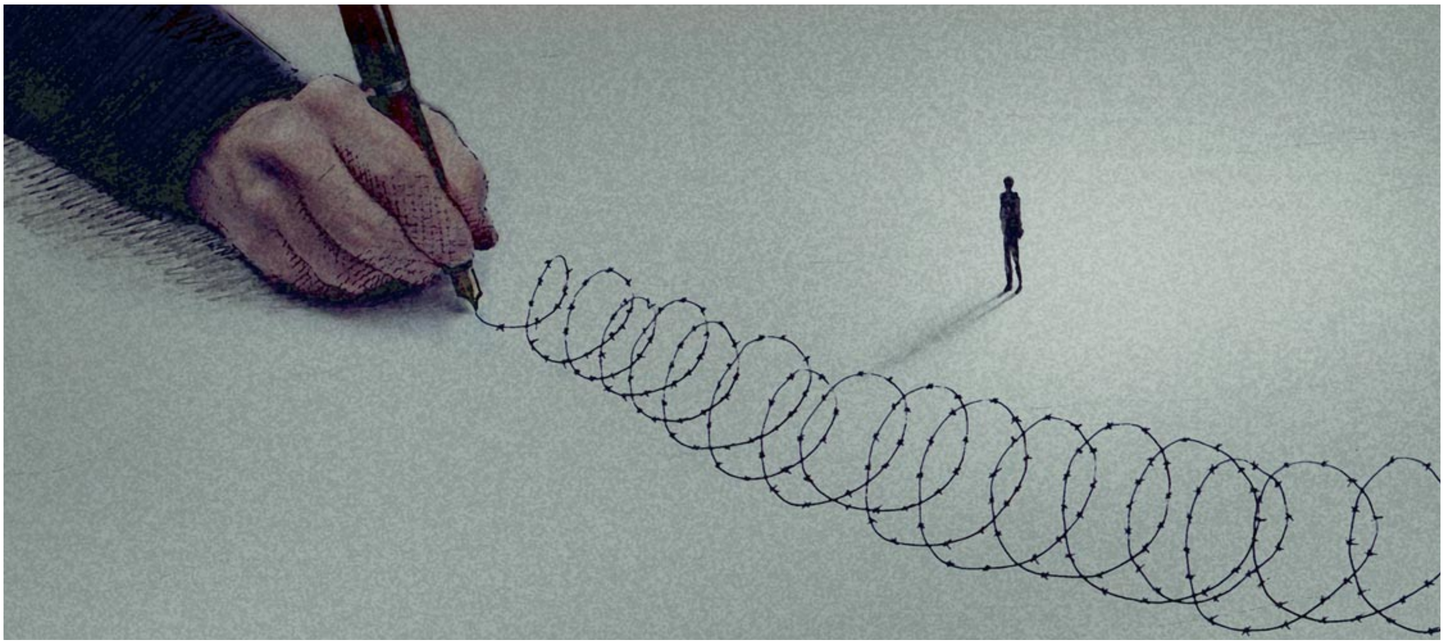
The Advocate
FOR INSTITUTIONAL INVESTORS

Dispatches from the Battleground:

Will Fee-Shifting Bylaws Keep Shareholders from the Courthouse?



Investors are rightly troubled by the *ATP Tour* ruling. Many publicly-traded corporations have already adopted fee-shifting provisions, potentially making shareholder litigation untenable. Institutional investors are fighting back.

By Edward Timlin

As discussed in the last edition of *The Advocate*, the Delaware Supreme Court's May 8, 2014 ruling in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014) presents a serious threat to meritorious stockholder litigation. *ATP* held that a non-stock corporation could adopt a bylaw "shifting" its attorneys' fees and expenses to any member that brought a lawsuit against the corporation (or its directors and officers) and failed to achieve "substantially all" of the relief sought. In other words, the Court upheld a fee-shifting bylaw that put a suing member on the hook for all of the corporation's attorneys' fees and expenses unless the plaintiff achieved complete victory in its lawsuit. Because no rational stockholder will seek to vindicate their rights in the face of personal exposure to unknown, uncapped, and uncontrollable defense costs, fee-shifting bylaws could chill even the most important and meritorious claims.

In the wake of *ATP*, dozens of publicly traded companies rushed to adopt one-way fee-shifting provisions. Investors were rightly troubled, and the institutional investor community mobilized to combat this threat to their rights. In response, corporate lobbyists led by the US Chamber of Commerce spent millions trying to derail efforts to prevent the expansion of *ATP* to public Delaware corporations. In a show of audacity, the Chamber has characterized its actions as in the interest of stockholders. But, make no mistake — the Chamber's goal is to shut the courthouse door on those same stockholders.

The Chamber's campaign is ongoing and remains dangerous. Some recent developments, however, suggest that investors may win this round of the battle, successfully limiting the dangerous precedent set in *ATP*.

First, legislative efforts to limit *ATP* to non-stock business associations are advancing. A bill limiting *ATP* was proposed almost immediately after the Court's decision in 2014. Unfortunately, the Chamber's massive lobbying effort succeeded in removing the bill from the 2014 calendar.

Fortunately, investors did not give up. In November 2014, institutional investors with approximately $2 trillion of assets under management wrote Delaware's Governor Jack Markell and other key policymakers, urging swift legislative action to limit *ATP's* reach.

