

# A POWER SHIFT: EVALUATING CORPORATE BYLAWS THAT ADD FEE-SHIFTING PROVISIONS AFTER THE DECISION IN *ATP TOUR, INC. v. DEUTSCHER TENNIS BUND*, 91 A.3D 554 (DEL. 2014)

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## I. INTRODUCTION

Fee-shifting provisions are not new to controversy.<sup>1</sup> Indeed, by their very nature, fee-shifting provisions are controversial because they shift the costs of litigation to a non-prevailing party,<sup>2</sup> a concept contrary to the widely accepted American Rule of litigation in which parties generally pay their own attorney's fees and costs.<sup>3</sup> Likewise, corporate bylaws have also spawned their own share of controversy and scrutiny.<sup>4</sup> Recently, fee-shifting provisions and corporate bylaws combined, presenting the state of Delaware and the companies incorporated there with a unique and complicated problem when it comes to members of non-stock corporations and stockholding plaintiffs of publicly-traded companies enforcing their rights to engage in derivative class action lawsuits<sup>5</sup> against their corporate

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1. See generally *Hensley v. Eckherhart*, 461 U.S. 424 (1983); *T.D. v. Lagrange Sch. Dist. No. 102*, 349 F.3d 469 (7th Cir. 2003); *Horowitch v. Diamond Aircraft Indus., Inc.*, 645 F.3d 1254 (11th Cir. 2011).
2. Berman DeValerio, *Delaware Corporations Turn To Bylaws Again To Discourage Lawsuits* (2014), <http://www.bermandevalerio.com/9-news/recent-developments/230-delaware-corporations-turn-to-bylaws-against-todiscourage-lawsuits> ("Fee-shifting provisions are also known as 'loser pays' provisions.").
3. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014) (citing *Mahani v. Edix Media Grp., Inc.*, 935 A.2d 242, 245 (Del. 2007)) ("Under the American Rule and Delaware law, litigants are normally responsible for paying their own litigation costs.").
4. See generally *Swanger v. Nat'l Juvenile Law Ctr.*, 714 S.W.2d 170 (Mo. App. E. Dist. 1986); *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339 (Del. 1983); *Gwin v. Thunderbird Motor Hotels, Inc.*, 119 S.E.2d 14 (Ga. 1961).
5. A Derivative Class Action is a suit by a beneficiary of a fiduciary to enforce a right belonging to the fiduciary. One example would be where a lawsuit is filed by a shareholder on the corporation's behalf against a third party (usually a corporate officer) because of the corporation's failure to take some action against the third party. *Derivative Class Action*, BLACK'S LAW DICTIONARY (4th pocket ed. 2011).

boards of directors.<sup>6</sup> For the first time in Delaware and U.S. history, the problem surfaced through the use of a fee-shifting provision within a non-stock corporation's bylaws, also known as a fee-shifting bylaw, raising a novel question for the Delaware Supreme Court to answer.<sup>7</sup>

The Delaware Supreme Court in *ATP Tour v. Deutscher Tennis Bund* held that fee-shifting bylaws are permissible under Delaware law because a corporation's bylaws are presumed to be valid.<sup>8</sup> Next, the court determined that if a fee-shifting bylaw is valid and enforceable, it may shift fees to a plaintiff who obtained no relief in a case of intra-corporate litigation.<sup>9</sup> However, the court limited its rule by holding that a fee-shifting bylaw would be unenforceable if a corporation's board of directors adopted it for an improper purpose.<sup>10</sup>

The substantial significance and far-reaching implications of the Delaware Supreme Court's holding in *ATP Tour* might slip past the everyday shareholder.<sup>11</sup> Indeed, these shareholders may not grasp that the implications of *ATP Tour* affect not only the state of Delaware, but also many companies and shareholders in other states across the entire country.<sup>12</sup> This significance is evidenced by the fact that many companies headquartered in states outside of Delaware choose to incorporate in Delaware because of the perceived advantages offered by the state,

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6. *ATP Tour Inc.*, 91 A.3d 554, at 558

In Delaware, corporate bylaws are considered contracts among a corporation's shareholders. This presents a problem to shareholders because contracts (and subsequently bylaws that are viewed as contracts) are allowed as a matter of law to fall within the exception to American Rule which generally requires parties to cover the costs of their legal fees.

*Id.*

*But see* Galaviz v. Berg, 763 F. Supp. 2d 1170, 1174 (N.D. Cal. 2011).

[I]t is generally accepted that corporate bylaws are to be construed according to the general rules governing the construction of statutes and contracts . . . but it does not follow that a contracting party may thereafter unilaterally add or modify contractual provisions [within a corporation's bylaws] of an agreement.

*Id.*

7. *ATP Tour, Inc.*, 91 A.3d 554, at 557 (stating that the "[United States] District Court [for the District of Delaware] reasoned that enforceability of [the fee provision] was a novel question of Delaware law.").

8. *Id.*

9. *Id.* at 559–60.

10. *Id.* at 560.

11. STATE OF DEL., *Why Businesses Choose Delaware*, [http://corplaw.delaware.gov/eng/why\\_delaware.shtml](http://corplaw.delaware.gov/eng/why_delaware.shtml) ("Delaware has been the premier state of [corporate] formation for business entities since the early 1900s [:] today, more than one million business entities have made Delaware their legal home . . . more than 60 percent of [ ] Fortune 500 companies are incorporated in Delaware.").

12. Many out-of-state companies that choose to incorporate in Delaware, despite being located or headquartered in other states, remain bound by Delaware jurisprudence.

advantages that other states currently cannot match.<sup>13</sup> One of these perceived advantages is the Delaware General Corporation Law statute, which offers companies that incorporate in Delaware more predictability and stability in corporate law-related jurisprudence than most other state statutes—a major selling point for most large-scale companies that choose to incorporate in Delaware.<sup>14</sup>

The holding from *ATP Tour* has also raised concerns over the impact the decision will have on the bylaws of both current and future companies that are incorporated in Delaware.<sup>15</sup> Some experts believe that the holding from *ATP Tour* will lead to a firestorm of boards of directors pushing to have fee-shifting provisions as a common feature of their Delaware-incorporated bylaws,<sup>16</sup> because it presents an opportunity for their incorporated businesses to address the burdens and huge expenses of intra-corporate litigation.<sup>17</sup> Others have expressed a different opinion, believing that the implications of the Delaware Supreme Court's decision will take a different course: that most companies incorporated in Delaware will not adopt fee-shifting provisions in their corporate bylaws due to the high threat of shareholder opposition.<sup>18</sup>

This Note argues that the Delaware Supreme Court's holding in *ATP Tour* was correct, in part because there was no adverse binding or persuasive authority opposing a corporation from adopting a fee-shifting

