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The Lost Lessons of Shareholder Derivative Suits

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Abstract

Merger litigation has changed dramatically. Today, nearly every announcement of a significant merger sparks litigation, and these cases look quite different from merger cases in the past. These cases are now filed primarily outside of Delaware, they typically settle without shareholders receiving any financial consideration, and corporate boards now have far more ex ante *power to shape these cases. Although these changes are often heralded as unprecedented, they are not. Over the past several decades, derivative suits experienced many of the same changes. This Article explores the similarities between the recent changes in merger litigation and the longer history of derivative suits. The trajectories of these lawsuits are not identical, but they nonetheless suggest larger lessons about shareholder litigation, including the predictable ways in which agency costs play out in the courtroom and at the settlement table. By uncovering the lost lessons of derivative suits, corporate law can finally tackle the deeper issues facing shareholder litigation.*

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Table of Contents

I. Introduction 1132

II. The Different Paths of Shareholder Litigation 1136
  A. Common Entrepreneurial Roots 1137
  B. Different Historical Trajectories 1140

III. The Hidden Similarities 1147
  A. Nonmonetary Settlements 1148
    1. Merger Litigation 1148
    2. Derivative Suits 1151
  B. A Race from Delaware's Courts 1156
    1. Merger Litigation 1156
    2. Derivative Suits 1160
  C. Board as Litigation Gatekeeper 1166
    1. Merger Litigation 1166
    2. Derivative Suits 1170

IV. Uncovering the Lost Lessons of Derivative Suits 1175
  A. Rethinking Settlements 1176
  B. Rethinking Forum 1180
  C. Rethinking Gatekeepers 1187

V. Conclusion 1195

I. Introduction

Merger litigation has changed in unprecedented ways. Just fifteen years ago, it was relatively rare for shareholders to file class actions to challenge mergers and acquisitions.[1] Today, these suits are ubiquitous,[2] and they look different than they ever did in the past. The settlements in these suits have changed. Shareholders no longer receive any money from most

1. *See* Matthew D. Cain et al., Essay, *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 621 tbl.1 (2018) (presenting data illustrating that, in 2005, only thirty-seven percent of mergers involving U.S. public companies with a transaction size of at least $100 million were challenged in court).

2. *See id.* (stating that 85 percent of mergers meeting this definition were challenged in 2017).

settlements of these cases, with most instead involving additional disclosures that are of little value.[3] The forums have changed. Merger cases used to be filed in Delaware and other state courts,[4] but they fled to federal court after Delaware started to crack down on them.[5] And the power of corporate boards has changed. Delaware now gives corporate boards enhanced powers to control these suits through the adoption of procedural rules in corporations' governing documents.[6] Corporate law has never seen anything like this.

Except that it has. Decades before these transformations began in merger litigation, derivative suits experienced many of these same changes.[7] Indeed, the similarities between the history of derivative suits and the more recent changes in merger litigation are striking. In derivative suits, for example, as in merger litigation, the case rarely ends with the plaintiff receiving any money as part of the settlement.[8] Instead, nonmonetary settlements where the corporation promises to make certain corporate governance reforms are far more common.[9] Similarly, just like in merger litigation, derivative suits used to be filed primarily in state court,[10] but they are now more commonly filed in federal court.[11] And just as Delaware

3. *See id.* at 623 tbl.3 (finding that 90 percent of merger settlements in 2017 were disclosure-only).

4. *See id.* at 621 tbl.1 (illustrating that only 7 percent of merger cases in 2005 were filed in federal court).

5. *See id.* (highlighting that 87 percent of merger cases in 2017 were filed in federal court).

6. *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 559 (Del. 2014) (declaring that the boards of Delaware corporations can include new procedural rules to govern fiduciary duty claims filed by their shareholders as long as these rules were adopted "for a proper purpose").

7. *See generally* Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749 (2010) [hereinafter Erickson I] (presenting an empirical examination of shareholder derivative suits in the federal courts).

8. *See id.* at 1754 ("Remarkably few of the [derivative] suits in my study ended with the corporation receiving a meaningful financial benefit.").

9. *See id.* at 1754–55 (explaining that modern settlement agreements often lack recompense but instead include certain actions that must be completed by the board).

10. *See infra* Part III.B.2.

11. *See infra* Part III.B.2.

now gives corporate boards more power to rein in merger litigation, Delaware has long given corporate boards the power to limit derivative suits, through both the demand requirement and special litigation committees.[12] When it comes to shareholder litigation, history is repeating itself.

The irony is that few have noticed. Scholars have long noted the common entrepreneurial roots of different types of shareholder litigation,[13] but these suits are otherwise analyzed within their own silos.[14] As a result, as merger litigation changed dramatically, few recognized the similarities to the earlier history of derivative suits.

These similarities matter because they reveal larger lessons about shareholder litigation. First, the similarities illustrate that the disclosure-only settlements in merger settlements are not a wholly new development. They are instead a variation on the nonmonetary settlements that have long been common in corporate law.[15] Viewed as a whole, these settlements illustrate how the agency costs inherent in representative litigation can impact negotiations at the settlement table.[16] Recognizing the common features of nonmonetary settlements in these different types of cases will

12. *See infra* Part III.C.2.

13. *See, e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 3 (1991) ("[P]laintiffs' class and derivative attorneys function essentially as entrepreneurs who bear a substantial amount of the litigation risk and exercise nearly plenary control over all important decisions in the lawsuit.").

14. *Compare* Cain et al., *supra* note 1, at 610–30 (analyzing data on merger class actions), *with* Erickson, *supra* note 7, at 1760–80 (analyzing data on derivative suits). Indeed, the more recent articles discussing both types of litigation focus on their differences. *See, e.g.*, Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 47 (2015) ("Corporate benefit should be returned to its doctrinal origins—the derivative suit—and no longer recognized as a justification for fee awards in the class action context.").

15. *See supra* notes 8–9 and accompanying text.

16. *See* Jessica Erickson, *The Gatekeepers of Shareholder Litigation*, 70 OKLA. L. REV. 237, 243–45 (2017) [hereinafter Erickson II] (explaining the risk of attorneys and defendants settling to benefit themselves at the expense of the shareholders).

also make it easier to recognize whatever variation of these settlements appears in the future.[17]

Second, the similarities demonstrate the limitations of relying on any one court to police shareholder lawsuits. The Delaware Court of Chancery has played a key role in overseeing shareholder litigation, helping to ensure that shareholders can hold corporate managers accountable for their misdeeds in court while keeping the agency costs of these suits in check.[18] Yet, in both merger litigation and derivative suits, shareholders left the Delaware Court of Chancery for federal court, at least in part to avoid the scrutiny of Delaware judges.[19] This forum shopping illustrates that Delaware alone cannot solve the problems with shareholder litigation.

Finally, the similarities expose the dangers of relying on corporate boards to oversee shareholder lawsuits. Given the bedrock principle that corporate boards oversee the business and affairs of corporations,[20] it is not surprising that courts have looked for ways to allow boards to exercise oversight over shareholder lawsuits, either through the adoption of new rules to govern these suits in corporate bylaws and charters or through procedures such as the demand requirement and special litigation committees (SLC).[21] Yet the legal system has never fully grappled with the conflicts of interests that arise when directors' power extends to claims that may someday be filed against them.[22]

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17. *See infra* Part IV.A.

18. *See* E. Norman Veasey & Michael P. Dooley, *The Role of Corporate Litigation in the Twenty-First Century*, 25 DEL. J. CORP. L. 131, 141 (2000) ("For the past 100 years, [Delaware] has been the laboratory where our most fundamental concepts of corporate governance have been developed and refined.").

19. *See infra* Part II.B.

20. *See* DEL. CODE ANN. tit. 8, § 141(a) (2019) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of the board of directors . . . .").

21. *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 784 (Del. 1981) (stating that the purpose of the demand requirement is to allow the board to adjudge whether a derivative suit would be detrimental to the company).

22. *Cf.* Amy Simmerman, Brad Sorrels & Lori Will, *Year in Review: Delaware Corporate Law and Litigation*, HARV. L. SCH. F. ON CORP.

This Article examines the lost lessons of shareholder litigation by analyzing the similar evolution of merger litigation and derivative suits. Part II explores how these lawsuits appear to be quite different, despite their common entrepreneurial roots. Part III then turns to the hidden similarities between these lawsuits, examining their common experiences with nonmonetary settlements, forum shopping, and director oversight. Part IV steps back and analyzes the broader lessons from these similarities.

To be clear, the point of this Article is not that these different types of shareholder litigation have followed identical trajectories. There are a number of important differences. The rise of merger litigation, for example, was quite sudden as was its later flight to federal court,[23] while derivative suits evolved more slowly and without nearly as much public attention.[24] These suits also address different types of misconduct and are brought on behalf of different parties,[25] so the comparison can only go so far. Yet by stepping back and analyzing their similarities, we can glean broader insight into the lost lessons of shareholder litigation.

II. The Different Paths of Shareholder Litigation

Corporate law has long offered shareholders a variety of litigation options to police the behavior of corporate managers.[26] These lawsuits are typically representative suits—derivative suits, for example, are filed on behalf of plaintiff corporations, while merger lawsuits are filed on behalf of a shareholder class.[27] The representative nature of these suits means that the plaintiffs' attorneys have more power than in typical litigation,

GOVERNANCE (Feb. 10, 2020), https://perma.cc/2565-EYSU (critiquing the traditional efficacy of SLCs while also noting that the Court of Chancery has recently shifted from a trend of deference to allowing some plaintiffs to proceed depending on the severity of the underlying complaint).

23. *See infra* Parts II.B, III.B.

24. *See infra* Parts II.B, III.B.

25. *See infra* notes 29–33 and accompanying text.

26. *See* Erickson II, *supra* note 16, at 237–38 (listing the various ways shareholders can redress corporate misconduct).

27. *See id.* at 241 (discussing shareholder lawsuits).

which can lead to abuses.[28] This Part first examines the common entrepreneurial roots of derivative suits and merger litigation before turning to how these similarities have nonetheless led to very different historical trajectories for the two types of lawsuits.

A. Common Entrepreneurial Roots

Shareholder derivative suits address different types of corporate governance challenges, which can easily mask their similarities. Shareholder derivative suits are brought on behalf of a plaintiff corporation,[29] and any recovery from the litigation goes to the corporation itself, rather than to the shareholders.[30] In contrast, merger lawsuits are typically class actions,[31] with one or more shareholders filing the litigation on behalf of a class of shareholders.[32] Any recovery from these lawsuits goes directly to the shareholders.[33]

Despite these differences, however, derivative suits and merger litigation share common entrepreneurial roots that distinguish them from traditional civil litigation. In most civil cases, the parties have a direct financial interest in the

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28. *See id.* at 242–45 (explaining the possible abuses of plaintiffs' attorneys in shareholder lawsuits).

29. *See* John Matheson, *Restoring the Promise of the Shareholder Derivative Suit*, 50 GA. L. REV. 327, 344 (2016) ("A derivative action allows shareholders to bring a suit against directors or officers in the name of the corporation itself.").

30. *See* Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 81 (2008) [hereinafter Erickson III] ("Any recovery in a derivative suit is returned to the corporation.").

31. *See* Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 135 (2004) [hereinafter Thompson & Thomas I] (describing this category of litigation as "class action lawsuits filed under state law challenging director conduct in mergers and acquisitions").

32. *See* Sean J. Griffith & Anthony A. Rickey, *Objections to Disclosure Settlements: A How-to Guide*, 70 OKLA. L. REV. 281, 292 (2017) (discussing the definition of the settlement class in merger lawsuits).

33. *Cf.* 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, 566 (2015) (referring to the slim likelihood that the plaintiff class will recover money in a merger lawsuit).

litigation because their money is on the line.[34] As a result, they have an incentive to monitor their attorney and make sure that the attorney is acting in their best interest.[35] This incentive to monitor allows the legal system to take a more hands off approach to these cases, respecting the parties' decisions regarding the course of the litigation as long as they comply with generally applicable rules.[36]

Shareholder litigation, however, is primarily representative litigation, which means that the true parties in interest do not control the litigation.[37] Instead, one or more shareholder plaintiffs represent the corporation or a broader class of shareholders.[38] In theory, these representative plaintiffs should monitor the litigation, ensuring that their attorneys act in the best interest of the true parties in interest.[39] Yet representative plaintiffs only receive their pro rata share of any

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34. *See* Erickson II, *supra* note 16, at 241 ("[In most cases,] a client can monitor his or her attorney's decisions, questioning those that do not appear to be in the client's best interests and ultimately firing the attorney if the client's wishes are not followed."); Hillary A. Sale, *Judges Who Settle*, 89 WASH. U. L. REV. 377, 390 (2011) ("Unlike individual private cases, like a contract dispute, aggregate and derivative parties cannot simply settle the case and dismiss their claims.").

35. *See* Erickson II, *supra* note 16, at 241 ("Whether the case is a multi-million dollar securities class action or a run-of-the-mill negligence case, there is always a concern that a lawyer will act in his or her own best interests rather than in the interests of the client.").

36. *See id.* (providing a practical example of how agency costs are reduced in certain classes of lawsuits).

37. *See* Thompson & Thomas I, *supra* note 31, at 148 (highlighting that representative litigation spreads risk across individual shareholders therefore lessening the marginal benefit for additional cost of monitoring attorneys).

38. *See, e.g.*, Deborah A. DeMott, SHAREHOLDER DERIVATIVE ACTIONS: LAW & PRACTICE § 1:1 (2020)

> A derivative suit differs in a fundamental respect from a class action brought by a corporation's shareholders. Both are representative actions, but the claims asserted in a derivative suit are those of the corporation, while the claims asserted in a class action are individual claims of injury suffered by the shareholders themselves.

39. *See* Erickson II, *supra* note 16, at 241 (explaining that, in more traditional litigation, plaintiff's take a more active role in monitoring their attorneys).

settlement in a class action.[40] In a derivative suit, their financial stake is even more attenuated because any recovery goes to the corporation and therefore the corporation's shareholders only benefit indirectly from the litigation.[41] As a result, in both merger litigation and derivative suits, representative plaintiffs often do not have sufficient financial interest to effectively monitor their attorneys.[42]

This financial reality leads to plaintiffs' attorneys often having a far greater investment in the litigation than the representative plaintiffs.[43] This investment means that the attorneys typically control the litigation, with the representative plaintiff serving only a nominal role. In this way, plaintiffs' attorneys are like litigation entrepreneurs, deciding what claims to file and making nearly all of the decisions related to the litigation.[44] In the words of Professor John Coffee, the reality is that "class actions and other representative actions . . . are largely lawyer financed, lawyer controlled, and lawyer settled, subject to generally weak client control and only modest oversight by courts."[45]

This situation creates obvious and oft-discussed agency costs. Without significant control by their clients, plaintiffs' attorneys can make decisions that benefit themselves at the

40. *See* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 701 (1986) ("[In a derivative suit,] the recovery goes not to the shareholder plaintiff, but to the corporation.").

41. *See id.* ("[T]he actual plaintiffs benefit only to the extent of their pro rata interest in the corporation.").

42. *See* Erickson II, *supra* note 16, at 242 ("The shareholder plaintiff incurs all of the costs of monitoring the attorney, but receives only a fraction of the benefits.").

43. *See* Thompson & Thomas I, *supra* note 31, at 148 ("Plaintiffs' lawyers are the dominant players in representative shareholder litigation, whether derivative actions, securities fraud class actions, or state acquisition-oriented class actions.").

44. *See* Macey & Miller, *supra* note 13, at 3 ("[P]laintiffs' class and derivative attorneys function essentially as entrepreneurs who bear a substantial amount of the litigation risk and exercise nearly plenary control over all important decisions in the lawsuit.").

