NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 14 FALL 2017 NUMBER 1

SCREENING OUT THE LOSERS: HOW DELAWARE CORPORATIONS CAN IMPLEMENT FEE-SHIFTING TO DETER FRIVOLOUS STRIKE SUITS

HENRIK BORN*

 J.D., 2018, New York University School of Law; B.A., 2013, Haverford College. This note began as a paper for Professor Catherine Sharkey's seminar on torts and the administrative state. I am grateful to Professor Sharkey and Professor Choi for their thoughtful advice and comments. Many thanks to Ariella Pultman and the members of the N.Y.U. Journal of Law and Business for their helpful critique and feedback. I thank my family for their and support.

INTRODUCTION

The principal U.S. securities anti-fraud provision—Rule 10b-5—has unassuming origins. In 1943, two lawyers at the Securities and Exchange Commission ("Commission" or "SEC") heard about the president of a company buying up company shares under suspicious circumstances from shareholders, and proposed a rule to bring him to justice.[1] What would become known as Rule 10b-5 was presented to the Commission, with all the commissioners quickly and silently indicating their approval. Only one—Sumner Pike—remarked, "Well, we are against fraud, aren't we?"[2] From these humble beginnings, 10b-5 securities fraud regulation has grown enormously in doctrinal complexity. As Justice Rehnquist observed about Rule 10b-5, "we deal with a judicial oak which has grown from little more than a legislative acorn."[3] A line of Supreme Court cases, drawing heavily on the common law of deceit and fraud, read several doctrinal elements into 10b-5 securities fraud.[4] But the most consequential Supreme Court decision in the evolution of modern securities fraud rules was *Basic v. Levinson*.[5] In *Basic*, the Court adopted the controversial Fraud-on-the-Market (FOTM) presumption of reliance.[6] Twenty-two years earlier, the Federal Rules of Civil Procedure had been

1. *Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967).
2. *Id.*
3. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975).
4. *See* John C.P. Goldberg & Benjamin C. Zipursky, *The Fraud-on-the-Market Tort*, 66 VAND. L. REV. 1755 (2013).
5. Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988). The FOTM theory assumes that, in a well-functioning securities market, "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action." *Id.*
6. *Id.* at 244.

revised to allow class actions for monetary damages under Federal Rule 23. If the Federal Rules revision set the stage for plaintiff shareholder class actions, *Basic* drew back the curtain.

The decades following *Basic* saw a dramatic rise in securities class action lawsuits. In the 1980s, class action settlements in the millions and sometimes billions of dollars started making headlines.[7] Opposition to increased corporate liability to plaintiff shareholder classes predictably mounted. Advocates for reform argued that the federal securities laws left corporate defendants vulnerable to meritless suits by enterprising plaintiffs' attorneys. In their view, private enforcement of the securities regime incentivized strike suits—effectively imposing a tax on common shareholders.[8] By 1995, efforts to curb the rise of 10b-5 class actions culminated in the passage of the Private Securities Litigation Reform Act (PSLRA).[9] The PSLRA directly targets frivolous lawsuits, instituting various procedural and substantive reforms to the securities class action regime. Concisely stated, the goal of the PSLRA was to make it easier for defendants to win. Some two decades later, however, the PSLRA's success in screening out strike suits is questionable.[10]

The latest installment in the doctrinal evolution of Rule 10b-5 came in 2014, when the Supreme Court decided *Halliburton Co. v. Erica P. John Fund, Inc.* (*Halliburton II*).[11] Many advocates for reform hoped—indeed, expected—that the Court would use the occasion to jettison the fraud-on-the-market presumption of reliance. The defense marshalled fairly compelling evidence to demonstrate the falsity of FOTM. Some Justices were persuaded by that evidence; however, a majority of the Court ultimately declined to overturn *Basic*. Although the Court preserved the FOTM presumption of reliance, it also held that defendants may rebut the presumption

7. Robert Klonoff, *The Decline of Class Actions,* 90 WASH. U. L. REV. 729, 737–39 (2013).

8. Strike suits refer to meritless securities fraud claims that are brought merely for their settlement value. *See infra* notes 15–18 and accompanying text.

9. Victor Schwartz & Christopher Appel, *Rebutting the Fraud on the Market Presumption in Securities Fraud Class Actions: Halliburton II Opens the Door,* 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 33, 40 (2016).

10. *Id.* at 41.

11. Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014).

at the class certification stage. Like the PSLRA, *Halliburton II* makes it easier, at least in theory, for defendants to prevail in securities class actions. Also like the PSLRA, however, the practical impact of *Haliburton II* on the amount of frivolous suits is doubtful.[12] Finally, *Halliburton II* preserves, for better or worse, the class action apparatus as the principal means of private enforcement of Rule 10b-5.

As of this writing, the size of settlements paid by corporate defendants in securities class actions remains staggering.[13] Meanwhile, the debate over reform continues. Against this backdrop, the aim of this Note is twofold. First, I identify evidence of frivolous 10b-5 class actions, arguing that these strike suits have survived repeated reform efforts. I then introduce fee-shifting as a device to optimally screen out frivolous securities fraud suits. Second, this Note argues that Delaware corporations can now, as a matter of U.S. law, adopt valid fee-shifting bylaws and charter provisions. That argument turns on my construction of Delaware's recently passed law, Senate Bill No. 75.[14] As we shall see, there is considerable diversity among commentators in their interpretations of how S.B. No. 75 constrains corporate fee-shifting. I argue that Delaware's new law, properly construed, permits corporations to adopt fee-shifting provisions in their bylaws or charters. This Note then anticipates likely challenges to the implementation of fee-shifting bylaws or charter amendments, including challenges based on Delaware legislation and federal preemption grounds, arguing that these objections are ultimately surmountable. Indeed, as I argue in this Note, far from impeding the federal securities

12. Robert L. Hickok & Gay Parks Rainville, *Defendants Look for Broader Interpretation of "Halliburton II"*, PEPPER HAMILTON LLP (2016), http://www.pepperlaw.com/publications/defendants-look-for-broader-interpretation-of-halliburton-ii-2016-06-07/ ("Despite the significance of *Halliburton II*, a majority of district courts have applied a narrow interpretation of its holding, rendering toothless defendants' right to rebut the *Basic* presumption.").

13. By one measure, aggregate investor losses on all filed cases in 2015 were $183 billion, and the average settlement value was $52 million. *See* SVETLANA STARYKH & STEFAN BOETTRICH, *Recent Trends in Securities Class Action Litigation: 2015 Full-Year Review*, NERA Econ. Consulting 1, 7, (2016), http://www.nera.com/content/dam/nera/publications/2016/2015_Securities_Trends_Report_NERA.pdf.

14. *See* DEL. CODE ANN. tit. 8, §§ 102(f), 109(b) (West 2015) [hereinafter S.B. NO. 75].

regulation scheme, corporate fee-shifting promises to further its purpose.

Finally, this Note considers how courts are likely to review challenges to fee-shifting based on implied preemption. As we shall see, the judicial track record is historically inconsistent in this area. To remedy that trend, I propose a framework for judicial review built on three core ingredients: the presumption against preemption, consideration of the underlying regulator's views, and a careful judicial scrutiny of the regulator's reasoning. This analytical framework incentivizes agencies to use transparent and inclusive rulemaking procedures to support assertions of preemptive power. The framework also prompts courts to accord deference in proportion to evidence that agencies brought their expertise to bear on questions of implied preemption.

This Note is organized as follows: Part I introduces fee-shifting, and argues that the current level of frivolous lawsuits justifies its implementation. Part II discusses the Delaware legal environment leading to the passage of S.B. No. 75, and interprets the law to allow for fee-shifting. Part III addresses the principal challenges to implementation of loser-pays regimes by corporations, and proposes a framework for judicial review.

I.
FEE-SHIFTING: CREATING THE INCENTIVES TO LITIGATE MERITORIOUS CLAIMS AND DETER FRIVOLOUS STRIKE SUITS

A. *There Are Persuasive Reasons to Believe that Many Rule 10b-5 Securities Class Actions Are Frivolous, Imposing an Unjustifiable Tax on Shareholders*

The prevalence of frivolous class action lawsuits generally, and frivolous securities class actions in particular, is by now a familiar refrain.[15] Critics of the class action apparatus evoke a broad range of abusive practices unfairly targeting corporate defendants.[16] But for all the complaints of widespread abusive

15. *See, e.g.*, A. C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 926–27 (1999).

16. *See* Richard H. Walker, David M. Levin & Adam C. Pritchard, *The New Securities Class Action: Federal Obstacles, State Detours*, 39 ARIZ. L. REV. 641 (1997).

litigation, the definition of frivolous lawsuits is sometimes taken for granted. What, after all, distinguishes a frivolous claim from a meritorious one? The only definitive response is that a meritorious claim achieves a judgment after trial.[17] However, virtually all securities class actions that survive the motion to dismiss stage are settled. The most conclusive way to judge a complaint's merit is therefore usually unavailable. A more practicable distinction might identify frivolous suits as those dismissed, and meritorious ones as those settled. This approach, however, fails to distinguish truly meritorious suits from lawsuits settled merely for their nuisance value.[18] Ultimately, we cannot observe a claim's merit conclusively prior to judgment.

That said, there are other reasons to believe that securities class actions are not always in shareholders' best interests. The 104th Congress certainly reached that conclusion before adopting the PSLRA: "today certain lawyers file frivolous 'strike' suits alleging violations of the Federal securities laws in the hope that defendants will quickly settle to avoid the expense of litigation."[19] Congress did not reach this view lightly; numerous distinguished experts testified at hearings, and dozens of relevant cases were referenced to support the conclusion that abusive strike suits exist. Granted, strong private interests backed a concerted lobbying effort to convince Congress of the existence of widespread abusive litigation. Nonetheless, staggering plaintiffs' attorney fee awards, the high volume of complaints filed, often at the slightest hint of corporate misconduct, and the consistent opinions of many experts all lend support to Congress' conclusion that frivolous strike suits unfairly afflict corporate defendants. Therefore, even though we do not directly observe frivolous claims, there are strong reasons to conclude, as Congress did, that frivolous securities class actions are a widespread phenomenon.

