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Fee-Shifting Bylaw and Charter Provisions: Can They Apply in Federal Court? – The Case for Preemption

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Testimony of Professor John C. Coffee Jr.,
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And
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Before
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"Fee-Shifting Bylaw and Charter Provisions: Can They Apply in Federal Court?— The Case For Preemption"

Beginning this year, a number of public corporations (including the recent Alibaba IPO) have adopted bylaws or charter provisions that shift the corporation's costs and expenses in shareholder litigation to the plaintiff shareholder if the latter is unsuccessful (or, in some cases, is less than completely successful[1]). Those companies that are "reporting" companies typically use a board-adopted bylaw, while IPO candidates employ a charter provision. Either way, the effect is a one-way "loser pays" rule imposed without any shareholder vote. These new provisions derive from a 2014 decision of the Delaware Supreme Court, ATP Tour, Inc. v. Deutscher Tennis Bund,[2] which found a particularly sweeping bylaw adopted by a Delaware non-stock corporation to be "facially valid." That decision makes clear that a fee-shifting bylaw can be enforceable under Delaware law and applicable to shareholders who acquired their shares both before and after the bylaw was adopted, but it further noted that a legally permissible bylaw that is adopted for an "improper purpose" will be unenforceable in equity. This limitation is an application of the familiar Delaware rule, first stated in Schnell v. Chris-Craft Industries,[3] that powers legitimately possessed may not be used for an inequitable purpose.

Although the number of public companies adopting such a bylaw is still relatively small, the trend is accelerating. Some 24 public companies (including IPOs) appear to have adopted such provisions between May 29 and September 29, 2014,[4] and a charter provision to this effect is becoming part of the standard IPO game plan. Many more companies appear likely to follow these first movers, at least if Delaware does not act legislatively to bar or restrict them.

So where does that leave us? The Delaware legislature may yet act to bar or limit fee-shifting provisions.[5] Delaware may be motivated to act by the very plausible fear that such bylaws will reduce the volume of litigation in Delaware courts and thereby adversely affect Delaware's leading local industry (i.e., corporate litigation). Still, even if Delaware were to act, the issue would still not disappear for three distinct reasons: (1) Delaware might only modestly limit the use of such bylaws, still permitting a substantial chill; (2) Corporations incorporated in other jurisdictions may adopt similar bylaws (and the prestige of the Delaware Supreme Court may lead other courts to accept its ruling, even if the Delaware legislature were to reverse or amend it); and (3) Corrective action by Delaware might start an interjurisdictional competition, as other, more conservative states (think, Texas) might seek to lure companies to reincorporate there to exploit their tolerance for such provisions. This brief memorandum will not attempt any brief-like statement of the complicated case law on preemption,[6] but will focus instead on the policy issues and the need for SEC action.

As our starting point, the initial question is: when will the Delaware Chancery Court (in the absence of new legislation) find that a fee-shifting provision was adopted for an improper purpose? Here, a particularly relevant statement in ATP Tour, Inc. is that:

> "The intent to deter litigation, however is not invariably an improper purpose. Fee-shifting provisions, by their nature, deter litigation. Because the fee-shifting provisions are not *per se* invalid, an intent to deter litigation would not necessarily render the bylaw unenforceable in equity." 91 A. 2d at 560.

Although it is certainly conceivable that a bylaw adopted after a specific corporate transaction was initiated by the board (or even after a lawsuit challenging the transaction had been filed) could be seen as a self-interested and "improper" attempt by the board to immunize itself, it is far less likely that a fee-shifting provision adopted well in advance of the transaction would be similarly invalidated—at least by Delaware courts. To be sure, the Delaware Supreme Court did not need to address these questions because the ATP Tour case came to it as a certified question from another court, and it properly limited itself to questions of law. Nonetheless, within Delaware and absent legislation, the message of ATP Tour seems clear: fee-shifting will be upheld unless evidence of bad faith or improper purpose can be shown.