45. JOHN C. COFFEE, JR., ENTREPRENEURIAL LITIGATION: ITS RISE, FALL, AND FUTURE 5 (2015).

expense of these clients, acting more like principals than legal agents or fiduciaries. These attorneys can, for example, make trade-offs in settlement negotiations that leave more money in their own pockets.[46] They can also choose to abandon positive-value claims and put their resources into other cases that offer higher possible payouts.[47]

To be clear, these economic incentives do not always lead to outcomes that are bad for shareholders.[48] In some cases, representative plaintiffs have a significant financial stake in the litigation and therefore greater incentives to monitor their attorneys.[49] And just because these attorneys sometimes have the ability to prioritize their own financial interest does not mean that they will do so. Moral and ethical constraints will often temper the financial conflicts in these cases. Nonetheless, entrepreneurial litigation deviates from the traditional models of litigation in ways that necessitate greater attention and oversight.[50]

B. Different Historical Trajectories

Although derivative suits and merger litigation have common entrepreneurial roots, they have had very different

46. *See* Erickson II, *supra* note 16, at 242 ("[R]educed monitoring in shareholder litigation can increase agency costs by allowing attorneys to seek a higher percentage of the recovery for their fee.").

47. *See id.* at 242–43 (providing a quantitative example of this principle in action).

48. *See* Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623, 623–26 (2017) (arguing that commentators need to remember "the existence of a parallel universe of stockholder deal litigation that does not fit" the traditional narrative about shareholder litigation); Jessica Erickson, *The (Un)changing Derivative Suit*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 58, 64 (Sean Griffith, et al. eds., 2018) [hereinafter Erickson IV] ("Shareholder derivative suits have shone in addressing particular types of corporate misconduct, most recently the backdating of stock options.").

49. *See generally* James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter: An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587 (2006) (illustrating that lead institutional plaintiffs often have significant stakes in the litigation).

50. *See* Erickson II, *supra* note 16, at 245 (arguing for the implementation of gatekeepers for shareholder litigation).

historical trajectories. Derivative suits are one of the oldest forms of shareholder litigation, recognized by courts as early as 1830.[51] In their early years, corporations were in favor of derivative suits because they could use these suits to create federal diversity jurisdiction and bring their business disputes into federal court.[52] Even after courts put a stop to these tactics, derivative suits flourished as the primary way that shareholders could police corporate managers.[53] The Supreme Court recognized the importance of these suits, stating in 1949 that they were the "chief regulator of corporate management."[54]

As these suits gained prominence, however, courts and legislatures began to regulate them more heavily, concerned that many derivative suits were strike suits brought primarily for their nuisance value.[55] In the early to mid-1900s, several states passed new legislation requiring shareholder plaintiffs to post a substantial bond before filing suit unless they owned a certain percentage of the corporation's stock.[56] This procedural hurdle was accompanied by others. Shareholder plaintiffs had to establish, for example, that they owned shares in the plaintiff

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51. *See* Matheson, *supra* note 29, at 341–42 (recounting the early history of derivative suits in the United States and their initial analogy to trust law).

52. *See* Donna I. Dennis, *Contrivance and Collusion: The Corporate Origins of Shareholder Derivative Litigation in the United States*, 67 RUTGERS U. L. REV. 1479, 1486 (2015)

> The first shareholder derivative suit to reach the U.S. Supreme Court—the landmark 1856 case, *Dodge v. Woolsey*—arose from circumstances in which corporate managers and their counsel appear to have orchestrated a shareholder action to secure a result that the corporate entity was unlikely to achieve in its own right.

53. *See, e.g.*, Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multijurisdictional Litigation,* 106 NW. U. L. REV. 1753, 1756 (2012) ("Derivative suits were the dominant form of shareholder litigation for most of the twentieth century.").

54. Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949).

55. *See id.* (noting that these suits were "aptly characterized in professional slang as 'strike suits[,]'" that "were brought not to redress real wrongs, but to realize upon their nuisance value.").

56. *See* Randall S. Thomas, *The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation*, 61 VAND. L. REV. 299, 305 (2008) ("[Although derivative suits were initially lauded,] states soon began focusing on their potential to be used as strike suit litigation, passing statutes requiring plaintiffs in derivative actions to post bonds to insure that they could pay corporate defendants' attorneys' fees and expenses in frivolous suits.").

corporation at the time of the alleged misconduct and continued to hold this stock throughout the litigation.[57]

States also gave corporate boards more control over these suits. The core precept in corporate law is that boards of directors, not shareholders, control corporations.[58] Given the board's broad powers, it would normally decide whether the corporation should file a lawsuit.[59] Derivative suits are an exception to this general rule because the defendants in derivative suits typically include the corporation's directors, who cannot reasonably be expected to sue themselves.[60] Yet, courts began to fashion ways for corporate boards to take back control of derivative suits under certain circumstances. For example, they required all shareholder plaintiffs to make a demand on the corporation's board of directors before filing suit, with a limited exception in some jurisdictions if the shareholder plaintiff could show that demand would be futile.[61] Later, states began to allow boards to form special litigation committees that could review the allegations in the litigation and to petition the court to dismiss the suit if the committee determined that the suit was not in the best interests of the corporation.[62]

57. *See* J. Travis Laster, *Goodbye to the Contemporaneous Ownership Requirement*, 33 DEL. J. CORP. L. 673, 673 (2008) (critiquing the contemporaneous ownership requirement as incoherent and arbitrary).

58. *See* DEL. CODE ANN. tit. 8, § 141(a) (2019) (vesting corporate power with the board of directors).

59. *See, e.g.*, Agostino v. Hicks, 845 A.2d 1110, 1115–16 (Del. Ch. 2004) ("[Although i]t is black-letter law that the board of directors of a Delaware corporation exercises all corporate powers . . . [the law recognizes that] directors and officers of a corporation may not hold themselves accountable to the corporation for their own wrongdoing.").

60. *See, e.g.,* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 271 (1986) ("The derivative suit is a striking exception to this fundamental principle of corporate law.").

61. *See* Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1748–50 (2004) [hereinafter Thompson & Thomas II] ("As a practical matter, plaintiffs never make such a demand on the board, but rather plead that a demand would be futile.").

62. *See* Kenneth B. Davis, Jr., *The Forgotten Derivative Suit*, 61 VAND. L. REV. 387, 401–02 (2008) [hereinafter Davis I] (discussing the case law governing SLCs).

These procedural hurdles were meant to screen out frivolous derivative claims, but they did not fully accomplish their goal.[63] Study after study cast doubt on the value of derivative suits. Professor Roberta Romano published a well-known study of derivative suits filed on behalf of public companies in the 1980s and 1990s, finding that "[s]hareholder-plaintiffs . . . have abysmal success in court . . . [and] the proportion of derivative suits with a cash payout to shareholders (21 percent) is significantly lower than that of class actions (67 percent)."[64] More common were settlements in which the plaintiff corporation agreed to make "cosmetic organizational change[s]" to its corporate governance practices, which she hypothesized were primarily to justify the award of attorneys' fees to plaintiffs' counsel.[65] A study thirty years later found that federal derivative suits followed a similar pattern, with most settlements involving "corporate governance reforms that are often untested and/or patently unhelpful for both the corporations and their shareholders."[66]

Over time, battered by procedural hurdles and empirical criticism, derivative suits largely faded from view.[67] Their lackluster settlements rarely made the front pages of the financial press. Securities class actions stepped in to address many of the same types of claims that derivative suits had traditionally addressed.[68] And the rise of institutional investors meant that larger shareholders did not need to resort to

63. *See* Thomson & Thomas II, *supra* note 61, at 1791–92 (analyzing whether Delaware should remove some of the obstacles to derivative litigation).

64. Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 60–61 (1991).

65. *Id.* at 63 (stating that "[a] likely explanation" for these settlements "is the need to paper a record to justify an award of attorneys' fees to courts").

66. Erickson I, *supra* note 7, at 1830 (providing an empirical examination of shareholder derivative suits in the federal courts).

67. *See* Erickson IV, *supra* note 48, at 58–65 (discussing the "deep and systematic problems" with derivative suits).

68. *See* Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAND. L. REV. 859, 861 (2003) (arguing that corporate governance outside of acquisitions and self-dealing transactions "has passed to federal law and in particular to shareholder litigation under Rule 10b-5").

litigation because they had the economic clout to make their voices heard in the boardroom.[69] In this new world of corporate governance, derivative suits play a minimal role in policing corporate managers.[70] Today, when the scholarly literature mentions derivative suits, it often characterizes them as corporate law relics that are largely "dead" or "forgotten."[71]

Merger litigation has followed a very different historical path. These suits are not new—shareholders have long been able to file class actions to challenge mergers or acquisitions.[72] Until recently, however, they were relatively rare and uncontroversial. A study of merger class actions in 1999 and 2000 found that only 10 percent of deals were challenged in court.[73] They found that, on average, the takeover offers that were challenged in court ended up with a substantially higher premium than other offers.[74] In a related study, they found that "large monetary settlements [were] paid to shareholders in many of these cases [and] that these settlements involved a substantially lower percentage level of attorneys' fees as

69. *See* Kenneth B. Davis, Jr., *Structural Bias, Special Litigation Committees, and the Vagaries of Director Independence*, 90 IOWA L. REV. 1305, 1353–54 (2005) [hereinafter Davis II]

> The ensuing years have seen boards and board committees with larger numbers of more independent directors, activism by institutional investors, private enforcement of the federal securities laws, and white-collar criminal prosecution all emerge as powerful deterrents to corporate misconduct.

70. *See* Thomas, *supra* note 56, at 305 ("Empirical studies show that compared to federal securities class actions, or to state court acquisition-oriented class actions, derivative suits are running a weak third in terms of their importance to shareholders.").

71. *See* Davis I, *supra* note 62, at 389 (referring to derivative suits as "forgotten"); *see also* Thompson & Thomas II, *supra* note 61, at 1749 n.6 ("Like the proverbial cat, derivative suits have been pronounced dead on numerous occasions . . . ."); Veasey & Dooley, *supra* note 18, at 142 (stating that commentators have proclaimed derivative suits "dead and gone and buried").

72. *See* Ann M. Scarlett, *Shareholder Derivative Litigation's Historical and Normative Foundations*, 61 BUFF. L. REV. 837, 843 (2013) ("Examples of representative litigation are found in the 'earliest days of English law.'" (citations omitted)).

73. *See* C.N.V. Krishnan et al., *Shareholder Litigation in Mergers and Acquisitions*, 18 J. CORP. FIN. 1248, 1254 tbl.1 (2012) (reporting the statistics from the study).

74. *See id.* at 1248.

compared to securities fraud class actions."[75] Overall, they concluded that "we believe that acquisition-oriented class actions substantially reduce management agency costs, while the litigation agency costs they create do not appear excessive."[76]

This rosy picture soon changed. Over the next several years, the incidence of merger litigation increased dramatically.[77] By 2013, nearly all mergers and acquisitions were challenged in court, often in multiple jurisdictions.[78] Even more troubling, these cases rarely ended with shareholders receiving cash payments or a higher merger premium. Instead, the settlements often involved the corporation agreeing to disclose additional information about the merger itself or the process that led up to its approval by the target company's board.[79] Empirical studies cast doubt on the value of these disclosures.[80] In light of these findings, nearly everyone agreed that "merger litigation [was] fundamentally broken."[81]

Delaware took a number of steps to reform these cases and protect its litigation franchise. Indeed, Vice Chancellor Slights of the Delaware Court of Chancery stated in jest that his job had become "pick[ing] up a club . . . and beating the cases over the head."[82] The court encouraged corporations to adopt forum

75. Thompson & Thomas I, *supra* note 31, at 138.

76. *Id.* at 140.

77. *See* Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 476 (2015) (highlighting that the rate of merger litigation increased from 39.5 percent in 2005 to 92.1 percent in 2011).

78. *See id.* (presenting data on the rise of multijurisdictional merger litigation).

79. *See* Fisch et al., *supra* note 33, at 559 ("Although deal litigation is pervasive, these lawsuits rarely result in a monetary recovery for the plaintiff class. Rather, the vast majority end in settlement or dismissal. In most settled cases, the only relief provided to shareholders consists of supplemental disclosures in the merger proxy statement.").

80. *See id.* at 562 ("[W]e find no support for the second hypothesis—that is, disclosure-only settlements do not appear to affect shareholder voting in any way.").

81. Cain et al., *supra* note 1, at 610.

82. Matthew Diller & Joseph R. Slights III, Lecture, *Corwin v. KKR Financial Holdings LLC—An "After-Action Report,"* 24 FORDHAM J. CORP. & FIN. L. 1, 18–19 (2018).

selection clauses in their charters, ensuring that these suits could only be brought in Delaware.[83] It announced that it would reject any disclosure-only settlement that did not include "'plainly material' disclosures."[84] And it changed the substantive standards of review by which it reviewed mergers and acquisitions, giving more deference to deals that were approved by independent and fully informed shareholders.[85]

For a while, it looked like these reforms would work. The percentage of deals challenged in court started to fall.[86] Soon, however, plaintiffs' attorneys changed their strategies to circumvent these new hurdles. For example, they filed their claims outside of Delaware where they could, either by suing companies without forum selection clauses or by packaging their claims as federal securities class actions, which are not covered by many board-adopted forum selection clauses.[87] They also circumvented judicial review of their deals with defendants by casting these deals as mootness payments, rather than formal settlements.[88] Today, according to the most recent data, approximately 85 percent of mergers and acquisitions are challenged in court, only slightly less than the high water mark in 2013.[89] The market for merger litigation changed in response to Delaware's actions, but it definitely did not disappear.

As these brief histories reveal, derivative suits and merger litigation have been on different historical trajectories for the

83. *See In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) (suggesting that judicial oversight would be more effective if counsel included forum selection clauses).

84. *In re* Trulia, Inc. S'holder Litig., 129 A.3d 884, 888–89 (Del. Ch. 2016).

85. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 305–06 (Del. 2015) (stating that the business judgment rule is the correct standard of review in post-closing damages actions); Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014) (holding that the deferential business judgment rule is the proper standard of review for actions between controlling stockholders and corporate subsidiaries in merger actions).

86. *See* Cain et al., *supra* note 1, at 620 (examining the changes in types of suits filed).

87. *See id.* at 628–29 (highlighting mechanisms by which litigants avoid Delaware courts).

88. *See id.* at 629 (describing the use of mootness payments in shareholder suits).

89. *See id.* at 620 (reporting data from the first ten months of 2017).

last several decades.[90] Derivative suits were once the cornerstone of corporate law, but faded under an array of procedural hurdles that gave more power to corporate boards.[91] Merger litigation, in contrast, remains a dominant form of corporate litigation, surviving a judicial assault that made no pretense of its intention to target these suits.[92]

These contrasting narratives create a perception that derivative suits and merger litigation are fundamentally different. Yes, they come from the same entrepreneurial roots with the same basic incentives for the parties involved, but the similarities end there. As we will see, however, there is a different way of understanding this history.[93] These two forms of litigation have more in common than it initially appears, and these similarities provide an important lesson on the nature of entrepreneurial litigation more broadly.

III. The Hidden Similarities

As the merger litigation crisis developed, it was largely treated as a new and distinctive set of problems.[94] Courts and scholars recognized that merger litigation typified the broader and quite well-known problems of entrepreneurial litigation, but the specific ways that these problems played out were seen as unique.[95] The disclosure-only settlements in merger cases, for example, were a new development, as was the trend of cases filed in multiple jurisdictions that have now largely left Delaware.[96] And one of the primary remedies proposed by courts—board-adopted rules to replace the default procedural

90. *Compare supra* notes 51–71 and accompanying text, *with supra* notes 72–89 and accompanying text.

91. *See supra* notes 51–71 and accompanying text.

92. *See supra* notes 72–89 and accompanying text.

93. *See infra* Part III.

94. *See supra* notes 82–85 and accompanying text.

95. *See supra* notes 78–85 and accompanying text.