To be sure, the evidence of strike suits discussed above all pertains to the time before the PSLRA's enactment. One must ask, then, whether any of the phenomena undergirding Con-

17. S. Choi et al., *The Screening Effect of the Private Securities Litigation Reform Act* 2, (U. Mich. L. Sch. Law & Economics Working Papers Archive: 2003–2009, Art. 69, 2007), http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1070&context=law_econ_archive.

18. *See id.*

19. S. REP. NO. 104-98, at 4, 6, 11 (1995).

gress' finding of widespread abusive litigation are still present. In other words, did the PSLRA, which sought to root out frivolous Rule 10b-5 claims, achieve its purpose? In answering this question we should again keep in mind that no precisely accurate measurement of the level of frivolous lawsuits can be made. Notwithstanding, several empirical studies have analyzed the impact of the PSLRA on securities class actions.[20] There is broad consensus that the PSLRA, at least initially, was beneficial to shareholders. Choi et. al, for example, found that the PSLRA indeed had a screening effect.[21]

Unfortunately, however, by all indications the PSLRA's welfare-enhancing effect for shareholders was short-lived. As one commentator observed, "[t]he plaintiff's bar has found ways to circumvent these reforms, and reinstitute the old abusive practices in new form."[22] One way in which plaintiff lawyers have reasserted their pre-PSLRA control over Rule 10b-5 lead plaintiffs is through so-called "pay to play" contributions to institutional funds.[23] Other observers have noted that despite an initial dip following the PSLRA's passage, the filing of meritless lawsuits quickly rebounded.[24] More recently, the Supreme Court's decision in *Halliburton II* promised an avenue for Rule 10b-5 defendants to dispose of baseless lawsuits earlier on. By allowing defendants to rebut the FOTM presumption at the class certification stage, corporations can theoretically defeat meritless claims in court instead of settling them for their nuisance value. However, in the three years since the decision, there is little indication that Rule 10b-5 defendants can succeed in rebutting the FOTM presumption.[25] Finally, the chorus of complaints about abusive securities class action lawsuits is as audible now as it was in the early 1990s.[26] In sum, there is robust evidence to support an inference that frivolous securi-

20. *See, e.g.,* Ashiq Ali & Sanjay Kallapur, *Securities Price Consequences of the Private Securities Litigation Reform Act of 1995 and Related Events*, 76 ACCT. REV. 431 (2001).

21. S. Choi et al., *supra* note 17, at 3.

22. ANDREW J. PINCUS, *What's Wrong with Securities Class Action Lawsuits?*, U.S. CHAMBER INST. FOR LEGAL REFORM 10 (2014).

23. *Id.* at 11 (citing John C. Coffee, Jr., *Nobody Asked Me, But. . .*, Nat'l L.J., Jan. 18, 2007).

24. *See, e.g.,* S. Choi et al., *supra* note 17, at 3.

25. *See* Hickok and Rainville, *supra* note 12.

26. *See, e.g.*, MUKESH BAJAJ ET AL., *Economic Consequences: The Real Cost of U.S. Securities Class Action Litigation?*, U.S. Chamber Inst. for Legal Reform, at

ties class actions presently exist and impose an unjustifiable burden on shareholders.

B. *Fee-Shifting, Properly Configured, Promises to Screen Out More Frivolous Lawsuits*

As we saw, the problem of frivolous lawsuits in the securities industry persists. The burden imposed by abusive litigation, however, is hardly unique to the securities industry. Opponents of allegedly baseless lawsuits targeting businesses have long proposed reforms to root out strike suits. These include caps on damages awarded after trial, mandatory arbitration clauses, and, of particular relevance to this Note, fee-shifting. This Part considers fee-shifting as a method to reduce strike suits specifically in the context of securities fraud. I argue that a particular form of fee-shifting—namely, symmetric shifting—optimally screens out frivolous securities class actions against corporations. Before arriving at that more nuanced conclusion, a discussion of the basic economics of fee-shifting is necessary.

Concisely stated, fee-shifting (also referred to as "loser pays") provides that the prevailing party to a lawsuit does not pay its legal fees. Instead, those fees are shifted to that party's adversary—the losing party. There are several theoretical justifications for the loser pays principle. Foremost of those is a concern for fairness. Indeed, most contemporary legal systems feature some form of fee-shifting, considering this rule as dictated by notions of fundamental fairness.[27] The U.S. principle that each party finances its own lawsuit (hereinafter "the American Rule") is the outlier here.

A corollary justification to the notion of fairness is the screening function. Fee-shifting affects the incentives of parties to litigate disputes in court.[28] Consider how the loser pays principle impacts a plaintiff's decision to bring suit in the first place. Intuitively, the stronger a plaintiff's claim, the more likely she is to sue under fee-shifting. A numerical example illustrates the point: Suppose the probability of her winning at

---

10 (2014), http://www.instituteforlegalreform.com/uploads/sites/1/EconomicConsequences_Web.pdf.

27. *See, e.g.,* Germany.

28. STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 429 (Harvard Univ. Press 2004).

trial is 80%, and the amount she stands to win at judgment is $10,000. Her expected return under the American Rule is therefore $8000. Assume also that the plaintiff's and the defendant's legal fees for litigating the suit until judgment are $9000 each. In this scenario, the plaintiff has a negative expected return under the American Rule ($8000 - $9000 = -$1000), and hence would not bring suit.

Now consider how introducing fee-shifting changes the expected return on litigating the suit. Under loser pays, the plaintiff's expected cost of litigating the suit is no longer $9000, but instead the legal fees for both parties, weighted by her probability of losing: 20% × $18,000 = $3600. Her expected return on bringing the suit is now positive ($8000 - $3600 = $4400), and she would therefore choose to bring the suit in the first place. In these circumstances, the availability of fee-shifting increases the plaintiff's incentive to bring suit where her claim is strong.[29] Importantly, the converse is also true: fee-shifting disincentivizes a plaintiff from bringing suit when her claim is weak (because the expected cost of the suit is now greater than it would be under the American Rule).[30] Fee-shifting thus magnifies the relative strength or weakness of a claim, making frivolous suits more costly and less likely to be litigated, while strong claims become more profitable and more likely to be litigated.

Nonetheless, an important caveat is necessary for the foregoing conclusion to hold. Thus far, I have taken for granted that fee-shifting is symmetrical. Symmetry in this context means that a court shifts fees after judgment in *either* direction. In other words, both the plaintiff and the defendant—whoever loses—stands to foot the bill for the legal expenses of the triumphant party. As we shall see, fee-shifting does not necessarily exhibit symmetry. And the precise mechanics of the applicable fee-shifting rule (i.e., whether it is symmetrical) in turn affect the expected return on a claim.

Having reviewed the basic economics underlying the loser pays principle, this Note next considers actual fee-shifting provisions adopted by corporations. Consider the fee-shifting provision at issue in *ATP Tour, Inc. v. Deutscher Tennis Bund*.[31] *ATP*

29. *Id.* at 428–432.
30. *Id.*
31. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014).

Tour is also of particular importance to recent developments in Delaware law discussed in Part II *infra*; for now, however, the focus is on the fee-shifting provision at issue in the case.

ATP Tour, Inc. is a Delaware non-stock membership corporation, comprised of tennis tournament operators.[32] A dispute arose between two of ATP Tour's members (Deutscher Tennis Bund and Qatar Tennis Federation) and the corporation when ATP Tour's board implemented a change to the tour schedule resulting in the downgrade of the tournament in Hamburg from the highest to the second-highest tournament tier.[33] The plaintiffs alleged federal antitrust violations and breach of fiduciary duties against the corporation and its directors. Following a ten-day jury trial, the United States District Court for the District of Delaware granted defendants' motion for judgment as a matter of law on all claims against the corporation and its directors.

The matter was not yet at an end. ATP Tour next moved to recover its legal fees pursuant to Rule 54 of the Federal Rules of Civil Procedure and Article 23.3(a) of ATP's bylaws. In 2006, one year prior to the dispute, the board had amended ATP Tour's corporate bylaws and added Article 23, which provides, in relevant part, as follows: "(a) In the event that [any member] initiates [any claim or counterclaim], and (ii) the Claiming Party . . . does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the League . . . for all fees, costs and expenses . . . that the parties may incur in connection with such Claim".[34] The district court certified the question of whether Article 23 is enforceable to the Delaware Supreme Court, which upheld the fee-shifting provision. A plain reading of Article 23.3(a) makes clear that fee-shifting in only one direction is contemplated by the bylaw: from the "League" to the "Claiming Party." There is no mention of shifting legal fees and expenses in the event that "Claiming Parties" succeed against the "League." Article 23 of ATP's bylaws, then, is an example of asymmetric fee-shifting, where legal fees are only

32. *Id.* at 555.
33. *Id.* at 556.
34. *Id.*

shifted in one direction (from the successful defendant to the unsuccessful plaintiff).

As suggested above, fee-shifting does not always achieve the desired outcome of encouraging meritorious suits while deterring frivolous ones. How, then, does an asymmetric loser pays regime like Article 23 in *ATP Tour* measure up? Albert Choi addresses this question in his recent paper on fee-shifting bylaws.[35] Choi demonstrates algebraically that the ATP Tour fee-shifting provision decreases the expected return on frivolous claims, but also the expected return on meritorious claims. In his words, "compared to the traditional, no-fee-shifting rule, the symmetric fee-shifting rule encourages more meritorious lawsuits while discouraging frivolous ones, while the ATP Tour Rule discourages all types of lawsuits."[36]

Put differently, the ATP Tour bylaw does function as a screen against frivolous lawsuits, but it also screens out meritorious ones. Choi argues convincingly that the optimal fee-shifting rule exhibits symmetry, providing for reimbursement of legal fees in both directions.[37] I concur with Choi's reasoning, and add that symmetric fee-shifting, in addition to producing more economically efficient outcomes, has the added benefit of fairness. Unlike the ATP Tour provision that only shifts fees to a losing plaintiff, symmetric fee-shifting does not appear to be designed to keep plaintiffs out of court.

