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The New Governance and the Challenge of Litigation Bylaws

Jill E. Fisch[†]

INTRODUCTION

Corporate governance mechanisms designed to ensure that managers act in shareholders' interests have evolved dramatically over the past 40 years.¹ A variety of regulatory and capital market developments have contributed to this evolution.² Law and economics scholars viewed the wave of corporate takeovers of the 1980s as harnessing market discipline to increase management accountability.³ When regulatory and economic developments, as well as the adoption of issuer-specific defensive measures such as the poison pill,⁴ reduced the incidence of hostile takeovers, corporate governance adapted through greater director independence and executive compensation plans that tied compensation more closely to issuer performance.⁵ This article refers to these developments as the “old governance.”

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¹ Ocasio and Joseph date the first use of the term “corporate governance” to 1972. See William Ocasio & John Joseph, *Cultural Adaptation and Institutional Change: The Evolution of Vocabularies of Corporate Governance, 1972–2003*, 33 *POETICS* 163, 166 (2005); see also Brian R. Cheffins, *The History of Corporate Governance*, in *THE OXFORD HANDBOOK OF CORPORATE GOVERNANCE* 46 (Mike Wright et al. eds., 2013) (describing developments in corporate governance from the 1970s to the 1990s).

² See generally Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 *COLUM. L. REV.* 863 (2013) (describing capital markets developments, including the reconcentration of share ownership, as driving changes in corporate governance).

³ See, e.g., JONATHAN R. MACEY, *CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN* 118-19 (2008) (explaining that takeovers provide a market-based system of disciplining underperforming managers).

⁴ See Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 *U. CHI. L. REV.* 871, 875-78 (2002) (explaining how the development of the poison pill dramatically changed the structure of the market for corporate control).

⁵ See *id.* at 872 (terming these developments “adaptive devices”).

Shareholders have continued to experiment with mechanisms to increase managerial accountability. Although shareholders have in some cases sought to impose these mechanisms by seeking regulatory changes,⁶ for the most part the innovations take the form of private ordering—that is, the adoption of issuer-specific rules that are contractual in nature (as opposed to statutes, agency rules, or decisional law).⁷ These governance innovations typically take the form of provisions in an issuer’s charter and bylaws.⁸ For example, shareholders responded to the poison pill by introducing bylaws seeking to limit the board’s authority to adopt or maintain a pill.⁹ Shareholder-adopted bylaw proposals have expanded to address a variety of other governance issues.¹⁰

The evolution has not been one-dimensional. As shareholders have sought to increase their role in corporate decisionmaking, issuers have responded by adopting mechanisms designed to constrain activist influence and, in particular, the potential short-term bias of some activist investors.¹¹ In some cases, board-adopted bylaws respond directly to shareholder efforts, such as when they impose procedures or conditions on the exercise of new shareholder governance rights.¹²

This article uses the term “the new governance”¹³ to describe the use of issuer-specific bylaws by both corporate

⁶ See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 971, 124 Stat. 1376, 1915 (codified as amended at 15 U.S.C. § 78n(a)(2) (2012)) (Dodd-Frank) (implementing governance reforms, including “say on pay”); Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249) (adopting a federal proxy access rule).

⁷ See, e.g., D. Gordon Smith et al., *Private Ordering with Shareholder Bylaws*, 80 *FORDHAM L. REV.* 125, 127 n.12 (2011) (discussing various uses of the term private ordering).

⁸ Although governance innovations can be implemented in either the charter or the bylaws, this article will focus on bylaw provisions because they can generally be adopted unilaterally by either the board or the shareholders. See *infra* notes 106-07 (describing director and shareholder authority to amend the bylaws). Shareholder responses can also take the form of a traditional contract. See, e.g., *UniSuper Ltd. v. News Corp.*, 898 A.2d 344, 345-46 (Del. Ch. 2006) (describing contractual provision limiting the board’s power to adopt a poison pill).

⁹ See *infra* note 55 (describing pill redemption bylaws).

¹⁰ See *infra* notes 70-102 (describing shareholder-adopted bylaws).

¹¹ For an analysis of the potential short-term orientation of institutional investors, see Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 *COLUM. L. REV.* 449 (2014).

¹² See ISS Proxy Advisory Services, Allergan, Inc. Aug. 6, 2014, at 7-8 (describing the board’s unilateral adoption of bylaws limiting shareholder power, based on shareholder-approved charter amendments, to act by written consent and to call a special shareholder meeting).

¹³ I do not intend to connect the analysis in this article to the use of the term “new governance” by scholars studying the relationship between institutional design and effective regulation, although there are some potential parallels between that work and the ideas discussed herein. See, e.g., Orly Lobel, *New Governance as Regulatory Governance*, in *THE OXFORD HANDBOOK OF GOVERNANCE* 3 (David Levi-Four ed., 2012),

boards and shareholders to structure governance rights.¹⁴ The critical characteristic of the new governance is that it reflects a structural approach to the balance of power between boards and shareholders. Importantly, this structural approach has been implemented through private ordering rather than regulatory reform.¹⁵

The advantages to implementing governance reform through private ordering include firm-specific tailoring of corporate governance rather than a one-size-fits-all approach, minimization of regulatory error, and the opportunity to overcome political and other constraints on regulatory change. Significantly, private-ordering governance innovations are distinctive in that they evolve through an iterative process. The new governance allows boards and shareholders each in turn to innovate and respond to governance changes.

The dark side of private ordering is that the process by which governance innovations are developed and adopted is poorly understood. Self-interested managers may adopt bylaws designed to insulate themselves from accountability to shareholders or market discipline. Institutional shareholders may propose reforms that are empirically untested or driven by objectives other than maximizing firm value. Policy entrepreneurs may advocate for changes for reasons that further their own agendas rather than enhancing value.¹⁶ At the same time, market discipline may be imperfect. Notably, commentators have questioned the extent to which the market responds to governance reforms through changes in stock price.¹⁷

<http://ssrn.com/abstract=2179160> [<http://perma.cc/2R9F-S5RC>] (describing new governance as “a school of thought that focuses on the significance of institutional design and culture for effective and legitimate regulation”).

¹⁴ To be fair, corporate governance does not reflect an abrupt shift between old and new governance. Indeed, this article views shareholder efforts to address the adoption and scope of the poison pill through bylaws that limit board authority as a transition to the structural approach that characterizes the new governance.

¹⁵ See also Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435, 496-97 (2012) [hereinafter Fisch, *Destructive Ambiguity*] (highlighting advantages of private ordering for developing procedures for shareholder nomination of director candidates).

¹⁶ See Matthew D. Cain, Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *How Corporate Governance Is Made: The Case of the Golden Leash*, 164 U. PA. L. REV. 649, 651-56 (2016) (examining empirically the role of intermediaries in governance innovation); Martin Lipton & Daniel Neff, *Harvard's Shareholder Rights Project Is Still Wrong* (Nov. 30, 2012), <http://corpgov.law.harvard.edu/2012/11/30/harvards-shareholder-rights-project-is-still-wrong/> [<http://perma.cc/F5ES-WE3W>] (describing efforts by the Harvard Shareholder Rights Project to de-stagger corporate boards as “[a] small but influential alliance of activist investor groups, academics and trade unions continues—successfully it must be said—to seek to overhaul corporate governance in America to suit their particular agendas and predilections”).

¹⁷ See, e.g., Cain et al., *supra* note 16, at 657-58.

These concerns raise the question of the extent to which the new governance requires regulatory or judicial oversight. Historically, Delaware has deferred to market forces to discipline governance innovation.¹⁸ If anything, the case for deferring to market forces has increased with capital market developments such as the rise of institutional voting, the influence of the proxy advisory firm Institutional Shareholder Services (ISS), and the ability of shareholders to initiate bylaw changes through the shareholder proposal process of Rule 14a-8.¹⁹ In keeping with this approach, Delaware has taken a largely hands-off approach to the new governance, although the courts have invalidated some shareholder innovations on the grounds that they unduly interfere with board authority and have policed board innovations that are extreme or adopted for an improper purpose.²⁰

In 2015, however, the Delaware legislature took the unusual step of amending the state's corporation statute to impose limits on the new governance with respect to so-called litigation bylaws.²¹ The legislative response was unusual because it interposed the legislature into a market process that was already responding to the introduction of litigation bylaws.²² The legislative response involved a rare package of mandatory provisions that individual issuers could not change.²³ Notably, the 2015 legislation displaced the traditional Delaware approach of allowing courts to police the adoption and use of litigation bylaws in the same way that they had policed other governance innovations such as the poison pill.

Part I of this article briefly sketches the background of corporate governance evolution. In Part II, the article introduces

¹⁸ Kahan & Rock, *supra* note 4, at 872. The seeming exception is the poison pill. Delaware courts developed an elaborate jurisprudence for reviewing board adoption and use of a pill. *See, e.g., Moran v. Household Int'l, Inc.*, 490 A.2d 1059 (Del. Ch. 1985) (evaluating board authority to adopt a poison pill); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1990) (applying analysis from *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), to analyze board's decision to maintain a poison pill to block a hostile transaction). In the end, however, the legal standard rarely involved judicial interference, and market forces likely proved far more significant in determining the extent to which a board could wield a pill to defend against a takeover attempt. *See Air Prods. & Chems, Inc. v. Airgas, Inc.*, 16 A.3d 48, 54-55 (Del. Ch. 2011).

¹⁹ *See, e.g.,* Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 655-67 (2008-2009) (describing market and regulatory developments that have increased the importance of shareholder voting).

²⁰ *See infra* notes 160-73.

²¹ DEL. CODE ANN. tit. 8, §§ 102(f), 109(b) (2015) (2015 legislation).

²² *See, e.g., ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 559 (Del. 2014) (upholding facial validity of fee-shifting bylaw but warning that context might limit its application).

²³ *See infra* notes 216-18 (describing the legislation in detail).

the new governance and explains how both shareholders and issuer boards have innovated through the adoption of governance bylaws. Part III describes the legal standards that courts have applied in evaluating the validity of governance bylaws and the rationale for this approach. In Part IV, the article considers the specific case of litigation bylaws. The article asks whether the 2015 legislation that restricted the scope of litigation bylaws can be justified in light of Delaware's traditional deference to the courts and the market. Toward that end, the article explores the extent to which litigation bylaws should be viewed as conceptually distinct from other new governance provisions.

The article concludes that, whether or not the legislature's actions were appropriate, they should be understood as context-specific. Litigation bylaws reflect an issuer's attempt partially to opt out of the package of Delaware law to which it has submitted by choosing to incorporate in Delaware. As a result, the legislature's response can be viewed as imposing a requirement that corporations that seek to avail themselves of Delaware law submit to the full package of Delaware corporate law—a package that includes both statutory provisions and oversight by the Delaware courts. In that light, the legislation need not signal an intention to subject the new governance to greater oversight.

I. BACKGROUND

In the United States, the focus on corporate governance began in the 1970s.²⁴ Brian Cheffins traces the origins of corporate governance to an effort by the SEC to address management accountability as part of the agency's regulatory agenda—specifically, the SEC's attempt to reduce payments by U.S. corporations of overseas bribes.²⁵ The foreign corrupt payments scandal²⁶ and the congressional response through the enactment of the Foreign Corrupt Practices Act of 1977²⁷ legitimized the SEC's involvement in the effort to reduce public companies' managerial agency costs.

²⁴ Cheffins, *supra* note 1, at 46.

²⁵ *Id.* at 2.

²⁶ See Mike Koehler, *The Story of the Foreign Corrupt Practices Act*, 73 OHIO ST. L.J. 929, 932 (2012) (describing the foreign corrupt payments problem).

²⁷ Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 102, 91 Stat. 1494, 1496, amended by Foreign Corrupt Practices Act Amendments of 1988, Pub. L. No. 100-418, 102 Stat. 1415, and by International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302 (codified as amended in scattered sections of 15 U.S.C. (2012)).

The initial concern over corrupt foreign payments extended to a broader focus on managerial agency costs. In the 1970s and 1980s, the market for corporate control began to function as a mechanism for addressing these agency costs.²⁸ The takeover market enabled strategic investors to overcome collective action limitations on shareholder power by purchasing control and using that control to replace management and adopt other governance changes.²⁹ Corporate takeovers were highly controversial, however,³⁰ and corporate America urged policymakers to take action to defend incumbent management against the much-maligned corporate “raiders.”³¹ Both states and the federal government took some initial steps in this direction—the states through the adoption of antitakeover statutes,³² and the federal government through the passage of the Williams Act.³³

The demand for regulatory interference with takeovers was reduced by the invention (and the Delaware courts’ acceptance) of the poison pill. The poison pill transformed the market for corporate control without the need for broad-based legislation.³⁴ Poison pills enabled corporate boards to exert greater power over the market for corporate control. At the same time, the pill placed heightened responsibility on boards to exercise that power appropriately. Together with the staggered board, the pill dramatically reduced an issuer’s vulnerability to a hostile tender offer.³⁵

²⁸ See Steven N. Kaplan, *The Evolution of U.S. Corporate Governance: We Are All Henry Kravis Now*, 7 U. OF CHI. J. PRIVATE EQUITY 5-6 (1997) (“The takeover wave of the 1980s appears to have been a capital market response to corporate governance deficiencies.”); FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 171-74 (1991) (discussing the importance of tender offers and advocating the prohibition of target resistance for controlling agency costs).

²⁹ See, e.g., John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer’s Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1152 (1994) (describing and challenging the claim by law and economics scholars that “the hostile takeover performs a desirable disciplinary function by replacing inefficient management”).

³⁰ See, e.g., John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1429 (1991) (describing the debate over hostile takeovers).

³¹ See, e.g., Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 868 n.41 (1993) (citing testimony by corporate issuers).

³² See, e.g., Matheson & Olson, *supra* note 30 (describing state antitakeover statutes).

³³ Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C. §§ 78l-78n (1988)); see Matheson & Olson, *supra* note 30, at 1435-37 (describing the adoption of the Williams Act).

³⁴ See Kahan & Rock, *supra* note 4.

³⁵ See, e.g., Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 891 (2002)

Corporate governance adapted to the pill.³⁶ The percentage of outside directors on corporate boards increased, as did the degree to which these directors were independent of management.³⁷ Executive compensation structures also evolved, shifting to forms of payment that provided high-powered management incentives, including the incentive for management to agree to the terms of an attractive takeover bid.³⁸ In part because of this adaptive process, the takeover era set into motion an increased focus on management accountability to shareholders. The defense of takeovers as a mechanism for reducing managerial agency costs thus translated into a broader agenda for governance reform.

The rise of the institutional investor created a means of pursuing that agenda. During this same time period, the ownership of the U.S. public corporation was shifting from the Berle and Means model of dispersed ownership to a structure in which institutional ownership began to dominate.³⁹ This trend was greatest among the largest issuers; by the 2000s, institutional investors owned more than 70% of the equity in the 1,000 largest U.S. corporations.⁴⁰ The new institutional investors were concerned about the governance of their portfolio companies. Public pension fund CalPERS led the way with its strategy of identifying underperforming companies and publicly targeting them for governance reform.⁴¹

Structural limitations and new agency problems, however, limited the role that these institutional investors were willing to play in corporate governance.⁴² In particular, most institutional investors' business models did not provide suitable incentives for portfolio managers to exercise their governance rights

(finding that an effective staggered board nearly doubles the likelihood that a target company will remain independent).

³⁶ Kahan & Rock, *supra* note 4, at 881-85.

³⁷ *Id.*; Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1472-73 (2007) (describing the rise of independent directors and director independence).

³⁸ Kahan & Rock, *supra* note 4, at 884.

³⁹ See Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961, 1962-63 (2010) (describing increase in institutional ownership and explaining it, in part, by the increased use, by retail investors, of institutional intermediaries such as mutual funds and pension funds); see also Gilson & Gordon, *supra* note 2, at 886 (terming this a "reconcentration of ownership").