96. *See supra* notes 79–81, 83, 88 and accompanying text.

rules that govern these cases—was also seen as a new step in corporate law.[97]

In some ways, these are indeed new developments that reflect the specific contours of merger litigation.[98] Yet, viewed through a broader lens, these developments bear a striking resemblance to the changes that occurred in derivative suits over the last several decades.[99] The disclosure-only settlements in merger litigation look a lot like the nonmonetary settlements that have long been common in derivative suits.[100] The pattern of merger class actions leaving Delaware for other state and federal courts looks a lot like the filing patterns of derivative suits.[101] And the decision to give boards more power over these cases harkens back to the power given to boards and independent committees in derivative suits.[102] As we will see, this resemblance is not accidental. The agency costs of representative litigation often play out in predictable ways, and recognizing these patterns provides a foundation for thinking about how to prevent these problems in the future.

A. Nonmonetary Settlements

1. Merger Litigation

The rise of disclosure-only settlements set the stage for the problems that arose in merger litigation. One prominent study reported that approximately 80 percent of settlements in merger class actions ended without the shareholder class receiving any monetary consideration.[103] Instead, the only consideration in these settlements was the defendant

97. *See* Erickson II, *supra* note 16, at 258–59 ("Corporate law has long allowed corporations to alter default rules in their charters and bylaws. It is therefore surprising that it took corporations until recently to use this power to address frivolous shareholder lawsuits.").

98. *See supra* notes 86–89 and accompanying text.

99. *See infra* Part III.A.

100. *See infra* Part III.B.

101. *See infra* Part III.C.

102. *See infra* Part III.C.

103. *See* ROBERT M. DAINES & OLGA KOUMRIAN, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS 6 (2013) (finding that these settlements resulted in nothing more than supplemental disclosures).

corporation's agreement to make additional disclosures about the merger.[104] The only people who received any money in these cases were the lawyers. Courts regularly awarded plaintiffs' attorneys a fee of $500,000 or more in these cases,[105] and defense attorneys received whatever fee they privately negotiated with their corporate clients. The shareholders, however, rarely saw a dime.[106]

For several years, however, courts appeared fine with this status quo, routinely approving disclosure-only settlements.[107] After all, in theory, additional disclosures *could* offer value,[108] providing shareholders with more information about the key terms of the merger and the process that led up to it. With this possibility in mind, along with a strong preference for disposing of cases on their dockets, courts permitted these settlements.[109] In doing so, courts pointed to the fact that Delaware had long recognized the potential value of non-monetary relief in litigation.[110]

Over time, however, the situation became untenable. The more courts approved these settlements, the more plaintiffs' attorneys filed new cases until nearly every deal was subject to litigation.[111] The final nail in the coffin was likely a 2015 study concluding these additional disclosures had no significant

104. *See id.* (discussing the settlement terms in merger litigation).

105. *See In re* Sauer-Danfoss Inc. S'holders Litig., 65 A.3d 1116, 1136 (Del. Ch. 2011) ("This Court has often awarded fees of approximately $400,000 to $500,000 for one or two meaningful disclosures, such as previously withheld projections or undisclosed conflicts faced by fiduciaries or their advisors.").

106. *See* DAINES & KOUMRIAN, *supra* note 103, at 9–10 (analyzing plaintiff attorney fees in merger litigation).

107. *See* Fisch et al., *supra* note 33, at 572 ("In short, plaintiffs negotiate, and courts approve, corrective disclosure in more than 60% of all transactions.").

108. *See id.* at 561 (acknowledging there may be some residual benefit to these types of settlements).

109. *See id.* at 564–66 (discussing why courts in Delaware tended to accept these settlements).

110. *See id.* at 566–67 (highlighting the enormous costs that flow from allowing cases to proceed to trial).

111. *See id.* at 558–59 (emphasizing the increased frequency of merger litigation).

impact on the outcome of the shareholder vote.[112] In other words, shareholders were not changing their minds as a result of this new information, challenging the contention that these disclosures were material and thus deserved judicial approval and accompanying fees for the plaintiffs' lawyers.[113]

After months of hinting that change was afoot,[114] the Delaware Court of Chancery put its foot down. In *In re Trulia, Inc. Stockholder Litigation*,[115] the court stated that it would not approve any disclosure-only settlement unless the disclosures were "plainly material."[116] The court rationalized this decision by noting that "far too often such litigation serves no useful purpose for stockholders."[117] Instead, the court stated

> [I]t serves only to generate fees for certain lawyers who are regular players in the enterprise of routinely filing hastily drafted complaints on behalf of stockholders on the heels of the public announcement of a deal and settling quickly on terms that yield no monetary compensation to the stockholders they represent.[118]

This decision was a landmark ruling in Delaware, setting off a chain of similar decisions rejecting disclosure-only settlements.[119]

112. *See id.* at 559 (reporting the study's results).

113. *See id.* ("If disclosure settlements do not affect shareholder voting, it is difficult to argue that they benefit shareholders.").

114. *See generally, e.g.*, Transcript of Settlement Hearing, Acevedo v. Aeroflex Holding Corp., No. 9730-VCL, 2015 WL 4127547 (Del. Ch. July 8, 2015) (rejecting a settlement that included modest changes to the deal terms and additional disclosures in exchange for a broad release and $800,000 in attorneys' fees); *In re* Riverbed Tech., Inc. Stockholders Litig., C.A. No. 10484-VCG, 2015 Del. Ch. LEXIS 241 (Del. Ch. Sept. 17, 2015) (approving a disclosure-only settlement, but with the warning that going forward the court would scrutinize these settlements far more carefully).

115. 129 A.3d 884 (Del. Ch. 2016).

116. *Id.* at 898–99.

117. *Id.* at 891–92.

118. *Id.* at 892.

119. *See, e.g.*, Order & Statement of Reasons at 6, Vergiev v. Aguero, No. L-2276-15 (N.J. Super. Ct. Law Div. June 6, 2016) (rejecting settlement and adopting *Trulia* into New Jersey law); Bushansky v. All. Fiber Optics Prods., Inc., No. 16-CV-294245, slip op. at 7–9 (Cal. Super. Ct. Sept. 29, 2017) (adopting *Trulia* standard into California law); Griffith v. Quality Distrib.,

For those who follow Delaware's corporate law jurisprudence, this narrative is well-known. It is often told in the same familiar way. Disclosure-only settlements became common, contributing to the proliferation of merger litigation, until Delaware finally addressed the problem in *Trulia*.[120] Yet this version of the narrative—a version in which merger litigation had sui generis settlement terms, leading to a sui generis judicial response—ignores the broader history of nonmonetary settlements.

2. *Derivative Suits*

Nonmonetary settlements have been common in derivative suits for decades. In her landmark study, Professor Roberta Romano surveyed shareholder lawsuits filed between the late 1960s and 1987.[121] She found that the percentage of derivative suits in her study that ended with a monetary settlement was far lower than the percentage of shareholder class actions.[122] She also found, however, that a significant number of settlements included corporate governance reforms, rather than cash consideration.[123] In several of the settlements, for example, the plaintiff corporation agreed to change the composition of its board; in others, the corporation agreed to change its policies on executive compensation or self-interested transactions.[124] Romano did not delve deeply into the merits of these reforms, but she did state that "while it is impossible to value the benefits from structural settlements with any precision, the gains seem inconsequential."[125]

Inc., No. 2D17-3160, slip op. at 13–14 (Fla. Dist. Ct. App. July 13, 2018) (adopting *Trulia* standard into Florida law).

120. There is more to the story, as we will see in subsequent sections. *See infra* Part III.B.

121. Romano, *supra* note 64, at 56.

122. *Id.* at 61 ("The proportion of derivative suits with a cash payment to shareholders (21 percent) is significantly lower than that of class actions (67 percent).").

123. *Id.* at 63.

124. *See id.* (examining the nature of self-interested transactions).

125. *Id.*

These nonmonetary settlements continued over the next few decades. A study of derivative suits filed in 2006 and 2007 found that the vast majority of settlements included some form of nonmonetary relief.[126] As in the Romano study, this nonmonetary relief was typically a promise by the plaintiff corporation to adopt corporate governance reforms.[127] This study looked at the particular reforms in these settlements, drawing on business and finance literature to conclude that these reforms were unlikely to benefit corporations or their shareholders.[128]

Despite this empirical evidence, Delaware has routinely approved these nonmonetary settlements in derivative suits. In *Ryan v. Gifford*,[129] for example, the court stated that "[i]t is difficult to place a value on such non-pecuniary benefits; however, such governance reforms can provide substantial benefits and are appropriately considered by the Court when evaluating a proposed settlement."[130] And in one of the most famous cases in corporate law, the Delaware Court of Chancery approved a settlement of an oversight case even while recognizing that "the changes in corporate practice that are presented as consideration for the settlement do not impress one as very significant."[131] This history suggests that Delaware's lax scrutiny of nonmonetary settlements in derivative suits, despite the empirical evidence casting significant doubt on the value of these settlements, may have opened the door for plaintiffs' attorneys to try similar tactics in merger litigation.

This history puts the rise of disclosure-only settlements in merger litigation in a new light. These settlements were not a historical anomaly that Delaware was unexpectedly forced to

126. *See* Erickson I, *supra* note 7, at 1798–99 (finding that 85 percent of the derivative suit settlements included some type of corporate governance reform).

127. *See id.* at 1804–05 (listing the reforms involved in the settlements).

128. *See id.* at 1807–29 (analyzing the effects of purported reforms).

129. No. 2213-CC, 2009 WL 18143 (Del. Ch. Jan. 2, 2009).

130. *Id.* at *10.

131. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (noting also that the settlement agreement included a requirement that the plaintiff-corporation create a new compliance committee even though the corporation already had such a committee).

confront in 2016. Rather, these settlements were an extension of a much longer history of nonmonetary settlements in shareholder litigation. Given this history, Delaware should not have been taken aback by the rise of these settlements in merger cases, nor should it have taken so long for courts to step in.

It is not surprising that nonmonetary settlements were used in both merger and derivative lawsuits because these lawsuits have the same underlying incentives that make these settlements so appealing. As discussed in Part I, there is a well-recognized conflict of interest between plaintiffs' attorneys and the shareholders they are supposed to represent.[132] Shareholders (or the plaintiff corporation in a derivative suit) want to maximize their recovery from the litigation, while plaintiffs' attorneys had an added desire to maximize their own fees.[133] In theory, representative shareholders should monitor the attorneys to ensure that they are watching out for the interests of the class or the plaintiff corporation. Yet these shareholders typically do not have a large enough financial stake in the case to make this type of monitoring a worthwhile investment.[134]

This conflict opens the door to nonmonetary settlements. Given the lax monitoring by shareholders, plaintiffs' attorneys can trade greater fees for themselves in exchange for reduced, or even no, financial consideration in the settlement itself.[135] If the attorneys bargain for a $1 million settlement, they might receive $300,000 in fees. If they can shift the consideration so the plaintiffs only receive the promise of corporate governance reforms or additional disclosures, they might be able to bargain for $500,000 in fees for themselves. Of course, many attorneys have strong ethical commitments that keep them from trading their clients' settlement leverage for their own, but the fact

132. *See supra* Part II.A.

133. *See* Erickson II, *supra* note 16, at 241–43 (discussing the "mismatched incentives" of shareholder-plaintiffs and their attorneys).

134. *See id.* at 241–42 (stating that shareholder-plaintiffs lack the necessary incentives to properly monitor their attorneys).

135. *See id.* at 242 ("[R]educed monitoring in shareholder litigation can increase agency costs by allowing attorneys to seek a higher percentage of the recovery for their fee.").

remains that nonmonetary settlements permit this type of trade-off.

As the above example demonstrates, these settlements are also a financial windfall for the defendants. Most settlements are zero-sum, which means that every dollar that goes to the plaintiffs is a dollar that comes out of the defendants' pocket.[136] In nonmonetary settlements, however, defendants can get out of litigation cheaply by only paying the plaintiffs' attorneys' fees. Defendants do not care about the allocation of money between the attorneys and plaintiffs; they only want to reduce their total financial outlay.[137] As a result, everyone at the settlement table is happy to trade nonmonetary consideration for monetary consideration, as long as the judge and the representative shareholders do not object (and they typically do not).[138]

These same incentives exist in other types of class actions as well. Outside of corporate law, plaintiffs' attorneys frequently negotiated coupon-only settlements in consumer class action.[139] In these settlements, the class members received coupons (i.e., five dollars off the purchase of a product made or sold by the defendants), while class counsel received multimillion-dollar fees.[140] Consumers often had to follow burdensome procedures to redeem these coupons, and class members who chose not to do so received no benefit from the settlement.[141]

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136. *See* Melvin Aron Eisenberg, *Private Ordering Through Negotiation: Dispute-Settlement and Rule-Making*, 89 HARV. L. REV. 637, 652 (1976) ("Furthermore, when the purpose of negotiation is dispute-settlement, the process tends to be a zero-sum game (that is, a contest in which the winner's gains are exactly balanced by the loser's losses).").

137. *See* Erickson II, *supra* note 16, at 244 ("[In nonmonetary settlements,] the defendants will probably still have to pay some money to the plaintiffs' attorney in fees, but the overall cost to the defendants will be much less than if they had to pay both the plaintiffs and the plaintiffs' attorney.").

138. *See* Sale, *supra* note 34, at 414 (arguing that judges are not "functioning as the fiduciaries the law requires them to be").

139. *See* S. REP. NO. 109–14, at 15–20 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 3, 30 (providing myriad examples of coupon class actions).

140. *See id.* (listing the fees awarded in these cases).

141. *See* Christopher R. Leslie, *A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation*, 49 UCLA L. REV. 991, 995 (2002) ("In many cases, the coupons are laden with restrictions intended to make redemption difficult.").

Congress set its sights on these settlements in the Class Action Fairness Act (CAFA).[142] The legislative history stated that the provisions related to coupon settlements were "aimed at situations in which plaintiffs' lawyers negotiate settlements under which class members receive nothing but essentially valueless coupons, while the class counsel receive substantial attorneys' fees."[143] CAFA required attorneys' fees to be based on the value of the coupons that are actually redeemed, rather than the purely hypothetical value of coupons that sit unused in class members' drawers.[144] They also required courts reviewing such settlements to make written findings that the settlement terms will benefit class members.[145]

The point of this discussion is not that nonmonetary settlements are always bad. There have been some valuable disclosures in merger lawsuits, some valuable corporate governance reforms in derivative suits, and some valuable coupons in consumer class actions.[146] Nonmonetary settlements cannot be reduced to a simple black or white/good or bad analysis. Yet these settlements do provide a unique opportunity for plaintiffs' attorneys and defendants to exploit the agency costs in shareholder litigation.[147] By viewing the disclosure-only settlements in merger litigation in isolation, divorced from the broader history and context of shareholder litigation, courts have overlooked their risks. As a result, when these settlements started to become common in merger cases, courts in Delaware

142. Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (codified as amended in scattered sections of 28 U.S.C.).

143. S. REP. NO. 109–14, at 30 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 3, 29–30.

144. *See* 28 U.S.C. § 1712 (2018)

> If a proposed settlement in a class action provides for a recovery of coupons to a class member, the portion of any attorney's fee award to class counsel that is attributable to the award of the coupons shall be based on the value to class members of the coupons that are redeemed.

145. *See id.* ("[T]he court may approve the proposed settlement only after a hearing to determine whether, and making a written finding that, the settlement is fair, reasonable, and adequate for class members.").

146. *See* Fisch et al., *supra* note 33, at 559 (stating that there is at least a slight benefit to the plaintiffs).

147. *See supra* notes 135–141 and accompanying text.

were fairly sanguine, approving these settlements with little scrutiny.[148] Had courts recognized these settlements as a new iteration of a broader problem, they might have stepped in earlier and used greater scrutiny to prevent the problems in merger litigation from getting as bad as they did.

