SPONSOR:

[HOUSE OF REPRESENTATIVES/DELAWARE STATE SENATE]
148th GENERAL ASSEMBLY

[HOUSE/SENATE] BILL NO. ___

AN ACT TO AMEND TITLE 8 OF THE DELAWARE CODE RELATING TO THE GENERAL CORPORATION LAW.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF DELAWARE (Two-thirds of all members elected to each house thereof concurring therein):

Section 1. Amend § 102(a)(1), Title 8 of the Delaware Code, by making insertions as shown by underline and deletions as shown by strike through as follows:

§ 102 Contents of certificate of incorporation.

(a) The certificate of incorporation shall set forth:

(1) The name of the corporation, which (i) shall contain 1 of the words "association," "company," "corporation," "club," "foundation," "fund," "incorporated," "institute," "society," "union," "syndicate," or "limited," (or abbreviations thereof, with or without punctuation), or words (or abbreviations thereof, with or without punctuation) of like import of foreign countries or jurisdictions (provided they are written in roman characters or letters); provided, however, that the Division of Corporations in the Department of State may waive such requirement (unless it determines that such name is, or might otherwise appear to be, that of a natural person) if such corporation executes, acknowledges and files with the Secretary of State in accordance with § 103 of this title a certificate stating that its total assets, as defined in § 503(i) of this title, are not less than $10,000,000, or, in the sole discretion of the Division of Corporations in the Department of State, if the corporation is both a nonprofit nonstock corporation and an association of professionals, (ii) shall be such as to distinguish it upon the records in the office of the Division of Corporations in the Department of State from the names that are reserved on such records and from the names on such records of each other corporation, partnership, limited partnership, limited liability company or statutory trust organized or registered as a domestic or foreign corporation, partnership, limited partnership, limited liability company or statutory trust under the laws of this State, except with the written consent of the person who has reserved such name or such other foreign corporation or domestic or foreign partnership, limited partnership, limited liability company or statutory trust, executed, acknowledged and filed with the Secretary of State in accordance with § 103 of this title, or except that, without prejudicing any rights of the person who has reserved

such name or such other foreign corporation or domestic or foreign partnership, limited partnership, limited liability company or statutory trust, the Division of Corporations in the Department of State may waive such requirement if the corporation demonstrates to the satisfaction of the Secretary of State that the corporation or a predecessor entity previously has made substantial use of such name or a substantially similar name, that the corporation has made reasonable efforts to secure such written consent, and that such waiver is in the interest of the State, (iii) except as permitted by § 395 of this title, shall not contain the word "trust," and (iv) shall not contain the word "bank," or any variation thereof, except for the name of a bank reporting to and under the supervision of the State Bank Commissioner of this State or a subsidiary of a bank or savings association (as those terms are defined in the Federal Deposit Insurance Act, as amended, at 12 U.S.C. § 1813), or a corporation regulated under the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1841 et seq., or the Home Owners' Loan Act, as amended, 12 U.S.C. § 1461 et seq.; provided, however, that this section shall not be construed to prevent the use of the word "bank," or any variation thereof, in a context clearly not purporting to refer to a banking business or otherwise likely to mislead the public about the nature of the business of the corporation or to lead to a pattern and practice of abuse that might cause harm to the interests of the public or the State as determined by the Division of Corporations in the Department of State;

Section 2. Amend § 102, Title 8 of the Delaware Code, by adding a new section, § 102(f), shown by underline as follows:

(f) The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an intracorporate claim, as defined in § 115 of this title.

Section 3. Amend § 109(b), Title 8 of the Delaware Code, by making insertions as shown by underline as follows:

(b) The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees. 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 intracorporate claim, as defined in § 115 of this title.

Section 4. Amend § 114(b), Title 8 of the Delaware Code, by making insertions as shown by underline as follows:

(b) Subsection (a) of this section shall not apply to:

(1) Sections 102(a)(4), (b)(1) and (2), 109(a), 114, 141, 154, 215, 228, 230(b), 241, 242, 253, 254, 255, 256, 257, 258, 271, 276, 311, 312, 313, 390, and 503 of this title, which apply to nonstock corporations by their terms;

(2) Sections 102(f), 109(b) (last sentence), 151, 152, 153, 155, 156, 157(d), 158, 161, 162, 163, 164, 165, 166, 167, 168, 203, 204, 205, 211, 212, 213, 214, 216, 219, 222, 231, 243, 244, 251, 252, 267, 274, 275, 324, 364, 366(a), 391 and 502(a)(5) of this title; and

(3) Subchapter XIV and subchapter XVI of this chapter.

Section 5. Amend Title 8 of the Delaware Code by adding a new section, § 115, shown by underline as follows:

§ 115. Forum selection provisions.

The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all intracorporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State. "Intracorporate claims" means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.

Section 6. Amend § 245(c), Title 8 of the Delaware Code, by making insertions as shown by underline as follows:

(c) A restated certificate of incorporation shall be specifically designated as such in its heading. It shall state, either in its heading or in an introductory paragraph, the corporation's present name, and, if it has been changed, the name under which it was originally incorporated, and the date of filing of its original certificate of incorporation with the Secretary of State. A restated certificate shall also state that it was duly adopted in accordance with this section. If it was adopted by the board of directors without a vote of the stockholders (unless it was adopted pursuant to § 241 of this title or without a vote of members pursuant to § 242(b)(3) of this title), it shall state that it only restates and integrates and does not further amend (except, if applicable, as permitted under § 242(a)(1) and §

242(b)(1) of this title) the provisions of the corporation's certificate of incorporation as theretofore amended or supplemented, and that there is no discrepancy between those provisions and the provisions of the restated certificate. A restated certificate of incorporation may omit (a) such provisions of the original certificate of incorporation which named the incorporator or incorporators, the initial board of directors and the original subscribers for shares, and (b) such provisions contained in any amendment to the certificate of incorporation as were necessary to effect a change, exchange, reclassification, subdivision, combination or cancellation of stock, if such change, exchange, reclassification, subdivision, combination or cancellation has become effective. Any such omissions shall not be deemed a further amendment.

Section 7. Amend § 363(a), Title 8 of the Delaware Code, by making insertions as shown by underline and deletions as shown by strike through as follows:

§ 363 Certain amendments and mergers; votes required; appraisal rights.

(a) Notwithstanding any other provisions of this chapter, a corporation that is not a public benefit corporation, may not, without the approval of ~~90%~~2/3 of the outstanding ~~shares of each class of the~~ stock of the corporation ~~of which there are outstanding shares, whether voting or nonvoting~~entitled to vote thereon:

(1) Amend its certificate of incorporation to include a provision authorized by § 362(a)(1) of this title; or

(2) Merge or consolidate with or into another entity if, as a result of such merger or consolidation, the shares in such corporation would become, or be converted into or exchanged for the right to receive, shares or other equity interests in a domestic or foreign public benefit corporation or similar entity.

The restrictions of this section shall not apply prior to the time that the corporation has received payment for any of its capital stock, or in the case of a nonstock corporation, prior to the time that it has members.