⁴⁰ Fisch, *supra* note 39, at 1963.

⁴¹ See Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 315-17 (2008) (describing CalPERS's activist strategy as a model for other institutions); Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 227, 251 (1996) (empirically analyzing the CalPERS effect).

⁴² See Gilson & Gordon, *supra* note 2, at 889-91.

actively.⁴³ Gilson and Gordon argue that the inability of this pool of institutional money to be proactive created a “governance gap,” which, in turn, created a market opportunity.⁴⁴ The specialized investor to exploit this market opportunity was the hedge fund. Gilson and Gordon portray the modern hedge fund as a governance arbitrageur that can harness institutional power to support governance reform.⁴⁵

That activist hedge funds have successfully mobilized the reconcentrated stakes of other more passive institutional investors is clear. Moreover, this mobilization empowered even passive institutions. Issuers must be responsive to the needs and demands of passive institutions because of the potential importance of those institutions in providing voting support for an activist campaign.⁴⁶ This has led to an increasing emphasis in corporate governance on issuer responsiveness to shareholder interests.

The appropriate level of such responsiveness from the perspective of maximizing firm or societal value is a difficult normative question that is beyond the scope of this article.⁴⁷ Some commentators have convincingly argued that the market has been too responsive to shareholder pressure and that the shareholder empowerment strategy “reached the outer limits of its effectiveness for the time being.”⁴⁸ Whatever the appropriate level, it is clear that, in the United States, shareholders are more active and effective in corporate governance than ever before.

II. GOVERNANCE INNOVATIONS

A. *The New Governance from the Shareholder’s Perspective*

Initial shareholder efforts at corporate governance focused on reducing managerial agency costs through two mechanisms. One was the increased use of a monitoring board comprised

⁴³ See Jill E. Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO ST. L.J. 1009, 1023-24 (1994) (providing a general formula that describes the collective action problem and explaining why, because of competition, the benefits to traditional institutional investors such as mutual funds and pension funds from activism are unlikely to outweigh the costs).

⁴⁴ Gilson & Gordon, *supra* note 2, at 896.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ For a summary of the debate, see Jennifer G. Hill, *The Rising Tension Between Shareholder and Director Power in the Common Law World*, 18 CORP. GOVERNANCE: AN INT’L REV. 344 (2010).

⁴⁸ William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 728 (2010).

primarily of independent directors.⁴⁹ The second was a refinement of executive compensation practices designed to create better managerial incentives by aligning the interests of executives with those of shareholders.⁵⁰ Delaware law mandates that shareholder governance initiatives be indirect.⁵¹ Under Delaware law, shareholders lack the authority to manage the corporation; hence, their efforts must be directed to increasing the accountability of those who possess that authority—officers and the board of directors.⁵²

In their initial form, both board and compensation reforms were implemented through private ordering.⁵³ For both, however, issuer-specific developments were supplemented by regulatory intervention. In the case of board reform, the self-regulatory organizations, at the behest of the SEC, mandated increased board independence by amending their listing requirements. With respect to compensation, shareholder efforts to reform the structure of executive compensation were assisted by regulatory measures such as the adoption of Internal Revenue Code section 162(m), which provided for more favorable tax treatment of performance-based executive compensation. Similarly, Congress adopted both increased disclosure requirements and an advisory shareholder vote on executive compensation as part of Dodd-Frank.⁵⁴

Shareholders also sought to use private ordering to limit directly a board's ability to resist a takeover attempt.

⁴⁹ See, e.g., Gordon, *supra* note 37, at 1514-20; Jill E. Fisch, *Taking Boards Seriously*, 19 CARDOZO L. REV. 265, 267 (1997) (noting that commentators have generally accepted the monitoring function of the board as displacing its role in managing the corporation).

⁵⁰ See, e.g., Kahan & Rock, *supra* note 4, at 884.

⁵¹ See DEL. CODE ANN. tit. 8, § 141(a) (2014) (giving boards of directors the authority to manage the corporation); see also Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 322 (2001) ("In the scheme of corporate governance the role of shareholders has been purposefully indirect. Shareholders' direct authority is limited." (quoting Int'l Bhd. of Teamsters Gen. Fund v. Fleming Cos., Inc., 975 P.2d 907, 911 (Okla. 1999))).

⁵² See, e.g., *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) ("Generally, shareholders have only two protections against perceived inadequate business performance. They may sell their stock (which, if done in sufficient numbers, may so affect security prices as to create an incentive for altered managerial performance), or they may vote to replace incumbent board members.").

⁵³ See, e.g., Gordon, *supra* note 37, at 1447-48 (recounting development of the focus on director independence); Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299, 310-12 (2009) (describing evolution of procedural mechanisms to address compensation, such as compensation committees).

⁵⁴ See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 972, 124 Stat. 1376, 1915 (2010) (codified as amended at 15 U.S.C. § 78n-2 (2012)).

Specifically, in the mid-1990s, some institutional investors proposed bylaws that attempted to restrict the board's adoption or use of a poison pill.⁵⁵ These provisions reflected an unprecedented effort by shareholders to use their statutory authority to adopt bylaws as a means of limiting board authority.⁵⁶ As such, they presented a novel tension between board and shareholder power.⁵⁷ Although an Oklahoma court upheld the validity of a pill redemption bylaw in 1999,⁵⁸ most commentators argued that Delaware courts would invalidate such a bylaw as impermissibly interfering with the board's managerial authority under Delaware General Corporation Law (DGCL) 141(a).⁵⁹

Delaware courts did not rule on the validity of so-called first generation pill redemption bylaws.⁶⁰ Investors modified their approach, however, to address concerns over the validity of such a bylaw. For example, Harvard Law Professor Lucian Bebchuk explored an alternative approach at Computer Associates. The Bebchuk bylaw, which he introduced through a shareholder proposal, would have required a board vote to adopt or extend a poison pill to be unanimous.⁶¹ Although Bebchuk sought to have a court determine the validity of the provision, the Delaware court refused to do so, holding that the issue was not ripe.⁶² The proposal was included in Computer Associates' proxy materials but was not approved by the

⁵⁵ Arbitrageur Guy Wyser-Pratte is credited with the introduction of the first such bylaw and introduced proposals for pill-redemption bylaws successfully in several cases in which he sought to persuade the target company boards to agree to an acquisition. See Kate Margolis, Comment, *Binding Shareholder Bylaw Amendments: An Antidote for the Poison Pill?*, 67 MISS. L.J. 817, 831 (1998); see also Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TULANE L. REV. 409, 421 (1998) [hereinafter Hamermesh, *Corporate Democracy*] (describing history of the AFL-CIO's introduction of a pill-redemption bylaw at Fleming Companies).

⁵⁶ See Hamermesh, *Corporate Democracy*, *supra* note 55, at 426-27 (noting that corporate bylaws had previously received little attention).

⁵⁷ See, e.g., Smith et al., *supra* note 7, at 140-43 (summarizing this debate).

⁵⁸ See *Int'l Bhd. of Teamsters Gen. Fund v. Fleming Cos., Inc.*, 975 P.2d 907, 908 (Okla. 1999).

⁵⁹ See, e.g., Hamermesh, *Corporate Democracy*, *supra* note 55, at 428-33; John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. MIAMI L. REV. 605, 613-16 (1997); Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L. J. 205 (2005).

⁶⁰ John C. Coates IV & Bradley C. Faris, *Second-Generation By-Laws: Post-Quickturn Alternatives*, 56 BUS. LAW. 1323, 1329 (2001) ("[N]o Delaware court has addressed the legality of first generation shareholder bylaws.").

⁶¹ *The Bebchuk Bylaw: Devilish... but Brilliant*, 6 M&A J. 1 (2006) [hereinafter *Bebchuk Bylaw*].

⁶² *Bebchuk v. CA, Inc.*, 902 A.2d 737, 738 (Del. Ch. 2006).

shareholders, so its validity under Delaware law was never tested.⁶³

Subsequently, Professor Bebchuk adopted a different strategy to reduce a board's ability to resist a hostile takeover, mounting a broad-based campaign to eliminate classified boards of directors.⁶⁴ Over the course of a few years, Bebchuk successfully persuaded many institutional investors to pressure issuers to declassify their boards. This shift was facilitated by the Harvard Shareholder Rights Project (SRP), a clinical program at Harvard Law School, directed by Professor Bebchuk.⁶⁵ The SRP mounted a campaign from 2012 to 2014 to eliminate staggered boards.⁶⁶ The strategy was very successful; as of 2014, "[a]lmost 90 percent of S&P 500 companies (and almost 60 percent of Russell 3000 companies) ha[d] annually elected boards."⁶⁷ According to a recent posting on the SRP site, the program is no longer operating.⁶⁸

Shareholders' mixed success at using private ordering to address the poison pill did not dissuade them from continuing to test the limits of their authority to restructure corporate decisionmaking through bylaw provisions. Instead of focusing on poison pills, shareholders began to introduce issuer-specific bylaws aimed more generally at the structure and composition of the board of directors and at the election process itself.

The demand for greater shareholder input into the selection of directors was heightened by the corporate governance scandals of the late 1990s that, in many cases, revealed substantial deficiencies at the board level. The massive fraud at Enron, for example, was attributed in part to the failure of its board to exercise sufficient oversight.⁶⁹ In

⁶³ Matthew F. Sullivan, *Shareholder Bylaw Proposals, Delaware Certification, and the SEC After CA, Inc. v. AFSCME Employees Pension Plan*, 87 U. DET. MERCY L. REV. 193, 205 n.59 (2010).

⁶⁴ A classified board enhances the effectiveness of a pill because it extends the procedures for replacing a majority of the board, in order to redeem the pill, for more than one election contest. See *Bebchuk Bylaw*, *supra* note 61, at 1-4.

⁶⁵ For a description of the SRP, see Daniel M. Gallagher & Joseph A. Grundfest, *Did Harvard Violate Federal Securities Law? The Campaign Against Classified Boards of Directors* 20-21 (Rock Ctr. for Corp. Governance, Working Paper No. 199, 2014), <http://ssrn.com/abstract=2536586> [<http://perma.cc/N3J3-8VP5>].

⁶⁶ *Id.*

⁶⁷ Marc S. Gerber, "US Corporate Governance: Boards of Directors Face Increased Scrutiny," SKADDEN (Jan. 16, 2014), <http://www.skadden.com/insights/us-corporate-governance-boards-directors-face-increased-scrutiny> [<http://perma.cc/K2NM-6THZ>].

⁶⁸ See *Shareholder Rights Project*, HARV. L. SCH., <http://www.srp.law.harvard.edu/companies-voting-on-proposals.shtml> [<http://perma.cc/X35Z-JZQ3>] (last visited June 17, 2016) ("With work on the declassification project completed last summer, the clinic has not been operating during the current academic year.").

⁶⁹ See, e.g., WILLIAM C. POWERS, JR. ET AL., REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORP. 24

addition, there were reasons to believe courts might be more receptive to shareholder efforts focused on the election process. For example, the Delaware Chancery Court explained in *Blasius Industries, Inc. v. Atlas Corp.* that the “question who should constitute the board of directors” was not one that could be “left to the agent’s business judgment.”⁷⁰

Shareholder efforts at restructuring the election process through bylaw amendments took several forms. One approach was to introduce a bylaw giving shareholders the right to nominate director candidates for inclusion on the issuer’s proxy statement. This power, which shareholders had sought since the 1940s, came to be known as proxy access.⁷¹ Proxy access faced an obstacle, however: SEC opposition to granting shareholders broad access to the issuer’s proxy statement. First, the SEC decided that proxy access proposals were not a proper subject for shareholder proposals under Rule 14a-8.⁷² When a federal court disagreed,⁷³ the SEC amended the shareholder proposal rule to exclude proxy access proposals explicitly.⁷⁴

Eventually, the SEC changed its position and, responding to enabling legislation in Dodd-Frank, adopted a federal proxy access rule, Rule 14a-11.⁷⁵ The rule, which implemented a mandatory standard by which shareholders could access the issuer’s proxy statement for the purpose of nominating director candidates, was highly controversial.⁷⁶ Business interests promptly filed suit challenging the rule and,

(2002) (concluding that the Enron board failed in its oversight duties and that appropriate board monitoring “could and should have been prevented or detected at an earlier time had the Board been more aggressive and vigilant”). Indeed, Enron’s outside directors settled claims of wrongdoing with the unusual agreement personally to pay money damages. See *Why Directors Pay—The Latest Wrinkle in the Corporate Governance Movement*, THOMPSON HINE (Jan. 1, 2005), <http://www.thomsonhine.com/publications/why-directors-pay--the-latest-wrinkle-in-the-corporate-governance-movement> [<http://perma.cc/RJB7-2QSK>] (reporting that the Enron directors agreed to pay \$13 million of their own money to settle investor lawsuits).

⁷⁰ *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 660 (Del. Ch. 1988).

⁷¹ See generally Fisch, *Destructive Ambiguity*, *supra* note 15 (describing history of proxy access).

⁷² See *AFSCME v. AIG, Inc.*, 462 F.3d 121, 131 (2d Cir. 2006) (describing the SEC’s position that AIG could properly exclude AFSCME’s proxy access proposal as not within the scope of Rule 14a-8).

⁷³ *Id.*

⁷⁴ Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 34-56914, 72 Fed. Reg. 70,450 (Dec. 11, 2007) (to be codified at 17 C.F.R. pt. 240).

⁷⁵ Facilitating Shareholder Director Nominations, Exchange Act Release No. 33-9136, Exchange Act Release No. 33-62,764, 75 Fed. Reg. 56,668, 56,677-93 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249).

⁷⁶ See Fisch, *Destructive Ambiguity*, *supra* note 15, at 441 (describing business interests’ opposition to Rule 14a-11).

in 2011, the D.C. Circuit invalidated it.⁷⁷ The litigation did not, however, disturb the SEC's amendment to Rule 14a-8, which had reversed its 2007 rulemaking⁷⁸ and opened the door for investors to use shareholder proposals to introduce proxy access bylaws.⁷⁹

The SEC's original position opposing proxy access shareholder proposals and the adoption and invalidation of Rule 14a-11 delayed shareholder efforts to implement proxy access through private ordering. Subsequently, however, investors renewed their focus on proxy access. In November 2014, the Office of the New York City Comptroller launched its "Boardroom Accountability Project" in which it introduced proxy access shareholder proposals at 75 issuers during the 2014-2015 proxy season.⁸⁰ The proposals received widespread support. Of the 40 that were voted on during the first half of 2015, 64% received majority shareholder support.⁸¹ In addition, several issuers agreed to implement proxy access voluntarily, either in response to the proposals or independently.⁸² Reports indicate that "[p]roxy access bylaws are proliferating."⁸³

Another initiative designed to increase shareholder power over the election of directors is majority voting. Although directors have traditionally been elected under a plurality voting standard, starting in 2005, shareholders began to

⁷⁷ *Bus. Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

⁷⁸ Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 34-56914, 72 Fed. Reg. 70,450 (Dec. 11, 2007) (to be codified at 17 C.F.R. pt. 240).

⁷⁹ See Fisch, *Destructive Ambiguity*, *supra* note 15, at 450-52 (explaining the effect of the amendment to Rule 14a-8 and its effectiveness as of September 20, 2011).

⁸⁰ *Boardroom Accountability Project*, N.Y.C. COMPTROLLER, <http://comptroller.nyc.gov/boardroom-accountability/> [<http://perma.cc/8824-DZE7>] (last visited June 17, 2016). Other shareholders also submitted proxy access proposals. See Elizabeth Ising, *Shareholder Proposal Developments During the 2015 Proxy Season*, HARV. L. SCH. FORUM ON CORP. GOV. & FIN. REG. (July 17, 2015), <http://corpgov.law.harvard.edu/2015/07/17/shareholder-proposal-developments-during-the-2015-proxy-season/> [<http://perma.cc/JPJ7-TJZY>] (reporting 108 proxy access proposals submitted during 2015 proxy season).