I. Fee-Shifting Provisions in Federal Court

But what is the status of such a board-adopted bylaw in federal court? Here, it is important to note that the ATP Tour case was in fact brought in federal court in Delaware. The plaintiff lost at trial,[7] and the defendant moved for its costs pursuant to the bylaw. The District Court denied this motion, effectively ruling that federal law preempts the enforcement of fee-shifting agreements when antitrust claims are involved.[8] But the Third Circuit reversed the District Court's order, ruling that before addressing federal preemption issues, the District Court should have first determined whether the bylaw was enforceable under state law.[9] In fact, the Third Circuit expressed skepticism that the bylaw was enforceable under Delaware law.[10] On remand, the District Court certified this question of the bylaw's enforceability under Delaware law to the Delaware Supreme Court.

With that initial question now resolved, the focus now shifts back to the preemption issue. In general, federal courts have refused to enforce state law penalties intended to deter frivolous litigation. In a leading case, Burlington Northern Railroad Company v. Woods,[11] a tort action was removed by the defendant from Alabama state court to federal court, where the defendant lost at trial and then appealed, posting a mandatory bond to stay the judgment. On affirmance of the decision below, the Eleventh Circuit granted plaintiff's motion for a mandatory penalty of 10% of the judgment amount, based on an Alabama statute that sought to deter frivolous appeals by imposing an automatic 10% penalty. The Supreme Court reversed, finding that the Alabama statute had no application to a case in federal court (even when removed to federal court based on diversity jurisdiction). Following its leading precedent of Hanna v. Plumer,[12] the Supreme Court held that federal procedural rules applied in federal court. Further, it noted a conflict between the Federal Rules of Civil Procedure (which permit a court in its discretion to impose a penalty for a frivolous appeal) and the Alabama statute (which made the penalty mandatory, whether the appeal was frivolous or not).

If we assume Burlington Northern to govern, the same conflict arguably exists between mandatory fee-shifting under a bylaw and the discretionary sanctions authorized for frivolous litigation by Federal Rule of Civil Procedure 11. Yet, other decisions have applied state law requirements that amount in substance to fee-shifting in federal court.[13] In any event, before one concludes that federal law should preempt state law on this issue, one must focus on a critical difference between Burlington Northern and the case of a fee-shifting bylaw. Fee-shifting under ATP Tours is not based on a state statute, but on a contract. Indeed, the Delaware statute authorizing broad bylaws is no different from that of any other state jurisdiction. Rather, under standard "black letter" corporate law, bylaws set forth a contract among the shareholders. From this perspective, the fee-shifting bylaw is the same as an indemnification provision in which one party by contract agreed to pay the other's legal expenses (at least under certain circumstances.) In fact, the ATP Tour decision emphasizes that contractual agreements are an exception to the usual American rule on fee-shifting (under which each side bears its own legal expenses) that Delaware normally follows.

Hence, the Supreme Court's standard position that federal procedural rules apply in federal court (and state procedural rules do not) might be sidestepped here if we view the bylaw as simply a contract among the parties. But again one cannot stop at this point either—for at least two reasons. First, federal courts have held that some contracts for indemnification are unenforceable because they conflict with the policies underlying specific federal statutes. The leading such decision is Globus v. Law Research Service, Inc.,[14] in which the Second Circuit denied indemnification to an underwriter who had knowledge of the misstatement because, it said, such indemnification would be contrary to the policies underlying the federal securities laws. Second, in Atlantic Marine Construction Co., Inc. v. United States District Court for the Western District of Texas,[15] the Supreme Court held in 2013 that contractual provisions among the parties do not supercede the Federal Rules of Civil Procedure but must be interpreted in a manner consistent with them. In Atlantic Marine, the parties had agreed to a forum-selection clause providing that all disputes would be litigated in Virginia. Yet, when a dispute arose, the plaintiff sued in Texas, and the defendant sought to have the case either dismissed or, in the alternative, transferred to federal court in Virginia. Both the district court and the Fifth Circuit refused to do either, ruling that 28 U.S.C. §1404(a) was the exclusive mechanism for enforcing a forum-selection clause. Both further concluded that the district court had to undertake a balancing-of-interests analysis. On appeal, the Supreme Court partially disagreed. Although it found that Section 1404 (and not the contract, itself) governed, it held that the District Court's analysis improperly placed the burden on the defendant to prove that the requested transfer was appropriate. Instead, it said the burden was on the plaintiff, as the party "flouting" its contractual obligations, to show that public-interest factors overwhelmingly disfavored the requested transfer to Virginia:

