U.S. CHAMBER
Institute for Legal Reform

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To Members of the Delaware Senate Judiciary Committee:

On behalf of the U.S. Chamber Institute for Legal Reform (ILR)—an affiliate of the U.S.Chamber of Commerce dedicated to making our nation's overall civil legal system simpler, fairer and faster for all participants—I urge you to decline to enact SB 75 and instead ask the Delaware Bar, after consultation with Delaware's Executive and Judicial Branches, as well as with the business community and other interested groups, to submit proposals that will give the Court of Chancery additional authority to deter the filing and prosecution of abusive lawsuits that today impose significant burdens on innocent shareholders. Please accept this letter as our testimony in opposition to SB 75 in its current form.

SB 75 would partially codify Court of Chancery decisions permitting corporations to adopt bylaws designating an exclusive forum for intracorporate litigation. Those rulings were an important step forward in eliminating the ability of plaintiffs' lawyers to coerce unjustified settlements by subjecting corporations to copycat lawsuits in multiple jurisdictions. Codifying the legal *status quo* in Delaware's corporation law would certainly be useful, although the proposal fails that test because it is more restrictive than current law.[1]

SB 75 also would impose a limitation, not embodied in existing law, on the ability of stock corporations to adopt a bylaw or charter provision providing for a losing party in intracorporate litigation to pay the winning party's attorneys' fees—no matter how unjustified the losing party's position in the litigation.

[1] The bill differs from the Court of Chancery's decisions by imposing a new, unjustified restriction on a corporation's ability to select, for example, the courts of its principal place of business as the forum for this type of litigation; the bill requires that any forum-selection provision permit suits to be brought in Delaware. The effect of that restriction, of course, is to provide a strong incentive for companies to select Delaware as the exclusive forum—because they otherwise would subject themselves to the very copycat litigation that the provision is designed to eliminate. We do not see any justification for this new restriction, which appears to rest entirely on suspicion of the ability of other States' courts to apply Delaware law—a suspicion that squarely conflicts with our nation's federal structure in general and the U.S. Constitution's Full Faith and Credit Clause in particular.

This proposal, if adopted, would eliminate an important mechanism that corporations have turned to in order to protect innocent shareholders against the significant costs of abusive litigation without providing an adequate replacement tool—either to corporations or to the Court of Chancery—to deter the filing and prosecution of these illegitimate actions. Particularly in light of the proposal's validation of forum-selection bylaws, Delaware must address the substantive problem of abusive lawsuits, which are now likely to become centralized in Delaware's courts.

ILR and the Chamber have long been concerned about the well-documented, widespread abuse in connection with lawsuits challenging merger and acquisition transactions. In 2012, ILR released a detailed study of the issue entitled *The Trial Lawyers' New Merger Tax*[2], and the problem was highlighted at our Legal Reform Summit that same year. As you know, several members of Delaware's distinguished Court of Chancery have expressed concern about this problem in recent years. There is good reason for that broad agreement—the data demonstrate that our country's M&A litigation system is broken:

- For the past four years (2011-2014), 93% of all transactions valued over $100 million have been challenged by one or more lawsuits[3]—can anyone seriously believe that every such deal violates the law, and that things have gotten so much worse since 2005, when only 39% of such deals triggered a lawsuit?[4]

- These cases virtually never result in a judgment on the merits, relatively few are dismissed, and an overwhelming number (70% or more) settle.[5]

- Most settlements—79% over the past four years—require only additional disclosures; just 6% produce additional compensation for shareholders (the rest involved other changes to deal terms, such as a reduced termination fee)[6]; ten years ago more than half resulted in a monetary benefit and only 10% were disclosure only.[7]

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[2] *See* Andrew Pincus, *The Trial Lawyers' New Merger Tax* (Oct. 2012), available at http://www.instituteforlegalreform.com/uploads/sites/1/M_and_A.pdf.

[3] *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2014 M&A Litigation* at 1 (2015), available at https://www.cornerstone.com/GetAttachment-/897c61ef-bfde-46e6-a2b8-5f94906c6ee2/Shareholder-Litigation-Involving-Acquisitions-2014-Review.pdf.

[4] *The Trial Lawyers' New Merger Tax*, *supra*, at 2.

[5] *Shareholder Litigation Involving Acquisitions of Public Companies*, *supra*, at 4.

[6] *Id.* at 5.

[7] *The Trial Lawyers' New Merger Tax*, *supra*, at 5.

- Although shareholders typically get nothing, the lawyers who file these cases do well: an average fee award *for disclosure-only settlements* of more than $465,000 in Delaware's Court of Chancery (and nearly $100,000 more in other jurisdictions).[8] That is a substantial amount of money for cases that produce very little, if anything, in the way of benefit for shareholders.

It is important to keep in mind, moreover, that this data does not quantify the burden that abusive lawsuits impose on innocent shareholders—in terms of defense costs, diversion of management time and attention, and deals not pursued because the total "merger tax" made them uneconomic.