⁸¹ PROXY PULSE, 2015 PROXY MID-SEASON REVIEW (2d ed. 2015), <http://media.broadridge.com/documents/ProxyPulse-Mid-Season-Second-Edition-2015.pdf?id=00203PPRUSA15JUNLPG02PPR&so=ms&po=bt&ct=cd&ot=wp&mt=jn&yr=15&rg=us> [<http://perma.cc/XU3J-VDFC>].

⁸² Nikita Stewart, *City Comptroller Reaches Deals with 5 Companies on Giving Shareholders Say on Directors*, N.Y. TIMES (Mar. 10, 2015), <http://www.nytimes.com/2015/03/11/nyregion/city-comptroller-reaches-deals-with-5-companies-on-giving-shareholders-say-on-directors.html> [<http://perma.cc/6UGD-VK7Q>] (reporting that five issuers had reached agreements with New York City to adopt proxy access and that three others decided to institute proxy access without having received a proposal to do so).

⁸³ Nicolas Grabar & Leah LaPorte Malone, *Getting Ready for Proxy Access*, CLEARY GOTTlieb (Oct. 20, 2015), <http://www.clearymawatch.com/2015/10/getting-ready-for-proxy-access/> [<http://perma.cc/H64N-LL3A>].

advocate for a change in the voting standard.⁸⁴ Delaware law explicitly allows shareholders to adopt majority voting through a bylaw provision,⁸⁵ and in 2006, the legislature amended the statute to prevent boards from amending or repealing a shareholder-adopted majority voting bylaw.⁸⁶ To date, the effort to persuade issuers to switch to majority voting has been very successful. Although only 9% of S&P 100 companies used majority voting as recently as 2005, more than 90% of S&P 500 companies now use some form of majority voting.⁸⁷

One of the substantial limits on shareholder power is that corporate statutes vest the authority to call a shareholder meeting in the board of directors.⁸⁸ Delaware law, however, authorizes the shareholders to adopt a bylaw that empowers them to call a special meeting, giving the shareholders increased control over the governance agenda.⁸⁹ Provisions giving shareholders the power to call a special meeting have been among the most popular shareholder proposals.⁹⁰ Their proliferation has led many issuers to adopt special meeting provisions voluntarily, although in some cases, issuers have implemented a provision that required a higher threshold than that requested by the shareholders.⁹¹

⁸⁴ See Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *Does Majority Voting Increase Board Accountability?*, U. CHI. L. REV. (forthcoming 2016); see also David C. McBride & Rolin P. Bissell, *Delaware's Flexible Approach to Majority Voting for Directors*, 10 WALL ST. LAW., June 2006, at 1 (describing move to adopt majority voting policies and bylaws).

⁸⁵ DEL. CODE ANN. tit. 8, § 216 (2015).

⁸⁶ The amendment added language providing that shareholder bylaws that specify “the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.” *Id.*; see McBride & Bissell, *supra* note 83, at 2 (explaining proposed statutory amendment and its purpose).

⁸⁷ Choi, *Majority Voting*, *supra* note 84. Some commentators have argued that the structure of a majority voting bylaw is limited by Delaware law. See, e.g., Frederick H. Alexander & James D. Honaker, *The Nuts and Bolts of Majority Voting*, MORRIS, NICHOLS, ARSHT & TUNNELL LLP (Dec. 7, 2006), <http://www.mnat.com/files/113.pdf> [<http://perma.cc/X4Q3-R4HF>].

⁸⁸ DEL. CODE ANN. tit. 8, § 211 (2009).

⁸⁹ J. Robert Brown Jr., *Delaware Law and the Right of Shareholders to Call Special Meetings*, [THE RACETO THE BOTTOM.ORG](http://www.theracetothetobottom.org) (Aug. 13, 2014, 6:01 AM), <http://www.theracetothetobottom.org/home/delaware-law-and-the-right-of-shareholders-to-call-special-m.html> [<http://perma.cc/4345-M62Z>].

⁹⁰ See Ning Chiu & Richard J. Sandler, *Spotlight on Shareholder Proposals: Special Meetings*, DAVIS POLK (July 19, 2011), <http://www.briefinggovernance.com/2011/07/spotlight-on-shareholder-proposals-independent-chairs/> [<http://perma.cc/8YRR-ZL65>] (describing expansion of special meeting rights as a response to “targeted activism”); see also Ising, *supra* note 80 (describing shareholder proposals regarding special meetings as receiving “high shareholder support”).

⁹¹ See *2014 Proxy Season Review*, SULLIVAN & CROMWELL 11 (June 25, 2014). Issuers have also introduced proposals with higher thresholds in an effort to block shareholders from voting on a shareholder special meeting proposal. See *id.* As of June 2014, more than 60% of S&P 500 companies had some type of provision allowing shareholders to call a special meeting, although the required threshold for making such

Shareholders have also focused on director qualifications and incentives. They have introduced proposals to impose requirements of particular expertise or experience on director candidates,⁹² to require greater director independence,⁹³ to establish a mandatory retirement age,⁹⁴ to limit director tenure,⁹⁵ and to increase director diversity.⁹⁶ Most state statutes expressly authorize a corporation to impose certain qualifications on director candidates.⁹⁷ For example, the Delaware statute explicitly provides that the charter or bylaws “may prescribe other qualifications for directors.”⁹⁸ Commentary suggests that permissible qualifications might include age and length of service.⁹⁹ The broader scope of permissible qualification requirements is unclear. Although the SEC has provided no-action guidance on the validity of various qualification requirements in the context

a request varies. *Id.* at 11. The SEC recently issued guidance indicating that it will no longer permit issuers to use this approach to exclude a shareholder proposal. *See Staff Legal Bulletin No. 14H (CF): Shareholder Proposals*, SEC (Oct. 22, 2015), <https://www.sec.gov/interps/legal/islb14h.htm> [<http://perma.cc/Y6LS-38UR>].

⁹² One popular example is shareholder proposals seeking to have companies in industries such as oil and gas or mining have a director with environmental expertise. *See Shareholders Press Boards on Social and Environmental Risks*, ERNST & YOUNG, <http://www.ey.com/US/en/Services/Specialty-Services/Climate-Change-and-Sustainability-Services/Shareholders-press-boards-on-social-and-environmental-risks---Take-action> [<http://perma.cc/SN6H-GWTQ>] (last visited June 17, 2016).

⁹³ *See, e.g.*, Intergraph Corp., 1995 SEC No-Act. LEXIS 362 (Mar. 2, 1995) (describing shareholder proposal to adopt a bylaw requirement that the board have a majority of independent directors).

⁹⁴ *See Hamermesh, Corporate Democracy, supra* note 55, at 482 n.312 (1998) (describing several shareholder bylaw proposals that would have mandated director retirement at age 70).

⁹⁵ ISS has highlighted director tenure as a concern, although it has not yet added the topic to its voting guidelines. Gerber, *supra* note 67.

⁹⁶ CalSTRS has filed 35 proposals asking for action on board diversity. Gretchen Morgenson, *Not Walking the Walk on Board Diversity*, N.Y. TIMES (May 31, 2014), http://www.nytimes.com/2014/06/01/business/not-walking-the-walk-on-board-diversity.html?_r=0 [<http://perma.cc/D5NJ-BUG5>]. Trillium filed 4 proposals in 2014 seeking board diversity. *Trillium Files Four Board Diversity Shareholder Proposals for 2015*, TRILLIUM ASSET MGMT. (Dec. 20, 2014), <http://www.trilliuminvest.com/14405/> [<http://perma.cc/DZF6-EL8S>]. A Price Waterhouse Survey in 2014 found that nine of ten investors believe that boards “should be revisiting their director diversity policies.” PRICEWATERHOUSECOOPERS, INVESTOR PERSPECTIVES: HOW INVESTORS ARE SHAPING BOARDS TODAY . . . AND INTO THE FUTURE 6 (2014), <https://www.pwc.com/us/en/governance-insights-center/publications/assets/pwc-investor-survey-2014.pdf> [<http://perma.cc/LC3K-L43Q>].

⁹⁷ *See, e.g.*, MODEL BUS. CORP. ACT § 8.02 (AM. BAR ASS’N 2002) (“The articles of incorporation or bylaws may prescribe qualifications for directors.”); S.D. CODIFIED LAWS § 47-1A-802 (2016) (“The articles of incorporation or bylaws may prescribe qualifications for directors.”).

⁹⁸ DEL. CODE ANN. tit. 8, § 141(a)-(b) (2014).

⁹⁹ *See* Lawrence A. Hamermesh, *Director Nominations*, 39 DEL. J. CORP. L. 117, 156 n.182 (2014) (“Examples of qualifications that may be permissible under section 8.02 are eligibility requirements based on residence, shareholdings, age, length of service, experience, expertise and professional licenses or certifications.”) (citing Corporate Laws Committee, ABA Section of Business Law, *Changes in the Model Business Corporation Act—Proposed Amendments to Section 8.02 Relating to Qualifications for Directors and Nominees for Directors*, 68 BUS. LAW. 781, 782 (2013)).

of Rule 14a-8 shareholder proposals,¹⁰⁰ courts have not ruled on the validity of the proposed bylaws.¹⁰¹

In addition, many shareholders support bylaws mandating the separation of the positions of chairman of the board and CEO.¹⁰² Bank of America recently responded to shareholder criticism of its decision to recombine the Chair and CEO positions and to give both titles to CEO Brian Moynihan by allowing shareholders to vote on a bylaw authorizing the combined role.¹⁰³ On September 22, 2015, shareholders approved the bylaw in a closely watched decision that many viewed as having important implications for the role of shareholders in determining a corporation's leadership structure.¹⁰⁴

Finally, a few activists have developed compensation schemes designed to increase the incentives for activist-nominated director candidates to pursue structural changes or otherwise increase shareholder value if elected. These so-called golden leash compensation arrangements were used in several activist campaigns in 2013 and appeared to decline in popularity after they generated negative publicity and attempts by some issuers to ban them through restrictive bylaws.¹⁰⁵ Recently, however, the golden leash has made a comeback in at least two activist contests,¹⁰⁶ and the first sitting directors subject to a golden leash joined the board of Dow Chemical in November 2014.¹⁰⁷

¹⁰⁰ See, e.g., Monsanto Co., SEC No-Action Letter, 2008 WL 5433185 (Nov. 7, 2008) (endorsing the company's Delaware counsel's position that the qualification appears to be unreasonable under state law).

¹⁰¹ Coates, *supra* note 60, at 482-83.

¹⁰² See Charles A. Tribbett, III, *Splitting the CEO and Chairman Roles—Yes or No?*, RUSSELL REYNOLDS ASSOCS. (Dec. 1, 2012), <http://www.russellreynolds.com/newsroom/splitting-the-ceo-and-chairman-roles-yes-or-no> [<http://perma.cc/8UMJ-39R3>] (reporting that the calls for separation are growing but that the actual voting results on such proposals are mixed).

¹⁰³ Barry B. Burr, *Florida SBA to Engage Bank of America on Separating CEO, Chairman Roles*, PENSIONS & INVESTMENTS (Sept. 1, 2015, 4:26 PM), <http://www.pionline.com/article/20150901/ONLINE/150909981/florida-sba-to-engage-bank-of-america-on-separating-ceo-chairman-roles> [<http://perma.cc/674G-YYBH>].

¹⁰⁴ See, e.g., Barry B. Burr, *Bank of America Shareholders Vote in Favor of Combining CEO, Chairman Roles*, PENSIONS & INVESTMENTS (Sept. 22, 2015, 10:23 AM), <http://www.pionline.com/article/20150922/ONLINE/150929971/bank-of-america-shareholders-vote-in-favor-of-combining-ceo-chairman-roles> [<http://perma.cc/LHW4-E5BF>]; Michael Corkery, *Victory for the Chief and the Board at Bank of America over a Dual Role*, N.Y. TIMES DEALBOOK (Sept. 22, 2015), <http://www.nytimes.com/2015/09/23/business/dealbook/bank-of-america-shareholders-allow-ceo-to-keep-chairmans-role.html> [<http://perma.cc/M5K6-QDDU>].

¹⁰⁵ See Cain et al., *supra* note 16, at 652-53.

¹⁰⁶ See Shane C. D'Souza & Deandra Schubert, *"Golden Leashes" Are Back: Will Shareholder Activists Win This Round?*, CANADIAN M&A PERSPECTIVES (Nov. 18, 2014), <http://www.canadianmergersacquisitions.com/2014/11/18/golden-leashes-are-back-will-shareholder-activists-win-this-round/> [<http://perma.cc/47K4-BAC8>].

¹⁰⁷ The directors were seated pursuant to a settlement between Dow and a shareholder activist. David Benoit & Joann S. Lublin, *Dow Chemical, Loeb Settle Board*

B. *The Boards Fight Back*

Most commentators agree that the foregoing developments led issuers to become more responsive to shareholder interests. Many issuers responded, however, to activist efforts to increase shareholder power and board accountability by attempting to limit the exercise of shareholder power and to maintain director primacy over issues such as the composition and structure of the board of directors. One tool that boards can use to limit the exercise of shareholder power is the bylaw.

In most states, directors and shareholders share the authority to amend the corporate bylaws,¹⁰⁸ but each can act unilaterally to do so.¹⁰⁹ The consequence is that the board can make governance changes without shareholder approval. One commentator explained that “these types of bylaws intended to inhibit shareholder actions are all the rage in corporate America.”¹¹⁰ Board efforts to limit shareholder control of the board can range from bylaws that impose substantive requirements on directors to those that institute procedural obstacles such as disclosure requirements and advance notice bylaws.

Dispute, WALL ST. J. (Nov. 21, 2014, 1:10 PM), <http://www.wsj.com/articles/dow-chemical-third-point-settle-board-dispute-1416578708> [<http://perma.cc/N4QU-NR5L>]. They were subsequently elected at the next annual meeting. Press Release, Dow Chem. Co., Dow Announces Results from Annual Stockholder Meeting (May 14, 2015), <http://www.dow.com/news/press-releases/dow%20announces%20results%20from%20annual%20stockholder%20meeting%20may%202015> [<http://perma.cc/QDV5-XENP>].

¹⁰⁸ In Delaware, the charter must affirmatively grant the board the power to amend the bylaws. See DEL. CODE ANN. tit. 8, § 109 (2015). Delaware corporate charters are virtually universal in granting boards this power. J. Robert Brown, Jr., *The Future Direction of Delaware Law (Including a Brief Exegesis on Fee Shifting Bylaws)*, 92 DEN. U. L. REV. ONLINE 49, 51 (2015), http://static1.1.sqspcdn.com/static/f/276323/26185020/1430369648393/The_Future_Direction_of_Delaware_Law_FINAL.pdf?token=RIc3XD44aEmVE5%2BTL1x7AvvQ3M0%3D [<http://perma.cc/JA3M-6X6D>]. Moreover, where the board has the power to amend the bylaws, the statute does not limit the board's power to amend a shareholder-adopted bylaw. See *Gen. DataComm Indus., Inc. v. Wis. Inv. Bd.*, 731 A.2d 818, 821 n.2, 822 (Del. Ch. 1999) (“[In Delaware,] . . . the corporation statutes allow the board of directors to amend the by-laws if the certificate or articles of incorporation so provide and place no express limits on the application of such director amendment authority to stockholder-adopted by-laws.”). The Model Business Corporation Act affirmatively grants the board the power to amend the bylaws unless the charter gives the shareholders the exclusive right to do so. See MODEL BUS. CORP. ACT § 10.20(b) (AM. BAR ASS'N 2002).