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13. STATE OF DEL., *supra* note 11. Advantages of incorporating in Delaware include “courts that specialize in corporate law issues (Delaware Chancery Court), strong corporate case law, and a Secretary of State’s office that specializes in corporate law while also offering incorporated companies advisors to help them with service.”
  14. *Id.* (“Benefits of this statute includes that it was and is shaped by corporate-law experts and protected from influence by special-interest groups. Additionally The Delaware legislature reviews the Delaware General Corporation Law (‘DGCL’) statute every year to ensure its ability to address current corporate law related issues. The Delaware General Corporation Law is also an enabling statute, where it is intended to permit corporations and their shareholders the maximum flexibility in ordering their affairs.”).
  15. DEL. DIV. OF CORPORATIONS 2013 ANNUAL REPORT, [http://corp.delaware.gov/Corporations\\_2013%20Annual%20Report.pdf](http://corp.delaware.gov/Corporations_2013%20Annual%20Report.pdf) (“In the year 2013, 34,234 new companies incorporated in the state of Delaware. Among those, include building materials distributor Stock Building Supply, global real estate network REMAX Holdings, storage solutions retailer The Container Store, the social networking service website Twitter, and movie theater and cinema chain AMC Entertainment.”).
  16. Francis Pileggi, *Supreme Court Upholds Fee-Shifting Provision in Bylaws*, (May 10, 2014), <http://www.delawarelitigation.com/2014/05/articles/delaware-supreme-court-updates/draft-supreme-court-case/>.
  17. Kevin Lacroix, *Delaware Upholds Fee-Shifting Bylaw Validity*, THE D&O DIARY (May 14, 2014), <http://www.dandodiary.com/2014/05/articles/corporate-governance/delaware-supreme-court-upholds-fee-shifting-bylaw-validity/>.
  18. Steven Davidoff Solomon, *A Ruling’s Chilling Effect on Corporate Litigation*, N.Y. TIMES: DEALBOOK (Mar. 23, 2014), [http://dealbook.nytimes.com/2014/05/23/a-rulings-chilling-effect-on-corporate-litigation/?\\_php=true&\\_type=blogs&\\_php=true&\\_type=blogs&module=BlogPost-Title&version=Blog%20Main&contentCollection=Deal%20Professor&action=Click&pgtype=Bl ogs&region=Body&\\_r=1](http://dealbook.nytimes.com/2014/05/23/a-rulings-chilling-effect-on-corporate-litigation/?_php=true&_type=blogs&_php=true&_type=blogs&module=BlogPost-Title&version=Blog%20Main&contentCollection=Deal%20Professor&action=Click&pgtype=Bl ogs&region=Body&_r=1).

provision within its corporate bylaws at the time of the court's holding. Furthermore, fee-shifting bylaws in the state of Delaware do not fall within the American Rule of litigation because corporate bylaws in Delaware are contractual in nature. Finally, the Delaware Supreme Court provided a clear standard for the adoption of facially valid bylaws under proper and equitable purposes. However, this Note will also argue that the Delaware Supreme Court's opinion should have included dictum which defined whether the holding also applies to publicly-held corporations. Section II of this Note discusses the legal background of fee-shifting provisions in corporate bylaws of companies incorporated in Delaware. Additionally, Section II of this Note offers existing law and a legal background on cases in Delaware that exhibit scenarios in which a Delaware court found that a particular bylaw was enacted for an equitable or inequitable purpose. Section III of this Note provides a detailed review of *ATP Tour*, including the major relevant issues of the case, the holding, and the Delaware Supreme Court's reasoning behind its decision.

Section IV will give an analysis of *ATP Tour* in three parts that discuss the lack of adverse authority against the validity and enforceability of fee-shifting bylaws, the equitable purpose standard established by the Delaware Supreme Court in *ATP Tour*, and the controversy caused by the Delaware Supreme Court not defining whether the holding of *ATP Tour* applies to publicly-held corporations. Finally, Section V will share the author's closing thoughts and recommendations on *ATP Tour*, while also looking into the future of derivative shareholder actions in the state of Delaware.

## II. LEGAL BACKGROUND

The significance and reasoning behind the Delaware Supreme Court's holding from *ATP Tour* is best grasped by reviewing the legal history of fee-shifting bylaws and their lack of historical jurisprudence in Delaware.

### A. Fee-shifting provisions in Delaware Pre-*ATP Tour*

In Delaware, prior to *ATP Tour*, most corporate law litigation that resulted in cases without prevailing plaintiffs followed the American Rule of litigation.<sup>19</sup> However, in areas outside of the corporate bylaw realm, disputes among fee-shifting provisions that were contractual in nature were upheld and enforced by the Delaware Supreme Court.

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19. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014) (citing to *Mahani v. Edix Media Grp., Inc.*, 935 A.2d 242, 245 (Del.2007) (“Under the American Rule and Delaware law, litigants are normally responsible for paying their own litigation costs.”)).

For example, *Mahani v. EDIX Media Group* involved an appeal of the Delaware Court of Chancery's decision to award the prevailing corporation party, Edix Media Group, Inc., the full amount of its attorney's fees and other expenses it incurred after enforcing a confidentiality and non-competition agreement, which contained a fee-shifting provision that shifted fees to the defendant, former employee Parham Mahani.<sup>20</sup> There, the fee-shifting provision stipulated that "[employee] expressly agrees to indemnify and hold harmless Corporation EDIX, its officers, directors, agents and other employees from . . . loss[es], damage[s], expense[s] or cost[s] (including attorneys' fees and disbursements) arising out of . . . the enforcement of this Agreement . . . ."<sup>21</sup> In that case, the Delaware Supreme Court noted that under the American Rule and Delaware law, litigants are generally responsible for paying their own litigation costs,<sup>22</sup> *except* when litigation involves a dispute over a contract that contains a fee-shifting provision.<sup>23</sup> Therefore, in *Mahani*, the Delaware Supreme Court enforced the fee-shifting provision and upheld the Chancery Court's decision to award EDIX Media Group the full amount of its attorney's fees and expenses.<sup>24</sup>

Similarly, *Sternberg v. Nanticoke Memorial Hospital, Inc.* involved a dispute between a doctor and his former employer, Nanticoke Memorial Hospital, over a fee-shifting provision in the hospital's Medical Staff Bylaws Credential Policy.<sup>25</sup> In that case, the doctor sued Nanticoke Memorial Hospital under the theories of tortious interference with existing business relationships, defamation and breach of the Medical Staff Bylaws.<sup>26</sup> Additionally, the doctor challenged the validity of the fee-shifting provision contained in the hospital's bylaws, contending that the provision violated public policy.<sup>27</sup> The provision in *Sternberg* stated:

Section 2.C.2 of the Credentials Policy states . . . by requesting an application and/or applying for appointment . . . or clinical privileges, the [employee] expressly accepts the following conditions: [. . .] (e) Legal Actions: if . . . an individual institutes legal action and does not prevail, [they] will reimburse [Nanticoke Memorial Hospital] and any member of

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20. *Mahani v. Edix Media Grp., Inc.*, 935 A.2d 242, 243–44 (Del. 2007).

21. *Id.* at 244.

22. *Id.* at 245–46.

23. *Id.*

24. *Id.* at 248.

25. *Sternberg v. Nanticoke Mem'l. Hosp., Inc.*, 62 A.3d 1212, 1214 (Del. 2013).

26. *Id.*

27. *Id.* at 1216.

the Medical Staff named in the action for all costs incurred in defending such legal action, including reasonable attorneys' fees.<sup>28</sup>

The Delaware Supreme Court in *Sternberg* did not believe that any national or public policy precluded the fee-shifting bylaw, noting that if Congress or the Delaware General Assembly wished to create limitation on the ability of private parties to enter into a contract providing for the shifting of attorneys' fees, one would have already done so.<sup>29</sup> Therefore, in *Sternberg*, the Delaware Supreme Court upheld a grant of summary judgment in favor of Nanticoke Memorial Hospital, which awarded the hospital its attorney's fees.<sup>30</sup>

*Mahani* and *Sternberg* set forth a precedent prior to *ATP Tour* that the Delaware Supreme Court was willing to enforce fee-shifting provisions where the dispute was contractual in nature and the enforcement of the fee-shifting provision was not opposed by public policy. However, in *ATP Tour*, the Delaware Supreme Court established a limitation on the enforceability of fee-shifting bylaw.

This limitation is best understood by reviewing the history of Delaware jurisprudence, where the Delaware Supreme Court established patterns of conduct that do and do not constitute circumstances in which a corporate bylaw was enacted for an equitable purpose.