> "Only under extraordinary circumstances unrelated to the convenience of the parties should a §1404(a) motion be denied."[16]

Because there was no preemption issue in Atlantic Marine, its relevance is limited, but it does have two implications: (1) contracts governing litigation are not necessarily enforced as written but must be interpreted through the prism of the Federal Rules of Civil Procedure; and (2) public policy questions may retain some modest relevance, even when there is no federal statute involved. On this basis, a forum selection bylaw requiring federal securities class actions to be brought in a preferred federal forum (for example, federal district court in Delaware) is likely enforceable, but will have to be implemented by means of Section 1404.

Atlantic Marine implies that fee shifting bylaws must at least be consistent with the Federal Rules of Civil Procedure, and these rules address the award of attorneys fees in Rules 54(d)(2) and 23(h). Under Rule 54(d)(2)(C), the court must give a party "an opportunity for adversary submissions on the motion in accordance with Rule 43(a) or 78" and the court "must find the facts and state its conclusions of law as provided in Rule 52(a)." Under Rule 23(h), the court must hold a hearing and any class member may object to the motion. These restrictions are minimal, but they do provide a hearing at which the SEC could appear.

II. Is One-Sided Fee-Shifting Inconsistent With the Policies Underlying the Federal Securities Laws?

To ask this question is not to answer it. The specific provision needs to be considered to determine the extent of the burden it imposes. Most such provisions will presumably require a losing shareholder who sued the company unsuccessfully to pay all the defendants' expenses, but many go even further and require the plaintiff to be completely successful on all its claims and obtain most of the relief sought—or face fee-shifting.[17] Thus, if a plaintiff sued for $100 million and obtained only $40 million (a notable victory by any realistic standard), it may not have been sufficiently successful to escape fee-shifting. Most (if not all) such bylaws will not pay the successful plaintiff's fees or expenses.[18] Thus, without more, such provisions have two key faults: (1) they are one-sided in that they reimburse successful defendants, but not successful plaintiffs (thus, they are unlike the English Rule which shifts fees both ways evenly); and (2) they require fee-shifting even in cases that were reasonable or even meritorious (but lost on a technical legal defense or were largely, but not entirely, successful).

But there is more. Some of these provisions are drafted so broadly that they expressly apply to "investigations" as well as to legal actions and some purport to require anyone who assists a plaintiff in such litigation to also share liability for fee shifting. Thus, a shareholder/whistleblower could be arguably held liable for the corporation's fees and expenses in defending a civil or criminal investigation by regulators—at least if not all the charges raised by the whistleblower were fully confirmed. Efforts to cover those who assist the shareholder plaintiff might even apply to expert witnesses and attorneys who assist the litigation (at least if they own shares).

Depending on one's perspective, these deficiencies may or may not seem as egregious as indemnifying a knowingly culpable defendant (which was the fact pattern in Globus), but they may do much more to deter and chill private enforcement of law. Inherently, defendants' fees and expenses will often exceed plaintiffs' expected fee award (in part because there tend to be multiple counsel representing the various defendants), and thus plaintiffs' attorneys must accept a potential liability greater than their potential gain. Since at least J. I. Case Co. v. Borak in 1964,[19] federal decisions and the SEC have asserted that private enforcement of law is a "necessary supplement" to public enforcement by the SEC and the Department of Justice.[20] Although the Supreme Court's attitude may be more equivocal today on this point (and clearly it will no longer imply a federal private cause of action, absent clear legislative direction), the Court has still shown itself unwilling to dismantle Rule 10b-5 class actions.[21] The SEC has not formally retreated from its support for private enforcement, but it is currently on the sidelines, and this issue will put its resolve to the test.