¹⁰⁹ In contrast, the Oklahoma legislature amended its corporation law after *International Brotherhood of Teamsters General Fund v. Fleming Cos., Inc.*, 975 P.2d 907, 911 (Okla. 1999), to provide that shareholders lack the power to amend the bylaws unless such power is affirmatively conferred by the charter. See 18 OKLA. STAT. tit. 18, § 1013 (2015).

¹¹⁰ Steven Davidoff Solomon, *Allergan-Valeant Fight Holds Lessons for All Corporate Shareholders*, N.Y. TIMES DEALBOOK (Sept. 18, 2014, 4:05 PM), <http://dealbook.nytimes.com/2014/09/18/allergan-valeant-fight-holds-lessons-for-all-corporate-shareholders/> [<http://perma.cc/A9YF-JHCG>].

One of the most frequently adopted bylaws that limits shareholders' ability to exercise their rights through the imposition of procedural restrictions is the advance notice bylaw.¹¹¹ An advance notice bylaw typically provides a shareholder with a window to submit notice to the corporate secretary of proposed actions to be taken at the next annual meeting, such as director nominations or shareholder proposals. Delaware courts have observed that "[a]dvance notice requirements are 'commonplace' and 'are often construed and frequently upheld as valid by Delaware courts.'"¹¹²

Advance notice provisions can apply not merely to shareholder actions at the annual meeting but also to shareholder power to call a special meeting. In *Mentor Graphics v. Quickturn*, the Delaware Chancery Court upheld a bylaw that allowed a delay of 90–100 days between a shareholder's request for an annual meeting and the holding of a meeting, concluding that such a delay, which coincided with the issuer's advance notice bylaw, was similarly permissible.¹¹³ The court held that the delay was reasonable in that it ensured that the shareholders would have sufficient time to inform themselves before the vote.

Delaware courts have been less tolerant of board-adopted bylaws that limit the ability of shareholders to act through written consent—a power that is explicitly conferred upon shareholders by statute unless the charter otherwise provides.¹¹⁴ In *Datapoint v. Plaza Securities*, the Chancery Court struck down a board-adopted bylaw that provided for a 60-day delay before the effectiveness of an action taken by shareholder written consent.¹¹⁵ The court held that such a provision impermissibly interfered with the shareholders' right to action by written consent. The *Datapoint* court noted, however, that a bylaw establishing a ministerial review of the validity of the consents would be valid.¹¹⁶ Subsequently, the Delaware Supreme Court struck down a similar bylaw that established a 20-day review period, finding that such a delay

¹¹¹ See Hamermesh, *Director Nominations*, *supra* note 99, at 136 (explaining that advance notice bylaws have "become standard in U.S. public companies").

¹¹² *Goggin v. Vermillion, Inc.*, No. 6465-VCN, 2011 WL 2347704, at *4 (Del. Ch. June 3, 2011) (quoting *Openwave Sys. Inc. v. Harbinger Capital Partners Master Fund I, Ltd.*, 924 A.2d 228, 238-39 (Del. Ch. 2007)).

¹¹³ *Mentor Graphics Corp. v. Quickturn Design Sys.*, 728 A.2d 25, 39 (Del. Ch. 1998).

¹¹⁴ See DEL. CODE ANN. tit. 8, § 228(a) (2014).

¹¹⁵ *Datapoint Corp. v. Plaza Sec. Co.*, 496 A.2d 1031, 1033 (Del. 1985).

¹¹⁶ *Id.* at 1036.

was “so pervasive as to intrude upon fundamental stockholder rights guaranteed by statute.”¹¹⁷

Boards have expanded the use of advance notice bylaws such that they now require not merely notice but the disclosure of increasingly detailed information about the nominees, the nominating shareholder, or both. As Larry Hamermesh notes, these requirements have “not yet attracted specific judicial attention.”¹¹⁸ Nonetheless, disclosure requirements can burden shareholder efforts to nominate competing directors and create additional litigation risk.

The recent Allergan case provided an extreme example of board-adopted bylaws limiting the exercise of shareholder governance rights.¹¹⁹ At the 2013 annual meeting, the shareholders of Allergan approved a charter amendment authorizing the holders of 25% of the company’s stock to call a special meeting. The Allergan board introduced the charter amendment after a majority of the shareholders had, the prior year, supported a precatory shareholder proposal introduced by John Chevedden that would have allowed 10% of the shareholders to call a special meeting.¹²⁰

In conjunction with the charter amendment, the Allergan board adopted a set of bylaws specifying the manner in which the special meeting provision could be used. The bylaws, which were disclosed in the 2013 proxy statement but were not submitted to the shareholders for approval, required extensive disclosure by not just the shareholders who made the special meeting request but all shareholders who joined the request. They also prohibited shareholders from “acting in concert” to request a special meeting, imposed various

¹¹⁷ *Allen v. Prime Computer, Inc.*, 540 A.2d 417, 421 (Del. 1988) (quoting *Datapoint*, 496 A.2d at 1036).

¹¹⁸ Hamermesh, *Director Nominations*, *supra* note 99, at 143.

¹¹⁹ See Steven Davidoff Solomon, “*In Botox Maker Fight, Focus on Clever Strategy Overshadows the Goal*,” N.Y. TIMES DEALBOOK (Aug. 12, 2014, 6:19 PM), <http://dealbook.nytimes.com/2014/08/12/in-allergan-fight-a-focus-on-clever-strategy-overshadows-the-goal/> [<http://perma.cc/MW68-9RAA>] (describing the battle between activist Pershing Square and the Allergan board).

¹²⁰ See *A Very Special Shareholder Meeting at Allergan*, ACTIVIST INV. BLOG (Aug. 12, 2014), http://www.theactivistinvestor.com/The_Activist_Investor/Blog/Entries/2014/8/12_A_Very_Special_Shareholder_Meeting.html [<http://perma.cc/MD5E-V3J7>]. Allergan filed a no-action request with the SEC seeking to exclude Chevedden’s proposal from its proxy statement but was not successful in having the proposal excluded. See Letter from Ted Yu, SEC Senior Special Counsel, to Matthew J. Maletta, Vice President, Assoc. Gen. Counsel & Sec’y, Allergan (Jan. 25, 2012), https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwiro_a5w97JAhXISyYKHc4BCZ4QFggcMAA&url=https%3A%2F%2Fwww.sec.gov%2Fdivisions%2Fcorpfin%2Fcf-noaction%2F14a-8%2F2012%2Fjohnchevedden012512-14a8.pdf&usq=AFQjCNE_jHBd6XP7I0uh33X4SYyiX65hMA&sig2=HR5Kj9cQrm0PQUufcp3Utw&bvm=bv.110151844,d.eWE [<http://perma.cc/VP3C-T8QR>].

administrative hurdles on shareholders seeking to join the request, and gave the board extensive discretion over the timing of the meeting.¹²¹

Proxy advisor ISS described the Allergan bylaws as “far more restrictive than any of the comparator companies the board apparently reviewed, with no discernable advantage for Allergan shareholders.”¹²² Shareholder activist Pershing Square and Valeant challenged the legality of the bylaws in conjunction with their efforts to call a special meeting for the purpose of removing Allergan directors in an attempt to obtain approval of Valeant’s takeover bid for Allergan.¹²³ Although Delaware Chancellor Bouchard characterized Allergan’s restrictions as “quite a horse-choker of a bylaw,”¹²⁴ the parties settled their dispute over the scope of the bylaws.¹²⁵ The request for a special meeting was mooted when Actavis agreed to purchase Allergan at a higher price than Valeant was prepared to offer.¹²⁶ As a result, many of the issues presented by the Allergan bylaws were never judicially resolved.¹²⁷

Some issuers have used bylaws to impose not only procedural requirements but also substantive limits on who is eligible to serve as a director. As with shareholder-proposed qualification requirements, the permissible scope of such

¹²¹ See ALLERGAN, INC., ALLERGAN BYLAWS, art. II (2014) http://www.allergan.com/miscellaneous-pages/allergan-pdf-files/agn_bylaws [<http://perma.cc/9C27-ANHN>]; see also ALLERGAN, INC., SCHEDULE 14A INFORMATION (2013), <https://www.sec.gov/Archives/edgar/data/850693/000119312513098497/d489296ddef14a.htm> [<http://perma.cc/K3FA-EUXV>] (14A filed by Allergan defending the bylaws).

¹²² *Institutional Shareholder Services (ISS) Recommends Allergan Shareholders Call a Special Meeting of Shareholders*, MARKETWATCH (Aug. 6, 2014, 3:04 PM), <http://www.marketwatch.com/story/institutional-shareholder-services-iss-recommends-allergan-shareholders-call-a-special-meeting-of-shareholders-2014-08-06-1520240> [<http://perma.cc/NTQ3-FLCJ>].

¹²³ *Valeant, Pershing Go Hostile in \$53.8 Billion Allergan Bid*, REUTERS (June 2, 2014, 11:00 AM), <http://www.cnn.com/2014/06/02/pershing-calls-for-removal-of-six-allergan-directors.html> [<http://perma.cc/JY7B-RHH9>]; Solomon, *supra* note 110.

¹²⁴ Solomon, *supra* note 110.

¹²⁵ See *Allergan Amends Shareholder Meeting Bylaws Ahead of Dec. 18 Meet*, REUTERS (Nov. 12, 2014, 7:57 AM), <http://www.reuters.com/article/2014/11/12/allergan-ma-valeant-pharms-idUSL3N0T25DY20141112> [<http://perma.cc/6VD2-GUNN>] (reporting that the board amended bylaws in November 2014 to reduce board’s discretion in setting the special meeting date and lessen the disclosure requirements for shareholders making a special meeting request).

¹²⁶ Caroline Humer, *Allergan Agrees to \$66 Billion Actavis Offer; Valeant Walks*, REUTERS (Nov. 17, 2014, 4:29 PM), <http://www.reuters.com/article/2014/11/17/us-allergan-actavis-idUSKCN0J00W720141117> [<http://perma.cc/E5LW-HC24>].

¹²⁷ Several investors challenged whether the Allergan bylaws could prevent shareholders from replacing removed directors at the special meeting. *In re Allergan, Inc. Shareholder Litig.*, Consol. C.A. No. 9609-CB, 2014 WL 5791350, at *1 (Del. Ch. Nov. 7, 2014). The court held that this issue was not ripe. *Id.* at *1-2.

bylaws is unclear.¹²⁸ As one commentator has observed, “the drafters of [the Delaware statute] noted that qualifications must not be unreasonably or inequitably imposed.”¹²⁹

In 2013, 32 issuers used the framework of establishing director qualifications to respond to the use by activist shareholders of golden leash compensation arrangements.¹³⁰ The adoptions used language suggested by the Wachtell Lipton law firm, which provided that “no director shall qualify for service” if he or she is a party to a compensation agreement with a third party.¹³¹ Wachtell explained that a board could adopt such a bylaw pursuant to its statutory authority to prescribe qualifications for directors.¹³² When ISS indicated that it would recommend against directors who adopted restrictive director qualification bylaws without shareholder approval,¹³³ most issuers repealed their golden leash bylaws,¹³⁴ and Wachtell advised its clients to refrain from adopting them.¹³⁵

Boards may also use bylaws to place substantive limits on otherwise permissible shareholder action. One example is a bylaw establishing a supermajority requirement for a shareholder vote.¹³⁶ In 1999, Shorewood’s board adopted a supermajority

¹²⁸ See, e.g., *Stroud v. Grace*, 606 A.2d 75, 92 (Del. 1992) (upholding charter provision requiring directors to have “substantial expertise in line (as distinct from staff) positions in the management of substantial business enterprises or substantial private institutions,” but indicating that a qualification cannot be unreasonably vague); *Stroud v. Milliken Enters., Inc.*, 585 A.2d 1306, 1308 (Del. Ch. 1988) (noting that a corporation can provide for reasonable director qualifications, but observing that “[i]t is not an overstatement to suggest that every valid by-law is always susceptible to potential misuse”).

¹²⁹ Brandon S. Gold, *Why the Wachtell Bylaw on Director Compensation by Shareholders Is Overbroad and May Fail Blasius Scrutiny*, CLS BLUE SKY BLOG (May 31, 2013), <http://clsbluesky.law.columbia.edu/2013/05/31/why-the-wachtell-bylaw-on-director-compensation-by-shareholders-is-overbroad-and-may-fail-blasius-scrutiny/> [<http://perma.cc/6R3M-AK2M>] (citing Del. Gen. Corp. Law Comm., Commentary on Legislative Proposals, 127th 2d Sess., at 2. (1974)).

¹³⁰ See Cain et al., *supra* note 16, at 653.

¹³¹ Martin Lipton, *Bylaw Protection Against Dissident Director Conflict/Enrichment Schemes*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 10, 2013), <http://corpgov.law.harvard.edu/2013/05/10/bylaw-protection-against-dissident-director-conflict-enrichment-schemes> [<http://perma.cc/N3MT-WVX4>].

¹³² *Id.*

¹³³ See CHRIS CERNICH ET AL., INSTITUTIONAL S’HOLDER SERVS. INC., WHEELING OUT THE PROCURSTEAN BED: BYLAW RESTRICTIONS ON DISSIDENT NOMINEE COMPENSATION 1 (2013), http://www.thedeal.com/first_word/Wheeling_Out_the_Procrustean_Bed_-_Bylaw_Restrictions_on_Dissident_Nominee_Compensation-1.pdf [<http://perma.cc/9VW8-FLEJ>].

¹³⁴ Cain et al., *supra* note 16, at 25.

¹³⁵ Martin Lipton, *ISS Publishes Guidance on Director Compensation (and Other Qualification) Bylaws*, HARV. L. SCH. (Jan. 16, 2014), <https://corpgov.law.harvard.edu/2014/01/16/iss-publishes-guidance-on-director-compensation-and-other-qualification-bylaws/> [<http://perma.cc/M6RX-P5FH>].

¹³⁶ Delaware law provides no limit on a board’s power to adopt such a provision. See Hamermesh, *Corporate Democracy*, *supra* note 55, at 487 n.343. In contrast, the Model Business Corporation Act does not permit a board unilaterally to

requirement for shareholder amendments to the bylaws as part of its defense against a takeover attempt by Chesapeake Corporation.¹³⁷ The bylaw was challenged, and applying the standard set out in *Unocal v. Mesa Petroleum*,¹³⁸ the court found that the provision was a disproportionate response to the threat posed in that case.¹³⁹ The court did not, however, indicate whether a board-adopted supermajority bylaw would be generally impermissible.¹⁴⁰

III. LEGAL ANALYSIS OF THE NEW GOVERNANCE

A. *Judicial Oversight of Shareholder Innovations*

As noted above, many commentators have argued that Delaware law limits shareholder power to adopt governance provisions.¹⁴¹ The most commonly cited rationale for this limitation is the tension between shareholders' authority to amend bylaws under section 109 and the board's authority to manage the corporation under section 141(a). As Larry Hamermesh and others have argued, the Fleming bylaw might well have been rejected by the Delaware courts on this basis.¹⁴²

Notably, however, the Delaware courts have provided "a critical dearth of precedent" on the extent to which board authority under section 141(a) limits shareholders' power to adopt bylaws.¹⁴³ In a number of cases, the courts appear to have deliberately avoided offering guidance as to the permissible scope of the shareholder power under the new governance.¹⁴⁴

adopt a provision establishing a supermajority shareholder vote requirement. *Id.*; see MODEL BUS. CORP. ACT §§ 7.27, 10.21 (AM. BAR ASS'N 2002).

¹³⁷ *Chesapeake Corp. v. Shore*, 771 A.2d 293, 296-97 (Del. Ch. 2000).

