CLEARY GOTTLIEB

ALERT MEMORANDUM

June 12, 2014 clearygottlieb.com

MUSCULAR BYLAWS: *ATP'S* LESSONS OF CONTINUING RELEVANCE

The Delaware Supreme Court's May 8 opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund*, is a reminder that corporate bylaws can be muscular vehicles for addressing many aspects of corporate affairs, including innovative mechanics for resolving disputes between stockholders and fiduciaries. The swift response to *ATP* by the Delaware bar, and the anticipated amendments to the Delaware General Corporation Law, are also reminders that Delaware statutory law can change rapidly in response to emerging events in the marketplace. Finally, what will remain of *ATP* after the General Assembly acts (as seems likely) has important implications to the use of bylaws outside of the narrow area *ATP* addressed—fee-shifting—including, particularly, forum selection clauses.

Litigation-related Bylaws, including Forum Selection Clauses. While *ATP* addressed a fee-shift bylaw in a non-stock corporation, its reasoning offers lessons beyond fee-shifting that are applicable to stock corporations.

1. *ATP* accepts that Delaware corporations can use bylaws to deter litigation. While it appears that the Delaware legislature may soon foreclose fee-shifting bylaws for stock corporations, there are other tools that are far less intrusive, but potentially helpful and, possibly, important, that bylaws can be used to implement. And, the Delaware Supreme Court made clear in *ATP* that Delaware companies can use bylaws to accomplish creative objectives, even including deterring litigation altogether, through muscular bylaws.[1] For example, in class actions under the federal securities laws, investors seeking to represent a class must disclose how many shares they own, how much damages they claim to have suffered, and how frequently they have brought (or attempted to bring) representative actions under those laws. Such information may be relevant in internal affairs disputes, particularly since so many are brought in a representative capacity. The information is readily available to the plaintiff, who by definition is a volunteer, and may be useful to the corporation, or its fiduciaries, in assessing the most efficacious means of resolving the underlying dispute. Such bylaws may also make it more likely that larger investors will become the stockholders who succeed in being appointed to pursue potentially meritorious litigation, which is a primary goal underlying the similar rule in place under the federal securities laws.

2. The *ATP* Court fully embraced the principles articulated by then-Chancellor, now Chief Justice, Strine in *Boilermakers Local 154 Ret. Fund v. Chevron Corp*., 73 A.2d 934 (Del.

[1] The broad scope of the Delaware General Corporation Law, however, can be tempered in at least two ways. The organic restraint is provided by the ability of stockholders to amend (or repeal) bylaws—or to replace the directors. Indeed, collective action by stockholders is perhaps more prevalent today than at any time in the recent past, in light of the chemistry among hedge fund activists, proxy advisory firms, and pension fund and other institutional investors. And, at the extreme, corporate action can be mooted through legislative change—at times, very swift legislative change.

Ch. 2013), which held that a bylaw fixing an exclusive forum for hearing "internal affairs" disputes was valid—as against all stockholders, including those who acquired their shares before the bylaw was enacted—where the corporate charter permitted the board to adopt bylaws unilaterally. While one may wonder why the Supreme Court did not place greater emphasis on the *Boilermakers* opinion, given how prominently it featured in the parties' briefs to the Court, *ATP* does not close before making clear that *Boilermakers* correctly expresses Delaware law on this critical point. While the popular expectation (confirmed by practice) is that Delaware companies will select the Delaware Court of Chancery as the exclusive forum for hearing internal affairs disputes, Delaware law would support the selection of a different forum, and it may be, for example, that some corporations would prefer to select courts in the state of their headquarters as the exclusive forum.

3. The forum selection clause embraced by *Boilermakers* is far milder than the fee-shifting bylaw considered by *ATP* in that the former simply channels litigation to a single competent court, while the latter is explicitly designed to *deter* litigation from being filed anywhere. The Supreme Court in *ATP* specifically noted, for example, that the "intent to deter litigation . . . is not invariably an improper purpose," and held that "fee-shifting provisions are not *per se* invalid, [so] an intent to deter litigation would not necessarily render the bylaw unenforceable in equity."

4. It is surely better to adopt bylaw amendments on a "clear day," without the pressures and exigencies of the moment, and the concern that those pressures and exigencies will provide a basis for challenging the validity of those bylaws. But that is not always possible or practical, and being confronted with real world issues is always a powerful motivator. In that context, it is important to note that the ATP bylaw was adopted contemporaneously with ATP's adoption of the reorganization that it thought might generate the litigation that the fee-shifting bylaw was intended to affect; indeed, deter. While the Delaware Supreme Court was not asked to address this fact specifically, its analysis (and the absence of any commentary to the contrary) provides comfort that forum selection clause bylaws adopted contemporaneously with corporate action, such as the entry into a merger agreement, are also not invalid solely for that reason.