The incentives created by an automatic "loser pays" rule seem particularly perverse. A reckless or incompetent attorney who files a half-baked complaint will face only a modest to moderate sanction when the action is dismissed on a motion to dismiss (because the defendant will not yet have incurred substantial legal expenses). But if the action is more meritorious and survives the motion to dismiss, it will proceed into the discovery stage. Now, the expenses really begin to mount (and can easily exceed several million dollars a year). The harder and longer the plaintiff's attorney works to prepare the case, the greater the potential sanction he faces. As a result, the incentive effect here is to encourage early (and probably premature) settlement before the facts are really developed. If the plaintiff's attorney loses (at trial, summary judgment, or whenever), the plaintiff's attorney has a strong incentive to negotiate a deal under which the attorney waives the right to appeal in return for defendants' waiver of fee-shifting. As a result, little appellate law may be made.

These outcomes seem inconsistent with Congress's attitude towards fee-shifting in securities class actions. Preemption seems especially justified in this area because Congress struck a special balance in this area. That balance recognizes that fee-shifting against the losing side may sometimes be appropriate, but it is conditioned on judicial oversight and applies to both sides. Under Section 21D(c)(3) of the Securities Exchange Act of 1934 (which provision was added by the Private Securities Litigation Reform Act of 1995), a presumption in favor of fee-shifting is created if any motion or pleading fails to comply with Rule 11(b) of the Federal Rules of Civil Procedure. This two-sided approach is equally punitive to both sides in making full fee-shifting (rather than a lesser financial sanction) the presumptive penalty, but it requires the court to find a violation of Rule 11. Because this approach is tougher and more punitive than the normal approach under Rule 11 of the Federal Rules (which would typically involve lesser financial sanctions), it represents a carefully balanced federal policy, but one that is in sharp conflict with automatic and one-sided fee-shifting without any role for judicial discretion. Effectively, board-adopted bylaws can turn a Congressionally-mandated system of two-sided fee shifting that is dependent on judicial discretion into an automatic system of one-way fee-shifting.

Bottom Line: Although there may be a case for preemption of fee-shifting bylaws in many contexts, this case is stronger in the case of securities litigation.

III. What Should the SEC Do?

The SEC could take a number of steps, all consistent with past practice. First, the SEC could assert the case for preemption selectively as an amicus curiae in cases where no violation of Rule 11 seemed present. This will require some careful case analysis by the SEC and should not be an automatic response. Alternatively, the SEC could assert that automatic fee-shifting is always in violation of the Securities Exchange Act, unless it is predicated on a judicial finding that Rule 11 was violated. This would be a riskier approach, and it might force the SEC to defend a less-than-attractive plaintiff's attorney.

Second, the SEC has in a closely related area refused to accelerate registration statements where the company's certificate of incorporation or bylaws contained a mandatory arbitration clause. This threat seems to have been effective, and companies that have considered challenging the SEC have ultimately backed down.[22] Yet, the SEC has not held up registration statements with fee-shifting provisions. This is inconsistent. Functionally, the two cases are equivalent, because both provisions effectively bar private enforcement.

Third, the SEC could require registrants to state in their registration statements that they understand that the SEC believes that the federal securities laws are inconsistent with fee-shifting bylaws. Such a statement is already specified in Forms S-1 and S-3 with respect to indemnification provisions.[23] This at least imposes an embarrassment cost on the issuer and alerts courts to the SEC's views without the need for an SEC amicus position.

Fourth, the SEC could focus disclosure on such provisions, thereby raising the "embarrassment cost" to the issuer. In the case of IPOs that involve such provisions, the SEC could require these terms to be disclosed up front as a major "risk factor." In contrast, in the Alibaba IPO, no disclosure focused on the impact of its fee-shifting charter provision. Although the SEC's staff appears to have missed the forest for the trees here, it must be stressed that enhanced disclosure alone is not an adequate remedy. Corporations will still use such provisions, even if they modestly impact the IPO price. Investors cannot adequately price the impact of a provision denying them the ability to enforce their legal rights because they do not know how likely it is that the corporate insiders will breach their duties.

Finally, the SEC is uniquely positioned to gather relevant data. In assessing the impact of fee-shifting bylaws, it would be useful to know what the average costs are that defendant firms incur on such litigation and that they would seek to shift. The impact on the typical plaintiff's firm could also be evaluated empirically. Similarly, the SEC could assess whether insurance could alleviate this problem (if it were available) and at what cost. Lastly, if Delaware were to impose partial curbs (permitting only some limited fee shifting), the SEC could assess the likely empirical impact of such a modified fee-shifting bylaw.