Section 8. Amend § 363(c), Title 8 of the Delaware Code, by making insertions as shown by underline and deletions as shown by strike through as follows:

(c) Notwithstanding any other provisions of this chapter, a corporation that is a public benefit corporation may not, without the approval of 2/3 of the outstanding ~~shares of each class of the~~ stock of the corporation ~~of which there are outstanding shares, whether voting or nonvoting~~entitled to vote thereon:

(1) Amend its certificate of incorporation to delete or amend a provision authorized by § 362(a)(1) or § 366(c) of this title; or

(2) Merge or consolidate with or into another entity if, as a result of such merger or consolidation, the shares in such corporation would become, or be converted into or exchanged for the right to receive, shares or other equity interests in a domestic or foreign corporation that is not a public benefit corporation or similar entity and the certificate of incorporation (or similar governing instrument) of which does not contain the identical provisions identifying the public benefit or public benefits pursuant to § 362(a) of this title or imposing requirements pursuant to § 366(c) of this title.

Section 9. Amend § 391(c), Title 8 of the Delaware Code, by making insertions as shown by underline and deletions as shown by strike through as follows:

(c) The Secretary of State may issue photocopies or electronic image copies of instruments on file, as well as instruments, documents and other papers not on file, and for all such photocopies or electronic image copies which are not certified by the Secretary of State, a fee of $10 shall be paid for the first page and $2.00 for each additional page. ~~The Secretary of State may also issue microfiche copies of instruments on file as well as instruments, documents and other papers not on file, and for each such microfiche a fee of $2.00 shall be paid therefor.~~ Notwithstanding Delaware's Freedom of Information Act [Chapter 100 of Title 29] or any other provision of law granting access to public records, the Secretary of State upon request shall issue only photocopies~~, microfiche~~ or electronic image copies of public records in exchange for the fees described ~~above~~in this section, and in no case shall the Secretary of State be required to provide copies (or access to copies) of such public records (including without limitation bulk data, digital copies of instruments, documents and other papers, databases or other information) in an electronic medium or in any form other than photocopies or electronic image copies of such public records in exchange, as applicable, for the fees described in this section or § 2318 of Title 29 for each such record associated with a file number.

Section 10. Sections 1through 8 shall be effective on August 1, 2015. Section 9 shall be effective upon its enactment into law.

Ssynopsis

Section 1. Section 1 amends Section 102(a)(1) to enable the Division of Corporations in the Department of State to waive the requirement under Section 102(a)(1)(ii) in certain limited circumstances.

Section 2. In *ATP Tours, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), the Delaware Supreme Court upheld as facially valid a bylaw imposing liability for certain legal fees of the nonstock corporation on certain members who participated in the litigation. In combination with the amendments to Sections 109(b) and 114(b)(2), new subsection (f) does not disturb that ruling in relation to nonstock corporations. In order to preserve the efficacy of the enforcement of fiduciary duties in stock corporations, however, new subsection (f) would invalidate a provision in the certificate of incorporation of a stock corporation that purports to impose liability upon a

stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an intracorporate claim, as defined in new Section 115. New subsection (f) is not intended, however, to prevent the application of such provisions pursuant to a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced.

Section 3. Like the concurrent amendment to Section 102, the new last sentence of subsection (b) would invalidate a provision in the bylaws of a stock corporation that purports to impose liability upon a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an intracorporate claim, as defined in new Section 115. The new last sentence of subsection (b) is not intended, however, to prevent the application of any provision in a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced.

Section 4. The amendment to Section 114 has the effect of avoiding the application to nonstock corporations of new Section 102(f) and the new last sentence of Section 109(b).

Section 5. New Section 115 confirms, as held in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation*, 73 A.2d 934 (Del. Ch. 2013), that the certificate of incorporation and bylaws of the corporation may effectively specify, consistent with applicable jurisdictional requirements, that claims arising under the DGCL, including claims of breach of fiduciary duty by current or former directors or officers or controlling stockholders of the corporation, or persons who aid and abet such a breach, must be brought only in the courts (including the federal court) in this State. Section 115 does not address the validity of a provision of the certificate of incorporation or bylaws that selects a forum other than the Delaware courts as an additional forum in which intracorporate claims may be brought, but it invalidates such a provision selecting the courts in a different State, or an arbitral forum, if it would preclude litigating such claims in the Delaware courts. Section 115 is not intended, however, to prevent the application of any such provision in a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced. Section 115 is not intended to foreclose evaluation of whether the specific terms and manner of adoption of a particular provision authorized by Section 115 comport with any relevant fiduciary obligation or operate reasonably in the circumstances presented. For example, such a provision may not be enforceable if the Delaware courts lack jurisdiction over indispensable parties or core elements of the subject matter of the litigation. Section 115 is also not intended to authorize a provision that purports to foreclose suit in a federal court based on federal jurisdiction, nor is Section 115 intended to limit or expand the jurisdiction of the Court of Chancery or the Superior Court.

Section 6. The amendment to Section 245(c) clarifies that a restated certificate is not required to state that it does not further amend the provisions of the corporation's certificate of incorporation if the only amendment thereto is to change the corporation's name without a vote of the stockholders.

Section 7. Section 7 amends Section 363(a) to change the approval required under that Section.

Section 8. Section 8 amends Section 363(c) to change the approval required under that Section.

Section 9. Section 9 amends Section 391(c) to confirm that in exchange for the fees described the Secretary of State may issue public records in the form of photocopies or electronic image copies and need not provide public records in any other form.

Section 10. Section 10 provides that the effective date of Sections 1 through 8 is August 1, 2015, and that Section 9 shall be effective upon its enactment into law.

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SPONSOR:

[HOUSE OF REPRESENTATIVES/DELAWARE STATE SENATE]
148th GENERAL ASSEMBLY

[HOUSE/SENATE] BILL NO. ___

AN ACT TO AMEND TITLE 8 OF THE DELAWARE CODE RELATING TO THE GENERAL CORPORATION LAW.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF DELAWARE (Two-thirds of all members elected to each house thereof concurring therein):

Section 1. Amend § 262(c), Title 8 of the Delaware Code, by making insertions as shown by underline and deletions as shown by strike through as follows:

(c) Any corporation may provide in its certificate of incorporation that appraisal rights under this section shall be available for the shares of any class or series of its stock as a result of an amendment to its certificate of incorporation, any merger or consolidation in which the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation. If the certificate of incorporation contains such a provision, the ~~procedures~~ provisions of this section, including those set forth in subsections (d), ~~and~~ (e), and (g) of this section, shall apply as nearly as is practicable.

Section 2. Amend § 262(g), Title 8 of the Delaware Code, by making insertions as shown by underline and deletions as shown by strike through as follows:

(g) At the hearing on such petition, the Court shall determine the stockholders who have complied with this section and who have become entitled to appraisal rights. The Court may require the stockholders who have demanded an appraisal for their shares and who hold stock represented by certificates to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder. If immediately before the merger or consolidation the shares of the class or series of stock of the constituent corporation as to which appraisal rights are available were listed on a national securities exchange, the Court shall dismiss the proceedings as to all holders of such shares who are otherwise entitled to appraisal rights unless (1) the total number of shares entitled to appraisal exceeds 1% of the outstanding shares of the class or series entitled to appraisal, (2) the value of the consideration provided in the merger or consolidation for such total number of shares exceeds $1 million, or (3) the merger was approved pursuant to § 253 or § 267 of this title.

