Private Ordering in Corporate Litigation

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Verity Winship, *Shareholder Litigation by Contract,* __ **B.U. L. Rev.** (forthcoming, 2015, available at SSRN.

The debate over litigation bylaws has been percolating in Delaware for several years, but it shifted into high gear last year, when the Delaware Supreme Court held unexpectedly that a fee-shifting bylaw was "facially valid." ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014). This decision prompted discussion of a corporate litigation crisis, which seems to have abated with action this summer by the Delaware General Assembly, passing legislation prohibiting fee-shifting bylaws and charter provisions for Delaware stock corporations. This legislation also addresses forum selection clauses, authorizing bylaws, or charter provisions designating Delaware as the exclusive forum for claims relating to "internal affairs" and prohibiting provisions designating courts outside of Delaware as the exclusive forum for such claims. Although the immediate threat of crisis has been abated, important issues remain regarding bylaw- and charter-provision-regulating corporate litigation. In *Shareholder Litigation by Contract* Verity Winship offers a useful framework for thinking about these issues.

Winship begins with a sensible premise: "procedural law should not be used to waive mandatory provisions of substantive law." (P. 6.) Of course, she recognizes that the number of mandatory provisions in state corporate law is few, but she includes among those provisions "the core duty of loyalty claim within the umbrella of state-law fiduciary suits." (P. 45.) This is a controversial claim, but one that seems to be shared by the Delaware General Assembly, as the implicit motivation for prohibiting fee-shifting is the desire to preserve fiduciary duty litigation.

It is probably worth noting that the legislation prohibiting fee-shifting was not drafted by members of the Delaware General Assembly, but rather by the Council of the Corporation Law Section of the Delaware State Bar Association, an organization comprising top Delaware corporate lawyers, who have a strong pecuniary interest in a vibrant litigation environment. That said, anyone who believes that fiduciary duty litigation is an important part of the corporate governance system should also endorse Winship's aspiration to "prevent procedural provisions from being used to kill shareholder litigation altogether" and to "also avoid throwing the baby out with the bathwater." (P. 6.)

Winship's approach depends on a contracting framework, which also is not uncontroversial, even though the *ATP* used this framework in approving the fee-shifting bylaw in that case. The Court in that case reasoned:

> 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 nonstock 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. (Pp. 9-10.)

In *Private Ordering with Shareholder Bylaws*, my co-authors and I suggested that shareholders in public corporations perform not only the conventional functions of selling, voting, and suing, but they also engage in contracting through bylaw amendments. One limitation on our proposal is embedded in the term "*shareholder* bylaws." The fee-shifting bylaw in *ATP* was a "*director* bylaw," which seems unlike "contracts among a corporation's shareholders." We criticized the Delaware Supreme Court's opinion in CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227, 238 (Del. 2008) for placing too much bylaw power in the corporate directors, and *ATP* suffers from this same shortcoming.

Critics of our contracting view note that bylaws are not really contracts, but are simply interpreted by the Delaware courts according to contract interpretation principles. You can see Kurt Heyman, a distinguished Delaware practitioner, making this argument in a recent panel discussion at Fordham Law School. This, of course, is merely a formal objection, which we assume that everyone who endorses the contracting framework recognizes. (Winship dedicates an entire section of her article to examining various caveats to treating bylaws and charters as contracts.) The issue is deciding the extent to which shareholders ought to be allowed to engage in private ordering. Or, in Winship's words, "Should there be any limit to the procedural provisions to which the parties can contract?" (P. 6.)

Winship's short answer is "yes." Bylaws should be limited by mandatory provisions in the statute, including the newly adopted fee-shifting prohibition. But if the underlying aspiration is to allow individual firms to act as "laboratories of corporate governance," the number of mandatory provisions must remain rather small. Thus, bylaw provisions altering discovery rules, requiring the posting of a bond, implementing contemporaneous ownership requirements, identifying additional prerequisites to filing derivative lawsuits, and myriad other issues are candidates for private ordering under a robust contracting system.

This article is a full-throated defense of private ordering in corporate governance. It is well written, thoroughly researched, doctrinally sophisticated, and conceptually challenging. And, if it is not clear by now, I add that it is well worth reading.

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