In conclusion, we saw that there is strong evidence of frivolous strike suits encumbering the securities industry. We then examined fee-shifting and its ability to screen out baseless claims, finding that symmetric fee shifting ideally performs that screening function. The discussion of fee-shifting thus far was largely theoretical, however, and did not account for the particularities of class action lawsuits. The next question, then, is how loser pays provisions work specifically in the context of Rule 10b-5 securities fraud class actions, and how those provisions can be implemented.

---

35. Albert Choi, *Optimal Fee-Shifting Bylaws*, 103 VA. L. REV. (forthcoming 2017).

36. *Id.* at 15.

37. *Id.* at 28–31.

II.
Fee-Shifting in Delaware: How Corporations Can Implement Loser Pays Provisions Governing Securities Fraud Class Actions

Part II proposes Delaware as a jurisdiction where fee-shifting is, as a positive matter, a feasible option for corporations to reduce their exposure to frivolous securities fraud claims. To that end, the decision in *ATP Tour* does double duty for this Note. In Part I we examined the fee-shifting provision in *ATP Tour* to illustrate why the optimal fee-shifting provision is symmetrical, and as an example of corporate bylaws implementing a loser pays regime. The decision is also important for an understanding of Delaware law governing corporate fee-shifting provisions. *ATP Tour* ignited a debate between the supporters and opponents of fee-shifting, recently culminating in the enactment of Senate Bill No. 75 in 2015. As we shall see, that bill has profound implications for corporations and directors: their ability to adopt fee-shifting provisions applicable to suits against the corporation depends on the limits to the new law's reach.

Before analyzing Delaware's approach to fee-shifting, it is worth pausing at a threshold question. Because this Note proposes an antidote to frivolous securities class actions, which are, of course, federal causes of action, why focus on state corporate law, and why Delaware in particular? In the United States, corporate law has traditionally been a concern of the states. While large, publicly traded companies are incorporated in diverse jurisdictions across the nation, Delaware has long been a leader in corporate law. Many of the nation's largest corporations are incorporated there.[38] Therefore, if Delaware law were to permit fee-shifting bylaws, the scope of corporations standing to benefit is vast. The other reason why this Note focuses on Delaware in particular is more by happenstance than design. As the following sections elaborate, the last two years have brought the issue of fee-shifting to center stage in Delaware corporate law. Nonetheless, there have been rele-

38. Per the state's Division of Corporations, 64% of Fortune 500 companies are incorporated in Delaware, and more than 1,000,000 entities in total have their seat in Delaware. *Why Businesses Choose Delaware*, Del. Div. Corp., https://corplaw.delaware.gov/why-businesses-choose-delaware (last visited Oct. 4, 2017).

vant developments in other jurisdictions. For example, Oklahoma and New Jersey have both also recently adopted legislation regarding fee-shifting.[39] For the reasons just outlined, however, the focus of the following sections is Delaware state law.

A. *From ATP Tour to Delaware Senate Bill No. 75: Fee-Shifting's Circuitous Path Through Delaware's Legal System*

The Delaware Supreme Court decision in *ATP Tour* sparked vigorous reactions from the corporate community. To fully explicate the import of *ATP Tour*, a more detailed account of the procedural history and holding of the case is necessary. As discussed above, the dispute arose when two plaintiff tournament owners sued the defendant non-stock member corporation, ATP Tour, Inc., and various of its directors and officers (hereinafter "ATP") for breach of fiduciary duties and antitrust violations. The plaintiffs filed suit in the Delaware District Court in 2008. Following a ten-day jury trial, the court granted ATP's motion for judgment as a matter of law for the state law claims, and the jury then found for defendants on the antitrust law claims.[40] Defendants then moved to recover attorney's fees and other costs amounting to just under $18,000,000, pursuant to Federal Rule of Civil Procedure 54(d)(2). Defendants relied on Article 23, the corporation's fee-shifting bylaw, as the basis for their claim for attorney's fees.

The district court acknowledged, in principle, a contractual exception to the American Rule that each party finances its own lawsuit.[41] However, the court found that awarding ATP its legal fees would conflict with federal antitrust law, and declined ATP's motion. The court "reasoned that federal law preempts the enforcement of fee-shifting agreements when antitrust claims are involved."[42] On appeal, the Third Circuit remanded for further consideration, finding that a preliminary issue to the preemption question needed resolution. Spe-

39. *See* N.J. Rev. Stat. § 14A:3-6.7 (2013); Okla. Stat. tit. 18, § 1126 (2016).

40. Bund v. ATP Tour, Inc., No. 07-178, 2009 U.S. Dist. LEXIS 97851, at *2 (D. Del. Oct. 19, 2009).

41. *Id.* at *6.

42. Deutscher Tennis Bund v. ATP Tour Inc., 480 F. App'x 124, 126 (3d Cir. 2012).

cifically, the appellate court held that "the by-law validity issue needs to be addressed, and a finding of validity must be made, before the constitutional issue of preemption can be considered."[43]

The question of the fee-shifting bylaw's validity eventually made its way to the Delaware Supreme Court after the circuit court certified four questions of state law. In 2014, the court issued a short en banc opinion in response to the certified questions. The court unanimously held that fee-shifting bylaws like ATP's Article 23 are facially valid under Delaware statutory and common law, and are therefore enforceable so long as they are adopted for equitable purposes and pursuant to applicable procedural requirements.[44] The Delaware Supreme Court thus sanctioned utilization of corporate bylaws to contract around the default American Rule and implement fee-shifting provisions.

Broadly read, the *ATP Tour* decision is a significant endorsement of corporate fee-shifting provisions in Delaware. Nonetheless, the Delaware Supreme Court was careful to qualify its holding. First, the opinion emphasizes that whether a fee-shifting bylaw is enforceable depends on the manner in which it is adopted. Since ATP Tour's board of directors had

---

43. *Id.* at 127.

44. The court elaborates that in principle fee-shifting provisions like Article 23 are not inconsistent with the DGCL and Delaware common law:

> A fee-shifting bylaw, like the one described in the first certified question, is facially valid. Neither the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws. A bylaw that allocates risk among parties in intra-corporate litigation would also appear to satisfy the DGCL's requirement that bylaws must "relat[e] to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." The corporate charter could permit fee-shifting provisions, either explicitly or implicitly by silence. Moreover, no principle of common law prohibits directors from enacting fee-shifting bylaws.
>
> Delaware follows the American Rule, under which parties to litigation generally must pay their own attorneys' fees and costs. But it is settled that contracting parties may agree to modify the American Rule and obligate the losing party to pay the prevailing party's fees. Because corporate bylaws are "contracts among a corporation's shareholders," a fee-shifting provision contained in a non-stock corporation's validly-enacted bylaw would fall within the contractual exception to the American Rule. Therefore, a fee-shifting bylaw would not be prohibited under Delaware common law.

ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014).

the power pursuant to the corporation's charter to amend the bylaws, Article 23 was adopted in proper manner.[45] Second, the Delaware court observed that otherwise facially valid bylaws will be unenforceable if adopted for inequitable purposes.[46] The court did not, however, elaborate on which purposes might be deemed inequitable. Most importantly, the decision leaves unanswered the question of how broadly the court's holding applies, or whether the ruling is more narrowly cabined to the facts of the case.[47] As noted above, the dispute in *ATP Tour* involved a non-stock member corporation. This leaves open the question of whether the court's sanctioning of ATP Tour's bylaw applies equally to fee-shifting provisions of public corporations.

Despite the uncertainty over the precise reach of *ATP Tour*'s holding (i.e., what bylaws pass muster, and which kind of corporations the holding covers), several commentators have advanced a broad construction of the court's opinion. One prolific commentator, Kevin LaCroix, suggested that *ATP Tour* may reach not only non-stock corporations like ATP Tour, Inc., but also public corporations incorporated in Delaware.[48] Others have gone even further in their assessment of how broadly *ATP Tour* applies. Consider the memorandum of one law firm to its clients following the decision: "The practical effect of this decision, along with the Court of Chancery's earlier decision in *Chevron* (written by then-Chancellor and now Chief Justice Strine), is that many boards of directors of private and public Delaware corporations should seriously consider adopting fee-shifting bylaws of their own."[49] That advice

45. *Id.* (citing Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437 (Del. 1971) for the applicable legal standard).

46. *Id.*

47. *Accord* Gregory DiCiancia, *Limiting Frivolous Shareholder Lawsuits Via Fee-Shifting Bylaws: A Call for Delaware to Overturn and Revise Its Fee-Shifting Bylaw Statute*, 56 B.C. L. Rev. 1537, 1559 (2015).

48. In a panel following publication of the decision, Lacroix commented: "So this idea that by bylaw, an unsuccessful litigant would bear the adversary's cost, is really radical—it could be transformative of the way shareholder litigation goes forward in our litigious environment." Yin Wilczek, *Litigation Reform Through Bylaws So Far a Success Story, Panelist Says*, Corporate Law & Accountability Report (BNA), 12 CARE Issue No. 31.

49. Wilson Sonsini Godrich & Rosati, *Delaware Supreme Court Endorses "Fee-Shifting" Bylaw in Certified Question of Law* (2014), https://www.wsgr.com/publications/PDFSearch/wsgralert-fee-shifting.pdf.

is given to public and private companies alike, advancing a broad construction of *ATP Tour* that reaches non-stock as well as stock corporations. And indeed, the opinion certainly leaves room for a plausible reading that the court sanctioned the use of fee-shifting bylaws for corporations irrespective of their status as public or private.[50]

As the months immediately following the Delaware Supreme Court's decision would show, the proponents of fee-shifting provisions for public corporations initially carried the day. Delaware companies, both public and private, began adopting loser-pays provisions into their bylaws or certificates of incorporation in short order.[51] Fee-shifting provisions, with the apparent blessing of Delaware's highest court, gained momentum. But then, just as rapidly as companies had begun to adopt loser-pays provisions, the pendulum swung back toward the American Rule. Two of the largest and most influential proxy advisory services (Glass-Lewis and Institutional Shareholder Services) spoke out against fee-shifting provisions, indicating in voting guidelines that they would not recommend reelecting boards that unilaterally acted to adopt loser-pays re-

50. The court bases its decision in part on its reading of Delaware corporate statutory law: "Neither the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws." *ATP Tour, Inc.*, 91 A.3d at 558. The DGCL applies to public and private Delaware corporations alike. Further, in its discussion of enforceability of fee-shifting bylaws in Delaware, the court cites *Schnell v. Chris-Craft Industries*—a decision involving a public Delaware corporation. *See supra* text accompanying note 45. Taken together, the court's discussion is amenable to a reading that its holding reaches stock corporations seated in Delaware too. *Accord* Ronald Mueller et al., *Gibson Dunn Discusses Supreme Court of Delaware Case Upholding Fee-Shifting Bylaws*, CLS Blue Sky Blog (May 16, 2014), http://clsbluesky.law.columbia.edu/2014/05/16/gibson-dunn-discussessupreme-court-of-delaware-case-upholding-fee-shifting-bylaws/.