B. A Race from Delaware's Courts

1. Merger Litigation

Delaware has never had a monopoly on merger litigation. Instead, these cases have long been spread among various state courts.[149] Nonetheless, Delaware has presided over a substantial percentage of these cases in recent years.[150] In 2004 and 2005, for example, companies facing a merger class action were sued in Delaware courts approximately 40 percent of the time.[151] This percentage dipped between 2006 and 2009, but then rebounded between 2011 and 2015.[152] During this latter period, which is the same period in which merger litigation was at its peak, more than half of all companies sued in connection with a merger or acquisition faced at least one lawsuit in Delaware.[153] Even if these companies faced parallel litigation in other courts, Delaware had some oversight over most of these disputes.[154]

At various times during this period, these cases dominated the docket of the Delaware Court of Chancery, outnumbering all other types of shareholder lawsuits.[155] In their landmark study of corporate litigation, Professors Thomas and Thompson found that merger class actions comprised approximately 80 percent

148. *See* Erickson II, *supra* note 16, at 225 ("For several years, judges in Delaware decried the developments in merger litigation.").

149. *See* Cain et al., *supra* note 1, at 621 tbl.1 (detailing the percentage of merger filings in various state courts).

150. *See id.* (demonstrating that 60 percent of mergers were filed in Delaware in 2015).

151. *See id.* (illustrating the percentage of mergers filed in Delaware).

152. *Id.*

153. *See id.*

154. *See id.*

155. *See* Thompson & Thomas I, *supra* note 31, at 137 (stating that these actions made up "the vast bulk" of Delaware court representative litigation).

of the breach of fiduciary duty claims filed in the Delaware Court of Chancery in 1999 and 2000.[156] They concluded that, at least for Delaware, merger class actions "have become the most visible form of shareholder litigation."[157] The concentration of these lawsuits in Delaware made it easier for Delaware judges to oversee the changes in this area and create a cohesive body of law to respond to these changes.

Federal courts traditionally played a much smaller role in merger litigation. Studies show that, between 2003 and 2007, less than 50 percent of merger cases were filed in federal court.[158] Federal courts oversaw securities class actions alleging other forms of corporate malfeasance, but shareholders rarely asked them to intervene in corporate mergers.[159] Federal and state courts thus abided by a rough division of the corporate and securities landscape—federal courts focused on disclosure claims outside of the merger context, while state courts, especially Delaware, handled merger cases as well as other cases alleging that corporate directors breached their fiduciary duty.

In 2015, however, the Delaware Court of Chancery handed down its decision in *Trulia*, cracking down on the disclosure-only settlements in merger litigation.[160] The fallout from this case was swift and dramatic, with plaintiffs in merger class actions immediately leaving Delaware for other jurisdictions. In 2015, 60 percent of companies sued in connection with a merger or acquisition faced at least one lawsuit in Delaware.[161] By 2017, that percentage had fallen to 9 percent.[162] These cases primarily ended up in federal court.[163]

156. *Id.* at 137.

157. *Id.* at 207.

158. *See* Cain et al., *supra* note 1, at 621 tbl.1 (finding that 7 percent of merger cases were filed in federal court in 2003, 0 percent in 2004, 7 percent in 2005, 12 percent in 2006, and 13 percent in 2007).

159. *See* Erickson II, *supra* note 16, at 272 (stating that securities class actions are filed in federal court).

160. *See generally In re* Trulia S'holder Litig., 129 A.3d 884 (Del. Ch. 2016).

161. *See* Cain et al., *supra* note 1, at 621 tbl.1.

162. *See id.*

163. *See id.* (reporting that the number of class actions filed in federal court increased from 20 percent in 2015 to 87 percent in 2017).

Recent data from Cornerstone Research found that, in 2018, 91 percent of deals were challenged in federal court.[164]

Shareholders did not just leave state courts. They have also left state law. Traditionally, Delaware law followed these cases regardless of where they were filed. Under choice of law rules, a corporation's internal affairs are governed by the law of the state where the corporation is incorporated.[165] As a result, Delaware fiduciary duty law governs a merger case filed against a Delaware corporation, even if that case was filed in federal court or in another state court.[166] As shareholders fled to federal court, however, they also repackaged their claims as federal securities claims rather than breach of fiduciary duty claims, skirting traditional choice of law rules.[167] By rejecting both Delaware's courts and its law, shareholders were able to avoid Delaware's scrutiny altogether.

Today, merger cases comprise a significant percentage of overall securities class actions. In 2009, for example, only 4 percent of securities class actions related to a merger or acquisition; by 2019, nearly 40 percent did.[168] These figures illustrate how plaintiffs' firms have searched for a new way to challenge corporate deals in the wake of Delaware's crackdown on the cases filed in their courts.

This shift into federal court may not be permanent. The federal securities laws provide for increased scrutiny of

164. *See* CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2018 M&A LITIGATION 4 (2019) [hereinafter REVIEW OF 2018 M&A LITIGATION] (reporting findings).

165. *See* RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 302 cmt. e (AM. LAW INST. 1977)

> Application of the local law of the state of incorporation will usually be supported by those choice-of-law factors favoring the needs of the interstate and international systems, certainty, predictability and uniformity of result, protection of justified expectations of the parties and ease in the application of the law to be applied.

166. *See* Jan Ting, *Why Do So Many Corporations Choose to Incorporate in Delaware?*, WHYY (Apr. 27, 2011), https://perma.cc/ZCE8-252W (describing how and why Delaware became the powerhouse of corporate legal authority in the United States and mechanics of the Court of Chancery).

167. *See* Erickson II, *supra* note 16, at 246 (explaining that the PSLRA overhauled the rules governing securities class actions).

168. *See* CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2019 YEAR IN REVIEW 5 (2020).

securities claims, including heightened pleading standards, stays on discovery, and mandatory Rule 11 inquiries, and it is too early to tell how this scrutiny will impact merger cases.[169] Additionally, it is unclear whether federal courts will follow Delaware's lead in rejecting many disclosure-only settlements. The primary reason that shareholders started filing their claims in federal court was to avoid *Trulia*'s scrutiny of disclosure-only settlements, as well as other Delaware cases that made it more difficult for shareholders to pursue their state law claims.[170] Yet at least a few federal courts have adopted *Trulia*.[171] Most federal courts have not ruled on this issue, leaving open the possibility that they will review disclosure-only settlement under more traditionally deferential standards. Until more courts weigh in, shareholders still have an incentive to file their suit in a federal forum that may be more hospitable to their claims.[172]

At the end of the day, however, the move of merger cases to the federal courts means that it is harder for any one court to exercise oversight over these cases. If these cases were all concentrated in Delaware, the Delaware Court of Chancery

169. *See* 15 U.S.C. § 78u-4 (2018) (listing the requirements for securities fraud actions).

170. *See* Cain et al., *supra* note 1, at 621–22 (discussing the immediate effects of *Trulia*).

171. *See, e.g.*, *In re* Walgreen Co. Stockholder Litig., 832 F.3d 718, 725–26 (7th Cir. 2016) (adopting *Trulia* because courts have "a continuing duty in a class action case to scrutinize the class attorney to see that he or she is adequately protecting the interests of the class"); Malone v. CST Brands, Inc., No. SA-16-CA-0955-FB, 2016 WL 8258791, at *6 (W.D. Tex. Nov. 10, 2016) (citing *Trulia* favorably for the proposition that "the public interest is not served by a strike suit designed to obtain a disclosure only settlement").

172. It is also unclear how the Private Securities Litigation Reform Act (PSLRA) applies to merger class actions. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.). The PSLRA includes several provisions designed to crack down on frivolous litigation, including heightened pleading standards for certain elements of securities fraud claims, mandatory Rule 11 inquiries at the end of the litigation, and (perhaps most importantly) a requirement that attorneys' fees "not exceed a reasonable percentage of the amount of any damages . . . actually paid to the class." 15 U.S.C. § 78u-4. These restrictions mean that the federal courts have their own set of tools to curtail frivolous merger cases, at least if these suits are filed under the federal securities laws. It remains to be seen, however, whether they will actually use these tools to stem the rising tide of merger cases in federal court.

could monitor them and shape the law in ways that account for broader trends and issues.[173] As we will explore, however, if an individual court or judge only has one merger case, it becomes harder for them to see the case as part of this broader picture and to do much to influence this picture.[174]

2. Derivative Suits

When merger cases first moved into federal courts, commentators analyzed this shift as a new phenomenon in corporate litigation. Yet derivative suits moved into federal courts years ago, and today most derivative suits are filed in federal court.[175] The earlier move of derivative suits into federal court foreshadowed the later trends in merger litigation, highlighting Delaware's difficulty in holding onto its cases.

The historical trajectory of derivative suits is more complicated than the more recent story of merger litigation. Shareholders started filing derivative suits in the United States in the 1800s.[176] The earliest cases in the United States were filed in state court and involved minority shareholders challenging malfeasance by the corporation's directors and officers.[177]

Before long, however, corporations started to embrace derivative suits, recognizing that they made it easier for corporations to secure a federal forum. For example, the first derivative suit filed in federal court challenged the legality of an

173. *See* Ting, *supra* note 166 (explaining why the concentration of business law cases in Delaware is beneficial to business).

174. *See infra* Part III.

175. *See* Erickson I, *supra* note 7, at 1754 (stating that "most" shareholder derivative suits are filed in federal court).

176. *See* Scarlett, *supra* note 72, at 871 (tracing the history of shareholder derivative suits in the United States).

177. *See, e.g.*, Robinson v. Smith, 3 Paige Ch. 222, 231 (N.Y. Ch. 1832) (alleging that the corporation's managers had mismanaged the corporation's assets); Taylor v. Miami Exporting Co., 5 Ohio 162, 164–65 (1831) (alleging that the corporation's directors had engaged in fraudulent practices that depreciated the value of the corporation's stock); Percy v. Millaudon, 8 Mart. (n.s.) 68, 68 (La. 1829) (alleging that the corporation's directors engaged in "fraudulent and unfaithful conduct").

Ohio state tax levied on an Ohio bank.[178] The bank did not want to contest the tax in Ohio state court for obvious reasons, so an out-of-state shareholder brought the suit instead.[179] The suit was styled as a derivative suit against the bank's directors and the Ohio tax collector for failing to challenge the tax in court.[180] The directors did not contest the allegations.[181] The U.S. Supreme Court held that there was diversity jurisdiction over the suit,[182] paving the way for corporations to use derivative suits to create a federal forum for their state law challenges.[183]

Within a few decades, however, corporations became more skeptical of derivative suits as more shareholders started to use them to challenge management's decisions.[184] At the same time, federal courts started to cut back on forum shopping in derivative suits.[185] In a series of decisions, the U.S. Supreme Court criticized corporations for manufacturing federal jurisdiction.[186] It also created new procedural hurdles for these

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178. *See* Dodge v. Woolsey, 59 U.S. (18 How.) 331, 336 (1856) (articulating the nature of the case before the court).

179. *See id.* (stating that the plaintiff was a citizen of Connecticut).

180. *See id.* at 339 ("[The plaintiff stockholder] had requested the directors of the bank to take measures, by suit or otherwise, to assert the franchises of the bank against the collection of what he believes to be an unconstitutional tax, and that they had refused to do so.").

181. *See id.* ("To this bill the defendant, George C. Dodge, filed an answer. The other defendants did not answer.").

182. *See id.* at 356 ("We do not know a case more appropriate to show the necessity for such a jurisdiction than that before us.").

183. *See* City of Davenport v. Dows, 85 U.S. (18 Wall.) 626, 627–28 (1873) (using a derivative suit to contest the legality of an Iowa state tax); City of Memphis v. Dean, 75 U.S. (8 Wall.) 64, 74 (1869) (using a derivative suit to litigate the legality of a contract between the corporation and the City of Memphis); *see also* Dennis, *supra* note 52, at 1486 ("[*Dodge*] implicitly condoned the calculated resort of corporate counsel to federal stockholder actions to gain more favorable outcomes than they anticipated obtaining in a direct suit by their clients in state court.").

184. *See* Dennis, *supra* note 52, at 1517 (explaining that corporate leaders began to view derivative suits "less as a useful tool").

185. *See id.* at 1500–01 (noting that corporations used improper practices to achieve jurisdiction in federal courts).

186. *See, e.g.*, Hawes v. Oakland, 104 U.S. 450, 453 (1881) (lamenting the fact that "the overburdened courts of the United States have this additional important litigation imposed upon them by a simulated and conventional

suits, including the demand requirement and the contemporaneous ownership requirement.[187]

In response to these developments, shareholders slowly returned to state court to file their derivative suits. Empirical data is not available regarding the precise percentage of derivative suits filed in federal versus state court during the twentieth century. Nonetheless, the literature suggests that these suits were primarily in state court.[188] For example, the first significant study of derivative suits examined those filed in certain New York state and federal courts.[189] The study found that, between 1932 and 1942, a total of 1,400 derivative suits were filed in the two New York state courts (New York County and King County) as well as one New York federal court (the Southern District of New York).[190] Of these 1,400 suits, only 130—or 9.3 percent—were filed in federal court.[191]

At some point over the next several decades, however, these cases slowly shifted to federal court. Again, the empirical record is incomplete, so it is difficult to tell exactly when this shift occurred. Nonetheless, by the late 1990s, the data suggests that most derivative suits were filed in federal court.[192] For example, a study of derivative suits in federal court found that shareholders filed four times as many derivative suits in federal court than they did in Delaware.[193] This study concluded that "[t]he federal courts are now the center of a significant

arrangement, unauthorized by the facts of the case or by the sound principles of equity jurisdiction").

187. *See* Dennis, *supra* note 52, at 1496 ("The Court . . . require[d] that stockholders make a sincere demand on a board of directors and receive a clear refusal of that demand prior to bringing a federal derivative action.").

188. *See* Scarlett, *supra* note 72, at 905 (discussing the findings of a 1944 study of shareholder derivative litigation).

189. *See* FRANKLIN S. WOOD, CHAMBER OF COMMERCE OF NEW YORK, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS 6 (1944) (reporting the results of the study).

190. *Id.* at 3–4.

191. *Id.* at 4.

192. *See* Thompson & Thomas II, *supra* note 61, at 1788 (postulating that plaintiffs filed more suits in federal courts for the purpose of avoiding 102(b)(7) in Delaware courts).

193. *See* Erickson I, *supra* note 7, at 1762 (reporting the results of the study).

percentage of corporate litigation."[194] A related study of reported decisions concerning derivative suits found that the majority of these decisions were from federal court.[195] Finally, a study of stock option backdating cases filed in 2006 and 2007 found that most of the derivative suits were filed in federal court, regardless of whether the plaintiff corporation was incorporated in Delaware or another state.[196]

There are likely two reasons for the shift of these cases into federal court. First, derivative suits are often filed in the same court as parallel securities class actions.[197] Studies have shown that shareholder derivative suits often arise out of the same underlying allegations as securities class actions.[198] A corporation that misstates its financial results, for example, will likely face a multitude of lawsuits.[199] It will face one or more securities class actions alleging that the corporation's public filings were false and misleading.[200] It may also face a shareholder derivative suit alleging that the corporation's board of directors violated its fiduciary duty of oversight by failing to

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194. *Id.*

195. *See* Davis, *supra* note 62, at 419 tbl.1 (noting that, of these cases, those involving allegations of corporate impropriety are more likely to be filed in federal court than cases involving allegations that a controlling shareholder exploited its control over the corporation).

196. *See* Quinn Curtis & Minor Myers, *Do the Merits Matter? Empirical Evidence on Shareholder Suits from Options Backdating Litigation*, 164 U. PA. L. REV. 291, 319 tbl.1 (2016) (finding that 56 percent of the cases brought on behalf of Delaware corporations were filed in federal court, as were 63 percent of cases brought on behalf of non-Delaware corporations).

197. *See* Erickson I, *supra* note 7, at 1827 ("The vast majority of the derivative suits in my study filed on behalf of public companies were accompanied by a parallel securities class action.").