Section 3. Amend § 262(h), Title 8 of the Delaware Code, by making insertions as shown by underline and deletions as shown by strike through as follows:

(h) After the Court determines the stockholders entitled to an appraisal, the appraisal proceeding shall be conducted in accordance with the rules of the Court of Chancery, including any rules specifically governing appraisal proceedings. Through such proceeding the Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors. Unless the Court in its discretion determines otherwise for good cause shown, and except as provided in this subsection, interest from the effective date of the merger through the date of payment of the judgment shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the merger and the date of payment of the judgment. At any time before the entry of judgment in the proceedings, the surviving corporation may pay to each stockholder entitled to appraisal an amount in cash, in which case interest shall accrue thereafter as provided herein only upon the difference, if any, between the amount so paid and the fair value of the shares as determined by the Court. Upon application by the surviving or resulting corporation or by any stockholder entitled to participate in the appraisal proceeding, the Court may, in its discretion, proceed to trial upon the appraisal prior to the final determination of the stockholders entitled to an appraisal. Any stockholder whose name appears on the list filed by the surviving or resulting corporation pursuant to subsection (f) of this section and who has submitted such stockholder's certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until it is finally determined that such stockholder is not entitled to appraisal rights under this section.

Section 4. Sections 1through 3 shall be effective only with respect to transactions consummated pursuant to agreements entered into on or after August 1, 2015 (or, in the case of mergers pursuant to Section 253, resolutions of the board of directors adopted on or after August 1, 2015 or, in the case of mergers pursuant to Section 267, authorizations provided on or after August 1, 2015 in accordance with an entity's (as defined in Section 267) governing documents (as defined in Section 267) and the laws of the jurisdiction under which such entity is formed or organized), and appraisal proceedings arising out of such transactions.

Ssynopsis

Section 1. The amendment to Section 262(c) is intended to clarify that where a provision of the certificate of incorporation confers appraisal rights where those rights otherwise do not exist, an appraisal proceeding must be dismissed under the new provisions of subsection (g) of Section 262, if applicable.

Section 2. The amendment to Section 262(g) limits the availability of a judicial determination and award of fair value where the corporation's shares had been traded on a national securities exchange. In that circumstance appraisal rights are essentially precluded unless the dispute with regard to valuation is substantial and involves little risk that the petition for appraisal will be used to achieve a settlement because of the nuisance value of discovery and other burdens of litigation. In a short-form merger under Section 253 or Section 267, however, there is no requirement of approval by the corporation's board of directors and therefore no obligation on the part of directors to approve and recommend the merger, and appraisal may be the only remedy. Accordingly, the limitation in new subsection (g) also is not applicable to mergers accomplished pursuant to Section 253 or Section 267.

Section 3. The amendment to Section 262(h) provides an option to the surviving corporation to pay to the stockholders seeking appraisal a sum of money, the amount of which is to be determined in the sole discretion of the surviving corporation, at any time before judgment is entered in the appraisal proceeding, with the result of avoiding the need to pay subsequently accruing interest on that sum. There is no requirement or inference that the amount so paid by the surviving corporation is equal to, greater than, or less than the fair value of the shares to be appraised. Where one or more stockholders' entitlement to appraisal is contested in good faith, the corporation may elect to pay such amount only to those stockholders whose entitlement to appraisal is uncontested.

Section 4. Section 4 provides that these amendments shall be effective only with respect to transactions consummated pursuant to agreements entered into on or after August 1, 2015 (or, in the case of mergers pursuant to Section 253, resolutions of the board of directors adopted on or after August 1, 2015 or, in the case of mergers pursuant to Section 267, authorizations provided on or after August 1, 2015 in accordance with an entity's (as defined in Section 267) governing documents (as defined in Section 267) and the laws of the jurisdiction under which such entity is formed or organized), and appraisal proceedings arising out of such transactions.

EXPLANATION OF COUNCIL LEGISLATIVE PROPOSAL

The proposed legislation arises from the Delaware Supreme Court's May 8, 2014 decision in *ATP Tour Inc. v. Deutscher Tennis Bund, et al.*, 91 A.3d 554 (Del. 2014) ("*ATP*"). This memo describes the *ATP* decision, the opportunity that some perceive that it presents, some concerns the decision raises, and the proposed legislation's efforts to establish balanced corporate policy in light of these issues.

The ATP Decision

ATP is a Delaware nonstock membership corporation that operates the professional men's tennis tour internationally. German and Qatari ATP members brought suit in federal court. Their primary allegation was that decisions by ATP's board to downgrade and change the timing of certain tournaments violated federal antitrust laws. The plaintiffs, who had individually "agreed to be bound by ATP's Bylaws, as amended from time to time" when they became members of ATP, were not successful. ATP had a bylaw that provided in essence that if any member brought a lawsuit that did not substantially achieve "the full remedy sought," then the plaintiffs would be obligated to reimburse ATP for attorneys' fees and expenses incurred in the lawsuit. Based on that bylaw, ATP asked the federal court to order the plaintiffs to reimburse its attorneys' fees. The federal court asked the Delaware Supreme Court to answer four legal questions relevant to the decision on the fee application. In response, the Delaware Supreme Court opined that fee shifting bylaws are permissible under Delaware law, but their enforcement is subject to equitable review. The Supreme Court based its opinion on statutory interpretation, not an endorsement of fee shifting as a matter of corporate law policy.

Although there had been concern about the volume of stockholder litigation involving public companies, corporate practitioners and commentators had not proposed fee shifting bylaws or charter provisions as a remedy. In fact, in 1999, when a stockholder proposal sought a vote to adopt a fee-shifting bylaw in a publicly traded corporation, a leading law firm opined to the SEC that such a bylaw would contravene applicable law

and policy.[1] Almost immediately after *ATP*, however, it was widely suggested that stock corporations (rather than a nonstock corporation as involved in *ATP*) consider adopting such provisions. For example, in a letter to the General Assembly, the Chamber of Commerce identified fee-shifting provisions as a "new tool" that *ATP* provided for public companies.

The Benefit Some Commentators Perceive In Fee-Shifting Provisions For Public Companies

Under Delaware law, directors manage the business and affairs of the corporation, subject to the constraints of statutory law and fiduciary duty. Stockholders' rights are limited but include the right to bring suit individually, as a group (a class action), or on behalf of the corporation (known as a derivative action), if directors are not honoring their legal or fiduciary obligations. Even though corporate managers seldom, if ever, believe that their conduct warrants legal action, class and derivative actions are widely recognized as important protections for stockholders, and critical to reducing investment risk and the cost of capital. See, e.g., *Agostino v. Hicks*, 845 A.2d 1110, 1116, (Del. Ch. 2004) (enforcement of fiduciary duties is important because "directors and officers of a corporation may not hold themselves accountable to the corporation for their own wrongdoing.").