51. John Coffee Jr. recounts the reaction to *ATP Tour* as follows: "Corporations and other business entities began to adopt such board-approved bylaws or, in the case of issuers preparing for an initial public offering, to insert "loser-pays" provisions into their certificates of incorporation. Between May 29, 2014 and September 29, 2014, some twenty-four companies (including some limited liability companies and limited partnerships that were planning a public offering) adopted such a provision, either by a board-passed bylaw or a charter provision (in the case of a firm planning an initial public offering (or "IPO")." John C. Coffee, Jr., *"Loser Pays": The Latest Installment in the Battle-Scarred, Cliff-Hanging Survival of the Rule 10b-5 Class Action*, 68 SMU L. REV. 689, 692 (2015).

gimes.[52] These objections to unilaterally adopted fee-shifting bylaws and charter amendments have had an understandably chilling effect on Delaware's corporate boards and decisions to adopt such provisions.[53]

Besides the shareholder advisory services, there were other formidable sources of opposition to the trend toward fee-shifting. Large institutional investors also opposed the proliferation of fee-shifting provisions in Delaware.[54] The institutional investors brought their influence to bear on the Delaware fee-shifting reformation in two-fold fashion. First, the vocal opposition of large shareholders resonates in corporate boardrooms responsive to shareholder concerns.[55] Relatedly, as we have seen, proxy advisory services responded to pressure from institutional investors to oppose corporate fee-shifting provisions.[56] Second, institutional investors used their clout to lobby Delaware lawmakers—a campaign that included sending letters to the Governor Jack Markell urging him to help stem the tide of new fee-shifting provisions.

One important caveat should be kept in mind here: the resistance by investor groups was not necessarily an indictment of fee-shifting per se. As discussed in Part I above, ATP Tour's loser-pays bylaw was asymmetric, providing for recovery of legal fees only in favor of the corporation and not the plaintiff-shareholders. As we saw, the effect of an asymmetric fee-shifting provision like ATP Tour's is to reduce the expected return

52. *See* Stephen Bainbridge, *Fee Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851 (2016); *see also* Teri E. O'Brien et al., *Key Changes to ISS and Glass Lewis Voting Guidelines,* Law360 (Dec. 16, 2014, 4:37 P.M.), https://www.law360.com/articles/602947/key-changes-to-iss-and-glass-lewis-voting-guidelines.

53. Shareholder proxy advisory services have strong influence on shareholder voting behavior. When the services recommend against reelection of incumbent boards, this creates a significant risk for incumbent directors that shareholders will vote in favor of other candidates. The voting guidelines of the most influential proxy advisory services therefore have considerable weight in how corporate boards decide to act.

54. Institutional investors wield increased clout over public corporations, as their assets under management and consequent share ownership have experienced sustained growth. Sarah Krouse, David Benoit & Tom McGinty, *Meet the New Corporate Power Brokers: Passive Investors*, WALL ST. J. (Oct. 24, 2016), http://www.wsj.com/articles/the-new-corporate-power-brokers-passive-investors-1477320101.

55. *See supra* text accompanying notes 50 and 51.

56. DiCiancia, *supra* note 47, at 1561.

on litigating even meritorious claims. The institutional investors may therefore oppose asymmetric loser-pays provisions without necessarily objecting to fee-shifting bylaws generally.

Finally, the Delaware State Bar Association also took a strong position against corporate fee-shifting provisions. The economic interests of the Delaware plaintiff's and defense bars were aligned here: the proliferation of fee-shifting provisions imposing steep costs on plaintiffs who fail to recover all or substantially all of the remedy sought would likely effect a dramatic reduction in litigation. And every suit deterred by the new loser-pays provisions represents foregone legal fees for attorneys on both sides of the dispute.[57] Sure enough, following the *ATP Tour* decision, the bar association promptly began drafting a bill to undo the Delaware Supreme Court's ruling. However, opposite the institutional investors and Delaware State Bar Association, there were powerful interests lobbying against legislation that would curtail fee-shifting. Specifically, the U.S. Chamber of Commerce, a strong business lobbying group, voiced its support for the *ATP Tour* ruling and opposition to legislation overturning it.[58] The battle lines in the struggle over loser-pays regimes in Delaware were drawn.

The Delaware legislature, confronted with pressure from the opposing interest groups, declined to vote on the draft bill in 2014, and delayed the decision to overturn *ATP Tour*[59] to the next legislative session.[60] The 2015 legislative session began with a new draft bill put forward by the Corporate Law Council.[61] This time, the legislature approved the bill and the

57. As Coffee remarks, the bar association would not make the case against fee-shifting by reference to their own foregone legal fees. Nonetheless, the economic incentives here are undeniable. *See* Coffee, *supra* note 51, at n.20.

58. *See* Jonathan Starkey, *Chamber Forces Delay on Fee-shifting Legislation*, DELAWARE ONLINE (Jun. 10, 2014, 1:00 PM), http://www.delawareonline.com/story/firststatepolitics/2014/06/10/fee-shiftingbill/10280791/.

59. S.B. No. 75 would eventually overturn *ATP Tour*, but only with regard to public Delaware companies (as opposed to non-stock corporations too). As the Synopsis of the law explains, "In combination with the amendments to Sections 109(b) and 114(b)(2), new subsection (f) does not disturb that ruling in relation to nonstock corporations." S.B. 75, 148th Gen. Assemb., First Reg. Sess. (Del. 2015).

60. Coffee, *supra* note 51, at 693.

61. The Council, appointed by the Delaware State Bar association, is responsible for proposing changes to the DGCL. *See* COUNCIL OF THE CORPORA-

opponents of corporate fee-shifting emerged victorious. The Delaware Senate adopted Bill No. 75 by an overwhelming margin of sixteen votes in favor and five opposed.[62] It passed the Delaware House the following month, and Governor Markell signed the bill into law on June 24, 2015.

What ultimately tipped the scales in favor of the fee-shifting opponents in Delaware? Albert Choi suggests that the Delaware legislature "possibly . . . acced[ed] to the influence of the Delaware plaintiffs' bar."[63] Coffee invokes a concern over reduced "Gross Domestic Product of the State," imposing a significant cost both economically and politically.[64] The bill itself states that the law was passed "[i]n order to preserve the efficacy of the enforcement of fiduciary duties in stock corporations."[65] It is unclear which of these reasons underlay the legislation, but whatever the motivation for S.B. No. 75's passage, it was a significant victory for the interest groups opposing loser-pays provisions, and a defeat for the corporations supporting them.[66]

The struggle over fee-shifting in the context of Delaware corporations seemed to be, at least for the time being, at an end with the enactment of S.B. No. 75. As we have seen, the momentum toward adoption of loser-pays provisions by corporations in the wake of *ATP Tour* first slowed, and finally stopped. In turn, this might suggest that the struggle over fee-shifting has ended with a blanket prohibition against fee-shifting bylaws and charter provisions. But this paints the picture in overly broad strokes. What, then, does the new Delaware law mean exactly for corporations and their ability to implement loser-pays provisions? To answer that question, a closer look at the text of the statute and the accompanying synopsis is called for. As the following section describes, the law leaves room for fee-shifting provisions governing certain claims against corporate defendants.

TION LAW SECTION, https://www.delawarecounselgroup.com/dsba-corporate-council/.

62. DiCiancia, *supra* note 47, at 1563.

63. A. Choi, *supra* note 35.

64. Coffee, *supra* note 51, at 693.

65. S.B. 75, *supra* note 14.

66. *See, e.g.*, Anthony Rickey, *Fee Shifting May Disrupt Delaware's Dominance,* Law360 (Mar. 13, 2015), http://www.law360.com/articles/631222/fee-shifting-may-disrupt-delaware-s-dominance.

B. *Interpreting the New DGCL: An Avenue to Implementation of Fee-Shifting Provisions in Corporate Bylaws and Charters to Curtail Frivolous Strike Suits*

The law enacted by the Delaware legislature amends existing sections of the DGCL to incorporate express prohibitions against fee-shifting. Specifically, the law amends Sections 102 and 109 of the DGCL, among others. Those sections govern the contents of the certificate of incorporation and the bylaws, respectively. A precise understanding of the amendments is important for purposes of this Note, and we therefore review them in some detail.

The Act added an entirely new subsection (f) to Section 102 of the DGCL, reading as follows: "The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title."[67] The Act also amends Section 109(b), adding the following: "The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title."[68]

Reading the amendments in conjunction, what stands out is that both prohibit "provision[s] that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation." This language thus targets fee-shifting regimes in the two most important contractual foundations of the Delaware corporation: the charter and the bylaws (in that order). One should note, however, that the amendments—applicable only to corporate charters and bylaws—do not entirely foreclose adoption of provisions imposing liability on shareholders for attorneys' fees or expenses.[69] Both amendments also focus the prohibition of fee-shifting provisions on "internal corporate claims," referencing DGCL Section 115 for definition.

67. S.B. No. 75, *supra* note 14, at 2.

68. *Id.*

69. Specifically, shareholders are still free to enter contractual agreements amongst themselves (shareholder agreements), or with the corporation. Both of these contracts would fall outside the purview of the charter and the bylaws, and consequently outside of the prohibitions in §§ 102 and 109. *Accord* A. Choi, *supra* note 35.