198. *See* Jessica M. Erickson, *Overlitigating Corporate Fraud: An Empirical Examination*, 97 IOWA L. REV. 49, 68 (2011) [hereinafter Erickson V] ("As the data above indicate, a significant percentage of shareholder derivative suits are accompanied by at least one parallel lawsuit, most commonly a securities class action filed in federal court.").

199. *See* Thomas & Thompson, *supra* note 53, at 1763 ("Many corporate complaints have elements of both breach of fiduciary duty and fraud, so substitution of one kind of litigation for another is a recurring possibility, even as the reach of each law and its perceived utility changes over time.").

200. *See id.* at 1775 (providing an example of a securities class action alleging that a company produced misleading disclosures).

prevent the misstatements.[201] The settlements in securities class actions are typically much larger than the settlements derivative suits, so the securities class actions tend to dominate.[202] As a result, it is not uncommon for shareholders who file derivative suits to file in the same court as a related securities class action and then litigate their claims on a parallel schedule.[203]

Second, as we have seen in merger class actions, shareholders may have started filing derivative suits in federal court to avoid the scrutiny of Delaware courts. In the merger context, shareholders file their cases in Delaware to avoid *Trulia*'s close review of disclosure-only settlements because federal courts use their own procedural standards to review settlements.[204] Similarly, by filing their claims under the federal securities laws, shareholders can avoid Delaware substantive law that makes it difficult for them to prevail on their claims.[205] In derivative suits, however, the law is largely the same whether shareholders file in state or federal court.[206] The internal affairs doctrine provides that the law of the state of incorporation applies to any fiduciary duty claim, regardless

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201. *See* Erickson I, *supra* note 7, at 1819 ("Many derivative suits are premised on a board's failure to prevent or remedy misconduct.").

202. *Compare* Thomas & Thompson, *supra* note 53, at 1777–78 (finding that few derivative suits end with a cash payment to the plaintiff corporation), *with* CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2019 REVIEW AND ANALYSIS 1 (2020) (reporting a median settlement in securities class actions of $11.5 million).

203. *See* Erickson I, *supra* note 7, at 1776 ("These parallels between securities class actions and derivative suits reflect a larger trend of shareholders filing derivative suits on the heels of filing a securities class action.").

204. *See supra* notes 158–164 and accompanying text.

205. *See* Sean J. Griffith, *Private Ordering Post-*Trulia*: Why No Pay Provisions Can Fix the Deal Tax and Forum Selection Provisions Can't*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES 2 (Steven Davidoff Solomon & Randall S. Thomas, eds., 2017) ("Once it became clear that Delaware would act to curtail merger-related nuisance claims, these lawyers began to take their claims elsewhere.").

206. *See* Thomas & Thompson, *supra* note 53, at 1763–64 ("Within this dual federal-state system, and a state system with more than fifty jurisdictions, procedural and jurisdictional rules make it possible to file suits in multiple jurisdictions arising from the same act, even if each jurisdiction applies the same substantive law.").

of where it is filed.[207] Moreover, state and federal courts tend to have similar procedural rules for derivative suits, such as the demand requirement.[208] As a result, forum shopping in a derivative suit does not afford the plaintiff a different set of applicable laws.

Yet Delaware courts may differ from federal courts in how they apply the law, even if the law itself is the same in either forum. As the courts charged to oversee Delaware law, they have more flexibility to change course and start cracking down on certain types of cases than federal courts sitting in diversity jurisdiction.[209] Delaware courts also see themselves as the guardian of Delaware corporate law, and therefore they may feel more responsibility to police frivolous claims.[210] Moreover, if a significant number of fiduciary duty cases are filed in Delaware, they can respond to broader trends in a way that is difficult for a federal court that may only see one or two corporate cases a year.[211] As a result, Delaware courts may often have a more skeptical eye than their federal counterparts, causing plaintiffs with weaker claims to adopt an "anywhere but Chancery"

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207. *See* CTS Corp. v. Dynamics Corp., 481 U.S. 69, 89 (1987) ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations . . . .").

208. *Compare* FED. R. CIV. P. 23.1(b)(3)(a) (requiring derivative plaintiffs to state with particularity in their complaint "any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members"), *with* DEL. CH. CT. R. 23.1(b) ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort.").

209. *See* Erickson II, *supra* note 16, at 268 (explaining, for example, how the second prong of the business judgement rule "gives judges the flexibility to override an SLC decision when something feels 'off'").

210. *See, e.g.*, *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 961 (Del. Ch. 2010) ("[While] policing frequent filers may cost some members of the bar financially, in the long run it enhances the legitimacy of our State and its law not to facilitate a system of transactional insurance through quasi-litigation.").

211. *See Anywhere but Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions*, 7 M&A J. 17, 17 (2007) ("Someone once commented on a panel that trying to argue Delaware fiduciary duty cases outside of Delaware is like taking Galatoire's secret recipes and giving them to a Jack-In-The-Box short-order cook.").

approach.[212] This approach helps explain why many shareholders may have chosen to file their derivative claims in federal court.[213]

As this history demonstrates, derivative suits moved into federal court long before merger litigation. This earlier shift received less attention than the later shift of merger litigation, but putting the two together reveals a broader development in corporate litigation. Across the board, shareholder suits have slowly moved from Delaware and other state courts to federal court, making it more difficult for Delaware to police these claims.[214]

C. Board as Litigation Gatekeeper

1. Merger Litigation

Over the past several years, the board of directors has emerged as the newest gatekeeper for frivolous merger claims.[215] As it became clear that Delaware was losing control over these cases, the state authorized corporate boards to take new steps to bring these cases back to Delaware and possibly go even further in restricting these cases.[216] In 2010, the Delaware Court of Chancery recognized that its efforts to crack down on frivolous claims may be causing these cases to flee to other jurisdictions.[217] To curb this trend, it invited corporate boards to adopt "charter provisions selecting an exclusive forum for

212. *See id.* at 18 (quoting Ted Mirvis of Wachtell, Lipton, Rosen and Katz).

213. *See id.* at 17 (explaining that plaintiffs' lawyers perceive greater settlements opportunities and greater vagary in results outside of Delaware).

214. *See* John Armour et al., *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUDS. 605, 607, 629 (2012) (focusing on published decisions in cases filed against Delaware companies, merger and acquisition cases, and litigation challenging leveraged buyouts).

215. *See* Erickson II, *supra* note 16, at 258–59 (discussing the corporation's role in addressing frivolous lawsuits).

216. *See id.* (explaining that corporations began to "experiment by putting other heightened procedures" into their bylaws and charters after the courts authorized fee-shifting provisions).

217. *See In re Revlon*, 990 A.2d at 960 ("Perhaps greater judicial oversight of frequent filers will accelerate their efforts to populate their portfolios by filing in other jurisdiction.").

intra-entity disputes" if "boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution."[218] Although this invitation was focused on forum selection clauses in corporate charters, many companies quickly included these provisions in their bylaws,[219] which corporate boards can typically amend on their own.[220] Within four years of Delaware's invitation, more than seven hundred public companies had adopted forum selection clauses.[221]

This development opened the door for boards to include other procedural mechanisms in corporations' governing document that make it more difficult for shareholders to file certain types of fiduciary duty claims. After considerable debate, the Delaware General Assembly banned corporations from adopting fee-shifting provisions.[222] The Delaware Court of Chancery, however, has suggested that other forms of private ordering would likely pass muster, at least absent evidence that the board had an improper motive in adopting them.[223]

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218. *Id.*

219. *See* Thomas & Thompson, *supra* note 53, at 1812 ("Some companies have put forum selection provisions in their charters prior to an initial public offering (IPO), a few have submitted charter amendments to a shareholder vote, but most of the adoptions by established public companies (still a small percentage of public companies) have been via director-passed bylaws . . . .").

220. *See* DEL. CODE ANN. tit. 8, § 109(b) (2019) ("The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.").

221. *See* Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, 14 J. EMPIRICAL LEGAL STUDS. 31, 33 (2017) (finding that, as of August 2014, 746 public companies had adopted these provisions).

222. *Compare* DEL. CODE ANN. tit. 8, § 109(b) ("The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in § 115 of this title."), *with* OKLA. STAT. tit. 18, § 1126 (2020) (mandating fee-shifting in all shareholder derivative suits).

223. *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (Del. 2014) ("Legally permissible bylaws adopted for an improper purpose are unenforceable in equity. The intent to deter litigation, however, is not invariably an improper purpose.").

Corporate boards have responded to this invitation by adopting other types of provisions including minimum ownership requirements,[224] arbitration requirements,[225] and bond requirements.[226] So far, these provisions are still relatively rare, but they show the potential for private ordering to curb the problems in merger litigation.

This new role for corporate boards reflects a broader acknowledgment that other gatekeepers involved in these cases may not be able to prevent these problems.[227] Most shareholder plaintiffs often lack sufficient incentives to closely monitor these lawsuits.[228] As a result, plaintiffs' attorneys can make litigation decisions that benefit themselves at the expense of the real parties in interest.[229] Judges are supposed to keep a watchful eye on the litigation to curb these problems, but this monitoring

224. *See, e.g.*, Imperial Holdings, Inc., Amended and Restated Bylaws, Current Report (Form 8–K) (Nov. 3, 2014) (stating that directors "need not be . . . shareholders of the corporation").

225. *See* Del. Cty. Emps. Ret. Fund v. Portnoy, No. 13-10405-DJC, 2014 WL 1271528, at *1 (D. Mass. Mar. 26, 2014) (concluding that the court was precluded from deciding whether the arbitration provision was valid and enforceable); Katz v. Commonwealth REIT, No. 24-C-13-001299, 2014 WL 9913855, at *2 (Md. Cir. Ct. Feb. 19, 2014) (granting defendants' Petition for an Order to Arbitrate); *see also* James D. Cox & Randall S. Thomas, *Corporate Darwinism: Disciplining Managers in a World with Weak Shareholder Litigation*, 95 N.C. L. REV. 19, 33 (2016) ("The 800-pound gorilla in the room that has yet to be addressed is whether any states will permit corporate bylaws that mandate sending shareholder-manager disputes to arbitration.").

226. *See* Hemispherx Biopharma, Inc., Current Report (Form 8-K) (July 3, 2014) (amending bylaws to create surety requirements for security holder claimants).

227. *See* Erickson II, *supra* note 16, at 239 ("None of the gatekeepers in these areas, however, have solved all of the problems in shareholder litigation.").

228. *See* Alon Klement, *Who Should Guard the Guardians? A New Approach for Monitoring Class Action Lawyers*, 21 REV. LITIG. 25, 45 (2002) ("Common to all agency problems is their correlation with the asymmetry of information between the principal and the agent. The less the principal is informed, the higher the agency costs will be."); Macey & Miller, *supra* note 13, at 19–20 (attributing high agency costs in class action and derivative litigation primarily to the inability of the class to effectively monitor the attorneys).

229. *See* Coffee, *supra* note 40, at 714 ("Often, the plaintiff's attorneys and the defendants can settle on a basis that is adverse to the interests of the plaintiffs.").

role is difficult in merger litigation, which presents unusual problems not found in other types of litigation.[230] Delaware judges have an advantage over other state and federal judges because they are well aware of the rising problems in merger litigation and have a vested interest in protecting the shareholder litigation franchise.[231] Yet, as we have seen, Delaware judges started losing their cases once they cracked down, with plaintiffs simply filing their claims elsewhere to avoid this scrutiny.[232]

Given the limitations of these other gatekeepers, it is not surprising that the legal system looked for another group to help address the problems with these suits. In theory, corporate boards are an obvious choice. They oversee the corporation's business and affairs more generally,[233] and they have an interest in protecting the corporation from frivolous litigation.[234] That said, corporate boards have an inherent conflict of interest when it comes to merger litigation, as they are typically among the defendants in these suits.[235] These suits

230. *See, e.g.*, *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 894 (Del. Ch. 2016) ("The lack of an adversarial process often requires that the Court become essentially a forensic examiner of proxy materials so that it can play devil's advocate in probing the value of the 'get' for stockholders in a proposed disclosure settlement."); *see also* Griffith, *supra* note 14, at 20 ("Judges tempted to launch a thorough inquiry into the merits of a claim at the time of settlement face significant information asymmetries exacerbated by a non-adversarial process and an undeveloped factual record.").

231. *See* Erickson II, *supra* note 16, at 257 (noting the Delaware Court of Chancery judges' expertise).

232. *See infra* Part III.B.1; *see also In re Trulia*, 129 A.3d at 899 (recognizing that enhanced judicial scrutiny of disclosure settlements could lead plaintiffs to sue fiduciaries of Delaware corporations in other jurisdictions in the hope of finding a forum more hospitable to signing off on settlements of "no genuine value"). The court in *Trulia* expressed hope that their "sister courts will reach the same conclusion if confronted with the issue." *Id.*

233. *See* DEL. CODE ANN. tit. 8, § 141(a) (2019) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .").

234. *See* Erickson II, *supra* note 16, at 273 (suggesting bylaw and charter amendments as two mechanisms to shield off frivolous lawsuits).

235. *See id.* at 276 ("Directors know that they are the likely defendants in any future shareholder lawsuit. It is inevitable, therefore, that their own self-interest will influence their decision making, especially as they consider

typically allege that the board members breached their fiduciary duty to the corporation by failing to cause the corporation to disclose all material information about the merger to the shareholders or by approving an inadequate merger price.[236] As a result, they face their own personal incentives to make it harder for shareholders to file these claims, even if these suits are in the best interests of shareholders.[237] As we will see in the next section, however, this is not the first time that corporate law has given potentially conflicted directors an outsized role in overseeing shareholder litigation.[238]

2. Derivative Suits

Corporate boards have long played a pivotal role in shareholder derivative suits.[239] Although shareholders file these suits on behalf of the plaintiff corporation, corporate law gives the board multiple opportunities to gain control over the litigation.[240] First, before a shareholder can file a derivative suit, it must make a demand on the corporation's board, asking the board to file the suit itself.[241] The demand requirement gives corporate boards the opportunity to take control of the lawsuit

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proposed amendments that will make it more difficult for them to be sued."); Michael J. Kaufman & John M. Wunderlich, *Paving the Delaware Way: Legislative and Equitable Limits on Bylaws After* ATP, 93 WASH. U. L. REV. 335, 377 (2015) ("In particular, the board's decision to adopt or to invoke a fee-shifting bylaw—or any bylaw that raises the similar specter of self-interest—must be enjoined where that decision constitutes an improper purpose or is otherwise inequitable under the circumstances.").

236. *See* Erickson II, *supra* note 16, at 253 ("Traditionally, a shareholder challenging a merger or acquisition would allege that the price was too low or the terms too onerous.").

237. *See id.* at 260–61 (explaining corporations' interest in obtaining quick resolutions and cheap settlements).

238. *See supra* Part III.2.

239. *See* Erickson II, *supra* note 16, at 263 (noting corporate boards' historic role as the "primary gatekeepers").

240. *See id.* at 264 (identifying two procedural mechanisms which return power to the board).

241. *See* DEL. CH. CT. R. 23.1(b) ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort.").

if they wish.[242] Delaware courts have held that this requirement is excused if demand would be futile, typically because the board faces a conflict of interest in reviewing it.[243] Second, if the case makes it past the demand requirement, the corporation can form a SLC that will investigate the allegations in the complaint and determine whether the suit is in the corporation's best interest.[244] If they decide that the suit is not in the corporation's best interest, they can ask the court to dismiss the suit.[245]

The demand requirement and SLC committees give corporate boards an opportunity to take control over derivative suits.[246] The rationale behind these procedures is that the plaintiff corporation is the real party in interest in these suits, and the board is normally entrusted to make decisions on behalf of the corporation.[247] Where directors face a significant risk of personal liability or another conflict of interest, it makes sense to place shareholders in charge of these suits instead.[248] If,

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242. *See* Am. Int'l Grp. v. Greenburg, 965 A.2d 763, 808 (Del. Ch. 2009) ("[The demand requirement] exists to preserve the primacy of board decisionmaking [*sic*] regarding legal claims belonging to the corporation.").

