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THE INTERSECTION OF FEE-SHIFTING BYLAWS AND SECURITIES FRAUD LITIGATION

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ABSTRACT

This Article examines the intersection of fee-shifting bylaws and federal private securities fraud suits. Specifically, this Article hypothesizes about the effects fee-shifting bylaws would have, if enforceable, on private securities fraud litigation. It then turns to the validity of fee-shifting bylaws under federal law and concludes that they are invalid as applied to securities fraud claims. In light of this conclusion, this Article considers whether Congress should pass legislation to validate fee-shifting bylaws and determines that it should not.

INTRODUCTION

Under the "American Rule," each party to a lawsuit pays its own attorney's fees.[1] Parties can, however, contract for a different arrangement.[2] In that regard, a number of corporations have recently amended their bylaws,[3] a document considered a contract between a

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1. DAVID F. HERR ET AL., FUNDAMENTALS OF LITIGATION PRACTICE § 30:2 (2014).

2. *Id.*

3. State corporate law requires a corporation to have bylaws. *See, e.g.*, MODEL BUS. CORP. ACT § 2.06(a) (2010) ("The incorporators or board of directors of a corporation shall adopt initial bylaws for the corporation."). Corporate law provides a corporation with broad latitude as to what can be included in its bylaws. *See, e.g.*, DEL. CODE ANN. tit. 8, § 109(b) (2015) ("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."); MODEL BUS. CORP. ACT § 2.06(b) (2010) ("The bylaws of a corporation may contain any provision that is not inconsistent with law or the articles of incorporation."). The content of a corporation's bylaws is almost always determined by its board of directors. In fact, a board can normally unilaterally change bylaws whenever it so desires. I say "normally" because state corporate law does contemplate a board being denied the power to change bylaws and instead having it reside solely in the corporation's stockholders. For example, Delaware law provides that a board does not have the power to change bylaws unless the corporation's certificate of incorporation confers such power. § 109(a). It is standard practice for a corporation to include language in its certificate of incorporation conferring such power. The statutory scheme, however, is reversed under the Model Business Corporation Act ("MBCA"). It provides that a board

corporation and its stockholders,[4] to contract around the American Rule.[5] These "fee-shifting bylaws" obligate a stockholder who fails to prevail in a suit against the corporation to pay the corporation's attorney's fees.[6]

Fee-shifting bylaws are a new phenomenon, bursting onto the scene in May 2014 following *ATP Tour, Inc. v. Deutscher Tennis Bund*.[7] In *ATP*, the Delaware Supreme Court held that a fee-shifting bylaw is facially valid under Delaware law.[8] Given that Delaware is the state of incorporation for the majority of US public companies, the opinion has received significant attention and promptly triggered proposed amendments to the Delaware General Corporation Law ("DGCL").

Fee-shifting bylaws raise issues under both state and federal law. This Article focuses on federal law; specifically, the intersection of fee-shifting bylaws and federal private securities fraud suits. Given that these suits are largely brought by stockholders, they fall squarely within the language of a typical fee-shifting bylaw.[9]

This Article proceeds as follows. Part I examines the *ATP* decision and post-decision developments. Part II provides an overview of the federal securities laws most commonly invoked in private securities fraud suits. Part III hypothesizes about the effects fee-shifting bylaws would have, if enforceable, on private securities fraud litigation. Part IV finds that fee-shifting bylaws are invalid as applied to securities fraud claims because such application would violate the anti-waiver provisions of federal securities law and the Supremacy Clause of the United States Constitution. In light of this finding, Part V considers whether Congress should pass legislation to validate fee-shifting bylaws and determines that it should not. Part VI concludes.

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can unilaterally amend a corporation's bylaws unless the corporation's articles of incorporation "reserve that power exclusively to the shareholders." MODEL BUS. CORP. ACT § 10.20(b)(1) (2010).

4. *See* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939 (Del. Ch. 2013) ("[T]he bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders . . . .").

5. *See infra* App.

6. *See infra* Part I.C.

7. 91 A.3d 554 (Del. 2014).

8. *Id.* at 558.

9. *See infra* Part III.

I. *ATP* AND ITS AFTERMATH

A. The ATP Litigation

ATP Tour, Inc. ("ATP") is the organizer of the ATP Tour, an international men's tennis circuit.[10] ATP was incorporated in Delaware in 1987 as a nonstock corporation.[11] As such, it has members instead of stockholders, but is governed by the DGCL, the same statute applicable to stock (regular) corporations.[12] In 2007, ATP's board of directors voted to restructure the ATP Tour.[13] As part of this restructuring, ATP downgraded the Hamburg, Germany, tennis tournament from first tier to second tier status.[14] The tournament is owned by the German and Qatari tennis federations, both of which are ATP members and neither of whom was happy about the downgrade.[15] Thus, they sued ATP and some of its directors in federal district court, alleging federal antitrust violations and breaches of their fiduciary duties to the corporation under Delaware law.[16] Following a jury trial, the district court granted the defendants' motion for judgment as a matter of law on the antitrust and fiduciary duty claims against the defendant directors.[17] The jury then returned a verdict for ATP on all remaining claims.[18]

Following its victory, ATP filed a motion with the district court pursuant to Federal Rule of Civil Procedure 54, seeking $17.87 million in attorney's fees and other costs it incurred in connection with the litigation.[19] ATP based its claim for these fees and costs on Article 23 of its bylaws.[20] This Article provides, in part, as follows:

> (a) In the event that (i) any [current or prior member or Owner or anyone on their behalf ("Claiming Party")] initiates or asserts any

10. Deutscher Tennis Bund v. ATP Tour Inc., 480 F. App'x 124, 125 (3d Cir. 2012).
11. *Id.*; *General Information Name Search*, DEL. DEP'T OF STATE, DIV. OF CORPS., https://icis.corp.delaware.gov/Ecorp/EntitySearch/NameSearch.aspx (search "Entity Name" for "ATP Tour, Inc.") (last visited Mar. 7, 2016).
12. DEL. CODE ANN. tit. 8, § 114 (2015).
13. Deutscher Tennis Bund v. ATP Tour, Inc., 610 F.3d 820, 825 (3d Cir. 2010).
14. *Id.* at 824.
15. *Id.*
16. *Id.*
17. *Id.* at 827.
18. *Id.* at 828.
19. Deutscher Tennis Bund v. ATP Tour Inc., No. 07–178, 2009 WL 3367041, at *1 (D. Del. Oct. 19, 2009) (quoting FED. R. CIV. P. 54(d)(2)(A)) ("A claim for attorney's fees and related nontaxable expenses must be made by motion unless the substantive law requires those fees to be proved at trial as an element of damages."), *vacated*, 480 F. App'x 124 (3d Cir. 2012).
20. *Id.*

> [claim or counterclaim ("Claim")] or joins, offers substantial assistance to or has a direct financial interest in any Claim against the League or any member or Owner (including any Claim purportedly filed on behalf of the League or any member), and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the League and any such member or Owners for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) (collectively, "Litigation Costs") that the parties may incur in connection with such Claim.[21]

ATP argued that Article 23 entitles it to attorney's fees because the Article falls within the contractual exception to the American Rule that each party pays its own attorney's fees.[22] The district court denied the motion.[23] It recognized that "bylaws, as internal documents governing a corporation, are binding on a corporation's board and members in most settings."[24] But it also pointed out that "ATP cites no case in which a court held that a board-adopted corporate bylaw can form the basis for the recovery of attorney's fees from members who sue the corporation, much less in actions where the bylaws are not directly at issue in the dispute."[25] The court also noted that ATP adopted Article 23 after the plaintiffs became members and, given the timing of enactment, possibly to deter members from bringing suits to challenge the ATP tour restructuring at issue in the case.[26] The court also observed that "[a]llowing corporate antitrust defendants to adopt bylaws that would impose attorney's fees on members who unsuccessfully—but without bad faith—file an antitrust suit would likely have a chilling effect on the filing of meritorious actions."[27] It thus concluded that "[p]ermitting corporations accused of anticompetitive

21. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 556 (Del. 2014) (alteration in original).

22. *Deutscher Tennis Bund*, 2009 WL 3367041, at *2.

23. *Id.*

24. *Id.* at *3.

25. *Id*.

26. *See id.* at *3, *4 n.4.

27. *Id.* at *4.

conduct to enforce bylaws with such potent deterrent potential would be antithetical to the purposes of the Sherman Act."[28]

ATP appealed the district court's denial of its motion for attorney's fees to the Third Circuit Court of Appeals.[29] The Third Circuit read the district court's ruling as preemption based; specifically, that "federal law preempts the enforcement of fee-shifting agreements when antitrust claims are involved."[30] It then concluded that federal preemption was not ripe for decision because "there has been no determination of whether Article 23.3 is valid (therefore, enforceable) under state law."[31] Thus, it remanded the case back to the district court to make such a determination.[32]

Following remand, ATP asked the district court to certify four questions related to the validity of a fee-shifting bylaw under Delaware law to the Delaware Supreme Court.[33] The district court granted the request, and the Delaware Supreme Court "accepted the certified questions based on principles of comity."[34] The questions were as follows:

> 1. May the Board of a Delaware non-stock corporation lawfully adopt a bylaw (i) that applies in the event that a member brings a claim against another member, a member sues the corporation, or the corporation sues a member (ii) pursuant to which the claimant is obligated to pay for "all fees, costs, and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses)" of the party against which the claim is made in the event that the claimant "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought"?
>
> 2. May such a bylaw be lawfully enforced against a member that obtains no relief at all on its claims against the corporation, even if the bylaw might be unenforceable in a different situation where the member obtains some relief?

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28. *Id.*
29. Deutscher Tennis Bund v. ATP Tour Inc., 480 F. App'x 124 (3d Cir. 2012).
30. *Id.* at 126.
31. *Id.*
32. *Id.* at 128.
33. Deutscher Tennis Bund v. ATP Tour, Inc., No. 07–178, 2013 WL 4478033, at *1 n.1 (D. Del 2013). The Delaware Constitution provides the Delaware Supreme Court with jurisdiction to hear and determine questions of law certified to it by other Delaware courts, including the district court. DEL. CONST. art. IV, § 11(8).
34. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 557 (Del. 2014).

