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A MOST ADEQUATE RESPONSE TO EXCESSIVE SHAREHOLDER LITIGATION

*Lawrence A. Hamermesh**

I. INTRODUCTION

Although Delaware statutes, as recently amended, prohibit charter and bylaw provisions that would shift fees to stockholders in litigation involving the corporation's internal affairs, those statutes leave open the possibility that charter and bylaw provisions may regulate other aspects of such stockholder litigation, in addition to choice of forum. This Article suggests that the enforceability of such provisions should depend on their tendency to deter or eliminate meritless litigation while not unduly deterring meritorious litigation. The Article examines a bylaw under which a stockholder claim would be dismissed if a committee chosen by the largest stockholders affirmatively supported such dismissal ("Litigation Review Committee Bylaw"). The Article evaluates this proposal against the backdrop of previous attempts to limit stockholder litigation, namely security for expenses statutes, special litigation committees in derivative suits, the "most adequate plaintiff" provision of the Private Securities Litigation Reform Act ("PSLRA") of 1995, and a recently adopted bylaw requiring consent of 3% of the stockholders in order to initiate a stockholder class or derivative action.

A. Waves of Concern About Shareholder Litigation

Time after time in the last century, critics of shareholder litigation—whether brought derivatively on behalf of the corporation or on behalf of a class of current or former shareholders—have expressed concern that such litigation might be brought, prosecuted, or settled in a

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manner contrary to the interests of the corporation or its shareholders, or both, due to a misalignment of interests between shareholders and the persons most likely to control and benefit from the litigation—namely, plaintiffs’ lawyers.¹ Each time such concerns have reached a climax, one or more legislative,² judicial,³ or private initiatives has emerged as a cure,⁴ or at least a palliative, for the perceived excesses or abuses of representative shareholder litigation. These initiatives have varied widely in their approach, degrees of success as a cure, and extent of adoption by the relevant authorities; and, depending on their approach to the problem, they have been subjected to varying criticisms of their efficiency or fairness or both.⁵

Particularly with regard to class action litigation challenging mergers and acquisitions, we now find ourselves riding yet another wave of antagonism to shareholder litigation.⁶ And, again, we see various

1. See, e.g., *In re Riverbed Tech., Inc. Stockholders Litig.*, No. 10484-VCG, 2015 Del. Ch. LEXIS 241, at *9-13 (Del. Ch. Sept. 17, 2015) (explaining that because individual plaintiff shareholders often have little interest in the outcome of class action litigation, the incentive of plaintiffs’ attorneys to accept a quick settlement in order to collect fees is largely unchecked).

2. See, e.g., *infra* Part II.A.1 (discussing adoption of New York’s “security for expenses” statute).

3. See, e.g., *infra* Part II.A.2 (discussing the use of special litigation committees as suggested by the Supreme Court of the United States and the Supreme Court of the State of Delaware around 1980).

4. See, e.g., Verity Winship, *Shareholder Litigation by Contract*, 96 B.U. L. REV. 485, 500-05 (2016) (discussing the use of forum selection clauses in organizational documents).

5. See, e.g., George D. Hornstein, *The Death Knell of Stockholders’ Derivative Suits in New York*, 32 CALIF. L. REV. 123, 143 (1944) (criticizing New York’s security for expenses statute as a “rich man’s law”).

6. Courts, lawyers, academics, trade organizations, and others have all expressed such antagonism. See, e.g., *In re Riverbed Tech., Inc. Stockholders Litig.*, 2015 Del. Ch. LEXIS 241, at *12 (“In combination, the incentives of the litigants [in shareholder class actions] may be inimical to the class: the individual plaintiff may have little actual stake in the outcome, her counsel may rationally believe a quick settlement and modest fee is in his best financial interest, and the defendants may be happy to ‘purchase,’ at the bargain price of disclosures of marginal benefit to the class and payment of the plaintiffs’ attorney fees, a broad release from liability.”); *In re Allied Healthcare S’holder Litig.*, No. 652188/2011, 2015 WL 6499467, at *3 (N.Y. Sup. Ct. Oct. 23, 2015) (“This practice of compensating class counsel no matter how meaningless the result is, creates the impression with most objective observers that these actions are brought merely for the purpose of generating legal fees. . . . These settlements are all too often entered into because the corporate officers are faced with the dilemma of protracted costly litigation versus a quick, relatively cheap settlement that releases the corporate officers and compensates class counsel with someone else’s money (the shareholders).”); ANDREW J. PINCUS, U.S. CHAMBER INST. FOR LEGAL REFORM, *THE TRIAL LAWYERS’ NEW MERGER TAX: CORPORATE MERGERS AND THE MEGA MILLION-DOLLAR LITIGATION TOLL ON OUR ECONOMY* 1 (2012) (describing merger litigation as “extortion through litigation, plain and simple”); Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 561 (2015) (contending that “the Delaware courts [should] stop awarding fees for disclosure-only settlements” because evidence suggests that disclosures in such settlements do not affect shareholder voting).

proposed cures and palliatives suggested, ranging from fee-shifting to more aggressive judicial policing of settlements and use of the power to dismiss complaints.⁷ Delaware law now limits the range of potential privately ordered responses, by prohibiting provisions of the certificate of incorporation or bylaws that would impose liability on a stockholder for fees and expenses incurred by the corporation or its directors and officers in stockholder litigation involving an internal corporate claim.⁸ The sponsors of the legislation establishing that prohibition, however, noted pointedly that it does not preclude other forms of private ordering, including charter and bylaw provisions, which might regulate the conduct of stockholder litigation.⁹

That suggestion points to a field for experimentation that is potentially broad, although fraught with uncertainty.¹⁰ Some commentators question the rationale, embraced by the Delaware courts but not necessarily controlling in other jurisdictions, that litigation-restricting charter and bylaw provisions are facially valid because they are part of a “flexible contract” among the stockholders and the corporation.¹¹ Even where that view is accepted, bylaw provisions that might be facially valid are susceptible to judicial invalidation or non-enforcement on the basis that they are improperly motivated, where

7. See, e.g., Fisch et al., *supra* note 6, at 585-86, 600-02 (urging rejection of disclosure only settlements); Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. CORP. L. (forthcoming 2017) (advocating early “triage” of shareholder representative litigation); *Delaware Supreme Court Endorses “Fee-Shifting” Bylaw in Certified Question of Law*, WILSON SONSINI GOODRICH & ROSATI (May 12, 2014), <https://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert-fee-shifting.htm> (“The practical effect of [the *ATP Tour, Inc.*] decision . . . is that many boards of directors of private and public Delaware corporations should seriously consider adopting fee-shifting bylaws of their own.”).

8. S.B. 75, 148th Gen. Assemb., Reg. Sess. (Del. 2015) (providing that the certificate of incorporation and 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”).

9. DEL. CORP. LAW COUNCIL, EXPLANATION OF COUNCIL LEGISLATIVE PROPOSAL 9 (2015), <http://www.corporatedefensedisputes.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.pdf> (“[T]he proposed legislation does not deprive corporations of the ability to adopt other provisions that address unproductive stockholder litigation by means other than fee-shifting.”).

10. For an exploration of the considerations that might be applied to evaluating the validity of such provisions, see Winship, *supra* note 4, at 522, 524-28, 532-36.

11. See, e.g., James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 272-78 (2015) (questioning the contractual premise of validity adopted in the Delaware court decisions); Mark Lebovitch & Jeroen van Kwawegen, *Of Babies and Bathwater: Detering Frivolous Stockholder Suits Without Closing the Courthouse Doors to Legitimate Claims*, 40 DEL. J. CORP. L. 491, 521 (2015) (noting that a director-adopted bylaw imposing fee-shifting is a “type of authorization for unilateral modification [that] might raise a Corbin or Williston eyebrow and is virtually unheard of in any type of contract”).

adopted by unilateral director action, or that they operate inequitably in a particular case.¹² Moreover, like the fee-shifting provisions that some companies adopted in 2014 in the wake of the Delaware Supreme Court's opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund*, an overly restrictive charter or bylaw provision could elicit another prohibitive legislative backlash.¹³ These considerations suggest that further development of charter and bylaw provisions that regulate stockholder litigation should be adopted, if at all, only after careful evaluation of the likelihood that they would achieve what ought to be their twin goals: (1) discouraging or eliminating unmeritorious representative litigation at an early stage of proceedings, before enormous defense costs are incurred, where that imposes net costs on corporations and their stockholders; while (2) avoiding the elimination or undue deterrence of meritorious litigation (namely, litigation with net benefits to corporations and their stockholders).¹⁴

This Article is an effort to guide such an evaluation, drawing on the experience of previous responses to perceived abuses of representative stockholder litigation. It examines another form of litigation-regulating charter or bylaw provision under which the corporation would establish a committee of stockholder representatives whose disapproval of continued prosecution of a claim in a stockholder class or derivative action involving the corporation's internal affairs results in dismissal of the claim, such as the Litigation Review Committee Bylaw.¹⁵ Below, this Article argues that the Litigation Review Committee Bylaw would be facially permissible under Delaware law;¹⁶ create a layer of independent, early review of the merits of stockholder litigation;¹⁷ allow for experimentation with important elements of the process (such as establishing the composition, compensation, and investigative powers of the committee);¹⁸ and be superior to certain other forms of litigation regulation, like the use of special litigation committees in derivative actions and the most adequate plaintiff provision in federal securities

12. See *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014) ("Bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose.").

13. Lebovitch & van Kwawegen, *supra* note 11, at 514 ("By the end of 2014, over 50 public companies, including multibillion dollar companies, adopted either bylaws or charter provisions requiring a stockholder who is not completely successful in litigation to pay the legal fees of corporate defendants.").

14. See, e.g., *id.* at 498.

15. A form of the proposed bylaw appears in the Appendix to this Article. See *infra* Appendix.

16. See *infra* Part IV.

17. See, e.g., *infra* Part III.C.

18. See *infra* Part III.C.

class actions, that have been tried in the past.¹⁹ This Article also favorably compares the Litigation Review Committee Bylaw to a form of bylaw, adopted by at least one public company, which would require approval of at least 3% of the stockholders to initiate a class or derivative action on their behalf.²⁰

This Article should not, however, be interpreted as an unqualified endorsement of the Litigation Review Committee Bylaw. Such a bylaw would not necessarily work well in all companies, and its utility would likely vary depending on the composition of the stockholder body and the nature of the claims being pursued in stockholder litigation. It is not, moreover, immune to some of the legitimate concerns that have been raised with respect to other palliative measures with similar characteristics.²¹ The more modest thesis advanced here, however, is that a bylaw of this sort is a worthy subject for experimentation.

B. *The Litigation Review Committee Bylaw*

The proposed Litigation Review Committee Bylaw would require that a claim in stockholder litigation arising under a corporation's internal affairs be dismissed, on motion of the corporation, if a "Litigation Review Committee" disapproves of the prosecution of the claim within 120 days after it is first asserted. Unlike the special litigation committee of directors developed in the context of stockholder derivative litigation, however, the Litigation Review Committee would not be appointed by the board of directors or comprised of directors; rather, its members would be selected by the stockholders having the largest beneficial interest in the corporation's stock. Thus, the Litigation Review Committee would resemble the most adequate plaintiff provision adopted in the PSLRA,²² in that it would rely on the substantial economic interest of those selecting its members to assure that internal corporate claims would be rejected or allowed to go forward based on their economic value to the corporation and its stockholders, and not based on extraneous considerations like the self-interest of plaintiffs' counsel or bias on the part of directors.²³ The Litigation Review Committee approach, moreover, would differ from the most

19. See *infra* Part III.B.

20. See *infra* Part III.B.

21. See, e.g., *infra* Part III.C. (discussing the shortcomings of the Litigation Review Committee Bylaw).

22. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 27, 109 Stat. 737, 739 (codified at 15 U.S.C. § 77z-1 (1995)).

