Cooley

May 19, 2014

On May 8, 2014, the Delaware Supreme Court held that a fee-shifting bylaw adopted by a board was facially valid under Delaware law.[1] A fee-shifting bylaw requires a plaintiff in intra-corporate litigation that sues and loses to pay the company's legal fees and costs. Generally, under Delaware law, parties to litigation are obligated to pay their own attorneys' fees and costs. In light of this case, however, companies may want to consider re-allocating that litigation expense—and perhaps deterring some future intra-corporate litigation—by adopting a fee-shifting bylaw.

According to the Delaware Supreme Court, a bylaw is facially valid (*i.e.*, permissible under Delaware law) when it is authorized by the Delaware General Corporation Law (DGCL), consistent with the company's certificate of incorporation, and its enactment is not otherwise prohibited. In determining that this type of fee shifting was valid, the Court noted that "[n]either the DGCL nor any other statute forbids the enactment of fee-shifting bylaws" and "no principle of common law prohibits … fee-shifting bylaws."

Although ruling that Delaware law permits these types of fee-shifting bylaws, the Delaware Supreme Court reiterated that "bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose." Rather, to determine whether a facially valid bylaw is enforceable will "turn on the circumstances surrounding its adoption and use."

The Court went on to explain that "[t]he intent to deter litigation, however, is not invariably an improper purpose." Thus, a corporate board, under the right circumstances, could consistent with its fiduciary duties adopt a fee-shifting bylaw for intra-corporate litigation where a purpose is to deter such litigation.

As the Delaware Supreme Court did not address the issue of whether ATP's fee-shifting bylaw was adopted for an inequitable purpose, it remains to be seen in what circumstances the adoption and use of a fee-shifting bylaw will be enforced. Whether a specific fee-shifting bylaw is enforceable will be a fact-specific determination that will depend on, among other things, the language of the provision, when it was adopted, why it was adopted and how it was used.

A fee-shifting bylaw, especially in conjunction with a forum selection bylaw, could serve as a significant deterrent to stockholder litigation.[2] Nevertheless, a fee shifting bylaw may not be appropriate for every company. Among other things, boards of directors should consider that:

- The opinion was adopted in the context of a non-stock corporation. Although the language of the opinion and the cases cited suggest it should apply to stock corporations, this is an open issue.
- The views of proxy advisory firms and institutional investors on fee-shifting bylaws are not yet known. Proxy advisory firms and/or institutional investors may very well react negatively to the adoption of a fee-shifting bylaw.
- If the case were brought in a forum outside of Delaware, the courts of that state might apply their own rules regarding fee-shifting, including applying unilateral fee-shifting bylaws bilaterally (*i.e.* allowing a plaintiff to recover fees from a company if successful in the litigation). Delaware judges, presiding over courts of equity, could also take issue with unilateral bylaws as inequitable.
- Under the DGCL, stockholders have the right to adopt bylaws, and they could seek to have such a bylaw overturned, nullified, limited or modified to operate bilaterally through a stockholder vote.
- Although deterring litigation in general was not considered by the court to be an improper purpose, seeking to deter specific stockholder litigation could be considered inequitable conduct. As a result, the timing and process for adopting a fee-shifting bylaw will be important. The best practice would be to adopt a fee-shifting bylaw at a time when there is no stockholder litigation pending and the board has no knowledge of any conduct or transaction that would likely lead to stockholder litigation.

Although the Delaware Supreme Court's decision is a promising development, a company should consider carefully, including consulting with outside counsel and others, whether adopting a fee-shifting bylaw is appropriate for its particular set of circumstances.

NOTES

1. *ATP Tour, Inc. v. Deutscher Tennis Bund*, Case No. 534, 2013 (Del. May 8, 2014). ATP Tour, Inc. ("ATP") is a Delaware membership corporation that operates a global professional men's tennis tour. The Deutscher Tennis Bund ("DTB") is a member of the ATP. In 2007, the ATP changed its tour schedule downgrading a tennis tournament owned and operated by DTB. DTB sued ATP in the United States District Court of Delaware alleging breach of fiduciary duty claims and antitrust claims. Following a trial, the court granted ATP's judgment as a matter of law as to certain claims and the jury found in favor of ATP on the remaining claims. ATP then sought to collect its costs and fees from DTB pursuant to its fee-shifting bylaw. Ultimately, the district court certified four questions of law to the Delaware Supreme Court regarding whether a fee-shifting bylaw was permissible under Delaware law. As a result, the Delaware Supreme Court did not address whether the bylaw at issue was valid under the facts and circumstances of the case.
2. Former Chancellor Strine, now Chief Justice of the Delaware Supreme Court, previously approved of the adoption of forum selection bylaws in *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

This content is provided for general informational purposes only, and your access or use of the content does not create an attorney-client relationship between you or your organization and Cooley LLP, Cooley (UK) LLP, or any other affiliated practice or entity (collectively referred to as "Cooley"). By accessing this content, you agree that the information provided does not constitute legal or other professional advice. This content is not a substitute for obtaining legal advice from a qualified attorney licensed in your jurisdiction, and you should not act or refrain from acting based on this content. This content may be changed without notice. It is not guaranteed to be complete, correct or up to date, and it may not reflect the most current legal developments. Prior results do not guarantee a similar outcome. Do not send any confidential information to Cooley, as we do not have any duty to keep any information you provide to us confidential. When advising companies, our attorney-client relationship is with the company, not with any individual. This content may have been generated with the assistance of artificial intelligence (AI) in accordance with our AI Principles, may be considered Attorney Advertising and is subject to our legal notices.

# Key Contacts



| | |
|---|---|
| Cydney Posner<br>San Francisco | cposner@cooley.com<br>+1 415 693 2132 |
| Sam Livermore<br>San Francisco | slivermore@cooley.com<br>+1 415 693 2113 |
| Koji Fukumura<br>San Diego | kfukumura@cooley.com<br>+1 858 550 6008 |
| Shannon Eagan<br>Palo Alto | seagan@cooley.com<br>+1 650 843 5909 |



This information is a general description of the law; it is not intended to provide specific legal advice nor is it intended to create an attorney-client relationship with Cooley LLP. Before taking any action on this information you should seek professional counsel.

Copyright © 2023 Cooley LLP, 3175 Hanover Street, Palo Alto, CA 94304; Cooley (UK) LLP, 22 Bishopsgate, London, UK EC2N 4BQ. Permission is granted to make and redistribute, without charge, copies of this entire document provided that such copies are complete and unaltered and identify Cooley LLP as the author. All other rights reserved.