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[1] 3Com Corp. No-Action Letter, 1999 SEC No-Act. LEXIS 595. The provision would have "require[d] any stockholder wishing to bring an action against 3Com or any 3Com officer to enter into an agreement reasonably satisfactory to 3Com providing that the losing party in the action pay the prevailing party's attorneys' fees and expenses incurred in the action." Asserting that this provision "violates general principles of contract law" and "violates public policy," counsel for the corporation argued:

> Bylaws are fundamentally different from an agreement negotiated among contracting parties in that a majority of a company's stockholders can amend the Bylaws without the consent of the other "contracting parties" to the Bylaws. It is true that this kind of arrangement could be (and frequently is) negotiated by the parties to a contractual arrangement (as is generally the case, for instance, in a registration rights agreement), but only with the initial consent of all parties involved. This initial consent is seldom truly obtained in the Bylaw context, since Bylaws, while binding upon a company and all its stockholders, are not usually negotiated and formally approved by all parties involved. Instead, a stockholder is deemed to be a party to the "contract" merely by virtue of ownership of shares in the company, without the opportunity to negotiate any of the Bylaws' provisions. As a practical matter, all but the most sophisticated stockholders "signing" the Bylaw "contract" by buying 3Com stock will be unaware of the provision establishing the ability to amend the Bylaws without each stockholder's consent. This important difference suggests that, notwithstanding some courts' view of the ability of parties to a negotiated contract to enter into a fee-shifting arrangement in the securities litigation context, the absence of adequate notice and a requirement of individual consent should preclude enforceability of the arrangement where, as here, the "contract" involved is a company's Bylaws.

Some officers and directors and their advocates assert, on the other hand, that stockholder litigation causes corporations expense without producing commensurate benefits. They have therefore welcomed the "new tool" *ATP* allegedly provides, because, as that opinion recognized, "fee-shifting provisions by their nature deter litigation." Thus, those who believe that stockholder litigation is excessive and undesirable perceive *ATP*-type provisions in corporate charters and bylaws as a means to constrain or eliminate it. Since June, 2014, approximately 39 corporations, of which 30 are Delaware entities, have adopted bylaw or charter provisions that purport to shift counsel fees to less than fully successful stockholder litigants, and related provisions that purport to affect how stockholder claims are litigated.[2]

Fee-Shifting Provisions Will Make Stockholder Litigation, Even if Meritorious, Untenable.

Most litigation testing the propriety of conduct under either the DGCL or the common law of fiduciary duty is initiated by stockholders. The Council believes that absent legislation, many Delaware corporations will eventually adopt *ATP*-type provisions. The Council is not alone in this view: Professor John C. Coffee, Jr., who has often criticized stockholder litigation, has warned that the trend toward adopting fee-shifting provisions "is accelerating, and it resembles the first trickle of water through a leak in a dam. Soon the dam breaks, and a cascade descends upon those below. … This could quickly become part of the standard IPO game plan." Harvey Pitt, a former chairman of the Securities and Exchange Commission, has said that fee shifting provisions could become the "corporate equivalent of the California Gold Rush…."[3]

If such adoption became widespread, the effects on stockholder litigation would be severe. Every lawsuit is a risk; no one can confidently

[2] Allen, Claudia H., "Fee-Shifting Bylaws: Where Are We Now?," Bloomberg Corporate Law & Accountability Report (January 16, 2015)..

[3] Pitt, Harvey L., "Reducing Litigation Perils Fairly", Bank and Corporate Governance Law Reporter 30, (January, 2015) [hereinafter, "Pitt"].

predict the outcome at the start. Moreover, virtually no lawsuits of any type substantially achieve in substance and amount the full remedy sought as the *ATP* bylaw contemplates. If fee shifting on such a broad basis is possible, even successful litigations could result in plaintiffs having to reimburse opponents' attorneys' fees. Because the consequences of any corporate decision affect investors only commensurately with the scope of their investments, few stockholders will rationally be able to accept the risk of exposure to millions of dollars in attorneys' fees to attempt to rectify a perceived corporate wrong, no matter how egregious.

Nor is it clear that this is a problem that can be solved through the courts. The *in terrorem* effect of fee shifting bylaws is self-enforcing: to even challenge the bylaw itself, a stockholder must risk paying uncapped legal fees of the corporation. In fact, at least one stockholder plaintiff has sought to dismiss its claim in the wake of a corporation's adoption of a fee-shifting bylaw.

The Problems That Open-Ended Use Of Fee-Shifting Provisions Would Create

1. *Fee-shifting provisions will curtail the development of the common law of corporations*

Delaware corporation law is built on two pillars: the Delaware General Corporation Law ("DGCL"), and the law of fiduciary duty. Statutory law provides a broadly enabling structure in which corporations can operate, but it cannot foresee every issue that may arise in the ongoing operation of the thousands of corporations that are a wealth-creating engine of the American economy. It has been the genius of the Delaware corporate legal structure that the law of fiduciary duty, administered on a case-by-case basis by the Delaware Court of Chancery and the Delaware Supreme Court, has over time filled in the legal gaps inevitably arising between the DGCL and the activities of the many corporations that have made Delaware their legal home.

Fiduciary duty law arises from the basic proposition that investors place their trust and confidence in the officers and directors who manage the

corporation. Corporate managers are not guarantors of business success, but must fulfill two basic responsibilities: a duty of care, that is to be adequately informed about business decisions they must make, and to act thoughtfully and deliberately; and the duty of loyalty, which the Supreme Court more than 75 years ago expressed with the following words: "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest." *Guth v. Loft Inc.*, 5 A.2d 503, 510 (Del. 1939).

For more than a century, the primary contributor to Delaware's national and international leadership in corporate law has been the Delaware courts' thoughtful and nuanced application of these basic fiduciary principles to the ever-evolving business landscape. What Delaware has achieved is the most developed body of case law of fiduciary duty, to which courts in Delaware and many other states look for guidance to resolve business disputes.

Gap filling through judicial decisions is critical to corporate law. The DGCL does not even contemplate many tools that have become commonly used, such as poison pills, advance notice bylaws, or fiduciary outs in merger agreements. Yet each of these tools, and many other features of modern corporate life, is regulated by common law developed through stockholder litigation. While we do not all agree with the outcome of each case, few would argue that any negative consequences of the constraints imposed by this body of law outweigh the benefits to corporations and their stockholders. Indeed, we would argue that the careful balance that underlies this body of law is what has maintained Delaware as the preeminent choice for incorporation through financial crises, the takeover era of the 1980s and various movements towards federal incorporation.

2. The absence of stockholder litigation would eliminate the only extant regulation of substantive corporate law

In the United States, no government body regulates the relationship between stockholders and management. The federal government regulates disclosure and trading in securities, but not the relationship between directors and stockholders. Nor do the administrative branches of state governments generally regulate this relationship. Although this relationship involves trillions of dollars, disputes regarding it are essentially governed solely by the courts. While managements and boards generally act consistently with their statutory and fiduciary obligations, this is not always the case, and currently, the only method for policing perceived misconduct is stockholder litigation.

Without stockholder-initiated litigation, there would be essentially no effective enforcement mechanism for statutory or fiduciary obligations. As one leading corporate attorney recently noted: "fiduciary attacks on announced deals are now the primary vehicle through which the Court [of Chancery] develops the rules that govern director conduct and that provide transaction planners (and plaintiffs' lawyers) the basis to plan (or attack) the next deal."[4] Permitting fee shifting as a limitation on stockholder litigation would be functionally equivalent to permitting corporate charter or bylaw provisions limiting or eliminating fiduciary duties of officers and directors. If investors were to perceive over time that statutory rights and fiduciary obligation had become hollow concepts, investors' confidence could diminish, and capital formation could be adversely affected

Eventually, other regulators would likely feel compelled to step in. The federal government might perceive a need to occupy the field of corporate law in order to maintain this critical aspect of the national and world economy. Alternatively, states' attorney generals might look for opportunities to fill the vacuum.