23. See, e.g., *infra* Part III.C.

adequate plaintiff²⁴ approach in federal securities class action litigation, because it would not require the largest stockholders to take on the additional role of class plaintiff.

Before evaluating the Litigation Review Committee proposal in more detail, however, it will be helpful to review its historical context and precedents.²⁵ What we see from that review, as developed below, is a succession of waves of discontent with shareholder litigation, expressing remarkably similar themes and arguments but yielding ever-evolving mechanisms to alleviate that expressed discontent.

II. A BRIEF HISTORY OF ATTEMPTS TO LIMIT SHAREHOLDER LITIGATION

A. *The Stockholder Derivative Suit*

1. The First Wave of Discontent

The stockholder derivative suit, firmly established in American jurisprudence by no later than 1855,²⁶ has been a perennial source of controversy. On one hand, it has been hailed as “the most important procedure the law has yet developed to police the internal affairs of corporations.”²⁷ Describing derivative suits in a 1942 opinion, Judge Simon Rifkind stated:

[Derivative suits] have accomplished much in policing the corporate system especially in protecting corporate ownership as against corporate management. They have educated corporate directors in the principles of fiduciary responsibility and undivided loyalty. They have encouraged faith in the wisdom of full disclosure to stockholders. They have discouraged membership on boards by persons not truly interested in the corporation The measure of effectiveness of the stockholder’s derivative suit cannot be taken by a computation of the money recovery in the litigated cases. The minatory effect of such actions has undoubtedly prevented diversion of large amounts from stockholders to managements and outsiders. Corporate attorneys now have an arsenal of authorities to support their cautioning advice to

24. See Private Securities Litigation Reform Act of 1995 § 27.

25. See *infra* Part II.

26. RALPH C. FERRARA ET AL., *SHAREHOLDER DERIVATIVE SUITS: BESIEGING THE BOARD* § 1.03 (2d ed. 2015) (“[T]he Supreme Court’s decision in *Dodge v. Woolsey*, firmly established the equitable jurisdiction of American courts to entertain shareholders’ derivative actions.”).

27. Daniel J. Dykstra, *The Revival of the Derivative Suit*, 116 U. PA. L. REV. 74, 77 (1967) (quoting Eugene V. Rostow, *To Whom and for What Ends Is Corporate Management Responsible?*, in *THE CORPORATION IN MODERN SOCIETY* 47-48 (Edward S. Mason ed., 1959)).

clients who may be disposed to risk evasion of the high standard the courts have imposed upon directors.²⁸

For every such encomium to the derivative suit, however, one can find several equally vehement condemnations. Perhaps because of the increasing frequency of derivative litigation, such condemnations seemed to reach a peak by the 1940s.²⁹ In 1936, no less a figure than Dean Roscoe Pound opined: “There is no need to recite the difficulties involved in stockholders’ suits for mismanagement. These suits have been abused quite as much as the powers of directors they have intended to restrain.”³⁰ Writing in the *Michigan Law Review* in 1937, practitioner Harris Berlack observed that “whatever differences may exist, one common characteristic is undeniably present wherever and whenever such an action is instituted: the stockholders’ suit is universally reviled and deplored.”³¹

Why? According to one commentator at the time, the “present evils” of the derivative suit included the fact that because of the need for risky contingent fee representation, the role of plaintiff’s counsel was usually left to “to the younger and less experienced or to the less successful and sometimes less scrupulous members of the profession.”³² The same observer therefore concluded, “[p]laintiffs, as a consequence, find it difficult to obtain proper representation; and defendants must oppose tactics that are not always the most ethical or, at the least, are subjected to an attack that is unnecessarily and unpleasantly belligerent.”³³ Others were less charitable: in a 1943 essay in the *Columbia Law Review*, it was asserted that stockholder derivative suits are “often an instrument of more or less genteel blackmail”;³⁴ a reply to

28. *Brendle v. Smith*, 46 F. Supp. 522, 525-26 (S.D.N.Y. 1942).

29. In a provocative analysis, Lawrence Mitchell suggests that the antagonism exhibited by the corporate bar to stockholder derivative litigation reflected anti-Semitism, rooted in the fact that stockholder plaintiffs’ lawyers tended to be Jewish. See Lawrence E. Mitchell, *Gentleman’s Agreement: The Antisemitic Origins of Restrictions on Stockholder Litigation*, 36 *QUEEN’S L.J.* 71 100-01 (2010).

30. Roscoe Pound, *Visitatorial Jurisdiction over Corporations in Equity*, 49 *HARV. L. REV.* 369, 395 (1936) (suggesting, as an alternative to private derivative litigation, use of judicial visitatorial power over for-profit corporations, as well as charitable corporations, as a check on mismanagement). Dean Pound’s suggestion never achieved traction.

31. Harris Berlack, *Stockholders’ Suits: A Possible Substitute*, 35 *MICH. L. REV.* 597, 599, 612 (1937) (proposing establishment of “a government official or agency specially charged with the duty of prosecuting actions to protect the rights of stockholder”). Mr. Berlack’s proposal was never implemented.

32. *Id.* at 603.

33. *Id.*

34. Harold D. Lasswell, Proposal, *A Non-Bureaucratic Alternative to Minority Stockholders’ Suits*, 43 *COLUM. L. REV.* 1036, 1036 (1943) (recommending a non-profit information bureau to promote shareholder monitoring of management).

that essay put up no resistance on that point, explaining that derivative suits “in their present virulent form . . . are a by-product of the depression and of the high fees awarded by courts to the successful practitioners in this field.”³⁵

These negative perceptions undoubtedly fueled the animosity toward derivative litigation advanced in the influential 1944 report on the subject prepared by a committee of the New York Chamber of Commerce chaired by Francis Wood (“Wood Report”).³⁶ Lacking nothing in enthusiasm, that report concluded plaintiffs’ attorneys in derivative litigation made “the ambulance chaser by comparison a paragon of propriety.”³⁷ According to the Wood Report, “the chief opportunity for profit in this field is finding a ‘situation’ where the management or directorate can be mulcted on some technical, arbitrary, or vicarious rule of absolute liability, regardless of their honesty, fairness, or good judgment.”³⁸ The report concluded, “derivative actions have come to harbor as a matter of course solicitation and inducement in bringing them, champerty and maintenance in their prosecution, the brokerage of litigation in their trial, and division of fees with laymen at their conclusion.”³⁹

The Wood Report launched more than verbal criticism. It also recommended and led to the adoption of New York’s “security for expenses” statute.⁴⁰ That statute requires the plaintiffs in derivative

35. Arthur H. Dean, Reply, *A Non-Bureaucratic Alternative to Minority Stockholders’ Suits*, 43 COLUM. L. REV. 1040, 1041 (1943).

36. FRANKLIN S. WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS’ DERIVATIVE SUITS (1944).

37. *Id.* at 47.

38. *Id.* at 36.

39. *Id.* at 48.

40. 1944 N.Y. LAWS 1455, signed April 9, 1944, adopting what now appears as N.Y. BUS. CORP. LAW § 627 (McKinney 2003). That statute provides:

In any [shareholders’ derivative action], unless the plaintiff or plaintiffs hold five percent or more of any class of the outstanding shares or hold voting trust certificates or a beneficial interest in shares representing five percent or more of any class of such shares, or the shares, voting trust certificates and beneficial interest of such plaintiff or plaintiffs have a fair value in excess of fifty thousand dollars, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney’s fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which the corporation may become liable under this chapter, under any contract or otherwise under law, to which the corporation shall have recourse in such amount as the court having jurisdiction of such action shall determine upon the termination of such action. The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or excessive.

litigation to post a bond to assure that an award of defense expenses would be funded. On the other hand, it also provides two important exceptions to that requirement: first, the court retains the discretion to determine the amount of the bond and the amount of any recourse to the bond; and second, the bond requirement does not apply at all if the plaintiffs in a particular case own 5% or more of the corporation's stock or shares worth over \$50,000.⁴¹

It is important for present purposes to note what the statute does not do. First, it does not explicitly define or alter the standards for determining when a court should order that the required security be applied to pay defense costs.⁴² Second, it does not require that a derivative suit be approved or supported by any threshold level of share ownership; if the bond required by the court is posted, the suit can go forward, regardless of merit and regardless of the number or value of shares whose holders support the suit.⁴³

Id.; see also Dykstra, *supra* note 27, at 88-89 (identifying states that adopted security for expenses statutes following New York's lead).

41. The \$50,000 was of course a far more substantial investment in 1944, when the statute was enacted, than it is today. Adjusted for inflation the statute would require a holding of \$685,875 in 2016 to avoid the bond requirement. See *CPI Inflation Calculator*, BUREAU LAB. STAT., <http://data.bls.gov/cgi-bin/cpicalc.pl> (last visited Nov. 26, 2016).

42. See, e.g., *Donner Mgmt. Co. v. Schaffer*, 48 Cal. Rptr. 3d 534, 541-42 (Ct. App. 2006) (stating California's security for expenses statute "does not define the circumstances under which the defendant may obtain attorney fees on a bond or other security furnished by the plaintiff"). Judicial interpretation of such statutes has inconsistently read such standards into the statutes. The U.S. Supreme Court stated that an award of defense costs is mandatory under New Jersey's security for expenses statute if the plaintiff "fails to make good his complaint," whatever that means. *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 544-45 (1949) ("[The] general effect [of the statute] is to make a plaintiff having so small an interest liable for all expenses and attorney's fees of the defense if he fails to make good his complaint . . ."). Likewise, in construing the California statute, *Donner* held that "a defendant may enforce a security posted under section 800 if he or she is determined to be the prevailing party." 48 Cal. Rptr. 3d at 541. In contrast, however, *Alphin v. Cotter*, No. 9804-2573, 1998 WL 1297098, at *5 (Pa. Ct. Com. Pl. June 18, 1999), interpreting Pennsylvania's security for expenses statute, 15 PA. CONST. STAT. § 1782(c) (2001), held: "This court does not believe defendants have a mandatory right to collect attorneys' fees from plaintiff under the relevant statutes. Rather, it is clearly a matter of the court's discretion to grant or deny such compensation" In so ruling, the court noted the absence of evidence "to support a conclusion that plaintiff's litigation of this issue involved dilatory, obdurate or vexatious conduct," suggesting that the award of fees out of posted security is subject to the same standards applicable to fee-shifting generally. See, e.g., *Hall v. Cole*, 412 U.S. 1, 5 (1973) ("[A] federal court may award counsel fees to a successful party when his opponent has acted 'in bad faith, vexatiously, wantonly, or for oppressive reasons.'" (quoting 6 JAMES WM. MOORE ET AL., *MOORE'S FEDERAL PRACTICE* ¶ 54.77(2) (2d ed. 1972))).

