FEE-SHIFTING AND SHAREHOLDER LITIGATION

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A fee-shifting provision, in a corporate charter or bylaws, 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 such a provision is enforceable in 2014, a number of corporations adopted fee-shifting bylaws, utilizing the directors' right to unilaterally amend bylaws without express shareholder approval. In 2015, the Delaware legislature reversed course by prohibiting fee-shifting provisions in both charters and bylaws. This back-and-forth history has left an important question unanswered: should fee-shifting be allowed in shareholder litigation and, if so, in what form? This Article first makes a theoretical claim that the optimal fee-shifting arrangement lies somewhere between the pro-defendant version adopted by the corporations and the no-fee-shifting version mandated by the Delaware legislature. A more balanced fee-shifting provision will do better in encouraging meritorious lawsuits while discouraging nonmeritorious 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 Article also undertakes an empirical investigation of 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. Building upon both the theoretical and empirical analyses, the Article finally argues that, instead of a categorical ban, the law should allow fee-shifting provisions in charters and bylaws but subject them to more robust judicial oversight. This will better allow the corporations and

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shareholders to realize the screening benefits of fee-shifting while protecting shareholders' right to bring suit.

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

[1] Matthew D. Cain & Steven M. Davidoff, Takeover Litigation in 2013, at 2 (The Ohio State Univ. Moritz Coll. of Law, Pub. Law & Legal Theory Working Paper Series, No. 236, 2014); see also Robert M. Daines & Olga Koumrian, Cornerstone Research, Shareholder Litigation Involving Mergers and Acquisitions 1 (2013) (reviewing, among other trends, M&A litigation in 2012). By 2014, the percentage of M&A deals that were subject to litigation reached nearly 95%; by 2015, however, the rate substantially decreased to 22%. See Steven Davidoff Solomon, Why the Surge in Merger Litigation Fizzled, N.Y. Times: DealBook (Jan. 22, 2016), https://www.nytimes.com/2016/01/23/business/dealbook/why-the-surge-in-merger-litigation-fizzled.html. At least according to Professor Steven Davidoff Solomon, the primary reasons behind the sharp decline are: (1) adoption of forum-selection

shareholder lawsuits. One strategy was a fee-shifting bylaw, which obligated the plaintiff-shareholder to reimburse the corporation's expenses (including attorneys' fees and other costs)[2] when the plaintiff was unsuccessful in litigation. Initially, whether the bylaw—adopted unilaterally by the directors and without express shareholder consent—would be upheld by the court was uncertain. But that uncertainty was resolved, at least in Delaware, through the case of *ATP Tour v. Deutscher Tennis Bund.*[3] In the case, the Delaware Supreme Court upheld the fee-shifting bylaw adopted by the directors of ATP Tour 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-

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bylaws that require intracorporate suits to be brought only in Delaware, thereby curtailing or eliminating multijurisdictional 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 Litigation,* 129 A.3d 884, 887, 898 (Del. Ch. 2016). See Solomon, supra. The story suggests that fee-shifting provisions might have played only a marginal role in curtailing M&A-related litigation. A legislative amendment prohibiting fee-shifting bylaws, however, can have 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 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, an M&A lawsuit involves not only the defendant and the target corporation, but also the purchasing corporation. When the target company's shareholders bring a breach of fiduciary duty suit, this implicates not just the target company, but also the purchasing company, which basically has nothing to gain by letting the lawsuit 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. I will not, however, strictly adhere to this distinction, but instead will use the terms fees, expenses, and costs interchangeably throughout the Article.

[3] 91 A.3d 554, 555 (Del. 2014).

[4] According to the court, "corporate bylaws are 'contracts among a corporation's shareholders.'" Id. at 558 (quoting Airgas, Inc. v. Air Prods. & Chems., 8 A.3d 1182, 1188 (Del. 2010)). The idea that the charters and bylaws constitute a "contract" between the shareholders and the corporation is often called the "contractarian" or "nexus of contract" theory. The theory has its origin in Professors Michael Jensen and William Meckling's seminal work. See Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 310–11 (1976) (stating that "most organizations are simply *legal fictions which serve as a nexus for a set of contracting relationships among individuals*" and that "[t]he private corporation or firm is simply one form of *legal fiction which serves as a nexus for contracting relationships*" (footnote omitted)). Jensen and Meckling make numerous references to

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.[6] Only a year later, however, the Delaware legislature took away that right by amending the Delaware General Corporation Law ("DGCL") to prohibit altogether fee-shifting provisions, either in the charter or the bylaws.[7]

This rocky history has left some important questions unanswered: as a matter of corporate law policy, should a fee-shifting provision be allowed either in the charter or the bylaws? What if the directors of a corporation were to incorporate a fee-shifting provision through a unilateral bylaw amendment?[8] If the answer is yes to either, should there

Professor Ronald Coase's earlier work. See R. H. Coase, The Nature of the Firm, 4 Economica 386 (1937).

[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. Granting such right to the directors, however, is not deemed to diminish the shareholders' right to amend bylaws. See Del. Code Ann. tit. 8, § 109 (2011).

[6] See Claudia H. Allen, Fee-Shifting Bylaws: Where Are We Now?, Bloomberg BNA (Feb. 2, 2015), https://www.bna.com/feeshifting-bylaws-n17179922685/#! [https://perma.cc/94AV-88QK] (reporting that thirty-nine firms have adopted a fee-shifting bylaw since *ATP Tour*).

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

[8] 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) if the right is exercised, whether it be done in "good faith." Courts have required a (different) combination of (1) a notice provision, which obligates the amending party to notify the counterparty about the proposed amendment several days prior; (2) a termination or opt-out right, which allows the counterparty to terminate the agreement if she does not agree with the proposed amendment; and (3) a nonretroactive application provision. See, e.g., Badie v. Bank of Am., 79 Cal. Rptr. 2d 273, 284–85 (Ct. App. 1998) (applying the implied covenant of good faith and fair dealing principle to unilateral insertion of an arbitration clause in credit card agreements); In re Halliburton Co., 80 S.W.3d 566, 569–70 (Tex. 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. See Sec. & Exch. Comm'n, SEC 873 (04-17), Form 8-K: Current Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934, Item 5.03. Shareholders can "terminate" their relationship with the corporation by selling their shares if they do not agree with the amendment. The notice and termination rights are

be any restrictions on the types of fee-shifting provisions they can adopt? Some 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.[9] This Article, by contrast, 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 Article links the corporate law literature

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different in two important dimensions. 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 counterparty terminates the agreement. See Albert H. Choi & Geeyoung Min, Amending Corporate Charters and Bylaws 20–21 (Univ. of Va. Sch. of Law, Law & Econ. Research Paper Series, No. 2017-21, 2017), https://ssrn.com/abstract=3024873 [https://perma.cc/5N4E-3M83] (comparing contract amendment with charter and bylaw amendment and discussing various mechanisms to maintain flexibility while curbing opportunism).

[9] See, e.g., Stephen M. 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, which would have suffered from less corporate litigation if fee-shifting was allowed); James D. Cox, Corporate Law and the Limits of Private Ordering, 93 Wash. U. L. Rev. 257 (2015) (questioning the validity of the contractarian approach to corporate law); Deborah A. 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 M. Lipton, Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws, 104 Geo. L.J. 583 (2016) (examining mandatory arbitration bylaws); see also Sean J. Griffith, Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees, 56 B.C. L. Rev. 1 (2015) [hereinafter Griffith, Correcting Corporate Benefit] (arguing that the courts should limit the scope of the corporate benefit doctrine to battle frivolous litigation); Sean J. Griffith, Private Ordering Post-*Trulia*: Why No Pay Provisions Can Fix the Deal Tax and Forum Selection Provisions Can't, *in* The Corporate Contract in Changing Times: Is the Law Keeping Up? (Steven Davidoff Solomon & Randall S. Thomas eds., 2017) (arguing that the corporations should adopt bylaws that commit not to pay any attorney compensation to eliminate deal litigation); Roberta Romano & Sarath Sanga, The Private Ordering Solution to Multiforum Shareholder Litigation, 14 J. Empirical Legal Stud. 31 (2017) (finding, among others, that companies that adopt exclusive forum bylaws have no worse corporate governance features than the ones that do not).

on charters and bylaws with the law and economics literature on fee-shifting rules in litigation and also investigates fee-shifting provisions that are used in commercial contracts.

Building on the law and economics literature on fee-shifting, this Article makes a theoretical argument that fee-shifting provisions can be useful and the optimal fee-shifting provision employs a symmetric shifting of the expenses, for example, by allowing either party to recover expenses from the other.[10] 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 a high probability of success), under the optimal fee-shifting regime, the plaintiff knows or expects 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 likely 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 nonmeritorious or even a frivolous claim (a claim with a very low probability of success), then under the optimal fee-shifting rule she knows that not only is she unlikely to get any recovery from the defendant-corporation, but she also will likely have to reimburse the defendant's litigation expenses. This makes her less likely to file or proceed with the claim, compared to the standard regime under which she need not worry about having to reimburse the defendant for the expenses in case of loss. In short, the optimal fee-shifting provision will magnify the positive return for the plaintiff with a meritorious claim and further depress the return for the plaintiff with a nonmeritorious one, thereby providing a more effective screening function.

[10] For a review of various theoretical analyses on fee-shifting provisions, see Avery Katz, The Effect of Frivolous Lawsuits on the Settlement of Litigation, 10 Int'l Rev. L. & Econ. 3 (1990) [hereinafter Katz, Effect of Frivolous Lawsuits]; Avery Katz, Measuring the Demand for Litigation: Is the English Rule Really Cheaper?, 3 J.L. Econ. & Org. 143 (1987) [hereinafter Katz, Measuring the Demand]; D. Rosenberg & S. Shavell, A Model in Which Suits Are Brought for Their Nuisance Value, 5 Int'l Rev. L. & Econ. 3 (1985); and Steven Shavell, Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs, 11 J. Legal Stud. 55 (1982). For an excellent survey, see Avery Wiener Katz & Chris William Sanchirico, Fee Shifting, *in* Procedural Law and Economics, Encyclopedia of Law and Economics 271 (Chris William Sanchirico ed., 2d ed. 2012). See also Jonathan T. Molot, Fee Shifting and the Free Market, 66 Vand. L. Rev. 1807 (2013) (arguing that fee-shifting should be used to screen meritorious lawsuits from meritless ones in addition to other market mechanisms such as insurance and litigation financing); Issachar Rosen-Zvi, Just Fee Shifting, 37 Fla. St. U. L. Rev. 717 (2010) (same).