243. *See* Aronson v. Lewis, 473 A.2d 805, 808 (Del. 1984), *overruled in part by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) ("In our view demand can only be excused where facts are alleged with particularity which create a reasonable doubt that the directors' action was entitled to the protections of the business judgment rule.").

244. *See In re* INFOUSA, Inc. S'holders Litig., 953 A.2d 963, 986 (Del. Ch. 2007) (explaining that the SLC must determine whether pursuing litigation "would be excessively costly to the corporation or harm its long-term strategic interests").

245. *See* Minor Myers, *The Decisions of Corporate Special Litigation Committees: An Empirical Investigation*, 84 IND. L.J. 1309, 1313 (2009) ("If the SLC concludes that pressing the claims is not in the best interests of the corporation, it will generally produce a written report supporting its conclusion and will move on behalf of the corporation to dismiss the claims.").

246. *See* Erickson II, *supra* note 16, at 264 ("Where possible, however, the law tries to return power to the board. This effort is reflected in two procedural mechanism—the demand requirement and special litigation committees.").

247. *See In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 120 (Del. Ch. 2009) ("The decision whether to initiate or pursue a lawsuit on behalf of the corporation is generally within the power and responsibility of the board of directors.").

248. *See* Erickson II, *supra* note 16, at 264–65 (stating that directors are unlikely to initiate litigation where the risk of personal liability is "meaningful").

however, directors (or a committee of directors) can review the allegations in an unbiased way, there is no reason to usurp their authority.[249]

These procedures reflect traditional corporate law principles of board primacy, but they also raise questions about whether board members can objectively review derivative claims.[250] The demand requirement and SLC review are premised on the idea that directors are either biased or unbiased.[251] If they themselves face a significant risk of liability or are beholden to the corporation or another defendant, then they are biased and cannot objectively review a shareholder demand or serve on an SLC.[252] Otherwise, however, they are deemed independent and can use the available means to regain control over the suit.[253]

Yet independence is not an on/off switch. As many scholars and even courts have noted, directors can face more subtle pressure to reject derivative claims, even if they are technically independent.[254] In controlling shareholder contexts, for example, directors may worry that, if they approve claims against the controller, the controller may retaliate in ways that

249. *See* Grimes v. Donald, 673 A.2d 1207, 1216 (Del. 1996), *overruled in part by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (stating that "[t]he demand requirement serves a salutary purpose," including that "if litigation is beneficial, the corporation can control the proceedings").

250. *See* Erickson II, *supra* note 16, at 266 (questioning whether directors "can ever act truly independently when it comes to evaluating claims against fellow directors").

251. *See* Davis II, *supra* note 69, at 1308 (listing the various factors that are used to determine whether a director is biased).

252. *See Grimes*, 673 A.2d at 1216

> The basis for claiming excusal would normally be that: (1) a majority of the board has a material financial or familial interest; (2) a majority of the board is incapable of acting independently for some other reason such as domination or control; or (3) the underlying transaction is not the product of a valid exercise of business judgment.

253. *See* Erickson II, *supra* note 16, at 266 (noting that Delaware law defers to directors free of conflict).

254. *See* Davis II, *supra* note 69, at 1317 ("[T]here are subtle, perhaps unconscious, influences that may cloud an outside director's objectivity.").

hurt the business.[255] More generally, directors may hesitate to support claims against their fellow directors, even if they are not technically beholden to them.[256] As the Supreme Court of Delaware stated, "notwithstanding our conviction that Delaware law entrusts the corporate power to a properly authorized committee, we must be mindful that directors are passing judgment on fellow directors in the same corporation and fellow directors, in this instance, who designated them to serve both as directors and committee members."[257] Under these circumstances, the court noted: "[t]he question naturally arises whether a 'there but for the grace of God go I' empathy might not play a role."[258]

Indeed, the procedural record suggests that corporate directors rarely support bringing claims against their fellow corporate managers. For example, a recent study of 384 SLC decisions between 1990 and 2015 found that SLC committees recommend dismissal of the derivative claims in nearly three-quarters of the cases in which an SLC filed a report.[259] The SLC only recommends that the company pursue or settle the litigation in 12 percent of cases, and this percentage has decreased over time.[260] The SLC process can also consume

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255. *See* Ann M. Lipton, *After* Corwin*: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977, 1984 (2019)

> Delaware courts continued to remain rock solid in their confidence that independent directors could faithfully consider a shareholder's demand that the corporation pursue litigation against a controlling shareholder alleged to have breached its duties to the corporation, despite their refusal to trust independent directors to stand against controllers in any other context.

See also Da Lin, *Beyond Beholden*, 44 J. CORP. L. 515, 557 (2019) (demonstrating the limitations of a legal framework for controlling shareholder transactions that focuses solely on whether directors are beholden to the controlling shareholder).

256. *See* Davis II, *supra* note 69, at 1307 ("In questioning whether deference to the SLC's determination is appropriate, courts and commentators have often invoked the notion of 'structural bias.'").

257. Zapata Corp. v. Maldonado, 430 A.2d 779, 787 (Del. 1981).

258. *Id.*

259. C.N.V. Krishnan et al., *How Do Legal Standards Matter? An Empirical Study of Special Litigation Committees*, 60 J. CORP. FIN. 1, 2 (2020).

260. *See id.* at 7 (showing a decreasing trend from 22 percent in the period of 1990–1995 to 8 percent in the period from 2011 to 2015).

considerable time during the course of the litigation, as the SLC filed a motion to stay in 38 percent of cases.[261]

The demand requirement did not fare much better. One study of derivative suits in federal court, for example, found that shareholder plaintiffs only made a demand on the corporation's board in 20.3 percent of cases.[262] In other words, despite the fact that nearly every jurisdiction in the United States requires shareholders to make a demand prior to filing a lawsuit, shareholders almost always declined to make a demand and instead argued that demand would be futile.[263] A study of derivative litigation in Delaware found a similar result.[264] In jurisdictions that recognize demand futility as a possible justification, the defendants filed a motion to dismiss on this ground in nearly 50 percent of the cases.[265] As this data suggests, even seemingly simple procedural requirements can force parties to spend considerable time fighting over these requirements in court.[266]

Stepping back, it is possible to draw some comparisons between the roles of corporate boards in shareholder derivative suits and merger litigation. In derivative suits, corporate boards play a larger role because the corporation is the real party in interest and boards typically have tremendous control over the

261. *See id.* at 6 (explaining that the motion to stay is "made to permit the SLC to complete its work without competing activity from the plaintiffs' law firms").

262. *See* Erickson I, *supra* note 7, at 1782 ("[D]espite the demand requirements adopted in nearly every state, the derivative plaintiff did not make a presuit demand in nearly 80 percent of the cases.").

263. *See id.* at 1782 (explaining that there is a "strong incentive" for plaintiffs to claim demand futility).

264. *See* Thompson & Thomas II, *supra* note 61, at 1748–50 ("We did not find a single example in which the complaint said that a demand had been made on the directors.").

265. *See* Erickson I, *supra* note 7, at 1783 ("In the eleven universal demand cases in which the derivative plaintiff did not make a presuit demand, the defendants filed a motion to dismiss on this basis in five of the cases, or just under half.").

266. *See id.* at 1784 (noting that corporations "spend significant time and money" fighting over procedural issues).

corporations.[267] Boards do not have the same power in merger litigation because corporations are typically the defendants in these suits and therefore they do not have unilateral power to block or dismiss the suits.[268] Nonetheless, the board's traditionally outsized role in derivative suits can provide insight into the new powers recently given to boards to include new procedural rules in corporate charters and bylaws.[269] This private ordering extends the board's powers to a broader subset of shareholder lawsuits, but raises some of the same concerns that have long been present in derivative suits, as we will see in the next Part.[270]

IV. Uncovering the Lost Lessons of Derivative Suits

Derivative suits have long been in their own analytical silos. Commentators have recognized the common entrepreneurial roots of most types of shareholder lawsuits, including derivative suits, but the comparisons have not gone much further. Yet these suits have much more in common with other types of shareholder litigation, especially merger litigation, than has previously been recognized.[271] Indeed, as Part II demonstrated, many of the problems recently seen in merger litigation resemble earlier problems seen in derivative suits.[272] This Part builds on these similarities to develop a set of broader lessons for shareholder litigation. It first examines the lessons relating to nonmonetary settlements before developing lessons for forum selection and the role of corporate boards in shareholder lawsuits.[273]

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267. *See In re* Activision Blizzard, Inc. Stockholder Litig., 124 A.3d 1025, 1044 (Del. Ch. 2015) ("A corporate claim is an asset of the corporation, so authority over the claim ordinarily rests with the board of directors.").

268. *See supra* note 235 and accompanying text.

269. *See supra* notes 219–221 and accompanying text.

270. *See infra* Part IV.

271. *See supra* Part III.

272. *See supra* Part II.

273. *See infra* Part IV.A–B.

A. Rethinking Settlements

The problems in merger litigation can be traced in large part to the prevalence of disclosure-only settlements. These settlements are relatively cheap, which create incentives for defendants to settle rather than litigate, even if claims have no merit.[274] Defendants' willingness to settle in turn created incentives for plaintiffs' attorneys to file an increasing number of these cases, leading to the sky-high filing rates of the past decade.[275] Yet, as Part II.A. explained, these settlements shared many of the same characteristics as the nonmonetary settlements that have long been common in derivative suits.[276] The actual consideration varies in the two types of cases—settlements in merger litigation involve disclosures about the planned merger, while settlements in derivative suits include corporate governance reforms.[277] The availability of nonmonetary relief in both types of suits, however, provided an incentive for defendants to cheaply settle cases with dubious merit, fueling the filing of these claims.[278]

The shared characteristics of the settlements in these cases provide two lessons for courts and policymakers. First, nonmonetary settlements are not a new invention that only recently appeared in merger litigation.[279] They have been around for a long time, and they have had a similar impact across different types of lawsuits.[280] This recognition should make it easier to identify potential problems if a new brand of nonmonetary settlements someday appears in shareholder litigation or in another type of representative litigation.

274. *See supra* Part II.A.

275. *See supra* Part II.A.

276. *See supra* Part II.A.

277. *See* Erickson I, *supra* note 7, at 1754 ("[S]hareholder derivative suits more commonly end with the parties agreeing to corporate governance settlements.").

278. *See supra* Part II.A.

279. *See* Coffee, *supra* note 40, at 716 ("By settling, neither side loses anything, and both recoup their legal expenses from the corporation (and thus indirectly from the shareholders).").

280. *See supra* Part III.A.

When disclosure-only settlements started to become more common in merger litigation, they were viewed as a new phenomenon.[281] As a result, it took courts in Delaware and elsewhere several years to recognize and respond to the problem. Indeed, the prevalence of merger litigation started to sharply rise in 2009,[282] but the Delaware Court of Chancery did not adopt a more skeptical standard of review of disclosure-only settlements until the *Trulia* decision in 2016.[283] Had the court recognized disclosure-only settlements as part of the larger problem of nonmonetary settlements in shareholder litigation, it might not have taken the court so long to act.[284]

Second, the shared characteristics of settlements in both types of shareholder litigation may suggest a need for a broader response. Under Delaware law, *Trulia* governs nonmonetary settlements in merger litigation, requiring the court to reject a disclosure-only settlement unless the disclosures are plainly material.[285] Yet this scrutiny does not extend to nonmonetary settlements in derivative suits.[286] Instead, Delaware courts routinely approved derivative settlements that include only corporate governance reforms.[287] The two types of settlements exist in wholly separate legal spheres, despite the common incentives that underlie them.[288]

281. *See* Fisch et al., *supra* note 33, at 564 ("The Delaware courts developed the scope of directors' state law disclosure obligations fairly recently.").

282. *See* Cain et al., *supra* note 1, at 620 ("From 2003 to 2008, litigation challenges ranged from 33% of completed deals (2004) to 43% of completed deals (2008). There was a sharp rise in the litigation rate in 2009 to 76% of completed deals.").

283. *See supra* notes 82–85 and accompanying text.

284. *See supra* notes 77–85 and accompanying text.

285. *See supra* notes 84–85 and accompanying text.

286. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (approving nonmonetary settlement while noting that "the changes in corporate practice that are presented as consideration for the settlement do not impress one as very significant").

287. *See In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 894 (Del. Ch. 2016) (discussing the "Court's willingness in the past" to approve disclosure-only settlements).

288. *See id.* at 887 (providing the court's perspective on only those disclosure claims "arising in deal litigation").

Perhaps the time has come for Delaware to adopt a version of *Trulia* for derivative suits. Such a standard would not bar all nonmonetary settlements in these suits, but it would hold parties to a higher standard when seeking court approval of settlements where the primary consideration is corporate governance reforms.[289] Studies have shown, for example, that derivative settlements often include reforms that have no connection whatsoever to the underlying misconduct alleged in the complaint.[290] These settlements instead often include the same laundry list of reforms, many of which are empirically untested or have been shown not to improve firm performance.[291]

Delaware or other jurisdictions could adopt a new standard of review for nonmonetary settlements in derivative suits that responds to these specific concerns. As part of this new standard, courts could require parties to demonstrate that the reforms included in settlements are specifically tailored to the types of corporate governance problems identified in the litigation. If a derivative plaintiff alleges that the corporation's board of directors abdicated its oversight responsibilities, the settlement should include specific reforms that increase the board's oversight over the corporation's business and affairs. Similarly, any proposed reforms should be supported by specific studies showing their impact on firm performance or other relevant metrics or by a detailed explanation of how the reform will be beneficial to the specific company in question. Courts may also examine the contractually agreed upon length of the reforms to make sure that the reforms have a chance to impact the corporation's governance practices.

289. *See id.* (requiring disclosure settlements to be "fair and reasonable").

290. *See* Erickson I, *supra* note 7, at 1811 ("Many more provisions in the settlement agreements, however, were not tailored to the specific problems alleged in the complaint. Indeed, there was often a striking disconnect between the alleged problems and the reforms in the settlement agreements.").

291. *See id.* at 1755 ("Drawing on business and finance literature, this Article demonstrates that corporate governance settlements often fail to live up to their potential because they include reforms that are unlikely to benefit corporations or their shareholders.").

This inquiry would likely be more difficult than the inquiry under *Trulia*. *Trulia* envisions a relatively cabined examination of the materiality of specific disclosures.[292] The judge must evaluate the specific disclosures in the context of the merger, determining whether it significantly adds to the total mix of information available to shareholders.[293] In conducting this examination, the judge can build on precedent evaluating similar disclosures in other merger cases.[294] In derivative suits, however, the inquiry is not that straightforward.[295] Derivative suits allege a variety of different types of governance failures, and it can be difficult to determine whether a specific set of reforms will have a material impact on the governance of particular companies.[296] Nonetheless, starting from a more skeptical vantage point and requiring the parties to identify the specific benefits of the proposed reforms could help.

Moreover, courts could decide to use a more searching review whenever they encounter nonmonetary settlements in representative litigation, even outside of the particular contexts of merger and derivative litigation. Again, nonmonetary settlements are not always bad, but they do raise particular concerns and therefore merit more judicial scrutiny than the typical settlement.[297] The exact test might vary in different types of litigation, but if courts heeded the lessons of derivative suits and merger litigation, they might be better prepared to

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292. *See In re Trulia, Inc.*, 129 A.3d at 894 (evaluating the issue of materiality in the context of supplemental disclosures).

293. *See id.* at 899 ("[I]nformation is material if, from the perspective of a reasonable stockholder, there is a substantial likelihood that it 'significantly alter[s] the "total mix" of information made available.'" (alteration in original) (quoting Arnold v. Soc'y for Sav. Bancorp, 650 A.2d 1270, 1277 (Del. 1994))).