Pursuant to Section 115, another new section of the Act adds to the Delaware Code, "'Internal corporate claims' means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery."[70] Section 15(i) defines internal corporate claims as those alleging breaches of duties by directors and officers of a corporation. Section 15(i) thus interacts with Sections 102 and 109 of the DGCL to prohibit loser-pays provisions that would hold plaintiff-shareholders liable for defendants' legal fees. Finally, DGCL Section 15(ii) covers appraisal actions, over which the Delaware Chancery Court is explicitly given jurisdiction under the DGCL.

Thus, the new amendments to the DGCL limit corporate fee-shifting provisions. But exactly what claims by plaintiff-shareholders are preempted? Section 15(i) defines internal corporate claims as those "based upon the violation of a duty," specifically contemplating breaches of fiduciary duties owed by directors to their corporations and shareholders. The Delaware Corporate Council defined intra-corporate claims in part by reference to fiduciary duties, recognizing that plaintiff-shareholder lawsuits alleging breaches of fiduciary duties make up a vast proportion of shareholder litigation in Delaware state courts. Indeed, in the memorandum explaining and advocating for the law, the Council describes its intent to preserve the availability of shareholder litigation:

> "Most litigation testing the propriety of conduct under either the DGCL or the common law of fiduciary duty is initiated by stockholders. The Council believes that absent legislation, many Delaware corporations will eventually adopt *ATP*-type provisions."[71]

And further:

> "It is no exaggeration to say that the Court of Chancery is an invisible presence in every boardroom where a public company deal is being considered, si-

70. S.B. No. 75, *supra* note 14, at 3.

71. *See* Delaware Corporate Law Council, *Explanation of Council Legislative Proposal* 3 (2015), http://www. delawarelitigation.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.docx.Memo.

> lently promoting compliance with its refined standards of fiduciary conduct. This constitutes a remarkable regulatory achievement. It should be recognized and protected by confiding to Chancery the prerogative to manage the docket and ultimately the destiny of Delaware-law fiduciary duty litigation."[72]

As the memorandum in support of S.B. No. 75 demonstrates, the Corporate Council sought to preserve fiduciary duty claims as an avenue for recourse for shareholders exposed to losses from corporate misconduct. The Council's memorandum, by describing the law's intended purpose, also suggests the limits of Section 102 and Section 109's reach. Conspicuously missing from the text of the statute and the Council's explanatory memorandum is any mention of claims brought under the federal securities regime.

Although there is scope for debate, this Note submits that the newly amended DGCL permits implementation of corporate fee-shifting provisions governing shareholder litigation over violations of the federal securities laws. The plain language of Sections 102 and 109, as we saw, define intra-corporate claims by reference to Section 115. And Section 115 defines intra-corporate claims as those alleging breaches of duties and appraisal actions. A loser-pays provision that by its terms applies to lawsuits brought under Section 10 and Rule 10b-5 of the Exchange Act, but not to appraisal or fiduciary duty-based claims, would not violate the DGCL. The purpose of the Act further supports this conclusion. Recall the Delaware Corporate Council's stated purpose for amending the General Law: to ensure the de facto availability of fiduciary duty lawsuits, and the continued involvement of the Chancery Court in the development of Delaware corporate law.[73] The adoption of fee-shifting regimes applicable to securities fraud lawsuits—brought under federal, not state law—would not impede either of those goals. In sum, loser-pays provisions contemplated by this Note would violate neither the letter nor the spirit of the newly-amended DGCL.

This reading of the Act is consistent with the commentary of some other observers. As Coffee concludes, the "language [of the newly adopted prohibitions against fee-shifting] did

72. *Id.* at 12.
73. *See* DiCiancia, *supra* note 47, at n.182.

not reach the securities class action."[74] DiCiancia advances a similar, though more guarded, reading of the new law: "Despite passage of Delaware's fee-shifting bylaw prohibition, uncertainty still remains as to the scope of the prohibition, specifically whether the prohibition applies to securities class action lawsuits."[75] As DiCiancia points out, some observers have taken the opposite position—reading the amended DGCL's prohibition of loser-pays provisions to include securities fraud claims.[76] Notably, Neil Cohen argues that the wording of Section 115 represents a deliberate choice of the Delaware legislature to encompass securities fraud claims in the Act's reach:

> If Sec. 115 were designed to excludes [sic.] securities fraud lawsuits it would define internal corporate claims as exclusively "claims in the right of the corporation"—instead, the definition says "*including* claims in the right of the corporation," leaving room for individual securities fraud claims.
>
> Similarly, the language of the section is not restricted to claims alleging "a violation of a duty"; rather, it includes claims "*based on* a violation of a duty." Securities fraud claims fit because they are based on a violation of a corporate officer's duty to loyally obey the law on behalf of his employer. Finally, the section does not limit coverage to claims under Delaware law. Section 115 could have been deliberately worded

74. Coffee, *supra* note 51, at 694. Coffee reasons as follows: "the Corporation Law Council defined 'intracorporate claim' to mean "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. This language reaches derivative actions, class actions based on a breach of fiduciary duty (such as the standard merger class action asserting that the directors sold the firm too cheaply), and appraisal actions." *Accord* A. Choi, *supra* note 35 ("Finally, since fee-shifting bylaws relate to the issues based on Delaware corporate law, they do not apply in the cases where shareholders bring a non-corporate claim, such as a claim based on federal securities laws that does not allege a violation of duty.").

75. DiCiancia, *supra* note 57, at 1564.

76. *See id.* at n.182 (describing commentators arguing that the statute should not be read so narrowly as to exclude federal securities fraud claims from its purview).

> to leave enough room for the Delaware courts to find that securities fraud cases are covered.[77]

Several arguments militate against Cohen's construction of the Delaware statute. First, Cohen argues that the legislature's choice to define internal corporate claims broadly (using "including" instead of a more exclusive and narrow term) evidences the intent to include securities claims in the definition. But there are different reasons why the legislature might prefer a broad definition over a narrower one; importantly, it may have wanted to include other causes of action without enumerating each one. Claims alleging corporate waste are one obvious example. The second reason why the definition of intra-corporate claims should not be read to include securities fraud claims relates back to the *ATP Tour* decision. Although S.B. No. 75 was initially perceived as overruling *ATP Tour*, the legislature went out of its way to explain that this was not the intended effect of the law's enactment.[78] The Delaware Supreme Court decision is therefore still binding precedent and a Delaware corporation could adopt a fee-shifting provision governing securities fraud claims without running afoul of the 2015 DGCL amendments, as long as it follows *ATP Tour*'s requirement of using proper procedure. Indeed, the legislature's decision not to overrule *ATP Tour* makes sense when viewed in this light: it allows the legislature to achieve its goal of keeping fiduciary duty-based claims in Delaware courts while preserving a way for corporations to screen out harmful strike suits through fee-shifting. Finally, Cohen's argument—that the legislature would have defined internal corporate claims to exclude securities fraud claims if it intended that definition—works at least as well in the opposite direction. If the corporate council had truly intended to prohibit fee-shifting after securities fraud litigation, it could have easily referenced the securities laws and Rule 10b-5 in the definition of internal corporate claims in Section 115.[79]

---

77. Neil Cohen, *Does Pending Delaware Legislation Cover Fee-Shifting in Securities cases?* (June 15, 2015), https://corpgov.law.harvard.edu/2015/06/15/does-pending-delaware-legislation-cover-fee-shifting-in-securities-cases/.

78. *See* S.B. No. 75, *supra* note 14.

79. Indeed, it is hardly plausible that the legislature would choose to include securities fraud claims in the definition so vaguely and indirectly. Federal securities fraud is, after all, a statutory offense. To define securities fraud claims as "based on a violation of a duty" would be circuitous and

As we have seen, Delaware corporations and the shareholders who own their shares continue to suffer unjustified losses in value through legal costs from frivolous securities class actions. Based on a careful review of the recent decision in *ATP Tour*, and the language and purpose of the 2015 Delaware law, this Note argues that corporations have a viable defense against those strike suits. The adoption of fee-shifting provisions holds the promise of reduced meritless claims (as demonstrated in Part I), and Delaware provides its corporations with the legal basis for implementation. A note on what procedure corporations intending to implement loser-pays regimes should follow is in order here. As discussed in this Part, the two principal documents in which a Delaware corporation specifies its governing rules are the charter and the bylaws. Corporations should consider amending their charters, or adopting new bylaws, as ATP Tour did. How best to navigate the internal corporate politics (i.e., how the board should frame the proposal to its shareholders, or how the shareholders should signal interest to the board) are beyond the scope of this Note; it suffices here to point out the bylaws and charter as the main avenues of implementation.[80]

This section has also addressed some objections to my proposal. As DiCiancia and Cohen's articles demonstrate, other interpretations of Delaware law are certainly possible. Probably the greatest hurdle to corporate fee-shifting provisions, however, has yet to be addressed. The following Part takes on the issue of federal preemption, making the argument that loser-pays regimes do not conflict with the federal securities regime.

III.
Defending the Proposal

A. *The Case Against Federal Preemption*

If one accepts the arguments in the foregoing Parts, Delaware corporations and their shareholders stand to gain by implementing loser-pays provisions, and Delaware law does not

---

inaccurate—in fact, a 10b-5 claim need not include any allegations of breached fiduciary duties.

80. Of course, shareholders are still free to enter contractual agreements with each other and with the corporation. This could be another, probably more costly method of adopting fee-shifting provisions.

prohibit their implementation. Unfortunately, the matter does not quite end there. The opponents of fee-shifting, particularly plaintiff lawyers, are likely to challenge the validity of fee-shifting provisions governing securities fraud claims under Rule 10b-5 and the federal securities laws. Given the novelty of Delaware's law, it is unclear how courts will construe its applicability to securities fraud class actions.[81] The issue, however, is bound to be raised in court—either in a direct challenge to a fee-shifting provision or by plaintiffs seeking a declaratory judgment to that end.[82] This Part anticipates and responds to arguments that are likely to be made against the validity of fee-shifting provisions, specifically, federal preemption.[83] Ultimately, I conclude that fee-shifting under Delaware law is not explicitly preempted by the federal securities regime and poses no obstacle to implementation of the securities laws.