#### B. Equitable and Inequitable Bylaws in Delaware Law

The power to create and amend the bylaws of an incorporated company has always been a powerful and inherent feature of the corporate structure.<sup>31</sup> In Delaware, a corporation's bylaws are presumed to be valid, meaning that Delaware courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws.<sup>32</sup> However, bylaws that are facially valid will not be enforceable if they are adopted for an inequitable purpose.<sup>33</sup>

The Delaware Supreme Court's equitable purpose limitation established in its holding from *ATP Tour* is best understood by reviewing Delaware precedent that established certain circumstances in which the adoption of a corporate bylaw was for an equitable purpose.

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28. *Id.*

29. *Id.* at 1217–18.

30. *Id.* at 1221.

31. 8 FLETCHER CYC. CORP. § 4176, Westlaw (database updated September 2014).

32. *Id.* at § 4184.

33. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014).

1. *Corporate Bylaws Enacted for a Valid and Equitable Purpose*

The main issue in *Frantz Manufacturing Company, v. EAC Industries* was the validity of EAC Industries' bylaw amendments, adopted with shareholder consent, after EAC Industries purchased Frantz Manufacturing and subsequently amended Frantz Manufacturing's bylaws.<sup>34</sup> The changes to the bylaws required that: (a) all members of the board of directors be present for a quorum; (b) that any board action had to be approved by a unanimous vote of the directors; (c) that ratification of all committee actions required unanimous approval by the directors; (d) that only one class of directors was allowed for the corporation; and (e) that stockholder approval was required for the indemnification of any of the board of directors.<sup>35</sup> To reach its holding, the Delaware Supreme Court had to determine whether, under those circumstances, the bylaw amendments were valid.<sup>36</sup> In *Franz Manufacturing Company*, the Delaware Supreme Court held that EAC Industries' bylaw amendments were adopted for an equitable purpose under the circumstances and should be valid as of the date of the stockholder consents.<sup>37</sup>

Similarly, in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation*, Chevron Corporation and FedEx adopted identical forum selection bylaws that restricted internal affair lawsuits against these corporations to the state of Delaware.<sup>38</sup> In that case, the stockholders of FedEx and Chevron sued the board of directors of their respective corporations for adopting these forum selection bylaws, arguing that the forum selection bylaws were statutorily invalid and that by adopting these bylaws, the board of directors had breached their fiduciary duties to the stockholders.<sup>39</sup> In *Boilermakers Local 154 Retirement Fund*, the Delaware Supreme Court held that the forum selection bylaws adopted by Chevron Corporation and FedEx were adopted for a valid and equitable purpose and were enforceable, because the stockholders of those corporations failed to meet their burden of showing that the forum selection bylaws were facially invalid.<sup>40</sup>

The Delaware Supreme Court's equitable purpose limitation established in its holding from *ATP Tour* is best understood by also reviewing Delaware precedent that established certain types of

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34. *Frantz Mfg. Co. v. EAC Indus.* 501 A.2d 401, 402–03 (Del. 1985).

35. *Id.* at 405.

36. *Id.* at 403.

37. *Id.* at 407.

38. *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 937–38 (Del. Ch. 2013).

39. *Id.* at 938.

40. *Id.* at 940.

circumstances which constitute the adoption of a corporate bylaw for an inequitable purpose.

## 2. *Corporate Bylaws Enacted for an Inequitable Purpose*

The issue in *Schnell v. Chris-Craft Industries* involved a bylaw amended by the Board of Directors that moved up the date of the annual stockholder meeting, and whether that bylaw was amended for an inequitable purpose.<sup>41</sup> In that case, the Delaware Supreme Court determined that the purpose behind the board of directors' decision to amend the bylaw was to reelect the board of directors into office quickly, so that the board could have the power to obstruct disapproving stockholders from exercising their right to undertake a proxy contest against management.<sup>42</sup> The court found this purpose was contrary to the established principles of corporate democracy.<sup>43</sup> Therefore, in *Schnell*, the Delaware Supreme Court overruled the Chancery Court and held that the moved up date of the stockholder meeting was enacted for an inequitable purpose, the new stockholder meeting date should be nullified, and that old date of the stockholder meeting should be reinstated.<sup>44</sup>

Likewise, *Hollinger International, Inc. v. Black* involved the enforcement of bylaws amendments made by a controlling stockholder of Hollinger International after the controlling stockholder engaged in wanton wrongful corporate conduct, which included selling a holding company—in which the stockholder had controlling interest—to a third party.<sup>45</sup> When Hollinger International's board of directors took measures to stop the transaction, the controlling stockholder had the holding party file a written consent, enacting an amendment of bylaws that required the Hollinger International Board of Directors to reach a unanimous decision regarding any significant decision.<sup>46</sup> This move by the controlling stockholder effectively abolished the committee that had been created to consider how Hollinger International could respond to the controlling stockholder's sale of the holding company; Hollinger International's independent directors were unable to end the controlling stockholder's injurious course of conduct towards the corporation.<sup>47</sup> In *Hollinger International*, the Delaware Court of Chancery ruled that the bylaw amendments made by the controlling

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41. *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971).

42. *Id.*

43. *Id.*

44. *Id.* at 439–40.

45. *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1028–29 (Del. Ch. 2004).

46. *Id.* at 1029.

47. *Id.*



stockholder were not consistent with the Delaware General Corporation Law, and thus, were adopted for an inequitable purpose.<sup>48</sup>

### III. EXPOSITION OF THE CASE

The significance of the holding from *ATP Tour* can best be understood and related to other companies incorporated in the state of Delaware by reviewing the facts and procedural history of the case.

#### A. Facts and Procedural History

The issues in *ATP Tour* arose after the board of directors for ATP Tour<sup>49</sup> voted to change the Tour schedule and format of the Hamburg Tournament, in which the tennis tournament was downgraded from the highest tier of tournaments to the second highest tier and then was moved from the spring season to the summer season.<sup>50</sup> This dispute arose because the Hamburg tournament, which was changed by ATP Tour's board of directors, is owned by two entities, Deutscher Tennis Bund and Qatar Tennis Federation (both entities collectively known as "the Federations") who are non-stock members of the corporation.<sup>51</sup>

Displeased with the Board of Directors' decisions to make changes to the Hamburg tournament, the Federations sued ATP Tour and six of its board members in the United States District Court for the District of Delaware, alleging antitrust claims and breach of Delaware fiduciary duty claims.<sup>52</sup> The Federations did not prevail on any of these claims.<sup>53</sup> ATP Tour then, under Article 23.3(a) of ATP Tour's bylaws,<sup>54</sup> moved to recover its legal fees, costs, and expenses.<sup>55</sup> Article 23.3(a) states:

In the event that (i) any [member or anyone on their behalf] initiates or asserts any [claim or counterclaim] or joins, offers substantial assistance to or has a direct financial interest in any claim against the League or any member or owner . . . and (ii) the claiming party . . . does not obtain a judgment on the merits that substantially achieves, in substance or amount, the full remedy sought, then each claiming party shall be obligated jointly and severally to reimburse the League and any such member or owners for all fees, costs and expenses of every kind and

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48. *Id.* at 1078–81.

49. See <http://www.atpworldtour.com/>. ATP Tour, Inc. is a non-stock Delaware corporation consisting of a collection of men's professional tennis tournaments.

50. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 556 (Del. 2014).

51. *Id.* at 555.

52. *Id.* at 556.