More recently, attention has been focused on another element of abuse—the use of "professional plaintiffs" to file these actions. A study conducted by three law professors found that

> repeat plaintiffs are common because states typically do not limit the number of lawsuits that individual plaintiffs are allowed to file. As a result, law firms can use the same individuals time and again as plaintiffs in their lawsuits. Some individuals have filed 30, 40, or even 50 shareholder lawsuits over the past several years. Other plaintiffs' lawyers have themselves served as repeat plaintiffs or named close family members as plaintiffs.
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> In a time when nearly all large mergers and acquisitions are challenged in court, the legal system needs shareholder plaintiffs who are ready and willing to protect absent class members from frivolous lawsuits. . . . [R]epeat plaintiffs with interests that separate them from the rest of the class are often unable to perform this crucial role.[9]

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[8] Robert M. Daines & Olga Koumrian, *Shareholder Litigation Involving Mergers and Acquisitions: Review of 2013 M&A Litigation* at 2, available at http://www.cornerstone.com/GetAttachment/7bd80347-124b-4b69-add5-575e33c3f61b/Settlements-of-M-and-A-Shareholder-Litigation.pdf.

[9] Stephen Choi, Jessica Erickson & Adam Pritchard, *Frequent Filers: The Problem of Shareholder Lawsuits and the Path to Reform* (March 2014), available at http://www.instituteforlegalreform.com-/uploads/sites/1/Frequent_Filers_Final_Version.pdf).

A recent Reuters investigative report concerned one plaintiff who has filed forty such claims, and never obtained a monetary benefit for shareholders.[10]

This problem, of course, is not a new one. It is one of the abuses of federal securities class actions addressed by the Private Securities Litigation Reform Act. The Senate Report on that legislation explained how this phenomenon contributes to the filing of abusive claims: "The proliferation of 'professional' plaintiffs has made it particularly easy for lawyers to find individuals willing to play the role of wronged investor for purposes of filing a
class action lawsuit. Professional plaintiffs often are motivated by the payment of a 'bonus' far in excess of their share of any recovery."[11] As a result, the litigation is controlled by lawyers, and not by a client whose desire to redress an injury led to the filing of the lawsuit.

On the positive side, forum-selection bylaws appear to be addressing yet another form of abuse in M&A lawsuits—the filing of multiple lawsuits in multiple states challenging the same transaction, which forces the company (and therefore the innocent shareholders) to agree to payments to multiple plaintiffs' attorneys in order to resolve the litigation.[12] A survey of 2014 data found that 60% of deals were challenged in only one jurisdiction, compared to past years when that was true of only 40%.[13]

Of course, adoption of these bylaws will mean that—given Delaware's preeminence as a corporate domicile—more of these cases will be filed in Delaware, and only in Delaware. It is therefore critical that Delaware address the problem of abusive lawsuits. After all, innocent shareholders will not benefit if these lawsuits become centralized in Delaware but abusive suits continue to be brought. The result would be more work for Delaware lawyers—particularly in light of the new restriction on forum-selection bylaws (see note 1, *supra*), but continued harm to Delaware shareholders.

What is needed are additional tools that the Court of Chancery can use, when appropriate, to eliminate the incentives to file unjustified lawsuits in the first place,

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[10] Thomas Hals, *A TV stock picker's other life: leading an onslaught of class action suits*, Reuters (Feb. 18, 2015), available at http://www.reuters.com/investigates/special-report/lawsuit-class-kramer/.

[11] S. Rep. 104-98, 104th Cong., 1st Sess. 10 (1994).

[12] *See The Trial Lawyers' New Merger Tax*, *supra*, at 6-7.

[13] *Shareholder Litigation Involving Acquisitions of Public Companies*, *supra*, at 3.

and that address some of the more flagrant abuses such as the use of professional plaintiffs. Limiting corporations' authority to adopt fee-shifting bylaws, and thereby depriving them of the ability to protect shareholders against the costs of these claims, without at the same time providing such solutions is unjustified and unwise, and entirely inconsistent with Delaware's tradition of a fair, clear legal framework.

First, the Delaware Bar has expressed the view that the Court of Chancery has all of the authority it needs to deter abusive filings. The facts simply do not support that contention: Delaware has not been immune from the epidemic of abuse in this area. Indeed, Court of Chancery rulings appear to establish the principle that any additional disclosure in connection with an M&A transaction presumptively can merit a several hundred thousand dollar attorneys' fee award.[14] That is a considerable incentive to file a lawsuit with respect to any proposed transaction, regardless of the merits of the claim.

