

Delaware Law Updates

ATP TOUR, INC. V. DEUTSCHER TENNIS BUND (GERMAN TENNIS FEDERATION), NO. 534, 2013

May 8, 2014

In this en banc decision, the Delaware Supreme Court answered certified questions of law from the United States District Court for the District of Delaware concerning the validity of a fee-shifting provision in a Delaware non-stock corporation's bylaws. The Supreme Court held, as a general legal matter, that fee-shifting provisions in a non-stock corporation's bylaws can be valid and enforceable under Delaware law if adopted through the appropriate corporate procedures and for a proper corporate purpose. The Supreme Court also held that bylaws normally apply to all members of a non-stock corporation regardless of whether the bylaw was adopted before or after the member in question became a member. Although the bylaw at issue was adopted by a non-stock corporation, the Court's reasoning and analysis rely on provisions of the Delaware General Corporation Law ("DGCL") and court decisions that apply to stock corporations.

ATP Tour, Inc. ("ATP") is a Delaware non-stock corporation that operates a global professional men's tennis tour. Among ATP's members are entities that own and operate professional men's tennis tournaments, including the two appellees (referred to together as the "Federations"). Upon joining ATP in the early 1990s, the Federations agreed to be bound by ATP's bylaws, as amended from time to time. In 2006, ATP's board amended the bylaws to add Article 23, a fee-shifting provision that shifts litigation fees and expenses to a "Claiming Party" in certain circumstances, including in the event litigation initiated by the Claiming Party does not result in "a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought" by the Claiming Party.

Displeased with changes in 2007 to the ATP tour's schedule and format, the Federations sued ATP and six of its board members in the District Court, alleging both federal antitrust claims and Delaware fiduciary duty claims. The Federations did not prevail on any of their claims, and ATP moved to recover its legal fees, costs and expenses, relying on Article 23 of ATP's bylaws. The District Court denied ATP's fee motion because it found the fee-shifting provision in Article 23 was preempted by federal antitrust laws. On appeal, the United States Court of Appeals for the Third Circuit found that the District Court should have decided whether Article 23 was enforceable as a matter of Delaware law before reaching the federal preemption question and vacated the District Court's order. On remand, the District Court reasoned that Article 23's enforceability was a novel question of Delaware law and certified four questions of law concerning the validity of Article 23 to the Delaware Supreme Court.

The first certified question asked whether the board of a Delaware non-stock corporation may lawfully adopt a bylaw that shifts all litigation expenses to a member plaintiff in intra-corporate litigation if the member "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought." Relying on the principle that a corporation's bylaws are presumed to be valid and citing sections of the DGCL and related decisions about the general validity of bylaws, the Court held that a fee-shifting bylaw is facially valid. The Court found that neither the DGCL nor any other Delaware statute forbids the enactment of a fee-shifting bylaw, and that such a bylaw would satisfy the DGCL's requirements for a valid bylaw. The Court also reasoned that bylaws are contracts "among a corporation's shareholders," such that a fee-shifting provision contained in a non-stock corporation's validly enacted bylaws would be a permissible, contractual exception to the American Rule that litigants generally pay their own attorneys' fees and costs. The Court stopped short, however, of finding that ATP's specific fee-shifting bylaw was enforceable. Citing *Schnell v. Chris-Craft Industries*, 285 A.2d 437 (Del. 1971) and other decisions that addressed legally possible but potentially inequitable conduct, the Court stated that the

enforceability of a facially valid bylaw may turn on the circumstances surrounding its adoption and use. Because it did not have those facts before it, and because certifications address questions of law only, the Court ultimately answered the first certified question by holding that “a bylaw of the type at issue here is facially valid, in the sense that it is permissible under the DGCL, and that it may be enforceable if adopted by the appropriate corporate procedures and for a proper corporate purpose.”

The second certified question asked whether a fee-shifting bylaw may be “lawfully enforced against a member that obtains no relief at all on its claims against the corporation, even if the bylaw might be unenforceable in a different situation where the member obtains some relief.” The Court interpreted this question as asking whether a more limited version of the ATP bylaw would be valid. Subject to the limitations set forth in its answer to the first certified question, the Court held that a fee-shifting bylaw could shift fees if a plaintiff obtained no relief in the litigation.

The third certified question asked whether the bylaw is “rendered unenforceable as a matter of law if one or more Board members subjectively intended the adoption of the bylaw to deter legal challenges by members to other potential corporate action then under consideration.” The Court reiterated the principle that legally permissible bylaws adopted for an improper purpose are unenforceable in equity. The Court noted, however, that “[t]he intent to deter litigation ... is not invariably an improper purpose” and that “[f]ee-shifting provisions, by their nature, deter litigation.” The Court then held that “[b]ecause fee-shifting provisions are not *per se* invalid, an intent to deter litigation would not necessarily render the bylaw unenforceable in equity.”

The fourth certified question asked whether “a fee-shifting bylaw provision is enforceable against members who joined the corporation before the provision’s enactment and who agreed to be bound by rules ‘that may be adopted and/or amended from time to time’ by the board.” The Court noted that the DGCL permits a corporation’s certificate of incorporation to “confer the power to adopt, amend or repeal bylaws upon the directors.” The Court then held that if a corporation’s certificate of incorporation confers that power on the directors, then members “will be bound by bylaws adopted unilaterally by their boards.” The Court thus answered the fourth certified question, assuming the fee-shifting bylaw is otherwise valid and enforceable, in the affirmative.

The Court summarized its conclusions by stating that “[u]nder Delaware law, a fee-shifting bylaw is not invalid *per se*, and the fact that it was adopted after entities became members will not affect its enforceability.”

