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State Bar Council Proposes New Legislation for Delaware Fee-Shifting Ban and Delaware Court of Chancery Considers Fee-Shifting Bylaw

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In December, we reported on the Delaware Court of Chancery's continued validation of board-adopted forum-selection bylaws in City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 234 (Del. Ch. 2014), and the proposed amendment to the Delaware General Corporation Law (DGCL) that would eliminate the ability of Delaware stock corporations to impose liability for attorneys' fees on shareholders through bylaw and charter provisions—a response to the Delaware Supreme Court's decision in ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 555 (Del. 2014).

With a new legislative proposal from the Delaware Corporation Law Council this month, legislative action may be on the horizon. This new proposal would not only prohibit stock corporations from imposing liability on shareholders through fee-shifting but also from designating a forum other than Delaware as the exclusive forum for resolving intracorporate disputes.

When the legislature passed a resolution delaying debate on the proposed amendment to the DGCL last June, it called upon the Delaware State Bar Association, its Corporation Law Section, and the Council of that Section "to continue its ongoing examination of the State's business entity laws" and "submit to the 148th General Assembly for consideration any legislative proposals deemed meritorious in continuing and promoting the adoption and use of the State's business entity laws by corporations and their investors." S.J. Res. 12, 147th Gen. Assemb., Reg. Sess. (Del. 2014). On March 6, 2015, the Council issued a second proposed amendment and explanatory paper advocating the proposal and addressing some of the issues raised by critics during the debate over the proposal's previous incarnation.

Like the Council's previous proposal, the new proposal would ban stock corporations from imposing liability on shareholders through fee-shifting provisions in bylaws or charters. The proposal also introduces new provisions, notably a statutory endorsement of bylaw or charter provisions that

designate Delaware as the exclusive forum for intracorporate claims and a prohibition of bylaws or charter provisions that designate a forum other than Delaware as the exclusive form for such claims. As with the previous proposal, this proposal would not prevent membership corporations like ATP from enacting fee-shifting bylaws. Fee-Shifting FAQs.

In the explanatory paper accompanying the proposal, the Council grounds its renewed support for a fee-shifting ban on the need to maintain the balance among the interests of directors, officers, and shareholders that has evolved through more than a century of shareholder litigation before Delaware courts. Central to the Council's justification for the proposal is the position that fee-shifting bylaws or charter provisions would virtually eliminate shareholder litigation. Thus, the Council emphasizes that corporations can enact bylaws and charter provisions that deter abusive litigation only to the extent that shareholders can challenge them through litigation. The Council observes that tools such as poison pills, advance-notice bylaws, and fiduciary outs in merger agreements all developed through the DGCL's broad enabling structure and have been "regulated by common law developed through stockholder litigation." Explanation of Council Legislative Proposal.

One such tool is a forum-selection bylaw requiring shareholders to bring all actions in Delaware courts, such as the bylaw validated by the Delaware Court of Chancery in Boilermakers Local 154 Retirement Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013). The new proposal would provide legislative support for these provisions, which the Council hopes will give courts in other jurisdictions "additional reason to honor" exclusive forum-selection provisions. However, believing that "the choice of Delaware incorporation and resulting implicit choice of Delaware corporation law should result in a preference for Delaware courts to resolve disputes," the Council also proposes preventing a Delaware corporation from designating an exclusive forum other than Delaware for intracorporate disputes, even though the Delaware Court of Chancery Court recently validated such a bylaw in City of Providence.

Shortly after the Council's proposal was announced, Lisa A. Rickard, President of the U.S. Chamber Institute for Legal Reform, commented that the "proposal does precious little to solve the broadly-recognized problem of abusive mergers and acquisitions litigation, while taking away the fee-shifting approach some companies have used to combat it." She called the proposal "a huge win for Delaware's lawsuit business at the expense of shareholders in Delaware companies." See Hazel Bradford, "Delaware bar association law council recommends fee-shifting limits," Pensions & Investments Online, March 9, 2015; Jonathan Starkey, "Chamber: Proposal threatens $1B corporate franchise," The News Journal, March 9, 2015.

If the proposal is approved by the Bar Association's Corporation Law Section and Executive Committee, it will be formally submitted to the General Assembly. If enacted, the amendments would become effective on August 1, 2015.

While the Delaware legislature considers banning fee-shifting provisions, the Delaware Court of Chancery earlier this week issued its first decision involving fee-shifting bylaws since ATP. At issue in Strougo v. Hollander, C.A. No. 9770-CB (Del. Ch. Mar. 16, 2015), was whether a Delaware corporation's non-reciprocal fee-shifting bylaw applied to a former stockholder's challenge to the fairness of a 10,000-1 reverse stock split that the corporation undertook at the behest of its Chief Executive Officer and controlling stockholder in order to take the company private.

The question whether the bylaw itself was facially valid under Delaware law was not before the Chancery Court. Rather, the plaintiff moved for partial judgment on the pleadings on the basis that the bylaw did not apply in this case because it was adopted after his stock had been cashed out by

the consummation of the reverse stock split.

The Court concluded that the bylaw did not apply in those circumstances because (1) it “was adopted after Plaintiff’s equity interest in the company was eliminated,” and (2) “Section 109(b) of the DGCL did not authorize a bylaw that regulates the rights or powers of a stockholder whose equity interest in the corporation has been eliminated before the bylaw was adopted.” Chancellor Bouchard distinguished this case from ATPand other decisions relied upon by the defendants because “none of them addressed whether a bylaw adopted after a stockholder’s interest has been eliminated applied in a lawsuit initiated by that former stockholder.”

We will continue to update you on the status of the legislation under consideration that might prohibit fee-shifting bylaws in stock corporations and other notable cases in this arena.

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