



GOVERNANCE PERSPECTIVES

Break Point? Delaware Supreme Court Upholds Validity of Fee-Shifting Bylaw

On May 8, 2014, in *ATP Tour, Inc. v. Deutscher Tennis Bund, et al.*, No. 534, 2013, the Delaware Supreme Court ruled that a bylaw shifting attorneys' fees and costs to the losing party in intra-corporate litigation can be valid and enforceable under Delaware law. While the case involved a member corporation and not a stock corporation, the decision has favorable implications for all Delaware corporate boards considering bylaws that could affect—and inhibit—certain forms of shareholder litigation. As a result of this decision, we recommend that all Delaware corporations consider fee-shifting bylaw provisions while also considering exclusive forum provisions.

ATP Tour, Inc. ("ATP") is a Delaware membership corporation whose members include professional tennis players and entities that own professional tennis tournaments. ATP's board of directors amended its bylaws in 2006 to add a provision that provided that, in the event a member asserts a claim against the league [ATP] and does not obtain a judgment on the merits that substantially achieves the full remedy sought, the member shall be obligated to reimburse the league

for all fees, costs, and expenses incurred in connection with the claim.

In 2007, the tournaments owned and operated by the German Tennis Federation and Qatar Tennis Federation were downgraded to a lower tier and moved from the spring to the summer season. The federations sued ATP on antitrust and breach of fiduciary duty theories. ATP prevailed at trial and moved to recover its fees and costs under its bylaw provision. After interim decisions relating to issues of federal preemption, the District Court certified four questions regarding the enforceability of the bylaw provision to the Delaware Supreme Court.

The Delaware Supreme Court held:

Are Fee-Shifting Bylaws Permissible Under Delaware Law? The Delaware Supreme Court held that fee-shifting bylaws are consistent with Delaware law, noting that contracting parties may agree to modify the so-called "American Rule" (which generally requires parties to pay their own costs and fees, regardless of the

outcome of a litigation) and instead require the losing party to pay the winner's attorneys' fees. Holding that corporate bylaws are "contracts among a corporation's shareholders," the court found that a fee-shifting bylaw would constitute a permissible exception to the American Rule.

Is a Bylaw Enforceable Even Against Members Who Joined the Corporation Before Its Adoption? The court held that, if directors are authorized by the corporation's certificate of incorporation to adopt, amend, or repeal bylaws, then stockholders will be bound by bylaws adopted solely by the board. This endorsement of the board's authority should have implications for proxy advisor positions on such provisions, although we have seen the advisory firms take a negative view of board action on comparable changes, like exclusive forum provisions.

Could the Bylaw in Question Shift Fees if a Plaintiff Obtained No Relief in the Litigation? This District Court asked whether, even if the "substantially achieves" language in the ATP bylaw made the bylaw unenforceable if a plaintiff were to obtain some relief, a more limited version of the ATP bylaw would at least be enforceable if no relief whatsoever were obtained by a plaintiff. The court answered this question in the affirmative.

Would the Bylaw in Question Be Unenforceable if Adopted for an Improper Purpose? The court held that a legally valid bylaw would be unenforceable in equity if adopted for an improper purpose. Importantly, the court noted that the intent to deter litigation is not, standing alone, an improper purpose.

There are some limitations on this decision inherent in the procedural mechanism that brought it before the Delaware Supreme Court. Thus, the court made clear that, given that it was addressing only the certified questions of law submitted by the District Court, not the merits of the dispute, it could not opine on the facts or the validity of the specific bylaw provision at issue.

Even given these limits, the decision is an important one that could significantly limit plaintiffs' appetite for litigation against Delaware corporations. Although *ATP* involved a closely held non-stock corporation, and the certified questions were framed accordingly, the reasoning in *ATP* should be equally applicable to stock corporations. The court's interpretation of the Delaware General Corporation Law, the contract theory of bylaws endorsement, and the precedents cited were not limited to non-stock corporations. Moreover, there does not appear to be any principled basis to suggest that the decision does not apply to Delaware companies generally. As with the Chancery Court's opinion last summer upholding the enforceability of an exclusive forum bylaw, see *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 956 (Del. Ch. 2013), the *ATP* opinion reinforces that traditional contract law principles continue fully to apply to corporate bylaws and that a board, if so authorized, may amend the bylaws in a manner consistent with its exercise of business judgment.

Obviously, however, the argument is not over, and—especially given the court's holding that fee-shifting provisions adopted for an "improper purpose" could be unenforceable—a board considering such bylaw amendments should do so carefully, with the assistance of counsel, and in circumstances that demonstrate it is a deliberate, well-considered step, taken for valid purposes to protect the corporation's interests.

In addition, it is possible that the proxy advisory firms will weigh in on this issue, much like they did on exclusive jurisdiction bylaws last year. Still, adoption of a loser-pays bylaw may well make sense for companies threatened by shareholder litigation, or considering strategic assessment plans, and in all events a loser-pays bylaw could be submitted for shareholder ratification if the proxy rating firms weigh in later. As such, we encourage companies to give this development appropriate consideration.

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