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Delaware Approves Bylaws That Shift Fees to Unsuccessful Plaintiffs

With class actions becoming more difficult to sustain, shareholder derivative actions appear to be an increasingly popular alternative to the plaintiff's bar. The risks and costs that companies face in such actions are substantial. However, Delaware has recently authorized another tool that companies incorporated in that state can use to protect themselves against unfounded shareholder litigation.

The Delaware Supreme Court ruled on May 8, 2014, that companies may adopt and enforce bylaws that shift all litigation expenses to a plaintiff in intracorporate litigation who "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought." *ATP Tour, Inc. v. Deutscher Tennis Bund*, No. 534, 2013, 2014 Del. LEXIS 209, at *7-*13 (Del. May 8, 2014). The court determined that such a fee-shifting provision is not barred by Delaware law; rather, the court concluded that it is consistent with the Delaware General Corporation Law governing bylaws. 8 Del. C. § 109(b).

The court explained that fee-shifting bylaws fall within an exception to the "American Rule," under which parties to litigation generally pay their own litigation fees and costs. An exception exists where contracting parties agree to modify the American Rule and obligate the defeated party to pay the prevailing party's fees. Corporate bylaws are contracts among a corporation's shareholders. *ATP Tour, Inc.*, 2014 Del. LEXIS at *9-*10 (citing *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010)). Hence, fee-shifting bylaws are facially enforceable agreements.

The court nonetheless cautioned that enforceability of fee-shifting bylaws depends on the manner of adoption and circumstances of enforcement. Bylaws shifting fees to unsuccessful litigants, by their nature, deter litigation. However, deterring litigation is not invariably an improper purpose. *ATP Tour, Inc.*, 2014 Del. LEXIS at *15. Fee-shifting bylaws are not enforced if adopted or used for inequitable purposes, such as to obstruct the legitimate exercise of shareholder rights. Such a determination will likely hinge on extensive factual review. Similarly, defining whether a shareholder had "substantially achieve[d], in substance and amount, the full remedy sought" will also require factual development.

Delaware has previously approved ways in which corporations can deter litigation, including bylaws that require all intracorporate litigation to be filed in a specific forum. See *In re Revlon, Inc. Shareholders Litig.*, 990 A.2d 940, 960 & n.8 (Del. Ch. 2010) (citing cases). The ability to shift fees to unsuccessful plaintiffs represents another tool available to corporations seeking protection from unfounded litigation.

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