294. *See id.* at 894 ("In Delaware, the percentage of such cases settled solely on the basis of supplemental disclosures grew significantly from 45.4% in 2005 to a high of 76.0% in 2012, and only recently has seen some decline.").

295. *See* Erickson I, *supra* note 7, at 1815 (explaining that many reforms in derivative suits are "part of a larger movement" rather than "specific solutions to specific allegations of misconduct").

296. *See id.* at 1822 (finding that many corporate governance settlements lacked the types of reforms that have proven impactful on corporate performance).

297. *See* Fisch et al., *supra* note 33, at 561 ("[T]he illusory benefit of supplemental disclosure must be weighed against the clear cost of merger litigation . . . .").

address new types of nonmonetary settlements, regardless of their precise form.

B. Rethinking Forum

Scholars and commentators long assumed that corporate and securities lawsuits each stayed in their own jurisdictional lane.[298] Corporate lawsuits—i.e., those filed under state corporate law such as merger litigation and derivative suits—were filed in state court, with public company suits primarily in Delaware.[299] In contrast, securities suits—i.e., those filed under the federal securities laws—stayed in federal court.[300] Over time, this dichotomy started to break down.[301] Scholars observed that Delaware was losing its cases, with shareholders filing an increasing percentage of state corporate cases in other venues.[302] At the same time, some plaintiffs' lawyers started to file many securities class actions in state court, exploiting loopholes in federal legislation providing for exclusive federal jurisdiction over these cases.[303] These trends complicated the traditional narrative about forum selection in corporate and securities litigation.

298. *See* Thompson & Thomas II, *supra* note 61, at 1760 ("While derivative suits against public corporations do occur outside the state, the Delaware courts capture the bulk of derivative litigation against public companies.").

299. *See id.* (referring to Delaware as "the country's most important corporate law jurisdiction.").

300. *See* 15 U.S.C. § 78aa(a) (2018) (granting exclusive jurisdiction to federal courts over classic securities fraud claims filed under section 10(b) of the Securities & Exchange Act of 1934); *see also* Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund, 138 S. Ct. 1061, 1066 (2018) (explaining that other types of securities cases, such as claims brought under Section 11 and 12 of the Securities Act of 1933, can be brought in either state or federal court).

301. *See supra* notes 212–213 and accompanying text.

302. *See supra* notes 213–214 and accompanying text.

303. *See* Jennifer J. Johnson, *Securities Class Actions in State Court*, 80 U. CIN. L. REV. 349, 350 (2011) (presenting data demonstrating that, after Congress passed the Private Securities Litigation Reform Act and the Securities Litigation Uniform Standards Act, plaintiffs' attorneys "increasingly have turned to filing alternative [securities] class actions in state court").

As Part II discussed, however, merger litigation and derivative suits did not just leave Delaware.[304] Both types of litigation left Delaware and ended up in federal court.[305] Derivative suits made this shift at least a few decades before merger litigation,[306] but both types of lawsuits are now filed primarily in federal court.[307] The scholarly literature has not previously recognized this point, nor has it fully explored the consequences of having cases that were traditionally filed in state court now in federal court.

In unpacking the lessons now, it is important to recognize that the two types of litigation did not follow identical paths. With derivative suits, the trend stayed largely under the radar.[308] No one knows exactly when derivative suits started to leave Delaware and other state courts, although at least by the 2000s, these suits were firmly in federal court.[309] With merger litigation, this shift was far more sudden and public.[310] In 2015, of those mergers challenged in court, 60 percent of mergers were challenged in Delaware, while only 20 percent were filed in federal court.[311] Just two years later, in 2017, the numbers

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304. *See supra* Part II.

305. *See supra* Part III.B.

306. *See* Erickson I, *supra* note 7, at 1754 (finding that, by at least the mid 2000s, most derivative suits were filed in federal court).

307. *See supra* Part III.B.2.

308. *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 41 (1993) (finding that over half of derivative and other corporate lawsuits (71 of the 139 total suits) were filed in federal courts); Armour et al., *supra* note 214, at 610 n.23

> In hindsight, Romano's data suggest that the federal courts have been a significant venue for corporate lawsuits for some time, but . . . neither she nor anyone else focused on this. Romano's original 1991 study does not discuss where suits were filed; the data we rely on here are mentioned only in her later book, and only in passing.

309. *See supra* note 306 and accompanying text.

310. *See supra* Part III.B.

311. *See* Cain et al., *supra* note 1, at 621 tbl.1 (finding that, between 2003 and 2015, a significant percentage of mergers were challenged in states other than Delaware). Indeed, many mergers were challenged in multiple courts, including the Delaware Court of Chancery, the state court in the state where the corporation was headquartered, and in some instances, federal court. *Id.*

looked quite different. Of those mergers challenged in court, only 9 percent of mergers were challenged in Delaware, while 87 percent were filed in federal court.[312] Merger cases left for federal court seemingly in the blink of an eye, while the shift for derivative suits was likely slower. At the end of the day, however, most derivative suits and merger litigation are now filed in federal court.[313]

Given that derivative suits have been in federal courts for far longer than merger lawsuits, it is worth asking what lessons we can draw from this experience. The first lesson is that it is easy for cases to fall under the radar when they are not concentrated in a single forum.[314] Once derivative suits moved into federal court, they became almost invisible.[315] Indeed, a prominent study of derivative suits assumed that derivative suits had largely disappeared after looking for these suits in Delaware and only finding a few of them.[316] After surveying the Delaware cases, this study concluded that "there are relatively few derivative suits against public companies" and that they had receded from the "lofty position" that they had historically held in corporate law.[317] Other studies referred to these suits as "dead,"[318] or stated that the evidence suggested that derivative suits "are not performing a large role in corporate

Yet, throughout this entire period, of those mergers challenged in court, the percentage of mergers challenged in federal court averaged only 28 percent, compared to 41 percent challenged in Delaware and 74 percent challenged in a state court other than Delaware. *Id.*

312. *Id.*

313. *See supra* notes 305–306 and accompanying text.

314. *See* REVIEW OF 2018 M&A LITIGATION, *supra* note 164, at 5 ("In 2018, only 45 percent of challenged M&A deals were litigated in one jurisdiction only, a five-year low.").

315. *See* Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1492 (2006) ("Derivative suits have been eclipsed in recent years by [other] form[s] of representative litigation . . . .").

316. *See* Thompson & Thomas II, *supra* note 61, at 1749 (finding a "small number of derivative suits").

317. *Id.* at 1756, 1773.

318. *See* Veasey & Dooley, *supra* note 18, at 142 (discussing how commentators refer to derivative suits).

governance."[319] In short, once these suits left Delaware, people assumed that these cases had largely disappeared and stopped paying as much attention to them.[320]

It is possible that merger cases will similarly fade from view once they are no longer concentrated in Delaware. Here, though, the different trajectories of derivative suits and merger litigation may play in merger litigation's favor. Unlike derivative suits, merger litigation did not go quietly into the night.[321] The flight of merger litigation into federal court was so sudden and was such a clear illustration of forum shopping that it generated significant attention, even prompting judges to suggest new ways to bring these cases back to Delaware.[322] Yet, this attention could wane as practitioners grow more accustomed to these cases being in federal court. And once cases are scattered across the country, no longer filling up any particular court's docket, it will be easier to forget about them. The point here is not that merger cases definitely will fade from view, but rather that the legal system should be attentive to the possibility given the lessons from derivative suits.

Second, even if merger cases stay in the spotlight, it may be harder to police them now that they have left Delaware.[323] The Delaware Court of Chancery serves an important monitoring role when it comes to corporate law.[324] Chancery judges do not just narrowly handle the cases in front of them; they keep an eye on broader trends and slowly shape the law to be responsive

319. Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1473 n.164 (2006).

320. *See* Veasey & Dooley, *supra* note 18, at 142 (referring to conversations that pronounced the derivative suit as "already dead and gone and buried").

321. *See* Cain et al., *supra* note 1, at 605 (describing Delaware's response to excessive merger litigation as forceful).

322. *See In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) (suggesting forum selection clauses as a method for bringing cases back to Delaware).

323. *See* Erickson II, *supra* note 16, at 257–58 (explaining that few courts outside of Delaware have the knowledge and incentives to properly police shareholder litigation).

324. *See* Sale, *supra* note 34, at 391 ("Judges have the power and the responsibility to guard against the agency issues and protect the interests of the shareholders and class members.").

to these trends.[325] This legal evolution then shapes corporate law throughout the country and even the world.[326] Will fiduciary duty law related to mergers evolve more slowly now that most merger cases are filed in federal court?

Again, the lessons of derivative suits are instructive here. When the majority of derivative suits moved into federal court, the ones that remained in Delaware looked different than the federal suits.[327] The derivative suits in federal court tended to be tagalong suits to securities class actions where derivative plaintiffs took securities claims and repackaged them as fiduciary duty claims.[328] These suits often ended with nonmonetary settlements that offered little benefit to plaintiff corporations or their shareholders.[329] These suits looked quite different than the derivative suits that remained in Delaware, which tended to involve more classic breaches of fiduciary duty, such as self-dealing or other conflicts of interest.[330] These cases

325. *See, e.g.*, Donald F. Parsons, Jr. & Jason S. Tyler, *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, 70 WASH. & LEE L. REV. 473, 524 (2013)

> Delaware's volume of corporate and alternative business entity cases, the fact that those cases are litigated before the relatively small, but expert, Delaware Court of Chancery and Supreme Court, and the responsiveness of its courts, its legislature, and the marketplace generally accelerate the development of refined doctrine, measured balance, and valuable predictability.

326. *See* Veasey & Dooley, *supra* note 18, at 141 ("Delaware has not only set the standard for the rest of the states in the United States, but increasingly is exercising influence abroad. For the past 100 years, this state has been the laboratory where our most fundamental concepts of corporate governance have been developed and refined.").

327. *See supra* Part III.B.2.

328. *See* Erickson V, *supra* note 198, at 80. ("Many shareholder derivative suits may simply serve as tagalong suits to other types of corporate litigation.").

329. *See* Erickson I, *supra* note 7, at 1754 ("Remarkably few of the suits in my study ended with the corporation receiving a meaningful financial benefit. Instead, shareholder derivative suits more commonly end with the parties agreeing to corporate governance settlements.").

330. *See* Thompson & Thomas II, *supra* note 61, at 1772–73 (reviewing derivative suits filed in Delaware and finding that "almost 60 percent of the complaints raise principally a duty of loyalty claim" and that these claims involved allegations of either self-dealing or mergers involving preferential treatment for insiders).

did not raise the same agency costs as the cases filed in federal court,[331] and as a result Delaware courts may not have been aware of the problems in these federal cases. It is hard to blame Delaware courts for failing to fully recognize the problems with these suits when the cases filed in Delaware courts did not raise these problems, at least not to the same extent.[332] The end result, however, was that Delaware has been slower to recognize the problems in these suits.[333]

There is a risk that the same thing could happen in merger litigation. Even today, merger cases have not fully left Delaware.[334] In 2018, for example, 13 percent of merger cases against Delaware corporations were challenged in Delaware, suggesting that Delaware will still oversee some of these cases.[335] Yet, if the merger cases that remain in Delaware look significantly different than cases filed in other jurisdictions, Delaware judges could miss broader trends. If, for example, plaintiffs' attorneys file more meritorious cases in Delaware with the idea that these cases would survive the scrutiny of Delaware judges and may benefit from more expert judging, Delaware judges may not learn about the broader problems happening with these cases in other jurisdictions. This in turn could cause Delaware courts to pass up opportunities to shape the law in ways that could improve the corporate law more

331. *See id.* at 1750 ("The cases do demonstrate some indicia of litigation agency costs (for example, suits being filed quickly, multiple suits per controversy, and repeat plaintiffs' law firms), but each of these costs is much less pronounced for derivative suits than for other forms of representative litigation.").

332. *See id.* ("[These cases] raise none of the problems of representative litigation that can arise in public companies.").

333. *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?,* 44 UCLA L. REV. 1009, 1094 (1997) (noting that in the 1980s, many management-led buyouts were likely challenged in other states, but only Delaware developed a robust case law on these types of deals). "[T]here seems to be a minimum number of cases required to generate a reasonably well-specified jurisprudence, and only Delaware seems to have passed this threshold." *Id.*

334. *See* REVIEW OF 2018 M&A LITIGATION, *supra* note 164, at 5 (surveying the jurisdictions in which plaintiffs filed merger claims).

335. *See id.* (reporting results of the review).

broadly.[336] One corporate lawyer has openly acknowledged this risk, stating

> The success of the Chancery system depends on its exposure to, and adjudication of, a large and representative docket of governance and deal cases. A court that handled such cases only episodically would be more likely to fall victim to the 'availability heuristic,' the cognitive bias that causes decision makers to be overly influenced by proximate examples.[337]

The situation in merger litigation is further complicated because the cases that are leaving Delaware are often also leaving Delaware law.[338] Any breach of fiduciary duty case filed against a corporation incorporated in Delaware will still be governed by Delaware law, regardless of where the cases is filed.[339] As we have seen, however, not all merger cases today are breach of fiduciary duty cases.[340] Shareholders can also challenge mergers under federal law, which eliminates all oversight by the Delaware judiciary.[341] The restrictions of the Private Securities Litigation Reform Act apply to these claims,[342] but these restrictions are not a perfect fit for the particular challenges of merger cases.[343] Moreover, these cases

336. *See* William Savitt, *Leave Merger Disclosure Litigation Where It Belongs*, 93 TEX. L. REV. SEE ALSO 173, 182 (2015) ("[A]ssigning disclosure claims to federal court would . . . interfere with Delaware's ability to shape its substantive law . . . .").

337. *Id.* at 186.

338. *See supra* Part III.B.1.

339. *See* Teleglobe Commc'ns Corp. v. BCE Inc. (*In re Teleglobe Commc'ns Corp.*), 493 F.3d 345, 385 n.37 (3d Cir. 2007) (explaining that the law of the state of incorporation governs issues relating to internal affairs).

340. *See supra* note 156 and accompanying text.

341. *See supra* Part III.B.1.

342. *See* 15 U.S.C. § 78u-4 (2018) ("The provisions of this subsection shall apply in each private action arising under this title [15 U.S.C. § 78a] that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.").

343. For example, the heightened pleading standards in the PSLRA only come into play if the defendant decides to file a motion to dismiss. *Id.* The defendant may agree to pay a mootness fee, rather than challenging the adequacy of the pleadings, to avoid the expense of a motion to dismiss. *Id.* Similarly, the lead plaintiff provisions only help if there are multiple applicants for the lead plaintiff position, at least some of whom have a substantial stake in the litigation. *Id.*

will be spread across federal courts throughout the country, making it difficult for particular federal judges to notice broader trends and respond accordingly.

There is no easy solution to this problem. Derivative suits are typically filed under state law, so forum selection clauses included in a corporation's charter or bylaws can bring these cases back to Delaware where they will presumably be subject to more scrutiny.[344] Many federal securities claims, however, are subject to exclusive federal jurisdiction, so corporations cannot simply decide that all merger cases must be filed in Delaware.[345] As a result, it will be up to federal law to respond to the new challenges in these cases, either through greater judicial oversight or by new federal legislation or rulemaking.

The precise solutions can wait for another day, but the broader lessons remain. While it is impossible to predict exactly what will happen in merger litigation, the experience in derivative suits suggests that merger cases could fade from our attention now that they have moved into federal court.[346] It could also be more difficult for courts to police these cases now that they are more dispersed. In the end, the legal system has not yet grappled with the costs of forum shopping in merger litigation, just as it has never grappled with the costs in derivative suits.

