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Proposed Amendments to the DGCL to Limit Applicability Of the Delaware Supreme Court's Holding in 'ATP Tour'

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In *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court, responding to four certified questions of law from the U.S. District Court of the District of Delaware, held that a fee-shifting provision of a Delaware nonstock corporation's bylaws applicable to intra-corporate disputes could be valid and enforceable (29 CCW 161, 5/21/14).[1] Although the Court emphasized that it was only addressing whether the nonstock corporation's bylaw was facially valid—and was expressly not addressing whether the bylaw or any application of it would be valid under a specified set of circumstances[2]—the opinion resulted in a discussion among corporate law practitioners as to whether stock companies should consider adopting fee-shifting bylaws.

Proposed Amendment to the DGCL

Soon after the opinion was released, the Council of the Corporation Law Section of the Delaware State Bar Association responded with proposed amendments to Delaware's General Corporation Law (the "DGCL") (29 CCW 170, 6/4/14). Legislation to amend Sections 102(b)(6) and 114 of the DGCL and add a new Section 331, which is intended to "confirm and codify the limited liability nature of corporations . . . to limit applicability of [*ATP*'s] holding to non-stock corporations, and to make clear that such liability may not be imposed on holders of stock in stock corporations"—was introduced to the Delaware General Assembly.[3] If enacted, the amendments would become effective on Aug. 1, 2014.

At this point, given the pending legislation, it would seem prudent for stock corporations and their counsel to discontinue considering the adoption of fee-shifting bylaws.[4] Even if the proposed amendments are not approved in this legislative session, stock corporations and their advisors may be well advised to take a wait-and-see approach to fee-shifting bylaws. Nevertheless, the opinion remains an important precedent for nonstock corporations, and it provides interesting insight on the Delaware Supreme Court's construction of bylaws generally.

The DGCL has historically afforded nonstock corporations greater organizational flexibility than stock corporations.[5] The express exclusion of nonstock corporations from the application of the proposed amendments represents a continuation of that historical practice, in apparent recognition of the fact that many nonstock corporations, whether trade organizations, homeowners associations or conferences, include in their organic documents provisions governing their internal affairs and the relations between or among the corporation, its members and the members of the governing body that would be inconsistent with the principles of limited liability reflected in the pro-

[1] *ATP Tour, Inc. v. Deutscher Tennis Bund*, No. 534, 2013 (Del. May 8, 2014).

[2] *Id.*, slip op. at 8 ("Whether the specific ATP fee-shifting bylaw is enforceable, however, depends on the manner in which it was adopted and the circumstances under which it was invoked. Bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose.").

[3] Del. S.B. 236, 147th Gen. Assem. (2014).

[4] The proposed amendments would not preclude corporations from entering into fee-shifting or other arrangements pursuant to contractual agreement. See *id.* ("Nothing in these amendments is intended to limit . . . the enforceability of any provision included in the certificate of incorporation or bylaws that binds any person pursuant to any separate contract, agreement deed or other instrument."). Accordingly, while the proposed amendments, if enacted, will eliminate the ability to impose such liability or other like-arrangements on stockholders pursuant to a stock corporation's bylaws, corporations and their counsel should consider whether, and in what circumstances, entering into separate contracts or agreements with stockholders may be feasible or advisable.

[5] *See* John Mark Zeberkiewicz & Blake Rohrbacher, *Delaware Nonstock Corporations*, 98 Corporate Practice Portfolio Series (BNA) ("Delaware's nonstock corporations are provided with an additional amount of flexibility in organizing their internal affairs, beyond that available to Delaware stock corporations.").

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posed amendments. But, in deciding whether, and in what manner, to adopt a fee-shifting bylaw, nonstock corporations and their counsel should carefully consider the Court's analysis and holding in *ATP*, as well as the issues that the Court was not able to address or resolve in the context of the certification of questions from the district court.

Interested in This Topic?

See John Mark Zeberkiewicz & Blake Rohrbacher, *Delaware Nonstock Corporations*, Portfolio 98 in the *Corporate Practice Portfolio Series*, available at Bloomberg BNA. Go to http://www.bna.com/delaware-nonstock-corporations-p17179881077/ for more information.

The Opinion

The Court in *ATP* addressed four separate questions that were certified to it: (1) whether the governing body of a nonstock corporation is permitted to adopt a fee-shifting bylaw; (2) whether such a bylaw may be enforced against a member that obtains no relief, even if it might be unenforceable in a situation where the member obtains some relief; (3) whether the bylaw would be rendered unenforceable if the members of the governing body intended it to deter legal challenges; and (4) whether the bylaw would be 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 as in effect from time to time).