By contrast, the fee-shifting provisions employed by ATP Tour and other corporations (prior to the 2015 legislative amendment) are broad and one-sided: they do not allow plaintiff-shareholders to recover fees from the defendant-corporations (in direct lawsuits) even when the plaintiffs are successful. Furthermore, they allow defendant-corporations to recover fees from the plaintiff-shareholders even when the plaintiffs partially prevail. This Article shows that such broad, one-sided fee-shifting poses the danger of discouraging even the meritorious suits from being filed and proceeding.[11] On the other side of the spectrum, the legislative amendment that bans all fee-shifting provisions (and forces an each-side-bears-own-cost rule) errs on the opposite end by not sufficiently encouraging the meritorious suits and discouraging the frivolous ones.[12] The Article also extends the analysis to the case of derivative lawsuits. The analysis reveals that symmetric fee-shifting is more effective in achieving the screening function with respect to direct

[11] Under the reasoning of *ATP Tour*, discouraging even the meritorious suits can possibly constitute a "proper purpose" behind adopting a fee-shifting provision through a unilateral amendment of the bylaws. See infra Section II.B 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. 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), see generally Albert H. Choi, Concentrated Ownership and Long-Term Shareholder Value, Harv. Bus. L. Rev. (forthcoming 2018).

[12] According to Professor Stephen 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. See Bainbridge, supra note 9, at 853–54, 854 n.14. If we think the legislative amendment is 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 generally Jonathan R. Macey & Geoffrey P. Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 Tex. L. Rev. 469 (1987) (describing how the Delaware bar is successful in influencing the Delaware legislature).

lawsuits compared to derivative lawsuits. This is because derivative lawsuits already incorporate partial, de facto fee-shifting by allowing the plaintiff's attorney to recover fees from the corporation if she is successful.[13] 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.

After presenting the theoretical argument, the Article empirically supports the claim by closely examining two other important practice areas where fee-shifting provisions play a prominent role.[14] The first 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 is indentures for publicly issued bonds—contracts that govern the relationship among the bondholders, the borrowing corporations, and the indenture trustees. For indentures, the federal Trust Indenture Act ("TIA"), 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, fee-shifting under the Trust Indenture Act depends on the court's determination of the merits of the claim.[15] These two sets of examples offer useful modules for devising

[13] In a derivative suit, the corporation is the plaintiff, and the corporation should reimburse the attorney who is representing its interests. Strictly speaking, therefore, there is no "fee-shifting." For the attorney who represents the shareholders and brings a derivative claim, however, there is de facto fee-shifting since the corporation, and not the shareholders, is reimbursing the expenses. Whether the attorney will be able to recover expenses in a derivate claim is subject to the court's finding of "common fund" or "substantial benefit" to the corporation. For more detailed analysis, see Griffith, Correcting Corporate Benefit, supra note 9, at 21–23.

[14] In a recent study, Professors Theodore Eisenberg and Geoffrey Miller examined more than 2,000 commercial contracts and showed that in about 60% of them, contracting entities opted out of the American pay-your-own-cost rule. Theodore Eisenberg & Geoffrey P. Miller, The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts, 98 Cornell L. Rev. 327, 350, 353–54 (2013). The contracts they studied included bond indentures, merger agreements, employment agreements, and securities purchase agreements, among others. By comparison, this Article focuses on two types of commercial contracts—bond indentures and stock purchase agreements—to examine how their fee-shifting provisions are structured.

[15] See infra Section III.B. Furthermore, in most civil litigation, courts are given the discretion to sanction (including by shifting the litigation expenses) plaintiffs or their attorneys for bringing frivolous claims. See Fed. R. Civ. P. 11; Del. Ch. R. 11. Similar to the Trust Indenture Act provision, fee-shifting rules in the civil procedure rules are meant to be the default rule which can be "contracted around," for instance, with bylaws or charters or

the optimal fee-shifting mechanism for shareholder litigation. Given that not all commercial contracts utilize a fee-shifting provision and that the adopted provisions vary, it is unlikely that there is a single fee-shifting provision that will work for all types of cases. In order to maintain flexibility, but also to guard against undue restriction on shareholders' rights to bring suit, the Article argues that, while allowing fee-shifting provisions in charters and bylaws, the courts should be more vigilant against one-sided fee-shifting provisions.

The Article is organized as follows. Part I briefly reviews Delaware's recent history with fee-shifting, focusing mostly on *ATP Tour* and the subsequent legislative amendment. The Part, in particular, analyzes the fee-shifting clause used by the directors of ATP Tour (and subsequent corporations) and highlights the problems associated with the provision. Part II presents an economic analysis of fee-shifting rules. Building on the existing law and economics literature, the Part first examines the 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 Part then extends the analysis to show how fee-shifting works with respect to a 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 the court). The Part concludes by laying out the potential downsides of adopting a fee-shifting provision. Part III presents examples from actual commercial contracts—in particular, stock purchase agreements and bond contracts (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. Part IV builds on the lessons from Parts II and III to analyze two possible avenues through which flexibility is preserved while prohibiting the directors' undue restriction on shareholders' right to bring litigation. The first mechanism relies on empowering shareholders, while the second invokes judicial monitoring. The Part argues that, given the problems of collective action and rational apathy associated with shareholder franchise, the better approach is for the court to apply a more stringent review. The final Part summarizes and concludes, with some thoughts for future research.

contracts. See also Fed. R. Civ. P. 54 (allowing the prevailing party to seek attorneys' fees and other costs from the losing party).

I. A TUMULTUOUS HISTORY OF FEE-SHIFTING PROVISIONS IN DELAWARE: FROM *ATP TOUR* TO DELAWARE'S LEGISLATIVE RESPONSE

ATP Tour, Inc., is a Delaware, nonstock, membership corporation that operates a global men's tennis tour. The case *ATP Tour v. Deutscher Tennis Bund* arose out of a dispute between the nonstock 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.[16] Displeased by the changes, the two members brought suit against the directors of ATP Tour in federal court, making both federal antitrust and Delaware corporate fiduciary duty claims. The plaintiffs were unsuccessful with respect to both claims, but that did not end the matter. ATP Tour then moved to recover its litigation expenses (including attorneys' fees) from the member-plaintiffs, in accordance with ATP Tour's bylaws. As amended by the corporation's directors in 2006, the bylaws allowed for such recovery when a member-plaintiff "[did] not obtain a judgment on the merits that substantially achieve[d] . . . the full remedy sought."[17] 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 principle.[18] According to the

[16] 91 A.3d at 555–56.

[17] Id. at 556. According to an experienced corporate and securities litigator, in practice, obtaining a judgment 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 "[f]or anyone who has ever litigated a corporate-law case, even the largest courtroom successes rarely achieve this level of victory").

[18] *ATP Tour*, 91 A.3d at 557–60; see also Airgas, Inc. v. Air Prods. & Chems., 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, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Corporate Contract, 89 Colum. L. Rev. 1416, 1426 (1989) (explaining the concept of "corporate contract" between shareholders and corporation

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.[19] More importantly, "[b]ecause corporate bylaws are 'contracts among a corporation's shareholders,' a fee-shifting provision contained in a nonstock corporation's validly-enacted bylaw would fall within the contractual exception to the American Rule."[20] 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 right is granted to the directors in the corporation's charter and so long as the amendment is not done for an "improper purpose."[21] The court went on to determine that adopting the fee-shifting provision for the purpose of deterring litigation is not necessarily done for an "improper purpose."[22] The court's analysis closely followed another important case in Delaware, *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,[23] which similarly upheld a forum selection bylaw provision that prohibited shareholders from bringing lawsuits in states (or forums) other than Delaware.[24]

The *ATP Tour* decision must have come as welcome news for a number of corporations. Within the span of about a year,[25] until the

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and among shareholders); see also Choi & Min, supra note 8 (discussing the contractarian principle and how amending contracts compares to amending charters and bylaws).

[19] *ATP Tour*, 91 A.3d at 558.

[20] Id. (footnote omitted) (quoting *Airgas*, 8 A.3d at 1188).

[21] Id. at 559–60. 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., Model Business Corporation Act § 10.20 (Am. Bar Ass'n 2016). As of 2015, twenty-four states follow the Model Business Corporation Act. See Craig Eastland, Survey of Fee-Shifting Bylaws Suggests DGCL Amendments Won't End Debate, CLS Blue Sky Blog (June 24, 2015), http://clsbluesky.law.columbia.edu/2015/06/24/survey-of-fee-shifting-bylaws-suggests-dgcl-amendments-wont-end-debate/ [https://perma.cc/L7QY-P3E6].

[22] *ATP Tour*, 91 A.3d at 560.

[23] 73 A.3d 934, 939 (Del. Ch. 2013).

[24] The two cases, *ATP Tour* and *Boilermakers*, have led to an opposite response from the Delaware legislature. While prohibiting fee-shifting bylaws, the amended DGCL now expressly authorizes forum selection bylaws so long as the selected forum is Delaware. Del. Code Ann. tit. 8, § 115 (Supp. 2016).

[25] The case was decided on May 8, 2014, *ATP Tour*, 91 A.3d at 554, while the legislative amendment became effective on August 1, 2015, An Act to Amend Title 8 of the Delaware Code Relating to the General Corporation Law, 80 Del. Laws ch. 40.

Delaware legislature's statutory amendment, about forty corporations adopted a fee-shifting provision, mostly in their bylaws.[26] 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.[27] Here is a sample fee-shifting bylaw provision, almost identical to that in *ATP Tour*, adopted by the directors of Echo Therapeutics:

> 5.13. Litigation Costs. To the fullest extent permitted by law, in the event that (i) any current or prior stockholder or anyone on their behalf ("Claiming Party") initiates or asserts any claim or counterclaim ("Claim") or joins, offers substantial assistance to, or has a direct financial interest in any Claim against the Corporation and/or any Director, Officer, Employee or Affiliate, and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the Corporation and any such Director, Officer, Employee or Affiliate, the greatest amount permitted by law of all fees, costs and expenses of every kind and description (including but not limited to, all reasonable attorney's fees and other litigation expenses) (collectively, "Litigation Costs") that the parties may incur in connection with such Claim.[28]

While there are many parts of this provision that are worthy of more detailed examination, two aspects of the provision are salient for our

[26] See Allen, supra note 6 (noting that thirty-nine firms have adopted a fee-shifting bylaw since *ATP Tour*); see also Mark Lebovitch & Jeroen van Kwawegen, Of Babies and Bathwater: Deterring Frivolous Stockholder Suits Without Closing the Courthouse Doors to Legitimate Claims, 40 Del. J. Corp. L. 491, 505 (2016) (stating that "[w]ithin days of the *ATP* opinion, prominent corporate law firms issued client alerts suggesting that boards of public stockholder corporations consider adopting similar bylaws"); Eastland, supra note 21 (reporting that Delaware public companies with fee-shifting bylaws "ballooned" from two to thirty-four between June 2014 and May 2015).

[27] See Lebovitch & Kwawegen, supra note 26, at 514. For the ATP Tour fee-shifting provision, see *ATP Tour*, 91 A.3d at 556.