43. It is not inconceivable, however, that the court's perception of the merits of a particular derivative suit might affect its exercise of discretion in setting the amount of the required security. Thus, the court could use a preliminary assessment of the merits to determine whether to set security at a level high enough that would likely force the plaintiff to abandon the litigation or low enough that the plaintiff would be likely to continue to pursue the case. See *Goldstein v. Weisman*, 185 F. Supp. 242, 251 (S.D.N.Y. 1960) (requiring plaintiff to post security of \$5,000 on nominal defendant

If the statute is intended to discourage commencement of meritless litigation without discouraging meritorious litigation, its rationale is necessarily twofold: the first premise must be that a person owning less than 5% or \$50,000 of the corporation's stock will be deterred from commencing or continuing to pursue a meritless derivative suit because of the prospect of having to pay a fee award; and the second premise is that a stockholder or group of stockholders owning more than 5% or \$50,000 have an investment in the corporation sufficient to assure that their decision to bring a derivative suit will be motivated by, and thus likely to serve, the interests of the corporation and not the private interests of themselves or their lawyers.⁴⁴

The first premise is at least uncertain, given the uncertainty as to whether the statute makes a fee award any more likely than under the prevailing bad faith exception to the American rule.⁴⁵ A sanction only rarely or lightly imposed is unlikely to deter undesired litigation activity to any material extent. The second premise is also uncertain—constitutionally sufficient as a basis for discrimination,⁴⁶ to be sure, but there is nothing in the statute that assures that a holder or a group of holders with sufficient shares to avoid the bond requirement will have resources or motivations adequate to ensure an informed, deliberate, and disinterested assessment of the merits of the litigation.⁴⁷ If only because of collective action problems, it seems eminently possible that disaggregated stockholders will underinvest in efforts to evaluate and then support meritorious litigation; and, it seems equally possible that stockholders with enough shares to avoid the bond requirement but, without the inclination to invest in evaluating derivative claims, could choose to support litigation that lacks merit. In sum, what the New York security for expenses statute lacks is any assurance that the persons (other than plaintiff's counsel) whose decisions determine whether a

corporation's motion to set security at \$75,000); *Neuwirth v. Namm-Loeser's, Inc.*, 161 F. Supp. 828, 830 (E.D.N.Y. 1958) (requiring plaintiff to post a \$1,000 bond, stating that "[i]f, as and when [the nominal corporate] defendant can demonstrate to the Court why its position in this action should not be neutral and that the amount of security so fixed has become inadequate it may apply to have the same increased").

44. See *Cohen*, 337 U.S. at 552 ("We do not think the state is forbidden to use the amount of one's financial interest, which measures his individual injury from the misconduct to be redressed, as some measure of the good faith and responsibility of one who seeks at his own election to act as custodian of the interests of all stockholders, and as an indication that he volunteers for the large burdens of the litigation from a real sense of grievance and is not putting forward a claim to capitalize personally on its harassment value.").

45. See *supra* notes 42-44 and accompanying text.

46. See *supra* note 44 and accompanying text.

47. See *supra* notes 40-44 and accompanying text.

bond is required will expend any resources to evaluate the quality of the derivative claims to be pursued.⁴⁸

2. The Second Wave of Discontent

Whatever its virtues, the adoption of New York's security for expenses statute led one influential commentator to describe it at the time as "the death knell for stockholders' derivative suits in New York."⁴⁹ Suffice it to say, however, that this prediction of the impact of the statute did not prove correct.⁵⁰ Derivative suits apparently became considerably more, not less, frequent in the late 1950s and early 1960s,⁵¹ and by the late 1970s, they were once again generating considerable consternation.⁵² Although the data, at the time, suggested that the increased frequency of such suits was by no means disproportionate in relation to the growth of litigation against corporations generally,⁵³ some

48. The California security for expenses statute at least requires the court to inquire into the merits of the litigation before requiring that a bond be posted: it requires the defendant seeking to require that posting to demonstrate "(1) [t]hat there is no reasonable possibility that the prosecution of the cause of action alleged in the complaint against the moving party will benefit the corporation or its shareholders"; or, "(2) [t]hat the moving party, if other than the corporation, did not participate in the transaction complained of in any capacity." CAL. CORP. CODE § 800(c)(1)–(2) (West 2014). This threshold inquiry into the merits, however, does not address the possibility that stockholders owning sufficient shares to avoid the bond requirement altogether might support a derivative suit due to inappropriate motives or without adequate investigation.

49. Hornstein, *supra* note 5, at 123.

50. See, e.g., Dykstra, *supra* note 27, at 90 (describing "judicial restraint" in avoiding "oppressive[]" application of security for expenses statutes); John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 261–62 (1981) (noting reports of the death of the derivative suit "proved exaggerated, . . . as plaintiffs discovered various tactics by which to outflank these statutes").

51. See Coffee & Schwartz, *supra* note 50, at 261–62, 262 n.5.

52. A 1978 article referred to "exponential growth of third-party and shareholder suits." Edward Paul Mattar III, *Indemnification and Liability Insurance for Corporate Board of Directors and Trustees—A Legal Guide for Directors*, 83 COM. L.J. 550, 550 (1978). A 1979 article in *Business Week* asserted that "the number of claims against corporate directors has jumped 300% in the past five years." *End of Directors' Rubber Stamp*, BUS. WEEK, Sept. 10, 1979, at 72. In 1977, in connection with the decision in *Shaffer v. Heitner*, 433 U.S. 186 (1977), a derivative suit on behalf of Greyhound Corporation, Justice Lewis Powell wrote privately to Justice Thurgood Marshall about his perception of the derivative suit:

While a single shareholder has standing to maintain a derivative shareholder suit, there are lawyers who make a plush living using tame clients who acquire one share of stock in numerous corporations for the purpose of setting the stage for 'strike' suits. The objective usually is to force a settlement and claim a generous fee to be paid by court order often from corporate funds.

Letter from Justice Lewis F. Powell, Jr., to Justice Thurgood Marshall (May 31, 1977), http://supremecourttopinions.wustl.edu/files/opinion_pdfs/1976/75-1812.pdf. Professor Verity Winship deserves the credit for bringing this letter to my attention.

53. Thomas M. Jones, *An Empirical Examination of the Incidence of Shareholder Derivative and Class Action Lawsuits, 1971-1978*, 60 B.U. L. REV. 306, 307 (1980) ("[I]ncreases in

were expressing concern that shareholder litigation would discourage qualified directors from serving as such, at least without strong indemnification and liability insurance policies.⁵⁴

It is thus not surprising, at least in hindsight, that the next round of attacks on derivative suits emerged around 1980. This round of attacks, however, came not from legislative action, but from opinions from two supreme courts: the Supreme Court of the United States and the Supreme Court of the State of Delaware. The first of these two opinions generated experience of particular relevance to the proposal in this Article and will be explored first.

In 1979, the U.S. Supreme Court concluded that, state law permitting, “the disinterested directors of an investment company may terminate a stockholders’ derivative suit brought against other directors under the Investment Company and Investment Advisers Acts of 1940.”⁵⁵ Defendants in derivative suits redoubled efforts to take up the suggestion that a special litigation committee of disinterested, independent directors could effectively resolve to dismiss such suits.⁵⁶ Through a series of state court opinions, which those efforts generated, it became widely accepted that such a committee could effectively determine that a derivative suit should not be continued, and that a court could accept that determination and dismiss the litigation at the instance of the committee and the corporation.⁵⁷ In 1990, that special litigation procedure was incorporated into the Model Business Corporation Act.⁵⁸

shareholder litigation make up only a small portion of the apparent increase in the number of suits being brought against corporations today.”).

54. *Id.* (inferring that corporate executives may either decline to serve on the boards of other firms or serve only with assurances that indemnification or liability insurance policies are adequate to protect them from financial losses); see also Mattar, *supra* note 52, at 550, 556; Alan R. Sloate, *Outside Corporate Directors: Will Increasing Liability Send Them Running Out of Board Rooms?*, N.Y. St. B.J. 618, 619-21 (1976).

55. *Burks v. Lasker*, 441 U.S. 471, 473 (1979).

56. Marc I. Steinberg, *The Use of Special Litigation Committees to Terminate Shareholder Derivative Suits*, 35 U. MIAMI L. REV. 1, 6-9 (1980) (indicating that *Burks v. Lasker*, which involved claims under the Investment Company Act, was the impetus for use of the special litigation committee).

57. *Abbey v. Control Data Corp.*, 603 F.2d 724, 729-30 (8th Cir. 1979); *Lewis v. Anderson*, 615 F.2d 778, 783 (9th Cir. 1979); *Gall v. Exxon Corp.*, 418 F. Supp. 508, 517-18 (S.D.N.Y. 1976); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1981); *Auerbach v. Bennett*, 393 N.E.2d 994, 1002-03 (N.Y. 1979).

58. Comm. on Corporate Laws, *Changes to the Model Business Corporation Act—Amendments Pertaining to Derivative Proceedings*, 45 BUS. LAW. 1241, 1246-47 (1990) (adding section 7.44(a) and (b)(2) of the Model Business Corporation Act, requiring dismissal of a derivative proceeding on motion of the corporation if a committee of qualified directors “has determined in good faith, after conducting a reasonable inquiry upon which its conclusions are based, that the maintenance of the derivative proceeding is not in the best interests of the corporation”).

As with the New York security for expenses statute, commentators on the special litigation committee fallout from *Burks v. Lasker* quickly concluded that the death knell of the derivative suit was sounding again.⁵⁹ Yet, as with the security for expenses statutes, the special litigation committee proved not up to the task of slaying the putative derivative suit dragon. The history of the Delaware courts' treatment of the use of the special litigation committee process demonstrates why it failed to live up to its initial reputation as a threat to the viability of derivative litigation. The first Delaware case to apply the analytical rubric supplied in the Delaware Supreme Court's 1981 *Zapata Corp. v. Maldonado* decision made it abundantly clear (and with deft irony) that a special committee's decision could not support dismissal unless it was based on an extensive investigation and report.⁶⁰ Second, subsequent efforts to use special litigation committees to dismiss derivative litigation foundered on an inability to convince the courts that the committee members were sufficiently disinterested and independent.⁶¹ Third, invoking the decision of a special litigation committee as a basis for dismissing a derivative suit inevitably triggered at least some

59. George W. Dent, Jr., *The Power of Directors to Terminate Shareholder Litigations: The Death of the Derivative Suit*, 75 NW. U. L. REV. 96, 98 (1981) ("[A] rule permitting the board to terminate derivative suits which, by hypothesis, it refuses to bring itself could mean the death of the derivative suit."); see also Kenneth B. Davis, Jr., *The Forgotten Derivative Suit*, 61 VAND. L. REV. 387, 391-92 (2008) (summarizing contemporaneous concerns about the impact of special litigation committees on derivative litigation).

60. 430 A.2d at 788-89; Kaplan v. Wyatt, 484 A.2d 501, 510-11 (Del. Ch. 1984) ("[A] report by a Special Litigation Committee recommending dismissal of a derivative suit must be at least 150 pages in length, exclusive of appendices and attachments In this case the Special Litigation Committee represents that it has interviewed more than 140 persons at various locations throughout the world during the course of its investigation The law firm retained by the Special Litigation Committee to assist it in its investigation is said to have expended more than 2,000 hours on the matter so far (this is plaintiff's figure—the Committee says the hours are 5,000 in number) and has received fees and reimbursements in the vicinity of \$500,000 for its efforts. The report itself is 156 pages in length, exclusive of attachments."); see *Sutherland v. Sutherland*, 958 A.2d 235, 236-37 (Del. Ch. 2008) ("[T]he special litigation committee has not satisfied the court that it acted in good faith and conducted a reasonable investigation.").