[4] William Savitt, *The Genius of the Modern Chancery System*, 2012 COLUM. BUS. L. REV. 570, 571 (hereinafter "Savitt").

The Problem Of Constraining Unproductive Stockholder Litigation

Advocates of *ATP*-type provisions argue that some, much, or most (depending on their perspective) of stockholder litigation lacks merit[5] and does not produce sufficient benefit to warrant its costs. Opponents of stockholder litigation have noted the expense resulting from a practice that has increased in recent years of a number of stockholders bringing essentially the same type of case contemporaneously in two or more jurisdictions (the problem of multi-forum litigation). The question these concerns pose is how best to address them.

The fact that stockholder litigation can be detrimental as well as beneficial should not result in virtually precluding it, as fee-shifting provisions would. To use a well-worn metaphor, that would be throwing the baby out with the bath water. Less drastic means should be used to channel stockholder litigation constructively towards meritorious claims.

Legislation is a relatively blunt tool and not sufficiently flexible to permit case-by-case adjustments to differing situations. DGCL provisions are fixed until at least the next General Assembly session, and amending statutory provisions is not always simple. In its deliberations this summer and fall, the Council wrestled with many attempts to formulate language that would focus fee shifting only on cases of limited merit and have appropriate procedural protections for adoption (e.g., such that a majority stockholder could not insulate self-dealing by imposing an onerous fee shifting provision on minority stockholders). We ultimately concluded that these drafting efforts could not achieve the twin goals of permitting meritorious claims to proceed while constraining meritless actions.

Delaware courts, with their case-by-case, sophisticated approach to adjudication, are far better equipped to balance those goals, and they already have sufficient tools to address and deter litigation of limited merit. These tools include:

[5] As Mr. Pitt has noted: "[T]here is a problem in attempting to discern which lawsuits are frivolous and which are not. Frivolousness, like beauty, is in the eye of the beholder. And, some cases said to be frivolous upon their institution turn out to be well-founded, while others, thought to be well-taken, turn out to be frivolous." Pitt, p. 31.

1. Motions to dismiss, which enable the court to terminate litigation at the outset, before expensive discovery proceedings, where the complaint lacks merit on its face.

2. Rule 11, which permits a court to impose on a litigant and/or its counsel the litigation costs, including attorneys' fees, opponents incur when the litigant has brought claims without adequate investigation or legal analysis.

3. Judicially developed doctrines of fee shifting where the court finds that a litigant has conducted itself either before or during litigation in deliberate disregard of the legitimate interests of others.

4. Determining whether or not the plaintiff is an appropriate representative of other stockholders, which is often critical in litigation brought as class or derivative actions; courts can evaluate any number of factors to determine whether the litigant and its counsel are appropriately advancing the interests of the corporation and/or other stockholders in pursuing the litigation.

5. Disapproving settlements of class or derivative actions, including where the case lacked merit from the outset, or imposing limitations on settlement terms.

6. Determining whether and how much stockholder plaintiffs' attorneys will be paid; courts can limit or refuse compensation to counsel for stockholders for cases lacking merit.

Advocates for fee-shifting provisions in stock corporations argue that the resolution of any problems that fee shifting provisions create should be left to the courts. Ironically, that expressed confidence in the ability of courts to sort out permissible fee-shifting provisions from impermissible ones should also produce confidence that the courts can adequately address litigation abuse. However, charter and bylaw provisions that essentially eliminate litigation cannot be reconciled with the view that courts can and should be trusted to address real problems effectively when and if they arise on a case by case basis.

Delaware courts have already addressed the problem of multi-forum litigation, by validating bylaws that require stockholders of Delaware corporations to bring cases in Delaware courts. *Boilermakers Local 154 Retirement Fund v. Chevron Corporation*, 73 A.2d 934 (Del. Ch. 2013).[6] The proposed legislation would give statutory force to the *Boilermakers* decision. Ultimately the significance of a venue provision like this in corporate charters and bylaws rests on the respect other courts will give it; statutory endorsement is intended to give other state and federal courts additional reason to honor such exclusive venue provisions.[7] The Council believes that if a Delaware corporation wants to specify a venue for intracorporate actions, the choice of Delaware incorporation and resulting implicit choice of Delaware corporation law should result in a preference for Delaware courts to resolve disputes. To the extent the prevalence of multi-forum litigation has made Delaware courts reluctant to police stockholder litigation, this proposal's enhanced means to end the multi-forum litigation problem should increase judicial confidence to use the tools available to supervise stockholder litigation more effectively.

Finally, the proposed legislation does not deprive corporations of the ability to adopt other provisions that address unproductive stockholder litigation by means other than fee-shifting. The DGCL is broadly enabling and gives wide authority to boards – and stockholders – to adopt binding bylaws and charter provisions. *ATP* and the recent case law addressing forum selection have respected the broadly enabling nature of the DGCL and suggest that some litigation-regulating provisions may be facially valid. Of course, such provisions may not be enforceable if inequitable, as the Supreme Court noted in *ATP*, stating that "[b]ylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable

[6] There is evidence that the increasing use of exclusive forum provisions has already reduced the severity of the problem of multi-forum shareholder litigation. Olga Koumrian, Cornerstone Research, Shareholder Litigation Involving Acquisitions of Public Companies, Review of 2014 M&A Litigation (2015), at 3, *available at* https://www.cornerstone.com/GetAttachment/897c61ef-bfde-46e6-a2b8-5f94906c6ee2/Shareholder-Litigation-Involving-Acquisitions-2014-Review.pdf.

[7] The proposed legislation would not address the validity of a bylaw specifying a non-Delaware venue, which the Court of Chancery found facially valid in *City of Providence v. First Citizens BancShares, Inc*., 2014 WL 4409816 (Del. Ch. Sept. 8, 2014); the legislation would insist, however, that no such provision could preclude bringing intracorporate claims in Delaware courts as a venue. Notably, corporations will remain free not to have a venue provision at all.

purpose." *Id.* Significantly, such enforceability can be tested in litigation because plaintiffs will be able to challenge such provisions without being subject to the risks inherent in fee-shifting.

A Note About Self Interest and Flexibility

We have considered criticism advanced last spring that this legislation is not motivated by policy concerns but is rather a protectionist act intended to enrich the members of the Council and their firms by invalidating measures that would significantly diminish litigation in Delaware. That criticism, of course, does not address the substance or merits of the issues; it is simply an assertion that whatever the Council does or does not recommend in relation to stockholder litigation is inherently tainted. In any event, we reject that criticism.

Those who have advanced that criticism have argued, and probably will argue, that other states may take steps to accommodate fee-shifting charter and bylaw provisions, and that businesses will therefore choose to incorporate in those other states, rather than in Delaware. That is indeed a risk, but recognizing that risk refutes the very criticism that the Council is acting out of self-interest.

Those who argue that the legislation is protectionist will also note that the DGCL is often praised for its flexibility, and that the inflexibility of the proposed legislation is counter to that tradition. This argument fails to recognize that while the DGCL and fiduciary law do provide remarkable flexibility, they also contain certain "bottom line" provisions that cannot be changed, such as information rights and the fiduciary duty of loyalty. No one seriously argues that the statute should be so flexible as to allow these to be eliminated. Yet fee-shifting is a backdoor method of doing exactly that.