¹³⁸ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

¹³⁹ *Chesapeake*, 771 A.2d at 297.

¹⁴⁰ *Id.* at 343 ("I do not reach Chesapeake's argument that a board of directors may not, by bylaw, require a supermajority vote to amend the bylaws.").

¹⁴¹ See, e.g., Smith, *supra* note 7, at 140-43 (summarizing this debate); Hamermesh, *Corporate Democracy*, *supra* note 55, at 444.

¹⁴² See *supra* note 58 and accompanying text.

¹⁴³ Hamermesh, *Corporate Democracy*, *supra* note 55, at 415.

¹⁴⁴ This reticence is at odds with Delaware courts' general inclination to provide explicit guidance to future actors even in cases in which that guidance is not necessary to resolve the case. See, e.g., Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1079-80 (2000) (describing this approach in the context of the Chancery Court's decision in *In re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996)) [hereinafter Fisch, *Peculiar Role*]. One possible explanation is, as one commentator describes it, "that Delaware corporate law is deeply ambivalent regarding the corporate governance role of shareholders." Christopher M. Bruner, *Shareholder Bylaws and the Delaware Corporation*, 11 TRANSACTIONS: TENN. J. BUS. L. 67, 73 (2009).

For example, in *Diceon Electronics v. Calvary Partners*, the Chancery Court refused to rule on the validity of a director qualification bylaw proposed by a shareholder in the context of an election contest.¹⁴⁵ The issuer challenged the bylaw as inconsistent with the board classification provision in the charter. The court, stating that the shareholders might not approve the proposed bylaw, explained that “scarce judicial resources must not be squandered on disputes that have no significant current impact on the parties and that may never ripen into a question appropriate for judicial resolution.”¹⁴⁶

Similarly, the State of Wisconsin Investment Board proposed a bylaw at General DataComm that would limit the board’s power to reprice certain employee stock options.¹⁴⁷ In *General DataComm v. Wisconsin Investment Board*, the court again chose not to intervene, refusing to grant the issuer’s motion for expedited proceedings or an injunction. The court explained that the issuer had failed to demonstrate a compelling justification for an expedited ruling in that the shareholders did not need a resolution of the bylaw’s validity in order to vote on it and that the issuer was not facing the threat of irreparable harm.

As discussed earlier, the Chancery Court reacted in the same fashion to Lucian Bebchuk’s effort to litigate the validity of his second-generation pill redemption bylaw in *Bebchuk v. CA*.¹⁴⁸ The court concluded that the issue was not ripe, noting that in both *Diceon* and *DataComm*, the shareholders overwhelmingly rejected the proposed bylaws, obviating the need for a judicial determination of their validity.¹⁴⁹ As the court explained, it was unnecessary for the court to “prematurely resolve a highly contentious and important matter before the court knows what pertinent facts might develop in the future.”¹⁵⁰

These cases provide one reason for the lack of clarity regarding the permissible scope of governance innovations: ripeness challenges make it difficult to test the validity of proposed bylaws prior to their adoption. There may be a circularity to the courts’ approach, however, in that shareholders may be reluctant to vote in favor of a proposed bylaw if there are serious questions about its validity.

¹⁴⁵ *Diceon Elects., Inc. v. Calvary Partners, L. P.*, Civ. Action. No. 11862, 1990 Del. Ch. LEXIS 209 (Del. Ch. Dec. 27, 1990).

¹⁴⁶ *Id.* at *3-4.

¹⁴⁷ *Gen. DataComm Indus., Inc. v. Wis. Inv. Bd.*, 731 A.2d 818 (Del. Ch. 1999).

¹⁴⁸ *Bebchuk v. CA, Inc.*, 902 A.2d 737, 738 (Del. Ch. 2006).

¹⁴⁹ *Id.* at 744.

¹⁵⁰ *Id.*

These difficulties were partially alleviated when the Delaware legislature amended its statute to allow the SEC to certify questions to the court, because the SEC might consider whether a proposed bylaw was legal under Delaware law in determining whether an issuer was required by Rule 14a-8 to include the proposal in its proxy statement.¹⁵¹ The SEC promptly used the certification procedure to ask the Delaware Supreme Court whether a bylaw requiring reimbursement of a dissident's proxy expenses was valid under Delaware law.¹⁵²

In *CA v. AFSCME*, one of the rare cases to address the legality of shareholder power to enact bylaws, the court sent somewhat mixed messages.¹⁵³ The court explained that shareholders did not have unlimited power to adopt bylaws under DGCL section 109; rather, such power was limited by the board's authority pursuant to section 141. As a result, the court concluded that the proposed bylaw, although valid and a proper subject for shareholder action under section 109,¹⁵⁴ was nonetheless invalid as a contractual arrangement that could preclude the board from discharging its fiduciary duties.¹⁵⁵

The Delaware legislature responded to the *CA v. AFSCME* decision by amending the Delaware statute in 2011.¹⁵⁶ The statutory amendments authorized shareholders to adopt both proxy access and expense reimbursement bylaws. In conjunction with these amendments, the legislature identified permissible conditions that such bylaws could impose, including disclosure requirements. The legislation did not address the broader issues raised by shareholder-adopted bylaws that potentially limit director power. Specifically, the statute did not speak to the limitations that the court had read section 141(a) as imposing on shareholder power under section 109.

A recent Chancery Court decision adhered to the reasoning in *CA v. AFSCME* to invalidate a different type of

¹⁵¹ 76 DEL. LAWS ch. 37, § 1 (2007) (amending DEL. CONST. art. IV, § 11(8)); see Jill E. Fisch, *Leave It to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 DEL. J. CORP. L. 731, 771 (2013) (describing certification procedure).

¹⁵² *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 230-31 (Del. 2008).

¹⁵³ The court began its opinion by distinguishing between process-oriented bylaws and those that mandate how the board should decide "substantive business decisions." *Id.* at 234-35. The court stated that the former do not encroach upon board authority. It then concluded that the bylaw at issue "has both the intent and the effect of regulating the process for electing directors of CA." *Id.* at 236.

¹⁵⁴ *Id.* at 237.

¹⁵⁵ *Id.* at 238.

¹⁵⁶ See DEL. CODE ANN. tit. 8, §§ 112, 113 (Supp. 2011) (authorizing proxy access and expense reimbursement bylaws).

shareholder-adopted bylaw. In *Gorman v. Salamone*,¹⁵⁷ the court invalidated a bylaw that authorized shareholders to remove and replace corporate officers without cause. The court, citing *CA v. AFSCME*, stated that shareholder power to amend the bylaws was not plenary and that such power was limited to procedural bylaws. It then explained that the bylaw in question was not process-oriented but rather allowed shareholders to make substantive business decisions. As a result, the court concluded that the bylaw interfered with the directors' authority to manage the company and was therefore invalid.¹⁵⁸

B. *Judicial Review of Board-Initiated Governance*

Because DGCL section 141(a) operates as a limit on shareholder power but not board power, board-adopted bylaws are subject to a different type of analysis. The case law takes a two-step approach. The first step asks whether the bylaw addresses permissible subject matter—that is, whether the bylaw is facially valid as within the board's statutory power.¹⁵⁹ The second step considers the context in which the provision is adopted or deployed. The courts have specifically observed that a facially permissible action may be invalid if undertaken for an improper purpose.¹⁶⁰

The question of facial validity is generally easy—boards have broad statutory authority to adopt bylaws. As the court explained in *ATP v. Deutscher Tennis Bund*,

Under Delaware law, a corporation's bylaws are “presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws.” To be facially valid, a bylaw must be authorized by the Delaware General Corporation Law [], consistent with the corporation's certificate of incorporation, and its enactment must not be otherwise prohibited.¹⁶¹

¹⁵⁷ *Gorman v. Salamone*, C.A., No. 10183-VCN, 2015 Del. Ch. LEXIS 202 (Del. Ch. July 31, 2015).

¹⁵⁸ *Id.* Notably, the Delaware statute explicitly vests the board with the authority to appoint corporate officers. *See* DEL. CODE ANN. tit. 8, § 142(b) (2016).

¹⁵⁹ *See, e.g.*, *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 557 (Del. 2014).

¹⁶⁰ *See, e.g., id.* at 558 (“Bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose.”); *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971) (stating that “inequitable action does not become permissible simply because it is legally possible”); *see also Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1357 (Del. 1985) (concluding that although the board had the power to adopt a poison pill, the “ultimate response” of the board to a takeover “must be judged by the [d]irectors' actions at that time”).

¹⁶¹ *ATP Tour, Inc.*, 91 A.3d at 557-58 (quoting *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985) (footnotes omitted)).

Because corporation statutes vest the board with general managerial authority, there is no reason to view board authority to adopt bylaws as limited in the way that shareholder authority might be limited by section 141(a). Moreover, the Delaware statute authorizes bylaws that address a broad range of matters, stating that the bylaws “may contain any provision . . . relating to the business of the corporation, the conduct of its affairs and its rights or powers or rights or powers of its stockholders, directors, officers or employees.”¹⁶²

The fact that a board-adopted governance provision is facially valid does not end the analysis. Delaware courts have applied heightened scrutiny to claims that board actions, including the adoption of bylaws, are improper in the context of a specific dispute or transaction.¹⁶³ In *Boilermakers v. Chevron*,¹⁶⁴ the court explained that “a statutorily and contractually valid bylaw may operate inequitably in a particular scenario.”¹⁶⁵ Similarly, in *ATP*,¹⁶⁶ the court stated that “[b]ylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose.”¹⁶⁷ Citing *Schnell v. Chris-Craft*,¹⁶⁸ the court observed that “inequitable action does not become permissible simply because it is legally possible.”¹⁶⁹

Delaware courts have applied this analysis and considered the adoption and use of board-adopted bylaws on a case-by-case basis. In *Hollinger International v. Black*, the court invalidated bylaws that required board decisions to be unanimous and imposed a board quorum requirement at 80%, finding that the bylaws “were clearly adopted for an inequitable purpose and have an inequitable effect.”¹⁷⁰ In contrast, similar bylaw provisions were upheld in *Frantz Manufacturing Co. v. EAC Industries*.¹⁷¹ Critical to the courts’ decisions in the two cases were the specific factual contexts in which the challenged bylaws were adopted.¹⁷²

Delaware law also provides two lines of authority for heightened review from the takeover context. In *Unocal*, the

¹⁶² DEL. CODE ANN. tit. 8, § 109(b) (2015).

¹⁶³ See *Moran*, 500 A.2d at 1357 (stating that corporate action must “be evaluated when and if the issue arises”).

¹⁶⁴ *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

¹⁶⁵ *Id.* at 949.

¹⁶⁶ *ATP Tour*, 91 A.3d 554.

¹⁶⁷ *Id.* at 558.

¹⁶⁸ *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437 (Del. 1971).

¹⁶⁹ *ATP Tour*, 91 A.3d at 558.

¹⁷⁰ *Hollinger Int’l, Inc. v. Black*, 844 A.2d 1022, 1080 (Del. Ch. 2004).

¹⁷¹ *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401 (Del. 1985).

¹⁷² See also *Datapoint Corp. v. Plaza Sec. Co.*, 496 A.2d 1031, 1036 (Del. 1985) (invalidating board-adopted bylaws because of the “underlying intent” behind them).

court held that when a board adopts defensive measures in the control context, those measures must be both reasonable and proportional to the threat posed.¹⁷³ Furthermore, defensive measures may not be preclusive, coercive, or draconian.¹⁷⁴ In *Blasius*, the court held that board actions taken for the primary purpose of interfering with a shareholder vote require a compelling justification, even if such actions are otherwise within the board's legal authority.¹⁷⁵ Courts have frequently analyzed board adoption or application of governance bylaws under the *Unocal* and/or *Blasius* standards.¹⁷⁶

C. *Advantages of the Case-Specific Approach*

The courts' case-by-case evaluation of new governance provisions is characteristic of Delaware lawmaking.¹⁷⁷ By viewing a bylaw within the context of the specific action in which it is to be applied, a court is able to assess its impact in light of the firm's ownership structure and in conjunction with other firm-specific governance provisions. Similarly, the courts' unwillingness to speculate as to the potential validity of a bylaw before it is adopted and applied enables market forces to restrain and redress overreaching and, in many cases, avoid the need for judicial intervention.

Developments in shareholder voting and the availability of market discipline reinforce the value of a market-based approach. For example, institutional investors carefully scrutinize board governance decisions and frequently challenge board decisions that are viewed as limiting shareholder rights.¹⁷⁸ Shareholder dissatisfaction with board responsiveness can lead to more withhold votes in subsequent director elections, a challenge that has new teeth for issuers that have adopted majority voting.¹⁷⁹

¹⁷³ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

¹⁷⁴ *Unitrin, Inc. v. Amer. Gen. Corp.*, 651 A.2d 1361, 1379 (Del. 1995).

¹⁷⁵ *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch.1988). The question of whether a case will trigger *Blasius* review is complex, and the courts have frequently rejected the argument that the *Blasius* standard applies. *See, e.g.*, *Stroud v. Grace*, 606 A.2d 75, 92 (Del. 1992) (finding that, on the facts presented, "it cannot be said that the 'primary purpose' of the board's action was to interfere with or impede exercise of the shareholder franchise").

¹⁷⁶ *See, e.g.*, *Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, 728 A.2d 25 (Del. Ch. 1998) (upholding advance notice provision in special meeting bylaw under *Unocal* standard).

¹⁷⁷ *See* Fisch, *Peculiar Role*, *supra* note 144.

¹⁷⁸ *See* Cain et al., *supra* note 16, at 3, 24-25.

¹⁷⁹ *See id.* at 24-25 (finding greater responsiveness to withhold votes by issuers that were subject to a majority voting rule); *see also* Choi et al., *Majority Voting*, *supra* note 84 (describing impact of a majority voting rule on director behavior).

Market discipline has been enhanced by the emergence of intermediaries that bring governance problems to the attention of institutional investors, helping to overcome information costs and collective action problems. The proxy advisory firms ISS and Glass Lewis play a major role in identifying and publicizing board-adopted bylaw provisions that they view as value decreasing.¹⁸⁰ Moreover, ISS attempts to persuade institutional investors to discipline directors by recommending against directors who adopt a bylaw that reduces shareholder rights.¹⁸¹ Because an ISS “withhold” recommendation raises the visibility of that director election and creates the possibility that the director will, even in the absence of a competing candidate, receive a high percentage of no or withhold votes, the threat of the withhold recommendation can have a significant effect on director behavior.¹⁸² For example, after directors who adopted a golden leash compensation bylaw at Provident Bank received a high number of withhold votes in response to an ISS withhold recommendation, directors at other firms quickly repealed similar bylaws.¹⁸³

Activist hedge funds are increasingly playing a similar role. As Gilson and Gordon explain, activists can exercise shareholder governance rights in a way that increases value for other shareholders.¹⁸⁴ This in turn leads institutional investors to place a higher value on governance rights—a value that may be reflected in market price.¹⁸⁵ It also leads even passive institutions to value shareholder governance rights and to vote in favor of governance changes that increase the possibility of a successful activist engagement.

The result is both experimentation and an evolutionary model of governance that is capable of responding to changing market conditions. Indeed, this so-called indeterminacy has been widely cited as one of the more valuable features of Delaware law.¹⁸⁶ Notably, it is a feature distinguished by judicial lawmaking freedom as opposed to greater legislative intervention.¹⁸⁷

¹⁸⁰ See Cain et al., *supra* note 16, at 12 (describing ISS’s role in communicating concerns over golden leash bylaws to institutional investors).

¹⁸¹ *Id.* at 24-25.

¹⁸² See, e.g., Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 873-74 (2010) (quantifying the effect of an ISS withhold recommendation in an uncontested director election).