61. *London v. Tyrrell*, No. 3321-CC, 2010 Del. Ch. LEXIS 54, at *1 (Del. Ch. Mar. 11, 2010) (denying special litigation committee motion to dismiss "because there are material questions of fact regarding (1) the [special litigation committee]'s independence, (2) the good faith of its investigation, and (3) whether the grounds upon which it recommended dismissal of this lawsuit are reasonable"); *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 939-40 (Del. Ch. 2003) ("Special litigation committees are permitted as a last chance for a corporation to control a derivative claim in circumstances when a majority of its directors cannot impartially consider a demand In evaluating the independence of a special litigation committee, this court must take into account the extraordinary importance and difficulty of such a committee's responsibility."); *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985) ("A defendant who desires to avail itself of this unique power to self destruct a suit brought against it ought to make certain that the Special Litigation Committee is truly independent. If a single member committee is to be used, the member should, like Caesar's wife, be above reproach.").

discovery—perhaps not plenary discovery, but discovery that was significant and substantive.⁶² Finally, the proponents of the special litigation committee dismissal determination were unable to prevail if there were any issue of material fact in their proof of the disinterestedness, independence, and reasonable investigation on the part of the committee.⁶³

Although there have been instances in which the special committee's judgment has led to dismissal,⁶⁴ one treatise explains the shortcomings of the special committee process as a tool to police shareholder derivative litigation:

[U]se of a special litigation committee is a highly problematic solution for corporations confronted by derivative litigation. It is a virtual certainty that every facet of the endeavor, from the independence of its membership (and the attorneys and other experts it employs) to the thoroughness of their investigation, analysis, and report, will be vigorously challenged by the derivative plaintiff and closely scrutinized by the courts, and the acceptance of a committee's recommendation is at best uncertain. To have any reasonable chance of passing judicial muster, the work of the committee will inevitably be time-consuming and costly. Employment of a special litigation committee cannot be looked upon as a facile or perfunctory way of disposing of derivative litigation.⁶⁵

It is important to note why the courts have subjected the special litigation process to scrutiny so searching that it has become a rarely used device. First, from the outset, the courts have expressed concern that the process could deprive a stockholder of the otherwise available legal right to commence litigation to vindicate the rights of the corporation.⁶⁶ When it first approved of the concept of dismissal upon

62. *Kaplan*, 484 A.2d at 510-11 (“[E]xperience shows (as it did here) that the plaintiff will attempt to seek all the discovery that he could possibly hope to obtain if he were seeking discovery on the merits of the allegations of the complaint.”).

63. *Zapata*, 430 A.2d at 787-89; *In re Oracle Corp. Derivative Litig.*, 824 A.2d at 920; *Kaplan*, 484 A.2d at 519.

64. *Kindt v. Lund*, No. 17751-NC, 2003 Del. Ch. LEXIS 62, at *13 (Del. Ch. May 30, 2003) (dismissing suit based on special litigation committee report and declining to proceed to discretionary second-step business judgment review); *Kaplan*, 484 A.2d at 520. It has been suggested that dismissals of derivative litigation at the instance of special litigation committees are underreported in judicial opinions, and that during the period from 1993 to 2006 there were fifty-eight instances of such dismissals. See Minor Myers, *The Decisions of the Corporate Special Litigation Committees: An Empirical Investigation*, 84 IND. L.J. 1309, 1320 (2009).

65. DAVID A. DREXLER ET AL., 2-42 DELAWARE CORPORATION LAW AND PRACTICE § 42.04 (2015).

66. See *Zapata*, 430 A.2d at 786-87; see also *Kaplan*, 484 A.2d at 509. (“[I]t must be kept in mind that the entire procedure is designed to provide a means, if warranted, to throw a derivative plaintiff out of Court before he has an opportunity to engage in any discovery whatever in support

action of a special litigation committee, the Delaware Supreme Court observed that “[i]f . . . corporations can consistently wrest bona fide derivative actions away from well-meaning derivative plaintiffs through the use of the committee mechanism, the derivative suit will lose much, if not all, of its generally-recognized effectiveness as an intra-corporate means of policing boards of directors.”⁶⁷ Second, the courts recognized that those doing the “wresting” away from the derivative plaintiff—namely, the members of the special litigation committee—are susceptible to bias, if only because of their typical association as directors with those charged in the litigation with wrongdoing.⁶⁸ As expressed in *Zapata*, “[t]he question naturally arises whether a ‘there but for the grace of God go I’ empathy might not play a role.”⁶⁹ Therefore, “[t]he further question arises whether inquiry as to independence, good faith and reasonable investigation is a sufficient safeguard against abuse, perhaps subconscious abuse.”⁷⁰ The relatively strict judicial scrutiny of special litigation committee recommendations to dismiss derivative litigation has thus been intended as an antidote to bias attributable to the fact that the decision-makers (committee members) are typically nominated by, and serve as, directors with the very individuals being sued in the derivative litigation they are called upon to decide whether to dismiss.⁷¹

All that said, the shortcomings of the special litigation committee process are not the only reason for the infrequency of its use.⁷² In fairness, the impact of that process may have been blunted or, perhaps more accurately, preempted, by a 1984 opinion by the other major supreme court referred to earlier: namely, the Delaware Supreme Court and its opinion in *Aronson v. Lewis*.⁷³ That opinion made the pre-suit demand requirement a much more formidable basis for dismissing derivative suits, using a procedure that (unlike the special committee process) required no discovery effort or investigative expense.⁷⁴ After

of the merits of his cause of action purportedly brought on the corporation’s behalf.”).

67. See *Zapata*, 430 A.2d at 786.

68. *Id.* at 787.

69. *Id.*

70. *Id.*

71. See *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 940 (Del. Ch. 2003) (“In evaluating the independence of a special litigation committee, this court must take into account the extraordinary importance and difficulty of such a committee’s responsibility. It is, I daresay, easier to say no to a friend, relative, colleague, or boss who seeks assent for an act (e.g., a transaction) that has not yet occurred than it would be to cause a corporation to sue that person.”).

72. See *Myers*, *supra* note 64, at 1316-17 (finding a total of 106 special litigation committees formed between 1993 and 2006).

73. 473 A.2d 805 (Del. 1984).

74. Several commentators have remarked on *Aronson*’s dramatic reconstruction and revival of

Aronson, the only derivative suits that survived dismissal—and were thus suitable for application of the special litigation process—were cases in which the court had determined (or the parties expected that it would determine) that the claims had merit, making it even more difficult for a special litigation committee to conclude that the case should be dismissed as contrary to the interests of the corporation.⁷⁵ Thus, the very efficacy of the post-*Aronson* Delaware Court of Chancery rule 23.1 motion to dismiss may go a long way to explain why it has eclipsed the special litigation committee process as a means of policing unmeritorious shareholder derivative litigation.⁷⁶

Still, the experience of the special litigation committee process in relation to derivative litigation may guide evaluation of contemporary proposals to limit shareholder litigation, including the Litigation Review Committee Bylaw proposal put forward in this Article.⁷⁷ What that experience teaches is that if the pertinent decision-makers are presumptively suspected of bias or lack of objectivity, such that the persons relying on their judgment must, beyond any issue of material fact, prove their independence and the reasonableness of their decision, all after substantial discovery, a process relying on such decision-makers is likely to be ineffective and at best only infrequently used.⁷⁸

B. Federal Securities Class Actions

Private class actions for damages under the federal securities laws (particularly under U.S. Securities and Exchange Commission (“SEC”) Rule 10b-5)⁷⁹ are a much newer phenomenon than shareholder derivative litigation: they can trace their origin only as far back as the 1940s, when Rule 10b-5 was adopted and the courts first recognized a private cause of action under that rule.⁸⁰ Despite its relative youth, however, class action litigation based on Rule 10b-5 has been at least as vilified as derivative suits. In 1975, the U.S. Supreme Court declared it “presents a danger of vexatiousness different in degree and in kind from

the pre-suit demand requirement. See David A. Skeel, Jr., *The Accidental Elegance of Aronson v. Lewis*, in *THE ICONIC CASES IN CORPORATE LAW* 167 (Jonathan R. Macey ed., 2008); Davis, *supra* note 59, at 399-400; Hamermesh & Wachter, *supra* note 7, at 36-37.

75. See Davis, *supra* note 59, at 439-41.

76. *Aronson*, 473 A.2d at 808.

77. See *infra* Part III.A-C.

78. Steinberg, *supra* note 56, at 25-28.

79. 17 C.F.R. § 240.10b-5 (1951).

80. *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D. Pa. 1946) (implying a private cause of action for damages under Rule 10b-5); Milton V. Freeman, *Administrative Procedures*, 22 BUS. LAW. 891, 921-23 (1967) (describing the adoption of Rule 10b-5).

that which accompanies litigation in general.”⁸¹ Inspired by the “Contract With America” in 1994, legislation was introduced in Congress to mandate a loser-pays rule specifically targeting federal securities class actions.⁸² Although that rule was never adopted, Congress did enact the PSLRA.⁸³ Echoing the 1944 Wood Report on derivative suits, the report accompanying the PSLRA harshly criticized securities class actions and, *inter alia*, concluded:

[T]oday 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. These suits, which unnecessarily increase the cost of raising capital and chill corporate disclosure, are often based on nothing more than a company’s announcement of bad news, not evidence of fraud. All too often, the same ‘professional’ plaintiffs appear as name plaintiffs in suit after suit.⁸⁴

One of the key solutions embraced by the PSLRA was to bring the “certain lawyers” to heel, through the presumptive mandate that the court appoint as lead plaintiff the “most adequate plaintiff,” namely the plaintiff having the largest financial interest in a recovery.⁸⁵ That lead plaintiff would in turn select lead counsel, “thereby increasing the role of institutional investors in securities class actions” with a view “to transfer[ring] primary control of private securities litigation from lawyers to investors.”⁸⁶

In the two decades that have ensued since the adoption of the most adequate plaintiff provision, there has been considerable debate about whether the provision has benefited investors or the public generally, as anticipated by its sponsors. From the outset, there has been a concern that large institutional investors would not step forward to fulfill their intended role as sponsors and monitors of class action litigation.⁸⁷ In

81. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975).

82. Thomas D. Rowe, Jr., *Indemnity or Compensation? The Contract with America, Loser-Pays Attorney Fee Shifting, and a One-Way Alternative*, 37 WASHBURN L.J. 317, 322 (1998) (describing the fee-shifting proposal as “draconian” because “it would have applied in unclear but potentially explosive ways to plaintiff class actions”).

83. Stephen J. Choi et al., *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869, 873 (2005).

84. See S. REP. NO. 104-98, at 4 (1995); WOOD, *supra* note 36, at 45-48.

85. In what surely must be regarded as a coup for law professors, this proposal stemmed directly from a then recent law review article suggesting this approach. See Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2105-06 (1995).

86. S. REP. NO. 104-98, at 6.

87. Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 540 (1997) (questioning whether the most adequate plaintiff provision would meaningfully

fact, the greatest increase in institutional investor involvement as class plaintiffs has been on the part of public pension funds, rather than larger institutional investors generally.⁸⁸ On the other hand, there is evidence that increased participation by institutional investors as lead plaintiffs in securities class actions has correlated positively with larger recoveries.⁸⁹ This correlation has been attributed to “cherry-picking,”⁹⁰ but, notwithstanding the pejorative connotation of the term cherry-picking, selectivity in bringing securities class actions that generate the greatest recoveries may well be at least one of the beneficial results intended by the most adequate plaintiff provision of the PSLRA.⁹¹

As advanced most notably by David Webber, however, there are reasons to be concerned that the PSLRA’s most adequate plaintiff approach fails to achieve the legislative goal of improving litigation quality by prioritizing the size of the plaintiff’s financial stake in any recovery.⁹² The absolute size of that interest does not necessarily assure motivation or ability to assess the merits of proposed litigation: a large institutional investor for whom even a large potential recovery is a “rounding error” may devote much less effort in assessing and monitoring securities litigation than an individual whose loss, though smaller in absolute terms, represents a significant portion of her net worth.⁹³ Nor should it be inflexibly assumed that individual investors

alter control of securities class action litigation, and whether economic interest in a potential recovery is a useful measure for choosing a lead plaintiff).

88. Choi et al., *supra* note 83, at 889 (noting “evidence strongly supports” the hypothesis that “public pension funds became more active as lead plaintiffs after the enactment of the PSLRA”).

89. *Id.* at 900 (reporting “evidence that public pension fund participation is correlated with a greater likelihood of a High-Value Outcome from litigation”).

