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Fee-Shifting Bylaws: The Delaware Supreme Court Decision in *ATP Tour*, Its Aftermath and the Potential Delaware Legislative Response

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The Decision

On May 8, 2014, the Delaware Supreme Court issued an opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund (German Tennis Federation)*, No. 534, 2013 (Del. May 8, 2014), holding that fee-shifting provisions in a Delaware non-stock corporation's bylaws are not *per se* invalid. The bylaw at issue shifted all litigation expenses to an unsuccessful plaintiff in intra-corporate litigation who did "not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought." The court noted it was not deciding whether the specific bylaw at issue was adopted for a proper purpose or enforceable under the circumstances.

The court answered four certified questions from the United States District Court for the District of Delaware as follows: (1) Fee-shifting bylaws may be lawfully adopted under Delaware law; (2) If otherwise valid and enforceable, the bylaw could shift fees if a plaintiff obtained no relief in the litigation (given the difficulty in applying a "substantially achieves" standard in the bylaw at issue); (3) The bylaw would be unenforceable if adopted for an improper purpose (notably, the court remarked that "an intent to deter litigation would not necessarily render the bylaw unenforceable"); and (4) The bylaw would generally be enforceable against members who joined the corporation before the provision's enactment. It is now up to the district court to rule on the adoption and enforceability of the fee-shifting bylaw under the particular circumstances in the litigation before it.

Varied Reactions

The *ATP Tour* decision received a great deal of attention, from both the media and the legal community. A number of commentators suggested that the decision would extend to stock corporations, including public companies, and that such companies consider adopting a fee-shifting bylaw in order to mitigate the increasing phenomenon of stockholder litigation that imposes significant costs, monetary and otherwise, on such companies. In the mergers and acquisitions transaction arena, for example, in 2013, stockholder plaintiffs filed lawsuits challenging approximately 94 percent of all announced deals, versus 54 percent in 2008. It seems to have become a knee-jerk reaction to file lawsuits upon the announcement of a deal. Shifting the cost of defending such litigation to unsuccessful plaintiffs would likely impose meaningful discipline on this phenomenon, by forcing a more merits-based assessment of the potential claims at the outset, or at least after initial discovery has been concluded.

However, unfavorable consequences may also result. Broadly speaking, there is a significant risk that efforts by boards of directors of public companies to curtail stockholder litigation will be perceived by some stockholders, governance advocates and proxy advisory firms as protectionist, anti-corporate governance actions deserving prompt and clear disapproval if attempted. In today's world, such disapproval could easily come not only in the form of public statements, but also in the form of stockholder action, such as stockholder proposals to repeal any board-adopted bylaw and/or "vote no"

campaigns against some or all directors who supported adoption of the offending bylaw (with particular focus on the members of the governance committee of the board). In addition, there is the risk that adoption of fee-shifting bylaws could significantly deter, or eliminate, even meritorious claims.

The Potential Delaware Legislative Response

In response to the decision, the Corporation Law Council of the Delaware State Bar Association has proposed legislation that, if adopted by the legislature, would limit applicability of the *ATP Tour* decision to non-stock corporations, and make clear that fee-shifting bylaws, or other charter or bylaw provisions, may not impose monetary liability on stockholders of stock corporations. The proposed amendments are intended to eliminate any implication that the limited liability protection of stockholders underlying Delaware corporation law can be undermined.

The proposed amendments include a change to Section 102(b)(6) of the Delaware General Corporation Law (DGCL), which permits a certificate of incorporation to include a provision imposing personal liability for the debts of the corporation on its stockholders to a specified extent and upon specified conditions, to clarify that any such provision may impose liability "*based solely on [a stockholder's] stock ownership*," and not on any other status or action of the stockholder. (Stockholders would continue to be subject to possible liability not arising from a charter provision, but based instead on specific acts or omissions of a stockholder, such as a guarantee of corporate debt or tortious conduct.)

The proposed amendments also include a new Section 331 of the DGCL that is intended to confirm and codify the limited liability nature of corporations by expressly stating that provisions in a certificate of incorporation or in bylaws may not impose monetary liability, or responsibility for corporate debts, on stockholders other than to the extent permitted by Section 102(b)(6), as described above, or by Section 202 of the DGCL, which permits transfer restrictions imposed by charter, bylaw or stockholder agreement that could result in monetary liability to stockholders.

The proposed new DGCL Section 331 would read as follows:

> Notwithstanding any other provision of this chapter, neither the certificate of incorporation nor the bylaws of any corporation may impose monetary liability, or responsibility for any debts of the corporation, on any stockholder of the corporation, except to the extent permitted by Sections 102(b)(6) and 202 of this title.

Notably, the synopsis to the proposed amendments clarifies that nothing in the proposed amendments is intended to limit the power of a court to impose sanctions under applicable law. If adopted by the legislature, the proposed amendments would become effective August 1, 2014.

In essence, the proposed legislation, if adopted, in furtherance of ensuring the doctrine of limited liability of stockholders, would answer with a clear "no" the question that has been debated since the *ATP Tour* decision as to whether public Delaware stock corporations may adopt fee-shifting bylaws. If the proposed legislation is not adopted, Delaware public companies will need to give careful consideration to whether, when and how to address the possibility of adopting a fee-shifting bylaw.