¹⁸³ See Cain et al., *supra* note 16, at 25 (reporting high withhold votes from directors at issuers that adopted golden leash compensation bylaws).

¹⁸⁴ Gilson & Gordon, *supra* note 2, at 897.

¹⁸⁵ Cf. Cain et al., *supra* note 16, at 47 (discussing market pricing of provisions in context of expected activism).

¹⁸⁶ See E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some*

The reliance on market discipline does not prevent Delaware courts from invalidating board-adopted bylaws when they deem it necessary. In *Chesapeake v. Shore*, for example, the court applied both *Unocal* and *Blasius* to invalidate a supermajority bylaw adopted by the Shorewood board in an attempt to prevent Chesapeake from using a consent solicitation to replace the Shorewood board.¹⁸⁸ The court concluded that the supermajority provision, in the context of Chesapeake's consent solicitation, was preclusive under *Unocal* because it made victory by Chesapeake "not realistically attainable."¹⁸⁹ The court further held that the bylaw interfered with the shareholder franchise and that, because the board failed to demonstrate a compelling justification for this interference, its actions were invalid under *Blasius*.¹⁹⁰ Similarly, Chancellor Bouchard's remarks in the Allergan hearing suggested a willingness to examine seriously the potential that the bylaws "perhaps impermissibly deprive the shareholders of a fair opportunity to remove directors."¹⁹¹

IV. LITIGATION BYLAWS

A. Governance Innovation and Litigation Bylaws

The most recent governance innovations are litigation bylaws. Litigation bylaws respond to concerns over the frequency and quality of shareholder litigation,¹⁹² with

Key Developments, 153 U. PA. L. REV. 1399, 1412-13 (2005) (terming this "the genius of our law"); Fisch, *Peculiar Role*, *supra* note 144, at 1085 (arguing that Delaware law's indeterminacy allows judges to respond to new circumstances); William B. Chandler III & Anthony A. Rickey, *Manufacturing Mystery: A Response to Professors Carney and Shepherd's "The Mystery of Delaware Law's Continuing Success,"* 2009 U. ILL. L. REV. 95, 97-98 (2009) (explaining that indeterminacy results from the messiness of real world cases).

¹⁸⁷ Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1591 (2005) ("The most noteworthy trait of Delaware's corporate law is the extent to which important and controversial legal rules are promulgated by the judiciary, rather than enacted by the legislature."); *see also In re Appraisal of Dell Inc., Consol. C.A., No. 9322-VCL*, 2015 Del. Ch. LEXIS 184 (Del. Ch. May 11, 2015) (defending the judiciary's role in developing Delaware corporate law).

¹⁸⁸ *Chesapeake Corp. v. Shore*, 771 A.2d 293, 296-97 (Del. Ch. 2000). The board actually adopted a package of five amendments to the bylaws—all designed to make Chesapeake's removal of the sitting board less likely. *See id.* at 305. Chesapeake only challenged the supermajority provision. *Id.* at 312.

¹⁸⁹ *Id.* at 341-42.

¹⁹⁰ *Id.* at 345.

¹⁹¹ Transcript of Oral Argument on Plaintiff's Motion to Expedite and Rulings of the Court, *PS Fund 1 LLC v. Allergan, Inc.*, No. 10057-CB, 2014 WL 4986715, at *26 (Del. Ch. Aug. 27, 2014).

¹⁹² *See* Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 469 (2015).

provisions aimed at addressing alleged litigation abuse. Issuers have adopted three basic types of litigation bylaws: exclusive forum (forum-selection) bylaws, fee-shifting (loser-pays) bylaws, and arbitration bylaws. Both the proliferation of litigation bylaws and the Delaware legislature's 2015 response challenge Delaware's traditional approach to governance innovation and raise questions about the role of judicial oversight in monitoring the adoption and use of governance bylaws.

Exclusive forum bylaws respond specifically to the phenomenon of multiforum litigation—lawsuits filed in multiple jurisdictions challenging the same transaction. They respond, in a contractual way, by designating one or more permissible forums for litigation in advance. Vice-Chancellor Laster first suggested the possibility of an exclusive forum bylaw in the 2010 case *In re Revlon Inc. Shareholders Litigation*.¹⁹³ Following *Revlon*, a number of issuers adopted exclusive forum provisions, generally by means of board-adopted bylaws.¹⁹⁴ Shareholders reacted negatively to these adoptions,¹⁹⁵ and several filed suit challenging the bylaws as improper under Delaware law.¹⁹⁶ In response to the adverse reaction, most issuers backed down and repealed their bylaws rather than attempting to defend them in court.¹⁹⁷ Two issuers, however—Chevron and FedEx—defended the bylaws in litigation.¹⁹⁸

In *Boilermakers v. Chevron*,¹⁹⁹ then-Chancellor Strine endorsed the use of exclusive forum bylaws. Writing broadly, Strine said that the board's statutory power to adopt bylaws under section 109 clearly extended to the bylaw in question. Strine explicitly endorsed a board's ability to respond to new situations and explained that the fact that a board-adopted bylaw involves a new use of statutory authority does not make it

¹⁹³ *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 960 (Del. Ch. 2010).

¹⁹⁴ See Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation* 11 (ECGI Working Paper Series in L., Working Paper No. 295/2015), <http://ssrn.com/abstract=2624951> [<http://perma.cc/H49U-YXZY>]; Claudia H. Allen, *Trends in Exclusive Forum Bylaws*, THE CONFERENCE BD., 2 (Jan. 2014), <http://ssrn.com/abstract=2411715> [<http://perma.cc/V38R-NU4P>].

¹⁹⁵ ISS has a general policy of recommending against directors who vote to adopt bylaws that reduce shareholder rights. INSTITUTIONAL SHAREHOLDER SERVICES (ISS), 2014 U.S. PROXY VOTING SUMMARY GUIDELINES 23 (2014). Glass Lewis has an even stronger position: it recommends against all forum selection bylaws and “will recommend voting against the chairman of the governance committee, or, in the absence of such a committee, the chairman of the board, who served during the period of time when the provision was adopted.” GLASS LEWIS & CO., PROXY PAPER GUIDELINES: 2015 PROXY SEASON 18-19 (2015).

¹⁹⁶ Romano & Sanga, *supra* note 194, at 11.

¹⁹⁷ *Id.*

¹⁹⁸ *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 937 (Del. Ch. 2013).

¹⁹⁹ *Id.*

invalid.²⁰⁰ The court further rejected the argument that the board's action was improper because it acted unilaterally, noting that shareholders who were unhappy with a board's adoption of a forum selection bylaw were free to repeal it.²⁰¹ Finally, Strine characterized an issuer's bylaws as a type of contract between the corporation and its shareholders and explained that the application and interpretation of bylaws should be understood in contract terms.²⁰²

Since the *Boilermakers* decision, the popularity of exclusive forum bylaws has increased dramatically. As of August 2014, 746 U.S. public companies had adopted them.²⁰³ Of the mid-stream adoptions, more than 60% were adopted without a shareholder vote.²⁰⁴ Courts both within and outside of Delaware have largely respected forum selection bylaws and dismissed lawsuits filed in jurisdictions other than those specified by the bylaws. For example, the Oregon Supreme Court overturned a trial court decision refusing to enforce a Delaware forum selection bylaw and held that the bylaw was both valid and enforceable under Oregon law.²⁰⁵ Similarly, in *City of Providence v. First Citizens BancShares*, the Delaware Chancery Court deferred to the decision by a Delaware corporation to select a North Carolina forum.²⁰⁶ Early evidence suggests that exclusive forum bylaws may be reducing the extent of multiforum litigation in merger cases.²⁰⁷

²⁰⁰ *Id.* at 953 (explaining that “boards of Delaware corporations have the flexibility to respond to changing dynamics in ways that are authorized by our statutory law”).

²⁰¹ *Id.* at 956 (“[T]he statutory regime provides protections for the stockholders, through the infeasible right of the stockholders to adopt and amend bylaws themselves.”).

²⁰² *Id.* at 955 (“[T]he bylaws constitute a binding part of the contract between a Delaware corporation and its stockholders.”); see also *Airgas, Inc. v. Air Products & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010) (observing that modern bylaws are “contracts among a corporation’s shareholders”) (citing *Centaur Partners, IV v. Nat’l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990)).

²⁰³ Romano & Sanga, *supra* note 194, at 2. Half of the adoptions have been in IPO companies. *Id.* at 25.

²⁰⁴ *Id.* at 27.

²⁰⁵ *Roberts v. TriQuint Semiconductor, Inc.*, 364 P.3d 328 (Or. 2015). The court noted that it was consistent with Oregon public policy to defer to Delaware law on the internal relationship between a Delaware corporation and its shareholders. *Id.* at 337-38.

²⁰⁶ *Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229, 234-35 (Del. Ch. 2014).

²⁰⁷ See MATTHEW D. CAIN & STEVEN DAVIDOFF SOLOMON, TAKEOVER LITIGATION IN 2014, at 3 (2015), <http://ssrn.com/abstract=2567902> [<http://perma.cc/BE5J-Q74C>] (reporting that multistate takeover litigation has declined for the past three years and suggesting that the increasing use of forum selection provisions may provide a possible explanation); see also Romano & Sanga, *supra* note 194, at 4 (providing evidence that adoption of forum selection provisions does not reflect managerial opportunism).

A second, more controversial type of litigation bylaw requires a shareholder that is unsuccessful in litigation to pay the defendants' attorneys' fees. These fee-shifting bylaws contravene the traditional American rule²⁰⁸ and impose a potentially substantial financial penalty on shareholders seeking to bring class actions and derivative suits. In 2014, the Delaware Supreme Court, in response to a certified question, upheld the facial validity of loser-pays bylaws in *ATP*.²⁰⁹ Relying heavily on the court's analysis of the bylaws as a contract,²¹⁰ the *ATP* court observed that no provision in the Delaware statute or case law forbid the adoption of fee-shifting bylaws and that a bylaw that allocated litigation risk among parties in corporate litigation properly related to the business of the corporation under section 109.²¹¹ The court further observed that it was not called upon to consider the issue of enforcement²¹² and that the possibility that the bylaw might not be enforceable in a particular context was not a basis for finding it facially invalid.²¹³

A final type of litigation bylaw requires specified claims to be brought in an arbitration proceeding rather than through litigation.²¹⁴ Commentators began to speculate over the potential

²⁰⁸ See, e.g., Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 6 (2015) (explaining how Delaware law has shifted away from the American rule to a system in which the corporation always pays).

²⁰⁹ *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 555 (Del. 2014).

²¹⁰ See *id.* at 558 (describing corporate bylaws as "contracts among a corporation's shareholders" (quoting *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010))).

²¹¹ *Id.*

²¹² *Id.* at 559. For cases considering this issue, see *Kastis v. Carter*, C.A. No. 8657-CB, 2014 WL 3708238 (Del. Ch. July 21, 2014), and *Strougo v. Hollander*, C.A. No. 9770-CB (Del. Ch. Mar. 16, 2015), http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwipmYOM8-JAhUKGD4KHW5tBJYQFggfMAA&url=http%3A%2F%2Fcourts.delaware.gov%2Fopinions%2Fdownload.aspx%3FID%3D220870&usg=AFQjCNGcEQ4fn9muENSb1R7wL9I8S5KIBA&sig2=bzz_druj-w_4P31nSrI2PQ [http://perma.cc/7Z3G-MRLR]. In *Strougo*, the Delaware court held that a fee-shifting bylaw that had been adopted after a shareholder had been cashed out could not validly be applied to that shareholder's claims. The court expressly noted that it was not called upon to consider the facial validity of the bylaw. *Strougo*, No. 9770-CB, at 1.

²¹³ *ATP*, 91 A.3d at 560. In 1999, a shareholder attempted to use Rule 14a-8 to propose a fee-shifting bylaw. The issuer successfully argued to the SEC that the provision violated "general principles of contract law" and "public policy." See 3Com Corp., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 595, at *17-21 (June 24, 1999). In 2014, Alibaba, which has a fee-shifting bylaw, successfully completed a public offering of its stock without interference by the SEC. See Kevin LaCroix, *IPO Companies and Fee-Shifting Bylaws*, D&O DIARY (Oct. 14, 2014), <http://www.dandodiary.com/2014/10/articles/ipo/ipo-companies-and-fee-shifting-bylaws/> [http://perma.cc/3654-BX5N]. Note that Alibaba is incorporated in the Grand Caymans, not Delaware. *Id.*

²¹⁴ See generally David H. Webber, *Shareholder Litigation Without Class Actions*, 57 ARIZ. L. REV. 201 (2015) (discussing potential legality and impact of arbitration bylaws).

board adoption of arbitration bylaws as a response to litigation abuse in light of the broad rationale for the court's decision to uphold forum selection bylaws in *Boilermakers*, as well as the U.S. Supreme Court's continued support of contractual arbitration provisions.²¹⁵ The potential of arbitration bylaws was enhanced by decisions by courts in Maryland and Massachusetts applying the reasoning of the *Boilermakers* decision to uphold the validity of a mandatory arbitration bylaw adopted by a Maryland REIT.²¹⁶ The SEC has questioned whether an issuer can use a bylaw to compel the arbitration of shareholder securities fraud claims.²¹⁷ It is unclear, however, whether the SEC has the power to prohibit a board from adopting a bylaw mandating arbitration of state law claims.²¹⁸

B. Delaware's Legislative Response to Litigation Bylaws

In 2015, the Delaware legislature amended the Delaware corporation statute explicitly to address litigation bylaws. The legislation had three components.²¹⁹ First, the amendments expressly authorized Delaware corporations to select the courts of the state of Delaware as an exclusive forum for the litigation of internal corporate claims through either a charter or bylaw provision.²²⁰ Second, the statute prohibited Delaware corporations from adopting an exclusive forum provision that did not include a

²¹⁵ See *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2311 (2013) (upholding class action waiver and arbitration provision in credit card contract); Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751, 751 (2015) (defending value and enforceability of board-adopted arbitration bylaws).

²¹⁶ *Katz v. Commonwealth REIT*, Case No. 24-C-13-001299, at 39 (Md. Cir. Ct. Feb. 19, 2014); *Corvex Mgmt. LP v. Commonwealth REIT*, Case No. 24-C-13-001111, 2013 WL 1915769, at *26-27 (Md. Cir. Ct. May 8, 2013); *Del. Cty. Emps. Ret. Fund v. Portnoy*, No. 13-10405-DJC, at *18-21 (D. Mass. Mar. 26, 2014).

²¹⁷ See, e.g., Hal Scott & Leslie Silverman, *SEC's Silent Opposition to Arbitration Bylaws Is Speaking Volumes*, COMMITTEE ON CAP. MKTS. REG. (Aug. 12, 2013), <http://capmksreg.org/news/secs-silent-opposition-to-arbitration-bylaws-is-speaking-volumes> [<http://perma.cc/T2V5-2PN7>] (describing SEC's ongoing opposition to arbitration bylaws); see also Letter from Ted Yu, Senior Special Counsel, SEC, to Matthew Lepore, Pfizer, dated Feb. 22, 2012 (explaining that there appears to be some basis for the view that a shareholder-proposed arbitration bylaw would be inconsistent with the federal securities laws).

²¹⁸ See Webber, *supra* note 214, at 208-09.

²¹⁹ *Synopsis, Senate Bill No. 75*, LEGIS.DELAWARE.GOV, <http://legis.delaware.gov/LIS/lis148.nsf/vwLegislation/SB+75> [<http://perma.cc/R9YM-JGBC>] (last visited Apr. 14, 2016); see Kevin M. LaCroix, *Del. Bans 'Loser Pays' Bylaws—What Questions Remain?*, LAW360 (June 16, 2015, 10:18 AM), <http://www.law360.com/articles/668001/del-bans-loser-pays-bylaws-what-questions-remain> [<http://perma.cc/FVQ5-8BEN>] (describing legislative adoption of Senate Bill 75 on June 11, 2015).