As to the first certified question—whether the governing body of a Delaware nonstock corporation may adopt a fee-shifting bylaw—the Court noted that bylaws ''are 'presumed to be valid, and the courts will construe the bylaws in a manner consistent with law rather than strike the bylaws down.' ''[6] The Court stated that fee-shifting bylaws were not prohibited by the DGCL or any other Delaware statute. According to the Court, a fee-shifting bylaw, which ''allocates risk among parties in intra-corporate litigation,''[7] satisfied the requirement in Section 109 of the DGCL that bylaws relate ''to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.''[8] The Court held that because bylaws are generally viewed as contracts and because parties may agree by contract to modify the so-called American Rule providing that litigation parties generally bear their own fees, a fee-shifting bylaw would represent a valid contractual modification to the American Rule.[9]

Importantly, the Court signaled that whether the specific bylaw at issue would be enforceable under specified circumstances would depend on the manner in which it was adopted and applied. Invoking the familiar *Schnell* doctrine, the Court indicated that a fee-shifting bylaw, even if valid on its face, would not be enforced if it were adopted or used to advance an inequitable purpose.[10] In this case, the certification of the questions to the Court did not provide stipulated facts that would have enabled the Court to determine whether the adoption and application of the bylaw at issue was inequitable. Because certifications only address issues of law, the Court was able to say only that the bylaw was valid on its face—meaning it was not expressly proscribed by statute and could be enforced under appropriate circumstances.

Second, the Court found that the bylaw could shift fees if a plaintiff obtained no relief in the litigation. As the Court noted, this second question involved whether a ''more limited'' version of the bylaw would be valid. The bylaw at issue could be invoked against any plaintiff who did not ''substantially achieve'' the full remedy sought. Due to the difficulty of applying the ''substantially achieve'' standard, the district court asked the Delaware Supreme Court to address whether the bylaw could be invoked in a situation in which the plaintiff achieved no relief at all. The Court found that the more limited version would be enforceable.

Third, the Court was asked whether the bylaw would be rendered unenforceable if one or more directors subjectively intended to deter legal challenges by adopting the bylaw. The Court stated that it was unable to provide a complete response. Although again invoking the *Schnell* doctrine, the Court stated that the intent to deter litigation is not invariably an improper purpose. Because fee-shifting provisions are not per se unenforceable, the governing body's intent to deter litigation would not, of itself, render the bylaw unenforceable.

Finally, the Court addressed whether the bylaw would be enforceable against members who join the corporation before its enactment. In this case, the Court found that, assuming the provision is otherwise valid, the provision would be enforceable against pre-adoption members. While the Court did not specifically address the issue, as a general matter, where the enforceability of a bylaw is limited in time or scope, the DGCL expressly delineates the limitation. For example, Section 202 of the DGCL provides that in the stock corporation context, transfer restrictions in the bylaws will not apply to existing stockholders unless they have voted for the restriction.[11]

Impact for Nonstock Corporations

Thus, although the proposed amendments to the DGCL, if enacted, would effectively end the discussion regarding fee-shifting bylaws in stock corporations, nonstock corporations and their counsel should nonetheless bear in mind the Court's analysis when deciding whether to adopt fee-shifting bylaws or to implement other arrangements through their bylaws. Importantly, while the Court held that a nonstock corporation's fee-shifting bylaw was not facially invalid, it specifically declined to address whether such bylaws are equitable under specified circumstances. The fact that the Court went out of its way to emphasize that it was not addressing equitable issues suggests that it may have some reservations

[6] *ATP*, slip op. at 8 (citing *Frantz v. Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985)).

[7] *ATP*, slip op. at 9.

[8] DEL. CODE tit. 8, § 109(b).

[9] *ATP*, slip op. at 9–10.

[10] *Id.*, slip op. at 10.

[11] DEL. CODE tit. 8, § 202; *see also* DEL. CODE tit. 8, § 145(f) (providing that, except under specified circumstances, a bylaw amendment that impairs or eliminates a right to indemnification or advancement of expenses does not apply to acts or omissions that occurred prior to the amendment's adoption).

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about the potential misuse of these types of provisions.

On that point, it is worth noting that the district court had already held that the provision violated public policy and was unenforceable in relation to the plaintiff's antitrust claims. Additionally, the Supreme Court's holding in *ATP*, and the decision by the drafters of the proposed amendments to the DGCL to limit the permissibility of fee-shifting bylaws to nonstock corporations, should not signal to practitioners that any and all arrangements or provisions may be set forth in a nonstock corporation's bylaws. Rather, bylaws adopted by nonstock corporations still must ''relat[e] to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its members, members of the governing body, officers or employees, and will also be tested under the *Schnell* doctrine.''[12]

[12] DEL. CODE tit. 8, §§ 109(b), 114(a).