There is also nothing unusual about tailoring the DGCL in light of market developments. Our courts must, as they did in *ATP*, respect the broadly enabling nature of the DGCL. Where, as here, the market begins to use the DGCL's breadth in new ways, it is the General Assembly, not the courts, that should evaluate whether, on public policy grounds, the statute's authorizing breadth should be narrowed. As to the subject of fee shifting

provisions in the context of stock corporations, particularly public ones, the Council believes that such tailoring is appropriate and consistent with tradition.

Critics of the legislation will also argue that the market can address these concerns—that is, that stockholders in the public markets currently exercise great power. They have been able to require companies to declassify their boards and take down other barriers to takeovers, for example. The extent to which adoption of fee-shifting provisions may prove to be tenable for large public companies is subject to debate, but there will be little constraint on adoption by many companies without significant market capitalization or with controlling stockholders, and fee shifting provisions will likely become common in the IPO market. Again, if the market really were a sufficient constraint, then that would be the case for all stockholder rights, including rights involving directors' fiduciary duty of loyalty and information rights.

The Council believes that the long-term interests of the State and its corporate citizens are best served by a flexible structure with a few basic unalterable rights. Almost seventy years ago, a noted corporate law professor criticized Delaware as leading a "race to the bottom" in competition among states for corporate charters. Whatever merit that criticism had at the time, it can no longer be fairly asserted, and we should not reinvigorate it. As litigators and transactional counselors steeped in decades of practice of Delaware corporate law, the members of the Council endorse the position the General Assembly unanimously expressed last June: that we "strongly support a level playing field that provides the ability for stockholders and investors to seek relief on its merits in the Courts of this State and believe that a proliferation of broad fee-shifting bylaws for stock corporations will upset the careful balance that the State has strived to maintain between the interests of directors, officers, and controlling stockholders, and the interests of other stockholders." We believe that increasing the use of exclusive forum provisions in certificates of incorporation and bylaws will enhance the ability of the Delaware courts to police stockholder litigation. We believe that if the view becomes widely held that the Delaware courts are incapable of exercising that policing

function appropriately – a result that we doubt will occur – those concerns should be addressed first to the courts, and only thereafter should legislation be considered to deal with the issue (just as we are concurrently addressing aspects of the appraisal litigation process).

We also believe that the market may continue to experiment with litigation-regulating bylaws that do not have the *in terrorem* effect of fee-shifting provisions, and that the courts will be able to develop an equitable jurisprudence that fairly regulates such provisions.

By proposing legislation that would limit *ATP* to its facts, the Council is seeking to preserve the tradition and status quo that preceded *ATP*, in which the courts, and not charter and bylaw provisions, control stockholder litigation and the allocation of litigation costs among the parties. That tradition has served the goals of wealth creation quite well over the years:

> It is no exaggeration to say that the Court of Chancery is an invisible presence in every boardroom where a public company deal is being considered, silently promoting compliance with its refined standards of fiduciary conduct. This constitutes a remarkable regulatory achievement. It should be recognized and protected by confiding to Chancery the prerogative to manage the docket and ultimately the destiny of Delaware-law fiduciary duty litigation.[8]

In the view of the Council, there is no crisis, in litigation or elsewhere, which warrants upsetting tradition by intruding on the Court of Chancery's "prerogative to manage the docket and ultimately the destiny of Delaware-law fiduciary duty litigation," and ultimately encouraging other regulators to step in. We have steadfastly declined to permit the fiduciary duties of corporate directors to be limited or eliminated by charter or bylaw provision, and we believe that permitting fee-shifting provisions would give corporations the authority to achieve essentially the same result.

[8] Savitt, at 601.

Fee-Shifting FAQs

Q. ***Who was responsible for drafting this legislation?***

A. The bill was drafted by the Corporation Law Council (the "Council"), which is a committee of the Delaware State Bar Association (the "DSBA"). The Council drafts recommendations for amendments to the Delaware General Corporation Law (the "DGCL") every year. The group includes 22 lawyers with significant representation from law firms that regularly represent corporations and their directors and officers in transactions and litigation, as well as lawyers who generally represent investor plaintiffs.

Q. ***Does that small group act alone?***

A. Any legislation the Council drafts must be approved by the DSBA Corporation Law Section, which consists of almost 500 Delaware attorneys, and must then be approved by the Executive Committee of the DSBA. In addition, the head of the Division of Corporations participates in Council deliberations as a non-voting member, so that there is administration input on legislation the Council drafts.

Q. ***Does this process result in legislation that causes the DGCL to favor the members of the Council and their clients?***

A. Although clients may make their views known to members of the Council, there is a strong tradition of "leaving clients at the door" when the Council deliberates. Furthermore, Council members understand that in order to preserve Delaware's status as the leading jurisdiction for incorporation, the DGCL must be balanced. Legislation that overly favors management would lead stockholders to abandon Delaware, whereas legislation that creates too much risk for managers would cause these decision-makers to favor other jurisdictions. The DGCL has successfully maintained this balance over the years, and Delaware has retained its edge, including through the pitched takeover battles of the 1980's, the corporate scandals of the early 2000s and the financial crisis of 2008. Unlike groups from outside Delaware that represent solely investors or solely management, the members of the Council have a specific interest in maintaining Delaware as a balanced jurisdiction and thus as the preeminent location for incorporation. As a result, the General Assembly has a unique reason to have confidence in the judgment of the members of the Council, and the DSBA.

Q. ***But isn't the legislation particularly favorable to the plaintiff's bar; wasn't it really drafted by them to preserve their ability to bring lawsuits?***

A. No. The legislation specifically endorses Delaware forum selection provisions, which will further support decisions by courts in other states to respect provisions selecting Delaware as the sole jurisdiction for stockholder litigation. This is the very remedy that corporations have been seeking for some time to curb abusive legislation. In fact, Council members who regularly represent directors and management actively participated in drafting the final bill.

Q. ***What prompted this legislation?***

A. On May 8th of last year, the Delaware Supreme Court decided the ATP case, which permitted a membership corporation to enforce a "fee-shifting" bylaw. The bylaw provided that any member who brought a lawsuit against the corporation or its members or directors would be liable to pay those defendants' legal fees if the member was not fully successful in the lawsuit. Because the DGCL does not have separate provisions for stock and member corporations, some corporate practitioners saw the case as an opportunity to press for fee shifting provisions for profit stock corporations, including publicly traded corporations.

Q. ***What happened after the case was decided?***

A. A number of national law firms quickly put out memos to their corporate clients, alerting them to the decision and suggesting that they consider whether to adopt fee-shifting provisions. Since the case was decided, over 30 public corporations have adopted fee shifting provisions, and six corporations have gone public with such provisions.

Q. ***Is this any different from the legislation that the DSBA proposed in June?***

A. Yes, although it still prohibits fee shifting provisions, it does so in a more targeted fashion. More importantly, the new proposal adds a legislative endorsement of Delaware forum selection clauses, which are another type of provision intended to curb certain abusive litigation practices. Although these provisions have been endorsed in Delaware and some other state courts, the legislation should further ensure their enforceability.