Courts have recognized several flavors of preemption. First, a brief note on the general principles underlying preemption, before considering the different species of preemption in turn. The constitutional principle of federalism establishes the coexistence of two sovereigns—the republic and the states. The Supremacy Clause provides that federal law "shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."[84] As the Supreme Court held, "(u)nder this principle, Congress has the power to preempt state law."[85] There are three distinct categories of preemption. First, Congress may expressly preempt state law through explicit preemption clauses. Courts have also recognized two additional doctrines under the larger category of implied preemption: "field" (or impossibility) and "conflict" (or obstacle) preemption. The first category of preemption—express—is also the easiest to dispose of here. While there are

81. As of this writing, there are no decisions or complaints in Delaware courts that address this issue of corporate fee-shifting provisions. *Accord* DiCiancia, *supra* note 47, at 1571.

82. *Id.*; Coffee, *supra* note 51, at 701.

83. In Part II *supra* we saw how a plaintiff can argue the invalidity of a fee-shifting provision under Delaware law without reaching the issue of preemption. Part III therefore does not revisit those arguments and focuses instead on the issue of preemption.

84. U.S. CONST. art. VI, cl. 2.

85. Arizona v. United States, 132 S. Ct. 2492, 2500 (2012).

several express preemption clauses in the federal securities laws (e.g., exemptions from state securities registration requirements under Section 18 of the Securities Act), none of them preempts fee-shifting.[86]

Courts infer field preemption when, despite the absence of express preemption clauses, federal regulation has so completely dominated a field that it implicitly preempts concomitant state regulation. "The intent to displace state law altogether can be inferred from a framework of regulation so pervasive . . . that Congress left no room for the States to supplement it or where there is a federal interest . . . so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject."[87] The case for field preemption is stronger than for express preemption, but, ultimately, unconvincing. In its regulation of the securities industry, Congress has long been sensitive to preexisting state laws. For instance, Congress initially allowed the coexistence of state "Blue sky" laws with the federal securities regime, expressing its intent to not upset state regulatory efforts. This demonstrates a deliberate effort by the federal legislature to not entirely dominate the field of securities regulation, but instead to preserve state regulations.

More importantly, the U.S. Supreme Court held in a line of decisions that there is a distinction between state corporate law and the federal securities laws. In *Santa Fe Indus. v. Green*, the Court reviewed Rule 10b-5 fraud claims brought by minority shareholders following a short-form merger. The plaintiffs, however, did not allege material omissions or misstatements, a required element of that federal antifraud provision. Instead, the minority shareholders argued that the federal securities fraud rules applied to breaches of fiduciary duty.[88] The Court, however, rejected this argument, emphasizing the distinction between state corporate and federal securities laws:

> Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of

86. *Accord* Coffee, *supra* note 51, at 698.

87. Arizona v. United States, 132 S. Ct. at 2501 (internal citations omitted).

88. *See* Roberta Karmel, *Reconciling Federal and State Interest in Securities Regulation in the United States and Europe*, 28 BROOK. J. INT'L L. 495, 504 (2003).

> the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden. As the Court stated in *Court v. Ash*, *supra*: "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."[89]

The Court's reasoning demonstrates its concern for preserving state corporate law as an area of regulation distinct from the federal securities laws. It follows that, to the extent fee-shifting provisions can be framed as instruments of corporate governance, they are not preempted by the national securities regime. I submit that fee-shifting provisions fit under the umbrella of corporate state law, and are therefore not preempted by the federal securities regime.

Opponents of fee-shifting might counter that this conceives of the field too narrowly. In their view, the relevant field is not corporate law generally, but rather fee-shifting provisions governing securities fraud claims against corporate defendants. Under this conception of the field, implied preemption seems more likely.

Indeed, the federal securities regime arguably provides for a fee-shifting mechanism of its own.[90] Section 21D(c) of the Exchange Act, enacted as part of the PSLRA, instructs courts to, upon final judgment, rule on whether either party violated Federal Rule of Civil Procedure 11(b).[91] If a court finds violations of Rule 11, Section 21D(c)(3) creates a presumption that the appropriate sanction is to shift the non-violating party's legal fees to the opposing party. The federal se-

89. Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1977).

90. *See* Coffee, *supra* note 51, at 700 (Coffee invokes Section 21D in his discussion of obstacle preemption).

91. Securities Exchange Act of 1934 § 21D(c), 15 U.S.C. § 78u-4 (2017) ("In any private action arising under this title, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.").

curities regime thus arguably overlaps here with corporate fee-shifting, giving rise to field preemption concerns.

Importantly, however, the analogy between fee-shifting bylaws and Section 21D(c) should not be overstated. Section 21D(c)(3)(A)(ii) provides that a court must find a "substantial failure" to comply with Rule 11(b). Further, the sanction for abusive litigation under Section 21D merely starts with the presumption of fee-shifting—but it need not end there. That is, courts may decide to fashion a different sanction than fee-shifting. The federal securities laws thus leave ample space for shareholders to adopt provisions triggered by a lower standard than "substantial failure," and providing for their desired remedy (i.e., fee-shifting) with certainty and definitude.[92] I therefore submit that Congress has not so thoroughly regulated this field—even if we define it narrowly as fee-shifting applicable to securities fraud claims—as to preempt state law.

Finally, a court may find fee-shifting provisions in corporate bylaws or charters preempted for conflicting with federal securities laws. Obstacle preemption is likely the strongest basis for finding implied preemption of state law here. Coffee makes the argument that corporate loser pays regimes would frustrate "important federal policies" enacted by the PSLRA.[93] As discussed in Part I above, Congress enacted the PSLRA to limit frivolous litigation. One of the goals of that end was ensuring that adequate plaintiffs be made lead plaintiff in class actions. Specifically, the PSLRA creates a rebuttable presumption that the lead plaintiff in a class action is the stakeholder with the largest financial stake in the litigation.[94] The effect of the law was that institutional investors, particularly pension funds, are now the most frequently chosen lead plaintiffs in securities fraud class actions. The reasoning behind this reform was that a lead plaintiff with significant financial interest

92. Indeed, this point bears repeating: by many accounts, and as I argue in Part I, the PSLRA was at best moderately successful in decreasing abusive litigation. Especially with regard to judicial involvement in fee-shifting, the evidence suggests the PSLRA has failed to create a reliable and consistent outcome. Baker, Perion, and Silver, for example, find "judges appear to cut fees randomly, typically with very little explanation for why they did so." Lynn Baker, Michael Perion & Charles Silver, *Is The Price Right? An Empirical Study of Fee-Setting In Securities Class Actions*, 115 COLUM. L. REV. 1371 (2015).

93. Coffee, *supra* note 51, at 698.

94. *See* A. Choi, *supra* note 35; *accord* S. Choi, *supra* note 17, at 204.

in the dispute would have stronger incentives to monitor class counsel, and thereby reduce the likelihood of abusive litigation.

The PSLRA thus overhauled the prior practice in securities class action litigation, where plaintiff lawyers would draw on so-called "stable" plaintiffs—nominal shareholders who own mere fractions of the corporation—to be plaintiffs repeatedly in class actions.[95] The concern over fee-shifting provisions here is that public pension funds might be deterred from being lead counsel in a class action, because their expected return on the lawsuit declines with fee-shifting. Specifically, in Coffee's words, "there is a substantial asymmetry between the pension fund's likely gains and losses."[96] The lead plaintiff pension fund can only recover in proportion to its ownership (when the case settles or returns a favorable verdict), but stands to foot the whole bill if the plaintiff loses. According to that theory, institutional investors will decline to act as lead plaintiffs, thereby restoring the previous status quo of "stable" lead plaintiffs in securities class action litigation. Thus, Coffee: "If this happened, Congress's intent would have been frustrated."[97]

The argument for obstacle preemption certainly has merit. I submit, however, that fee-shifting ultimately does not create an obstacle to the federal securities regime: quite the opposite, it affirmatively furthers its purpose. As with field preemption, a reviewing court's analysis is guided by "the purpose of Congress, [which] is the ultimate touchstone in every preemption case."[98] Further, in the absence of express preemption courts follow a presumption against implied preemption.[99] This raises the bar for a finding that fee-shifting frustrates congressional purpose underlying the securities regime.

95. *See* Schwartz & Appel, *supra* note 9, at 40.

96. Coffee, *supra* note 51, at 609.

97. *Id.* at 699.

98. Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996) (internal quotation marks omitted).

99. "[I]n all pre-emption cases, and particularly in those in which Congress has legislated in a field which the States have traditionally occupied, we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." (internal citations omitted) Wyeth v. Levine, 555 U.S. 555, 565 (2009).

But courts will rebut the presumption if the federal policies are shown to be frustrated by state law. Let us then probe the arguments in favor of obstacle preemption more deeply.

First, for the theory espoused by Coffee—that fee-shifting deters institutional plaintiffs from taking the lead—to hold, institutional investors must have a net expected loss from being lead plaintiff.[100] However, there are reasons to question the conclusion that institutional investors will indeed have negative expected returns on leading the class in a securities class action. For one, shareholder concentration has been on a steady rise for many years now. This trend is driven by the growth in institutional investors, who now hold vast proportions of publicly traded corporations' securities.[101] As the institutional investors' ownership increases, so does their share in the recovery from the settlements. More importantly, Coffee's estimation of an investor's return on becoming lead plaintiff does not account for the change in strength of claims brought after introduction of fee-shifting.[102] The great benefit of fee-shifting, after all, is screening out frivolous claims. Therefore, under fee-shifting we expect that the most meritorious claims—those with admission of corporate wrongdoing, gov-

100. Recall from the discussion in Part I that plaintiffs will be deterred from bringing suit if their expected return from the lawsuit is negative. The same intuition applies here regarding an institutional investor's decision to be lead plaintiff as it does to plaintiffs' incentives to bring suit generally. See *supra* Part I for the discussion of how expected return on a claim affects a plaintiff's decision to litigate.

