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November 24, 2014

The Honorable Jack Markell
Office of the Governor
150 Martin Luther King Jr. Blvd South, 2nd Floor
Dover, Delaware 19901

RE: *Legislation on "Fee Shifting" Bylaws*

Dear Governor Markell:

As institutional investors collectively managing assets of almost $2 trillion that represent millions of current and retired teachers, first responders, and government employees, we write asking for swift legislative action to curtail the spread of so-called "fee shifting" bylaws, which have been adopted by more than 30 companies this summer.

While lobbyists hired by corporate interests are trying to portray these bylaws as protecting shareholders, the exact opposite is true. These bylaws effectively make corporate directors and officers unaccountable for serious wrongdoing. The General Assembly must act promptly to restore confidence in Delaware's credibility in developing a balanced corporate law, preserve stockholders' access to the court system, and make clear that directors and officers cannot insulate themselves from accountability under the guise of unilateral bylaw or charter provisions.

On May 8, 2014, the Delaware Supreme Court issued an opinion in *ATP Tour, Inc., et. al. v. Deutscher Tennis Bund*, in which the Court held that directors *of a non-stock corporation* may adopt a bylaw requiring any member who commences litigation against that *non-stock corporation* or its directors, or derivatively on behalf of that corporation, to be personally liable for the legal expenses of the company and its officers

and directors unless the member "obtain[s] a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought" in the litigation.[1]

Although decided in the context of a *non-stock corporation*, lobbyists and lawyers representing the interest in entrenched directors of *publicly traded Delaware corporations* have seized on this language to urge their clients to use this opportunity to immunize their conduct from any meaningful judicial oversight by imposing liability for corporate expenses directly on stockholders. The Council of the Corporation Law Section of the Delaware Bar Association responded to the *ATP* ruling by proposing legislation that would appropriately limit the ruling's application in the public company context. Specifically, the General Assembly was asked to approve Senate Bill 236 of the 147th General Assembly, which would have limited the application of *ATP Tour* to the context in which it was decided, a non-stock corporation, and reaffirmed the limited liability nature of publicly traded corporations by making clear that corporate directors cannot impose financial liability on stockholders by unilaterally adopting a bylaw purporting to do so.

Corporate lobbyists responded by presenting a campaign that wrongly characterized "fee-shifting" bylaws as somehow protective of stockholder interests. We must make clear that these lobbyists do not speak for the interests of the nation's public investors. The "Institute for Legal Reform" (the "Institute") acting in concert with the U.S. Chamber of Commerce, sent at least two letters to the members of the General Assembly suggesting that this content-neutral legislation "would only protect frivolous lawsuits" and that fee-shifting bylaws unilaterally adopted by corporate directors "gives corporations a way to protect shareholders against these costs of abusive litigation." In response, the General Assembly did not act on Senate Bill 236, but instead the Senate of the State of Delaware adopted Resolution No. 12, which calls for continued consideration of these important issues.

The Institute's arguments are directly contrary to the interests of investors in publicly traded Delaware corporations. Far from protecting corporations from "frivolous litigation," these fee-shifting provisions effectively bar any judicial oversight of misconduct of corporate directors. They undermine the most fundamental premise of the corporate form – that stockholders, simply by virtue of their investment, cannot be responsible for corporate debts.

First, the fee-shifting bylaw approved by in *ATP Tour*, if applied to stock corporations, essentially removes judicial oversight over corporate wrongdoing by effectively foreclosing stockholders' access to courts. The fundamental premise of Delaware corporate law is that while stockholders contribute capital and own the equity

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1 *ATP Tour, Inc., et. al. v. Deutscher Tennis Bund, et. al.*, 91 A.3d 554 (Del. Supr. 2014).

of a corporation, the directors and officers are delegated the statutory responsibility for managing the business affairs of the enterprise and are charged with the corresponding fiduciary obligation to act in the best interests of the stockholders and the company. These statutory and fiduciary obligations are meaningful, however, only to the extent they can be enforced by the Delaware courts. Fee-shifting bylaws will foreclose meritorious stockholder claims render illusory the fiduciary obligations of corporate directors.

To be clear, the kind of fee-shifting bylaw approved in *ATP Tour* does not further stockholders' interests by protecting corporations from "frivolous litigation." Instead, such provisions bar all judicial oversight by making it economically unfeasible for stockholders to seek redress in Delaware courts to protect their rights. Without adequate protections and reasonable access to the courts to hold corporate fiduciaries accountable when they violate their obligations to stockholders, investor confidence diminishes and market participation suffers, hurting investors and the businesses in which they invest.[2] In other words, closing the courthouse doors to investors could very directly and materially impair the Delaware economy. Moreover, depriving investors of access to the courts will eliminate an important check-and-balance on the behavior of corporate fiduciaries, and will predictably cause and increase unlawful or disloyal conduct by directors and officers, with a corresponding negative effect on our investment portfolios and the public markets generally.

Second, Delaware has a substantial interest in the development of its corporate law, and the inevitable widespread adoption of fee-shifting bylaws will impair the development of that law. For more than one hundred years, the Delaware judiciary has provided a fair forum for the resolution of intra-corporate disputes. The Delaware Court of Chancery is generally considered the nation's "pre-eminent" business court,[3] and virtually every state in the country looks to Delaware law in the development of its own corporate law.[4] If Delaware corporations adopt fee-shifting bylaws, however, the

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2 Notably, while many commentators have linked the need for fee-shifting bylaws with the fact that some companies have incurred expenses defending non-meritorious litigations, the courts already have the ability to dismiss such suits and award sanctions if the action is truly frivolous.