> 3. Is such a bylaw rendered unenforceable as a matter of law if one or more Board members subjectively intended the adoption of the bylaw to deter legal challenges by members to other potential corporate action then under consideration?
>
> 4. Is such a bylaw enforceable against a member if it was adopted after the member had joined the corporation, but where the member had agreed to be bound by the corporation's rules "that may be adopted and/or amended from time to time" by the corporation's Board, and where the member was a member at the time that it commenced the lawsuit against the corporation?[35]

The court addressed each certified question in a May 2014 unanimous *en banc* opinion. In analyzing the first question, the court stated that "[t]o be facially valid, a bylaw must be authorized by the . . . (DGCL), consistent with the corporation's certificate of incorporation, and its enactment must not be otherwise prohibited."[36] The court found that the DGCL permits a fee-shifting bylaw that "allocates risk among parties in intra-corporate litigation"[37] because it falls within the DGCL requirement that a bylaw "relat[e] 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."[38] It then noted that a "corporate charter could permit fee-shifting provisions, either explicitly or implicitly by silence,"[39] and that "no principle of common law prohibits directors from enacting fee-shifting bylaws."[40] Thus, it held that "[a] fee-shifting bylaw, like the one described in the first certified question, is facially valid."[41] The court then noted that corporate bylaws are "contracts among a corporation's stockholders"[42] and thus concluded that a "validly-enacted bylaw would fall within the contractual exception to the American Rule."[43]

The court, however, cautioned that "[w]hether the specific ATP fee-shifting bylaw is enforceable . . . depends on the manner in which it was adopted and the circumstances under which it was invoked. Bylaws that may otherwise be facially valid will not be enforced if adopted or used for

35. *Id.*
36. *Id.* at 557–58 (footnote omitted).
37. *Id.* at 558.
38. *Id.* (alteration in original) (quoting DEL. CODE ANN. tit. 8, § 109(b) (2015)).
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.* (quoting Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010)).
43. *Id.*

an inequitable purpose."[44] It then answered the second certified question in the affirmative, subject to the foregoing limitation.[45] The court, likewise, affirmatively answered the third certified question. Notably, it stated as follows:

> Legally permissible bylaws adopted for an improper purpose are unenforceable in equity. The intent to deter litigation, however, is not invariably an improper purpose. Fee-shifting provisions, by their nature, deter litigation. Because fee-shifting provisions are not *per se* invalid, an intent to deter litigation would not necessarily render the bylaw unenforceable in equity.[46]

The court did not otherwise address what would constitute an improper purpose in the fee-shifting bylaw context.[47]

Finally, the court also answered the fourth certified question in the affirmative. Specifically, it stated that if a corporation's certificate of incorporation empowers its board of directors to adopt or amend bylaws, as contemplated by DGCL Section 109(a), "stockholders will be bound by bylaws adopted unilaterally by their boards."[48]

In sum, the court held that a fee-shifting bylaw is enforceable under Delaware corporate law unless the corporation adopted it for an improper purpose. A purpose of deterring litigation is not necessarily improper, and whether the bylaw was adopted after the plaintiff became a member/stockholder is not relevant to the analysis. Other than the forgoing, the court provided no guidance on distinguishing between a proper and an improper purpose with respect to a fee-shifting bylaw, presumably leaving it to the lower courts to flesh out.[49]

Note that the fact that ATP is a non-stock corporation is not significant. The court's opinion was grounded in statutory analysis of DGCL

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44. *Id.*

45. *Id.* at 560.

46. *Id.*

47. *See id.* The court did mention some situations where it or the Chancery Court invalidated and upheld various bylaws, but none of these situations are particularly analogous to one likely to arise when a corporation adopts a fee-shifting bylaw. *Id.* at 558–59.

48. *Id.* at 560 (quoting Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 956 (Del. Ch. 2013)).

49. At the 42nd Annual Securities Regulation Institute held in San Diego from January 26–28, 2015, Chief Justice Strine of the Delaware Supreme Court purportedly stated in regards to *ATP* that: "the Court was only responding to narrow questions posed to the Court by the federal district court considering the underlying case. The Court merely determined that the board has 'legal authority' to adopt such a bylaw. . . . The context in which the provision was being applied was not before the Court." Mike Gettelman, *Delaware CJ Strine (and Others) Weigh-In on Fee-Shifting Bylaws*, MIKE GETTELMAN'S BLOG (Feb. 2, 2015), https://www.thecorporatecounsel.net/member/blogs/gettelman/.

provisions that are applicable to both stock and non-stock corporations.[50] Note also that the court did not address the specific language of the ATP bylaw because it was not necessary to do so in answering the certified questions, and furthermore the court did not have a fully-developed factual record before it.[51]

B. The Aftermath

A little over a month after the *ATP* decision, the Corporation Law Council, a committee of the Delaware State Bar Association, drafted, and Delaware legislators introduced, Senate Bill 236 of the 147th Delaware General Assembly which included an amendment to the DGCL "intended to limit applicability of [the] holding [in *ATP*] to non-stock corporations, and to make clear that such liability may not be imposed on holders of stock in stock corporations."[52] Specifically, the bill proposed adding a new section 331 to the DGCL providing as follows: "Notwithstanding any other provision of this chapter, neither the certificate of incorporation nor the bylaws of any corporation may impose monetary liability, or responsibility for any debts of the corporation, on any stockholder of the corporation . . . ."[53] While there initially appeared to be sufficient support for the amendment, its consideration was postponed in the wake of objections to the amendment from the Chamber of Commerce and other business groups, specifically that fee-shifting bylaws provide a useful means for reducing frivolous litigation.[54]

As a result, the Corporation Law Council drafted a replacement bill. This bill contained DGCL amendments similar to those of the original bill but with more specificity and narrower in application. Specifically, corporations would be prohibited from including in their certificates of incorporation or bylaws "any provision that would impose liability on a

50. *But see* 1 DAVID A. DREXLER ET AL., DELAWARE CORPORATION LAW AND PRACTICE § 9.03 (2015) ("Although the ATP opinion is based on statutory provisions and common law principles applicable to stock and non-stock corporations alike, given the unusual facts and procedural context, the scope of the opinion's holdings—and, importantly, the enforceability of such a bylaw as to stock corporations, either 'facially' or in any particular circumstances—is as yet unclear.").

51. *See ATP*, 91 A.3d at 555 (stating that "we cannot directly address the bylaw at issue").

52. S. 236, 147th Gen. Assemb., Reg. Sess. (Del. 2014).

53. *Id.*

54. *See, e.g.*, Jonathan Starkey, *Chamber Forces Delay on Fee-Shifting Legislation*, NEWS J. (June 10, 2014, 1:52 PM), http://www.delawareonline.com/story/firststatepolitics/2014/06/10/fee-shifting-bill/10280791/; *see also* S.J. Res. 12, 147th Gen. Assemb., Reg. Sess. (Del. 2014) (calling "upon the Delaware State Bar Association, its Corporation Law Section, and the Council of that Section, to continue examination of important proposed amendments to the [DGCL] relating to fee-shifting bylaws and other aspects of corporate litigation").

stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an intracorporate claim, as defined in § 115 of this title."[55] Section 115 defines "intracorporate claims" as "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery."[56] Note that these changes do not expressly prohibit fee-shifting bylaws to extra-corporate claims, which, presumably, include those under the federal securities laws. This is in contrast to the prohibition in the original proposed amendments, which was not limited to intracorporate claims. The Council's written explanation for the adopted amendments does not address why it decided to add the intracorporate limitation.[57]

Notwithstanding the seemingly inevitable legislative response, at least fifty-one corporations adopted fee-shifting bylaws or charter provisions between May 8, 2014 (the date of the *ATP* opinion) and June 24, 2015 (the date Delaware's governor signed the DGCL fee-shifting amendments into law).[58] Of these adoptees, forty are Delaware corporations and eleven are non-Delaware corporations.[59] See the Appendix at the end of this Article for some details.[60]

C. A Typical Fee-Shifting Bylaw

While there is some variation among the provisions of the adoptee corporations, the following provision from the bylaws of Insys Therapeutics, Inc. ("ITI"), a Delaware corporation whose stock is traded on the NASDAQ Global Market,[61] is typical:

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55. DEL. CORP. LAW COUNCIL, AN ACT TO AMEND TITLE 8 OF THE DELAWARE CODE RELATING TO THE GENERAL CORPORATION LAW (2015) (proposing legislation), *available at* http://www.delawarelitigation.com/2015/03/articles/commentary/delaware-proposes-new-fee-shifting-and-forum-selection-legislation/.

56. *Id*.

57. *See* Francis Pileggi, *Delaware Proposes New Fee-Shifting and Forum Selection Legislation*, DEL. CORP. & COM. LITIG. BLOG (Mar. 6, 2015), http://www.delawarelitigation.com/2015/03/articles/commentary/delaware-proposes-new-fee-shifting-and-forum-selection-legislation/, *archived at* http://perma.cc/U2SR-QQEF.

58. *See infra* App.

59. *See infra* App.

60. For convenience, unless the context otherwise requires, references in this Article to fee-shifting bylaws includes fee-shifting charter provisions.

61. Insys Therapeutics, Inc., Annual Report (Form 10-K) (Mar. 4, 2014).

> *Section 50. Litigation Costs.* To the fullest extent permitted by law, in the event that (i) any current or prior stockholder or anyone on their behalf (*"Claiming Party"*) initiates or asserts any claim or counterclaim, including any derivative action brought by or in the right of the corporation (*"Claim"*) or joins, offers substantial assistance to, or has a direct financial interest in any Claim against the corporation and/or any director, officer, employee or Affiliate of the corporation, and (ii) the party bringing the Claim does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party that initiated or asserted the Claim or joined, offered substantial assistance to, or had a direct financial interest in the Claim shall be obligated jointly and severally to reimburse the corporation and any such director, officer, employee or Affiliate of the corporation, the greatest amount permitted by law of all fees, costs and expenses of every kind and description (including but not limited to, all reasonable attorney's fees and other litigation expenses) (collectively, *"Litigation Costs"*) that the corporation and/or any director, officer, employee or Affiliate of the corporation may incur in connection with such Claim. For purposes of this Section, *"Affiliate"* of the corporation shall mean any person or entity that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the corporation.[62]

The Board of Directors of ITI added this provision to its bylaws in November of 2014.[63] ITI's SEC filing disclosing the change does not specify why it was made.[64]

The provision tracks ATP's fee-shifting bylaw fairly closely, with "stockholder" substituted for "member" since, as a stock corporation, ITI has stockholders instead of members.[65] It also clarifies the reach of the provision by specifying it applies to claims against the corporation and "any director, officer, employee or Affiliate of the corporation" (ATP's bylaw is not particularly clear on this point).[66]

62. Insys Therapeutics, Inc., Current Report (Form 8-K), at exhibit 3.1 (Nov. 10, 2014).
63. *Id.*
64. *See id.*
65. *Id*.
66. *Id*. at exhibit 3.1.

Some additional points about the ITI bylaw:

- It provides for one-sided (or unilateral) fee shifting. Specifically, it requires a stockholder to reimburse the corporation, directors, officers, etc. for their fees and expenses unless the stockholder prevails but does not require the losing parties to reimburse a prevailing stockholder.
- It applies to "any claim or counterclaim" by a stockholder. Thus, for example, it applies to breach of fiduciary duty claims brought directly or derivatively against the corporation's directors under Delaware law and fraud claims brought against the corporation under federal securities law. In other words, it ostensibly applies to claims under both state law and federal law. Notably, the ATP litigation involved claims under both state law (breach of fiduciary duty) and federal law (antitrust violations). Nonetheless, the Delaware Supreme Court did not address this aspect. It simply labeled the litigation as "intra-corporate" without explaining what it meant by the term.[67]
- It provides for joint and several plaintiff liability on fee-shifting obligations. As a result, the lead plaintiff in an unsuccessful class action could be ordered to pay the entire defense tab.
- A plaintiff must prevail on the merits to avoid being obligated to pay the defendants' fees and expenses. Hence, a plaintiff would still owe fees under the bylaw even if he or she negotiates a favorable settlement, because in such a case, the plaintiff will not have won on the merits. Certainly a corporation could agree to waive or reduce a stockholder's obligations under the bylaw as part of a settlement, but the

67. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 555 (Del. 2014). To be fair, the Delaware Chancery Court in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.* includes an excerpt from an article defining intra-corporate disputes as disputes pursuant to the internal affairs doctrine. 73 A.3d 934, 960 n.129 (Del. Ch. 2013) (citing Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 370, 373 (2013)). This excerpt also characterizes a securities fraud claim as not intra-corporate. *Id*. *ATP* did not expressly address whether a fee-shifting bylaw can apply to extra-corporate claims, so I consider it an open issue. *But see* Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. (forthcoming 2015) (arguing that charter and bylaw provisions apply only to a corporation's internal affairs and therefore not to extra-corporate claims).

bylaw undoubtedly provides a corporation with additional leverage in settlement negotiations.

- Not only must the plaintiff win on the merits, it also must receive a judgment that "substantially achieves, in substance and amount, the full remedy sought." The bylaw leaves it to the courts to discern what "substantially achieves" means.