90. *Id.* at 900-01 (noting evidence that “public pension funds are simply cherry-picking by participating in cases in which characteristics observable prior to the filing of suit indicate the case is likely to result in a large settlement”).

91. Selectivity that focuses only on the size of a potential settlement, however, may not result in prosecution of cases in which liability is most deserved; it may simply take advantage of large potential damages to extract a settlement regardless of the likelihood of liability. That untoward possibility, of course, presupposes that defendants’ willingness to settle is unrelated to their perceptions of the likelihood of liability, and dependent only on the scope of potential damages. *Id.* at 901-03.

92. David H. Webber, *The Plight of the Individual Investor in Securities Class Actions*, 106 NW. U. L. REV. 157, 168 (2012).

93. *Id.* at 173-74 (“[F]or institutional investors, most stock frauds are rounding errors. For individuals, they can be life-altering experiences.”). On the other hand, Webber has also suggested that involvement of public pension funds (particularly if underfunded) in securities class action litigation may stem in part from the presence of individual board members who have suffered losses as individual securities holders or sellers. David H. Webber, *Is “Pay-to-Play” Driving Public Pension Fund Activism in Securities Class Actions? An Empirical Study*, 90 B.U. L. REV. 2031, 2080-81 (2010) (“Such funds may be pursuing lead plaintiff appointments because the beneficiary board members personally incur losses in securities frauds, and thereby are more highly motivated to take the lead in a class action to remedy the loss.”).

lack the sophistication attributed to institutional investors.⁹⁴ Moreover, an institutional investor with a large loss but with a large continuing equity interest in the company may have a substantial interest in minimizing the adverse impact of litigation on the issuer.⁹⁵ Finally, institutional investors may have an interest in using securities litigation to secure long-term governance reforms instead of litigation-specific recoveries.⁹⁶

Like the security for expenses statutes in derivative litigation, then, the PSLRA's most adequate plaintiff rule depends on what is at best a rough correlation between (1) the plaintiff's financial stake in the litigation and (2) the likelihood that the litigation will be initiated and prosecuted on its merits, rather than for private benefits of the plaintiff or plaintiff's counsel.⁹⁷

C. Mergers and Acquisitions Class Action Deal Litigation

In a path-breaking 2004 article,⁹⁸ Professors Thompson and Thomas identified class actions challenging mergers and acquisitions on the basis of state law of fiduciary duties as a new wave of shareholder litigation, succeeding derivative suits and class actions based on federal securities law.⁹⁹ Thompson and Thomas were optimistic that this new

94. Webber, *supra* note 92, at 180 (urging openness to appointing individual investors as co-lead plaintiffs with institutional investors, and noting that "some concentrated individual investors are sophisticated; basic economic and psychological principles suggest they are likely to be highly motivated").

95. *Id.* at 196 ("Even after a fraud is revealed, institutional investors often hold some stake in the defendant company.").

96. *Id.* at 202-03 ("Current and future shareholders likely benefit[] from [governance] reforms, but selling shareholders d[o] not . . . [T]he tradeoff between compensation and corporate governance reform raises concerns about another threshold purpose of securities class action: deterrence of fraud.").

97. In contrast, securities class action litigation in Canada relies on a threshold judicial inquiry into the merits. See Louis-Martin O'Neill et al., *Secondary Market Liability: Supreme Court of Canada Clarifies the Screening Mechanism for Class Actions*, DAVIES (Apr. 21, 2015), <https://reaction.dwpv.com/rs/vm.ashx?ct=24F76F1AD2E30AEDC1D180A9D12E9010DCBE7BB3D38714DD4CF371647BF8D90DDD78035> (describing the opinion of the Canadian Supreme Court in *Theratechnologies Inc. v. 121851 Canada Inc.*, [2015] 2 S.C.R. 106 (Can.), applying article 225.4 of the Québec Securities Act, which requires that the Canadian courts preliminarily determine whether "there is a reasonable possibility that it will be resolved in favour of the plaintiff," and holding that "the gatekeeping role of the courts under article 225.4 requires that the [Canadian] courts 'undertake a reasoned consideration of the evidence to ensure that the action has some merit'" (quoting Securities Act, R.S.Q., c. V-1.1, § 225.4 (Can.))).

98. Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133 (2004).

99. *Id.* at 135 ("[A] new form of shareholder litigation has emerged that is distinct from derivative or securities fraud claims: class action lawsuits filed under state law challenging director conduct in mergers and acquisitions. The empirical data reported in this article show that these

wave of shareholder litigation would be superior to their predecessor forms of shareholder litigation as a tool of managerial accountability: they expressed the view that “acquisition-oriented class actions substantially reduce management agency costs, while the litigation agency costs they create do not appear excessive.”¹⁰⁰

In the decade that followed this sanguine assessment, however, a much more negative view of acquisition-oriented class actions came to predominate. The Delaware courts themselves sounded alarms about the state of stockholder representative litigation.¹⁰¹ Much of the blame for the perceived abuses of acquisition-oriented shareholder class actions was placed upon the increased incidence of so-called multi-forum litigation, in which multiple shareholder class representatives would initiate duplicative fiduciary duty litigation in multiple jurisdictions.¹⁰² Dictum in a 2010 opinion of the Delaware Court of Chancery suggested a possible solution to this particular problem: a provision in the corporation’s certificate of incorporation requiring that litigation relating to the corporation’s internal affairs be conducted exclusively in a single forum, namely the courts of the state of incorporation.¹⁰³ The court recognized in the opinion, however, “[t]he issues implicated by an exclusive forum selection provision must await resolution in an appropriate case.”¹⁰⁴

The world only had to wait three years for that “appropriate case.” In his influential 2013 opinion in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,¹⁰⁵ the Chancellor plowed some very important ground. First, his opinion established (albeit theoretically subject to reversal by the Delaware Supreme Court) that a bylaw establishing an exclusive forum for litigating internal affairs claims is at least facially valid;¹⁰⁶ second, the opinion acknowledged that enforceability in a

acquisition-oriented suits are now the dominant form of corporate litigation and outnumber derivative suits by a wide margin.”).

100. *Id.* at 140.

101. See, e.g., *In re Revlon, Inc. S’holders Litig.*, 990 A.2d 940, 959-60 (Del. Ch. 2010) (“Once a pattern for settlement is established, . . . [t]he resulting system involves little real litigation activity, generates questionable benefits for class members, provides transaction-wide releases for defendants, and offers a good living for the traditional plaintiffs’ bar.”). See *supra* notes 5-6, for criticisms of stockholder representative litigation.

102. See Theodore N. Mirvis, *Anywhere but Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions*, M&A J., May 2007, at 17.

103. *In re Revlon, Inc. S’holders Litig.*, 990 A.2d at 960 (“[I]f boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.”).

104. *Id.* at 961 n.8.

105. 73 A.3d 934 (Del. Ch. 2013).

106. *Id.* at 939 (“[F]orum selection bylaws are not facially invalid as a matter of statutory

specific case might be a different matter,¹⁰⁷ and that improperly motivated adoption or inequitable or unreasonable application of such a bylaw could result in non-enforcement;¹⁰⁸ finally, and perhaps most importantly for purposes of this Article, the court articulated a potentially sweeping rationale for finding the bylaw facially valid.¹⁰⁹ The court explained:

[B]ylaws, together with the certificate of incorporation and the broader [Delaware General Corporation Law], form part of a flexible contract between corporations and stockholders, in the sense that the certificate of incorporation may authorize the board to amend the bylaws' terms and that stockholders who invest in such corporations assent to be bound by board-adopted bylaws when they buy stock in those corporations.¹¹⁰

Although that flexible contract does not, as the court explained, extend to "external" claims such as "a tort claim against the company based on a personal injury [the plaintiff] suffered that occurred on the company's premises or a contract claim based on a commercial contract with the corporation,"¹¹¹ it would apparently extend to any provision of the charter or bylaws regulating matters of internal corporate affairs, including litigation of claims within that space.¹¹² It does not take much imagination to see that this rationale for the exclusive forum bylaw at least theoretically supports a wide variety of other provisions regulating stockholder litigation.¹¹³

III. THE CONTEXT AND CONTENT OF THE LITIGATION REVIEW COMMITTEE BYLAW

A. Recent Responses

In evaluating the Litigation Review Committee Bylaw suggested in this Article, it is useful first to consider briefly two other approaches to

law.").

107. *Id.* at 949.

108. *Id.* at 958 (holding that plaintiff can argue that "the forum selection clause should not be respected because its application would be unreasonable," or that "the bylaw was being used for improper purposes inconsistent with the directors' fiduciary duties").

109. *Id.* at 949-50.

110. *Id.* at 940.

111. *Id.* at 952, 957.

112. *Id.* at 951-52.

113. For a thoughtful inventory and critique of such possible provisions, see Winship, *supra* note 4, at 531-32. As Professor Winship notes, charter and bylaw provisions could conceivably prescribe limitations on discovery, time for bringing suit, and damages. *Id.* Other applications could include establishing pleading requirements and burdens of proof.

limiting stockholder litigation that rest on the flexible contract theory articulated in *Boilermakers Local 154 Retirement Fund* and *ATP Tour, Inc.*¹¹⁴ The first approach is the one evaluated in *ATP Tour, Inc.* itself: a bylaw requiring the stockholder plaintiff to pay the fees and expenses of the defendants if the plaintiff “does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought.”¹¹⁵ Supporters and critics of this bylaw agreed on one thing: the bylaw would significantly deter litigation.¹¹⁶ What they disagreed about, however, was whether the bylaw would deter meritorious as well as frivolous litigation.¹¹⁷ That disagreement has yet to be tested empirically: the Delaware General Assembly reined in that experimentation in 2015, adopting legislation declaring that fee-shifting provisions in the certificate of incorporation or the bylaws are invalid.¹¹⁸ As noted earlier, however, that legislation conspicuously left open the possibility that other charter or bylaw provisions regulating stockholder litigation might be valid.¹¹⁹

B. *The Imperial Holdings Bylaw*

The second flexible contract approach to limiting stockholder litigation would exploit that possibility but has received far less attention than fee-shifting provisions. In 2014, Imperial Holdings, Inc. (“Imperial Holdings”), a Florida corporation, adopted a bylaw that requires the written approval of the holders of at least 3% of the outstanding shares as a condition to a stockholder bringing a “representative claim”

114. See *infra* Part.III.A–B.

115. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 556 (Del. 2014).

116. *Id.* at 560 (“Fee-shifting provisions, by their nature, deter litigation. Because fee-shifting provisions are not per se invalid, an intent to deter litigation would not necessarily render the bylaw unenforceable in equity.”); Lebovitch & van Kwawegen, *supra* note 11, at 495 (finding fee-shifting bylaw “is likely to eliminate all stockholder litigation, irrespective of merit”); Liz Hoffman, *Delaware to Weigh Who Pays Legal Fees in Corporate Litigation*, WALL ST. J. (June 10, 2014), <http://blogs.wsj.com/law/2014/06/10/delaware-to-weigh-who-pays-legal-fees-in-corporate-litigation> (noting a letter from the Chamber of Commerce’s Institute for Legal Reform describing fee-shifting provisions as “a new tool authorized by the Delaware courts[,] . . . which businesses could use to reduce the amount of unnecessary litigation that accompanies corporate mergers”).

117. Lebovitch & van Kwawegen, *supra* note 11, at 495 (“The inability of fee-shifting bylaws to differentiate between meritorious and frivolous suits while impairing fundamental stockholder rights is a fundamental flaw with the entire concept.”).

