

## **New Strategy for Deterring Intracorporate Litigation?: Delaware Supreme Court Supports Fee-Shifting Bylaws**

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A fee-shifting bylaw of a Delaware non-stock corporation is not facially invalid according to the Delaware Supreme Court's May 8, 2014 opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund*.

In this case, ATP Tour, Inc., a non-stock membership corporation ("ATP") governed by a seven member board, had adopted a bylaw provision which provided that current and former members of ATP would be responsible for the litigation costs arising out of any litigation initiated by any such member against ATP or any of the other members in which the initiating party did not obtain a judgment on the merits that substantially achieved in substance and amount the full remedy sought. The bylaw provision had been adopted, in accordance with ATP's charter, by the Board unilaterally without any consent from the members. The members had agreed at the time they joined ATP to be bound by the bylaws, as amended from time to time. Two members of ATP initiated a suit against ATP relating to certain actions taken with respect the ATP's tournament schedule and format alleging both federal antitrust claims and Delaware fiduciary duty claims but did not prevail on any of their claims. ATP then moved to recover its legal fees relating to such actions.

The District Court denied ATP's motion to recover legal fees on the basis that federal law preempts the enforcement of fee-shifting agreements when antitrust claims are involved. ATP appealed and the United States Court of Appeals for the Third Circuit vacated the District Court's order and remanded the case to the District Court finding that the District Court should have decided the matter of enforceability of the bylaw provision under Delaware law before reaching the federal preemption question.

Responding to certified questions of law from the Delaware District Court, the Supreme Court found that "[n]either the [Delaware General Corporation Law] nor any other Delaware statute forbids the enactment of fee-shifting bylaws" and that "a fee-shifting provision contained [within] a validly-enacted bylaw ... would not be prohibited under Delaware common law." Accordingly, the Supreme Court held that "fee-shifting provisions in a non-stock corporation's bylaws can be valid and enforceable under Delaware law."

The Supreme Court declined however to opine on the enforceability of the bylaw at issue because the certification did not provide sufficient factual basis on which to determine if the bylaw was enacted for a proper purpose or properly applied.

Nevertheless, the Supreme Court provided guidance to sharpen the focus on the enforceability of fee-shifting bylaws in general. Noting that contractual fee-shifting provisions inherently serve to deter litigation, the Supreme Court held that "intent to deter litigation ... is not an invariably improper purpose" for a fee-shifting bylaw. Rather, consideration must be

given to “the manner in which [the bylaw] was adopted and the circumstances under which it was invoked,” and that bylaws that “may otherwise be facially valid will not be enforced if adopted or used for inequitable purpose,” according to the Supreme Court. The Court also noted that a bylaw that allocates risk among parties in an intracorporate litigation would also appear to satisfy the DGCL’s requirement that a bylaw must “relate to the business of the corporation, the conduct of its affairs and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.” The Court further noted that Delaware follows the American rule under which parties to a litigation must generally pay their own attorneys’ fees and costs; but parties can modify the American rule by contract. Because bylaws are contracts among a corporation’s shareholders, a fee-shifting provision contained in a validly adopted bylaw would fall within the contractual exception to the American rule and therefore is not prohibited by Delaware law. Lastly, the Supreme Court held that a fee-shifting bylaw is applicable to members joining the organization prior to the bylaw’s unilateral adoption by the board if such authority is provided in the organization’s charter.

Although the Supreme Court’s opinion was with respect to a non-stock corporation, its analysis of the DGCL and common law principles appears equally applicable to a stock corporation. And, when considered in conjunction with the Court of Chancery decision in *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, upholding a forum-selection bylaw, one might conclude that Delaware’s business courts do not disfavor reasonable board efforts to restrict intracorporate litigation. In this regard, one must consider whether the logic underlying forum-selection and fee-shifting bylaws could also support a requirement that shareholder disputes be submitted to binding arbitration. As such, the framework for boards to develop bylaws tending to restrict intracorporate litigation may be taking shape, but to what extent the Delaware business courts will permit such efforts remains to be seen.

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