenture securities outstanding, or to any suit instituted by any indenture security holder for the enforcement of the payment of the principal of or interest on any indenture security, on or after the respective due dates expressed in such indenture security.

Before we get to the Trust Indenture Act fee-shifting provision, when we examine the legislative history surrounding the enactment of the Trust Indenture Act, it supports the conclusion that the main reason behind the adoption of the fee-shifting provision was to curtail frivolous litigation ("strike suits"), particularly by bondholders against the indenture trustees.[65] According to the SEC commissioner, William O. Douglas, the provision is there "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."[66] This rationale resonates fairly well with the concern that many transactional attorneys expressed over numerous lawsuits that were brought against mergers and acquisitions deals in Delaware, a large majority of which settled with only nominal consideration or nominal changes, such as additional, supplemental disclosure.[67] The difference, of course, is that while the Delaware legislature decided to prohibit fee-shifting altogether, under the rationale of preserving "the efficacy of the enforcement of fiduciary duties in stock corporations,"[68] the US Congress expressly endorsed fee-shifting as a means of controlling strike suits.

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[65] S. Rep. No. 76-248, at 7 (1939) (stating that the provision is intended to "discourage the brining of groundless suits against the trustee").

[66] Regulation of the Sale of Securities: Hearing on S. 2344 before the Subcommittee on Securities and Exchange, Senate Banking and Currency Committee, 75th Cong. 69 (1937). H.C. McCollom, an experienced New York City attorney, also gave a statement before the Senate in 1937. His view was similar to Douglas'. He opined that § 315(e) was wisely designed to prevent strike suits. *Regulation of the Sale of Securities: Hearing on S. 2344 Before the Subcommittee on Securities and Exchange, Senate Banking and Currency Committee*, 75th Cong. 162 (1937). McCollom emphasized that the provision "does not force the court to require an undertaking or to assess costs and attorneys' fees;" instead, it is entirely up the court's discretion. *Id.* Although courts were given broad discretion, McCollom thought inconceivable that they would abuse the discretion in a meritorious case brought in good faith. On the other hand, he believed that the provision would "prevent the growing menace of suits deliberately brought without proper foundation in order to obtain a consideration for withdrawal." *Id.*

[67] See supra note 1 and the surrounding text regarding the recent, high frequency of litigation against mergers and acquisitions deals and how that prompted some transactional attorneys to adopt fee-shifting provisions through unilateral bylaw amendments.

[68] S. 75, 148th Gen. Assemb. 80 Del. Laws, c. 40, §2 (2015).

When we examine the Trust Indenture Act fee-shifting provision, there are some notable characteristics. Foremost, the fee-shifting clause is a default and not a mandatory provision (in accordance with the parenthetical clause of "unless it is expressly provided therein that any such provision is excluded).[69] While a more extensive empirical analysis is needed to determine how many indentures opt out of fee-shifting, when we examine some recent bond offerings, we see that all bond indentures include a fee-shifting provision, that is identical to the provision from the Trust Indenture Act.[70] Second, unlike mid-stream corporate bylaw amendments, the fee-shifting provisions in indentures are agreed-upon at the time of the issuance. Hence, it is more likely that the provision will be done on an arms-length basis and be reflected in the price of the bond. This is more akin to having a fee-shifting provision in an IPO charter or bylaws. Third, unlike bylaws, indenture provisions cannot be unilaterally amended by the corporation. To the extent that an amendment to the fee-shifting provision would "adversely affect" the rights of the bondholder, it will require consent from both the indenture trustee and the holders of 50% or more of the outstanding principal amount.[71]

There are also some interesting comparisons when we examine the fee-shifting provisions used in publicly issued bonds alongside those in stock purchase agreements. First, under the Trust Indenture Act, whether or not the losing party will have to reimburse the litigation expenses of the winning party is left under the discretion of the court, with "due regard to the merits and good faith of the claims or defenses" made by the party.[72] Hence, the Act

[69] The original provision made fee-shifting optional: "the indenture to be qualified *may contain provisions* to the effect that all parties thereto…agree that the court may in its discretion require…the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys' fees, *against any party litigant in such suit*, having due regard to the merits and good faith of the claims or defenses made by such party litigant…." (emphases added). Trust Indenture Act of 1939 §315(e). The Act was later amended to make fee-shifting a default provision.