²²⁰ The statute defines internal corporate claims as "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." DEL. CODE ANN. tit. 8, § 115 (2016).

Delaware court as a forum. Third, the legislation forbade corporations from adopting a charter or bylaw provision that imposed liability upon a stockholder in connection with the litigation of an internal corporate claim.²²¹

The amendments were the result of a yearlong process following the *ATP* decision. Less than a month after the decision, the Executive Committee of the Delaware State Bar Association approved a legislative proposal, Senate Bill 236, which would have banned fee-shifting bylaws at stock corporations.²²² Business interests responded. The Chamber of Commerce wrote to Delaware Senator Bryan Townsend, defending fee-shifting bylaws as a valuable “new tool . . . which businesses could use to reduce the amount of unnecessary litigation that accompanies corporate mergers and acquisitions.”²²³ The Chamber argued that the matter required further study.²²⁴ The legislature responded by adopting a joint resolution asking the Bar to reconsider the proposal and to give business interests the opportunity to provide their input.²²⁵ Institutional investors engaged in a letter-writing campaign in support of a legislative ban on fee-shifting bylaws;²²⁶ business interests mounted a campaign in opposition to such a ban.²²⁷

On March 6, 2015, the Council issued a second proposal and explanation.²²⁸ The Council identified several problems with fee-shifting bylaws and warned that they would make even meritorious litigation untenable, curtail the development of Delaware corporate law, and potentially invite the federal government to intervene in an effort to ensure board and

²²¹ DEL. CODE ANN. tit. 8, §§ 102(f), 109(b).

²²² *Id.*; Jonathan Starkey, *Chamber Forces Delay on Fee-Shifting Legislation*, DELAWAREONLINE (June 10, 2014, 1:52 PM), <http://www.delawareonline.com/story/firststatepolitics/2014/06/10/fee-shifting-bill/10280791/> [<http://perma.cc/FVQ5-8BEN>]; S.B. 236, 147th Gen. Assemb. (Del. 2014).

²²³ Letter from Andrew Wynne, Director, State Legislative Affairs, to Senator Bryan Townsend (June 5, 2015), <https://www.documentcloud.org/documents/1184979-chamber-letter-to-townsend.html> [<http://perma.cc/9NFFY-PVRM>].

²²⁴ *Id.*

²²⁵ See S.J. Res. 12, 147th Gen. Assemb. (Del. 2014).

²²⁶ See Letter to Governor Jack Markell (Nov. 24, 2014), [http://www.cii.org/files/issues_and_advocacy/legal_issues/Letter%20to%20Governor%20Markell%20\(Final\).pdf](http://www.cii.org/files/issues_and_advocacy/legal_issues/Letter%20to%20Governor%20Markell%20(Final).pdf) [<http://perma.cc/DGE8-T8DM>] (“[A]sking for swift legislative action to curtail the spread of so-called ‘fee shifting’ bylaws.”).

²²⁷ See Letter to Members of the Delaware Senate from Harold Kin, Executive Vice President, U.S. Chamber Institute for Legal Reform (May 6, 2015), http://www.instituteforlegalreform.com/uploads/sites/1/ILR_Letter_to_DE_Senate.pdf [<http://perma.cc/WF7T-HFAA>] (warning that the ban “calls into question Delaware’s commitment to maintaining the balanced legal system that until now has been the hallmark of its corporate franchise”).

²²⁸ See Explanation of Council Legislative Proposal, <http://www.corporatedefensedisputes.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.pdf> [<http://perma.cc/A6U7-8CRF>] (last visited June 17, 2016).

management accountability. In addition, the Council explained that fee-shifting provisions were an unnecessary response to frivolous litigation and that courts and issuers had other tools available to address litigation abuse. On June 11, 2015, the legislature adopted the Council's proposal.²²⁹

The effect of the legislation is straightforward. Delaware corporations are authorized to adopt a charter or bylaw provision that selects the Delaware courts as the exclusive forum for shareholder litigation. They are also authorized to select a non-Delaware forum in addition to, but not to the exclusion of, the Delaware courts. A provision selecting the headquarters state rather than Delaware, as in *City of Providence v. First Citizens*, is not permitted. Similarly, because arbitration bylaws do not allow litigation in Delaware courts, they are prohibited by the amendments. Finally, the amendments bar provisions that impose liability for attorneys' fees on shareholder plaintiffs, but they do not speak to the use of bylaws that limit or forbid the award of attorneys' fees to successful plaintiffs.²³⁰

C. *Justifying the Legislative Response*

The 2015 legislation reflects an unprecedented departure from Delaware's traditional approach to corporate law. First, the mandatory nature of the amendments is in marked contrast to the broadly enabling structure of the Delaware statute.²³¹ Very few provisions in the statute impose mandatory rules on corporations.²³² For example, the statute does not require corporate boards to have a minimum number of independent directors or provide a definition of what constitutes independence. Nor does it impose criteria for board service or minimum qualifications for officers or require a corporation to establish particular board committees. The statute does not dictate a

²²⁹ LaCroix, *supra* note 219.

²³⁰ See A. Thompson Bayliss & Mark Mixon, "No Pay" Provisions: The Forgotten Middle Ground in the Fee-Shifting Battle, HARV. L. SCH. FORUM ON CORP. GOV. & FIN. REG. (June 1, 2015), <http://corpgov.law.harvard.edu/2015/06/01/no-pay-provisions-the-forgotten-middle-ground-in-the-fee-shifting-battle/> [<http://perma.cc/QY42-D9UN>] (proposing no-fee bylaws).

²³¹ See, e.g., Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 674 (2005) ("[T]he Delaware approach to corporate law keeps statutory mandates to a minimum. And even some of the mandatory terms are subject to being overridden through charter and bylaw provisions.").

²³² For exceptions, see DEL. CODE ANN. tit. 8, § 170(a) (2015) (restricting circumstances under which a board may declare a dividend); *id.* at § 211(b) (requiring an annual meeting of shareholders).

required capital structure, mandate equal voting rights, or even require that common stock be entitled to vote.

Indeed, both the legislature and the courts have generally taken a permissive approach to corporate governance innovation, leaving the market to evaluate firm-specific governance changes and to impose discipline on firms that adopt poor governance provisions. Although scholars actively debate the extent to which this market discipline is effective,²³³ Delaware courts defer to market forces. This deference is particularly appropriate given the dominance of Delaware incorporation among large, publicly traded corporations that are most subject to the disciplinary force of the market, as implemented through the trading decisions of institutional investors, analysts' coverage, and proxy advisors' recommendations.²³⁴

This enabling approach can be defended on several grounds. First, it may be difficult to determine the substantive effect of governance innovations.²³⁵ A regulatory response creates the risk of regulatory error. Instead, firm-specific innovation offers the opportunity to test particular provisions and evaluate their effect on firm value. Second, particular governance innovations may have a differential impact—increasing the value of some firms and decreasing the value of others.²³⁶ An enabling rule allows efficient, firm-specific tailoring. Finally, the business world is dynamic. An enabling approach allows the corporate structure to respond to business developments more quickly than would be possible through regulation (and without the potential political gridlock that sometimes limits the scope of regulatory reform).

Even where Delaware law has limited the scope of governance innovation, it has done so through incremental and contextual judicial decisionmaking rather than broad-based legislation. Thus, for example, although Delaware courts

²³³ See Cain et al., *supra* note 16, at 658-59 (reporting inconsistent results from studies of the price effect of governance innovation and positing that this might be “due in part to the well-known methodological problems associated with measuring the wealth effects of corporate governance terms”).

²³⁴ See, e.g., Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 713 (2006) (explaining role of mandatory disclosure regulation in facilitating market discipline imposed by information traders).

²³⁵ See, e.g., Cain et al., *supra* note 16, at 6 (warning that the market may not price governance provisions unless and until they have the potential to impact a specific issuer and that market reaction may also depend on the salience of the governance term).

²³⁶ See, e.g., Martijn Cremers & Simone Sepe, *The Shareholder Value of Empowered Boards*, 68 STAN. L. REV. 1, 65 (2016) (demonstrating that staggered boards are particularly valuable for firms with long-term customers or in industries that require relationship-specific investments).

approved director authority to adopt a poison pill, the courts both provided parameters regarding the basis for the decision to adopt a pill and the circumstances under which a board might be barred from continuing to use a pill to thwart a takeover attempt.²³⁷ Similarly, the courts imposed limits on the permissible structure of a pill, invalidating, for example, pills that limited the authority of future boards.²³⁸

The 2015 legislation explicitly prevents issuers from engaging in private ordering with respect to litigation bylaws; instead, it both mandates the inclusion of a Delaware court in a forum selection provision and completely bans fee shifting. In addition, the amendments override the role of Delaware courts in policing innovation with respect to litigation bylaws on a case-by-case basis. On what grounds, if any, can these departures from Delaware's traditional approach be justified?

One possibility is that they cannot, and the legislation is purely protectionist,²³⁹ favoring the interests of the Delaware Bar in particular.²⁴⁰ Commentators have described Delaware corporate law as driven by interest groups,²⁴¹ and the most influential interest group consists of the Delaware lawyers who play a pivotal role in the development of corporate legislation.²⁴² By preserving both the existing volume of Delaware litigation and Delaware as a forum, the legislation serves the interests of both the plaintiff and defense Bar.

Although interest group politics undoubtedly played a role in the legislation, viewing the legislation as a product of interest group self-interest is both superficial and incomplete. Delaware's dominance in corporate law benefits a variety of interest groups beyond Delaware litigation lawyers, including

²³⁷ See, e.g., *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 54-55 (Del. Ch. 2011); *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1076 (Del. Ch. 1985).

²³⁸ See, e.g., *Quickturn Design Sys. v. Shapiro*, 721 A.2d 1281, 1282-83 (Del. 1998) (invalidating delayed-redemption provision in poison pill).

²³⁹ The Council explicitly noted this claim. See Explanation of Council, Legislative Proposal, *supra* note 228, at 10 (acknowledging and rejecting criticism that the proposed legislation was "a protectionist act intended to enrich the members of the Council and their firms by invalidating measures that would significantly diminish litigation in Delaware").

²⁴⁰ See, e.g., John L. Reed, *Delaware (Again) Proposes Sledgehammering Fee-Shifting Bylaws*, DLA PIPER (Mar. 10, 2015), <https://www.dlapiper.com/en/us/insights/publications/2015/03/delaware-again-proposes-sledgehammering/> [http://perma.cc/MS52-S3NP] (describing the legislation as a "litigation land grab").

²⁴¹ See, e.g., Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 472 (1987).

²⁴² See Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1755 (2006) (describing the role of the Delaware Council).

Delaware taxpayers.²⁴³ Although the legislation may protect the turf of Delaware litigators, it risks adversely affecting other Delaware interests by reducing the demand for Delaware incorporation. Specifically, the 2015 legislation creates an opportunity for other states to compete with Delaware by offering issuers the freedom to adopt litigation bylaws prohibited by Delaware law.²⁴⁴ To the extent that issuers value the freedom to adopt litigation bylaws barred by the legislation, they may, at the margin, choose to leave Delaware in favor of incorporating in other states.²⁴⁵

An alternative explanation is that the legislation was necessary to protect shareholder rights. The basis for concluding that litigation bylaws inflict a distinctive form of shareholder harm, however, is unclear. Delaware corporate law authorizes issuers to adopt a variety of structural provisions that arguably impose greater limits on shareholder rights than litigation bylaws, including dual class stock,²⁴⁶ effective staggered boards,²⁴⁷ and supermajority voting requirements.²⁴⁸ In addition, although the loser-pays bylaw in *ATP* was extreme, the legislation prohibits even more moderate provisions.²⁴⁹

Moreover, at the time the legislature acted, the potential impact of litigation bylaws was unknown. Only 30 Delaware corporations adopted loser-pays bylaws following the *ATP*

²⁴³ See Stephen Bainbridge, *Delaware's Decision: Viewing Fee Shifting Bylaws Through a Public Choice Lens* (Nov. 18, 2014, 10:35 AM), <http://www.professorbainbridge.com/professorbainbridge.com/2014/11/delawares-decision-viewing-fee-shifting-bylaws-through-a-public-choice-lens.html> [<http://perma.cc/58V3-E7B4>] (noting that Delaware franchise taxes account for up to 30% of the state's budget, the equivalent of \$3,000 for a family of four).

²⁴⁴ Indeed, one state has already done so. See OKLA. STAT. tit. 18, § 1162 (2015). Notably, the Oklahoma statute goes further than permitting fee-shifting bylaws; it requires fee-shifting in unsuccessful derivative litigation. *Id.*

²⁴⁵ The Delaware council recognized this concern. See Explanation of Council, Legislative Proposal, *supra* note 228, at 10 (“[O]ther states may take steps to accommodate fee-shifting charter and bylaw provisions, and [] businesses will therefore choose to incorporate in those other states, rather than in Delaware.”).

²⁴⁶ See Reed, *supra* note 240 (questioning whether the legislation can be justified in terms of fairness to shareholders in light of the permissibility of dual class stock).

²⁴⁷ See *Bebchuk Bylaw*, *supra* note 61, at 2 (demonstrating the strength of an effective staggered board in protecting management from the discipline of the takeover market).

²⁴⁸ See C. WILLIAM PHILLIPS & PREETHI KRISHNAMURTHY, COVINGTON & BURLING, *THE LANDSCAPE OF U.S. HOSTILE TAKEOVER LITIGATION 10-11* (2011), <https://www.cov.com/~media/files/corporate/publications/2001/12/oid6533.pdf> [<http://perma.cc/YYG4-SQUD>] (describing how supermajority provisions can operate to impede shareholders' ability to accept a hostile tender offer).

²⁴⁹ See Reed, *supra* note 240 (“[T]here is no room for a middle ground of proportionate fee allocation, or a measured cap system. . . .”).

decision,²⁵⁰ and there were reasons to question whether boards would have been willing or able to adopt such provisions to the extent they were perceived by institutional shareholders or ISS as interfering with shareholder rights.²⁵¹ In addition, the statute extends to litigation bylaws that are approved by the shareholders. It is reasonable to conclude that the adoption of a litigation bylaw through a process that involves both board and shareholder approval might reasonably reflect a judgment that, for that issuer, the provision adds value by reducing the cost of frivolous litigation. The basis for the legislature to second-guess that judgment is not compelling.

Another possibility, suggested by my colleague Ed Rock and examined by Armour, Black, and Cheffins,²⁵² is that the legislature viewed the 2015 legislation as necessary to protect the manner in which Delaware lawmaking occurs. To the extent that Delaware's lawmaking is distinctive because of the judicial role,²⁵³ that distinctiveness is undercut if the viability of Delaware litigation is reduced, because the Delaware courts will have fewer opportunities to weigh in and provide guidance to issuers.²⁵⁴ This reduces the predictive value of Delaware law and weakens Delaware's attractiveness as a state of incorporation.²⁵⁵ Notably, in contrast to the distinctive role of the Delaware courts, the provisions of the Delaware statute are more easily copied by other states. In addition, reducing litigation volume lessens the lawmaking role of the expert Delaware Chancery Court judges. Under this theory, litigation bylaws are distinctive and problematic, not because of the impact on shareholders, but because of the impact on Delaware lawmaking.

If the legislative objective was to protect Delaware litigation, however, the absolute ban on all fee-shifting bylaws appears to be both over- and underinclusive. As noted above, although the Council stated that fee-shifting bylaws would make stockholder litigation "[u]ntenable,"²⁵⁶ a more moderate fee-shifting bylaw would be unlikely to reduce the volume of

²⁵⁰ See Explanation of Council, Legislative Proposal, *supra* note 228, at 3.