53. *Id.*

54. Article 23.3 was the fee-shifting provision within ATP Tour's bylaws.

55. *ATP Tour*, 91 A.3d at 556.

description (including . . . all reasonable attorney's fees and other litigation expenses) that the parties may incur in connection with such [a] claim.<sup>56</sup>

The Delaware District Court denied ATP Tour's Federal Rule of Civil Procedure 54 motion<sup>57</sup> because it found that the fee-shifting provision was contrary to the policy underlying federal antitrust claims.<sup>58</sup> ATP Tour appealed this decision to the United States Court of Appeals for the Third Circuit, which vacated the order of the district court.<sup>59</sup> There, the Third Circuit held that the district court should not have decided whether the fee-shifting provision was enforceable as a matter of Delaware law before addressing the federal preemption question.<sup>60</sup> On remand of the case, the district court determined that the enforceability of a fee-shifting provision in a corporation's bylaws was a novel question of law for the Delaware Supreme Court to address.<sup>61</sup>

Therefore, the district court submitted the following four questions of law for the Delaware Supreme Court to answer:

(1) May the board of a Delaware non-stock corporation lawfully adopt a bylaw (i) that applies in the event that a member brings a claim against another member, a member sues the corporation, or the corporation sues a member (ii) pursuant to which the claimant is obligated to pay for "all fees, costs, and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses)" of the party against which the claim is made in the event that the claimant "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought"; (2) may such a bylaw be lawfully enforced against a member that obtains no relief at all on its claims against the corporation, even if the bylaw might be unenforceable in a different situation where the member obtains some relief; (3) is such a bylaw rendered unenforceable as a matter of law if one or more board members subjectively intended the adoption of the bylaw to deter legal challenges by members to other potential corporate action then under consideration; and (4) is such a bylaw enforceable against a member if it was adopted after the member had joined the corporation, but where the member had agreed to be bound by the corporation's rules "that may be adopted and/or amended from time to time" by the corporation's board,

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56. *Id.*

57. *See* Fed. R. Civ. P. 54. Rule 54 of the Federal Rules of Civil Procedure requires a party to make a motion in order to make a claim for attorney's fees.

58. *ATP Tour*, 91 A.3d at 556.

59. *Id.*

60. *Id.* at 556-57.

61. *Id.* at 557.

and where the member was a member at the time that it commenced the lawsuit against the corporation?<sup>62</sup>

## B. Majority Opinion

On the basis of comity, the Delaware Supreme Court was asked to answer whether ATP Tour's fee-shifting bylaw was permissible under Delaware law, and whether it was adopted for a proper purpose and was enforceable under the circumstances presented to the court.<sup>63</sup> The court began its analysis by addressing the question of whether the board of directors of a Delaware corporation may lawfully adopt a bylaw that shifts all litigation expenses to a plaintiff in intra-corporate litigation who "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought."<sup>64</sup>

### 1. Analysis of the Validity of Fee-Shifting Bylaw Under Delaware Law

The Delaware Supreme Court opined that, generally, a corporation's bylaws are presumed to be valid, and that courts will construe a corporation's bylaws in a manner provided by law rather than strike them down.<sup>65</sup> In *ATP Tour*, the court held that in order for a fee-shifting bylaw to be facially valid, it must be authorized by the Delaware General Corporation Law statute, be consistent with a corporation's certificate of incorporation, and the enactment of the fee-shifting bylaw must not otherwise be prohibited.<sup>66</sup>

Then, the court found that a fee-shifting bylaw is facially valid, because neither the Delaware General Corporation Law statute nor any other Delaware statute prohibited a corporation from enacting a fee-shifting bylaw.<sup>67</sup> The court also found that a fee-shifting bylaw, that allocates risk among parties involved in an intra-corporate dispute, would satisfy the Delaware General Corporation Law's requirement that all corporate bylaws be related to the business of the corporation, the conduct of the corporation's affairs, and the corporation's rights or powers or the rights or powers of the corporation's stockholders, directors, officers or employees.<sup>68</sup> Additionally, the court found that a corporation's corporate charter<sup>69</sup> could

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62. *Id.*

63. *Id.* at 560.

64. *Id.* at 557.

65. *Id.*

66. *Id.* at 557–58.

67. *Id.* at 558.

68. *Id.*

69. INVESTOPEDIA.COM, <http://www.investopedia.com/terms/c/corporatecharter.asp> ("A corporate charter is defined as a 'written document filed with a U.S. state by the founders of a corporation

permit a fee-shifting provision within the corporation's bylaws either by explicitly stating them or by implicit silence.<sup>70</sup>

Finally, the court found that no principle of the common law prohibited a board of directors from enacting a fee-shifting bylaw.<sup>71</sup> In *ATP Tour*, the Delaware Supreme Court noted that Delaware generally follows the American Rule of litigation,<sup>72</sup> but that it was well understood that this rule could be modified by contracting parties, whereby the parties could agree to obligate a losing party to cover the cost of the prevailing party's legal fees.<sup>73</sup> The court stated that "because corporate bylaws are 'contracts among a corporation's shareholders,' a fee-shifting provision contained in a . . . corporation's . . . bylaw[s] would fall within the contractual exception to the American Rule."<sup>74</sup> Therefore, the court ruled that a fee-shifting bylaw would not be prohibited under Delaware common law.<sup>75</sup>

In the next part of its analysis, the Delaware Supreme Court focused on whether ATP Tour's fee-shifting bylaw was adopted for an equitable purpose.

## *2. Analysis of Whether the Specific ATP Fee-Shifting Bylaw Was Adopted For an Equitable Purpose*

In this part of its analysis, the Delaware Supreme Court held that whether the specific ATP Tour fee-shifting bylaw was enforceable depended upon on the manner in which it was adopted and the circumstances under which the bylaw was invoked.<sup>76</sup> Furthermore, the court found that facially valid bylaws would not be enforceable against members or stockholders of a corporation if they were adopted or used for an inequitable purpose.<sup>77</sup> Here, the court was unable to rule as a matter of law whether the specific ATP Tour bylaw was enacted for a proper purpose, but the court did find that the enforceability of a facially valid corporate bylaw would turn on the circumstances surrounding the bylaw's

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detailing the major components of a company such as its objectives, its structure and its planned operations.' A corporate charter can also referred to as a 'charter' or the 'articles of incorporation.'").

70. *ATP Tour, Inc.*, 91 A.3d at 558.

71. *Id.*

72. *Id.* (citing from *Mahani v. Edix Media Grp., Inc.*, 935 A.2d 242, 245 (Del. 2007) (where "under the American Rule and Delaware law, litigants are normally responsible for paying their own litigation costs.")).

73. *Id.* (citing from *Sternberg v. Nanticoke Mem'l Hosp., Inc.*, 62 A.3d 1212, 1218 (Del. 2013) ("an exception to the American Rule is found in contract litigation that involves a fee-shifting provision.")).

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

adoption and use.<sup>78</sup> The court also ruled that a facially valid bylaw that is permissible under the Delaware General Corporation Law statute would be enforceable if it was adopted by the appropriate corporate procedures and for a proper corporate purpose.<sup>79</sup>

In the next part of its analysis, the Delaware Supreme Court addressed the second certified question presented by the district court,<sup>80</sup> and held that a fee-shifting bylaw would be enforceable if the plaintiff in an intra-corporate action obtained no relief at all against the defendant corporation.<sup>81</sup>

In response to the third question asked by district court,<sup>82</sup> the Delaware Supreme Court held that legally permissible bylaws adopted for an inequitable purpose are unenforceable in equity.<sup>83</sup> However, the court found that the intent to deter litigation, was not an improper purpose.<sup>84</sup> The court ruled that fee-shifting provisions, by their nature, act to deter litigation, and therefore are not *per se* invalid and would not render a fee-shifting bylaw unenforceable in equity.<sup>85</sup>

In the fourth and final question posed to the Delaware Supreme Court, the court held that a fee-shifting provision, if valid, is enforceable against members of corporation prior to the enactment into the corporation's bylaws.<sup>86</sup> The court supported this reasoning by citing to the Delaware General Corporation Law, which permits a corporation to confer the power to adopt, amend or repeal the bylaws of the corporation upon the board of directors.<sup>87</sup>

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78. *Id.* at 559.