[70] See, e.g., recent indentures used by J.C. Penny Corporation (https://www.sec.gov/Archives/edgar/data/1166126/000119312516630643/d217423dex41.htm), Citigroup (https://www.sec.gov/Archives/edgar/data/831001/000119312513439891/d621350dex48.htm), Cincinnati Bell Inc. (https://www.sec.gov/Archives/edgar/data/716133/000095015716002192/ex4-1.htm), Novelis Corporation (https://www.sec.gov/Archives/edgar/data/1304280/000130428016000103/nvl-8xkexh41x2026indenture.htm), Mizuho Financial Group (https://www.sec.gov/Archives/edgar/data/1335730/000119312516708087/d257540dex41.htm), Nu Skin Enterprises, Inc. (https://www.sec.gov/Archives/edgar/data/1021561/000102156116000161/ex4-1.htm), and BMW Vehicle Owner Trust (https://www.sec.gov/Archives/edgar/data/1136586/000092963816001591/exhibit4-1.htm) See also Revised Model Simplified Indenture section 6.09. See also Eisenberg & Miller, supra note 12, at 373—374 (finding that 62.3% of bond indentures in the sample contained a fee-shifting clause and stating that "the fee agreements who observed, however, not only displayed a pattern of not opting out of the norm but in fact showed that parties tend to specifically restate the norm as part of their indenture).

[71] See Revised Model Simplified Indenture section 9.02. With respect to a publicly issued bond, there are three types of amendment: (1) an amendment to cure ambiguity, inconsistency, or defect or that does not "adversely affect" the rights of the bondholders; (2) an amendment to change the principal, interest, right to bring suit, or maturity; and (3) all others. To execute the second type of amendment, an individual consent is required, whereas with respect to the first, the indenture trustee, together with the issuer, can amend the contract. The third category, to which amending the fee-shifting provision to shift more fees to the bondholders likely falls, requires 50% or more of the outstanding bondholders to agree.

[72] According to the SEC Commissioner, William O. Douglas, the discretion is there to allow the courts "to select those cases, if any, which the court deemed are not brought in good faith or which are not meritorious, so that the court may, in the exercise of a sound discretion, require the filing of an undertaking for costs…[the Commission] trust[s] the courts in situations of that sort." Regulation of the Sale of Securities: Hearing on S. 2344 before the

allows for a second possibility for the fee-shifting provision: ex-post judicial determination.[73] Presumably, in a complex commercial transaction (including a stock purchase transaction), the court may not be in the best position to determine whether certain claims or defenses are made in "good faith" or "with merit." In such settings, it may be more desirable for the parties to make fee-shifting independent of the court's determination. On the other hand, in the case of an investor-corporation dispute, when the court is presumed to have relevant expertise, it may be better to leave fee-shifting subject to the court's discretion. If we think about the context of shareholders' suits against the corporation or the directors and officers in Delaware, given that the Delaware courts have substantial expertise and knowledge in corporate law matters, it could be that replicating the Trust Indenture Act module may be more beneficial for the shareholders and the corporations.

The second important aspect about the fee-shifting provision in the Trust Indenture Act (and the bond indentures) is that the fee-shifting provision does not apply to (1) bondholders who own more than 10 percent of the outstanding principal or (2) bondholders who sue for enforcement of any of the payment provisions. With respect to the latter, the ready analogy in the shareholder context is to dividend or liquidation payments, particularly when such are stipulated either in the charter or the bylaws.[74] With respect to the former, the 10-percent holder exception can be justified based on the reasoning that since a block-holder is more likely to internalize all the costs and benefits associated with a lawsuit, her decision to bring suit against the corporation is more likely to be optimal and less likely to be frivolous. This exception is not applicable to arms-length commercial contracts but can be readily applied to the context of shareholder lawsuits. In sum, bond indentures offer us another module for fee-shifting provisions, which relies more on ex-post judicial determination and excludes the provision from applying to a large block-holder.

IV. Implications for Optimal Fee-Shifting Bylaws

While fee-shifting provisions are widely used in commercial contracts, not all commercial contracts have a fee-shifting provision, and this implies that even the sophisticated commercial entities may decide to forgo adopting the provision at the time of entering into a contract. This may be because the contracting parties believe, at the time of formation, that a fee-shifting provision does not necessarily maximize their joint, contractual surplus. Perhaps this is due to the concern about expending (much) more resources at trial or about (substantially) reducing the chances of settlement when there is a dispute.[75] Furthermore, the provisions that are used in commercial contracts often differ. The differences in the provisions that are used in

Subcommittee on Securities and Exchange, Senate Banking and Currency Committee, 75th Cong. 69 (1937). The US Supreme Court has determined that the plaintiff (usually the bondholders) can also get reimbursed for the expenses from the defendant (usually the issuer). See Christianburg Garment Co. v. Equal Employment Opportunity Commission, 434 U.S. 412, 416 and n.7 (1978).