Conclusion

The impact of fee-shifting bylaws could be decisive. The defendant's expenses in a securities class action can easily exceed $10 million, and this amount would bankrupt many smaller plaintiff's law firms. It is questionable (and certainly unresolved) whether plaintiff's law firms could obtain liability insurance to cover these amounts. Even if a bold plaintiff's law firm did sue, it would likely have to agree to indemnify the class representative from fee-shifting, and some class representatives might decline the position, fearing that the plaintiff's firm could not fully protect them.

As the case proceeded, the defendant's expenses will progressively mount, increasing the potential penalty. This will predictably force cheaper settlements, thereby injuring the class. If fee-shifting bylaws are upheld, defendant issuers should logically regard them as a riskless move that has little downside. Probably, proxy advisors would object to such board-adopted bylaws,[24] but this is not the kind of board action that could easily fuel a proxy contest or be easily overturned by a shareholder vote.[25] As a result, such provisions, unless challenged by the SEC, will predictably become prevalent.

Bottom Line: For the short-term, the ball is still in Delaware's court while its legislature considers possible curbs. That process will not likely be resolved until 2015. Although the SEC need not oppose all fee-shifting provisions adopted through board or shareholder action, it must be prepared to take on open-ended and more sweeping provision—or concede the decline of private enforcement. At present, the SEC seems to be ducking this issue, but continued irresolution will only further injure the SEC's already damaged reputation.

Final Thought: If Delaware does act to restrain fee-shifting through bylaws, the potential for a "race to the bottom" arises. Other states of a more conservative bent (consider, for example, Texas) might accept or even endorse fee-shifting provisions. At this point, some corporate lawyers will predictably advise their clients to reincorporate in Texas, and many IPO issuers might prefer to incorporate in Texas initially. Even if small changes in corporate law will not produce a migration into or away from Delaware, the permissibility of automatic fee-shifting is a major difference that will fuel interjurisdictional competition because it protects corporate managers and directors from potential personal liability. In this light, an SEC announcement that it will challenge fee-shifting provisions would chill interstate charter competition (and might even be welcomed in Delaware). Delaware alone cannot solve this problem.

Endnotes

[1] For an example of how sweeping some of the bylaws can be, see Article Sixteenth of the Second Amended and Restated Certificate of Incorporation of Smart & Final Stores, Inc. (available at http://www.sec.gov/Archives/edgar/data/1563407/000104746914007436/a2221270zex-3_1.htm). The company is a West Coast food and supply chain, which is incorporated in Delaware. Article Sixteenth reads as follows:

> Notwithstanding anything in this Certificate of Incorporation to the contrary, to the fullest extent permitted by law, in the event that (i) any current or prior stockholder or anyone on their behalf (a "Claiming Party") initiates any action, suit or proceeding, whether civil, criminal, administrative, or investigative, or asserts any claim or counterclaim (each, a "Claim") or joins, offers substantial assistance to or has a direct financial interest in any Claim against the Corporation (including any Claim purportedly filed on behalf of any other stockholder) and/or any director, officer, employee or affiliate thereof (each, a "Company Party"), 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 applicable Company Party for all fees, costs, and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) that the applicable Company Party may incur in connection with such Claim. If any provision (or any part thereof) of this Article SIXTEENTH shall be held to be invalid, illegal or unenforceable facially or as applied to any circumstance for any reason whatsoever: (1) the validity, legality and enforceability of such provision (or part thereof) in any other circumstance and of the remaining provisions of this Article SIXTEENTH (including, without limitation, each portion of any subsection of this Article SIXTEENTH containing any such provision (or part thereof) held to be invalid, illegal or unenforceable that is not itself held to be invalid, illegal or unenforceable) shall not in any way be affected or impaired thereby, and (2) to the fullest extent permitted by law, the provisions of this Article SIXTEENTH (including, without limitation, each such portion containing any such provisions (or part thereof) held to be invalid, illegal or unenforceable) shall be construed for the benefit of the Corporation to the fullest extent permitted by law so as to (a) give effect to the intent manifested by the provision (or part thereof) held invalid, illegal, or unenforceable, and (b) permit the Corporation to protect its directors, officers, employees and agents from personal liability in respect of their good faith service. Any person or entity purchasing or otherwise acquiring any interest in the shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this Article SIXTEENTH.