101. MATTEO TONELLO & STEPHAN RABIMOV, THE 2010 INSTITUTIONAL INVESTMENT REPORT: TRENDS IN ASSET ALLOCATION AND PORTFOLIO COMPOSITION 27 tbl.13 (2010) (Conference Board Research Report, No. R-1468-10-RR, 2010), http://ssrn.com/abstract=1707512 (describing how institutional ownership in U.S. public corporations grew to 73% in 2009).

102. Specifically, Coffee assumes a 50% chance of success (i.e., settlement), 1–3% recovery of investor losses, and cost of failure of at least $10 million. *See* Coffee, *supra* note 51, at 699. Coffee concludes that these figures lead to an "asymmetry between the pension fund's likely gains and losses," making it hard for the fund to justify being lead plaintiff to its pensioners. Coffee is right to point out that some claims will have a negative expected return, and pension funds will be deterred from being lead plaintiff in class actions based on those claims. However, this paints the picture in strokes too broad. The beauty of fee-shifting, as we saw, is that it incentivizes meritorious claims—those with high likelihood of success (and higher than 50%). As the strength of the claim increases, so does the pension fund's (or other institutional investor's) expected return on litigating the claim and being lead plaintiff.

ernment sanctions, etc.[103]—will still be brought.[104] Therefore, under a loser-pays regime, institutional investors will still have the incentive to be lead plaintiff, but only in class actions based on claims exhibiting the factors we associate with merit.[105]

A related but distinct point also raises doubt over the supposed deterrent effect of fee-shifting on institutional investor lead plaintiffs. As we saw in Part I, the incentives of plaintiffs to bring suit are sensitive to the design of the fee-shifting regime. In particular, whether the provision exhibits symmetry, or is asymmetric as in *ATP Tour*, is essential to how the provision affects plaintiffs' incentives to litigate. The argument for obstacle preemption seems to assume asymmetric fee-shifting to the detriment of plaintiffs à la *ATP Tour*.[106] However, as we saw, symmetric fee-shifting actually incentivizes litigation of meritorious suits while also screening out frivolous ones.

Finally, even assuming that fee-shifting deters institutional investors from becoming lead plaintiffs, this does not make implied preemption a forgone conclusion. Coffee identifies the goal of the federal securities laws, for purposes of the preemp-

103. *See* STARYKH & BOETTRICH, *supra* note 13, at 35. Examples of these factors are admitted accounting irregularities and being sanctioned by the government or a regulatory agency. The effect of fee-shifting is to increase the cost of litigating claims with the smallest likelihood of success. And these are precisely the frivolous claims that ought to be deterred. At the same time, once these claims fall away, the median settlement value increases.

104. Let's assume the defendant corporation has been sanctioned by the SEC, and admitted to accounting irregularities. If the lead plaintiff then reasonably has a 90% probability of achieving settlement for alleged investor losses in the order of several billions of dollars, a pension fund could surely justify being lead plaintiff to its pensioners.

105. Ultimately, this assertion can be tested empirically by estimating settlement amounts, percentage recovery by the lead plaintiff of the settlement amount, and the likelihood of settling. That estimation is beyond the purview of this Note; it does point to a future area for research in evaluating the desirability of corporate fee-shifting. For now, it suffices to emphasize the larger point that fee-shifting theoretically incentivizes the lead plaintiff to litigate stronger claims which also have higher expected settlement amounts. How well are these lead plaintiffs positioned to assess the merit of securities fraud claims? Very well. Years of experience as lead plaintiffs and the publicly available body of research by firms like Cornerstone Research and NERA make clear what factors distinguish meritorious from frivolous claims.

106. *See* Coffee, *supra* note 51, at 698–99. He only mentions shifting in the direction of plaintiffs, and invokes the "substantially all" recovery standard used in the ATP Tour provision.

tion analysis, as the lead plaintiff presumption enacted by the PSLRA. However, a better view is that the relevant goal of the PSLRA (and, more broadly, the federal securities regime) is the overarching objective to reduce frivolous litigation. The presumption in favor of more invested plaintiffs taking the lead is just a means to achieve that overarching goal, rather than an end in itself. Framed this way, the goal of the federal securities laws is hardly obstructed by corporate fee-shifting.

Indeed, it is likely that even with a reduction in institutional investors acting as lead plaintiffs, fee-shifting will achieve a net decrease in frivolous litigation. Recall that the objective of the PSLRA's presumption in favor of plaintiffs with the biggest financial interest as lead plaintiffs was to enhance the incentives of lead plaintiffs to monitor class counsel. This in turn was thought to enhance restraint by lead plaintiffs over plaintiff lawyers' inclination to frivolously litigate. One important point should allay any concern that fee-shifting will frustrate the goal of reducing strike suits: once fee-shifting is introduced, lead plaintiffs actually stand to lose money if they litigate frivolous claims. Therefore, fee-shifting provisions promoted by this Note would enhance a plaintiff's incentive to monitor class counsel, and disincentivize litigation of frivolous claims.[107]

The preemption challenge to corporate fee-shifting certainly has force. Ultimately, however, for the foregoing reasons, I submit that the federal securities regime does not preempt—explicitly or implicitly—fee-shifting bylaws or charter provisions. Indeed, for the reasons we observed, symmetric fee-shifting furthers the purpose of the federal securities laws by screening out frivolous claims.

B. *A Framework for Judicial Review*

By now my position—in favor of fee-shifting, and against preemption—should be clear. The foregoing makes the case that fee-shifting bylaws are consistent with, and in furtherance of, the federal securities regime. The analysis would end here, if no relevant agency had taken a position on the preemption

107. Perhaps lead plaintiffs in securities class actions would even negotiate for indemnity from lead counsel to act as lead plaintiff. In that case, lead counsel would be especially interested in pursuing only meritorious claims, and the need to monitor would diminish accordingly.

question. Where a federal agency expresses a view on preemption, however, courts may acknowledge the agency's view. To what extent courts defer to agency positions on implied preemption is an important and unresolved question. Relatedly, there is also uncertainty about what role the presumption against preemption plays in the context of securities fraud.

This Part addresses these questions about how courts should resolve implied preemption challenges to loser-pays bylaws.[108] The doctrinal approach by a reviewing court turns largely on three issues: the import of the presumption against preemption, whether to consult the underlying regulator, and how much deference the regulator's position receives. In what follows, I propose an analytical framework to guide courts in their assessment of these issues to resolve implied preemption questions. Finally, I apply that framework to the question of implied preemption of fee-shifting bylaws, concluding that they are not preempted.

Recall my earlier assertion that courts apply a substantive canon—the presumption against preemption—to cases of implied preemption.[109] While any advocate arguing against preemption would surely invoke the presumption, the reality is that courts have not applied the doctrine straightforwardly. Indeed, as one observer puts it, the field is a "muddle" of confusion.[110] The Supreme Court's inconsistent application of the doctrine is well-documented.[111] Given the Court's apparent ambivalence toward the presumption, how are judges to decide whether to apply the canon?

There is limited case law on preemption of state law by the federal securities regime.[112] Nonetheless, I submit that relevant Supreme Court jurisprudence favors application of the anti-preemption presumption to a challenge of fee-shifting by-

108. *See* Coffee, *supra* note 51 (observing that the preemption question will eventually take "center stage").

109. *Supra* notes 98–99 and accompanying text.

110. Ernest A. Young, *The Ordinary Diet of the Law: The Presumption Against Preemption in the Roberts Court*, 2011 SUP. CT. REV. 253, 256 (2012).

111. *See* William W. Buzbee, *Preemption Hard Look Review, Regulatory Interaction, and the Quest for Stewardship and Intergenerational Equity*, 77 GEO. WASH. L. REV. 1521, 1563 (2009). *Accord* Young, *supra* note 110, at 277–78 (describing how the Supreme Court sometimes mentions the presumption, other times ignores it, but insists on its continued relevance).

112. *See* Anthony E. Szydlowski, *Preemption in the Securities Industry: A Diminished Standard?*, 74 ST. JOHN'S L. REV. 259, 266 (2012).

laws based on implied preemption. Several Supreme Court decisions, albeit from contexts outside of securities law, demonstrate a pronounced reluctance to find preemption in the absence of clear congressional intent to that effect.[113] As Facciolo notes, the decisions in *O'Melveny*, *Freightliner*, and *Cipollone* suggest that the Court would not find congressional intent to preempt state securities laws without express statutory language to that effect. Facciolo argues, "If the securities industry wants to be subject exclusively or primarily to uniform federal law, at least in certain business lines, there is a clear need to lobby Congress in the legislative process and the SEC in the rulemaking process to clearly enunciate the preemptive scope of the federal securities laws and SEC rules and regulations."[114] So, while my research indicates no case law directly on preemption of fee-shifting provisions by the federal securities laws, the Court's use of the presumption against preemption in analogous contexts recommends its application here too.

However, one might fairly ask, does the Supreme Court's historically inconsistent application of the presumption against preemption disfavor its application here? After all, the cases cited by Facciolo are all from before 1995, and the federal laws at issue, as well as the composition of the Court, have changed. In *Geier v. Am. Honda Motor Co.*, a more recently decided preemption case, the Court did not even mention the presumption against preemption.[115] And in *Wyeth v. Levine*, the latest Supreme Court decision in this area, Wyeth argued that the presumption is entirely inapplicable to implied preemption analyses.[116] However, the Court firmly rejected this line of argument, affirming its commitment to the presumption against preemption in the absence of clear congressional intent to preempt.[117] Courts deciding implied preemption

113. Francis J. Facciolo and Richard L. Stone, *Avoiding the Inevitable: The Continuing Viability of State Law Claims in the Face of Primary Jurisdiction and Preemption Challenges Under the Securities Exchange Act of 1934,* 1995 COLUM. BUS. L. REV. 525, 534–38 (1995) (discussing the holdings in *O'Melveny*, *Freightliner*, and *Cipollone*).
114. *Id.* at 538.
115. Mary J. Davis, *The "New" Presumption Against Preemption*, 61 HASTINGS L.J. 1217, 1235 (2010).
116. Wyeth v. Levine, 555 U.S. 555, 565, n.3 (2009).
117. *Id.*

challenges to fee-shifting bylaws would therefore do well to apply the presumption against preemption—the doctrine most consistent with federalism values and Supreme Court precedent.