118. Whether fee-shifting charter and bylaw provisions are found to be effective and develop in states other than Delaware remains to be seen. For a mandatory, public ordering approach, not involving charter or bylaw provisions, see 18 OKLA. STAT. tit. 18 § 1126(C) (2014) (noting in stockholder derivative actions the court “shall require the nonprevailing party or parties to pay the prevailing party or parties the reasonable expenses including attorneys’ fees, taxable as costs, incurred as a result of such action”).

119. See *supra* note 9 and accompanying text.

(defined to include class action claims of breach of fiduciary by the directors).¹²⁰ The rationale for this bylaw was similar to the most adequate plaintiff provision of the federal securities laws; namely, that a suit on behalf of stockholders ought to enjoy a reasonably substantial level of support from the stockholders to be benefited by the prosecution of the litigation, so that such litigation would be controlled, in effect, by persons having a significant economic interest in the outcome of the litigation.¹²¹

Reflection suggests a number of limitations, however, on the utility of the Imperial Holdings bylaw. First, read literally, it would preclude the filing of suit until *after* delivery of the requisite percentage of stockholder consents.¹²² Thus, a stockholder owning less than 3% of the stock would need to solicit and obtain sufficient consents of other stockholders before filing suit.¹²³ Given the time that solicitation could entail,¹²⁴ it takes little imagination to see the potential for impairment of

120. Section 3.16 of the Imperial Holdings bylaws provides:

Except where a private right of action at a lower threshold than that required by this bylaw is expressly authorized by applicable statute, a current or prior shareholder or group of shareholders (collectively, a "Claiming Shareholder") may not initiate a claim in a court of law on behalf of (1) the corporation and/or (2) any class of current and/or prior shareholders against the corporation and/or against any director and/or officer of the corporation in his or her official capacity, unless the Claiming Shareholder, no later than the date the claim is asserted, delivers to the Secretary written consents by beneficial shareholders owning at least 3% of the outstanding shares of the corporation as of (i) the date the claim was discovered (or should have been discovered) by the Claiming Shareholder or (ii), if on behalf of a class consisting only of prior shareholders, the last date on which a shareholder must have held shares to be included in the class.

Imperial Holdings, Inc., Current Report (Form 8-K) (Oct. 23, 2014).

121. See Allison Frankel, *Shareholder Challengers Minimum-Stake-to-Sue Bylaw*, REUTERS (Jan. 21, 2015), <http://blogs.reuters.com/alison-frankel/2015/01/21/shareholder-challenges-over-minimum-stake-to-sue-bylaw> (noting that the bylaw "was intended to stop shareholders without a real financial interest in the outcome of their own case from hijacking deals and forcing the company to defend meritless litigation"). Delaware's public benefit corporation statute takes a similar approach, prescribing a 2% or \$2 million ownership threshold for bringing a derivative suit to enforce the directors' statutory obligation to balance the pecuniary interests of stockholders with the interests of others "materially affected by the corporation's conduct." DEL. CODE ANN. tit. 8, §§ 365, 367 (2016).

122. See *supra* note 120 and accompanying text.

123. The 3% consent requirement is not likely to be an insuperable barrier. When the SEC adopted its subsequently vacated proxy access rule in 2010, it found, based on data on stock ownership in public companies, "reaching the 3% ownership threshold we are adopting is possible for a significant number of shareholders either individually or by a number of shareholders aggregating their holdings in order to satisfy the ownership requirement." Facilitating Shareholder Director Nominations No. 179, 75 Fed. Reg. 56692. It would likely be easier to meet a 3% consent requirement as specified in the Imperial Holdings bylaws, which, unlike SEC Rule 14a-11, does not impose a holding period requirement. *Id.* at 56690 n.221.

124. Unless consents were solicited and received from ten or fewer stockholders, it is likely that a plaintiff stockholder seeking the approval required by the Imperial Holdings bylaw would need to comply with the SEC's proxy rules. 17 C.F.R. § 240.14a-1-5.

meritorious claims: delaying commencement of litigation in order to solicit consents to satisfy the bylaw's 3% support requirement could effectively preclude expedited relief in cases in which such relief is important and valuable (to cure significant disclosure failures, for example,¹²⁵ or to enjoin the operation of unduly burdensome deal protection devices).¹²⁶

Of course, a court asked to enforce the Imperial Holdings bylaw in such a situation could well choose not to apply it literally and decline to dismiss or stay the case summarily on the theory (as recognized in *ATP Tour, Inc.*) that the bylaw would apply inequitably or unreasonably in such circumstances.¹²⁷ Or, as with the security for expenses statutes governing derivative actions,¹²⁸ the court could allow the case to proceed and defer enforcement of the bylaw in order to afford the stockholder plaintiff an opportunity to gather the required consents.¹²⁹ Indeed, this sort of case-by-case determination of whether to enforce a bylaw as written is a common judicial approach to questions of bylaw validity in which the courts decline to declare a bylaw generally or facially invalid but do not shrink from exercising judgment as to whether to enforce a bylaw in a particular situation.¹³⁰ However, if a case-by-case threshold,

125. See, e.g., *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 425-27 (Del. Ch. 2002) (enjoining an exchange offer by controlling stockholder due to failure to provide investment banker valuation analysis).

126. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings Inc.*, 506 A.2d 173, 176, 184-85 (Del. 1986) (enjoining "lock up" asset option and break-up fee provision).

127. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014) (noting that despite facial validity, whether a "fee-shifting bylaw is enforceable . . . depends on the manner in which it was adopted and the circumstances under which it was invoked"); see also *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 943-58 (Del. Ch. 2013) ("[I]f a plaintiff believes that a forum selection clause cannot be equitably enforced in a particular situation, the plaintiff may sue in her preferred forum and respond to the defendant's motion to dismiss for improper venue by arguing that, under *Bremen [v. Zapata Off-Shore Co.]*, 407 U.S. 1, 15 (1972)], the forum selection clause should not be respected because its application would be unreasonable.").

128. See, e.g., *Baker v. MacFadden Publ'ns, Inc.*, 90 N.E.2d 876, 878 (1950) (finding a court may vacate an order of security for expenses based on joinder of shareholders owning sufficient shares to meet the 5% or \$50,000 threshold for exemption from the security requirement); Dykstra, *supra* note 27, at 93 ("It is now accepted practice to give a plaintiff time after he has filed his complaint to ascertain whether other shareholders will join.").

129. A similar approach has been taken in stockholder derivative litigation when a named plaintiff loses standing (by selling his stock, for example) to continue to prosecute the case; in such a situation, the courts have allowed the litigation to continue by affording a plaintiff's counsel an opportunity to identify another stockholder to intervene as plaintiff and continue the litigation. See, e.g., *In re Extreme Networks, Inc. S'holder Derivative Litig.*, 573 F. Supp. 2d 1228, 1237 (N.D. Cal. 2008) (dismissing named plaintiff who sold his shares, but noting that "another qualified shareholder can intervene on the grounds that their rights are no longer represented"); *In re MAXXAM, Inc.*, 698 A.2d 949, 956 (Del. Ch. 1996).

130. See Lawrence A. Hamermesh, *Director Nominations*, 39 DEL. J. CORP. L. 117, 148 (2014) ("[I]t is surely far easier for a court to find a case-specific equitable reason for declining to enforce a

judicial determination regarding the merits of the suit is going to be made before enforcing (or not enforcing) the bylaw, so such a bylaw may add little to the courts' already existing power to control which cases go forward and when expedited discovery proceedings are appropriate.¹³¹ One suspects that if the Delaware Court of Chancery found that a stockholder complaint presented compellingly meritorious claims, it would either decline to enforce the bylaw based on equitable considerations, or would look for (and likely find) a way to interpret the bylaw to avoid dismissal.¹³²

The foregoing review of the Imperial Holdings bylaw only addresses possible concerns about "false negatives" (application of the bylaw to preclude meritorious claims) and how the courts might avoid such preclusion on a case-by-case basis. There is also potential, however, for "false positives" (i.e., failure to weed out unmeritorious claims). The Imperial Holdings bylaw would permit *any* 3% stockholder or group of stockholders to enable prosecution of a representative claim, regardless of the merits of the case, their level of knowledge of relevant facts or their competence to evaluate those merits, and any personal conflicting motivation for approving the litigation.¹³³ Thus, and like the security for expenses statutes and the most adequate plaintiff provision of the PSLRA, the Imperial Holdings bylaw is a relatively blunt instrument that would only, at best, indirectly fulfill the twin objectives of eliminating unmeritorious litigation without unduly discouraging litigation that serves the interest of stockholders and the corporation.¹³⁴

bylaw limitation rather than to make a generally applicable pronouncement about the formal validity of such a limitation."); see also *Strougo v. Hollander*, 111 A.3d 590, 598 (Del. Ch. 2015) (declining to apply a fee-shifting bylaw to a plaintiff who was no longer a stockholder at the time the bylaw was adopted).

131. *Hamermesh & Wachter*, *supra* note 7, at 5 (finding Delaware's "system resolves shareholder litigation by encouraging the early presentation of relevant facts pleaded in the complaint, and by either dismissing the complaint if those facts fail to demonstrate legal merit, or identifying how the complaint is meritorious, in a fashion that encourages the protagonists to settle").

132. See *Hamermesh*, *supra* note 130, at 148 ("[T]he courts have given effect to concerns about the negative effects of advance notice provisions by construing such provisions narrowly, to avoid impairment of the shareholders' right to nominate directors."). On the other hand, depending on the circumstances, the court might well conclude that an inability to garner support from 3% of the stockholders indicates that the complaint lacks compelling merit.

133. See, e.g., CAL. CORP. CODE § 800(c)(1) (West 2014) (requiring inquiry into the merits of litigation). The Imperial Holdings bylaw does not require such inquiry. See *supra* note 120.

134. See *Frankel*, *supra* note 121 ("[The] bylaw was intended to stop shareholders without a real financial interest in the outcome of their own case from hijacking deals and forcing the company to defend meritless litigation.").

C. *Evaluation of the Litigation Review Committee Bylaw*

The proposed Litigation Review Committee Bylaw is, quite obviously, modeled on the special litigation committee procedure described above.¹³⁵ Like that procedure, the proposed bylaw would create an opportunity to evaluate and, if deemed appropriate, terminate the prosecution of claims in stockholder litigation; no advance consent or approval to commence such litigation would be required.¹³⁶ Most importantly, the Litigation Review Committee would be required, in order to cause the dismissal of claims in stockholder litigation, to make an affirmative, case-specific determination about the merits of allowing the continuing prosecution of the claims.¹³⁷ Unlike the security for expenses statutes in derivative suits, and the most adequate plaintiff approach of the PSLRA, the evaluation of claims through the Litigation Review Committee process would not depend solely on a rough correlation between the plaintiffs' share ownership and their motivation and ability to control the litigation, although the generally positive motivation would play a role through the designation of committee members by the largest stockholders of the corporation.¹³⁸

The Litigation Review Committee Bylaw is more comprehensive than the special litigation committee procedure, in that it applies to stockholder class actions as well as derivative suits, but its reach would still be limited to litigation involving the corporation's internal affairs and, thus, within the scope of the flexible contract identified in *Boilermakers Local 154 Retirement Fund* and *ATP Tour, Inc.*¹³⁹ And, by

135. See *supra* Part II.A.2.

136. Compare *Zapata Corp. v. Maldonado*, 430 A.2d 779, 782-84 (Del. 1981) (discussing directors' "managerial decision making power, which encompasses decisions whether to initiate, or refrain from entering, litigation"), and Steinberg, *supra* note 56, at 4-6, 16, with *infra* Appendix ("No stockholder may continue to prosecute an internal corporate claim . . . derivatively on behalf of the corporation or on behalf of a class of stockholders of the corporation, if . . . the prosecution of that claim is disapproved by or on behalf of the Litigation Review Committee.").

