U.S. CHAMBER
Institute for Legal Reform

Harold H. Kim
Executive Vice President
hkim@uschamber.com
202.463.5599 direct

May 6, 2015

To Members of the Delaware Senate:

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 in its current form. Instead, you should 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.

SB 75 would partially codify Court of Chancery decisions permitting corporations to adopt bylaws designating an exclusive forum for intracorporate litigation. Codifying the legal *status quo* would be useful, but this proposal is more restrictive than current law.[1]

SB 75 also would impose a new limitation 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.

This proposal, if adopted, would eliminate an important mechanism that corporations invoke to protect innocent shareholders against the costs of abusive litigation—***without providing an adequate replacement tool to deter the filing and prosecution of these illegitimate actions.***

The widespread abuse in connection with lawsuits challenging merger and acquisition transactions is well-documented:

[1] The bill imposes a new, unjustified restriction on a corporation's ability to select, for example, the courts of its principal place of business as the exclusive forum; it requires that any forum-selection provision permit suits to be brought in Delaware. That provides a strong incentive for companies to select Delaware as the exclusive forum—to avoid subjecting themselves to the copycat litigation in multiple courts that the provision is designed to eliminate.

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

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

- 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); ten years ago more than half resulted in a monetary benefit and only 10% were disclosure only.

- 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). That is a substantial amount of money for cases that produce very little, if anything, in the way of benefit for shareholders.

This data does not include defense costs, diversion of management time and attention, and the costs of deals not pursued because the total "merger tax" made them uneconomic.

More recently, attention has been focused on a second element of abuse—the use of "professional plaintiffs." A study conducted by three law professors found that "[s]ome individuals have filed 30, 40, or even 50 shareholder lawsuits over the past several years." A recent Reuters investigative report concerned one plaintiff who has filed ***forty*** such claims, and never obtained a monetary benefit for shareholders.

Forum-selection bylaws appear to be addressing one aspect of the problem—the filing of multiple lawsuits in multiple states challenging the same transaction. 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.

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, 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.

First, the Delaware Bar has said that the Court of Chancery has all of the authority it needs to deter abusive filings. But 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. That is a considerable incentive to file a lawsuit, 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.[2]

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 Delaware follows the "American rule," which provides that parties to litigation generally pay their own attorneys' fees unless the losing party has acted in bad faith or the claim is frivolous.

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—the House of Representatives passed such a tailored, targeted fee-shifting proposal by an overwhelming bipartisan vote in 2013, and a similar measure was just introduced by a bipartisan group of Senators.[3]

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 the very different effect of more limited standards such as those set forth in the federal legislation. And given the Bar's recognition that Delaware's courts

---

[2] The Court of Chancery cannot 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). Faced with reduced fees, plaintiffs' lawyers, who depend on this litigation for their livelihoods, will 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.

[3] H.R. 3309, § 3(b), 113th Cong., 1st Sess. (Dec. 5, 2013), which passed the House by a vote of 325-91; S. 1137, § 7(b), 114th Cong., 1st Sess. (2015).

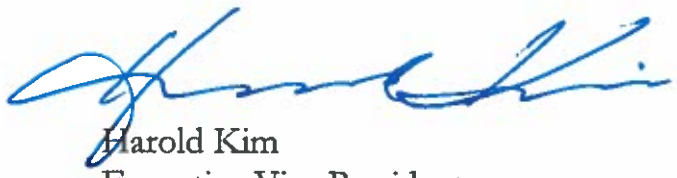
undertake a "case-by-case, sophisticated approach to adjudication," with which we agree, there is little risk that the Court of Chancery will exercise this additional authority in anything other than an appropriate manner.

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 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 in the Private Securities Litigation Reform Act, passed with bipartisan support in 1995, to address the problem of professional plaintiffs in federal securities litigation.[4]

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.

Thank you for considering these views.

Sincerely,



Harold Kim
Executive Vice President

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