Besides applying the presumption against preemption, courts must also decide whether to consult the underlying regulator—here the SEC—in adjudication of preemption challenges. The reasons for deferring to agencies on questions of implied preemption are familiar justifications for the administrative state: agencies can bring to bear their institutional expertise, and are comparatively less prone to political influence. Indeed, some commentators have argued that agencies are uniquely well-positioned to assess preemption challenges.[118] It stands to reason, then, that courts adjudicating preemption challenges in the securities industry should consider the position of the SEC on questions of implied preemption. However, this raises a final, related question: How much deference should courts accord the underlying regulator's view?

To provide a preliminary answer, in lawyerly fashion: it depends. A more substantive response requires a deeper dive into relevant administrative law, particularly, into judicial review of agency decisions. Under the *Chevron* framework, courts defer to agency interpretations of ambiguous organic statutes so long as those interpretations are reasonable.[119] After the Supreme Court decision in *Mead*, agencies only receive *Chevron* deference to the extent that they use rules that have the "force of law."[120] To the extent agency interpretations do not have the "force of law," courts still accord them *Skidmore* respect if they persuade the court.[121] How much deference courts accord the SEC's view on preemption of fee-shifting

118. Catherine M. Sharkey, *Products Liability Preemption: An Institutional Approach*, 76 GEO. WASH. L. REV. 449, 477 (2008) ("With respect to answering the key regulatory policy issue at the heart of the preemption query—namely, whether there in fact should be a uniform federal regulatory policy—federal agencies emerge as the institutional actor best equipped to provide the answer").

119. *Chevron, U.S.A., Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 844 (1984).

120. *United States* v. *Mead Corp.*, 533 U.S. 218, 226–27 (2001) (holding that *Chevron* deference to agency rules is only appropriate where Congress delegated authority to make rules carrying the force of law—for instance, by giving the agency adjudication or notice-and-comment rulemaking power).

121. *Id.* at 228.

provisions by the Exchange Act ostensibly turns on how the agency reached its interpretation.

My research indicates that the SEC weighed in on preemption of fee-shifting bylaws just once. In a speech at Tulane University Law School, former Commission Chair Mary Jo White commented, "I am concerned about any provision in the bylaws of a company that could inappropriately stifle shareholders' ability to seek redress under the federal securities laws."[122] Chair White's speech reflects her concern that corporate fee-shifting provisions may interfere with private enforcement of the securities regime. Evidently, the SEC views Delaware fee-shifting bylaws as conflicting with—and hence preempted by—the federal securities laws.

Let us assume that a loser-pays bylaw is challenged on implied preemption grounds, and the reviewing court considers the regulator's position. At least in theory, the court would apply the *Chevron* framework described above. As of now, the court would have nothing more to draw on than Mary Jo White's remarks from her speech. Those remarks clearly do not carry the "force of law," and therefore do not pass Step Zero en route to *Chevron* deference.[123] Nor would the court defer to the agency's position under *Skidmore*, because the relatively informal remarks are unlikely to "persuade" the court.

However, when the issue gets litigated the SEC could advise the court on its views of preemption in a more formal manner—for instance, by submitting an amicus curiae brief.[124] If the SEC spells out its position in an amicus brief, this brings us to a more nebulous area of administrative law. Again, the *Chevron* framework theoretically applies: agency amicus briefs do not carry the force of law, but they may persuade the court and receive *Skidmore* deference. In practice, however, the judicial record of deferring to agency views on implied preemption is hardly transparent or systematic. Schol-

---

122. Stephanie Russell-Kraft, *SEC's White 'Concerned' About Some Fee-Shifting Bylaws*, LAW360 (Mar. 19, 2015, 5:30 PM), https://www.law360. com/securities/articles/633617/sec-s-white-concerned-about-some-fee-shifting-bylaws.

123. That is to say, the SEC did not employ its notice-and-comment rulemaking power to issue a fee-shifting prohibition.

124. This scenario is not purely hypothetical. Indeed, the former chair suggested in her speech that the agency is closely following the fee-shifting debate and might submit an amicus brief when the opportunity arises. *See* Russell-Kraft, *supra* note 122.

ars have documented the Supreme Court's consideration of agency interpretations without resort to the *Chevron* framework—a phenomenon Sharkey calls "cryptic reliance" on agency positions.[125]

To summarize, agencies are well-positioned to assess the merits of preempting state laws. In theory, courts follow the *Chevron* framework to evaluate an agency's position, however, in practice, they sometimes defer to an agency's position without explicitly following *Chevron* or otherwise explaining their deference to the agency. In light of this reality, the normative question posed earlier sounds especially urgent: How much deference should courts accord agency views on implied preemption? Several commentators have suggested doctrinal frameworks to guide judicial review in these cases. William Buzbee, for instance, suggests that the Supreme Court apply a "Hard Look" review to agency assertions of preemptive effect.[126] Sharkey has proposed an "agency reference model" for courts to elicit agency views on preemption in products liability cases.[127] She concludes that the *Skidmore* level of deference to agency interpretations is desirable here.[128] Buzbee and Sharkey advance different standards of review, but they share an important characteristic: both call on the reviewing court to carefully scrutinize the agency's basis for asserting preemptive effect.

In my view, how we name the doctrinal framework for courts to follow is of secondary importance. To be sure, consistent adherence by the judiciary to one doctrine—whether it be hard look review or *Skidmore* deference—is desirable for obvious reasons. But if past is prologue the Supreme Court is in no rush to formally adopt a doctrinal framework for reviewing agency assertions of preemptive effect.[129] Here is where I part

---

125. Catherine M. Sharkey, *What Riegel Portends for FDA Preemption of State Law Products Liability Claims*, 103 Nw. U. L. Rev. 437, 431 (2009).

126. Buzbee, *supra* note 111, at 1558, 1572–73 (arguing that a "Hard Look" standard of review, adopted by the Court in *State Farm*, should apply to agency assertions of preemptive effect; Buzbee argues this review will incentivize agencies to engage in an "open and deliberative process" before claiming preemptive power).

127. Sharkey, *supra* note 118, at 485.

128. *Id.* at 492–93, 498.

129. As we saw, there have been numerous analytical frameworks proposed for adoption by the Supreme Court. Sharkey advanced her agency reference model in two separate articles predating the *Wyeth* decision, yet

ways with Sharkey and Buzbee: I argue that it is less important that the Court categorize its analytical framework as either Hard Look review or *Skidmore* deference. The more important objective is that courts apply a searching, careful scrutiny to agency interpretations regarding implied preemption—whether they call it Hard Look review, *Skidmore* deference, or supply no label whatsoever. This incentivizes agencies to do (and show) their work: using their most inclusive and deliberative rulemaking procedures promises *Chevron* deference, but unfounded claims of preemptive power will not pass careful judicial scrutiny.

Finally, consider how this prescription for judicial review applies to the context of fee-shifting provisions. Assume again that a loser-pays bylaw is challenged in court on implied preemption grounds. A reviewing court would be ill-advised to put much stock in the informal remarks of the SEC's former chair. If the SEC submits an amicus brief arguing in favor of implied preemption, the court should then probe the record for evidence showing that the agency brought its expertise to bear on the question of preemption. Deference to the SEC's assertion of preemptive effect then turns on the robustness of the agency's reasoning—ideally supported by calculations demonstrating net benefits from preemption. The onus is therefore on the agency to convince the court that—contrary to the arguments I make in this Note—fee-shifting bylaws frustrate the federal securities regime. This framework thus incentivizes agencies to apply their expertise to preemption questions, and directs courts to subject agency interpretations to careful, searching review.

Conclusion

The debate over corporate fee-shifting in Delaware goes on. This Note advances the position that fee-shifting, in furtherance of the federal regulatory design, offers shareholders the opportunity to reduce frivolous litigation by raising the costs of litigating meritless claims. At the same time, shareholders and directors should be sensitive to the importance of calibrating the fee-shifting provision for optimal results. Loser-pays rules have the potential to work as blunt tools in circum-

---

the Court declined to adopt it or otherwise clarify its framework for determining the appropriate level of deference.

stances where more focused instruments—like scalpels rather than sledgehammers—are needed. But as new research like Choi's demonstrates, by implementing symmetrical fee-shifting provisions, one can achieve the desired result of deterring frivolous lawsuits while retaining the incentives to pursue meritorious claims.

The legal challenges to the widespread adoption of fee-shifting in Delaware are not insignificant. Courts are bound to weigh in on the challenges to fee-shifting, particularly federal preemption concerns. This Note makes a proactive attempt at demonstrating how corporate loser-pays bylaws and charter provisions not only avoid running afoul of congressional intent but also further the achievement of the federal securities regime's goals. The Note therefore both urges fee-shifting as a desirable policy instrument, and suggests a line of argumentation to rebut legal challenges to its implementation.

Finally, we considered how courts should adjudicate legal challenges based on implied preemption. This Note advances a framework for judicial review that includes three major ingredients. First, courts deciding preemption challenges in the securities context should follow the presumption against preemption—a doctrine that promotes federalism values and is firmly grounded in Supreme Court precedent. Second, courts should draw on the expertise of the underlying regulator to resolve questions of implied preemption. The *Chevron* and *Skidmore* doctrines theoretically apply to judicial review of agency interpretations. However, the historical record shows that courts sometimes defer to agencies without invoking these doctrines. The third component of the analytical framework seeks to remedy that trend: courts should carefully scrutinize an agency's assertion of preemptive effect. If a reviewing court finds that the agency brought its expertise to bear on the question of preemption, it may conscientiously defer to the regulator. Lastly, we saw how this analytical framework applies to corporate fee-shifting provisions in Delaware. The SEC has not used its notice-and-comment rulemaking authority to regulate loser-pays bylaws; Mary Jo White did however articulate the agency's position that corporate fee-shifting conflicts with the federal securities regime. If a loser-pays provision is challenged on implied preemption grounds and the SEC submits an amicus brief, the reviewing court, following the framework outlined above, should accord deference in proportion to evidence that the agency exercised its expertise. Until that time, this Note sets out the reasoning why fee-shifting provisions stand to weed out strike suits and maximize shareholder value.