



## Delaware Supreme Court Finds Litigation Fee-Shifting Bylaws Facially Valid

May 27, 2014

On May 8, 2014, the Delaware Supreme Court held that provisions in a non-stock corporation's bylaws requiring that litigation costs and fees be shifted to the losing party can be valid in Delaware. In *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Court, sitting *en banc*, explained that assuming fee-shifting bylaws are not prohibited by the company's corporate charter, such bylaws are facially valid because they do not violate the Delaware General Corporation Law ("DGCL") or any other Delaware statute, nor are they repugnant to any principle of common law. The Court reasoned that the "American Rule," which requires litigants to pay their own attorneys' fees and costs, can be modified by contracting parties and that since "corporate bylaws are 'contracts among a corporation's shareholders,' a fee-shifting provision contained in a non-stock corporation's validly-enacted bylaw would fall within the contractual exception to the American Rule."<sup>1</sup>

Notwithstanding its finding on the facial validity of fee-shifting bylaws, the Court explained that whether a specific bylaw would be enforceable "depends on the manner in which it was adopted and the circumstances under which it was invoked" and that facially valid bylaws "will not be enforced if adopted or used for an inequitable purpose." The Court, issuing its ruling in response to four certified questions of law from United States District Court for the District of Delaware, did not have the occasion to determine the enforceability of the specific fee-shifting provisions at issue in the underlying district court case. The Court stated, however, that the intent to deter litigation is "not invariably an improper purpose," as "[f]ee-shifting provisions, by their nature, deter litigation."

The Court's decision has generated considerable controversy among legal practitioners, scholars, and news reporters. Many have raised concerns regarding the potentially broad implication of the Court's ruling, which appears by virtue of its reliance on the DGCL to apply with equal force to Delaware stock corporations. Some have argued that if it is relied upon by publicly held companies, the ruling will likely have a significant chilling effect on shareholder lawsuits and could be devastating to the plaintiffs' bar. Accordingly, on May 22, 2014, an amendment to the DGCL was proposed, which seeks to limit the Court's holding on the facial validity of fee-shifting bylaws to non-stock corporations. Specifically, proposed Section 331 to the DGCL would prevent the certificate of incorporation or the bylaws of any corporation from imposing monetary liability or responsibility for any debts of the corporation on any shareholder of the corporation (except as explicitly permitted under the DGCL). Public companies pondering the possibility of adopting fee-shifting bylaws may consider waiting until

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<sup>1</sup> *ATP Tour, Inc. v. Deutscher Tennis Bund*, 2014 WL 1847446, at \*3 (Del. Supr. May 8, 2014).

the Delaware General Assembly votes on the proposed amendment before coming to any conclusions, since the adoption of the legislative amendment could render the issue moot.

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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](mailto:yafit.cohn@stblaw.com), or any other member of the Firm's Securities Litigation Practice or the Firm's Public Company Advisory Practice.

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