79. *Id.*

80. *Id.* at 559–560. The second question asked by the district court was, “may [a] [fee-shifting] bylaw be lawfully enforced against a member that obtains no relief at all on its claims against the corporation, even if the bylaw might be unenforceable in a different situation where the member obtains some relief?” *Id.*

81. *Id.* at 560.

82. *Id.* The third question submitted to the Delaware Supreme Court was, “is [a] [fee-shifting] bylaw rendered unenforceable as a matter of law if one or more Board members subjectively intended the adoption of the bylaw to deter legal challenges by members to other potential corporate action then under consideration?” *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.* The fourth question submitted to the Delaware Supreme Court was, is [a] [fee-shifting] bylaw enforceable against a member if it was adopted after the member had joined the corporation, but where the member had agreed to be bound by the corporation's rules ‘that may be adopted and/or amended from time to time’ by the corporation . . . and where the member was a member at the time that it commenced the lawsuit against the corporation?

*Id.*

87. *Id.*

#### IV. ANALYSIS

The Delaware Supreme Court in *ATP Tour* was correct in its holding that a fee-shifting provision in a corporation's bylaws, if enacted for a proper and equitable purpose, is enforceable against a non-prevailing party in an intra-corporate litigation under Delaware law. However, the court should have clearly defined whether the holding applies to publicly-held corporations. Part A of this section will discuss the lack of mandatory and persuasive authority to support a finding of a fee-shifting bylaw as unenforceable or inequitable as a matter of law. Part B will discuss the equitable standard limitation adopted by the Delaware Supreme Court and how it provides a clear standard for future intra-corporate litigation involving fee-shifting bylaws of corporations. Finally, Part C will discuss the public policies supporting and opposing the Delaware Supreme Court's holding in *ATP Tour* applying to publicly-held corporations. Part C will also discuss how the holding will impact future intra-corporate litigation in Delaware.

##### A. There Is No Adverse Authority Against The Enforceability of A Fee-shifting Bylaw

The Delaware Supreme Court's holding in *ATP Tour* is best understood by analyzing the lack of binding and persuasive authority on the topic of fee-shifting bylaws available to the court prior to its holding.

##### 1. *Fee-Shifting Bylaw Authority Prior to ATP Tour*

As noted by the Delaware Supreme Court in *ATP Tour*, the enforceability of fee-shifting provision in a corporation's bylaws, at the time it was asked by the United States District Court for Delaware, was a novel question of law.<sup>88</sup> In *ATP Tour*, the Delaware Supreme Court found that there were no Delaware statutes prohibiting the enactment of a fee-shifting bylaw.<sup>89</sup> The court also mentioned that their search included the Delaware General Corporate Law statute, which also did not speak to or prohibit the enactment of a fee-shifting bylaw.<sup>90</sup> In fact, the court found that a fee-shifting bylaw satisfied the Delaware General Corporation Law's requirement that corporate bylaws relate to the business of the corporation, the conduct of its affairs, and its right or powers or the rights or powers of

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88. *Id.* at 557.

89. *Id.* at 558.

90. *Id.*

its stockholders, directors, officers, or employees.<sup>91</sup> Finally, due to the contractual nature of corporate bylaws in the state of the Delaware,<sup>92</sup> the court found that no principle of the common law prohibits a board of directors from enacting fee-shifting bylaws.<sup>93</sup>

In addition, at the time of the holding in *ATP Tour*, all legal authority related to the enforceability of a fee-shifting provision in a corporation's bylaws supported the court's decision.<sup>94</sup> For example, the *only* precedent available to the Delaware Supreme Court prior to *ATP Tour*, was *Sternberg v. Nanticoke Memorial Hospital, Inc.*, where the Delaware Supreme Court chose to uphold the validity and enforceability of a fee-shifting bylaw in Nanticoke Memorial Hospital's Medical Staff Bylaws Credential Policy.<sup>95</sup> In that case, the doctor suing Nanticoke Memorial Hospital challenged the validity of the fee-shifting provision, arguing that it was against public policy.<sup>96</sup> There, the Delaware Supreme Court did not find the doctor's argument persuasive and that there was no national or public policy that precluded the enforcement of Nanticoke Memorial Hospital's fee-shifting bylaw.<sup>97</sup>

Because this was the *only* Delaware precedent closely related to the fee-shifting provisions of *ATP Tour*, it would have been irrational and inconsistent for the Delaware Supreme Court to overrule itself, when the facts of both cases were similar enough<sup>98</sup> to warrant a finding that a fee-shifting provision in a corporation's bylaws as valid and enforceable as a matter of Delaware law. Furthermore, due to the lack of the persuasive authority available in all of the states across the country, including the prominent business states,<sup>99</sup> on the topic of fee-shifting bylaws at the time of the holding of *ATP Tour*, the Delaware Supreme Court was justified in

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91. *Id.* (citing to the language of subsection (b) of §109 of the Delaware General Corporation Law statute).

92. *See* *Airgas, Inc. v. Air Products and Chemicals, Inc.*, 8 A.3d 1182, 1188 (Del. 2010) (stating that "corporate . . . bylaws are contracts among a corporation's shareholders; [thus] [the] rules of contract interpretation apply.").

93. *ATP Tour, Inc.*, 91 A.3d at 558.

94. Indeed, a search of the term "fee-shifting bylaw" using Westlaw Next™ and Lexis Nexis Advance® will reveal that during that prior to the holding of *ATP Tour*, only one other case in the entire country spoke to the topic of the validity of a fee-shifting bylaw. However, that Delaware case did not address the topic of a fee-shifting provision within a Delaware corporation's bylaws.

95. *Sternberg v. Nanticoke Mem'l. Hosp., Inc.*, 62 A.3d 1212, 1221 (Del. 2013). Notably, Nanticoke Memorial Hospital is not incorporated in the state of Delaware but does have an office located within the state.

96. *Id.* at 1216.

97. *Id.* at 1217–18.

98. *ATP Tour* involved the members of a corporation challenging the validity and enforceability of a fee-shifting provision after they lost in an intra-company action, and *Sternberg* involved the validity and enforceability of a fee-shifting provision after the doctor of the defendant, Nanticoke Memorial Hospital, lost an intra-company dispute against his employer.

99. New York, Illinois, California, Texas, and Florida.

its holding that a fee-shifting bylaw can be valid and enforceable under Delaware Law.<sup>100</sup>

Therefore, the Delaware Supreme Court was correct to rule that a fee shifting bylaw, which is adopted for an equitable purpose, is enforceable as a matter of law; it is consistent with *Sternberg*; falls within the language of the Delaware General Corporate Law's section 109(b)'s requirements; and is supported by the contractual view of corporate bylaws between consenting parties in Delaware.

## 2. *Legal Authority Post ATP Tour*

Since the Delaware Supreme Court's holding in *ATP Tour*, there have been no new cases in Delaware, federal court, or any other state addressing the topic of the validity of a fee-shifting provision contained within a corporation's bylaws.<sup>101</sup> However, fifteen days after the holding of *ATP Tour*, the state of Oklahoma's legislature passed an Act that permits the shifting of a prevailing party or party's litigation expenses, including attorney fees, to a non-prevailing party or parties as a result of any derivative action instituted by a shareholder of a domestic or foreign corporation.<sup>102</sup> The Act went into effect in Oklahoma in November of 2014, and is binding upon non-stock and stock issuing companies that are incorporated in the state of Oklahoma.<sup>103</sup>

In contrast, within a week of the *ATP Tour* decision, the Corporate Law Section of the Delaware State Bar Association approved, in a divided vote, proposed amendments to the Delaware General Corporation Law statute that would prohibit any Delaware Stock corporation from adopting a fee-shifting provision in its bylaws.<sup>104</sup> The proposed amendments were then sent to the Delaware General Assembly for passage, but the United States Chamber of Commerce's institute for Legal Reform resisted the move, asking that the approval of the amendments be delayed so that

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100. Despite the fact that the enforceability of a fee-shifting provision contained within a corporation's bylaws was a novel question of Delaware law, it was also a novel question of national law. Thus, by having no persuasive authority to turn to that would support a finding against the enforceability of a fee-shifting bylaw, the court correctly addressed the question by focusing solely on Delaware jurisprudence.

