SQUIRE SANDERS

DELAWARE HIGH COURT APPROVES FEE-SHIFTING BYLAWS

On May 8, 2014, in an opinion that could significantly limit shareholder litigation involving Delaware corporations, the Supreme Court of Delaware (Court) held that a fee-shifting bylaw requiring unsuccessful member plaintiffs to bear the fees, costs and expenses of intra-corporate litigation is not prohibited by Delaware law and may be enforceable.[1]

The case, *ATP Tour, Inc. v. Deutscher Tennis Bund*, involved the Court's response to four certified questions stemming from a fee-shifting bylaw adopted by the board of ATP Tour, Inc., a Delaware non-stock membership corporation that operates a global professional men's tennis tour. While the *ATP Tour* case involved a non-stock membership corporation, the Court's reliance on the Delaware General Corporation Law (DGCL) in support of its conclusion suggests that the decision would apply equally to Delaware stock corporations and their stockholders. The Court observed in a footnote that the DGCL applies equally to non-stock corporations[2] and stated in broad terms that "[n]either the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws." [3]

In support of its conclusion, the Court began with the established principles that corporate bylaws generally are presumed to be valid under Delaware law and that bylaws are contracts among a corporation's shareholders. Such bylaws therefore fall within the contractual exception to the "American Rule" that otherwise generally requires parties to litigation to pay their own attorneys' fees.[4]

The Court articulated three requirements for such a bylaw to be "facially valid": (1) it must be authorized by the DGCL, (2) it must be consistent with the corporation's certificate of incorporation,[5] and (3) its enactment must not be otherwise prohibited.[6] The Court concluded that fee-shifting bylaws satisfy these requirements and are permissible under Delaware law. The Court noted, however, that even if a bylaw satisfies these requirements, it will not be enforced if adopted or used for an inequitable purpose.

As an example, the Court cited, among other precedents, its prior decision in *Schnell v. Chris-Craft Industries*, in which it had set aside a board-adopted bylaw amendment that accelerated the date of an annual stockholder meeting to occur a month earlier than the originally scheduled date, where the board adopting such bylaw had the improper purpose of perpetuating itself in office and obstructing dissident stockholders' legitimate rights to undertake a proxy contest.[7]

Because the Court did not address the merits of the specific bylaw at issue in the *ATP Tour* case, it is hard to know whether ATP Tour's enactment of its fee-shifting bylaw would be deemed to be for a proper purpose. The Court clarified that deterring litigation is not invariably an improper purpose.

Corporate boards that wish to implement fee-shifting bylaws should consult with counsel and consider enacting such provisions well in advance of any specific litigation, to minimize the likelihood that a court would impute an improper purpose, such as obstructing a specific, potentially valid shareholder claim.

The Court in *ATP Tour* also answered three related certified questions. In response to these questions, the Court concluded that an otherwise valid and enforceable fee-shifting bylaw (1) would at least be valid as applied to the case where a plaintiff obtains no relief at all against the corporation in the litigation, (2) is unenforceable if adopted for an improper purpose, but, as noted above, deterring litigation is not invariably an improper purpose, and (3) applies not only to members who join the corporation after adoption of the bylaw, but also to members who join the corporation before the bylaw's adoption.

Although it remains to be seen whether Delaware courts will uphold other fee-shifting provisions, including those in the bylaws of stock corporations, the potential impact of this opinion could be significant if directors make such a provision a common feature of Delaware corporations' bylaws and such provisions continue to be upheld.

1 *ATP Tour, Inc. v. Deutscher Tennis Bund*, 2014 Del. LEXIS 209 (Del. May 8, 2014).

2 *Id.* at *7; *accord* 8 Del. C. §114(a).

3 *Id.* at *9.

4 *Id.* at *8-10.

5 *Id.* at *8. The Court also noted that such a fee-shifting provision could be contained in the charter. *Id.*

6 *Id.* at *8 (citing 8 Del. C. §109(b); *Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 337, 398 (Del. 2010)).

7 285 A.2d 437 (Del. 1971).

Such fee-shifting bylaws could be an effective tool in discouraging frivolous claims, and a significant deterrent to shareholder litigation generally. In addition, it should be noted that the *ATP Tour* opinion follows closely on the heels of the Delaware Chancery Court's 2013 ruling in *Boilermakers Local 154 Retirement Fund v. Chevron Corp., et al.*, which upheld the facial validity of forum selection bylaws of Delaware corporations.[8] The combined effect of these cases may enable and embolden corporate boards to adopt other new contractual bylaw provisions that could further deter and meaningfully alter the landscape of shareholder litigation involving Delaware corporations.

Contact

Daniel G. Berick
T +1 216 479 8374
E daniel.berick@squiresanders.com

Nicholas Unkovic
T +1 415 954 0275
E nicholas.unkovic@squiresanders.com

Laura E. Kacenjar
T +1 415 954 0269
E laura.kacenjar@squiresanders.com

8 73 A.3d 934, 963 (Del. Ch. June 25, 2013).