Obviously, this provision goes beyond a "loser pays" rule and is in effect "a-less-than-100%-successful-plaintiff-pays" rule.

For the Alibaba example, see Section 173 ("Claims Against the Corporation") of the Amended and Restated Memorandum and Articles of Association of Alibaba Group Holding limited, which is incorporated in the Cayman Islands (available at http://www.sec.gov/Archives/edgar/data/1577552/000119312514333674/d709111dex32.htm).

[2] 91 A. 3d 554 (2014). This decision is fully consistent with other recent Delaware decisions upholding board-adopted bylaws containing forum selection clauses requiring intracorporate litigation to be brought in Delaware. See Boilermakers Local 154 Retirement Fund v. Chevron Corp., 73 A. 3d 934 (2013) and City of Providence v. First Citizens Bankshares, Inc., 2014 Del. Ch. LEXIS 168 (Del. Ch. Sept. 8, 2014). State court decisions in Louisiana, New York, Illinois and elsewhere have recently upheld and enforced Delaware forum selection clauses

[3] 285 A. 2d 437 (Del. 1971).

[4] I have been provided this list by a coalition of plaintiff's attorneys and have only checked and confirmed some of the examples. Yet, as of late September, 2014, additional companies were adopting this approach on a daily basis, and some of the most prominent law firms in the U.S. were advising them.

[5] I will defer to Professor Lawrence A. Hamermesh with regard to this topic of pending developments in Delaware. However, it should be noted that, shortly after the ATP Tour decision, the Corporation Law Section of the Delaware State Bar Association proposed in mid-2014 an amendment to the Delaware General Corporation Law that would deny Delaware corporations the authority to adopt fee-shifting bylaws. For a time, this provision seemed headed for adoption, but then the process slowed as corporate lobbyists appeared on the scene. This lobbying battle poses a unique and still unresolved conflict between the interests of Delaware corporations and those of the Delaware Bar.

[6] Nonetheless, it is relevant to observe that a number of cases have addressed the issue of federal preemption in connection with deciding whether state anti-takeover statutes were in conflict with the goals of the Williams Act (i.e., Sections 13 and 14(d),(e), and (f) of the Securities Exchange Act of 1934). The most popular standard adopted in these cases has been the "meaningful opportunity for success" test. See, e.g., City Capital Associates v. Interco, Inc., 696 F. Supp. 1551 (D. Del. 1988); West Point-Pepperell, Inc. v. Farley, Inc., 711 F. Supp. 1096, 1102 (N.D. Ga. 1989); RP Acquisition Corp. v. Staley Cont'l, Inc., 686 F. Supp. 476, 482 (D. Del. 1988); BNS Inc. v. Koppers Co., 683 F. Supp. 458, 469 (D. Del 1988). If this standard were to govern, it would not preempt all fee-shifting bylaws, but only those likely to impose an "undue burden" by precluding shareholder litigation. Bylaws that imposed a more modest sanction could be upheld.

[7] For the treatment of the substantive claims, see Deutscher Tennis Bund v. ATP Tour, Inc., 610 F. 3d 820 (3d Cir. 2010).

[8] See Deutscher Tennis Bund v. ATP Tour, Inc., 2009 U.S. Dist. LEXIS 97851, 2009 WL 3367041 at *4 (D. Del. Oct. 19, 2009).

[9] See Deutscher Tennis Bund v. ATP Tour, Inc., 480 Fed. Appx. 124, 126 (3d Cir. 2012).

[10] Id. at 127 ("Indeed, we have doubts that Delaware courts would conclude that Article 23.3 imposes a legally enforceable burden on Deutscher and Qatar."). Apparently, it guessed wrong.

[11] 480 U.S. 1 (1987).