101. Indeed, a search conducted on Westlaw Next™ and Lexis Nexis Advance® by this author exactly six months after the decision of *ATP Tour* (Nov. 8, 2014) resulted in zero results related to new cases by any other state or federal courts addressing the topic of the enforceability of a fee-shifting provision in a corporation's bylaws (fee-shifting bylaw).

102. OKLA. STAT. ANN. tit. 18, § 1126(C) (West 2014).

103. OKLA. STAT. ANN. tit. 18, § 1126 (West 2014).

104. Peter L. Welsh, C. Thomas Brown & Elizabeth Downing Johnston, *Delaware Supreme Court Upholds a One-Way Fee-Shifting Bylaw*, FINANCIER WORLDWIDE (Oct. 2014), [http://www.financierworldwide.com/delaware-supreme-court-upholds-a-one-way-fee-shifting-bylaw/#.VF6KevnF\\_aw](http://www.financierworldwide.com/delaware-supreme-court-upholds-a-one-way-fee-shifting-bylaw/#.VF6KevnF_aw).



impact of the amendments could be better understood.<sup>105</sup> The amendments were subsequently withdrawn to permit the Delaware General Assembly to further consider the issue during its next session, which is expected to likely to take place sometime in early 2015.<sup>106</sup>

From the lack of adverse authority, to the subsequent inaction and uncertainty by the Delaware state legislature, and the subsequent enactment of a statute permitting the use of fee-shifting bylaws by another state's legislature only fifteen days later, one can see that the Delaware Supreme Court's holding, that a fee-shifting bylaw is facially valid and enforceable as a matter of Delaware law, was reasonable, rational, and correct.

#### B. The *ATP Tour* Holding Provides a Clear Standard for Enforcing Fee-Shifting Bylaws

In *ATP Tour*, the Delaware Supreme Court, after holding that a fee-shifting provision contained within a corporation's bylaws was facially valid, then turned its focus to the manner in which the fee-shifting bylaw was adopted and the circumstances under which it was invoked by the board of directors.<sup>107</sup> Here, the court found that fee-shifting bylaws that are facially valid would not be enforceable if they were adopted or used by the board of directors for an inequitable purpose.<sup>108</sup>

To establish a framework for evaluating whether a bylaw was adopted and used for an equitable purpose, the court cited to an example of an inequitable purpose, *Schnell v. Chris-Craft Industries*, where the court overturned a board-amended bylaw that allowed the board of directors to enter office in such a fashion that they would be able to restrict the voting rights of the company's stockholders.<sup>109</sup> The court then offered *Hollinger International, Inc. v. Black* as another case that fell under the inequitable bylaw standard.<sup>110</sup> In that case, the Delaware Supreme Court affirmed the finding of the Delaware Court of Chancery that the bylaw amendments enacted by a controlling shareholder, which prevented the board of directors from acting on any matter of significance except by unanimous vote and set the board of director's quorum requirement at 80%, were clearly adopted for an inequitable purpose.<sup>111</sup>

In contrast, to demonstrate circumstances under which the enactment and use of a bylaw would be equitable, the court cited to the *Frantz*

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105. *Id.*

106. *Id.*

107. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014).

108. *Id.*

109. *Id.*

110. *Id.* at 559.

111. *Id.*

*Manufacturing Co. v. EAC Industries* case, where it upheld the validity and enforceability of amended bylaws that increased the board of directors' quorum requirement and mandated that all board of directors' actions be unanimous.<sup>112</sup> There, the Delaware Supreme Court found that the bylaw amendments were a permissible attempt of a stockholder to avoid disenfranchisement as the corporation's majority stockholder and were equitable under the circumstances.<sup>113</sup> The court also included one more example of a case that contained corporate bylaws that were enacted for proper equitable purposes and two cases that contained corporate bylaws that were enacted for improper and inequitable purposes.<sup>114</sup>

The equitable purpose framework established by the Delaware Supreme Court in *ATP Tour* provides clear guidance to future litigants involved in intra-corporate disputes regarding the validity and enforceability of fee-shifting bylaws in Delaware. Based on the analysis conducted by the court, one can see that as long as fee-shifting bylaw does not restrict the rights of the board of directors to run the corporation or affect any substantial rights of the board of directors or stockholders, the fee-shifting bylaw should be enforceable. One instance where a fee-shifting bylaw could clearly be adopted for an improper and inequitable purpose under the court's equity test would be where the board of directors enacts the bylaw and attempts to enforce it against its shareholders during ongoing intra-corporate litigation. In this hypothetical, the Delaware Supreme Court would likely rely on the inequitable purpose precedent established in *Schnell v. Chris-Craft Industries* and *Hollinger International* to find that the enactment of the fee-shifting bylaw was for an improper and inequitable purpose. Therefore, because the holding of *ATP Tour* provided a clear equitable purpose standard that contains a rational-based limitation on the enforceability of a fee-shifting provision contained within a corporation's bylaws, the Delaware Supreme Court's holding was correct as a matter of Delaware law.

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112. *Id.*

113. *Id.*

114. In footnote 31 of *ATP Tour*, the Delaware Supreme Court cited to *Stroud v. Grace*, 606 A.2d 75, 83 (Del. 1992) (upholding bylaw amendments against claims of entrenchment because "there was no evidence that the board adopted the Amendments as defensive measures and the record clearly indicated that there was no threat to the board's control"); the court also cited to *Datapoint Corp. v. Plaza Sec. Co.*, 496 A.2d 1031, 1036 (Del. 1985) (invalidating the board of directors' adopted bylaw amendments because the "underlying intent" behind them was "to give management an opportunity to distribute 'opposing solicitation material' to challenge written stockholder consents"); then the court cited to *In re Osteopathic Hosp. Ass'n of Del.*, 191 A.2d 333, 336 (Del. Ch. 1963) (invalidating a membership bylaw because a "change of so fundamental a character to the structure of this . . . unique organization was improper without the consent of the group whose interests are adversely affected" . . . the association's members.").

### C. The Delaware Supreme Court Should Have Defined Whether *ATP Tour* Applied to Publicly-Held Corporations

In *ATP Tour*, the Delaware Supreme Court's opinion should have included dictum which clearly defined whether the holding applies to publicly-held corporations. By not doing so, the court has caused confusion, concern, and hostility on both sides of the public policy argument for and against applying *ATP Tour* to publicly-held corporations incorporated in Delaware.

The implications and confusion caused by the holding of *ATP Tour* are best understood by first evaluating the public policy arguments favoring applying the holding to Delaware publicly-held corporations.

#### 1. Public Policies That Favor *ATP Tour* Applying to Publicly-Held Corporations

In *Sternberg*, a doctor challenged the validity of the fee-shifting provision contained in his hospital's Medical Staff Bylaws Credential Policy, arguing that the fee-shifting provision violated public policy.<sup>115</sup> At the time of that case, the Delaware Supreme Court did not find that any national or public policy precluded the use of the fee-shifting bylaw, noting that if Congress or the Delaware General Assembly wished to create limitation on the ability of private parties to enter into a contract providing for the shifting of attorneys' fees, they would have already created the limitation.<sup>116</sup> Therefore, in *Sternberg*, the Delaware Supreme Court upheld the enforceability of the fee-shifting bylaw in the non-corporation hospital's bylaws.<sup>117</sup> Public policy towards fee-shifting bylaws did not change after *Sternberg*, but did, substantially, after *ATP Tour*.