C. Rethinking Gatekeepers

The final lesson that emerges from the experience in derivative suits relates to the role of corporate boards. As Part III.C. explained, in recent years, Delaware opened the door for boards to include new procedural hurdles in their corporate charters and bylaws that make it more difficult to file shareholder lawsuits.[347] As corporate boards start to dabble in procedural rulemaking, however, courts might heed the lessons from shareholder derivative suits. In derivative suits, corporate

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344. *See In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 n.8 (Del. Ch. 2010) (explaining the value of forum selection clauses while noting companies may not "wholly exempt themselves from Delaware oversight").

345. *See supra* note 303 and accompanying text.

346. *See supra* notes 315–320 and accompanying text.

347. *See supra* Part III.C.

boards have long had the power to take control of litigation through the demand requirement and the formation of an SLC committee.[348] This experience provides lessons about the role of structural bias in board decision making that may be relevant for courts as they experiment with a new gatekeeping role for corporate boards in merger litigation.[349]

The experience in derivative suits reflects a longstanding concern over structural bias when it comes to board oversight of shareholder litigation.[350] In most derivative suits, as in most merger litigation, directors are among the defendants in the lawsuit.[351] Even if a derivative complaint does not name the entire board, the directors who are not named as defendants may still be predisposed to allow their fellow directors to avoid liability.[352] Interestingly, the two procedural hurdles in derivative suits—the demand requirement and SLC review—handle the risk of structural bias differently, and this difference provides insights for merger litigation.[353]

When it comes to the demand requirement, courts have adopted a black-or-white view of director independence.[354] Demand is excused only if a majority of the directors cannot evaluate the demand in an unbiased way.[355] In evaluating individual directors, the plaintiff must identify specific reasons why the director cannot evaluate a demand in an independent

348. *See supra* Part III.C.2.

349. *See* Davis II, *supra* note 69, at 1325 ("[E]ven SLC members intent on doing the right thing face a serious challenge to their objectivity.").

350. *See id.* at 1324 n.87 ("Subjects, once induced to espouse a position they do not believe, will modify their views to conform to their stated position in order to avoid seeing themselves as dishonest.").

351. *See* Erickson I, *supra* note 7, at 1772 ("Consistent with the conventional wisdom, these plaintiffs targeted a significant number of directors—a median of nine per suit. This number reflects the fact that most complaints named the entire board of directors.").

352. *See supra* notes 256–258 and accompanying text.

353. *See supra* Part III.C.2.

354. *See supra* note 251 and accompanying text.

355. *See* Aronson v. Lewis, 473 A.2d 805, 808 (Del. 1984), *overruled in part by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) ("In our view demand can only be excused where facts are alleged with particularity which create a reasonable doubt that the directors' action was entitled to the protections of the business judgment rule.").

way.[356] The risk of structural bias, on its own, is not enough.[357] There are sound reasons for this insistence on particularized allegations. If derivative plaintiffs could establish that a director is biased simply by pointing to the omnipresent risk of structural bias, demand would always be futile.[358]

Yet, even if there are pragmatic reasons for conducting a director-by-director examination, these reasons do not erase the reality of structural bias. Indeed, conventional wisdom is that, if a derivative plaintiff makes demand on the board, the board will almost certainly reject it.[359] Recognizing this fact, derivative plaintiffs almost never make a demand, instead arguing that demand is futile.[360] And so the first stage of almost every derivative suit is a protracted fight over demand futility.[361] In these fights, courts examine the minute details of directors' business and social relationships, while ignoring

356. *See id.* at 816 (requiring plaintiff only to allege specific facts, not evidence).

357. *See id.* at 815 n.8

> We recognize that drawing the line at a majority of the board may be an arguably arbitrary dividing point. Critics will charge that we are ignoring the structural bias common to corporate boards throughout America, as well as the other unseen socialization processes cutting against independent discussion and decisionmaking in the boardroom. The difficulty with structural bias in a demand futile case is simply one of establishing it in the complaint for purposes of Rule 23.1.

358. *See* Erickson II, *supra* note 16, at 276 ("For obvious reasons, directors are not unbiased decision makers when it comes to deciding if the corporation should be able to sue them.").

359. *See* Matheson, *supra* note 29, at 359 (stating that if the plaintiff makes a demand, "the most likely scenario" is that the board will reject it). Moreover, if the derivative plaintiff makes a demand, courts view the demand as a tacit admission that the board is competent to review it. *Id.* In this scenario, if the board rejects the demand, the plaintiff's only option is to challenge the board's decision as wrongful, which is an uphill battle. *Id.*

360. *See* Erickson I, *supra* note 7, at 1782 (surveying federal derivative suits and finding that "despite the demand requirements adopted in nearly every state, the derivative plaintiff did not make a presuit demand in nearly 80 percent of the cases").

361. *See* Erickson II, *supra* note 16, at 267 ("[T]he demand requirement and the SLC process mean that shareholders must run a gauntlet of procedural hurdles before they can present the substance of their claims.").

broader structural concerns.[362] In short, the review of demand futility in derivative suits gets bogged down in details of individual director relationships without ever reckoning with broader concerns of structural bias.[363]

Courts could face similar issues in reviewing new charter and bylaw amendments that purport to govern merger and other forms of litigation. The Delaware General Corporate Law now explicitly authorizes boards to include forum selection clauses in bylaws and charters,[364] and the Delaware Court of Chancery has stated that it will permit other rules as long as they were adopted "for a proper purpose."[365] On its face, this standard is quite different than the standard that courts use to review claims of demand futility, focusing on the subjective motivations of the adopting board rather than their business or personal relationships.

Yet, in many ways, its impact may be similar. Both standards force the court to do an individual assessment focused on particular directors, whether it be their motivations or relationships.[366] This assessment will have to be repeated in every case, as a board's motivation in one case could differ from the motivations of another board even if the underlying bylaw amendments are identical. Yet the time and expense of such a case-by-case review will still not fully reckon with the risk of

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362. *See* Matheson, *supra* note 29, at 363 (explaining that courts evaluate whether a director "will receive a personal financial benefit").

363. *See Aronson*, 473 A.2d at 817 ("In Delaware mere directorial approval of a transaction, absent particularized facts supporting a breach of fiduciary duty claim, or otherwise establishing the lack of independence or disinterestedness of a majority of the directors, is insufficient to excuse demand.").

364. *See* DEL. CODE ANN. tit. 8, § 115 (2019) ("The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State . . . .").

365. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 559 (Del. 2014). The only procedural rule that is expressly off the table are those that require the losing party to pay their opponents' legal fees. DEL. CODE ANN. tit. 8, § 109(b) (2019).

366. *See* Matheson, *supra* note 29, at 363 (noting a director may be interested "if the director was dominated by a shareholder or director who is a defendant").

structural bias.[367] Even if a board can articulate a proper purpose for its actions, it is still quite possible that the board was also motivated by the desire to protect itself from future litigation, whether consciously or not.[368] A board can easily claim that its goal was to prevent frivolous suits or better screen claims, without acknowledging that they would be the defendants in these hypothetical future suits.[369] This standard therefore creates a litigation fight at the start of these suits without ever acknowledging the more serious concerns.[370]

Interestingly, courts have used a different approach when it comes to the second procedural hurdle in derivative suits—SLC committees. Rather than only focusing on the independence of individual SLC members, Delaware courts have crafted a standard that recognizes the structural bias inherent in *all* SLC investigations.[371] In reviewing an SLC recommendation, Delaware courts typically use an intermediate form of scrutiny that examines both the committee's independence and process, as well as whether it had a reasonable basis for its recommendation.[372] Even if the committee meets its burden of proof on these elements, the court will still go on to apply "its own independent business judgment"

367. *See* Erickson II, *supra* note 16, at 263 ("[C]orporate boards have *wide latitude* to use procedure to police shareholder claims." (emphasis added)).

368. *See id.* at 262 ("It goes against human nature to presume that directors will put the corporation's interests ahead of their own. As a result, we should be wary of trusting directors to serve as faithful monitors of the corporation's interests, and much less of the legal system more broadly.").

369. *See id.* at 264–66 (discussing the conflict of interest which often arises when corporate boards evaluate derivative claims).

370. *See* Davis II, *supra* note 69, at 1323 ("Group membership can be a powerful force—much more powerful than we might intuitively expect—of influence on how individuals act in settings that relate the group to outsiders.").

371. *See* Erickson II, *supra* note 16, at 268 ("[Under Zapata,] judges are supposed to be broader protectors of the corporate interest.").

372. *See, e.g.*, *In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 928 (Del. Ch. 2003) ("In order to prevail on its motion to terminate the Delaware Derivative Action, the SLC must persuade me that: (1) its members were independent; (2) that they acted in good faith; and (3) that they had reasonable bases for their recommendations.").

to determine whether the motion should be granted.[373] This standard expressly acknowledges that complete deference to nominally independent directors may not be appropriate where the board is considering claims against fellow directors.[374]

Empirical studies have shown that this judicial oversight matters.[375] In states that adopt a weaker form of scrutiny, SLCs are more likely to recommend dismissal.[376] Cases in these jurisdictions also settle for smaller amounts.[377] Moreover, after the Delaware Court of Chancery increased judicial scrutiny of SLC decisions, SLCs became less likely to recommend dismissal of the claims, further suggesting that more stringent review can blunt the impact of structural bias.[378]

Courts might adopt a similar standard of review when it comes to bylaw amendments that impose new procedural requirements in merger cases and other types of shareholder litigation. Given that the directors adopting these bylaw amendments could be among the defendants in any future suit, they have an incentive to adopt rules that bar even meritorious

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373. Zapata Corp. v. Maldonado, 430 A.2d 779, 789 (Del. 1981) ("The second step is intended to thwart instances where corporate actions meet the criteria of step one, but the result does not appear to satisfy its spirit, or where corporate actions would simply prematurely terminate a stockholder grievance deserving of further consideration in the corporation's interest.").

374. *See id.* at 787

> We are not satisfied, however, that acceptance of the 'business judgment' rationale at this stage of derivative litigation is a proper balancing point. While we admit an analogy with a normal case respecting board judgment, it seems to us that there is sufficient risk in the realities of a situation like the one presented in this case to justify caution beyond adherence to the theory of business judgment.

375. *See* Krishnan et al., *supra* note 259, at 17 ("[S]tronger judicial review of SLC reports seems more likely to help the plaintiff . . . .").

376. *See id.* ("[W]eaker judicial review of [SLC] reports makes it more likely that defendants will win.").

377. *See id.* ("[I]n states with the lowest level of judicial review for SLC reports, we find that SLCs are most likely to recommend case dismissal, more likely to have a case dismissed, and least likely to result in a high value settlement.").

378. *See id.* at 16 (discussing the effect of the change of the legal standard in Delaware).

claims.[379] Indeed, among the first procedural rules that corporate boards adopted were fee-shifting bylaws, which required the losing party in a shareholder suit to pay their opponent's attorneys' fees.[380] Fee-shifting bylaws may make sense in other contexts, but they are likely a death knell for merger litigation and other forms of representative litigation because a shareholder who only stands to gain their pro rata share of any litigation proceeds would now be on the hook for all of the costs.[381] In other words, as soon as corporate boards were given the opportunity to adopt new procedural rules for these suits, some adopted rules that effectively insulated them from litigation.[382] And the Delaware courts let them.[383]

A better approach would be to recognize the structural bias that exists when directors adopt procedural rules to govern suits that may someday be filed against them. An intermediate form of scrutiny—similar to the standard used to review SLC decisions—would take this bias into account and allow the courts to examine the objective reasonableness of any new procedural rules.[384] The examination should focus on the likely impact of the rule. Is the rule designed to sort meritorious cases from meritless ones? Or is it likely to make it more difficult for all plaintiffs to proceed with their claims, regardless of the claims' underlying merit? This objective standard would permit

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379. *See* Erickson II, *supra* note 16, at 273 ("[C]orporate boards and shareholders have already started to use these [bylaw and charter] amendments to limit merger litigation.").

380. *See id.* ("Several companies similarly adopted fee-shifting bylaws and charter amendments before they were barred by the Delaware General Assembly.").

381. *See* Griffith, *supra* note 14, at 29 ("Whatever the effects of a move to fee-shifting may be in other contexts, it almost certainly will kill shareholder litigation because it would force *representative* litigants to bear *individual* responsibility for the full cost of an unsuccessful suit." (emphasis in original)).

382. *See* Erickson II, *supra* note 16, at 273 (suggesting that the new procedural rules discouraged the filing of meritless claims).

383. *But see* DEL. CODE ANN. tit. 8, § 109(b) (2019) (changing the law to prevent fee-shifting provisions in corporate charters and bylaws).

384. *See supra* notes 371–374 and accompanying text.

procedural rules that help courts sort representative claims, while invalidating those that do not.[385]

Viewed through this lens, fee-shifting bylaws are obviously suspect, as they discourage all representative claims. Forum selection clauses, on the other hand, are likely fine, at least if they direct claims into a court with a reasonable relationship to the claims.[386] With these procedural tools, therefore, the standard mimics what Delaware has already done by statute.[387] This approach, however, could also apply to new types of procedural rules that future boards might adopt, including heightened pleading standards, limits on discovery, and new standing rules.[388] At the same time, it does not require the plaintiff to unearth evidence that any particular directors adopted the rule with a nefarious purpose, nor does it impugn the integrity of particular directors. It simply recognizes that we all have a natural tendency toward self-interest that, in this particular context, requires greater oversight by courts.[389]

More broadly, this approach would provide a foundation that future courts can use when deciding whether corporate boards should have greater power to influence shareholder lawsuits. It is unlikely that we have seen the last attempt by corporate boards to gain control over these suits. Rather than crafting a standard of review anew every time boards take this step, courts should recognize the familiar themes at play and use a similar standard. This approach will bring the lost lessons

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385. Other scholars have also advocated an intermediate level of scrutiny for this type of bylaw amendment, although they propose a different test. *See, e.g.*, Kaufman & Wunderlich, *supra* note 235, at 362 ("In our view, a proportionate and reasonable fee-shifting bylaw that responds to a legitimate threat to corporate welfare is one that provides for two-way shifting of reasonable fees for frivolous litigation as determined by a neutral arbiter.").

386. *See In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) (encouraging corporation to include forum selection clauses in their bylaws and charters).

387. *See* DEL. CODE ANN. tit. 8, § 109(b) (banning fee-shifting provisions); *id.* at § 115 (authorizing forum selection clauses).

388. *See, e.g.*, Jessica Erickson, *Investing in Corporate Procedure*, 99 B.U. L. REV. 1367, 1371–72 (2019) ("The field of civil procedure offers specific solutions to the problems of agency costs and cost asymmetries seen in shareholder litigation.").

389. *See supra* notes 235–237 and accompanying text.

of shareholder litigation out of the shadows to benefit future shareholder lawsuits.

V. Conclusion

Derivative suits are often viewed as the sleepier cousin of other, more interesting types of shareholder litigation. As the parties in merger litigation experimented with new types of settlements, fled to federal courts, and then pushed back on board control over these lawsuits, derivative suits stayed largely in the background. Yet, derivative suits had already survived many of these same developments.[390] Derivative suits have their own form of nonmonetary settlements, they have also fled to federal court, and they are also subject to board review.[391] These changes happened more slowly and received less attention than in merger litigation, but the changes themselves are remarkably similar.

These parallels provide lessons in the broader issues facing shareholder litigation.[392] The recent events in merger litigation are not unique. Instead, they are more common challenges that have arisen before and could arise again in other types of litigation.[393] Recognizing this fact should make courts and policymakers better prepared if similar issues arise in the future. Courts could develop, for example, broader rules to govern nonmonetary settlements, rather than addressing these settlements on a more ad hoc basis in different types of litigation.[394] They could also face more directly the challenges that inevitably arise when boards of directors have the power to review claims that may someday be filed against them.[395] By uncovering the lost lessons of derivative suits, the legal system will be ready if history repeats itself again.

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390. *See supra* Part III.
391. *See supra* Part III.
392. *See supra* Part IV.
393. *See supra* Part III.
394. *See supra* Part IV.A.
395. *See supra* Part IV.C.