- An attorney bringing a claim on behalf of a stockholder seemingly falls under the definition of "Claiming Party" and is therefore also arguably potentially obligated to pay the defendants' fees and expenses. However, this reading seems to be a real stretch given that basic principles of contract law apply to bylaws, and the attorney neither consented nor bargained for being subject to the bylaw. In other words, there is no mutual consent or consideration and therefore no basis by which the attorney is bound.[68]

In sum, the ITI fee-shifting bylaw, as is the case with the ATP fee-shifting bylaw and those adopted by most of the corporations listed in the Appendix, is extremely one-sided in favor of the corporation.

The extreme one-sidedness of the bylaw is underscored by comparing it to the fee-shifting provision recently added to the Oklahoma General Corporation Act. Oklahoma was the first state to address fee-shifting in its corporate code. The statutory provision states as follows:

> In any derivative action instituted by a shareholder of a domestic or foreign corporation, the court having jurisdiction, upon final judgment, shall require the nonprevailing party or parties to pay the prevailing party or parties the reasonable expenses, including attorney fees, taxable as costs, incurred as a result of such action.[69]

Notice that the provision provides for two-sided fee-shifting, applies only to derivative actions, does not require the prevailing party to substantially achieve the full remedy sought, and applies only if the litigation goes to final judgment. In in other words, it is much more balanced than the ITI fee-shifting bylaw.

68. *See* RESTATEMENT (SECOND) OF CONTRACTS § 17(1) (1981); *see also* Strougo v. Hollander, 111 A.3d 590, 592 (Del. Ch. 2015) (noting in the bylaw context that "a non-party to a contract is not bound by the terms of that contract").

69. OKLA. STAT. tit. 18, § 1126(C) (2014).

II. FEDERAL SECURITIES LAWS

As mentioned above, this Article focuses on the potential implications of fee-shifting bylaws on federal securities laws. In that regard, this Part provides an overview of the provisions most implicated.

A. Overview

The Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") are the primary federal securities law statutes. A core theme of both these acts is disclosure. In that regard, the Securities Act generally requires most public offerings to be registered with the Securities and Exchange Commission ("SEC").[70] A company—or more precisely, the "issuer"—registers an offering by filing a registration statement. Pursuant to SEC regulations, a registration statement must set forth, or incorporate by reference,[71] various disclosures about the issuer and the offering. These disclosures include audited financial statements, comparative selected financial information, and a detailed description of the issuer's business, properties, intended use of offering proceeds, transactions with management, legal proceedings, and executive compensation.[72] As part of the offering process, the issuer must make available to the public the prospectus for the offering.[73] A prospectus is a subpart of a registration statement, and it comprises the bulk of the required disclosures.[74] The policy behind the registration and prospectus requirements is to provide potential investors with a standard package of information about the issuer and offering so that they can make informed investment decisions.[75]

70. 15 U.S.C. § 77e (2012).

71. "Incorporate by reference" means that the required information is not actually set forth in the document but instead it contains a cross reference to some other SEC filing by the company that contains (or will contain) the required information. 1 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 3:73 (2015).

72. *See id.* §§ 6:21, 6:23.

73. 15 U.S.C. § 77e(b).

74. *See* U.S. SEC. & EXCH. COMM'N, FORM S-1: REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933 4–6 (2016) (specifying contents of a prospectus).

75. *See, e.g.*, SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953) (citing A.C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 40 (1941)) ("The design of the [Securities Act] is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.").

The Exchange Act is generally focused on secondary trading markets. On the disclosure front, it requires public companies[76] to prepare and file with the SEC annual and quarterly reports disclosing financial results, risk factors, and executive compensation. A public company must also file a current report typically within four business days of the occurrence of various events.[77] Triggering events include entering into or terminating a material definitive agreement, entering into bankruptcy or receivership, completing an acquisition or disposition of assets, a change in control of the company, departure of directors or certain officers, election of directors, and amendments to the company's charter or bylaws.[78] The policy behind these reporting obligations is to provide investors access to information they can use to make informed trading decisions (the reports are accessible on the SEC's website shortly after filing).[79]

B. Antifraud Provisions

The above disclosure obligations are negatively reinforced by antifraud provisions of the Securities Act and the Exchange Act; specifically, sections 11 and 12(a)(2) of the Securities Act[80] and section 10(b) and Rule 10b-5 of the Exchange Act,[81] among other provisions.[82] Under section 11 of the Securities Act, an investor in a public offering can sue the issuer, its chief executive officer, its chief financial officer, its directors, and the underwriters of the offering if it turns out that the issuer's registration statement contained a material misstatement or omission.[83] Likewise,

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76. In this context, a public company is one that has securities registered under the Exchange Act. A company is required to register securities under the Exchange Act if (1) the securities are listed on a national securities exchange, 15 U.S.C. § 78*l*(b) (2014); (2) the company has $10 million or more in total assets and a class of equity securities held of record by (a) 2,000 or more persons, or (b) 500 or more persons who are not accredited investors, *id.* §78*l*(g); or (3) the company has filed a registration statement under the Securities Act that became effective, *id.* §78o(d). Thus, essentially any company with publicly traded securities will have to register the securities under the Exchange Act and thereby become subject to the Exchange Act's disclosure requirements.

77. *See, e.g.*, 1 BLOOMENTHAL & WOLFF, *supra* note 71, §§ 6:31, 6:33.

78. U.S. SEC. & EXCH. COMM'N, FORM 8-K 4–21 (2014).

79. *See, e.g.*, 1 BLOOMENTHAL & WOLFF, *supra* note 71, § 12:27.

80. 15 U.S.C. §§ 77k, 77*l*(a)(2) (2014).

81. *Id.* § 78j(b); 17 C.F.R. § 240.10b-5 (2016).

82. Other provisions in the Exchange Act prohibit the solicitation of proxies by means of materially false or misleading statements. See Securities Act section 15 and Exchange Act section 20 which, in certain circumstances, impose joint and several liability on controlling persons of issuers who have violated the Securities Act or the Exchange Act. 15 U.S.C. §§ 77o, 78t.

83. 15 U.S.C. § 77(k) (2014). Technically, the civil liability provisions of the federal securities laws require an untrue statement of a material fact or omission of a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading.

under section 12(a)(2), an investor can sue the seller of securities if the prospectus contained a material misstatement or omission.[84] Neither claim requires a plaintiff to prove the defendant acted with a particular state of mind; however, with the exception of the issuer who is strictly liable, a defendant can avoid liability under both antifraud provisions of the Securities Act if he performed a reasonable investigation or due diligence of the issuer and the offering.[85]

A company faces potential liability under §10(b)/Rule 10b-5 of the Exchange Act if its Exchange Act reports or other information it releases to the marketplace are not accurate and complete.

As explained by the Supreme Court in *Dura Pharmaceuticals, Inc. v. Broudo*:

> Section 10(b) of the Securities Exchange Act of 1934 forbids (1) the "use or employ[ment] . . . of any . . . deceptive device," (2) "in connection with the purchase or sale of any security," and (3) "in contravention of" Securities and Exchange Commission "rules and regulations." 15 U.S.C. § 78j(b). Commission Rule 10b-5 forbids, among other things, the making of any "untrue statement of a material fact" or the omission of any material fact "necessary in order to make the statements made . . . not misleading." 17 C.F.R. § 240.10b-5 (2004).
>
> The courts have implied from these statutes and Rule a private damages action, which resembles, but is not identical to, common-law tort actions for deceit and misrepresentation. And Congress has imposed statutory requirements on that private action.

See, e.g., *id.* §§ 77k(a), 77*l*(a)(2). The customary practice, which I use in this Article, is to use the much shorter "material misstatement or omission," although it does not have the exact same meaning.

84. *Id.* § 77*l*(a)(2). To determine whether someone is a "seller" for purposes of § 12(a)(2), courts apply the test set forth by the Supreme Court in *Pinter v. Dahl*, 486 U.S. 622 (1988), with respect to identical language under section 12(a)(1) of the Securities Act. *See, e.g.*, Wilson v. Saintine Exploration & Drilling Corp., 872 F.2d 1124, 1126 (2d Cir. 1989). In *Pinter*, the Court held that a seller is the "owner who passed title, or other interest in the security, to the buyer for value," or a person "who successfully solicit[ed] the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." 486 U.S. at 642, 647. Note that the term "prospectus" as used in section 12(a)(2) is broader than the subpart of a registration statement labeled a prospectus. It includes any "document that describes a public offering of securities by an issuer or controlling stockholder." Gustafson v. Alloyd Co., 513 U.S. 561, 584 (1995).

85. 15 U.S.C. § 77k(b)(3) (providing for a reasonable investigation defense); *id.* § 77*l*(a)(2) (providing for a reasonable care defense).

In cases involving publicly traded securities and purchases or sales in public securities markets, the action's basic elements include:

(1) *a material misrepresentation (or omission)*;

(2) *scienter*, *i.e., a wrongful state of mind*;

(3) *a connection with the purchase or sale of a security*;

(4) *reliance*, often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation";

(5) *economic loss*; and

(6) *"loss causation," i.e.*, a causal connection between the material misrepresentation and the loss.[86]

Note that § 10(b)/Rule 10b-5 is very broad in its reach. It applies not just to Exchange Act reports but to any public statements made by a company by whatever means (e.g., press releases, interviews, and tweets).[87] Furthermore, § 10(b)/Rule 10b-5 applies to misstatements and omissions by both public and private companies, although it comes up most often in the public company context. Additionally, as the above quote mentions, courts have recognized an implied private cause of action under § 10(b)/Rule 10b-5.

Also note that section 11, section 12(a)(2), and Rule 10b-5 liability overlap when a material misstatement or omission appears in the prospectus, which is often the case given that the prospectus contains or incorporates by reference the bulk of the required substantive disclosure.[88] In such an event, a plaintiff may very well sue the company under all three provisions, although it is not uncommon for a plaintiff to leave off a Rule 10b-5 claim given its more onerous elements as compared to sections 11 and 12(a)(2). Rule 10b-5 is, nonetheless, the most commonly invoked liability provision because, as mentioned above, it reaches material misstatements and omissions by a company regardless of the medium in which they appear, as opposed to sections 11 and 12(a)(2), whose reach is

86. 544 U.S. 336, 341–42 (2005) (citations omitted).

87. *See, e.g.*, 2 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES LAW HANDBOOK § 27:16 (2015) (noting that Rule 10b-5 imposes "liability and responsibility for false or misleading statements in connection with press releases, letters, and reports to shareholders, and the like").

88. *See, e.g.*, U.S. SEC. & EXCH. COMM'N, *supra* note 74, at 1, 4–6 (specifying the contents of a registration statement and prospectus).

limited to material misstatements and omissions in a registration statement or prospectus, respectively.

III. FEDERAL SECURITIES LAWS IMPLICATIONS

Clearly, a claim brought by a stockholder under one or more federal securities law antifraud provisions would fall within the language of the ITI or similar fee-shifting bylaw ("typical fee-shifting bylaw") because the language covers "any claim" by "any current or prior stockholder." This Part discusses the likely effects fee-shifting bylaws would have on securities fraud litigation if they so applied. The discussion is academic because, as Part IV demonstrates, fee-shifting bylaws are invalid when applied to federal securities law claims. In a sense, this Part lays the foundation for the analysis in Part IV.