Q. ***What's wrong with letting the market decide whether these provisions should be adopted? Isn't the DGCL supposed to provide flexibility?***

A. Although the DGCL provides great flexibility, corporate law does have certain bottom line provisions that cannot be altered, including common law concepts of fiduciary duty: directors of all corporations owe stockholders fiduciary duties of care and loyalty. In addition, there are certain statutory rights that cannot be altered, such as the right to obtain information from the corporation. This legislation is in keeping with the natural course of the development of our law. Because the statute is broadly enabling, new uses are proposed that may be deemed at odds with the overall structure of our law. The courts must be disciplined to give the DGCL the broadly enabling effect its terms have, and depend on the General Assembly to address uses of the statute that might be deemed problematic as a policy matter. In this case, the Council believes that fee shifting provisions are problematic for stock corporations, but not member corporations, and recommends tailoring the DGCL accordingly.

Q. ***But fee-shifting provisions do not alter these rights, do they?***

A. The purpose and effect of these provisions is to significantly, if not completely, deter the enforcement of stockholder protections. Stockholder suits are generally brought by one or more stockholders on behalf of, or to benefit, many stockholders. Very few, if any, stockholders will be willing to risk individually paying the corporation's legal fees on

behalf of other stockholders. Accordingly, fee-shifting effectively eliminates stockholder rights, because stockholder litigation is the only method of enforcing them. This would be a radical change in the corporate landscape.

Q. ***But if those provisions are so troubling, aren't the courts likely to strike them down?***

A. Not necessarily: the courts are bound to interpret and apply the DGCL as enacted by the General Assembly. The DGCL is broadly enabling, and courts can't pick and choose which charter and bylaw provisions are valid just based on a policy preference. However, even if it were possible that the court would invalidate such provisions, no stockholder could afford the risk of bringing a claim to challenge them because of the risk of losing that challenge and being required to pay the uncapped legal fees of the corporation.

Q. But if this is what corporate managements really want, will other states adopt provisions permitting fee-shifting, and will corporations migrate to such jurisdictions?

A. That is a risk that the Council considered when drafting the proposed legislation. However, the Council firmly believes that the best way to maintain Delaware as the preeminent for a corporation is to maintain a balanced statute.

Q. Are there specific risks to failing to adopt the proposed legislation, so as to permit fee-shifting to go forward?

A. Yes. In the United States, stockholder litigation regulates stockholders and managers. There is no federal or state regulator that enforces the rights of stockholders: they are enforced almost entirely through the mechanism of stockholder lawsuits. A jurisprudence has developed in Delaware over the last hundred years, which has been very successful in regulating this critical relationship. If the ability of stockholders to bring lawsuits were seriously curtailed by fee-shifting provisions, a regulator is quite likely to fill the void--perhaps the federal government. In the long term, this would likely be a much more costly (and less effective) method of overseeing this relationship than the current lawsuit-based system.

Q. Is there anything that can be done to address abusive stockholder litigation?

A. Yes. The Delaware courts have already taken a strong step in this direction by validating "forum selection" provisions as consistent with the broadly enabling structure of the DGCL. These provisions require that lawsuits by stockholders be brought in a single jurisdiction. Such a provision enables courts to more effectively address abusive litigation because plaintiffs cannot "shop" for favorable forums. The Delaware courts have also addressed abusive litigation in the last several years by, among other things, closely reviewing (and in some cases rejecting) certain settlement proposals, and by dismissing some cases at an early stage. The Council believes that the courts have sufficient tools to address this problem.

Q. Does the proposed legislation take any steps to address abusive stockholder litigation?

A. Yes. The proposed legislation will statutorily validate forum selection provisions, in order to ensure that courts outside of Delaware continue to respect provisions requiring that stockholder litigation be brought in Delaware. This provision will give Delaware courts a strong hand in addressing litigation that the courts determine to be abusive, while ensuring that Delaware courts are always available to Delaware corporations and their stockholders. However, the legislation does not permit charter or bylaw provisions that preclude stockholders from bringing their claims in Delaware courts. In other words, the legislation would prohibit provisions that selected another state as the exclusive forum.

Q. Does that change current law?

A. Consistent with the prior discussion, the proposal does limit the broadly enabling nature of the DGCL as to forum selection provisions. Specifically, a recent Chancery Court decision enforced a provision selecting North Carolina courts as the sole forum for a Delaware corporation. The Council believes that stockholders of Delaware corporations should not be denied access to the protection of the Delaware courts. Thus, the broadly enabling nature of the DGCL would be trimmed back to address this issue. In particular, the Council believes that the value of Delaware as a favored jurisdiction of incorporation is dependent on a consistent development of a balance of corporate law, and that the Delaware courts are best situated to continue to oversee that development.

Q. Does legislation include any other provisions to limit stockholder litigation?

A. Yes. The Council is proposing legislation that will address concerns that the "appraisal" statute (which provides stockholders with certain rights following corporate mergers) is being abused. First, the legislation eliminates "nuisance" appraisal suits for stock exchange-traded companies, by requiring such suits involve claims for at least $1M or one percent of the outstanding shares. Second, the legislation provides a method by which a corporation can stop appraisal claims from accruing interest, which has been a significant concern. These appraisal measures, together with the forum selection provisions, should provide significant relief to corporations that believe that they are being victimized by abusive litigation tactics.

Q. Are those tools sufficient to contain problematic litigation?

A. If not, the recent decisions upholding forum selection and fee-shifting provisions suggest that corporations may adopt additional provisions that regulate abusive litigation tactics. Unlike fee-shifting provisions, stockholders could challenge such provisions without risking significant liability, so that a jurisprudence permitting reasonable litigation regulating bylaws may develop.

Section 262 Appraisal Amendments

The purpose of this paper is to summarize briefly the considerations leading to the currently proposed amendments for Delaware's appraisal statute, Section 262 of the Delaware General Corporation Law ("DGCL").

Background

In February 2014, the Council of the Corporation Law Section of the Delaware State Bar Association (the "Council") appointed a subcommittee comprised primarily of Council members to study the desirability of amendments to Section 262. Creation of the subcommittee arose in part because of increasing commentary about "appraisal arbitrage" and whether it is consistent with the intended purpose of the appraisal statute.[1] Appraisal arbitrage is generally understood to be the acquisition of shares with attendant appraisal rights purchased after the public announcement of a planned merger. Successful appraisal arbitrage anticipates that the merger will be consummated, appraisal rights will be perfected and the recovery (including interest) will provide a favorable return.

The subcommittee initially considered whether to modify Section 262 to eliminate or limit appraisal arbitrage. Several considerations led the subcommittee to recommend and Council to conclude that the statute should not limit appraisal rights to shares held before the public announcement of a proposed transaction. Council does not believe appraisal arbitrage upsets a proper balance between the

ability of corporations to engage in desirable value enhancing transactions and the ability of dissenting stockholders to receive fair value for their holdings.

- Delaware law since at least 1989 explicitly has recognized the right of a stockholder who has otherwise perfected his appraisal rights to pursue appraisal of shares purchased after the terms of the merger were announced.[2]

- Recent case law has suggested that a market test of a transaction will serve as a proxy for fair value in appraisal suits, so that arm's-length deals with adequate market checks do not create appraisal risks for buyers.