[28] Echo Therapeutics, Inc., Amended and Restated By-Laws of Echo Therapeutics, Inc. 9 (July 24, 2014), http://www.sec.gov/Archives/edgar/data/1031927/000141588914002261/ex3-2.htm [https://perma.cc/3H7X-6FS2].

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 plaintiff-shareholders); perhaps more importantly, the amount of expenses that the plaintiffs' attorneys can recover will be determined by the court. In a direct suit, by contrast, the recovery will go 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 only one direction, from the defendant to the plaintiff, and even when the plaintiff achieves a partial victory. The provision shifts the defendant's litigation expenses to the plaintiff when the plaintiff "does not obtain a judgment on the merits that substantially achieves . . . the full remedy sought."[29] 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 her lawyer and jointly and severally) will have to pay for the defendant's litigation expenses.[30] 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. In the case of a direct lawsuit, even though the plaintiff has been fully successful on 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, the court will allow the plaintiff's attorney to recover fees

[29] Id.

[30] If the plaintiff, in either a direct or a derivative suit, owns only a small number of shares in the corporation, the plaintiff would be unwilling to bear the substantial cost of litigation. Especially given that the attorneys are the ones who often take the entrepreneurial role, one would expect the attorneys to agree to indemnify the plaintiff against liability. See Sections II.D and II.E for more detailed analysis.

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.[31]

The Delaware legislature, possibly in acceding to the influence of the Delaware plaintiffs' bar,[32] responded by amending Sections 102 and 109 of the DGCL.[33] The amended Section 102 deals with charters and

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[31] See supra note 13 and accompanying text (providing a more detailed analysis).

[32] See, e.g., Lebovitch & Kwawegen, supra note 26, at 495, 537–38 (arguing that the *ATP Tour* fee-shifting 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 through 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 9, at 875 (noting that "all corporate lawyers . . . have a strong incentive to oppose fee-shifting bylaws"). Another influential group that spoke out against the fee-shifting bylaws is proxy advisory firms, including Glass Lewis and Institutional Shareholder Services. See Glass, Lewis & Co., LLC, Proxy Paper Guidelines: 2016 Proxy Season, An Overview of the Glass Lewis Approach to Proxy Advice 38 (2016), http://www.glasslewis.com/wp-content/uploads/2016/01/2016_Guidelines_United_States.pdf [https://perma.cc/VT9V-7NHF] ("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 S'holder Servs., United States Proxy Voting Guideline Updates: 2015 Benchmark Policy Recommendations 7 (Nov. 6, 2014), http://www.issgovernance.com/file/policy/2015USPolicyUpdates.pdf [https://perma.cc/Z2HB-FGKE] ("Generally vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits . . . .").

[33] S. 75, 148th Gen. Assemb. (Del. 2015) (amending Del. Code Ann. tit. 8, §§ 102, 109). The legislature's initial attempt to overturn the decision failed putatively due to a "significant backlash from business groups supporting such [fee-shifting] bylaws." See Bainbridge, supra note 9, at 854. As a compromise, the legislature requested that the Corporate Law Council of the Delaware State Bar Association study the problem and report back in time for the 2015 legislative session. Id. "In March 2015, the Delaware Bar proposed legislation that would limit the availability of fee-shifting bylaws to nonprofit corporations" and the bill was introduced as Senate Bill 75. Id. It passed the Delaware Senate on May 12, 2015, and was approved by the Delaware House on June 11, 2015. Id. The law was signed by Governor Jack Markell on June 24, 2015. Id. The legislative amendment deals with both bylaws and charters. Id.

This Article's focus, however, is on bylaws because bylaws can be unilaterally amended by the directors without shareholder approval. By contrast, a charter amendment requires shareholder approval in Delaware. See Del. Code Ann. tit. 8, § 242 (Supp. 2016). While 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 fraught with various dangers, including the collective action problem, rational apathy, and lack of information. See, e.g., Lucian Arye Bebchuk, Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments, 102 Harv. L. Rev. 1820, 1825 (1989) (stating that opting out in midstream cannot be defended the same as opting out in the initial charter). Even in the modern day of shareholder activism and institutional ownership, there are various means that the managers and the directors can employ in

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 corporations."[34] The new DGCL § 102(f) states: "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."[35] Similarly, the newly inserted second sentence in DGCL § 109(b) now states: "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."[36] 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."[37] In short, Sections 102 and 109 of the DGCL now prohibit the corporation from having a provision in either 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.[38] As far as fee-shifting is concerned, at

denying what the shareholders seek through charter amendment. See Geeyoung Min, Shareholder Activism and Charter Amendments, J. Corp. L. (forthcoming 2018) (manuscript at 36–37), http://ssrn.com/abstract=2738961 [https://perma.cc/JV28-RSNV] (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).

[34] S. 75, 148th Gen. Assemb. Apart from a brief legislative synopsis, there seems to be no publicly available record on the legislative history behind the amendment.

[35] Del. Code Ann. tit. 8, § 102(f).

[36] Id. § 109(b).

[37] Id. § 115.

[38] 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. As far as the bylaws and the charters are concerned, the prohibition is unconditional. See Solak v. Sarowitz, No. 12299–CB, 2016 WL 7468070, at *8 (Del. Ch. Dec. 27, 2016) (deciding that a fee-shifting bylaw that operates only when shareholders file suit in a jurisdiction in contravention to the exclusive forum bylaw is still in violation of § 109(b)). At the same time, the prohibition covers only bylaws and charters and does not deal with nonstock corporations or noncorporate claims. First, §§ 102 and 109 prohibit fee-shifting clauses from being present only in either the charter or the bylaws, but not in other corporate documents. So, if the shareholders were to execute a similar fee-shifting provision in an agreement amongst themselves, such an agreement would likely be upheld by a court. See S. 75, 148th

least with respect to direct suits, Delaware corporate law mandates the traditional, bear-your-own-cost rule: the American Rule.[39]

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.[40] 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 . . . the full remedy sought"); second is to consider ATP Tour–style fee-shifting that is asymmetric and pro-defendant; and third is to

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Gen. Assemb. (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, leaving the holding of *ATP Tour* valid for nonstock corporations (including ATP Tour). Id. Third, because the amended statute only prohibits imposing liability on the shareholder, it leaves open the possibility that a fee-shifting clause could make the attorney representing a claim or a third-party financing entity bear the litigation costs of the corporation (and other defendants). See Del. Code Ann. tit. 8, §§ 102(f), 109(b). 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 noncorporate claim, such as a claim based on federal securities laws that does not allege a violation of duty. See John C. Coffee, Jr., Delaware Throws a Curveball, CLS Blue Sky Blog (Mar. 16, 2015), http://clsbluesky.law.columbia.edu/2015/03/16/delaware-throws-a-curveball/ [https://perma.cc/G6S4-JXM7] (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).

[39] 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 nonprevailing 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 nonprevailing party or parties to pay the prevailing party or parties the reasonable expenses, including attorney fees, taxable as costs, incurred as a result of such action." Okla. Stat. tit. 18, § 1126(C) (Supp. 2017) (emphasis added). Professor Bainbridge has argued that this is an attempt to compete away those corporations currently incorporated in Delaware. See Bainbridge, supra note 9, at 870. 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 Business Corporation Act § 7.46(2) (Am. Bar Ass'n 2016).

[40] See supra note 10 (listing references).

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 this Part is on the issue of credibility and screening: that fee-shifting provisions can increase the returns of meritorious lawsuits while depressing the returns of frivolous lawsuits. The Part is organized as follows. After the analytical building blocks are presented in Section II.A, Section II.B applies them to the ATP Tour fee-shifting clause. Section II.C, which is the core of the Part, analyzes a more symmetric fee-shifting regime and then compares the symmetric regime with the ATP Tour fee-shifting clause. Sections II.D and II.E extend the analysis to plaintiff attorneys' incentives, and Section II.F concludes the Part with an informal analysis on the costs of relying on fee-shifting.

A. The Basic Setup

To make the analysis more concrete, consider a simple numerical setup. Suppose a plaintiff (shareholder) contemplates bringing a direct lawsuit against a single defendant (corporation).[41] Assume for now that the plaintiff-attorney pair tries to maximize its expected joint return from the lawsuit. If the parties proceed to trial, there are three possible outcomes: full, partial, or no recovery for the plaintiff. No recovery is

[41] There are a couple of important aspects about the lawsuit that are 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's 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's value will likely increase (assuming that the size of the recovery is larger than the expenses that the corporation has to incur). For a more detailed examination of this issue, see Albert H. Choi & Kathryn E. Spier, Taking a Financial Position in Your Opponent in Litigation (Va. Law & Econ. Research Paper No. 3, 2016), https://ssrn.com/abstract=2733710 [https://perma.cc/J3TZ-2RM2]. Second, when shareholders bring a 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 Verification, 37 J. Legal Stud. 503, 517 (2008) (analyzing how incentive structure can be used together with costly lawsuits).

equivalent to the plaintiff losing at trial, while partial recovery can be thought of as the court granting the plaintiff less than the full remedy sought by the plaintiff. In terms of monetary (or monetized, in the case where the remedy sought is not damages) values, 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 $1 - p - q$. We can assume that both parties are aware of the probabilities. Finally, assume that both the plaintiff and the defendant expect to incur a (monetized) litigation cost of C each.[42]

With these parameters under the traditional no-fee-shifting rule, the plaintiff's expected return is $pD + q\alpha D - C$.[43] Regardless of the outcome, the plaintiff incurs the cost of C but does not reimburse the expenses of 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").[44] 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 will not 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, the parties will settle the case at some value between $pD + q\alpha D - C$ and $pD + q\alpha D + C$.[45] At the same time, when the potential recovery (D) is

[42] Although the model assumes that both sides incur the same litigation cost, in many shareholder litigation suits, this may not be true. Corporate defendants, for instance, could employ multiple sets of counsel: e.g., for the corporation, the directors, and so on. The analysis can easily adapt to such asymmetric cost situations. We can, instead, set the defendant's cost at βC where $\beta > 1$. See Joel Edan Friedlander, Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform, 72 Bus. Law. 623, 636–42 (2017) (arguing that corporate defendants often spend significantly more resources than plaintiffs).

[43] 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 15 (discussing judicial discretion under both the federal and Delaware procedural rules).

[44] See Del. Code. Ann. tit. 8, §§ 102(f), 109(b) (Supp. 2016).

[45] 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

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

B. The ATP Tour *Rule*

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 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 gets only partial recovery (does not achieve the full remedy sought).[46] 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 rewritten as $pD + q\alpha D - C - (1 - p)C$. When we compare this outcome 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

the Coase theorem). As is well known in the literature, the parties may fail to settle when (1) one plaintiff has a sufficiently more optimistic belief about the trial outcome than the defendant (nonconvergent priors setting) or (2) one party has private information that is not shared by the other (asymmetric information setup). See, e.g., J.J. Prescott & Kathryn E. Spier, A Comprehensive Theory of Civil Settlement, 91 N.Y.U. L. Rev. 59 (2016) (examining litigants' settlement behavior under different informational assumptions).