A. Securities Fraud Class Action Litigation

Claims brought under section 11, section 12(a)(2), and Rule 10b-5 can be brought individually, but they are mostly brought as representative, or class, actions. As the SEC has explained:

> Since the enforcement activities of [the SEC] do not serve to make whole investors who have been injured by a fraudulent course of business and since it is economically impracticable in many instances for investors individually to pursue available remedies, the representative action appears to provide the most meaningful method by which their claims may be pursued and the Congressional policy favoring such remedies may be vindicated.[89]

Bringing a class action requires a member of the class to agree to serve as the representative, or lead, plaintiff.[90] A typical securities fraud class action is brought on behalf of all investors who purchased a corporation's stock between the date the corporation made material misstatements to the marketplace and the date it made corrective disclosure (referred to as the "class period"). For example, *Erica P. John Fund, Inc. v. Halliburton Co. (Halliburton I)*,[91] a case that has twice been reviewed by the Supreme

89. Dolgow v. Anderson, 43 F.R.D. 472, 483–84 (E.D.N.Y. 1968) (quoting amicus brief filed in a different case by the SEC).

90. *See* FED. R. CIV. P. 23(a).

91. 131 S. Ct. 2179 (2011).

Court,[92] involved a securities fraud class action suit "brought on behalf of all investors who purchased Halliburton common stock between June 3, 1999, and December 7, 2001."[93] Thus, for the suit to have been brought, it was necessary for at least one of those individual Halliburton stockholders to have voluntarily agreed to serve as lead plaintiff, which Erica P. John Fund, Inc. did.[94]

As is well known, securities fraud class actions are commonly initiated by entrepreneurial plaintiffs' firms and not a company's stockholders.[95] In other words, it is a law firm that seeks out a lead plaintiff following revelation of a corporate misdeed as opposed to a stockholder seeking out a law firm to bring the case. Historically, plaintiffs' firms have had little difficulty convincing stockholders to serve as lead plaintiffs. This is because these firms take the cases on a contingency fee basis and also advance litigation expenses to the lead plaintiff with repayment contingent on the outcome of the case.[96] Hence, lead plaintiffs incur little to no out-of-pocket costs for agreeing to serve. At the same time, they gain benefits such as being able to closely monitor and control the litigation. Furthermore, they share in any recovery generated by the litigation.[97] Thus, they are willing to serve because the benefits of doing so outweigh the costs.

A stockholder's cost-benefit analysis for serving as a lead plaintiff would change drastically if the defendant corporation had a typical fee-shifting bylaw in place. Specifically, the stockholder would have to take into account that serving as lead plaintiff would make the stockholder jointly and severally liable for all fees and expenses incurred by the corporation and its directors, officers, and employees in the litigation unless the class receives "a judgment on the merits that substantially

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92. For a subsequent development of *Halliburton*, see Halliburton Co. v. Erica P. John Fund, Inc. (*Halliburton II*), 134 S. Ct. 2398 (2014).

93. *Halliburton I*, 131 S. Ct. at 2183.

94. *See* Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02–CV–1152–M, 2008 WL 4791492 (N.D. Tex. 2008). The Archdiocese of Milwaukee Supporting Fund, Inc. later changed its name to Erica P. John Fund, Inc. *See* Annysa Johnson, *Archdiocese Fund Part of Class-Action Case Against Halliburton*, MILWAUKEE J. SENTINEL (Mar. 23, 2011), *available at* http://www.jsonline.com/news/religion/118549224.html.

95. *See, e.g.*, ANDREW J. PINCUS, U.S. CHAMBER INST. FOR LEGAL REFORM, WHAT'S WRONG WITH SECURITIES CLASS ACTION LAWSUITS? 10 (2014), *available at* http://www.instituteforlegalreform.com/uploads/sites/1/Securities_Class_Actions_Final1.pdf.

96. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.8(e)(1) (2013) (providing that "a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter").

97. Theodore Eisenberg & Geoffrey P. Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 UCLA L. REV. 1303, 1305 (2006).

achieves, in substance and amount, the full remedy sought."[98] These litigation costs could easily reach into the millions of dollars.[99] Hence, it seems extremely unlikely that a stockholder would be willing to serve as a lead plaintiff when the risk of being saddled with millions in litigation costs is factored into the analysis. This seems true even for a case where proving liability appears to be a "slam dunk," given that the class not only has to win, but also must substantially achieve the full remedy sought. In other words, even a win on the merits may trigger a fee-shifting obligation if the plaintiff was, in hindsight, overly aggressive regarding the amount of damages sought.

To be sure, other stockholders who participate in the class action would arguably become jointly and severally liable under a fee-shifting bylaw since they would have "a direct financial interest in [the] Claim."[100] As a result, the lead plaintiff may not ultimately be obligated to pay the entire fee-shifting obligation, but it would depend, in part, on whom the defendants decide to pursue for the fee-shifting obligation. Since a fee-shifting bylaw provides for joint and several liability, the defendants could seek to collect the entire amount from the lead plaintiff. The defendants could, theoretically, pursue recovery from class members other than the lead plaintiff, but this strikes me as highly unlikely given the lead plaintiff's name is on the marquee. Additionally, a lead plaintiff who is ordered to pay a fee-shifting obligation could thereafter seek contribution from members of the class since all class members are jointly obligated. Doing so could be unrealistic, however, depending on the financial status of class members, and it would certainly be time consuming and expensive.

The wrinkle as to non-lead plaintiffs, or "absent" class members, is that they passively become class members by not opting out of the class as opposed to taking affirmative action to join.[101] Hence, obligating them under a fee-shifting bylaw to which they presumably did not affirmatively consent for being part of a class for which they did not consent raises significant due process issues. Consequently, the defendants and lead plaintiff will face significant legal hurdles in collecting from absent class members. In other words, the entire fee-shifting obligation will likely fall on the lead plaintiff.

98. Insys Therapeutics, Inc., *supra* note 62, at exhibit 3.1.
99. *See* PINCUS, *supra* note 95, at 6.
100. Insys Therapeutics, Inc., *supra* note 62, at exhibit 3.1.
101. *See* 3 WILLIAM B. RUBENSTEIN ET AL., NEWBERG ON CLASS ACTIONS § 9:38 (5th ed. 2015).

Furthermore, the lead plaintiff shoulders significant fee-shifting risk but divides the spoils of victory pro rata among class members after plaintiffs' counsel takes its substantial contingent fee and expenses.[102] This uncompensated fee-shifting risk even in victory creates a free-rider problem where a rational stockholder is likely to sit back and hope a fellow stockholder steps forward to be lead plaintiff, further reducing the likelihood of any stockholder volunteering to serve.

B. Constraints on Shifting Fee-Shifting Risk

An obvious workaround would be for a plaintiffs' firm to agree in connection with signing up a lead plaintiff to indemnify it against any obligations under a fee-shifting bylaw resulting from the litigation. The problem with this approach, however, is that it likely violates state rules of legal ethics. Most states have based their legal ethics rules on the American Bar Association Model Rules of Professional Conduct ("MRPC").[103] MRPC Rule 1.8(e) prohibits a lawyer from providing "financial assistance to a client in connection with pending or contemplated litigation," but it does allow a lawyer to "advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter."[104] While I have not located any case law on point, it seems to me that agreeing to pay a contingent financial obligation of a lead plaintiff relating to a contemplated or pending securities fraud class action would constitute providing financial assistance. The arrangement could arguably constitute an advancement of litigation expenses, but I view this as a real stretch. The exception is designed to allow lawyers to cover plaintiff litigation expenses *during* an ongoing case so that a plaintiff is not denied access to the courts because of financial constraints.[105] A promise to cover a contingent *post*-litigation obligation does not sound like an "advancement," nor would a plaintiff be denied access to the courts in the same sense by a fee-shifting bylaw because the bylaw would have no financial implications until court

102. Note that the Securities Act and the Exchange Act, prohibit a lead plaintiff from getting more than its pro rata share of a recovery, although it may be awarded reasonable costs and expenses directly related to serving as the lead plaintiff. Securities Act of 1933, 15 U.S.C. § 77z-1(a)(2)(A)(vi) (2014); Securities Exchange Act of 1934, 15 U.S.C. § 78u-4(a)(2)(A)(vi) (2014).

103. *See, e.g.*, *Model Rules of Professional Conduct*, AM. BAR ASS'N, http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct.html (last visited Nov. 13, 2015).

104. MODEL RULES OF PROF'L CONDUCT R. 1.8(e)(1) (2013).

105. *See id.* R. 1.8 cmt. 10.

proceedings had concluded. Being unwilling to pursue litigation because of a fee-shifting risk is simply different than being unable to pursue litigation because of financial constraints.

Additionally, allowing a law firm to assume plaintiffs' potentially multi-million dollar fee-shifting risk would likely give it "too great a financial stake in the litigation," a concern underlying both MRPC Rules 1.8(e) and 1.8(i), which generally prohibit a lawyer from acquiring a proprietary interest in a case.[106] Furthermore, a securities fraud class action lead plaintiff may be reluctant to discharge a plaintiffs' firm out of apprehension that the firm would renege on its promise to cover the plaintiffs' fee-shifting obligations. Avoiding this sort of impact on a lawyer-client relationship is an additional rationale underlying Rule 1.8(i).[107]

In sum, I suspect that the cost-benefit analysis plus the free-rider problem spurred by a fee-shifting bylaw eliminates the willingness of any stockholder to serve as lead plaintiff. Furthermore, state ethical rules likely prevent a plaintiffs' firm from remedying the situation by assuming the fee-shifting risk on behalf of a stockholder. As a result, a corporation can essentially opt-out of securities fraud class actions by adopting a fee-shifting bylaw.

C. Securities Fraud Individual Litigation

As mentioned above, securities fraud claims can be, and sometimes are, brought individually. Historically, however, the large majority of securities fraud claims have not been brought individually because they are so-called negative expected value claims—claims where the estimated cost of litigating exceeds the expected recovery from doing so. Take a straightforward example. Say you bought 100,000 shares of Acme Inc. on the New York Stock Exchange for $40 per share, or $4 million in the aggregate. As it turns out, the quarterly report Acme filed with the SEC the week before your purchase contained a material misstatement. Specifically, the report overstated Acme's earnings per share for the quarter. When this misstatement came to light three weeks later, Acme's stock dropped $3.00 per share as a result, meaning you suffered $300,000

106. *Id.* ("Lawyers may not subsidize lawsuits . . . because such assistance gives lawyers too great a financial stake in the litigation."); *see also id.* R. 1.8 cmt. 16 (stating that Rule 1.8(i) "is designed to avoid giving the lawyer too great an interest in the representation").

107. *See id.* R. 1.8 cmt. 16 (stating that "when the lawyer acquires an ownership interest in the subject of the representation, it will be more difficult for a client to discharge the lawyer if the client so desires").

in damages. In other words, if you litigated your claim to final judgment and prevailed, you would be awarded $300,000 in damages. Securities fraud claims, however, are expensive and time consuming to litigate, and thus litigating your claim to final judgment would undoubtedly cost more than $300,000. As a result, it is senseless for you to pursue the claim or for a plaintiffs' attorney to take it on a contingency fee basis. It becomes even more senseless if you factor in the vagaries of securities fraud litigation. Specifically, since you purchased your shares on the open market and not as part of a registered securities offering, you would be suing under Rule 10b-5, which means to win you must prove scienter and loss causation, among other things. Proving these two elements can be difficult even if there is no doubt that Acme's quarterly report contained a material misstatement. Thus, you would need to factor this uncertainty into your cost-benefit analysis. For example, if you estimate you have an 80% chance of prevailing, the risk-adjusted award on your claim would drop 20% to $240,000, making it even more senseless to pursue.[108]

If, in the above Acme hypothetical, we increase the number of shares you bought and/or the price drop resulting from the misstatement, you will eventually reach a tipping point where your claim flips from negative to positive expected value and therefore makes sense to pursue. Where this point lies in any particular case is hard to say, but given the cost, time, and uncertainty associated with litigating a securities fraud claim, it is likely in the millions of dollars of damages range. And when pro-defendant, one-sided fee-shifting is added into the mix, this number perhaps tops $10 million because a stockholder will now have to take into account the risk of having to pay the corporation's litigation costs in addition to its own in the event it does not "substantially achieve" the remedy sought. The "substantially achieve" requirement significantly increases the uncertainty because, in an Acme-type situation, the corporation will argue that the drop in stock price was at least in part due to factors other than disclosure of the corporation's misstatement. In other words, a stockholder could win a judgment against Acme but be awarded $2.00 instead of $3.00 per share because the court attributes $1.00 of the drop to, for example, a general decline in the market. In such a situation, the corporation will obviously argue that getting 66.7% of the $3.00 per share sought does not constitute "substantially achieving, in substance and amount, the full remedy

108. Of course, this negative expected value analysis has not historically hindered securities fraud class actions. This is because the economies of scale resulting from aggregating individual negative expected value claims into a class transforms the litigation into positive expected value claim.

sought," thus triggering plaintiff's obligation to pay the corporation's attorney's fees under the fee-shifting bylaw.