[73] See also, Eisenberg & Miller, supra note 12, at 352 (showing that 4.3% of 2347 commercial contracts contained symmetric fee-shifting with judicial discretion).

[74] The Trust Indenture Act mandates a strong, protective provision that allows a bondholder to sue to enforce the payment provisions (such as principal, interest, and redemption payment provisions). See Trust Indenture Act §316(b). TIA section §315(e) disallows the issuer-corporation from shifting the fees to the bondholder when the bondholder is trying to receive payment pursuant to TIA §316(b). See also Revised Model Simplified Indenture section 6.07.

[75] See supra section II-D.

the stock purchase agreements versus the bond indentures, as shown above, serve as evidence in support. Both of these points support the argument that the optimal fee-shifting provision (including whether to have one) should vary from transaction to transaction.[76] The principle should also apply to matters governing shareholders and their corporations, including the cases dealing with internal matters of corporate governance. In terms of constructing the optimal system, therefore, leaving a certain amount of drafting freedom to the directors and the shareholders seems desirable. At the same time, to prevent the possibility of the directors' (or the shareholders', for that matter) unduly restricting the shareholders' right to bring suit,[77] some restriction on that contractual freedom would be necessary.

In Delaware, neither the directors nor the shareholders have an unfettered discretion in amending bylaws. Foremost, bylaws must not conflict with the certificate of incorporation, the law, or public policy.[78] More importantly, bylaw amendments must also be done for "proper" or "equitable" purpose and effect, and there is a line of cases that interprets what "proper" or "equitable" purpose and effect means.[79] One possibility, for allowing sufficient freedom to the directors and the shareholders while limiting abuse, therefore, is for the courts to apply the "proper" or "equitable" purpose and effect standard more vigorously to fee-shifting bylaws and, in the process, become more vigilant in making sure that the shareholders' right to bring suit is

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[76] See also Eisenberg & Miller, at supra note 12 (showing that, within the sample, about 40% of contracts adopt the more traditional English fee-shifting rule, 40% use American fee-shifting rule, and 20% use a modified fee-shifting rule).

[77] This is likely when the directors' (officers') protection of private benefits outweighs their share (most likely to be less than one) of the loss in firm value. See supra note 9 for more detailed analysis. See also Albert Choi & George Triantis, The Effect of Bargaining Power on Contract Design, 98 Va. L. Rev. 1665 (2012) for an analysis of how even sophisticated commercial entities can enter into an inefficient, one-sided contract when one party has a superior bargaining power against the other.

[78] See, e.g., CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227 (Del. 2008) (invalidating stockholder-sponsored bylaw amendment that would require a company to pay the fees of certain stockholder sponsored proxy solicitations because it may prevent the board of directors from exercising their managerial power under DGCL §141(a)); and Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182 (Del. 2010) (invalidating a bylaw that an annual meeting be held in January because it would conflict with a certificate of incorporation provision requiring a staggered board, which the Delaware Supreme Court interpreted as requiring that directors serve terms of approximately three years before standing for re-election). In addition, bylaws may be examined under the Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) standard if adopted in response to a hostile threat, or Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) standard if they affect the shareholder franchise.

[79] The relevant cases include Schnell v. Chris-Craft Industries, 285 A.2d 437 (Del. 1971) (finding directors' bylaw amendment that changed the date of the shareholder meeting done with improper purpose); Frantz Manufacturing Co. v. EAC Industries, 501 A.2d 401 (Del. 1985) (finding majority stockholders' bylaw amendment restricting the board's freedom to adopt anti-takeover devices done for equitable purpose); Hollinger International, Inc. v. Black, 844 A.2d 1022 (Del. Ch. 2004) (finding controlling shareholder's bylaw amendment requiring unanimity on board action dealing with significant matter improper); and Icahn Partners LP v. Amylin Pharmaceuticals, Inc., C.A. No. 7404-VCN, slip op. at 1 (Del. Ch. Apr. 20, 2012) (granting expedited proceeding to the plaintiffs who alleged that the advance notice bylaw adopted by the board prevented stockholders from submitting director nominations). Some of these cases are cited by the ATP Tour Court. See ATP Tour at 558—559. There also is a small number of (relatively older) cases that require bylaws to be "reasonable." See, e.g., In re Osteopathic Hosp. Ass'n of Delaware, 195 A.2d 759, 764—765 (Del. 1963) (invalidating bylaw that gave voting rights to laymen individuals who were not physicians because the bylaw was "legally unreasonable" and "patently unreasonable as a matter of law"). While this line of cases may impose a distinctive requirement on bylaw amendments, the test doesn't seem materially different from the "proper" and "equitable" requirement.