And there is no significant downside risk to filing an unjustified claim. The costs of discovery are borne principally by the defendant, and the plaintiffs' other costs of litigation are minimal. An entrepreneurial lawyer therefore has every incentive to challenge as many transactions as possible in order to maximize his or her chances to recover fee awards.[15]

This calculus would be quite different if a plaintiff who filed abusive claims faced a real risk of having to pay a prevailing defendant's legal fees, but there is no such risk under current Delaware law. That is because Delaware, including the Court of Chancery, follows the "American rule," which provides that "parties to litigation generally must pay their own attorneys' fees and costs."[16] The only exceptions under which a losing plaintiff must pay the defendant's fees require proof of "bad faith"—"where the losing party has acted in bad faith, vexatiously, wantonly, or for oppressive

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[14] *See, e.g., Sample v. Gumbiner*, C.A. No. 8833-VCN (July 31, 2014) (allocated award of $202,500); *In re True Religion*, Ca.A. No. 8598-VCG (Del. Ch. 2014) ($400,000); *In re KSW*, C.A. No. 7875-VCG (Del. Ch. 2013) ($360,000); *In re Complete Genomics*, C.A. No. 7888-VCL (Del. Ch. 2013) ($315,000); *In re SauerDanfoss Inc. Shareholders Litigation*, 2011 WL 2519210, at *17 (Del. Ch. Apr. 29, 2011) ($400-500,000).

[15] The claim that the Court of Chancery will be able to use its authority to approve fee awards to deter abusive filings (by, for example, reducing fees for disclosure-only settlements or even refusing to approve such settlements) misunderstands the dynamic nature of litigation systems and the entrepreneurial acuity of plaintiffs' lawyers—something that we at ILR have observed in multiple contexts. Faced with reduced fees for such settlements, plaintiffs' lawyers, who depend on this litigation for their livelihoods, are just as likely (perhaps more likely) to raise the price of settlement or require innocent companies to expend even more in litigation costs, and thereby inflict an even greater financial burden on innocent shareholders.

[16] *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014); *see also, e.g., MBKS Co. v. Reddy*, 924 A.2d 965, 977 (Del. Ch. 2007), *aff'd*, 945 A.2d 1080 (Del. 2008).

reasons"[17]—or frivolousness.[18] The Court of Chancery has said that it "seldom invoke[s]" such exceptions.[19]

One way to provide the necessary, but now absent, downside risk for filing abusive claims would be to expand the Court of Chancery's discretionary authority to shift fees to include cases that plainly should not have been brought but that do not satisfy the extremely narrow "bad faith" or "frivolousness" exceptions. The U.S. Congress is considering just that approach to address the strikingly-similar problem of abusive patent litigation—just last Congress, the House of Representatives passed such a tailored, targeted fee-shifting proposal by an overwhelming bipartisan vote.[20] And a similar measure was just introduced by a bipartisan group of Senators.[21]

The Delaware Bar's discussion of the adverse consequences of fee-shifting assumes an across-the-board "loser pays" rule that would shift fees in every case. The Bar never addressed more limited standards such as those set forth in the federal legislation—standards that plainly could not have those adverse consequences because of their restricted scope, but that would provide an important disincentive to the filing of illegitimate lawsuits that harm, rather than benefit, innocent shareholders. And given the Bar's recognition that Delaware's courts undertake a "case-by-case, sophisticated approach to adjudication," with which we agree, there is little risk that the Court of Chancery will exercise this additional authority in anything other than an appropriate manner.

Second, professional plaintiffs are an obvious source of abusive lawsuits, and Delaware should address that problem as well. A plaintiff invoking the jurisdiction of the Court of Chancery should be required to disclose prior representative actions filed in state or federal court and represent that he or she is not being compensated in any manner for serving as plaintiff. In addition, parties who have filed multiple actions should be prohibited from instituting additional representative claims unless the Court of Chancery finds good cause to permit them to do so. Similar provisions were included

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[17] *MBKS*, 924 A.2d at 977 (internal quotation marks omitted); *see also P.J. Bale, Inc. v. Rapuano*, 888 A.2d 232, at *1 (Del. 2005); *Choupak v. Rirkin*, 2015 WL 1589610, at *21–23 (Del. Ch. 2015).

[18] Court of Chancery Rule 11.

[19] *Dobler v. Montgomery Cellular Holding Co.*, 2004 WL 5382074, at *19 (Del. Ch. 2004); *see also Soterion Corp. v. Soteria Mezzanine Corp.*, 2012 WL 5378251, at *18 (Del. Ch. 2012) ("Only rarely do Delaware courts deviate from the American Rule.").

[20] H.R. 3309, § 3(b), 113th Cong., 1st Sess. (Dec. 5, 2013), which passed the House by a vote of 325-91. The House Report's description of the problem of patent litigation abuse is quite similar to the abusive of M&A litigation. S. Rep. 113-279, 113th Cong., 1st Sess. 21-22 & 58-59 (2013).

[21] S. 1137, § 7(b), 114th Cong., 1st Sess. (2015).

in the Private Securities Litigation Reform Act, passed with bipartisan support in 1995, to address the similar problem of professional plaintiffs in federal securities litigation.[22]

Delaware has a long tradition of fair, thoughtful corporate law standards. SB 75 skews the playing field in one direction—toward illegitimate lawsuits—and calls into question Delaware's commitment to maintaining the balanced legal system that until now has been the hallmark of its corporate franchise. Requiring the Bar to supplement its proposal with measures to give the Court of Chancery additional authority to deal with abusive lawsuits is essential if Delaware is to continue to provide an equitable legal framework.

Thank you for considering these views.

Sincerely,

Harold Kim

[22] *See* 15 U.S.C. §§ 77z-1(a) & 78u-4(a)).