[46] 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 her expenses reimbursed by the corporation. Such a strategic claim will further worsen the "token" settlement problem.

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 sum, with the *ATP Tour* Rule, the plaintiff is strictly worse off compared to the Amended DGCL Rule unless the plaintiff is certain (with probability of one) to get the 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.

Table 1: Comparison Between ATP Tour *and Amended DGCL Fee-Shifting Provisions*

***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 (asymmetric and pro-defendant fee-shifting)	$pD + q\alpha D - C - (1-p)C$

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 (either $p+q$ is close to 1 or p is 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. As 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 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 greater 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 < \$500$) for the plaintiff to have a credible lawsuit.

C. Symmetric Fee-Shifting Rule and the Benefits of Screening

An important reason for the difference between the *ATP Tour* Rule and the Amended DGCL Rule is the asymmetry built into the former. 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 achieves only partial success. In case of partial success, 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); or (3) the defendant bears all the expenses (pro-plaintiff rule).[47] 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 straightforward. 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).

[47] One could argue that a truly symmetric fee-shifting provision requires each party to bear its own expenses if the plaintiff gets a partial recovery. If we allocate the expenses either to the plaintiff or to 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 to the defendant; whereas if we treat it as the plaintiff's "loss," making the plaintiff reimburse the defendant may make more sense. Finally, in addition to the three possible symmetric rules, we can also think of a rule that grants discretion to the court. See Section III.A for an analysis on how courts interpret the word "prevails" in fee-shifting clauses in commercial contracts (and in other settings) to determine who will bear the cost if neither party achieves an absolute win.

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

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	$pD + q\alpha D - C + (p + q)C - (1 - p - q)C$

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 of partial recovery (pro-plaintiff rule), the next highest when each party bears its own cost (neutral rule), and the lowest when the plaintiff bears all costs (pro-defendant rule). 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, focus on the symmetric fee-shifting rule, under which the defendant bears all costs if the plaintiff gets only partial recovery (the pro-plaintiff rule). The pro-plaintiff rule makes the comparison easier largely because the plaintiff's expected return depends on $p + q$ in a systematic way.

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 under the symmetric fee-shifting rule will be higher when $p + q$ is greater than 0.5: $(p + q)C - (1 - p - q)C > 0$ when $p + q > 0.5$.[48] When the plaintiff has a relatively high chance of

[48] The reason why the cutoff is at 0.5 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 stand for the plaintiff's litigation cost and C_d for the defendant's litigation cost, the threshold will be given by the ratio of $C_d/(C_p + C_d)$. 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

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 $p + q > 0.5$. 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 (or nonmeritorious), 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 $p + q < 0.5$. In short, compared to the traditional, no-fee-shifting rule, the symmetric fee-shifting rule will be better at screening meritorious from nonmeritorious lawsuits.[49] 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.[50] Table 3 summarizes the results.[51]

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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.

[49] 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 supports the conclusion that the overall quality of the claims reaching the latter stage of litigation improved. James W. Hughes & Edward A. Snyder, Litigation and Settlement Under the English and American Rules: Theory and Evidence, 38 J.L. & Econ. 225, 234–43 (1995). This is consistent with the screening function provided by the fee-shifting rule.

[50] 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 the expected return 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 Section IV.B for more on this analysis.

[51] There are three knife-edge situations where the expected returns are equal. First, when $p + q = 0.5$, both the Amended DGCL Rule and the symmetric fee-shifting rule produce the same expected returns. Second, when $p = 1$ and $q = 0$, the Amended DGCL and *ATP Tour* Rules produce the same expected return, while the return from a symmetric fee-shifting rule is strictly higher. Third, when $p = q = 0$, all three rules produce the same expected return.

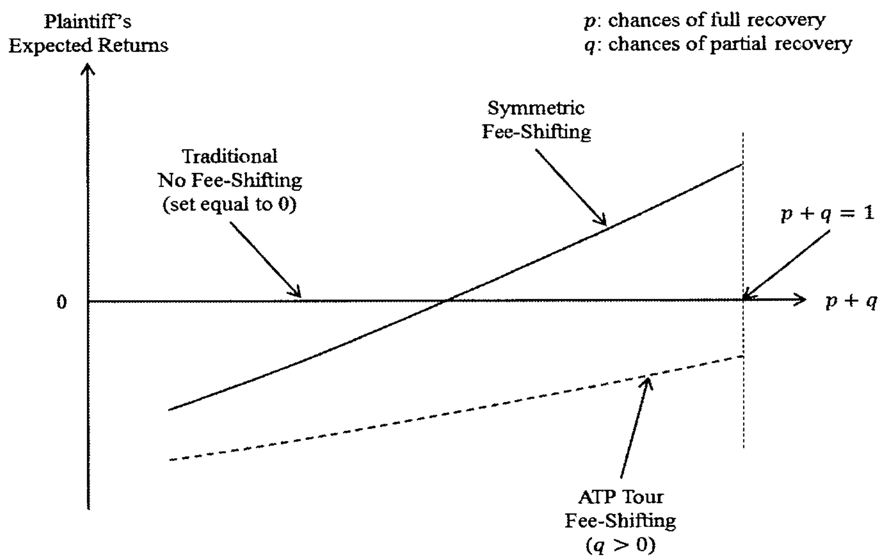
Table 3: Comparison Among Three Fee-Shifting Rules

Likelihood of Plaintiff (Partial and Full) Success	**Ranking of Plaintiff's Expected Returns**
$p + q > 0.5$	Symmetric Fee-Shifting Rule > Amended DGCL Rule > *ATP Tour* Rule
$p + q < 0.5$	Amended DGCL Rule > Symmetric Fee-Shifting Rule > *ATP Tour* Rule

To better see the screening function performed by the symmetric fee-shifting rule, consider a simple thought experiment. Suppose we vary the plaintiff's aggregate chances of partial or full recovery $(p + q)$ from (near) zero to one. As we vary the aggregate 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 the recovery (D) or the cost (C). In this setting, under the traditional rule, the plaintiff should be 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, on the other hand, 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, with the expected return from the Amended DGCL Rule 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 $p + q > 0.5$ and $pD + q\alpha D - C + (p + q)C - (1 - p - q)C < 0$ when $p + q < 0.5$. That is, under the symmetric fee-shifting rule, the plaintiff will 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, the symmetric fee-shifting rule encourages more meritorious lawsuits while discouraging nonmeritorious (or 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 of 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 (by varying D or C). 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, the plaintiff will never file suit under the *ATP Tour* Rule. In contrast, under the symmetric fee-shifting rule, only a plaintiff with a relatively high chance ($p + q$ close to 1) of securing (either partial or full) recovery will file suit.

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



In addition to the screening function performed by the symmetric fee-shifting rule, Figure 1 also reveals another important insight: the plaintiff's incentive to file (and proceed) when the plaintiff has relatively little or no information about the probability of success (the case of the "uninformed" plaintiff). So far, we have assumed that both the plaintiff and the defendant have some information about the merits of the case (i.e., whether $p + q$ is closer to one or closer to zero). But in certain cases, especially when all the relevant information is in the hands of the defendant, this may no longer be true, especially for the plaintiff. From the figure, this is tantamount to the plaintiff not knowing where on the horizontal axis her chances of success lie. For ease of comparison, suppose the plaintiff believes that the aggregate probability of success $(p + q)$ is roughly evenly distributed between zero and one. In that setting, Figure 1 reveals that, if we impose the *ATP Tour* Rule, because the plaintiff's expected return is strictly lower regardless of the merits of the case, an uninformed plaintiff will be strongly discouraged from filing (and proceeding with) the suit. Hence, the *ATP Tour* Rule, compared to the traditional, no-fee-shifting rule, functions as an unconditional deterrent against an uninformed plaintiff.

By contrast, under the symmetric fee-shifting rule, because the rule tilts the plaintiff's expected return depending on the probability of success, it is feasible to keep the uninformed plaintiff's expected return roughly about the same compared to the traditional, no-fee-shifting rule. In fact, depending on which version of the symmetric rule we adopt, we can create an expected return that may be slightly higher or lower than that under the traditional rule. Recall that we can craft three different symmetric fee-shifting rules: (1) a pro-plaintiff rule that requires the defendant to reimburse the plaintiff's expenses in case of partial success; (2) a neutral rule that uses no fee-shifting in case of partial success; and (3) a pro-defendant rule that requires the plaintiff to reimburse the defendant's expenses in case of partial success. While all three versions offer the screening benefits,[52] depending on which rule we adopt, the expected return for an uninformed plaintiff will differ. The line that represents the expected return under the pro-plaintiff symmetric fee-shifting rule will lie above that of the line under the neutral rule, which,

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[52] When we compare among the three rules, we see that, while all three can provide the screening function, their efficacy differs. The pro-plaintiff rule is most effective in screening when the added probability of $p + q$ rises or falls together. The pro-defendant 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. Finally, the neutral rule, under which each party will bear its own litigation expenses when the plaintiff gets partial recovery, depends on both p and q but relies more on the former than the latter.

in turn, will be located above the line under the pro-defendant symmetric fee-shifting rule. To the extent that we believe the symmetric fee-shifting rule encourages or discourages too many uninformed plaintiffs to file suit, we can tailor the rule by crafting different fee-shifting regimes in case of the plaintiff's partial success.[53] In the process, we can attempt to keep the uninformed plaintiff's incentive to file and proceed with a case neutral, stronger, or weaker compared to the traditional, no-fee-shifting case.

D. Attorney's Expected Return Under Different Fee-Shifting Rules

So far, we have assumed that the plaintiff-shareholder 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 the more complex settings. We consider two important variations: (1) the expected return from the attorney's perspective in a direct suit 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, such as 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 possibly more stringent judicial oversight.

[53] The optimal rule should also depend on our conception of what "partial success" means and possible cost asymmetries. First, if we think of plaintiff's partial success as the plaintiff's near complete vindication of her right, we should treat partial recovery more like full recovery and move toward adopting the pro-plaintiff 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 pro-defendant rule) would make more sense. And finally, if partial victory should be thought of as neither side having a complete upper hand, the neutral rule using the traditional allocation mechanism would be more desirable. Since partial success will depend a lot on the context, we can also devise a more complex fee-shifting rule that combines all three approaches. The second factor is cost asymmetry. When the defendant is expected to spend more resources in litigation than the plaintiff, for instance, the plaintiff's expected return will pivot downward. To restore symmetry, the court could allow a more generous pro-plaintiff rule.