not being unduly (or "improperly") restricted.[80] The ATP Tour Court, by contrast, reasoned that deterring shareholder litigation—without distinguishing between meritorious versus frivolous ones—constituted a "proper" and "equitable" purpose.[81] While the application of a more vigorous "proper" or "equitable" purpose and effect test can vary from case to case, we can also think of some general guidelines. For instance, in line with the analysis from above, the court could determine that a fee-shifting provision, which is asymmetric and imposes expenses on shareholders on a broad range of outcomes (as with the ATP Tour Rule), is done for "improper" or "inequitable" purpose of denying shareholders' right to bring even meritorious claims. Conversely, a more symmetric fee-shifting provision (as in the stock purchase agreements or the indentures) can be deemed to stem from the "proper" or the "equitable" purpose of screening meritorious claims from frivolous ones. Such judicious application of the "proper" and "equitable" purpose test can, I argue, better preserve and promote "the efficacy of the enforcement of fiduciary duties in stock corporations."[82]

Conclusion

Fee-shifting bylaws have had a tumultuous history in Delaware. Once a subject matter that received little attention from the scholars and practitioners, it acquired a national spotlight when the Delaware Supreme Court validated a provision in 2014. Numerous companies immediately responded by adopting their own versions, presumably in response to the dramatic rise in deal-related litigation. Only a year later, the Delaware legislature closed off the floodgate by prohibiting fee-shifting provisions altogether for public corporations. The purpose of this paper is to provide a more even-handed analysis of fee-shifting provisions. The paper

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[80] See Lebovitch and Kwawegen (2016), supra note 23, for more general, non-economic argument about how ATP Tour fee-shifting rule even discourages meritorious suits.

[81] See supra notes 18 and 19 and surrounding text. Another possibility is to impose some procedural (process-based) restrictions on by-law amendments, as done by courts interpreting unilateral change-of-terms clauses in contracts. However, as noted earlier, there are important differences between contract amendments and bylaw amendments, which could render process-based protections less useful for bylaw amendments. See supra note 7.

[82] S. 75, 148th Gen. Assemb. 80 Del. Laws, c. 40, §2 (2015). The ATP Tour court stated that "the intent to deter litigation…is not invariably an improper purpose," suggesting that deterring litigation across the board could constitute a proper purpose. ATP Tour at 560. See also supra note 4. This paper argues that this is probably too lenient an application of what constitutes a "proper" purpose and effect, and the standard should distinguish between deterring frivolous ones from deterring meritorious lawsuits. While the more vigorous application of the "proper" purpose and effect test will more likely to apply to directors' amending the bylaws, in theory, it can also check the abuse of block-holders (or controlling shareholders) from adopting a provision that could be detrimental to the minority shareholders or undermine the directors' rights (such as that under DGCL §141(a)). See Hollinger International, Inc. v. Black, 844 A.2d 1022 (Del. Ch. 2004). There are two other, possible mechanisms that could check directors' abusing their right to unilaterally amend bylaws. First, under Delaware law, if shareholders are dissatisfied with any bylaw adopted by the directors, they can repeal that bylaw by passing their own resolution. DGCL §109(a) states that "the fact that such [amendment] power has been so conferred upon the directors…shall not divest the stockholders…to adopt, amend or repeal bylaws." At least in theory, this can work as a check against the directors' unfettered discretion over bylaw amendments. Second, we can require the directors to submit their fee-shifting bylaw amendment to the shareholders for approval. Under either procedural mechanism, having to convene a shareholder meeting (or attempt to act through written consent) and to subject either a shareholder-initiated repeal (or alternate bylaw) proposal or board-proposed bylaw to shareholder vote would be cumbersome and entail the collective action and rational apathy problems. After all, if we had sufficient faith in the shareholders' making and adopting their own repeal or bylaw proposals, there would not have been any concern over ATP Tour fee-shifting bylaws and the Delaware legislature presumably didn't have to amend the DGCL so as to prohibit fee-shifting.

demonstrates why the responses by both the corporations that adopted the provisions prior to the legislative amendment and the Delaware legislature are suboptimal. The analysis has followed two tracks: a theoretical analysis of pros and cons of fee-shifting provisions and an empirical support of how sophisticated commercial contracts often utilize fee-shifting provisions. The paper has argued that a more even-handed, symmetric fee-shifting provision can lead to better screening of meritorious lawsuits from frivolous ones and that, to preserve the flexibility while preventing undue restriction on shareholders' right to bring suit, the court could become more vigilant in its application of the "proper purpose" test with respect to bylaw amendments. While the focus of the paper is on fee-shifting bylaws, the analysis also sheds light more generally on the issues of corporate governance and the courts' application of the contractarian principle in interpreting charters and bylaws.