According to corporate law experts, it has become an established practice that almost any merger or sale transaction at an American company leads to a lawsuit.<sup>118</sup> This is especially true in the state of Delaware, which is home to much merger & acquisition ("M&A") activity.<sup>119</sup> Those in favor of the holding in *ATP Tour* believe that the adoption of fee-shifting bylaws by publicly-held corporations could help M&A companies by deterring many meritless shareholder lawsuits that are brought solely for the purpose of extracting a settlement from the board of directors.<sup>120</sup> These types of

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115. *Sternberg v. Nanticoke Mem'l. Hosp., Inc.*, 62 A.3d 1212, 1216 (Del. 2013).

116. *Id.* at 1217–18.

117. *Id.* at 1221.

118. Welsh, Brown & Johnston, *supra* note 104.

119. *Id.*

120. William J. Sushon, Samantha A. Brutlag & Edward N. Moss, *Shifting Sands: Practical Advice on Delaware Fee-Shifting Bylaws*, N.Y.L.J., (Aug. 11, 2014), <http://www.newyorklawjournal.com/id=1202666097449/Shifting-Sands-Practical-Advice-on-Delaware-FeeShifting-Bylaws>.

settlements, known as “peppercorn settlements,” involve the shareholder of a corporation challenging the pending merger or acquisition of a company by the parent corporation, where the shareholder alleges that the pending merger or acquisition constitutes a breach of the board of directors’ fiduciary duties.<sup>121</sup> Next, instead of taking the disputed matter to court to determine the merits of the case, the parties reach a fast settlement, in which the plaintiff-stockholders release their claims on behalf of the shareholders class of the corporation in exchange for enhanced disclosure in the Securities Exchange Commission filings, seeking approval of the transaction in addition to a six-figure or higher attorneys’ fee award.<sup>122</sup>

In 2012, the Vice Chancellor of the Delaware Chancery Court stated that:

[a]fter the announcement of a merger or acquisition, stockholder class action suits typically follow like mushrooms follow [] rain . . . and plaintiffs then rely on the court to . . . determin[e] which [lawsuits] are meritorious and what value they confer upon the stockholders . . . this . . . creates a risk of excessive merger litigation, where the costs to the stockholders exceed the benefits.<sup>123</sup>

These concerns expressed in 2012 had merit, because in 2013, shareholders challenged a whopping 94% of board of director deals valued over \$100 million, with an average of \$1.1 million in attorneys’ fees requested in each suit by plaintiffs.<sup>124</sup> Those numbers are just the tip of the iceberg of an ongoing problem in intra-corporate litigation, where from the period of 2005–2012, stockholders challenged 70.42% of publicly-held corporation transactions.<sup>125</sup>

These statistics suggest that many shareholder lawsuits are not instituted to perform a policing function of the board of directors, but instead are used as an easy gateway to generating massive plaintiffs’ attorneys’ fees.<sup>126</sup> These statistics may also better explain why some experts believe that the holding in *ATP Tour* will lead to a firestorm of boards of directors pushing to have fee-shifting provisions as a common feature of their Delaware-incorporated bylaws,<sup>127</sup> because it presents a legitimate opportunity for Delaware-incorporated businesses to try to

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121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* (citing Steven M. Davidoff, *Confronting the Peppercorn Settlement in Merger Litigation*, (Feb. 2014), [http://scholarship.law.upenn.edu/faculty\\_scholarship/775/](http://scholarship.law.upenn.edu/faculty_scholarship/775/).)

126. Sushon, Brutlag & Noss, *supra* note 120.

127. Pileggi, *supra* note 16.

address the burdens and huge expenses of intra-corporate litigation.<sup>128</sup> Recent developments in Delaware post *ATP Tour* support this view.

For example, since the holding of *ATP Tour*, six publicly-held companies<sup>129</sup> located in Delaware have adopted fee-shifting bylaws.<sup>130</sup> Two of these companies—Echo Therapeutics, Inc. and Biolase, Inc.—were sued by their shareholders in 2014 over the personnel/structure of their boards of directors.<sup>131</sup> In a statement released by the Echo Therapeutics company, the Board of Directors for Echo Therapeutics determined that the adoption of a fee-shifting bylaw was “in the best interest of all its shareholders because it deterred future frivolous litigation.”<sup>132</sup> Echo Therapeutics’ fee-shifting bylaw mirrors the exact language of the disputed bylaw in *ATP Tour*, and states that:

In the event that (i) any current or prior stockholder or anyone on their behalf initiates [or] asserts any claim or counterclaim or joins, offers substantial assistance to, or has a direct financial interest in any claim against the [Echo Therapeutics] and/or any Director, Officer, Employee or Affiliate and (ii) the claiming party . . . does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then [the] claiming party shall be obligated . . . to reimburse [] [Echo Therapeutics] the greatest amount permitted by law of all fees, costs, and expenses of every kind . . . including all reasonable attorneys’ fees and other litigation costs that the parties may incur in connection with the claim.<sup>133</sup>

Based on the high costs placed on the corporations involved in intra-corporate disputes, including challenges to the structure of the board of the directors and the decisions the boards make in merger & acquisition activities, it is easy to see that publicly-held corporations in Delaware are likely to support the view that *ATP Tour* applies to them and will, therefore, continue to adopt fee-shifting bylaws.

The concern and confusion caused by the holding of *ATP Tour* is best understood by also evaluating the public policy arguments opposing the holding applying to Delaware publicly-held corporations.

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128. Lacroix, *supra* note 18.

129. Echo Therapeutics Inc., Biolase Inc., Westlake Chemical Partners LP, Townsquare Media LLC, Viper Energy Partners LP, and LGL Grp., Inc.

130. Tom Hals, *U.S. Companies Adopt Bylaws That Could Quash Some Investor Lawsuits* (07/07/2014), <http://www.reuters.com/article/2014/07/07/usa-litigation-companies-idUSL2NOPE1YZ20140707>.

131. *Id.*

132. *Id.*

133. Keith Paul Bishop, *Public Company Adopts Fee Shifting Bylaw*, CAL. CORP. & SEC. L. (July 1, 2014), <http://calcorporatelaw.com/2014/07/public-company-adopts-fee-shifting-bylaw/>.

## 2. *Public Policies that Oppose ATP Tour Applying to Publicly-Held Corporations*

In contrast to corporate law experts who favor applying *ATP Tour* to Delaware publicly-held corporations, some critics believe that fee-shifting bylaws are against public policy and will invariably lead most companies in Delaware to not adopt fee-shifting bylaws, due the high threat of shareholder opposition.<sup>134</sup> Indeed, these experts argue that when a board of directors chooses to enact a fee-shifting bylaw, it could face unfavorable responses from its shareholders and the business market; stockholders might view the bylaw as limiting their rights and respond with a public statement of disapproval or by voting to repeal the action; institutional investors and advisors may not approve of the bylaw and they could pursue actions to remove the board of directors from the corporation.<sup>135</sup>

One Connecticut senator went as far to reach out to the Securities and Exchange Commission to request that the agency investigate one of these publicly-held companies that adopted a fee-shifting bylaw.<sup>136</sup> In his letter to the SEC, Senator Blumenthal stated:

The potential ramifications from [*ATP Tour*] are immense. No rational investor, even with significant financial interests at stake and when presented with clear evidence of corporate misconduct, will brave litigation when the corporate defendants can force the investor to face financial ruin unless he substantially wins on every point . . . Delaware is home to many of the country's largest public companies.<sup>137</sup>

Indeed, other corporate law experts have expressed similar concerns. For example, the November 2014 issue of the *Bank and Corporate Governance Law Reporter* included a series of four essays discussing views that oppose or support limiting the application of the holding from *ATP Tour* to publicly-held corporations.<sup>138</sup>

The first article in the Reporter argues against the use of fee-shifting bylaws because they are one-sided, in that they reimburse successful

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134. Solomon, *supra* note 18.