In March 2015, the Corporate Law Section of the Delaware State Bar Association — a respected, bipartisan body typically responsible for proposing amendments to Delaware's General Corporation Law — presented a revised bill to the Delaware State Legislature. The revised bill would prohibit fee-shifting provisions, in either the bylaws or charters of Delaware corporations, that apply to "intra-corporate claims" such as stockholder breach of fiduciary duty claims and appraisal actions.

On May 12, 2015, the upper house of the Delaware State Legislature passed the revised bill, and, on June 11, the lower house passed the revised bill. The bill will now be presented to Governor Markell for his signature.

Second, the Delaware Chancery Court issued a decision in March 2015 voicing its concern with the policy implications of allowing fee-shifting bylaws at public companies. In *Strougo v. Hollander*, 111 A.3d 590 (Del. Ch. 2015), a controlling stockholder caused the company to conduct a reverse stock split, cashing out the public stockholders involuntarily. Stockholders initiated a lawsuit challenging the conflicted transaction. After the stockholders had been cashed out, the company adopted a fee-shifting bylaw. The stockholders then amended their complaint to challenge the bylaw in addition to the transaction itself. The Chancery Court ruled that the bylaw was not enforceable because it was not adopted until after the stockholders' shares were cashed out and a corporation cannot adopt bylaws purporting to govern its relationship with former stockholders.

Because the Court in *Strougo* ruled for the stockholders based on the timing of the bylaw's adoption, it did not reach the broader issue of the validity of fee-shifting bylaws in general. But, Chancellor Bouchard made clear the Court's skepticism regarding the propriety of such provisions. Specifically, Chancellor Bouchard wrote that "[m]odern corporate law recognizes that stockholders have three fundamental, substantive rights: to vote, to sell, and to sue." The Court recognized that, in a case like *Strougo*, a fee-shifting bylaw would prevent "rational stockholder[s]" from initiating meritorious suits because each stockholder's recovery would be dwarfed by the "[d]efendants' uncapped attorneys' fees." "This reality demonstrates the serious policy questions implicated by fee-shifting bylaws in general, including whether it would be statutorily permissible and/or equitable to adopt bylaws that functionally deprive stockholders of an important right: the right to sue to vindicate their interests as stockholders."

Because no rational stockholder will seek to vindicate their rights in the face of personal exposure to unknown, uncapped, and uncontrollable defense costs, these fee-shifting bylaws could chill even the most important and promising claims.

Third, on March 19, 2015, Securities and Exchange Commission Chair Mary Jo White expressed her disapproval of fee-shifting bylaws, perhaps signaling how the SEC will respond if corporations adopt fee-shifting bylaws purporting to apply to federal securities claims. Ms. White told Tulane University Law School's Corporate Law Institute that she is "concerned about any provision in the bylaws of a company that could inappropriately stifle shareholders' ability to seek redress under the federal securities laws."

Dozens of publicly-traded corporations have already adopted fee-shifting bylaws, and the threat of more widespread adoption remains imminent. However, recent developments hopefully signal that legislators, judges, and regulators will be responsive when the investment community acts in a united fashion.

Edward Timlin is an Associate in BLB&G's New York office. He can be reached at edward.timlin@blbglaw.com.

Final Word

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Delaware Enacts Legislation Banning Fee-Shifting Bylaws

The Editors

The institutional investor community, which spoke with a clear voice in opposition to the ATP Tour decision, was instrumental in delivering this victory for shareholder rights.

On June 25, 2015, shortly after this issue of *The Advocate* went to press, Delaware Governor Jack Markell tendered investors a victory in their ongoing battle against fee-shifting provisions. By signing into law Senate Bill 75, Governor Markell curbed the Delaware Supreme Court's recent decision in *ATP Tour* upholding a non-stock corporation's bylaw "shifting" its attorneys' fees and expenses to any member that brought a lawsuit against the corporation (or its directors and officers), but failed to achieve a complete victory in the lawsuit. The Delaware Supreme Court's decision attracted a great deal of attention in the financial community, spawning a vociferous debate. While corporate interests sought to expand fee-shifting bylaws to public companies, the institutional investor community understood that if these provisions are allowed to infect the charters of public corporations, they would effectively eliminate stockholders' ability to sue, even in the most meritorious cases.

Recognizing the manifest unfairness of such fee-shifting provisions and the importance of this issue to the integrity of the public capital markets, institutional investors representing approximately $2 trillion in assets wrote Governor Markell and other key policymakers in Fall 2014, urging prompt legislative action to limit *ATP Tour*. The Delaware legislature and Governor Markell agreed with investors. By signing into law Senate Bill 75, Delaware has prohibited the spread of corporate fee-shifting provisions for stockholder claims against Delaware corporations or their directors and officers. The institutional investor community, which spoke with a clear voice in opposition to the *ATP Tour* decision, was instrumental in delivering this victory for shareholder rights.

Unfortunately, this key victory does not end the matter. While stockholders have won this battle, corporate interests will almost certainly continue their efforts to restrict stockholder rights and powers. The U.S. Chamber of Commerce, for example, may direct its lobbying efforts on the fee-shifting issue to other states where corporations frequently incorporate, opening new battlegrounds on this critical issue. It is thus important that investors remain vigilant.

For further background on this ongoing issue, please see "Dispatches from the Battlefield: Will Fee-Shifting Bylaws Keep Shareholders from the Courthouse?" on page 10 of *The Advocate*.