- Where transactions cannot be subject to a market check for structural reasons (such as buy outs by controlling stockholders who are unwilling to sell), fiduciary duties and litigation may not be sufficient to ensure that the merger price reflects the fair value of the acquired shares.

- To the extent that the appraisal remedy is necessary to protect stockholders, its effectiveness would be curtailed if the statute were amended to limit the ability to transfer the right. The assignment and acquisition of financial claims (in contrast to tort claims) generally has been accepted historically and presently as lawful and consistent with public policy.[3]

- Studies of appraisal arbitrage do not suggest that it encourages frivolous litigation. Unlike the case of representative litigation, which occurs in more than 90% of the public mergers and consolidations, only 17% of the appraisal eligible transactions during 2013 resulted in appraisal litigation in Delaware.[4]

- Appraisal cases seem to be self-selecting, attacking primarily conflict transactions or transactions involving questionable pricing. Such transactions, which have a greater potential for unfairness and frequently result in appraisal awards at a premium to the merger price, sometimes a very significant premium.[5]

- Appraisal cases attacking the merger consideration in non-conflict transactions are fewer in number and often result in appraisal results below or near the merger consideration.[6]

- To the extent that the buyer in a merger has concern about an increased number of merger claimants and the overall cost of the transaction, the buyer

can negotiate an appraisal out condition (e.g. a right not to close the merger if more than a specified percentage of shareholders dissent and demand appraisal). The fact that such appraisal-out conditions remain fairly rare suggests that the availability of appraisal arbitrage is not a significant factor in the market.

The Legislative Proposals

The Council proposes two modifications to Section 262 to improve its operation. The first modification limits pursuit of otherwise qualified appraisal claims in public company transactions if the claim is *de minimis.* The second modification addresses the concern that appraisal arbitrageurs may be incented to pursue claims simply because of the amount of interest they would be able to recover on the award. It gives corporations options to prevent interest arbitrage.

A. The *De Minimis* Exception

The proposed legislation would amend Section 262(g) to impose limits on the availability of a judicial determination and award of fair value where the otherwise eligible appraisal shares have been traded on a national securities exchange. If 99% of the stockholders accept the merger consideration, or the amount in dispute is less than or approaches the cost of litigation, it is difficult to justify the use of judicial and party resources to provide a judicial determination of value. Thus, the amendment would permit a surviving corporation in a merger or consolidation to obtain dismissal of an otherwise perfected appraisal claim unless (i) the total number of shares entitled to appraisal exceeds 1% of the outstanding

number of shares that could have sought appraisal; or (2) the value of the merger consideration for the total number of shares entitled to appraisal exceeds $1 million; or (iii) the merger was approved pursuant to Section 253 or Section 267. Appraisal rights would be precluded unless the dispute with regard to valuation meets a minimum threshold of significance measured by the number of dissenters or the amount in dispute. Surmounting one of these hurdles minimizes risk that appraisal will be used to achieve a settlement simply because of the nuisance value of discovery, the cost of financial experts and other burdens of litigation. Section 253 and Section 267 short form mergers are not subject to the appraisal limitation because appraisal may be the only remedy available.[7] The *de minimis* carve-out will apply only to shares traded on a national securities exchange. The difficulty of valuing the merger consideration in a private company and the unlikely prospect that the one percent threshold would not be met counseled against providing a *de minimis* exception in cases not involving shares traded on a national securities exchange.

B. The Corporation's Option to Pay and Limit the Accrual of Interest

The proposed amendment to Section 262(h) would provide corporations the option of limiting the accrual of interest on appraisal awards. Since 2007, Section 262(h) generally provides for an award of interest equal to Delaware's legal rate of interest – the Federal Reserve discount rate plus 5%.[8] That amendment was

designed to simplify the appraisal proceeding and limit the amount of time previously spent by the parties, the court and experts on determining a proper rate of interest.[9] Some commentators and practitioners became concerned that the statutory interest rate, which for the last several years has provided an attractive rate relative to money market and government yields, encouraged interest arbitrage by appraisal claimants. Empirical studies cast doubt on this supposition and hedge funds openly engaged in appraisal arbitrage have substantially greater investment return targets than the legal rate.[10] The Council, however, believes corporations should have the option to cut off the accrual of interest by paying to the appraisal claimants a sum of money of the corporation's choosing. Thereafter, with respect to the amount paid, interest would not accrue. Interest would only accrue if the judicial award exceeded the amount paid, and then would accrue only on the excess. The corporation exercising this option would need to pay all claimants unless there is a good faith basis for contesting a stockholder's entitlement to appraisal. Payment pursuant to this option would not give rise to any inference with respect to the fair value of the shares to be appraised. The option this amendment would afford corporations would permit them to make a rational choice about the relative cost of paying or retaining all or a portion of the merger consideration during the pendency of the dispute.

Because respondent corporations would have this option, the incentive for interest rate arbitrage will be dampened without compromising the interests of pre-existing equity holders. The reason for that is that interest rate arbitrage investors cannot depend on receiving the statutory rate as to most of the merger consideration, because a respondent could immediately tender, for example, 75% of the transaction price, thus reducing the petitioners' ability to get the statutory rate as to the bulk of the amount likely to be due at the end of the proceeding. As a result, the amendment better ensures the appraisal actions will be motivated by a genuine interest in proving that the transaction price was unfair.

Effective Date

The proposed legislation provides for the amendments to be effective with respect to merger or consolidation transactions pursuant to agreements first entered into on or after August 1, 2015. It would not affect pending litigation.

[1] *See, e.g.,* Fried Frank M&A Briefing (6/18/14), *New Activist Weapon, The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications; Kobi Kastiel, Why Delaware Appraisal Awards Exceed the Merger Price,* http.blogs.law.harvard.edu/corpgov/2014/09/23.

[2] *Salomon Brothers Inc. v. Interstate Bakeries Corporation,* 576 A.2d 650 (Del. Ch. 1989).

[3] 6 *Del. C.* § 2702 (assignees of bonds, specialties and notes may enforce in their own name); 10 *Del. C.* § 3902 (assignees of contracts may enforce in their own name); Lauren D. Gojkovich, *Leveraging Litigation: How Shareholders Can Use Litigation Leverage to Double Down on Their Investment in High Stakes Securities Litigation*; 16 STAN. L.J. Bus. & Fin., 100, 111 (2010).

[4] Steven Epstein, Philip Richter, et al., *Keeping Current: Delaware Appraisal: Practical Considerations*, BUSINESS LAW TODAY, 1 (October 2014); Myers, Minor and Korsmo, Charles, *Appraisal Arbitrage and the Future of Public Company M&A* (April 14, 2014) forthcoming, 92 Washington University Law Review ____ at 1-5, 41-47 (2015) Brooklyn Law School Legal Studies Paper No. 388 (hereinafter "Korsmo & Myers (2014)").

[5] *Id.*

[6] *Id.*

[7] *Glassman v. Unocal Exploration Corp.,* 777 A. 2d 242 (Del. 2001)

[8] 6 *Del. C.* § 2301.

[9] *See e.g. Lebman v. National Union Electric Corp.,* 441 A.2d 824 (Del. Ch. 1980); Dole Transcript (2015) at 24-26.

[10] Korsmo & Myers (2014) at 2, 24-25.