137. The bylaw's prohibition of committee action by unanimous written consent is intended to promote case-by-case engagement and to avoid rote review by committee members. See *infra* Appendix (referring to subsection (f) of the author's proposed bylaw).

138. Compare N.Y. BUS. CORP. L. § 627 (McKinney 2003) (requiring that plaintiffs hold at least 5% of the corporation's shares), and Weiss & Beckerman, *supra* note 85, at 2059-60, 2105 (discussing plaintiffs' and their attorneys' ability and incentive to control the litigation), with *infra* Appendix (omitting minimum share requirements for initiating litigation).

139. Dismissal at the instance of a Litigation Review Committee thus would not, like a special litigation committee determination in derivative litigation, depend on the power of a committee of the board of directors to manage a corporate asset in the form of a claim by the corporation. Rather, it would depend upon the application of the bylaw as a contract binding the stockholder to consent to dismissal, if the committee determines that the stockholder's claim should be dismissed. As a result, the Litigation Review Committee could act on class action claims as well as claims in derivative suits. But see *infra* note 141 (discussing a limitation on the power of the Litigation

reaching both such forms of litigation, it more fully addresses the field in which litigation agency costs are most likely to arise (i.e., where the litigation is most at risk of serving the interest of plaintiffs' counsel instead of a stockholder client or stockholders generally).¹⁴⁰

The Litigation Review Committee Bylaw has several other advantages; moreover, over the special litigation committee, its predecessor process in derivative suits.¹⁴¹ First, through its implementation in the form of a bylaw, it achieves a degree of legitimacy, in terms of stockholder consent, by virtue of the fact that stockholders could, if they wished, unilaterally eliminate the procedure.¹⁴² Second, the proposed method for constituting the committee—in which the members are selected by the largest stockholders of the company—would largely avoid the “structural bias” concerns that have led the courts to demand strong proof of independence and reasonable investigation before accepting a special litigation committee’s recommendation that litigation be dismissed.¹⁴³

Review Committee relative to a special litigation committee of directors).

140. See Weiss & Beckerman, *supra* note 85, at 2064.

141. Before noting such advantages, it is important to recognize that the authority of a Litigation Review Committee as proposed here is considerably narrower than that of the traditional director-comprised special litigation committee. For example, a board special litigation committee is typically endowed with the power to prosecute or settle claims on behalf of the corporation. See, e.g., Myers, *supra* note 64, at 1313 (“After its investigation, the [special litigation committee] decides whether to pursue the claims, settle them, or seek their dismissal.”). It is at best doubtful, in contrast, that a Litigation Review Committee, not being comprised of directors, would be given such authority over claims by or against the corporation.

142. See *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 943, 955-56 (Del. Ch. 2013) (“[T]he statutory regime provides protections for the stockholders, through the indefeasible right of the stockholders to adopt and amend bylaws themselves.”). That right, of course, may be limited by provisions requiring approval by a supermajority stockholder vote, or by the presence of a majority stockholder opposed to elimination of the bylaw. But, that right is often practically available and meaningful, and, where that is the case, a court should be more willing to give effect to the bylaw than in a case, like the special litigation committee procedure, in which the stockholders have no say in the matter at all other than before the court.

143. See *infra* Appendix (referring to subsection (b) of the author’s proposed bylaw). A desire to eliminate concern about such bias is what prompts the inclusion of a provision in the bylaw precluding removal of the committee members except by stockholder vote. See *infra* Appendix (referring to subsection (c) of the author’s proposed bylaw). That concern also appears to underlie the provision in the Model Business Corporation Act, adopted in 1990, authorizing appointment of a special litigation panel by the court, rather than by the board of directors. MODEL BUS. CORP. ACT § 7.44(f) (AM. BAR ASS’N 1991) (“[U]pon motion by the corporation [the court may appoint a panel of one or more individuals] to make a determination whether the maintenance of the derivative proceeding is in the best interests of the corporation.”). Professor Gevurtz made a similar proposal in 1985, suggesting judicial appointment of provisional directors to determine the disposition of derivative litigation. See Franklin A. Gevurtz, *Who Represents the Corporation? In Search of a Better Method for Determining the Corporate Interest in Derivative Suits*, 46 U. PITT. L. REV. 265, 324-25 (1985) (proposing to, in lieu of permitting courts to appoint a special litigation committee, “have the courts automatically appoint a panel of provisional litigation directors in every derivative

To the contrary, the selection of committee members by the largest stockholders should encourage a much more deferential form of judicial review. Hence, the proposed bylaw would require that judicial review be limited by applying a standard similar to the standard applicable to judicial review of arbitral awards in which the decision is subject to judicial countermand only based on affirmative evidence of misconduct by the tribunal.¹⁴⁴ While the bylaw does not attempt to define the nature of the misconduct that might lead a court to reject a committee decision to discontinue prosecution of one or more claims in stockholder litigation, the analogy to review of arbitral awards ought to suggest that such misconduct must materially compromise the integrity of the decision.¹⁴⁵ Through this approach to judicial review, the Litigation Review Committee Bylaw would avoid much of the cost of the special litigation committee process and would be much more likely to be effective and, therefore, employed.

The proposed Litigation Review Committee Bylaw is also flexible in a variety of important respects. The first such respect involves timing: as proposed here, the bylaw would require the Litigation Review Committee to recommend dismissal of a claim in stockholder litigation

suit. These court-appointed directors would be charged with making all litigation decisions for the corporation as the real plaintiff in the action"). The Litigation Review Committee Bylaw, in contrast to these approaches, does not require judicial involvement in selection of the members. See George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WISC. L. REV. 881, 907 (proposing that proxy solicitation by public corporations be managed by a committee of the ten to twenty largest stockholders).

144. 9 U.S.C. § 10 (2012) (stating an arbitral award may be vacated "(1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made"). It has been suggested that because contracting parties can effectively forgo ordinary appellate review by agreeing to arbitration, they can achieve the lesser included result—forgoing or limiting appellate review in litigation—by contract. See Robert G. Bone, *Party Rulemaking: Making Procedural Rules Through Party Choice*, 90 TEX. L. REV. 1329, 1351 (2012).

145. See, e.g., *Wise v. Wachovia Sec., LLC*, 450 F.3d 265, 269 (7th Cir. 2006) ("When parties agree to arbitrate their disputes they opt out of the court system, and when one of them challenges the resulting arbitration award he perforce does so not on the ground that the arbitrators made a mistake but that they violated the agreement to arbitrate, as by corruption, evident partiality, exceeding their powers, etc.—conduct to which the parties did not consent when they included an arbitration clause in their contract. That is why in the typical arbitration, which unlike the one in this case is concerned with interpreting a contract, the issue for the court is not whether the contract interpretation is incorrect or even wacky but whether the arbitrators had failed to interpret the contract at all, for only then were they exceeding the authority granted to them by the contract's arbitration clause." (citations omitted)).

within 120 days after its assertion.¹⁴⁶ Of course, a committee could act more quickly if it concluded that a more prompt determination were necessary to avoid undue cost to the corporation and its stockholders. It is certainly open to debate, on the other hand, whether that time limitation is too short, but there is legislative support for the proposition that even complex cases can and should be evaluated and resolved within 120 days, subject only to a narrow scope of judicial review, if the relevant tribunal is disinterested and reasonably sophisticated in matters of the sort.¹⁴⁷ And, allowing a significantly longer period exacerbates the possibility that a plaintiff could reasonably invest significant time and energy in prosecuting a case only to learn thereafter that the committee has resolved to reject continued prosecution of the claims being pursued.¹⁴⁸

There is also room for flexibility in defining the composition of the Litigation Review Committee. As proposed here, the members would be selected by the three largest stockholders, who would be identified based on beneficial ownership reports as filed with the SEC.¹⁴⁹ Like the most adequate plaintiff provision of the PSLRA, however, this approach could be criticized because it fails to account for the possibility of “empty ownership” resulting from a person’s holding of financial instruments (puts, for example) that effectively reduce the person’s net economic interest in the stock.¹⁵⁰ The framework of the proposed bylaw would of course permit a more refined approach to determining the level of

146. See *infra* Appendix (referring to subsection (b) of the author’s proposed bylaw).

147. The Delaware Rapid Arbitration Act contemplates that “an arbitrator shall issue a final award within the time fixed by an agreement or, if not so fixed, within 120 days of the arbitrator’s acceptance of the arbitrator’s appointment,” unless extended (by no more than 60 days) by the parties’ agreement. DEL. CODE ANN. tit. 10, § 5808(b) (2016).

148. That possibility exists, of course, even with the proposed 120-day deadline, especially where litigation necessarily addresses an expedited transaction. In that circumstance, however, the plaintiff (and plaintiff’s counsel) and the defendants share an interest in a prompt determination by the committee.

149. See *infra* Appendix (referring to subsection (b) of the author’s proposed bylaw). The number of members could vary, of course, although the experience with special litigation committees suggests that the Litigation Review Committee should be comprised of more than one member. See, e.g., *Hasan v. CleveTrust Realty Inv’rs*, 729 F.2d 372, 379-380 (6th Cir. 1984) (rejecting dismissal based on determination by a one-person special litigation committee); *Sutherland v. Sutherland*, 958 A.2d 235, 243-44 (Del. Ch. 2008) (rejecting one-person litigation committee recommendation of dismissal); *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985) (“If a single member committee is to be used, the member should, like Caesar’s wife, be above reproach.”); *Houle v. Low*, 556 N.E.2d 51, 58 (Mass. 1990) (finding the fact that the special litigation committee was comprised of just one director is “a factor to be weighed in deciding whether the committee was independent and unbiased”).

150. See Webber, *supra* note 92, at 183 (“[O]mission of derivatives from the largest financial interest calculation may lead to the appointment of lead plaintiff applicants who do not actually have the largest financial interest in the litigation.”).

ownership that would identify the stockholders entitled to select the members of the committee.

Another area of flexibility and room for experimentation is the matter of the informational rights of the Litigation Review Committee. The bylaw proposed here is silent on that matter out of a preference for case-by-case determinations of how the committee should be informed, and should inform itself, of relevant facts and law.¹⁵¹ Not all cases would require the same level of inquiry. And, while it might be useful to be more prescriptive of committee rights to information,¹⁵² it does not seem unreasonable to expect that corporate directors and officers interested in supporting a committee determination to discontinue claims in stockholder litigation would also have an interest in responding fully and fairly to a committee request for information (or would fairly expect a refusal to reject litigation claims if management were uncooperative in supplying requested information).¹⁵³ Likewise, to the extent that committee members share or are guided by their designating stockholders' economic interest in the corporation, they can be expected to make optimal choices about the level of cost and effort to devote to gathering information.¹⁵⁴ For all of these reasons it would seem imprudent to constrain the committee members' information gathering discretion through provisions in the Litigation Review Committee Bylaw.

Perhaps, the most troublesome uncertainty about the efficacy of the proposed Litigation Review Committee Bylaw is whether the largest stockholders would participate cooperatively in fulfilling their responsibilities under the bylaw to select the members of the

151. See *infra* Appendix.

152. The director members of a special litigation committee, unlike the non-director members of the Litigation Review Committee, enjoy a statutory right of access to corporate information. See, e.g., DEL. CODE ANN. tit. 8, § 220(d) (2016) ("Any director shall have the right to examine the corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to the director's position as a director.").