Given the above analysis, it would likely be only institutional investors who hold large enough stock positions in companies to potentially have a positive expected value in securities fraud claims. For a variety of reasons, many institutional investors have been reluctant to pursue claims against companies. Instead, they typically free-ride on class actions lead by other plaintiffs. This approach would obviously have to change for companies with fee-shifting bylaws, considering such bylaws essentially eliminate securities fraud class actions. It does not, however, mean that previously reluctant institutional stockholders will suddenly aggressively pursue individual claims. While fiduciary duty issues may require them to take a closer look at bringing a claim, they are free to take a conservative approach in valuing a claim and apply a significant discount factor in light of the risk and uncertainty injected into the mix by a fee-shifting bylaw. The bottom line is that the impact that fee-shifting bylaws would have on individual securities fraud claims is unclear. My suspicion is that they would decrease in number because fee-shifting bylaws would significantly raise the damages threshold for a claim to have a positive expected value, thereby significantly decreasing the pool of stockholders who could potentially bring a claim.

IV. VALIDITY OF FEE-SHIFTING BYLAWS IN FEDERAL SECURITIES LAWS CLAIMS

This Part argues that a fee-shifting bylaw is invalid as applied to a federal securities law claim because it (1) violates the anti-waiver provisions of the Securities Act and the Exchange Act and (2) is preempted by federal law.

A. Anti-waiver Provisions

Securities Act section 14 provides as follows: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the [SEC] shall be void."[109] The Exchange Act contains an almost identical provision.[110] As a result, a company imposed stockholder waiver of section 11 or 12(a)(2) of the Securities Act or §10/Rule 10b-5

109. 15 U.S.C. § 77n (2014).
110. *See id.* § 78cc(a).

under the Exchange Act is void. Hence, if a fee-shifting bylaw constitutes such a waiver, it is invalid as applied to claims under those provisions.

The leading case in the area is *Shearson/American Express, Inc. v. McMahon*,[111] which was decided by the Supreme Court in 1987. The McMahons were customers of Shearson, a brokerage firm.[112] They sued their Shearson broker and Shearson in federal court, alleging that the broker violated Rule 10b-5 "by engaging in fraudulent, excessive trading on respondents' accounts and by making false statements and omitting material facts from the advice given to respondents."[113] As is standard practice in the brokerage industry, Shearson customer agreements signed by the McMahons included a mandatory arbitration provision that provided as follows:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect.[114]

Thus, the defendants moved to compel arbitration, and the district court granted the motion.[115]

Among the issues addressed by the Supreme Court was whether the agreement to arbitrate fell within section 29(a) of the Exchange Act and was therefore invalid with respect to a Rule 10b-5 claim.[116] The Court held that a contractual provision is void under section 29(a) if it "weaken[s] [a party's] ability to recover under the [Exchange] Act."[117] It then concluded that the arbitration provision at issue in the case did not weaken the McMahons' ability to recover, noting that the Federal Arbitration Act "establishes a 'federal policy favoring arbitration'"[118] and citing to various cases endorsing arbitration of Exchange Act claims.[119] The Court also observed that "[i]n the exercise of its regulatory authority, the SEC has

111. 482 U.S. 220 (1987).
112. *Id.* at 222–23.
113. *Id.* at 223.
114. *Id.*
115. *Id.*
116. *Id.* at 227.
117. *Id.* at 230 (quoting Wilko v. Swan, 346 U.S. 427, 432 (1953)).
118. *Id.* at 226 (quoting Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983)).
119. *Id.* at 232.

specifically approved the arbitration procedures of the New York Stock Exchange, the American Stock Exchange, and the NASD, the organizations mentioned in the arbitration agreement at issue in this case."[120] It then concluded "that where, as in this case, the prescribed procedures are subject to [SEC] authority, an arbitration agreement does not effect a waiver of the protections of the [Exchange] Act."[121]

Two years later, in *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[122] the Court extended its holding in *McMahon* to section 14 of the Securities Act. In the process, it overruled *Wilko v. Swan*, a 1953 Supreme Court case that invalidated under section 14 the application of an arbitration provision to a Securities Act section 12(a)(2) claim.[123] The *Rodriguez* Court noted that Securities Act section 14 and Exchange Act section 29(a) "should be construed harmoniously because they 'constitute interrelated components of the federal regulatory scheme governing transactions in securities.'"[124]

Given the newness of the issue, no court has yet addressed whether a fee-shifting bylaw is void under the anti-waiver provisions as applied to federal securities law claims. I believe the answer is yes, at least with respect to stockholders with negative value claims, because a fee-shifting bylaw weakens their ability to recover under federal securities law, the standard established by the Supreme Court for determining the scope of sections 14 and 29(a). Specifically, the only sensible way for a stockholder with a negative value claim to recover under federal securities laws is by participating in a class action lawsuit. However, as discussed above, if the typical fee-shifting bylaw is applicable to securities law claims, no one will be willing to serve as lead plaintiff in a class action. Thus, no class action will be brought, and therefore negative value claim stockholders will have no recourse.[125] In other words, their ability to recover under federal securities laws will have been weakened to the point of death. At

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120. *Id.* at 234.

121. *Id.*

122. 490 U.S. 477, 480 (1989).

123. *Id*.

124. *Id.* at 484–85 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206 (1976)).

125. I note that the Court rejected this line of argument in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011), and *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013). These cases, however, are not on point. *AT&T Mobility* dealt with whether the Federal Arbitration Act ("FAA") preempted a California law prohibiting class arbitration waivers in consumer contracts. Likewise, *American Express* dealt with whether a class arbitration waiver falls within the "effective vindication" exception to the FAA. In other words, neither of them dealt with whether a contractual provision that essentially bans securities fraud class actions violates the anti-waiver provisions of federal securities laws.

the same time, there is no federal policy generally favoring fee-shifting, nor is fee-shifting subject to SEC authority, as is the case with arbitration. Thus, *McMahon* and *Rodriguez* are easily distinguishable.

I view a fee-shifting bylaw somewhat analogous to the "no-action clause" at issue in *McMahan & Co. v. Wherehouse Entertainment, Inc.*,[126] which the court found was void under sections 14 and 29(a). In this 1995 case, plaintiffs purchased debentures issued by Wherehouse Entertainment in a registered offering.[127] Plaintiffs later claimed that the related registration statements and prospectus were materially misleading, and thus sued Wherehouse Entertainment and related parties under section 11 of the Securities Act and § 10/Rule 10b-5 of the Exchange Act.[128] In a motion for summary judgment, defendants asserted, among other things, that plaintiffs' claims were barred by the no-action clause of the indenture governing the debentures.[129] This clause provided as follows:

> *Limitation on Suits.* A Securityholder may pursue any remedy with respect to this Indenture or the Securities only if:
>
> (1) the Holder gives to the [Indenture] Trustee written notice of a continuing Event of Default;
>
> (2) the Holders of at least 25% in principal amount of the Securities make a written request to the Trustee to pursue the remedy;
>
> (3) such Holder or Holders offer to the Trustee indemnity satisfactory to the Trustee against any loss, liability or expense;
>
> (4) the Trustee does not comply with the request within 60 days after receipt of the request and the offer of indemnity; and
>
> (5) during such 60-day period the Holders of a majority in principal amount of the Securities do not give the Trustee a direction inconsistent with the request.[130]

As the court noted, "[s]uch no-action clauses frequently are included in indentures to limit suits arising from those agreements."[131]

126. 65 F.3d 1044, 1051 (2d Cir. 1995).
127. *Id.* at 1045.
128. *Id.* at 1047.
129. *Id.*
130. *Id.* at 1050 (footnote omitted).
131. *Id.*

The district court acknowledged that plaintiffs failed to comply with the no-action clause but nonetheless denied defendants' motion for summary judgment on the federal securities law claims.[132] It ruled that the no-action clause was inoperable as applied to these claims under sections 14 and 29(a) "because it infringed on plaintiffs' substantive rights under the securities laws."[133] Defendants argued on appeal that the no-action clause is analogous to an arbitration clause in that it "does not constitute a 'waiver,' but, rather, establishes a procedure that must be followed before an action may be brought."[134] The Second Circuit rejected this argument, reasoning:

> Arbitration clauses are enforceable under federal securities laws because they are procedural in nature and do not serve to waive compliance with the provisions of substantive law. The no-action clause in this case can operate to bar a minority plaintiff class from exercising its substantive rights under federal securities law upon the vote of a majority of the debentureholders. Further, a plaintiff's inability to indemnify the Trustee, as required by the no-action clause here, would bar that plaintiff from commencing a securities law claim. The statutory framework of the 1933 and 1934 Acts compels the conclusion that individual securityholders may not be forced to forego their rights under the federal securities laws due to a contract provision. Thus, the district court properly found that actions based on federal securities laws may not be precluded by the no-action clause.[135]

I view the "minority plaintiff class" referenced by the court as akin to a negative value claim plaintiff class and the Trustee indemnification requirement akin to a fee-shifting obligation.

B. Federal Preemption

The Supremacy Clause of the United States Constitution provides that the Constitution, and the laws passed by Congress pursuant to it, are "the supreme Law of the Land."[136] Thus, federal law overrides, or preempts,

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132. *Id.* at 1051.
133. *Id.*
134. *Id.*
135. *Id.* (citations omitted).
136. U.S. CONST. art. VI, cl. 2.

conflicting state law.[137] Courts have developed an extensive body of case law delineating various categories of preemption. Among these categories are "impossibility preemption," which applies when "compliance with both federal and state regulations is a physical impossibility,"[138] and "obstacle preemption," which applies when "state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"[139] I discuss applicability of these preemption doctrines to fee-shifting bylaws below. Note that my discussion is limited to the preemption of fee-shifting bylaws as applied to stockholder claims brought under federal securities law. In other words, the discussion is not relevant to fee-shifting bylaws as applied to state law claims.

As a threshold issue, a fee-shifting bylaw, as mentioned above, is considered contractual in nature, and one normally thinks of preemption in terms of a state law, not a contractual provision, conflicting with a federal law. Courts and commentators, however, have long recognized that federal law can preempt a contractual provision that is valid under state law.[140]

1. Impossibility Preemption

The case for impossibility preemption is based on the fact that both the Securities Act and the Exchange Act have provisions addressing the payment of attorney's fees. Specifically, section 11(e)(3) of the Securities Act provides:

> In any suit under this or any other section of [the Securities Act] . . . if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant . . . if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit . . . .[141]

137. *See, e.g.*, Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n, 461 U.S. 190, 203–04 (1983).

138. *Id.* at 204 (quoting Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142–43 (1963)).

