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ALERT

Delaware General Corporation Law-Bylaw Provisions | May 20, 2014

On May 8, 2014, the Supreme Court of Delaware issued an opinion that may deter lawsuits by shareholders of Delaware corporations. The Court held that a bylaw requiring unsuccessful member plaintiffs to pay the fees, costs and expenses of the prevailing corporate defendant in intra-corporate litigation was facially valid under Delaware law and may be enforceable.[1] This practice is referred to as "fee-shifting." Generally, under Delaware law, each party to litigation bears its own attorneys' fees and expenses (the "American Rule"). In view of the holdings in this case, companies may want to consider adopting a fee-shifting bylaw and thus perhaps deter some future shareholder litigation, including frivolous claims.

The case, *ATP Tour, Inc. v. Deutscher Tennis Bund*, involved the Court's response to four 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 (the "DGCL") in support of its conclusion suggests that the decision would apply equally to Delaware stock corporations and their stockholders. The Court indicated in a footnote that the provisions of the DGCL apply equally to non-stock corporations and stated in broad terms that "[n]either the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws."

In support of its conclusion, the Court began with the established principles that (i) corporate bylaws generally are presumed to be valid under Delaware law, and (ii) bylaws are contracts among a corporation's shareholders. Such a fee-shifting bylaw therefore falls within the contractual exception to the American Rule.

The Court articulated three requirements for such a bylaw to be "facially valid": (i) it must be authorized by the DGCL; (ii) it must be consistent with the corporation's certificate of incorporation; and (iii) its enactment must not be otherwise prohibited. 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 improper purpose.

Because the Court did not address the merits of the specific bylaw at issue in the *ATP Tour* case, it is not known 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. Furthermore, this bylaw provision was adopted by a Delaware non-stock corporation. The ability to adopt similar provisions by companies, including mutual holding companies, or banks incorporated in different jurisdictions or under federal law, is unclear.

Boards that wish to implement fee-shifting bylaws should consult with counsel and consider enacting these provisions well in advance of any specific litigation, to minimize the

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

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 questions. The Court concluded that an otherwise valid and enforceable fee-shifting bylaw (i) would at least be valid as applied to the case where a plaintiff obtains no relief at all against the corporation in the litigation, (ii) is unenforceable if adopted for an improper purpose, but, as discussed above, deterring litigation is not invariably an improper purpose, and (iii) applies not only to members who join the corporation after adoption of the bylaw, but also to members who joined the corporation before the bylaw's adoption.

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 the Delaware Chancery Court's June 2013 ruling in *Boilermakers Local 154 Retirement Fund v. Chevron Corp., et al.*,[2] which upheld the facial validity of forum selection bylaws of Delaware corporations.

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Should you have any questions regarding the content of this Alert or need assistance, please do not hesitate to contact Ross Bevan (rbeva@sfttlaw.com); Ray Tiernan (rtier@sfttlaw.com) or Eric Marion (emarion@sfttlaw.com).

[2] 73 A.3d 934, 963 (Del. Ch. June 25, 2013).