When a plaintiff-shareholder brings a direct suit against the corporation, just like any other civil suit, 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. We can start with the conventional assumption that it is the attorney who incurs all the litigation expenses and gets paid a percentage ($\theta \in (0,1)$) of the recovery for the plaintiff (or the 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 (indemnification) agreement for the (defendant's) expenses for which the plaintiff becomes liable.[54] Table 4 represents the expected returns for the attorney under different fee-shifting rules. For the sake of simplicity, Table 4 uses only the symmetric fee-shifting rule with the defendant bearing both costs in the case of partial recovery (the pro-plaintiff rule).

[54] The implicit assumption here is that an individual shareholder would refuse to become the named or the lead plaintiff and would be possibly liable for the defendant's litigation expenses unless the attorney agrees, in advance, to indemnify her. The 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 assume that such a plaintiff would demand indemnification from the attorney, as part of the retainer agreement. See George S. Geis, Shareholder Derivative Litigation and the Preclusion Problem, 100 Va. L. Rev. 261, 311–12 (2014). Also, because the amended statute does not expressly prohibit corporations from adopting a fee-shifting bylaw or a charter provision that imposes liability on the plaintiff's attorney (and not the plaintiff-shareholder), were a corporation to adopt such a provision, the plaintiff's attorney would be directly responsible for the fees and expenses of the corporation (and other defendants). See supra note 38.

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

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 (asymmetric 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	$\theta(pD + q\alpha D) - C + (p + q)C$ $-(1 - p - q)C$

At the same time, under these assumptions, the fee-shifting rule will no longer affect the plaintiff-shareholder's expected return, as 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 is unaffected by the rule. The attorney's incentive to file and prosecute a lawsuit is attenuated since she only gets 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.

E. 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 when the prosecution is successful. Since the initial claim belongs to the corporation, any recovery will flow back to the corporation rather than to the plaintiff-shareholder.[55] 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, to what extent.[56] At the same time, since the plaintiff's attorney receives compensation from the corporation and not from the plaintiff-shareholder, then from the plaintiff's attorney's perspective, a partial fee-shifting rule is already built into the regime.[57] That is, if the derivative prosecution is successful, the attorney gets to recover litigation expenses from some other entity, 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 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 for the attorney.[58] 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

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[55] 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.

[56] In assessing attorney compensation in Delaware, courts apply what is 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. v. Thomas, 420 A.2d 142, 149 (Del. 1980).

[57] 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 Griffith, Correcting Corporate Benefit, supra note 9, at 22–23. Professor Sean 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 a seemingly minor additional disclosure. Id. at 52–53.

[58] 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 worth pursuing. With a negative expected value suit, presumably it is also difficult for the attorney to secure a profitable settlement against the defendant.

compensation).[59] To reflect this possibility, as a variation of the previous analysis, suppose that, in the case that the plaintiff prevails, the attorney receives compensation of $(1 + \delta)C$, where $\delta > 0$ represents a measure of extra compensation.[60] 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 will still receive $(1 + \delta)C$ as compensation in the case of partial recovery.[61] 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"[62] 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.

[59] For instance, the attorney can successfully claim the complexity of the case or the attorney's ability to receive higher compensation. See supra note 56 (listing *Sugarland* factors).

[60] When δ is close to zero, again the derivative suit will have a negative expected value from the attorney's perspective. So, we will assume that δ is sufficiently large and is bounded away from zero. While we are assuming that δ is a constant, we can also let δ depend on the amount of recovery (D or αD). That would be more consistent with the "common fund" doctrine and with the fact that the court will consider the litigation result as a factor in determining compensation. See supra note 57.

[61] 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 generally Griffith, Correcting Corporate Benefit, supra note 9 (examining the corporate benefit doctrine and fee-shifting in shareholder litigation).

[62] See supra note 28.

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

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 (asymmetric 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	$(p+q)(1+\delta)C - C - (1-p-q)C$

A few points are salient from Table 5. 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 that under the traditional, no-fee-shifting regime, which is in contrast to the analysis 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 rule has a built-in asymmetric fee-shifting feature in favor of 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 unsuccessful. The *ATP Tour* Rule, compared to the symmetric fee-shifting rule, does so more by shifting the corporation's expenses even when the plaintiff-shareholder is only 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, the attorney's expected return in both cases will also rise. But unlike the case with direct suits, the expected return under the 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 $(p+q) < 1$. Again, both of these results 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 case of loss. While the Amended DGCL Rule has the upside of fee-shifting (from the attorney's perspective), the symmetric fee-shifting rule also creates the downside. Because of this downside, the 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.

F. 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 nonmeritorious ones. The analysis, however, is not meant to argue that fee-shifting provisions are always beneficial or efficient. As the next Part will show, while many sophisticated contracting parties will often adopt a fee-shifting rule in their contracts, others do not. This provides empirical support to the argument that the fee-shifting rule may not always be optimal. Law and economics scholars have also noted (primarily through theoretical analyses) at least two potential costs of using a fee-shifting rule: (1) encouraging more resources to be spent 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 than the other).[63] While an exhaustive analysis of these concerns will require much more economic analysis and, therefore, is beyond the scope of this Article, this Section will informally review these two arguments and possible mitigating factors.[64]

Fee-shifting rules could encourage the litigants to spend more resources if they were to proceed to trial, which could lead to possible overspending by the litigants. The reasons are twofold.[65] First, because

[63] See infra notes 66–67.

[64] See Katz & Sanchirico, supra note 10, at 275–86 (providing a more detailed analysis and comprehensive overview).

[65] See Katz, Measuring the Demand, supra note 10, at 159–61 (providing a more detailed presentation of the arguments).

there is a chance that a litigant can get all her expenses reimbursed by the counterparty if she prevails, the marginal cost of spending an additional dollar is lower than under the no-fee-shifting (each-side-bears-own-cost) rule. For instance, if a litigant is contemplating spending an additional $1,000 at trial but knows that there is a 40% chance that the cost will be borne by the counterparty, the expected additional cost of spending $1,000 goes down to $600. Second, because the prevailing litigant also gets to recover the expenses, the stakes of the case are likely to be 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, larger expenditures by both parties do not necessarily mean that the inefficiency will always realize. A larger aggregate expenditure at trial implies a larger surplus from settlement, which leads to a greater 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 of settlement is sufficiently high, 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 the merits of the litigation. 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 each party is willing to pay or accept 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. Also suppose that both the plaintiff and the defendant expect to spend $500 at trial. If the damages (D) are set at $2,000, without fee-shifting, the innocent defendant is expected to lose $500, while the guilty defendant is expected to lose $2,500, at trial. But with fee-shifting, the innocent defendant knows that she will lose nothing while the guilty defendant knows that she will lose $3,000 ($2,000 of damages plus $1,000 of total litigation expenses) from trial: the difference in expected losses between the two types of defendants has widened. When the plaintiff is unaware of which type of defendant she is facing, the guilty defendant has a greater 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.[66]

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 nonmeritorious lawsuits, while increasing the returns of meritorious ones, the (potential) decrease in the rate of settlement can be offset by the decrease in the rate of filing and by the selection effect. Using the same numbers from above, suppose that while the defendant knows the culpability for certain, the plaintiff believes that there is a 25% chance that she is facing a guilty defendant and a 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 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 becomes noncredible for the plaintiff, the defendant will refuse to settle, expecting the plaintiff to drop the case when the settlement negotiations

[66] See A. Mitchell Polinsky & Daniel L. Rubinfeld, Does the English Rule Discourage Low-Probability-of-Prevailing Plaintiffs?, 27 J. Legal Stud. 519, 526–31 (1998). In their analysis, a plaintiff has private information about the probability of prevailing at trial, and an uninformed defendant makes a take-it-or-leave-it settlement offer. They assume that, although the plaintiff's expected return may be negative, the fee-shifting rule will have no effect on the filing rate; and if the defendant were to make a positive settlement offer, all plaintiff types (even those with negative expected values) would file suit. In short, credibility is not a concern. Another line of analysis, which examines litigation and settlement under different fee-shifting rules, assumes that 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 chance of his prevailing at trial is 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 "nonconvergent 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 not to bear the cost of trial, which leads her to demand more in settlement. See Shavell, supra note 10, at 63–69.

fail.[67] Conversely, when more meritorious lawsuits proceed, the defendant will be more willing to settle with the plaintiff, thereby increasing the rate of settlement.[68] 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 the 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 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 a non-shareholder-director context could be useful. While fee-shifting provisions are quite prevalent in commercial contracts,[69] in this Part, we focus on fee-shifting provisions in two different types of contracts: stock purchase agreements and bond indentures. The first example demonstrates how commercial entities, in an arm's-length negotiation, would agree on a fee-shifting provision when they agree to buy and sell stock. The second example

[67] 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 0.5 when a symmetric fee-shifting rule is applied. That is, if the probability of winning is larger (less) than 0.5, the plaintiff's expected return will increase (decrease) when a fee-shifting rule applies. If the distribution is skewed to the left (more mass below 0.5), 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 0.5, thereby reducing the expected return from the fee-shifting rule.

[68] 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 be willing to file. Hence, the model will have to take this fact into consideration along with the possible cost of filing suit. See generally Katz, Effect of Frivolous Lawsuits, supra note 10 (developing a model of ligation and settlement given frivolous lawsuits).

[69] See Eisenberg & Miller, supra note 14, at 331–32. Fee-shifting provisions are also frequently observed in consumer contracts, and they usually shift fees in favor of the manufacturers. Such provisions also raise concerns about consumer protection. See Jeffrey C. Bright, Unilateral Attorney's Fees Clauses: A Proposal to Shift to the Golden Rule, 61 Drake L. Rev. 85, 114–15, 119 (2012).

shows us how dispersed public investors agree on a fee-shifting provision with a corporate borrower. With respect to the second example, the federal Trust Indenture Act provides further guidance on fee-shifting provisions.[70] Both examples demonstrate 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

In many commercial contracts, it is quite easy 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 contract.[71] 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 for the parties. As an example, we first 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 company's stock.[72] Both the buyer and the target

[70] See infra Section III.B.

[71] Even if one of the contracting parties has the right to unilaterally amend the contract, it is quite unlikely that the party will be able to unilaterally impose a fee-shifting clause without giving the counterparty an option to either opt out of such a term or terminate the contract. See supra note 8.