139. *Id.* (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

140. *See, e.g.*, Aronson v. Quick Point Pencil Co., 440 U.S. 257, 266 (1979); Lear, Inc. v. Adkins, 395 U.S. 653, 673–74 (1969); Brulotte v. Thys Co., 379 U.S. 29, 32–33 (1964); Vault Corp. v. Quaid Software Ltd., 847 F.2d 255, 270 (5th Cir. 1988) (citing 17 U.S.C. § 117); *see also generally* Christina Bohannan, *Copyright Preemption of Contracts*, 67 MD. L. REV. 616 (2008); Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 CALIF. L. REV. 111 (1999).

141. 15 U.S.C. § 77k(e) (2014).

Congress added this provision to the Securities Act in 1934 in an effort to deter strike/nuisance suits.[142] Courts have interpreted the "without merit" standard to encompass "claims and defenses that . . . *border on the frivolous*."[143] It is within a court's discretion to determine whether this standard is met.[144]

Congress again took up the award of attorney's fees in federal securities fraud claims in 1995 as part of the Private Securities Litigation Reform Act ("PSLRA").[145] The PSLRA amended the Securities Act and the Exchange Act with the twin goals of "curb[ing] frivolous, lawyer-driven litigation, while preserving investors' ability to recover on meritorious claims."[146] Regarding attorney's fees, the PSLRA added section 27(c) to the Securities Act and section 21D(c) to the Exchange Act. These are parallel provisions that require a court to (1) assess compliance with Federal Rule of Civil Procedure 11(b) by the parties and their attorneys upon final adjudication of any private action under the specific act, and (2) presumptively award a party reasonable attorney's fees and other expenses incurred in the action if it finds that the opposing party has failed to comply.[147] These changes are viewed as amendments to, and partial repeal of, Rule 11 exclusively for private securities fraud litigation.[148] The changes, among other things, impose fee-shifting, a notion disfavored by Rule 11.[149] As the PSLRA conference report explains:

> Existing Rule 11 has not deterred abusive securities litigation. Courts often fail to impose Rule 11 sanctions even where such sanctions are warranted. When sanctions are awarded, they are generally insufficient to make whole the victim of a Rule 11 violation: the amount of the sanction is limited to an amount that the court deems sufficient to deter repetition of the sanctioned conduct,

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142. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 741 (1975); *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 210 n.30 (1976).

143. Layman v. Combs, 994 F.2d 1344, 1353 (9th Cir. 1992) (quoting W. Fed. Corp. v. Erickson, 739 F.2d 1439, 1444 (9th Cir. 1984)).

144. *See, e.g.*, Rucker v. La-Co, Inc., 496 F.2d 850, 853 (8th Cir. 1974).

145. 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.).

146. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322 (2007).

147. Securities Act of 1933 § 27(c), 15 U.S.C. § 77z-1 (2014); Exchange Act of 1934 § 21D(c), 15 U.S.C. § 78-u4 (2014).

148. *See, e.g.*, JEROLD S. SOLOVY ET AL., JENNER & BLOCK, PRACTICE SERIES: SANCTIONS UNDER RULE 11 6 (2010), *available at* http://jenner.com/system/assets/assets/5514/original/Sanctions_20Under_20Rule_2011-Complete_2010.pdf?1323114005.

149. *Id.* at 11.

> rather than imposing a sanction that equals the costs imposed on the victim by the violation. Finally, courts have been unable to apply Rule 11 to the complaint in such a way that the victim of the ensuing lawsuit is compensated for all attorney's fees and costs incurred in the entire action.[150]

As a general matter, a party violates Rule 11(b) if a court determines a claim the party has brought is frivolous.[151]

Congress left Securities Act section 11(e)(3) in place even though section 27(c) overlaps with it. Perhaps they did this because arguably section 11(e)(3) provides a court more latitude to impose fee-shifting because of the "borders on frivolous standard." The big difference between the two sections is that section 27(c) provides the court less discretion in that it imposes a presumption in favor of awarding attorney's fees, which is not the case under section 11(e)(3).

The bottom line is that even under the stricter PSLRA attorney's fees provisions, it is ultimately up to the court to determine whether fee-shifting is warranted in a particular securities fraud case based on its assessment of the merits. Conversely, a typical fee-shifting bylaw removes a court's assessment of the merits from the equation because it simply mandates fee-shifting regardless of the merits if plaintiff "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought."[152]

It is this discretion/no-discretion distinction that is at the crux of an impossibility preemption argument because courts have held under the doctrine that federal law which affords a decision maker discretion overrides state law which takes away that discretion.[153] For example, the court addressed the issue in *Credit Suisse First Boston Corp. v. Grunwald*.[154] The case involved a clash between National Association of Securities Dealers ("NASD") arbitration rules and California's Ethics Standards for neutral arbitrators.[155] After determining that NASD rules approved by the SEC have preemptive force over conflicting state law, the

150. H.R. REP. NO. 104-369, at 39 (1995) (Conf. Rep.) (footnote omitted).

151. *See, e.g.*, Indus. Risk Insurers v. M.A.N. Gutehoffnungshutte GmbH, 141 F.3d 1434, 1448 (11th Cir. 1998).

152. *See, e.g.*, Insys Therapeutics, Inc., Current Report (Form 8-K), at exhibit 3.1 (Nov. 10, 2014).

153. *See, e.g.*, Credit Suisse First Bos. Corp. v. Grunwald, 400 F.3d 1119, 1133 (9th Cir. 2005); Bloemendaal v. Morgan Stanley Smith Barney LLC, No. EDCV 10–1455 DSF (PLAx), 2011 WL 2161352, at *6 (C.D. Cal. May 23, 2011), *aff'd sub nom.* McDaniel v. Wells Fargo Invs., LLC, 717 F.3d 668 (9th Cir. 2013).

154. 400 F.3d 1119 (9th Cir. 2005).

155. *Id.* at 1121.

court turned to whether NASD rules for arbitration disqualification overrode those of California under the doctrine of impossibility preemption.[156]

Specifically, California's Ethics Standards provide for mandatory and automatic disqualification of an arbitrator who fails to make a required disclosure if a party serves a timely notice of disqualification.[157] Conversely, the NASD Code provides that the NASD Director of Arbitration "may" remove an arbitrator who has failed to make a required disclosure.[158] As the court summed things up, "[t]hus, in the event of a failure to make a required disclosure, the California Ethics Standards require disqualification once a party serves a notice of disqualification, while the NASD Code grants discretion to the NASD Director of Arbitration to decide whether the arbitrator should be disqualified."[159] As a result:

> The NASD Director of Arbitration would find himself in a catch-22 if the California Ethics Standards applied to NASD arbitrations. If the NASD Director exercises his discretion under the NASD Code by refusing to dismiss an arbitrator that failed to make a required disclosure, the Director violates the California Ethics Standards' mandatory disqualification provision. Alternatively, if the Director determines that he is bound by the California Ethics Standards, he effectively forfeits his discretionary authority under the NASD Code.[160]

Hence, the court concluded that "[a]pplication of the California Ethics Standards to NASD arbitrations would strip the Director of Arbitration of his federally-recognized obligation to make a determination whether an arbitrator should in fact be disqualified. Because the NASD Director cannot comply with both sets of disqualification rules, the California Ethics Standards are preempted."[161]

The rule clash at issue in *Credit Suisse* is no different than the clash between a fee-shifting bylaw and federal securities laws. A court would find itself in a catch-22 if a fee-shifting bylaw applied to federal securities

156. *Id.* at 1133.

157. *Id.*

158. *Id.*; *see also* UNIF. CODE OF ARBITRATION § 10308(d)(2) (2007) ("[T]he Director may remove an arbitrator from an arbitration panel based on information that is required to be disclosed pursuant to Rule 10312 and that was not previously disclosed.").

159. *Credit Suisse*, 400 F.3d at 1133.

160. *Id.* (citations omitted).

161. *Id.* at 1134.

law claims. If the court exercises its discretion under Securities Act section 11(e)(3) or 27(c) or Exchange Act section 21D(c), by choosing not to award attorney's fees in a case where a plaintiff failed to obtain a judgment for the full remedy sought, the court violates the bylaw's mandatory fee-shifting language. Alternatively, if the court determines that it is bound by the fee-shifting bylaw, it effectively forfeits its discretionary authority under federal securities laws. In other words, application of a fee-shifting bylaw would strip the court of its federally-recognized obligation to make a determination whether attorney's fees should in fact be awarded. Thus, under the reasoning of *Credit Suisse*, federal securities law preempts fee-shifting bylaws.

2. Obstacle Preemption

As mentioned above, obstacle preemption arises when "state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"[162] Per the Supreme Court:

> What is a sufficient obstacle is a matter of judgment, to be informed by examining the federal statute as a whole and identifying its purpose and intended effects . . . . If the purpose of the act cannot otherwise be accomplished—if its operation within its chosen field else must be frustrated and its provisions be refused their natural effect—the state law must yield to the regulation of Congress within the sphere of its delegated power."[163]

In my judgment, a fee-shifting bylaw frustrates the purpose of the PSLRA and is therefore invalid under the doctrine of obstacle preemption. In that regard, below is some background on the PSLRA.

Securities antifraud provisions are designed to deter erroneous disclosure and provide a compensation avenue to wronged investors. They also supplement public enforcement of federal securities laws by enabling plaintiffs to serve as "private attorneys general," an important consideration given the resource constraints of the SEC.[164] The provisions,

162. Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n, 461 U.S. 190, 204 (1983) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

163. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 373 (2000) (quoting Savage v. Jones, 225 U.S. 501, 533 (1912) (internal quotation marks omitted)).

164. Barbara Black, Stoneridge Investment Partners v. Scientific-Atlanta, Inc.*: Reliance on Deceptive Conduct and the Future of Securities Fraud Class Actions*, 36 SEC. REG. L.J. 330, 338 (2008) (footnotes omitted) ("[E]mpirical studies make clear that the SEC cannot investigate and bring enforcement actions against all corporate wrongdoers; the concept of the private plaintiffs acting as a

however, are subject to abuse, especially when it comes to class action litigation. Specifically, plaintiffs' firms have long been accused of bringing unmeritorious securities fraud claims, or strike suits. The story goes that plaintiffs' firms bring strike suits because of their nuisance value. They figure a company is likely to settle the suit regardless of the merits to avoid the expense, uncertainty, and disruption of protracted litigation.[165] Thus, they recruit a stockholder to serve as lead plaintiff, file suit, and then negotiate a settlement with the company that includes a nice payment to the plaintiffs' firm for its time and expense in bringing the suit.

This dynamic was behind Congress's enactment of the PSLRA, which, as mentioned above, amended the Securities Act and the Exchange Act in an effort to curb frivolous securities suits.[166] In addition to the attorney's fees provisions, these amendments also included the following:

- *Heightened pleading standards*. In addition to pleading fraud with particularity as required by Federal Rule of Civil Procedure 9(b), the PSLRA requires a Rule 10b-5 complaint to "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed."[167] Further, the complaint must also "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind [i.e., scienter]."[168]

- *Lead plaintiff and class counsel selection*. The PSLRA requires the court to appoint the lead plaintiff in a securities fraud class action, presumptively the investor with the largest financial

'private attorney general' as a necessary supplement to the SEC's enforcement powers maintains its vitality.").

165. *See, e.g.*, Selby P. Brown, Comment, *Don't Throw the Baby Out with the Bath Water: The Merits of the Intermediate Approach to the Securities Litigation Uniform Standards Act*, 66 OKLA. L. REV. 363, 370 (2014).

166. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 313–14, 322 (2007).

167. 15 U.S.C. § 78u-4(b)(1) (2014).