3 http://courts.delaware.gov/chancery/index.stm ("The Delaware Court of Chancery is widely recognized as the nation's preeminent forum for the determination of disputes involving the internal affairs of the thousands upon thousands of Delaware corporations and other business entities through which a vast amount of the world's commercial affairs is conducted. Its unique competence in and exposure to issues of business law are unmatched.").

4 *See, e.g.*, *Billings v. GTFM, LLC*, 449 Mass. 281, 292 (2007); *Achey v. Linn County Bank*, 261 Kan. 669, 676 (1997); *Davidson v. Ecological Science Corporation*, 266 So.2d 71 (Fla. 3d DCA 1972); *In re Comverse Tech., Inc.*, 56 A.D.3d 49, 56 (N.Y. App. 1st Dep't 2008); *Ward v. Idsinga*, 2013 Mich. App. LEXIS 1427 at *12-13; *Oakland Raiders v. Nat'l Football League*, 93 Cal. App. 4th 572, 586 n. 5 (Cal. App. Ct. 2001); *Sound Infiniti, Inc., ex. rel. Pisheyar v. Snyder*, 169 Wash. 2d 199, 209 (2010); *Shenker v. Laureate Educ., Inc.*, 411 Md. 317, 338 n.14 (2009); *Nev. Classified Sch. Emples. Ass'n v. Quaglia*, 124

Delaware judiciary will be relegated to the sidelines and a major justification for investing in Delaware corporations will disappear.

Finally, allowing directors to impose on stockholders personal liability for corporate expenses without the stockholders' express consent is the antithesis of the corporate form. Investors rely on the shield from corporate liability created by the corporate form, and corporations could not provide the products and services they provide without adequate access to investor capital. How can a stockholder reasonably invest limited capital in a corporation, if the directors of that corporation could adopt a bylaw that would impose personal liability on that stockholder for corporate debts that would greatly exceed the value of the original investment? And in the context of fee-shifting bylaws in particular, how could the stockholder-owners of corporations place trillions of dollars in the hands of fiduciaries who immunize themselves from legal challenge? Allowing directors to impose personal liability on stockholders through bylaw amendments would make continued investment in Delaware corporations untenable. Such unilateral authority by corporate directors eliminates the protections commonly understood to be provided by the corporate form, and threatens to turn a common investment in a Delaware corporation into a guarantee of unlimited corporate debt.

In sum, requiring stockholders to bear the expenses a corporation may incur in fighting stockholders' efforts to protect their interests effectively eliminates the ability of stockholders to look to Delaware courts to protect their rights as the owners of corporations. Allowing corporate directors to disregard the limited liability nature of the corporate form through the unilateral adoption of bylaws threatens continued public investment in Delaware corporations. Immediate action is necessary to ensure that Delaware maintains its preeminence in the field of corporate law, and to protect the very underpinnings of our publicly traded financial markets.

If you have any questions, please feel free to contact Jay Chaudhuri, General Counsel & Senior Policy Advisor at the North Carolina Department of State Treasurer, at (919) 508-1024 or jay.chaudhuri@nctreasurer.com.

Nev. 60, 63-64 (2008); *Crandon Capital Partners v. Shelk*, 342 Ore. 555, 567 (2007); *Katz Corp v. T.H. Canty & Co.*, 168 Conn. 201, 208-09, 362 A.2d 975 (1974).

Very truly yours,

/s/

Guus Warringa, Chief Counsel
APG Asset Management NV

/s/

Matthew Jacobs, General Counsel
California Public Employees' Retirement System

/s/

Brian Bartow, General Counsel
California State Teachers' Retirement System

/s/

Adam Franklin, General Counsel
Colorado Public Employees' Retirement Association

/s/

Catherine LeMarr, General Counsel
Office of Connecticut State Treasurer's Office

/s/

Michael McCauley, Senior Officer, Investment Programs & Governance
Florida State Board of Administration

/s/

Rhonda Smith, Executive Director
Houston Municipal Employees Pension System

/s/

Chris Supple, Executive Director and General Counsel
Pension Reserve Investment Management Board Commonwealth of Massachusetts

/s/

Thomas F. Gibson, Chairman
Middlesex County Retirement Board

/s/

Antaoli van der Krans, Senior Advisor Responsible Investment & Governance
MN Services

/s/

Board of Trustees
The New York City Employees' Retirement System

/s/

Board of Trustees
The New York City Police Pension Fund

/s/

Board of Trustees
The Board of Education Retirement System of the City of New York

/s/

Board of Trustees
The Teachers' Retirement System of the City of New York

/s/

Board of Trustees
The New York City Fire Department Pension Fund

/s/

Board of Trustees
The Teachers' Retirement Systems' Variable A

/s/

Jay J. Chaudhuri, General Counsel & Senior Policy Advisor
North Carolina Department of State Treasurer

/s/

Tom Rhinehart, Chief of Staff
Oregon State Treasurer's Office

/s/

Mark Hovey, Chief Investment Officer
San Diego City Employees' Retirement System