5. Forum selection bylaws should, as we have argued, do more than just select the forum for internal corporate affair disputes; they should also provide that stockholders who bring covered suits outside of that selected forum consent to the jurisdiction of the selected forum for purposes of enforcing that clause, and to their counsel in the foreign litigation being deemed their agent for service of process in a forum selection clause enforcement action. *See "Forum Selection Clauses in the 'Foreign' Court,"* The Harvard Law School Forum on Corporate Governance and Financial Regulation (March 29, 2014). *ATP* broadly construes the scope of Delaware Code § 109(b), and thereby reinforces that these collateral, but helpful (and, in some cases, essential), provisions of forum selection clauses are valid under Delaware law.

Fee-shifting for non-stock corporations. Under the so-called American Rule, each side normally pays their own attorneys' fees, regardless of who wins the litigation. For public policy reasons, however, many statutes alter that rule and reward successful litigants by entitling them to recover from the other side the fees incurred in the litigation. Fee-shifting can also be accomplished through bilateral contracts. Consistent with the ability to embrace fee-

shifting by contract, ATP's Board adopted a bylaw that provided for fee-shifting where a member brought suit (or a counterclaim) against the corporation and failed to obtain a judgment on the merits that substantially achieved the full remedy sought. The Delaware Supreme Court addressed a number of facial challenges to the fee-shifting bylaw, rejecting them all. The analysis embraced by the Court has application well beyond the narrow facts presented by *ATP.*

1. While ATP is a non-stock corporation, the Court's analysis would apply to Delaware stock corporations as well. Indeed, the statutory analysis conducted by the Court focused on provisions of the Delaware Code that are equally applicable to stock corporations. Presumably for that reason, the Corporation Law Council of the Delaware State Bar Association proposed legislation that would limit applicability of *ATP* to non-stock corporations, barring stock corporations from imposing monetary liability on stockholders. The proposed amendment is expected to be considered by the General Assembly during its current session, and, if approved, would become effective August 1.

2. *ATP* remains the law for non-stock Delaware corporations. While it held that such corporations have the abstract power to adopt bylaws that provide for fee-shifting, the Court made clear that such bylaws could not apply where it would be inequitable for them to do so. But *ATP* does not answer what circumstances would be needed to render a fee-shifting bylaw inequitable. One can imagine, though, a court being concerned about the fairness of such a provision, such as does it by design, or as applied, operate in an even-handed way? That said, the *ATP* Court did not appear concerned about the one-sided nature of ATP's bylaw: ATP can recover its fees from a member, but even if ATP is the claiming party, and pursues causes of action that wholly fail, the bylaw does not permit the member to recover its fees from ATP.

3. The ATP bylaw also purports to apply not only to members of the corporation, but to third parties who offer "substantial assistance" to members who bring claims against the corporation. The Supreme Court did not address whether such third parties could be bound by the bylaw, and if so, how. While members of a non-stock corporation (just like stockholders in a stock corporation) consent to, and are bound by, subsequent amendments to the bylaws made by the board of directors (or the equivalent) when the charter gives the board the unilateral right to make such amendments, it is not obvious how third parties who "substantially assist" such members have consented to a bylaw driven fee-shift. If they are, how far does it go? To entities that finance the litigation? To counsel who represent the members in the suit?

4. While *ATP* addressed the law applicable to stock corporations, its facts, particularly as regards the constituencies that were affected by the bylaw, were far different than those in a typical stock corporation, especially a public company. ATP operates a professional men's tennis tour, and its members are sports professionals and entities that own and operate professional men's tennis tournaments. Stockholders of public corporations, in contrast, come in all shapes and sizes, and the overwhelming majority have no real connection to the business of the corporation; rather, they are investors of varied size and duration. Imposing obligations, and risks, on members of a sophisticated and likely well-financed small group may well require a very different analysis than imposing the same obligations on a stockholder group consisting of the typical demographics of a stock corporation, including, for example, retail investors.

* * *

Please feel free to call any of your regular contacts at the firm or any of our partners and counsel listed under "Corporate Governance" in the Practices Section of the website if you have any questions.

Cleary Gottlieb Steen & Hamilton LLP

Office Locations

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS
12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW
Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE
Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME
Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN
Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG
Cleary Gottlieb Steen & Hamilton (Hong Kong)
Hysan Place, 37th Floor
500 Hennessy Road
Causeway Bay
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING
Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES
CGSH International Legal Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO
Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299

ABU DHABI
Al Sila Tower, 27th Floor
Sowwah Square, PO Box 29920
Abu Dhabi, United Arab Emirates
T: +971 2 412 1700
F: +971 2 412 1899

SEOUL
Cleary Gottlieb Steen & Hamilton LLP
Foreign Legal Consultant Office
19F, Ferrum Tower
19, Eulji-ro 5-gil, Jung-gu
Seoul 100-210, Korea
T: +82 2 6353 8000
F: +82 2 6353 8099