[12] 380 U.S. 460 (1965).

[13] The case most favorable to enforcing a fee-shifting bylaw is probably Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949), which upheld the application of a state mandatory security-for-expense bond requirement in federal court. The Supreme Court concluded that this statute was not truly procedural because its real intent was to deter frivolous litigation, not regulate procedure. Such an argument could also be made for fee-shifting bylaws, which similarly levy costs against the losing plaintiff. But Cohen was enforcing a substantive state policy intended to regulate corporate governance (which is traditionally left to state law). In this sense, Cohen is easily distinguishable. First, Delaware has no substantive policy favoring fee-shifting (but rather generally follows the American Rule and leaves departures from that rule to private ordering at present). Second, while the security-for-expense bond in Cohen applied only to derivative actions (which are principally brought in state court), the fee-shifting bylaw here at issue will apply to federal securities class actions (which cannot be brought in state court, at least in the case of Rule 10b-5, because federal courts have exclusive subject matter jurisdiction). Hence, it is arguable that Delaware lacks any legitimate interest in regulating actions that can exclusively be filed in federal court.

[14] 418 F. 2d 1276 (2d Cir. 1969). Globus does not stand alone and has been widely followed. See, e.g., Heizer Corp. v. Ross, 601 F. 2d 330, 334 (7th Cir. 1979); DeHaas v. Empire Petroleum Co., 286 F. Supp. 809, 815 (D. Colo. 1968), aff'd in relevant part, 435 F. 2d 1223 (10th Cir. 1970).

[15] 134 S. Ct. 568 (2013).

[16] 134 S. Ct. at 581.

[17] For example, the actual bylaw in the ATP Tour case was even more sweeping (and was still upheld by the Delaware Supreme Court) in that it required the plaintiff to reimburse the other side's expenses if it did "not obtain a judgment on the merits that substantially achieves, in substance in amount, the full remedy sought." 91 A. 3d at 555. Wow! Plaintiffs rarely win on everything and so could achieve a 95% victory and still face fee-shifting. See also the bylaw set forth supra in Note 1.

[18] The successful plaintiff's attorney can seek a court-awarded fee from the class's recovery, but under the American rule defendants are not usually liable for the plaintiff's attorney fees, even if the facts were overwhelmingly in the plaintiff's favor. Thus, the plaintiff's fees comes from its successful clients' recovery, not from the defendants.

[19] 377 U.S. 426 (1964).

[20] Id at 432.

[21] See Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014) (upholding "fraud on the market" doctrine).

[22] In 2012, the Carlyle Group inserted a mandatory arbitration provision into its governance documents as it was preparing its IPO, but quickly dropped it under regulatory and investor pressure. See Note, In a Bind: Mandatory Arbitration Clauses in the Corporate Derivative Context, 28 Ohio St. J. on Disp. Resol. 737, 745 (2013).

[23] See Form S-3 at Item 13 ("Disclosure for Securities Act Liabilities"). This Item requires the registrant to provide the information required by Item 510 of at Regulation S-K (17 C.F.R. 229.510), which requires the registrant (if indemnification is authorized) to state that it has "been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed by the Act and is therefore unenforceable."

[24] Indeed, Institutional Shareholder Services has also objected to board-adopted forum selection bylaws and supported an effort to repeal Chevron's bylaw to this effect.

[25] Activists could seek passage of an advisory shareholder vote recommending the repeal of the bylaw, but such a vote (presumably pursuant to SEC Rule 14a-8) will likely have to be precatory only. See CA, Inc. v. AFSCME Employees Pension Plan, 953 A. 2d 227 (Del 2008) (holding that a bylaw mandating reimbursement of expenses in proxy contests must be subject to a "fiduciary out," meaning that the board can refuse to accept the shareholders' position). In administering Rule 14a-8, the SEC will generally permit issuers to exclude shareholder resolutions that are not simply precatory. With respect to the possibility of a proxy contest, the passage of a fee-shifting bylaw will hardly reduce the corporation's value and thus will not make it a candidate for hedge fund activism (which usually is aimed at increasing share value over the short-term). No one else is likely to undertake the high costs of a proxy contest.