²⁵¹ See Cain et al., *supra* note 16, at 25-26 (noting that 30 of 32 issuers repealed golden leash prohibition bylaws in response to criticism from ISS and institutional investors).

²⁵² See John Armour, Bernard S. Black & Brian R. Cheffins, *Is Delaware Losing Its Cases?*, 9 J. EMP. LEG. STUD. 605 (2012).

²⁵³ Fisch, *Peculiar Role*, *supra* note 144, at 1064.

²⁵⁴ Armour et al., *supra* note 252, at 652.

²⁵⁵ See *id.* ("[I]f Delaware loses a significant number of quality cases, this would impair the ability of its courts to develop new precedents. In the long run, this might diminish Delaware's value-added for firms and affect its market share in incorporations, its ability to charge a premium price to public companies, or both.").

²⁵⁶ Explanation of Council, *supra* note 228, at 3.

Delaware litigation to the point where the role of the Delaware courts and the evolution of Delaware law are adversely affected. At the same time, the legislation does not address other bylaws that might burden shareholder litigation.²⁵⁷ Boards can presumably adopt alternative approaches such as bylaws that require minimum ownership thresholds, limit the scope of available damages, or eliminate the availability of fees to prevailing plaintiffs.²⁵⁸ There are many governance innovations that reduce the availability of shareholder litigation, and it is likely that if market forces find the existing level of litigation to be excessive, this legislation will not end the battle.

In commenting on a prior draft of this article at the Pomerantz Lecture, Charles Elson offered the explanation that the Delaware legislature sought to maintain a corporate law that balanced the interests of shareholders and managers.²⁵⁹ Elson argued that the legislature has intervened in situations in which the law has drifted away from that balance, citing the adoption of DGCL section 102(b)(7) after the court's decision in *Smith v. Van Gorkom*.²⁶⁰ Other commentators have also described Delaware corporate law as balanced, noting, for example, that Delaware adopted a moderate antitakeover statute²⁶¹ rather than the approach like that of either California, which has no antitakeover statute,²⁶² or Pennsylvania, which has an extreme one.²⁶³

Significantly, however, prior legislative interventions have created options, not mandatory rules. Section 102(b)(7) authorizes but does not require issuers to limit director liability

²⁵⁷ Indeed, the Delaware Council explicitly explained that “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.” *Id.* at 9.

²⁵⁸ See Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 559-63 (2015) [hereinafter Fisch et al., *Peppercorn*]; Bayliss & Mixon, *supra* note 230.

²⁵⁹ See Kathryn Meier, *Delaware Law Issues Update: Unique Conference Brings Together National, Legal, Corporate, Communities*, U. DAILY (Dec. 5, 2013, 12:57 PM), <http://www.udel.edu/udaily/2014/dec/delaware-law-issues-120513.html> [<http://perma.cc/7SC3-H47E>] (quoting Elson as explaining that “Delaware law preserves national, fair balance”).

²⁶⁰ See R. Franklin Balotti & Mark J. Gentile, *Elimination or Limitation of Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5 (1987) (reviewing circumstances leading to the legislative adoption of DGCL § 102(b)(7)).

²⁶¹ Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 855-56 (1993).

²⁶² Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the “Race” Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1826 (2002).

²⁶³ Romano, *supra* note 261, at 853.

for money damages.²⁶⁴ Issuers have the option of exempting a transaction from the scope of the Delaware antitakeover statute or waiving its application in advance.²⁶⁵ Similarly, although the legislature has amended the statute to address issues such as majority voting,²⁶⁶ proxy access,²⁶⁷ and reimbursement of proxy expenses,²⁶⁸ in each case the statute is enabling—authorizing but not mandating—the creation of greater shareholder voting power. Legislative action to create options for individual issuers to balance director and shareholder rights is different from legislative intervention to effect a particular balance of rights—as the 2015 legislation does.

Robert Jackson, as the second commentator at the Pomerantz Lecture, explained the 2015 legislation in terms of federalism. Jackson cited Mark Roe's work. Roe describes Delaware as operating within the shadow of the federal government, which is able to preempt Delaware if members of Congress, the SEC, or the federal courts are unhappy with the policy choices reflected in Delaware corporate law.²⁶⁹ Delaware lawmakers have admitted that the threat of congressional intervention is a factor that they take into account in structuring corporate law.²⁷⁰ Roe and others have attributed, in particular, Delaware's 2009 legislation authorizing proxy access bylaws as an effort to forestall the federal adoption of a mandatory proxy access rule.²⁷¹ In the same way, Jackson reasoned, federal lawmakers

²⁶⁴ DEL. CODE ANN. tit. 8, § 102(b)(7) (2015).

²⁶⁵ *Id.* § 203(b)(3).

²⁶⁶ *Id.* § 216.

²⁶⁷ *Id.* § 112.

²⁶⁸ *Id.* § 113.

²⁶⁹ See Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 592 (2003) ("Delaware's competition in making corporate law thus comes not . . . primarily[] from other states, but also from the federal government . . ."); see also John C. Coffee, Jr., *The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards*, 8 CARDOZO L. REV. 759, 768 (1987) (arguing that Delaware law responded to threat of federal minimum standards by becoming more responsive to shareholder interests); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 923-24 (1982) (describing ways in which Delaware corporate law shifted from being pro-management to more shareholder friendly).

²⁷⁰ See, e.g., Leo E. Strine, Jr., Speech, *Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward*, 63 BUS. LAW. 1079, 1081 (2008) ("When state law appeared to substantial elements of the investment community to be insufficient to protect investor interests, calls for congressional action arose, calls that influenced state lawmakers to reexamine the balance of interests between managers and stockholders.").

²⁷¹ See Mark J. Roe, *The Corporate Shareholder's Vote and Its Political Economy, in Delaware and in Washington*, 2 HARV. BUS. L. REV. 1, 14 (2012); Lisa M. Fairfax, *Delaware's New Proxy Access: Much Ado About Nothing?*, 11 TRANSACTIONS: TENN. J. BUS. L. 87, 90 (2009) (citing commentary speculating that Delaware adopted legislation authorizing proxy access and reimbursement bylaws "not only to confirm or

might have viewed the *ATP* decision authorizing fee-shifting bylaws as too pro-management and responded by preempting Delaware's control over shareholder litigation.

Regardless of the degree to which Mark Roe's characterization of the threat of federal government motivates Delaware lawmaking,²⁷² Delaware assuredly had little to fear from Congress or the Supreme Court in terms of shareholder litigation rights. Congress previously expressed concern about excessive shareholder litigation, and it revised federal law in an effort to limit the potential for litigation abuse.²⁷³ The Supreme Court articulated similar concerns and repeatedly restricted the scope of shareholder litigation rights.²⁷⁴ In view of these policy positions, it seems unlikely that federal lawmakers would have intervened out of a concern that *ATP* was insufficiently shareholder-friendly.

This article suggests another possible justification for the 2015 legislation—the theory of Delaware corporate law as a package of legislation and ongoing judicial oversight. As I and others have previously observed, Delaware corporate law is largely judge-made law.²⁷⁵ The legislative design creates an affirmative role for judicial lawmaking that is a unique and valuable supplement to the statute. By mandating that Delaware corporations retain the right to litigate in the Delaware courts, with their unique features, the legislature may be viewed as requiring corporations that wish to avail themselves of Delaware law to purchase the full package. In other words, a corporation cannot opt into Delaware law without accepting the Delaware court's ability to interpret and mold that law to a specific transactional context.

otherwise reassert its role as leader in the corporate governance arena, but also to prevent or curtail further federal encroachment into this area”).

²⁷² Notably, to the extent that Delaware adopted sections 112 and 113 in an effort to prevent the SEC from adopting a proxy access rule, it was unsuccessful. See Fisch, *Destructive Ambiguity*, *supra* note 15, at 447-52 (describing the SEC's adoption and the D.C. Circuit's subsequent invalidation of Rule 14a-11).

²⁷³ Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737; Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified at 15 U.S.C. § 78bb).

²⁷⁴ See Jill E. Fisch, *Federal Securities Fraud Litigation as a Lawmaking Partnership*, 93 WASH. U. L. REV. 453, 460 (2016) (citing cases reducing the scope of shareholder litigation because of a concern about litigation abuse).

²⁷⁵ See *In re Appraisal of Dell Inc.*, 2015 Del. Ch. LEXIS 184, at *38-39 (Del. Ch. July 13, 2015) (“Historically the judiciary, rather than the General Assembly, has taken the lead when addressing corporate law issues.”); see also Lawrence Hamermesh, *How We Make Law in Delaware, and What to Expect from Us in the Future*, 2 J. BUS. & TECH. L. 409, 409 (2007) (“The best-known of the principal policymakers in Delaware are the members of the judiciary.”).

A similar analysis applies to fee shifting. Notably, the courts' power over litigation fees allows them to adjust litigation incentives and, indirectly, to determine the extent of judicial oversight that is necessary in a particular substantive context.²⁷⁶ Courts can increase fee awards in order to reward plaintiffs' lawyers for bringing valuable cases and can reduce or eliminate fee awards to discourage meritless litigation.²⁷⁷ A fee-shifting bylaw, however, would allow an issuer to usurp judicial discretion over this calculus. This effect would undermine the courts' ability to police the public good aspect of Delaware litigation.²⁷⁸ By retaining judicial control over the incentive structure of shareholder litigation, the prohibition on fee shifting, like the mandate of a Delaware forum, thus preserves the judicial component of Delaware corporate law.

D. *Implications of This Analysis*

Understanding the rationale for the Delaware legislation can help inform the scope of the legislation's implications for future governance innovations. In particular, the foregoing analysis suggests that litigation bylaws are distinctive because of their potential impact on the lawmaking role of the Delaware courts. The ban on fee shifting should not be read as a legislative judgment that fee-shifting bylaws are bad for corporations or impermissibly interfere with shareholder rights. Similarly, the 2015 legislation does not signal that the legislature is likely to intervene to prohibit other governance innovations that are

²⁷⁶ See Fisch et al., *Peppercorn*, *supra* note 258, at 573-74 (describing judicial sensitivity to incentive effect of fee awards in merger litigation); Phillip R. Sumpter, *Adjusting Attorneys' Fee Awards: The Delaware Court of Chancery's Answer to Incentivizing Meritorious Disclosure-Only Settlements*, 15 U. PA. J. BUS. L. 669, 675 (2013) (explaining how judges respond to the incentives they provide by "awarding varying levels of attorneys' fees to plaintiffs' counsel").

²⁷⁷ See *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1252 (Del. 2012) (approving Chancery Court's award of \$300 million fee on the ground that it "creates a healthy incentive for plaintiff's lawyers to actually seek real achievement for the companies that they represent in derivative actions and the classes that they represent in class actions" (quoting Transcript of Oral Argument on Plaintiff's Petition for Award of Attorneys' Fees and Expenses and Rulings of the Court at 85, *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 52 A.3d 761 (Del. Ch. 2011) (No. 961-CS)); see also *In re Sauer-Danfoss Inc. S'holders Litig.*, 65 A.3d 1116, 1136-37 (Del. Ch. 2011) (surveying fee awards in prior cases relative to the perceived value generated by the litigation). Presumably the Delaware courts also retain the authority to order fee shifting in cases of litigation abuse.

²⁷⁸ Significantly, the Delaware courts are particularly well-suited to consider the broader policy implications of shareholder litigation. See, e.g., *Zapata Corp. v. Maldonado*, 430 A.2d 779, 789 (Del. 1981) (authorizing courts to "give special consideration to matters of law and public policy in addition to the corporation's best interests" in deciding whether to grant corporation's motion to dismiss derivative litigation).

potentially value-decreasing or as an instruction to the courts to be more aggressive in policing the scope of the new governance.

Rather than being understood in terms of shareholder power or substantive limits on managerial authority, the legislation should be viewed as narrowly tailored to preserving the structure of the statutory scheme that enables firm-specific innovation constrained by market discipline and judicial oversight. It is that structure that corporate America appears to value, as reflected in its choice of Delaware incorporation.

The analysis also has implications in terms of the potential evolutionary response to the legislation. As the Delaware Council noted, issuers have the option of responding to perceived litigation abuse through alternative innovations. Indeed, shortly after the legislation was adopted, two commentators published an article advocating a “no fees” bylaw that would prohibit a court from awarding attorneys’ fees to a successful plaintiff and require each side instead to bear its own costs in shareholder litigation.²⁷⁹ As the commentators correctly observed, a literal reading of the 2015 amendments would not prohibit such a bylaw.²⁸⁰ Under the reasoning advanced in this article, however, the proposed bylaw would be problematic in that it would similarly constrain judicial discretion by prohibiting courts from incentivizing and rewarding plaintiffs for bringing cases that the courts view as socially valuable.

Another potential innovation would require shareholder collective action to initiate litigation. For example, an issuer might adopt a bylaw requiring consent by a minimum percentage of the outstanding shares before a shareholder is permitted to initiate a derivative suit.²⁸¹ Such a bylaw might ensure both that a substantial number of shareholders view the suit as valuable and that the litigation is not being brought solely to further the interests of plaintiffs’ counsel.²⁸² This article argues that courts should not view this bylaw’s restriction as analogous to fee shifting and that, because it is

²⁷⁹ See Bayliss & Mixon, *supra* note 230.

²⁸⁰ *Id.*

²⁸¹ At least one issuer has adopted such a bylaw. See Alison Frankel, *The Latest in Restrictive Corporate Bylaws: Small Shareholders Can’t Sue*, REUTERS (Nov. 13, 2014), <http://blogs.reuters.com/alison-frankel/2014/11/13/the-latest-in-restrictive-corporate-bylaws-small-shareholders-cant-sue/> [<http://perma.cc/UXL4-L6UD>] (describing adoption of such a bylaw by Imperial Holdings).

²⁸² See, e.g., Transcript of Settlement Hearing and Rulings of the Court at 8, *In re Gen-Probe, Inc., S’holder Litig.* (No. 7495-VCL) (Del. Ch. Apr. 10, 2013), <http://blogs.reuters.com/alison-frankel/files/2014/11/gen-probeshareholder-transcript.pdf> [<http://perma.cc/M2FV-C2NF>] (expressing concern about representative plaintiff who owned two shares of stock in the company).

not, the bylaw should be upheld despite the fact that it would limit the ability of small shareholders to bring suit.

This article's analysis thus offers guidelines for issuers in attempting to respond to the Council's invitation for further governance innovation to address the potential for litigation abuse. Delaware's intervention with respect to litigation bylaws should not, however, be read more broadly. In particular, the legislation neither reflects a substantive view about the appropriate balance of power between shareholder and director authority nor the appropriate role of bylaws in structuring that balance. The precise limitations on the new governance remain unclear, and although future innovation may require a reexamination of the current legal framework, the Delaware legislature has, for the moment, preserved the existing role of the courts in analyzing that framework on a case-by-case basis.

CONCLUSION

The new governance challenges the traditional allocation of power between shareholders and the board of directors. The extent to which issuer-specific governance provisions that structure or restructure decisionmaking authority are permissible remains unclear under Delaware law. On the one hand, shareholder efforts present the potential to interfere with the board's statutory authority to run the company. On the other hand, board-adopted bylaws can constrain the shareholder electoral power upon which the board's statutory authority is based.

Litigation bylaws offered courts the opportunity to consider the appropriate balance of authority and the degree to which individual issuers could adjust this balance. The 2015 legislation eliminated this opportunity by imposing mandatory restrictions on the permissible scope of litigation bylaws. Although the legislation is in tension with Delaware's traditional approach to governance innovation, it can be rationalized as preserving the critical component of judicial lawmaking as part of the package that constitutes Delaware corporate law. In light of this explanation, the legislation should not be read as a broader limitation on the scope of the new governance.