Simpson Thacher

Memorandum

Delaware Prohibits Stock Corporations From Enacting Fee-Shifting Bylaws for Intra-Corporate Disputes

July 23, 2015

On June 24, 2015, Delaware enacted legislation that limits the Delaware Supreme Court's 2014 decision in *ATP Tour, Inc. v. Deutscher Tennis Bund*, which upheld the facial validity of a non-stock corporation's bylaw provisions that require litigation costs and fees to be shifted to the losing party.[1] The bill, which goes into effect on August 1, 2015, will prohibit stock corporations from adopting certificate of incorporation or bylaw provisions that hold shareholders liable for the corporation's attorneys' fees and costs in intra-corporate litigation. Delaware's legislation appears to settle the controversy generated by *ATP Tour* as to the scope of the ruling's applicability. Nonetheless, the new statute leaves some practical questions unanswered—in particular, whether the limitation in the statute's limitation of the ban to intra-corporate disputes would allow stock corporations to adopt fee-shifting bylaws for federal securities cases.

Fee-Shifting Bylaws and *ATP Tour*

Under the "American Rule," parties must pay their own attorneys' fees and costs in a litigation unless a statute, contract, or other equitable basis provides otherwise. Fee-shifting bylaws alter the "American Rule" by requiring unsuccessful plaintiffs to pay for the corporation's costs in defending the suit they brought. Such bylaws were at issue in *ATP Tour*, in which two tennis federations joined ATP as members and "agreed to be bound by ATP's bylaws, as amended from time to time."[2] After they joined, the ATP board adopted a fee-shifting bylaw provision, requiring the member federations to pay all of ATP's defense expenses if they did not "substantially achieve[], in substance and amount, the full remedy sought…" in a litigation against ATP. The Delaware Supreme Court held that, assuming the company's corporate charter does not prohibit a fee-shifting bylaw, such a bylaw is facially valid under Delaware law. Moreover, the court reasoned that since bylaws are contracts among a corporation's shareholders, fee-shifting bylaws fall within the contractual

[1] *See ATP Tour, Inc. v. Deutscher Tennis Bund,* 91 A.3d 554, 555 (Del. 2014).

[2] *ATP Tour*, 91 A.3d at 556.

exception to the "American rule," provided that the bylaws were not enacted for an inequitable purpose.

The court's decision sparked fervent debate over whether the case's holding would apply equally to stock corporations. Shortly after the issuance of the *ATP Tour* decision, the Corporate Law Section of the Delaware State Bar Association received and approved a legislative proposal that would prohibit public companies from adopting fee-shifting bylaws. The Delaware General Assembly ultimately proposed Senate Bill 75, which passed and was then signed by Governor Bullock last month.

Delaware Senate Bill 75

Senate Bill 75 declares that the corporate certificates and bylaws of stock corporations "may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim, as defined in [Section] 115 . . . ."[3] Section 115, which Senate Bill 75 adds to the Delaware General Corporation Law, defines "internal corporate claims" as "claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." Accordingly, Senate Bill 75 does not invalidate fee-shifting provisions falling outside of these two definitional categories The statute's fee-shifting prohibition applies, for example, to derivatives actions, merger class actions, and appraisal actions, but appears to exclude securities class actions, which do not require a breach of fiduciary duty for successful claims and do not fall under the Chancery Court's jurisdiction.[4]

The statute does not prohibit fee-shifting provisions in contracts executed between stock corporations and their shareholders.[5] Additionally, Senate Bill 75 amends the Delaware General Corporation Law to exempt non-stock corporations from the prohibition on fee-shifting bylaws for "internal corporate claims" in accordance with *ATP Tour*.

Practical Implications

Senate Bill 75 essentially forecloses the availability of fee-shifting bylaws to publicly held corporations incorporated in Delaware. While, on its face, the statute's prohibition on fee-shifting bylaws does not seem to apply to securities class actions, federal courts may rule the matter preempted by federal securities laws. In addition, for a number of practical reasons, including the risk of overwhelmingly negative shareholder reaction and negative proxy advisory firm recommendations, it is unlikely that corporate boards will adopt fee-shifting bylaws for actions not explicitly covered by the new statute

---

[3] Sen. 75, 148th Gen. Assemb., 1st Reg. Sess. (Del. 2015).

[4] *See* John C. Coffee, Jr., *Delaware Throws a Curveball,* THE CLS BLUE SKY BLOG (Mar. 16, 2015).

[5] *See* Thomson Reuters, *Survey of Fee-Shifting Bylaws Suggests DGCL Amendments Won't End Debate*, LEGAL SOLUTIONS BLOG (June 5, 2015).

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at (212) 455-3815 or yafit.cohn@stblaw.com, any other member of the Firm's Public Company Advisory Practice, or any of the following members of the Firm's Litigation Practice:

NEW YORK CITY

Paul C. Gluckow
+1-212-455-2653
pgluckow@stblaw.com

Peter E. Kazanoff
+1-212-455-3525
pkazanoff@stblaw.com

Joseph M. McLaughlin
+1-212-455-3242
jmclaughlin@stblaw.com

Lynn K. Neuner
+1-212-455-2696
lneuner@stblaw.com

Jonathan K. Youngwood
+1-212-455-3539
jyoungwood@stblaw.com

PALO ALTO

James G. Kreissman
+1-650-251-5080
jkreissman@stblaw.com

LOS ANGELES

Chet A. Kronenberg
+1-310-407-7557
ckronenberg@stblaw.com

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000