135. Jennifer L. Vergilii and Brian Mielcusny, *The Delaware Supreme Court's 'ATP Tour' Decision: Most Observers Overstating Potential Impact on Fee-Shifting Bylaws* BLOOMBERG L. (Sept. 3, 2014), <http://www.bna.com/delaware-supreme-courts-n17179894367/>.

136. Josh Zembik, *Blumenthal Calls On SEC To Protect Critical Check On Corporate Malfeasance* (Oct. 30, 2014), <http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-sec-to-protect-critical-check-on-corporate-malfeasance>.

137. *Id.*

138. See Harvey L. Pitt, *Reducing Litigation Perils Fairly*, BANK & CORP. GOVERNANCE L. REP., no. 3, Nov. 3, 2014, at 26. Notably, of the four authors, one did support applying ATP Tour to Delaware publicly-held corporations, provided the fee-shifting bylaw is adopted at the time the company first incorporates.

defendants but not successful plaintiffs, and they require fee-shifting even in cases that were reasonable or meritorious but were lost on a technical legal defense or a defense that was not entirely successful.<sup>139</sup> The author also expresses concern that most fee-shifting bylaws are drafted broadly enough that they can also apply to investigations, as well as to others who assist a plaintiff-shareholder in litigation against the corporation.<sup>140</sup> The author then argues that the incentive effect of fee-shifting bylaws is to encourage early settlement before the facts of a case have really developed; the plaintiff's attorney has a strong incentive<sup>141</sup> to negotiate a deal under which the attorney waives the right to appeal in return for the defendants' waiver of the fee-shifting bylaw.<sup>142</sup> Finally, the author of this article concludes that without judicial discretion, board-adopted fee-shifting bylaws could turn in an automatic system of one-way fee-shifting.<sup>143</sup>

The second article argues against the applicability of fee-shifting bylaws, finding them unacceptable when such a bylaw is adopted after individuals have invested in the corporation.<sup>144</sup> The author goes further and states that fee-shifting bylaws impose intolerable risk on a stockholder's decision to sue the board of directors for breach of fiduciary duty, and that such a lawsuit against is an impossible challenge; anything less than total success in an intra-corporate dispute would result in the stockholder having to pay the corporation's costs of defense.<sup>145</sup> Therefore, the author argues, corporations that adopt fee-shifting bylaws exceed the limits of the doctrine of corporate consent.<sup>146</sup> Finally, the author offers four factors to be considered for identifying the limits of the doctrine of corporate consent: (1) the number and character of the investors;<sup>147</sup> (2) whether the bylaw is in place before the investors invest or is adopted after investors have invested;<sup>148</sup> (3) whether the likely impact of the changes are reasonably understandable to investors; and (4) whether the bylaw impairs some strong

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139. John C. Coffee, Jr., *Fee-shifting and the SEC: Does It Still Believe in Private Enforcement?*, 53 BANK & CORP. GOVERNANCE L. REP. no. 3, Nov. 3, 2014, at 12.

140. *Id.* at 13.

141. *See* Sushon, *supra* note 120. This is the exact opposite view of those who believe that fee-shifting bylaws are proper response mechanism for peppercorn settlements.

142. Coffee Jr., *supra* note 139, at 13.

143. *Id.* at 14.

144. Lawrence A. Hamermesh, *Do Broad Fee-shifting Bylaws Comply with the Doctrine of Corporate Consent?*, 53 BANK & CORP. GOVERNANCE L. REP., no. 3, Nov. 3, 2014, at 19.

145. *Id.*

146. *Id.* at 17. "The Doctrine of Corporate Consent treats stockholders as having implicitly consented to changes adopted by the Board of Directors."

147. *See id.* Meaningful consent is more assumed among a small group of experienced investors represented by legal counsel than when an investment is sold to a large number of unsophisticated investors.

148. *See id.* Investors who chose to invest after a bylaw is in place can more easily be seen as having provided consent, unlike those who already own an investment at the time the fee-shifting bylaw was adopted.

and reasonable expectation on the part of the investors, in light of the corporate contract.<sup>149</sup>

The third article focuses on the three steps the Delaware Legislature should take to restrict the holding of *ATP Tour*, to create a “fair compromise” between a corporation’s need to protect itself from meritless lawsuits without barring the shareholders’ need to allow legitimate lawsuits proceed.<sup>150</sup> In this article, the author argues that the first step of a “fair compromise” can be reached if the Delaware legislature requires that fee-shifting bylaws be approved by majority shareholder vote and, where a controlling shareholder is involved, also by a majority vote of the minority shares.<sup>151</sup> Additionally, the author argues that another “fair compromise” could be reached in the second step, if the Delaware legislature requires that any fee-shifting bylaw is invalid after the plaintiffs have survived a motion to dismiss.<sup>152</sup> Next, the author argues that the third step to a “fair compromise” would be for the Delaware legislature to require a fee-shifting bylaw to stipulate that the corporation must pay the plaintiff’s costs for all procedural and substantive issues won by the plaintiffs in the trial court, even if the decision is overturned on appeal.<sup>153</sup> Finally, the author concludes that only fee-shifting bylaws, that serve the purpose of safeguarding meritorious lawsuits, should be allowed to be enforceable.<sup>154</sup>

## V. CONCLUSION

The Delaware Supreme Court in *ATP Tour* was correct in its holding that a fee-shifting provision in a corporation’s bylaws, if enacted for a proper and equitable purpose, is enforceable against a non-prevailing party in an intra-corporate litigation under Delaware law. This holding was correct because there is no adverse authority that supports a finding against the validity and enforceability of a fee-shifting bylaw, the court provided a clear equitable standard for evaluating the circumstances in which a fee-shifting bylaw is enacted for an equitable or inequitable purpose, and the enforceability of a fee-shifting provision is consistent with Delaware’s contractual view of corporate bylaws.

However, the Delaware Supreme Court’s holding should have defined whether the holding of *ATP Tour* applied to publicly-held corporations. By not addressing this question in the court’s holding, *ATP Tour* has led to

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149. Hamermesh, *supra* note 144, at 17–18.

150. Neil J. Cohen, *Is There a Legislative Compromise to Limit Fee-Shifting Bylaws?*, 53 BANK & CORP. GOVERNANCE L. REP., no. 3, Nov. 3, 2014, at 21.

151. *Id.*

152. *Id.*

153. *Id.* at 22.

154. *Id.*



national corporate confusion, where some publicly-held companies have adopted fee-shifting bylaws, while others are waiting to see what the Delaware Legislature will decide in early 2015.

Based on the expenses involved with intra-corporate litigation, the high challenge rate of merger & acquisition activity by stockholders, and the contractual view of corporate bylaws in the state of Delaware, the holding of *ATP Tour* will likely be held to apply to publicly-held corporations by the Delaware Supreme Court in a later case. This holding rightfully raises a higher burden of risk for plaintiffs that bring intra-corporate actions against board of directors, because it protects a valid interest for a corporation's board of directors and shareholders by preventing them from wasting company time, money, and resources on frivolous lawsuits. Furthermore, one could certainly argue that the shareholders of a corporation that oppose the adoption of a fee-shifting bylaw are free to sell their stock in the corporation. Finally, one must also consider that the holding of *ATP Tour* does not mandate that companies incorporated in Delaware adopt fee-shifting bylaws, only that they are permitted to do so for an equitable purpose.