[72] Privately negotiated stock acquisitions are used to acquire privately held or closely held target companies. This transactional form is in contrast to tender offers which are made to dispersed shareholders. While we are using stock purchase agreements as the main example in this Section, fee-shifting provisions are prevalent in many other types of commercial contracts, including supply, manufacturing, licensing, and lease agreements. See, e.g., Green Mountain Coffee Roasters, Inc., Supply Agreement, § I(j) (Mar. 27, 2009), https://www.sec.gov/Archives/edgar/data/944136/000119312509140760/dex1031.htm [https://perma.cc/7MQK-BWRG] (supply agreement); NSA, Inc., Exclusive Manufacturing Agreement, § 41 (Apr. 1, 2005), https://www.sec.gov/Archives/edgar/data/787253/000119312510032460/dex1051.htm [https://perma.cc/45K2-QEBL] (manufacturing agreement); NS Wells Acquisition LLC, Office Lease Agreement, § 26.02 (Mar. 27, 2014), https://www.sec.gov/Archives/edgar/data/1503802/000110465914024882/a14-9393_1ex10d1.htm [https://perma.cc/4VUQ-2DM3] (lease agreement); see also Model Merger Agreement for Acquisition of a

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[73] 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 incurred in such Proceeding, in addition to any relief to which such party may be entitled.[74]

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

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Public Company § 7.3(a)(ii) (Am. Bar Ass'n 2011) (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." Id. § 7.3 cmt; see also, Eisenberg & Miller, supra note 14 (studying 2,347 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 pay-your-own-cost rule).

[73] 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., Common Stock Purchase Agreement, § 6.7 (May 22, 2009), https://www.sec.gov/Archives/edgar/data/798528/000119312509118417/dex101.htm [https://perma.cc/C9HC-5KF8]; the agreement used by Vertical V, Inc., Stock Purchase Agreement, § 22 (Aug. 3, 2010), https://www.sec.gov/Archives/edgar/data/1532961/000119312513024365/d470124dex1015.htm [https://perma.cc/6YXL-HFKX]; and the agreement used by Soar Solutions, Inc., Stock Purchase Agreement, § 12 (June 27, 2003), https://www.sec.gov/Archives/edgar/data/1298978/000119312505054368/dex1012.htm [https://perma.cc/LJU8-QWCD]. While the model stock purchase agreement allows the recovery of only "reasonable" attorneys' fees, some contractual fee-shifting provisions do not include such a restriction. In such cases, some courts show their unwillingness to allow the winning party to recover all expenses and fees by imposing a statute-based "reasonableness" requirement. See Mahani v. Edix Media Grp., 935 A.2d 242, 244–45, 247 (Del. 2007) (Delaware Supreme Court imposing a 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'l Corp., No. 06 Civ. 7609(NRB), 2014 WL 1553638, at *4 (S.D.N.Y. Apr. 17, 2014) (stating that "any entitlement to attorneys' fees here arises exclusively from the language of the contract, and not from a statutory scheme").

[74] Model Stock Purchase Agreement, § 12.15 (Am. Bar Ass'n 2010).

Governmental Body or arbitrator."[75] 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 by 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. 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 must have achieved the "complete relief" sought.[76] Similarly, under Delaware law, "prevailing" has been interpreted by courts to mean "predominance in the litigation."[77] Even when recovery is less than complete, therefore, New York and Delaware courts let the winning party recover litigation expenses, including attorneys' fees, from the losing party.[78] 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

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[75] Id. § 1.

[76] See *Matsumura*, 2014 WL 1553638, at *4–5; see also Chainani v. Lucchino, 942 N.Y.S.2d 735, 736 (App. Div. 2012) (stating that to determine whether a party has prevailed, a "fundamental consideration is whether that party has 'prevailed with respect to the central relief sought'" (quoting Nestor v. McDowell, 615 N.E.2d 991, 994 (N.Y. 1993))).

[77] Comrie v. Enterasys Networks, No. 19254, 2004 WL 936505, at *2–3 (Del. Ch. Apr. 27, 2004) (citing Brandin v. Gottlieb, No. Civ. A. 14819, 2000 WL 1005954, at *28 (Del. Ch. July 13, 2000)). In this 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 (the option trigger clause) in the stock purchase agreement. Id. at *3.

[78] Sykes v. RFD Third Ave. I Assocs., LLC, 833 N.Y.S.2d 76, 77–78 (App. Div. 2007) ("To be considered a 'prevailing party,' one must simply prevail on the central claims advanced, and receive substantial relief in consequence thereof.").

sought, it is likely that the plaintiff has "prevailed" in litigation.[79] Under the ATP Tour bylaws, by contrast, when the plaintiff "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought," the plaintiff will still have to reimburse the defendant's litigation expenses.[80] In short, when compared to the fee-shifting provisions used in commercial contracts, the fee-shifting bylaw provisions adopted by corporations are more favorable toward the defendant corporations (and their directors and affiliates).[81]

B. Fee-Shifting Provisions in Bond Indentures and Under the Trust Indenture Act

Another important set of comparisons comes from the fee-shifting provisions used by bondholders and corporate borrowers. Just like shareholders, bondholders are investors to the corporation, and when the bond is issued to the public, its ownership often gets dispersed. Although the rules that determine the rights and obligations of a public bondholder are different from those for a public shareholder, there are a few important aspects of the relationship that make the comparison relevant: (1) that both are investors to a corporation and (2) that dispersed ownership often leads to similar collective action problems.

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[79] 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 the 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 full expectation damages), it is reasonable to conclude that the plaintiff "prevailed" in litigation. See, e.g., *Comrie*, 2004 WL 936505, at *2–3. 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 (e.g., did not mitigate the damages), then it is more difficult to argue that the plaintiff "prevailed" in litigation.

[80] *ATP Tour*, 91 A.3d at 556. 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*, 2004 WL 936505, at *3.

[81] The Article later argues that, when directors unilaterally adopt a fee-shifting bylaw with such one-sided provisions, the court should deem such provisions to be "improper" or "inequitable." See infra Section IV.B.

Furthermore, given that the Delaware courts have used the contract principle in interpreting charters and bylaws, the bond contract can also serve as a natural comparison.

In addition to 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 of the Trust Indenture Act. One requirement under the Act is to have an indenture trustee who will act as an agent of the bondholders to protect their interests against the corporation, especially when the corporation has defaulted on its obligations.[82] Obviously, aligning the interests of the indenture trustee with those of the bondholders becomes an important issue, and when there is a dispute between the bondholders and the indenture trustee, the Trust Indenture Act allows for fee-shifting.[83] The relevant provision is contained in Section 315(e) of the Trust Indenture Act:[84]

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[82] See Trust Indenture Act of 1939 § 310(a)(1), 15 U.S.C. § 77jjj(a)(1) (2012) (stating that "[t]here shall at all times be one or more trustees under every indenture qualified or to be qualified pursuant to this subchapter"). While a detailed examination of an indenture trustee's obligations to the bondholders is beyond the scope of this Article, according to the Trust Indenture Act, an indenture trustee's obligations differ depending on whether the issuer has defaulted on its obligation. In the absence of default, the indenture trustee's obligation is to "perform only those duties that are specifically set forth in th[e] Indenture"; whereas, if the issuer has defaulted on its obligations, the trustee must "exercise . . . such of the rights and powers vested in [the trustee] by th[e] Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of its own affairs." See Trust Indenture Act of 1939 § 315(a), (c), 15 U.S.C. § 77ooo(a), (c); Revised Model Simplified Indenture § 7.01 (1999), *reprinted in* 55 Bus. Law. 1115, 1139–40 (2000); see also Lorenz v. CSX Corp., 1 F.3d 1406, 1415 (3d Cir. 1993) (noting that "the duties of an indenture trustee . . . are defined exclusively by the terms of the indenture"); Meckel v. Cont'l Res. Co., 758 F.2d 811, 816 (2d Cir. 1985) (clarifying that an indenture trustee does not owe a duty of undivided loyalty because her obligations are "exclusively defined by the terms of the indenture agreement").

[83] See Trust Indenture Act of 1939 § 315(e), 15 U.S.C. § 77ooo(e); see also Trust Indenture Act of 1939 § 323(a), 15 U.S.C. § 77www(a) (allowing for statutory fee-shifting in litigation involving false or misleading statements). Unlike § 315(e), fee-shifting under § 323(a) cannot be contracted around and is mandatory, albeit subject to judicial discretion. 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 of 1976, 42 U.S.C. § 1988(b) (one-way fee-shifting for attorneys who bring civil rights actions against the U.S. government); the Privacy Act of 1974, 5 U.S.C. § 552a(g)(3)(B) (one-way fee-shifting for attorneys successful in lawsuits against a federal agency); the Fair Debt Collection Practices Act, 15 U.S.C. § 1692k(a)(3) (automatic fee-shifting for successful plaintiff attorneys against creditors who engaged in abusive and deceptive conduct); the Age Discrimination in Employment Act of 1967, 29 U.S.C. § 626(b) (one-way fee-shifting for plaintiffs who successfully challenge discrimination based on age); the Patent Act, 35 U.S.C.

> 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

§ 285 (two-way fee-shifting to prevailing parties in "exceptional [patent] cases"); and the Internal Revenue Code, I.R.C. § 7430(a), (c) (awarding court costs and attorney fees to the party that "prevails" against the Internal Revenue Service). With respect to civil rights statutes, see Sean Farhang, The Litigation State: Public Regulation and Private Lawsuits in the U.S. 147–50 (2010). With respect to the Patent Act, recently the U.S. Supreme Court expanded the scope of fee-shifting by interpreting "exceptional" 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, 134 S. Ct. 1749, 1756 (2014). According to a couple of commentators, this expansion of fee-shifting will deter nonpracticing 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 (Sept. 16, 2015), http://www.ipwatchdog.com/2015/09/16/patent-fee-shifting-stops-not-only-patent-trolls-but-industry-bullies-too/id=61575/.

[84] Two explanations on § 315(e) are in order. First, although the fee-shifting provision can apply even when bondholders bring suit against the corporation, in practice this rarely occurs. This is due to the presence of so-called "no-action" clauses in indentures, which require, among other things, 25% (in principal) of the bondholders to make a demand to the indenture trustee to pursue a remedy before a bondholder can bring suit against the corporation. See Revised Model Simplified Indenture § 6.06 (1999), *reprinted in* 55 Bus. Law. 1115, 1137–38 (2000). The 25% requirement effectively implies that the bondholders, who want to bring suit (presumably those holding more than 25% of the outstanding principal), will fall under the 10% exception in § 315(e), thereby bypassing fee-shifting. A bondholders' lawsuit against an indenture trustee, by contrast, is not subject to the no-action clause, and a bondholder, holding substantially less than 10%, can bring suit against the trustee and be subject to fee-shifting. Second, an indenture trustee usually has an indemnification agreement with the corporation, under which the corporation has the obligation not only to indemnify the trustee for any losses and expenses (subject to gross negligence, willful misconduct, and bad faith exceptions) but also to defend the lawsuit. See Revised Model Simplified Indenture § 7.07 (1999), *reprinted in* 55 Bus. Law. 1115, 1142 (2000). Hence, while the lawsuit is technically between the bondholders and the indenture trustee, the actual defending party is the corporation, and the corporation will have to compensate the bondholders (including litigation expenses under the fee-shifting provision) if the trustee is found liable. For relatively recent cases on § 315(e), see *Abrams v. Bank of Texas*, No. 4:10–CV–482–Y, 2010 WL 4683605, at *2, *4 (N.D. Tex. Nov. 12, 2010), and *Semi-Tech Litigation, LLC v. Bankers Trust Co.*, No. 02 Civ. 0711 LAK, 2007 WL 211085, at *1–2 (S.D.N.Y. Jan. 26, 2007).

> costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorney's 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.[85]

Before we get to the Trust Indenture Act fee-shifting provision, it is useful to briefly examine the legislative history surrounding the enactment of the Trust Indenture Act. The legislative history 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 indenture trustees.[86] 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."[87] This rationale resonates fairly well with the concern that many transactional attorneys expressed over the numerous lawsuits that were brought against mergers and acquisitions deals in Delaware, a large majority of which settled with

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[85] Trust Indenture Act of 1939 § 315(e), 15 U.S.C. § 77ooo(e).

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

[87] Regulation of Sale of Securities: Hearing on S. 2344 Before the Subcomm. on Sec. & Exch. of the S. Comm. on Banking & Currency, 75th Cong. 69 (1937) (statement of William O. Douglas, Comm'r, Securities & Exchange Commission). H.C. McCollom, an experienced New York City attorney, also gave a statement before the Senate in 1937. Id. at 156 (statement of H.C. McCollom). His view was similar to Douglas's. He opined that § 315(e) was wisely designed to prevent strike suits. 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 to the court's discretion. Id. at 162. Although courts were given broad discretion, McCollom thought it 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.

only nominal considerations or nominal changes, such as additional, supplemental disclosure.[88] 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," the U.S. Congress expressly endorsed fee-shifting as a means of controlling strike (frivolous) suits.[89]

Turning to the Trust Indenture Act fee-shifting provision, we observe that 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").[90] While a more up-to-date, 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, which is identical to the provision from the Trust Indenture Act.[91] Second, unlike

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[88] See supra note 1 and accompanying text (discussing 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).

[89] Del. S., Synopsis S. 148-75, at 15 (2015); see supra note 87.

[90] Trust Indenture Act of 1939 § 315(e), 15 U.S.C. § 77ooo(e). The original provision made fee-shifting optional:

> The indenture to be qualified *may contain provisions* to the effect that all parties thereto, including the indenture security holders, 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 . . . .

Trust Indenture Act of 1939 § 315(e), 53 Stat. 1149, 1172 (1940) (current version at 15 U.S.C. § 77ooo(e)) (emphasis added). The Act was later amended to make fee-shifting a default provision.

[91] See, for example, recent indentures used by J.C. Penney Corp., Inc., Indenture (Form 8K) § 6.11 (June 23, 2016), https://www.sec.gov/Archives/edgar/data/1166126/000119312516630643/d217423dex41.htm [https://perma.cc/C9YX-FMHU]; Citigroup Inc., Indenture (Form 8K) § 6.08 (2013), https://www.sec.gov/Archives/edgar/data/831001/000119312513439891/d621350dex48.htm [https://perma.cc/C57J-3PK8]; Cincinnati Bell Inc., Indenture (Form 8K) § 6.11 (Sept. 22, 2016), https://www.sec.gov/Archives/edgar/data/716133/000095015716002192/ex4-1.htm [https://perma.cc/PN3Z-U7N5]; Novelis Corp., Indenture (Form 8K) § 6.11 (Sept. 14, 2016), https://www.sec.gov/Archives/edgar/data/1304280/000130428016000103/nvl-8xkexh41x2026indenture.htm [https://perma.cc/S3P9-A88Z]; Mizuho Financial Group, Inc., Senior Indenture (Form 8K) § 4.12 (Sept. 13, 2016), https://www.sec.gov/Archives/edgar/data/1335730/000119312516708087/d257540dex41.htm [https://perma.cc/K4NU-PFHM]; Nu Skin Enterprises, Inc., Indenture (Form 8K) § 6.11 (June 16, 2016), https://www.sec.gov/Archives/edgar/data/1021561/000102156116000161/ex4-1.htm [https://perma.cc/KZN8-7NZH]; and BMW Vehicle Owner Trust, Indenture

midstream corporate bylaw amendments, the fee-shifting provisions in indentures are agreed upon at the time of the bond issuance. Hence, it is more likely that the provision will be done on an arm's-length basis and be reflected in the price of the bond. This is more akin to having a fee-shifting provision in an IPO (initial public offering) 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.[92]

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, who needs to pay "due regard to the merits and good faith of the claims or defenses" made by the party.[93] Hence, the Act allows for a second possibility for

(Form 8K) § 5.13 (July 20, 2016), https://www.sec.gov/Archives/edgar/data/1136586/000092963816001591/exhibit4-1.htm [https://perma.cc/H9NQ-MSQ7]. See also Revised Model Simplified Indenture § 6.09 (1999), *reprinted in* 55 Bus. Law. 1115, 1139 (2000) (adopting nearly identical language as the Trust Indenture Act § 315(e)); Eisenberg & Miller, supra note 14, at 373–74 (finding that 62.3% of bond indentures in the sample contained a fee-shifting clause and stating that "[t]he fee agreements we 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").

[92] See Revised Model Simplified Indenture §§ 9.01–9.02 (1999), *reprinted in* 55 Bus. Law. 1115, 1146 (2000). With respect to a publicly issued bond, there are three types of amendments: (1) an amendment to cure ambiguity, inconsistency, or defect, or that does not "adversely affect" the rights of the bondholders (§ 9.01); (2) an amendment to change the principal, interest, right to bring suit, or maturity (§ 9.02(1)–(3)); and (3) all others (§ 9.02). Id. To execute the second type of amendment, individual consent is required, whereas with respect to the first, the indenture trustee, together with the issuer, can amend the contract. The third category, in 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. Id.

[93] Trust Indenture Act of 1939 § 315(e), 15 U.S.C. § 77ooo(e). According to then–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 Sale of Securities: Hearing on S. 2344 Before the Subcomm. on Sec. & Exch. of the S. Comm. on Banking & Currency, 75th Cong. 103 (1937); see also supra note 87 (describing other similar statements during the Senate Hearings). The U.S. Supreme Court the fee-shifting provision: ex post judicial determination.[94] 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 shareholders' suits against the corporation or the directors and officers in Delaware, replicating the Trust Indenture Act model may be more beneficial for the shareholders and the corporations given that the Delaware courts have substantial expertise and knowledge in corporate law matters.

The second important aspect about the fee-shifting provision in the Trust Indenture Act (and bond indentures) is that the fee-shifting provision does not apply to (1) bondholders who own more than 10% of the outstanding principal or (2) bondholders who sue for enforcement of any of the payment provisions.[95] With respect to the latter, the ready analogy in the shareholder context is dividend or liquidation payments, particularly when such are stipulated either in the charter or the bylaws. With respect to the former, the 10% holder exception can be justified based on the reasoning that since a blockholder is more likely to internalize all the costs and benefits associated with a lawsuit, her decision to bring a suit against the indenture trustee is more likely to be optimal and less likely to be frivolous.[96] This exception is not applicable to arm's-length commercial contracts but can be readily applied to the

has determined that the plaintiff (usually the bondholders) can also get reimbursed for the expenses from the defendant (usually the issuer). See Christiansburg Garment Co. v. EEOC, 434 U.S. 412, 416–17, 416 n.7 (1978).

[94] See Eisenberg & Miller, supra note 14, at 351–52 (showing that 4.3% of 2,347 commercial contracts contained symmetric fee-shifting with judicial discretion).

[95] 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 of 1939 § 316(b), 15 U.S.C. § 77ppp(b). TIA § 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 §§ 6.07, 6.09 (1999), *reprinted in* 55 Bus. Law. 1115, 1138–39 (2000) (adopting nearly the identical language as Trust Indenture Act §§ 316(b) and 315(e), respectively).

[96] See supra note 84 (explaining why the 10% bondholder exception will almost always apply when bondholders want to bring a suit against the corporation).

context of shareholder lawsuits. In sum, bond indentures offer another module for fee-shifting provisions, which rely more on ex post judicial determination and exclude the provision from applying to a large blockholder.

IV. IMPLICATIONS FOR FEE-SHIFTING IN SHAREHOLDER LITIGATION

While fee-shifting provisions are widely used in commercial contracts, there are variations in terms of both the incidence of adoption and the types of fee-shifting provisions used. Foremost, some sophisticated commercial entities do not use fee-shifting provisions in their contracts, possibly because they believe, at the time of contract formation, that a fee-shifting provision does not necessarily maximize their joint surplus.[97] Furthermore, the provisions that are used in commercial contracts often differ. The differences in the provisions that are used in stock purchase agreements versus bond indentures, as shown above, serve as useful examples.[98] Both of these points support the argument that the optimal fee-shifting provision (including whether to have one) should vary from transaction to transaction or from corporation to corporation.[99] This 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, 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 unduly restricting the shareholders' right to bring suit,[100] some restriction on that

[97] Perhaps this is due to the concern about expending (many) more resources at trial or about (substantially) reducing the chances of settlement when there is a dispute. See supra Section II.D.

[98] See supra Part III.

[99] See Eisenberg & Miller, supra note 14, at 352 (showing that within the sample, about 40% of contracts adopt the more traditional English fee-shifting rule, about 40% use the American fee-shifting rule, and about 20% use a modified fee-shifting rule).

[100] 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 11; see also Albert Choi & George Triantis, The Effect of Bargaining Power on Contract Design, 98 Va. L. Rev. 1665, 1708 (2012) (analyzing how even sophisticated commercial entities can enter into an inefficient, one-sided contract when one party has superior bargaining power against the other).

contractual freedom would be necessary.[101] We can achieve this goal through two distinct mechanisms: one that relies on express shareholder approval and the other, on a judicial check. This Part compares these two mechanisms and ultimately argues that, given all the problems associated with the shareholder approval process, ex post judicial scrutiny would be more desirable in achieving the tradeoff.

A. Shareholder Intervention or Approval Mechanism

If the directors want to adopt a fee-shifting provision in the charter, the corporate statute requires them to submit such a proposal and to receive shareholders' approval.[102] A shareholder approval mechanism is already in place for charter amendments. We can imagine a similar approach with respect to bylaws. While allowing the directors to amend the bylaws to adopt a fee-shifting provision, we can empower the shareholders to have the ultimate say. This can work through two possible avenues. First, under Delaware law, if shareholders are dissatisfied with any bylaw adopted by the directors, they can repeal that bylaw by passing their own bylaw amendment resolution. Under Delaware law, even when the right to amend the bylaws has been granted to the directors, shareholders still preserve the right to "adopt, amend, or repeal bylaws."[103] Given that the shareholders already have this power, reliance on this mechanism will not require any change in the statutes or case law. Second, a more aggressive mechanism might require the directors to submit their fee-shifting bylaw amendment to the shareholders for approval, similar to the requirements for a charter amendment. Generally, once the directors have the right to amend bylaws, the board's amendment of the bylaws does not require shareholder approval, with exceptions for bylaw amendments which stagger the board or change the voting threshold for director elections.[104]

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[101] See supra note 8 (describing how contract law imposes limitations on one's right to unilaterally amend a contract).