153. One possible reason for reticence, however, could be a legitimate desire to preserve an attorney-client privilege attaching to communications that might be relevant to the committee's deliberations. If only because of uncertainty and novelty about the nature of the relationship between the corporation and members of a Litigation Review Committee, the corporation may be reluctant to risk waiving the privilege by sharing attorney-client communications with the committee members. Even if the corporation and the committee members could conceivably invoke privilege by relying on a "common interest," the scope of what constitutes a "common interest" is unclear and, it appears, may vary from jurisdiction to jurisdiction. See, e.g., 3Com Corp. v. Diamond II Holdings, Inc., No. 3933-VCN 2010 LEXIS 126, at *12 (Del. Ch. May 31, 2010) ("Delaware . . . employs a broader rule [than Massachusetts] when determining whether a communication was, or has remained, confidential for privilege purposes.").

154. See, e.g., Weiss & Beckerman, *supra* note 85, at 2095-97 (describing the relationship between economic interests and effective monitoring of class litigation).

committee.¹⁵⁵ An isolated refusal or failure to select a member can be dealt with by inviting the next largest stockholder to make the selection.¹⁵⁶ More problematic would be more widespread non-acceptance of the invitation to designate a committee member. Several provisions of the proposed bylaw are designed to overcome such reticence. First, it is explicit that the largest stockholders would not be required to designate one of their own principals, officers, or agents as a committee member; rather, they could choose any person they deem adequately qualified to perform the functions of a committee member.¹⁵⁷ This aspect of the bylaw avoids the concern, most pronounced in the PSLRA's most adequate plaintiff provision, that an institutional investor or other large stockholder would be reluctant to take on the full responsibility of acting as a plaintiff in litigation.¹⁵⁸ Second, the proposed bylaw contemplates a treatment of committee members that is designed to encourage service, or at least minimize the burdens of service, as a committee member.¹⁵⁹ Thus, the bylaw would authorize the corporation or the designating stockholder or both to compensate committee members for their service in that capacity,¹⁶⁰ leaving the details and terms of such compensation to ad hoc negotiation and experimentation.¹⁶¹ In addition, the bylaw would afford committee members the most protective rights of indemnification and advancement of expenses that the corporation provides to any of its directors and officers.¹⁶²

155. See *infra* Appendix (referring to subsection (b)(i) and (ii) of the author's proposed bylaw).

156. See *infra* Appendix (referring to subsection (b)(ii) of the author's proposed bylaw).

157. See *infra* Appendix (referring to subsection (b)(ii) of the author's proposed bylaw). Thus, a stockholder might select an experienced lawyer to serve on a Litigation Review Committee. And, of course, a Litigation Review Committee, once constituted, could retain a law firm to assist in evaluating claims in stockholder litigation. That retention could be ad hoc, or could be on a continuing basis addressing multiple successive lawsuits.

158. See *supra* note 87 and accompanying text.

159. See *infra* Appendix (referring to subsections (c), (d), and (e) of the author's proposed bylaw).

160. See *infra* Appendix (referring to subsection (d) of the author's proposed bylaw).

161. Except in cases where the stockholder litigation targets the designating stockholder as a defendant, there should ordinarily be no concern about whether compensation to be paid by that stockholder inappropriately incentivizes the committee member. To the contrary, such compensation should enhance the perception that the member's conduct on the committee is motivated by the interests of stockholders generally. See, e.g., Matthew D. Cain et al., *How Corporate Governance Is Made: The Case of the Golden Leash*, 164 U. PA. L. REV. 649, 666-71 (2016) (describing the development of and response to activists' arrangements—referred to as “golden leashes”—to provide incentive compensation for their director nominees).

162. See *infra* Appendix (referring to subsection (e) of the author's proposed bylaw). It may be advisable to implement such indemnification and advancement undertakings by express contract, since it is at least doubtful that a member of the Litigation Review Committee would be considered a “director, officer, employee or agent of the corporation” and thus within the coverage of the

The Litigation Review Committee Bylaw, as proposed here, is silent on the question of the role of the stockholders who select the members of the committee.¹⁶³ As with directors chosen to represent a particular stockholder on the board of directors, it might reasonably be expected that a member of the Litigation Review Committee would share information with her designating stockholder about an evaluation of a pending stockholder claim.¹⁶⁴ A designating stockholder might also prefer direct input into the work of the Litigation Review Committee, in which case an institutional stockholder might choose to appoint one of its own officers or employees. On the other hand, a designating stockholder might prefer to keep a greater distance from the evaluation of stockholder litigation claims and, in particular, from any non-public material information that might emerge from such an evaluation.¹⁶⁵ Accordingly, the proposed Litigation Review Committee Bylaw avoids any specification concerning the role of the designating stockholders or the extent to which litigation-related information may or should be shared with them.¹⁶⁶

Apart from the uncertainty about the likely level of stockholder willingness to participate in the selection of Litigation Review Committee members, the proposed bylaw inevitably presents significant cost issues. Like special litigation committees in derivative actions, a Litigation Review Committee of the sort proposed here would, in any particular case, have to devote non-trivial resources to investigating a claim in order to determine whether to require its dismissal.¹⁶⁷ The costs of doing so, which have contributed to the infrequency of use of special litigation committees in derivative litigation, would surely also

corporate indemnification statute. DEL. CODE ANN. tit. 8, § 145(a) (2016). The same consideration would probably apply with respect to provision of insurance coverage for service as a member of the committee (that is, it may be advisable to provide for such insurance through express contract rather than assume that an existing director and officer liability insurance policy would apply to committee members).

163. See *infra* Appendix.

164. See J. Travis Laster & John Mark Zeberkiewicz, *The Rights and Duties of Blockholder Directors*, 70 BUS. LAW. 33, 54-57 (2014) ("Delaware law has developed a rule that accommodates information sharing."). The possibility of such information sharing, on the other hand, may exacerbate the uncertainty noted above as to whether sharing with the committee information otherwise subject to attorney-client privilege might waive that privilege. See *supra* note 153 and accompanying text.

165. *Id.* at 54 ("When counsel work predominantly with public companies and are steeped in concerns about Regulation FD and insider trading, the intuitive response is strongly against any type of information sharing . . .").

166. See *infra* Appendix.

167. See Comm. on Corporate Laws, *supra* note 58, at 1244 (providing an example of how a board of directors must utilize resources in order to respond to a demand).

discourage use of the Litigation Review Committee proposed here. Other techniques for addressing stockholder litigation (such as early settlements or motions to dismiss) may well be preferred. But, in some cases a Litigation Review Committee, like a special litigation committee in a derivative suit, may be the most cost-effective means of evaluating whether specific claims are beneficial to the corporation and its stockholders or should be dismissed as contrary to their interests.¹⁶⁸ In short, the Litigation Review Committee Bylaw may be a means to establish, and have available, a process that could effectively be used in cases in which other options are less attractive.

IV. CONCLUSION

In the wake of judicial opinions validating charter and bylaw provisions that regulate the conduct of stockholder class and derivative litigation,¹⁶⁹ and Delaware legislation that prohibits such provisions that impose fee-shifting but that otherwise leaves open the possibility of other litigation-regulating provisions,¹⁷⁰ it is predictable that further experimentation with such provisions will occur. When it does, the validity and utility of such provisions should be judged by their ability to eliminate or discourage litigation that provides no net benefit to stockholders, while at the same time avoiding deterrence or elimination of beneficial litigation.

The problem of counterproductive stockholder litigation is not new, and it has been addressed repeatedly in the last seventy-five years.¹⁷¹ Previous approaches to separating “good” cases from “bad” cases have either failed or achieved questionable success.¹⁷² As means to screen litigation, security for expenses statutes in derivative litigation and the most adequate plaintiff provisions of the PSLRA have depended on a correlation between share ownership and sufficient motivation to monitor and control litigation efficiently—a correlation that may be statistically supportable, but that does not in any way assure thoughtful evaluation in any particular case.¹⁷³ In contrast, the special litigation committee procedure in derivative litigation, while it certainly adopts a case-specific focus, suffers from substantial judicial skepticism due to

168. See Steinberg, *supra* note 56, at 5-7 (providing examples of the role that special litigation committees play in derivative lawsuits).

169. See *supra* Part II.C.

170. See *supra* Part III.A.

171. See *supra* Part II.

172. See *supra* Part II.

173. See *supra* Part II.B.

the possibility of structural bias, and as a result has become a costly and relatively rarely used approach to controlling litigation.¹⁷⁴

The Litigation Review Committee Bylaw proposed in this Article exploits the evolving authority for litigation-regulating bylaws and attempts to take advantage of the virtues and avoid the shortcomings of earlier approaches to limiting stockholder litigation.¹⁷⁵ By empowering a committee selected by the company's largest stockholders to require dismissal of claims in stockholder class and derivative litigation, the Litigation Review Committee Bylaw draws on the best elements of (1) the security for expenses statutes and the most adequate plaintiff provisions of the PSLRA—in particular, their reliance on a correlation between share ownership and optimal litigation choices—and (2) the special litigation committee, with its case-specific review of the merits of litigation involving the corporation's internal affairs. Possible lack of interest on the part of large stockholders in selecting committee members, and the costs of the work of a Litigation Review Committee, may make the proposed bylaw relatively unattractive as a preferred means for addressing stockholder class and derivative action. But, it may be a useful option in certain situations and may commend itself as an experiment in using authority to regulate internal affairs litigation through bylaw provisions.

174. See *supra* note 145 and accompanying text.

175. See *supra* Part III.C.

APPENDIX

THE LITIGATION REVIEW COMMITTEE BYLAW

Article [X], Section [A]

(a) No stockholder may continue to prosecute an internal corporate claim, as defined in Section 115 of the Delaware General Corporation Law, derivatively on behalf of the corporation or on behalf of a class of stockholders of the corporation, if, within 120 days after such claim is first asserted in a complaint or other pleading, the prosecution of that claim is disapproved by or on behalf of the Litigation Review Committee. If the Litigation Review Committee timely disapproves of the prosecution of the claim, the stockholder shall be deemed to have consented to the dismissal of the claim on motion of the corporation, unless (i) the disapproval was procured by corruption, fraud, or undue means, (ii) there was evident partiality or corruption on the part of any of the members of the Litigation Review Committee, or (iii) the members were guilty of misconduct in connection with their disapproval.

(b) The Litigation Review Committee shall be comprised of [three] individuals elected in accordance with the following procedure:

(i) Within 10 days after each annual meeting of stockholders, the Secretary of the corporation shall identify the [three] persons, other than any affiliate or associate of the corporation or any of its directors, holding the beneficial interest in the largest number of shares of the corporation's common stock as most recently reported on beneficial ownership reports filed with the Securities and Exchange Commission;

(ii) Within two days after doing so, the Secretary shall request that each such stockholder select an individual (who may but need not be affiliated with such stockholder) to serve as a member of the Litigation Review Committee for a term of one year or until his or her successor is elected and qualified;

(iii) Within 10 days after such request, each such stockholder shall advise the Secretary of the name and address (including email address) of the individual selected to serve;

(iv) Upon receipt of such names by the Secretary, the individuals selected shall be deemed to be constituted as the Litigation Review Committee;

(v) If a stockholder identified in accordance with subparagraph (i) declines to select an individual to serve as a member of the Litigation Review Committee, the Secretary may request that the holder of the next largest number of the corporation's shares select such an individual.

(c) Members of the Litigation Review Committee may not be removed as such except by a vote of stockholders.

(d) Members of the Litigation Review Committee may be compensated for their services as members of the committee by the corporation or the stockholder who selected them, or both.

(e) For proceedings arising out of their actions or inactions as members, the corporation shall agree that members of the Litigation Review Committee shall have the most extensive rights to indemnification and advancement of fees and expenses arising from their service as members of the committee that are provided for any of the directors and officers of the corporation.

(f) For purposes of quorum and voting requirements, meetings, and notice of meetings, the Litigation Review Committee shall be considered to be a committee of the board of directors, except that the Litigation Review Committee may not act by unanimous written consent to disapprove the prosecution of an internal corporate claim.