168. *Id.* § 78u-4(b)(2). The PSLRA, did not, however, specify what constitutes a "strong inference." The Supreme Court addressed the issue in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, ruling that in order to qualify as "strong," "an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." 551 U.S. at 314.

interest in the case.[169] The lead plaintiff is then charged with selecting class counsel, subject to court approval.[170]

- *Discovery stay*. The PSLRA imposes a stay on discovery during the pendency of a defendant's motion to dismiss.[171]

As the PSLRA Conference Report explains:

> The overriding purpose of our Nation's securities laws is to protect investors and to maintain confidence in the securities markets, so that our national savings, capital formation and investment may grow for the benefit of all Americans.
>
> The private securities litigation system is too important to the integrity of American capital markets to allow this system to be undermined by those who seek to line their own pockets by bringing abusive and meritless suits. Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs. This legislation seeks to return the securities litigation system to that high standard.[172]

With respect to the PSLRA provisions addressing the award of attorney's fees, the conference report states as follows:

> The Conference Committee recognizes the need to reduce significantly the filing of meritless securities lawsuits without hindering the ability of victims of fraud to pursue legitimate claims. The Conference Committee seeks to solve this problem by strengthening the application of Rule 11 of the Federal Rules of Civil Procedure in private securities actions.[173]

Thus, both the PSLRA generally and the attorney's fees provisions specifically reflect a deliberate and careful balancing by Congress to

169. §§ 77z-1(a)(3)(B), 78u-4(a)(3)(B).
170. §§ 77z-1(a)(3)(B)(v), 78u-4(a)(3)(B)(v).
171. §§ 77z-1(b)(1); 78u-4(b)(3)(B).
172. H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.).
173. *Id.* at 39.

preserve private securities fraud lawsuits while reducing abusive and meritless suits.[174]

Simply put, a fee-shifting bylaw upsets the balance struck by Congress and therefore frustrates the purpose of the PSLRA. It upsets this balance because, as discussed in Part III above, the likely effect of a fee-shifting bylaw would be to eliminate securities fraud class actions and decrease individual actions regardless of merit. In other words, fee-shifting bylaws, if enforceable, would greatly hinder the ability of victims of fraud to pursue legitimate claims, in stark contrast to the stated goals of the PSLRA. Hence, a fee-shifting bylaw "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress"[175] and is therefore invalid under the doctrine of obstacle preemption.

C. Validity of Less One-Sided Fee-Shifting Bylaws

The fee-shifting bylaw analyzed above is extremely one-sided in favor of the corporation as discussed in Part I.C. Hence, this section considers whether a corporation could craft a less one-sided, or more fair, fee-shifting bylaw that would not violate the anti-waiver provisions of the Securities Act and the Exchange Act or be preempted by federal law.

My anti-waiver and obstacle preemption arguments are both based largely on the high probability that the typical fee-shifting bylaw would eliminate securities fraud class actions. Thus, tweaking the language of the bylaw so that it has less of an impact on a stockholder's cost-benefit analysis for serving as a lead plaintiff would be a way around these arguments. For example, a corporation could provide for two-sided fee-shifting and not require the prevailing party to substantially achieve the full remedy sought, similar to the Oklahoma fee-shifting statutory provision discussed in Part I.C. above. The problem with this approach,

174. Congress did in fact consider going with a more defendant-favorable rule but nothing as extreme as what the typical fee-shifting bylaw imposes. Specifically, an earlier version of the PSLRA contained a provision imposing the prevailing party's attorney's fees on a losing party if the court determines "(A) the position of the losing party was not substantially justified, (B) imposing fees and expenses on the losing party or the losing party's attorney would be just, and (C) the cost of such fees and expenses to the prevailing party is substantially burdensome or unjust." Private Securities Litigation Reform Act of 1995, H.R. 1058, 104th Cong. § 3(a) (1995) (House engrossed version Mar. 8, 1995). It ultimately, however, decided to go with the Rule 11 approach. *See generally* Thomas D. Rowe, Jr., *Indemnity or Compensation? The Contract with America, Loser-Pays Attorney Fee Shifting, and a One-Way Alternative*, 37 WASHBURN L.J. 317, 322–27 (1998) (discussing legislative history of the PSLRA).

175. Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n, 461 U.S. 190, 204 (1983) (citing Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

however, is that it would severely undercut the deterrent effect of a fee-shifting bylaw on securities fraud class actions and derivative suits, which likely is a corporation's primary, if not only, reason for adopting a fee-shifting bylaw.

My impossibility preemption argument is based on the fact that the typical fee-shifting bylaw overrides a court's discretion to award or not award fees depending on the case's merits. Thus, a corporation could sidestep the issue by building such discretion into the language of the bylaw. Such an approach, however, would mean that whether fee-shifting is warranted in a particular securities fraud case is ultimately up to the court, which is no different than the rule applicable to a corporation without a fee-shifting bylaw. In other words, adopting such a fee-shifting bylaw would be pointless.

The bottom line is that a corporation could adopt a fee-shifting bylaw that would pass muster under federal securities laws. Doing so, however, would be senseless because the bylaw would be largely toothless and would not change the status quo.

V. SHOULD CONGRESS VALIDATE FEE-SHIFTING BYLAWS?

Congress could, of course, amend the securities laws to validate the typical fee-shifting bylaw. This Part explains why it should not do so. Given the current political climate in Washington, I view the discussion that follows as largely academic.

As recognized by the Delaware Supreme Court in *ATP*, the purpose behind the typical fee-shifting bylaw is to deter litigation.[176] Hence, Congress should validate typical fee-shifting bylaws only if it concludes that (1) there is too much securities fraud litigation and (2) typical fee-shifting bylaws are the most sensible way to deal with the problem. An obvious claim for condition (1) being met is that notwithstanding the passage of the PSLRA, there are still too many frivolous securities fraud class action suits being brought. Even if this claim is true, however, it fails condition (2) for several reasons. First, as discussed above, a typical fee-shifting bylaw deters all securities fraud class actions, regardless of merit, not just frivolous class actions.

176. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (2014).

Second, the antifraud provisions apply to transactions in securities,[177] a term that includes stock, bonds, debentures, and options, among others.[178] Conversely, the typical fee-shifting bylaw applies only to stockholders.[179] Even if written more broadly, a typical fee-shifting bylaw would not apply to non-stockholders because bylaws are a contract between the corporation and its stockholders.[180] In other words, a non-stockholder is not bound by a corporation's bylaws. Thus, a typical fee-shifting bylaw would not deter frivolous class actions brought by holders of securities other than stock. Similarly, the typical fee-shifting bylaw applies only to suits against a corporation or a corporation's officer, director, or affiliate and therefore would not deter frivolous class actions against underwriters and accounting firms under section 11 of the Securities Act.[181]

Hence, validating typical fee-shifting bylaws to combat frivolous litigation would be both over- and under-inclusive. A more sensible approach would be one targeted exclusively to frivolous litigation that covers suits by all types of securities holders, not just stockholders, and all types of defendants, not just corporations and their affiliates. Such an approach could include, for example, giving a court more latitude to dismiss claims it views as frivolous.

Some commentators have gone further and argued, albeit in a different context, that the problem is not frivolous securities fraud class actions, but all securities fraud class actions.[182] The crux of the argument is that these suits, even if meritorious, neither effectively deter fraud[183] nor effectively compensate those harmed by fraud.[184] At the same time, they generate enormous amounts of legal fees and expenses, most of which are covered

177. *See, e.g.*, 15 U.S.C. § 77k(a) (2014) (referring to "any person acquiring such security"); *see also* § 77*l*(a)(2) (referring to a person who "offers or sells a security").

178. 15 U.S.C. § 77b(a)(1) (2014).

179. *See* discussion *supra* Part I.C.

180. *See, e.g.*, Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939 (Del. Ch. 2013) ("[T]he bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders . . . .").

181. *See* discussion *supra* Part I.C.

182. *See, e.g.*, PINCUS, *supra* note 95, at 2.

183. Securities fraud class actions allegedly do not effectively deter fraud because individual wrongdoers, as opposed to their corporate employers, are almost never held accountable. *See id*. at 3.

184. They allegedly do not effectively compensate those harmed by fraud because it is the corporation, and thus indirectly its shareholders, who pays any resulting settlement or judgment to a subset of its shareholders (those who bought or sold during the class period), and thus indirectly its shareholders pay any resulting settlement or judgment. Since a diversified shareholder will sometimes be in the class and other times not in the class, any recovery it gets will likely be cancelled out by money it indirectly lost when it was not in the class, especially when litigation costs and expenses are factored in. *See id*; *see also* William W. Bratton & Michael L.Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 93–97 (2011).

directly or indirectly by corporate America. Hence, the costs simply outweigh the benefits. As a result, securities fraud class actions, it is argued, should be abolished, especially considering that the strongest deterrence comes from governmental enforcement, which would remain in place.

Even if Congress were to conclude that the costs of securities fraud class actions outweigh the benefits (a topic beyond the scope of this Article), addressing the problem by validating typical fee-shifting bylaws would fail condition (2). A more direct and sensible approach in such an alternate reality would be to amend the securities laws to allow corporations to opt out of securities fraud class actions[185] as opposed to letting them do so indirectly and imperfectly through fee-shifting bylaws. In other words, even if the costs truly do outweigh the benefits—a contestable point[186]—it still would not make sense for Congress to validate fee-shifting bylaws.

The bottom line is that if Congress were to once again address securities fraud class actions, validating typical fee-shifting bylaws would not be a prudent approach. I suspect proponents of typical fee-shifting bylaws as a solution to securities fraud class actions run amok would agree, at least privately, since all potential fixes would be on the table if Congress were open to amending the Securities Act and Exchange Act. Nonetheless, it is not surprising that business interests strongly support fee-shifting bylaws even though the problem that needs to be cured is both unclear and contestable and the fix is far short of perfect because it is a "fix" that is currently on the table.

VI. CONCLUSION

The typical fee-shifting bylaw seemingly applies to federal securities fraud claims brought by stockholders because such claims fall squarely within the bylaw's language. Such application would drastically change the cost-benefit analysis of serving as lead plaintiff in a securities fraud class action, making it highly unlikely that anyone would agree to serve. The result would be that corporations could essentially opt out of securities fraud class actions.

185. To be clear, I am not advocating that Congress do this. All I am saying is that even in an alternate reality, it would not make sense for Congress to do so.

186. *See, e.g.*, Barbara Black, *Eliminating Securities Fraud Class Actions Under the Radar*, 2009 COLUM. BUS. L. REV. 802, 807–20.

Typical fee-shifting bylaws, however, are invalid as applied to federal securities fraud claims. Specifically, such application violates the anti-waiver provisions of federal securities law and the Supremacy Clause under the doctrines of impossibility and obstacle preemption. Congress, of course, could amend federal securities law to validate typical fee-shifting bylaws, but it should not do so because better fixes are possible.

APPENDIX

The below table lists corporations (with the exception of Alibaba) that have adopted fee-shifting bylaws or charter provisions between May 8, 2014, the date the court released its opinion in *ATP*, and March 16, 2015. The "Notes" column specifies notable departures from the language of the ITI fee-shifting bylaw discussed in Part I.C. A blank Notes box means no notable differences. Some basic statistics follow the table.

Name	**Jurisdiction of Incorporation**	**Notes**
Air Industries Group[187]	Nevada	Requires claiming party to bear its own litigation costs and prohibits claiming party and its attorneys from receiving fees or expenses from a common fund or a corporate benefit conferred on the corporation
Alibaba Group Holding Limited[188]	Cayman Islands	Does not include "substantially achieve . . . full remedy sought" limitation
American Spectrum Realty, Inc.[189]	Maryland	
ATD Corporation[190]	Delaware	Limited to claims falling within internal affairs doctrine
Barnwell Industries, Inc.[191]	Delaware	Requires claiming party to bear its own litigation costs and prohibits claiming party and its attorneys from receiving fees or expenses from a common fund or a corporate benefit conferred on the corporation
BBX Capital Corporation[192]	Florida	
BFC Financial Corporation[193]	Florida	
Biolase, Inc.[194]	Delaware	Applies only to claims brought by current or former directors

187. Air Indus. Grp., Current Report (Form 8-K), at exhibit 3.1 (Oct. 22, 2014).

188. Alibaba Grp. Holding Ltd., Amendment No. 6 to Form F-1 Registration Statement (Form F-1/A), at exhibit 3.2 (Sept. 5, 2014).