[102] See Del. Code Ann. tit. 8, § 242 (Supp. 2016).

[103] See id. § 109(a) (stating that "[t]he fact that such [amendment] power has been so conferred upon the directors . . . shall not divest the stockholders . . . nor limit their power to adopt, amend or repeal bylaws").

[104] See id. § 141(d) (stating that the board can be staggered "by the certificate of incorporation or by an initial bylaw, or by a bylaw adopted by a vote of the stockholders"); id. § 216 (stating that "[a] bylaw amendment adopted by stockholders which specifies the

Hence, deploying this mechanism would be tantamount to putting the fee-shifting bylaw on par with staggered board or director election bylaws. Both mechanisms grant an express voice to the shareholders, either before or after the bylaw has been adopted, so that they can either undo or prevent an undesirable fee-shifting bylaw.

While, in theory, empowering shareholders through a voting mechanism functions as a check on directors' power, it suffers from two problems. First, under either mechanism, having to convene a shareholder meeting (or attempt to act through written consent) and to subject either a shareholder-initiated repeal proposal or board-proposed bylaw to shareholder vote is cumbersome and costly. Relying on a shareholder voting mechanism also entails collective action, misinformation, and rational apathy problems.[105] After all, if the Delaware legislature had sufficient faith in the shareholder voting process, it presumably did not have to amend the statute to prohibit fee-shifting even in charters. Amending the charter requires shareholder approval, and the shareholders simply could reject the directors' charter amendment proposal to include a fee-shifting provision. Nevertheless, the new DGCL § 102(f) disallows a fee-shifting provision from being included in the charter.[106] The second problem is that when ownership is concentrated, the mechanism may confer too much power to a controlling shareholder, who may abuse the process to the detriment of the minority shareholders. It is not inconceivable that a controlling shareholder could make the corporation adopt a fee-shifting bylaw, so as to make it prohibitively costly for the minority shareholders to bring suit

votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors").

[105] See supra note 33. Shareholder voting is not the only context in which the misinformation and collective action problems can arise. Particularly in a takeover context, Delaware courts have been willing to allow the target corporation's board to adopt defensive or other strategic measures based on the theory that the target shareholders could have been "mistaken" about the fundamental value of the corporation or the strategic benefit being offered. The notion that an acquirer can make a "substantively coercive" offer and that shareholders can "mistakenly" tender their shares is consistent with this theory. See, e.g., Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1384 (Del. 1995); Paramount Commc'ns v. Time Inc., 571 A.2d 1140, 1153 (Del. 1989); Air Prods. & Chems. v. Airgas, Inc., 16 A.3d 48, 108 (Del. Ch. 2011); Mercier v. Inter-Tel, Inc., 929 A.2d 786, 821 (Del. Ch. 2007).

[106] Del. Code Ann. tit. 8, § 102(f) (stating that "[t]he 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").

against the controlling shareholder.[107] In short, subjecting a fee-shifting bylaw to shareholder approval may provide too little protection when the ownership is dispersed or give power to the wrong party when the ownership is concentrated.[108]

B. Judicial Monitoring of Fee-Shifting Provisions

In addition to the procedural requirements, bylaw and charter amendments are also subject to ex post judicial review in Delaware.[109] Especially with respect to bylaw amendments, bylaws must not conflict with the certificate of incorporation, the law, or public policy.[110] More importantly, bylaw amendments must 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.[111] One

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[107] See infra note 111 (listing cases of controlling shareholders imposing bylaw amendments that undermine the rights of the minority shareholders).

[108] As previously mentioned, two influential proxy advisory firms, Glass Lewis and Institutional Shareholder Services, have spoken against fee-shifting provisions, especially when adopted through bylaws without shareholder approval, and instead recommend for institutional shareholders to vote against directors who adopt fee-shifting bylaws without shareholder approval. See supra note 32. This Article argues that the proxy advisory firms' recommendations should take into consideration the screening benefits of fee-shifting rules, and when the provision is symmetric and narrow, the adopting directors should be supported.

[109] See Choi & Min, supra note 8, at 2, 8, 15 (discussing judicial oversight on charter and bylaw amendments and how courts have become more lenient in allowing amendments, especially unilateral bylaw amendments, under the theory that the charter and bylaws constitute a "contract" between shareholders and the corporation and also among shareholders).

[110] See, e.g., Airgas, Inc. v. Air Prods. & Chems., 8 A.3d 1182, 1194–95 (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 reelection); CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 234–36, 240 (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)). In addition, bylaws may be examined under the *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949 (Del. 1985), standard if adopted in response to a hostile threat, or the *Blasius Industries v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988), standard if they affect the shareholder franchise.

[111] The relevant cases include *Frantz Manufacturing Co. v. EAC Industries*, 501 A.2d 401, 402–03 (Del. 1985) (finding majority stockholders' bylaw amendment restricting the board's freedom to adopt anti-takeover devices done for equitable purposes); *Schnell v. Chris-Craft Industries*, 285 A.2d 437, 438–39 (Del. 1971) (finding directors' bylaw amendment that changed the date of the shareholder meeting done with improper purpose); and *Hollinger*

possibility for allowing sufficient freedom to the directors and the shareholders while limiting abuse is for the courts to apply the "proper" or "equitable" purpose and effect standard more vigorously to fee-shifting provisions and, in the process, become more vigilant in making sure that the shareholders' right to bring suit is not unduly or improperly restricted.[112] The *ATP Tour* court, for comparison, reasoned that deterring shareholder litigation—without distinguishing between meritorious versus frivolous claims—constituted a "proper" and "equitable" purpose.[113] Unlike the mechanisms that rely on shareholder intervention or approval, judicial monitoring based on the "proper" or "equitable" purpose test is not subject to collective action or rational apathy problems and can also provide an effective check against controlling shareholder abuse against the minority shareholders.

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 Parts II and III, the court could determine that a fee-shifting provision, which is asymmetric and imposes expenses on shareholders on a broad

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International v. Black, 844 A.2d 1022, 1080–81 (Del. Ch. 2004) (finding controlling shareholder's bylaw amendment requiring unanimity on board action dealing with significant matters improper). Some of these cases are cited by the *ATP Tour* court. See 91 A.3d at 558–59. There is also a small number of (relatively older) cases that require bylaws to be "reasonable." See, e.g., In re Osteopathic Hosp. Ass'n of Del., 195 A.2d 759, 764–65 (Del. 1963) (invalidating a bylaw that gave voting rights to 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 does not seem materially different from the "proper" and "equitable" requirement.

[112] See Choi & Min, supra note 8, at 18–19 (discussing how, even under contract law, courts apply protective standards, such as the implied duty of good faith and fair dealing, to protect counterparties from opportunistic behavior that can arise in the context of contract amendment); see also Lebovitch & Kwawegen, supra note 26, at 515–18 (providing a general, noneconomic argument about how the *ATP Tour* fee-shifting rule discourages meritorious suits). The recommendation also goes to the proxy advisory firms. Rather than categorically recommending against fee-shifting bylaws (or opposing directors in their elections who adopted them), Glass Lewis and Institutional Shareholder Services can take a more balanced approach, as advocated in this Article. See supra note 32 (describing the recent position taken by those proxy advisory firms).

[113] See supra note 21 and accompanying text. Another possibility is to impose some procedural (process-based) restrictions on bylaw 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 8.

range of outcomes (as with the *ATP Tour* Rule), is done for the "improper" or "inequitable" purpose of denying shareholders' right to bring even meritorious claims. When challenged, the court can strike down such a provision for failing the "proper" and "equitable" purpose test. By contrast, a more symmetric fee-shifting provision (as in the stock purchase agreements or the bond indentures) can be deemed to stem from the "proper" or the "equitable" purpose of screening meritorious claims from nonmeritorious ones. The court could also consider various case-specific characteristics—such as whether the defendant is spending many more resources on litigation than the plaintiff (cost asymmetry), whether the plaintiff is at a significant informational advantage at the beginning of the litigation (information asymmetry), whether the amount spent is "reasonable" or what portion of the expenses constitutes a "reasonable" expense, or whether the lawsuit is being brought by a shareholder with a large ownership interest (similar to the exception contained in the Trust Indenture Act § 315(e))—in adjusting and applying a symmetric fee-shifting provision. Finally, given that the default is no fee-shifting, if the directors or the shareholders wanted to adopt a fee-shifting provision, they would first have to go through the bylaw or charter amendment process, so the flexibility of whether to adopt a fee-shifting provision is also preserved. Such judicious application of the "proper" and "equitable" purpose test can better preserve and promote "the efficacy of the enforcement of fiduciary duties in stock corporations."[114]

CONCLUSION

Fee-shifting provisions on shareholder litigation have had a tumultuous history in Delaware. Once a subject matter that received

[114] Del. S., Synopsis S. 148-75, at 15 (2015). The *ATP Tour* court remarked that "[t]he intent to deter litigation . . . is not invariably an improper purpose," suggesting that deterring litigation across the board could constitute a proper purpose. 91 A.3d at 560. This Article 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 lawsuits from deterring meritorious lawsuits. While the more vigorous application of the "proper" purpose and effect test will likely apply more to directors' amending of the bylaws, in theory, it can also check the abuse of blockholders (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), which grants broad power to the board of directors in managing the business and affairs of corporations incorporated in Delaware). See, e.g., *Hollinger*, 844 A.2d at 1028–30.

little attention from scholars and practitioners, it acquired a national spotlight when the Delaware Supreme Court validated a fee-shifting bylaw provision in 2014. The ruling came as a surprise partly because the provision in question seemed one-sided and was adopted unilaterally by the directors. A number of companies immediately responded by adopting their own versions putatively in response to the dramatic rise in deal-related litigation. Only a year later, the Delaware legislature reversed course by prohibiting fee-shifting provisions altogether, in charters and bylaws, for for-profit corporations. The purpose of this Article is to provide a more even-handed analysis of fee-shifting mechanisms in shareholder litigation. The Article shows why the responses by both the corporations that adopted the provisions prior to the legislative amendment and the Delaware legislature may not be optimal. The analysis has followed two tracks: (1) a theoretical analysis of costs and benefits of fee-shifting provisions and (2) an empirical discovery of how sophisticated commercial contracts often utilize fee-shifting provisions. The Article 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, courts could become more vigilant against one-sided fee-shifting provisions. Especially with respect to bylaw amendments, courts could utilize the "proper purpose" test. While the focus of the Article is on fee-shifting bylaws, the analysis also sheds light more generally on issues of corporate governance and courts' application of the contractarian principle in interpreting charters and bylaws.

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