189. Am. Spectrum Realty, Inc., Current Report (Form 8-K), at exhibit 3.1 (July 25, 2014).

190. ATD Corp., Amendment No. 2 to Form S-1 Registration Statement (Form S-1/A), at exhibit 3.2 (Aug. 19, 2014).

191. Barnwell Indus., Inc., Annual Report (Form 10-K), at exhibit 3.2 (Dec. 18, 2014).

192. BBX Capital Corp., Current Report (Form 8-K), at exhibit 3.1 (Feb. 12, 2015).

193. BFC Fin. Corp., Current Report (Form 8-K), at exhibit 3.1 (Feb. 12, 2015).

194. Biolase, Inc., Current Report (Form 8-K), at exhibit 3.1 (June 30, 2014).

Name	Jurisdiction of Incorporation	Notes
Bridgeline Digital, Inc.[195]	Delaware	Requires claiming party to bear its own litigation costs and prohibits claiming party and its attorneys from receiving fees or expenses from a common fund or a corporate benefit conferred on the corporation
Cadista Holdings Inc.[196]	Delaware	
CIG Wireless Corp.[197]	Nevada	Corporation can require a less than 5% shareholder plaintiff to provide surety for expenses
Cogent Communications Holdings, Inc.[198]	Delaware	Requires claiming party to bear its own litigation costs and prohibits claiming party and its attorneys from receiving fees or expenses from a common fund or a corporate benefit conferred on the corporation
CoLucid Pharmaceuticals, Inc.[199]	Delaware	
Cryo-Cell International, Inc.[200]	Delaware	Limited to claims falling within internal affairs doctrine
Echo Therapeutics, Inc.[201]	Delaware	
Epiq Systems, Inc.[202]	Missouri	Applies only to claims brought in a forum other than the Jackson County Missouri Circuit Court, or, if such court lacks subject matter jurisdiction, the U.S. District Court for the Western District of Missouri; does not include "substantially achieve . . . full remedy sought" limitation
Evolent Health, Inc.[203]	Delaware	Limited to claims falling within internal affairs doctrine
FDO Holdings, Inc.[204]	Delaware	Charter provision

195. Bridgeline Digital, Inc., Quarterly Report (Form 10-Q), at exhibit 3.2 (Feb. 17, 2015).
196. Cadista Holdings Inc., Current Report (Form 8-K), at exhibit 3.1 (Oct. 8, 2014).
197. CIG Wireless Corp., Current Report (Form 10-Q), at exhibit 3.1 (Nov. 14, 2014).
198. Cogent Commc'ns Holdings, Inc., Current Report (Form 8-K), at exhibit 3.2 (Nov. 5, 2014).
199. CoLucid Pharmaceuticals, Inc., Registration Statement (Form S-1), at exhibit 3.2 (Mar. 30, 2015).
200. Cryo-Cell Int'l, Inc., Current Report (Form 8-K), at exhibit 3.2 (Sept. 26, 2014).
201. Echo Therapeutics, Inc., Current Report (Form 8-K), at exhibit 3.2 (July 29, 2014).
202. Epiq Sys., Inc., Current Report (Form 8-K), at exhibit 3.1 (Oct. 8, 2014).
203. Evolent Health, Inc., Current Report (Form 8-K), at exhibit 3.1 (June 10, 2015).
204. FDO Holdings, Inc., Registration Statement (Form S-1), 41 (Nov. 7, 2014).

Name	**Jurisdiction of Incorporation**	**Notes**
First Aviation Services, Inc.[205]	Delaware	
Frequency Electronics, Inc.[206]	Delaware	
Freshpet, Inc.[207]	Delaware	Charter provision; limited to claims falling within internal affairs doctrine
GAMCO Investors, Inc.[208]	Delaware	
GWG Holdings, Inc.[209]	Delaware	
Hemispherx Biopharma, Inc.[210]	Delaware	Corporation can require a less than 5% shareholder to provide surety for expenses
Highlands Bankshares, Inc.[211]	Virginia	Limited to claims falling within internal affairs doctrine
IDI, Inc. (f/k/a Tiger Media, Inc.)[212]	Delaware	Limited to claims falling within internal affairs doctrine
Informatica Corporation[213]	Delaware	Applies only to claims filed in a court outside of Delaware
Insys Therapeutics, Inc.[214]	Delaware	
Interactive Brokers Group, Inc.[215]	Delaware	Does not include "substantially achieve . . . full remedy sought" limitation
Iradimed Corporation[216]	Delaware	
Juno Therapeutics, Inc.[217]	Delaware	
KLX Inc.[218]	Delaware	
Lannett Company, Inc.[219]	Delaware	

205. Strougo v. Hollander, 111 A.3d 590, 592 (Del. Ch. 2015).
206. Frequency Elecs., Inc., Current Report (Form 8-K), at exhibit 3.1 (Dec. 18, 2014).
207. Freshpet, Inc., Amendment No. 3 to Form S-1 Registration Statement (Form S-1/A), 32–33 (Nov. 4, 2014).
208. GAMCO Investors, Inc., Current Report (Form 8-K), at exhibit 3.3 (Sept. 26, 2014).
209. GWG Holdings, Inc., Quarterly Report (Form 10-Q), at exhibit 3.1 (Nov. 13, 2014).
210. Hemispherx Biopharma, Inc., Current Report (Form 8-K), at exhibit 3.1 (June 24, 2015).
211. Highlands Bankshares, Inc., Current Report (Form 8-K), at exhibit 3.1 (Nov. 18, 2014).
212. Tiger Media, Inc., Current Report (Form 8-K), at exhibit 3.3 (Mar. 26, 2015).
213. Informatica Corp., Current Report (Form 8-K), at exhibit 3.1 (Apr. 7, 2015).
214. Insys Therapeutics, Inc., Current Report (Form 8-K), at exhibit 3.1 (Nov. 10, 2014).
215. Interactive Brokers Grp., Inc., Current Report (Form 8-K), at exhibit 3.1 (Dec. 22, 2014).
216. Iradimed Corp., Current Report (Form 8-K), at exhibit 3.2 (Dec. 16, 2014).
217. Juno Therapeutics, Inc., Amendment No. 2 to Form S-1 (Form S-1/A), at exhibit 3.2 (Dec. 9, 2014).
218. KLX Inc., Current Report (Form 8-K), at exhibit 3.2 (Dec. 19, 2014).
219. Lannett Co., Inc., Annual Report (Form 10-K), at exhibit 3.6 (Aug. 29, 2014).

Name	**Jurisdiction of Incorporation**	**Notes**
The LGL Group, Inc.[220]	Delaware	Requires claiming party to bear its own litigation costs and prohibits claiming party and its attorneys from receiving fees or expenses from a common fund or a corporate benefit conferred on the corporation
Marine Products Corporation[221]	Delaware	Limited to claims falling within internal affairs doctrine; does not include "substantially achieve . . . full remedy sought" limitation
Mongolia Holdings, Inc.[222]	Delaware	
Nature's Sunshine Products, Inc.[223]	Utah	
Net Element, Inc.[224]	Delaware	Requires claiming party to bear its own litigation costs and prohibits claiming party and its attorneys from receiving fees or expenses from a common fund or a corporate benefit conferred on the corporation
Odyssey Marine Exploration[225]	Nevada	
Planet Fitness, Inc.[226]	Delaware	Charter provision; applies only to claims filed in a court outside of Delaware
Plasmatech Biopharmaceuticals Inc.[227]	Delaware	Limited to claims falling within internal affairs doctrine
PRA Group, Inc.[228]	Delaware	
Press Ganey Holdings, Inc.[229]	Delaware	Charter provision; limited to claims falling within internal affairs doctrine
PrimeEnergy Corporation[230]	Delaware	Requires claiming party to bear its own litigation costs and prohibits

220. LGL Grp., Inc., Current Report (Form 8-K), at exhibit 3.1 (June 17, 2014).
221. Marine Products Corp., Quarterly Report (Form 10-Q), at exhibit 3.2 (Nov. 3, 2014).
222. Mong. Holdings, Inc., Current Report (Form 8-K), at exhibit 3.1 (Nov. 25, 2014).
223. Nature's Sunshine Products, Inc., Current Report (Form 8-K), at exhibit 3.1 (Aug. 29, 2014).
224. Net Element, Inc., Current Report (Form 8-K), at exhibit 3.2 (June 16, 2015).
225. Odyssey Marine Exploration, Inc., Current Report (Form 8-K), at exhibit 3.3 (Mar. 13, 2015).
226. Planet Fitness, Inc., Registration Statement (Form S-1), at exhibit 3.1 (June 22, 2015).
227. PlasmaTech Biopharmaceuticals, Inc., Current Report (Form 8-K), at exhibit 3.1 (Mar. 4, 2015).
228. PRA Grp., Inc., Current Report (Form 8-K), at exhibit 3.2 (Oct. 29, 2014).
229. Press Ganey Holdings, Inc., Current Report (Form 8-K), at exhibit 3.1 (May 27, 2015).
230. PrimeEnergy Corp., Current Report (Form 8-K), at exhibit 3.2 (May 22, 2015).

Name	**Jurisdiction of Incorporation**	**Notes**
		claiming party and its attorneys from receiving fees or expenses from a common fund or a corporate benefit conferred on the corporation
Riverbed Technology, Inc.[231]	Delaware	Limited to claims falling within internal affairs doctrine and brought in a court located outside of Delaware
Rollins, Inc.[232]	Delaware	Does not include "substantially achieve . . . full remedy sought" limitation
RPC, Inc.[233]	Delaware	Does not include "substantially achieve . . . full remedy sought" limitation
Smart & Final Stores, Inc.[234]	Delaware	Charter provision
Stemcells, Inc.[235]	Delaware	
Townsquare Media, Inc.[236]	Delaware	Charter provision; limited to claims falling within internal affairs doctrine
Western Capital Resources, Inc.[237]	Minnesota	

231. Riverbed Tech., Inc., Current Report (Form 8-K), at exhibit 3.1 (Dec. 15, 2014).
232. Rollins, Inc., Quarterly Report (Form 10-Q), at exhibit 3.1 (Oct. 29, 2014).
233. RPC, Inc., Quarterly Report (Form 10-Q), at exhibit 3.2 (Nov. 3, 2014).
234. Smart & Final Stores, Inc., Amendment No. 5 to Form S-1 (Form S-1/A), at exhibit 3.1 (Sept. 19, 2014).
235. Stemcells, Inc., Current Report (Form 8-K), at exhibit 3.(II) (Oct. 23, 2015).
236. Townsquare Media, Inc., Registration Statement (Form S-1/A), at exhibit 3.1 (July 14, 2014).
237. W. Capital Res., Inc., Quarterly Report (Form 10-Q), at exhibit 3.2 (Aug. 12, 2014).

Total number of corporations:	51
Total number of jurisdictions:	9

Jurisdiction breakdown	
Delaware	40
Nevada	3
Florida	2
Cayman Islands	1
Maryland	1
Minnesota	1
Missouri	1
Virginia	1
Utah	1

Bylaws vs. Charter breakdown	
Bylaws	45
Charter	6
Internal affairs only:	11