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# Recent Delaware Decisions

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There have been several significant rulings recently by Delaware courts.

***"Fee-shifting" By-Laws***

On May 8, 2014, the Delaware Supreme Court ruled that the board of a Delaware non-stock corporation can, for a proper purpose, adopt a so-called fee-shifting by-law that requires a plaintiff-stockholder to pay the corporation's legal expenses if the plaintiff loses on a claim it has brought against the corporation (ATP Tour, Inc., et al. v. Deutscher Tennis Bund, et al., No. 534, 2013, 2014 WL 1847446 (Del. May 8, 2014)). The ruling can be presumed to apply to Delaware stock corporations, as well.

The court held that, if adopted for a proper purpose, fee-shifting by-laws are valid on the basis that:

Neither the Delaware General Corporation Law (DGCL) nor other Delaware law prohibits the enactment of such by-laws.

The fee-shifting by-law's application to purely intra-corporate litigation - usually reserved to derivative actions or proceedings brought on behalf of the corporation, claims for breach of a fiduciary duty owed by any director, officer or other employee of the corporation, claims arising under any provision of the DGCL, and claims governed by the internal affairs doctrine - satisfies the DGCL's requirement that a by-law 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.

A provision for fee-shifting is not required under Delaware law to be included in a corporation's certificate of incorporation and can therefore be made part of the corporation's by-laws.

Parties may by contract modify the usual "American Rule" that parties bear their own legal expenses to require the losing party to pay the prevailing party's legal expenses. Because under Delaware law by-laws are treated as a contract among the corporation and its stockholders, it is permissible to modify the American Rule by adopting a fee-shifting by-law.

The court also held that a valid and enforceable fee-shifting by-law is enforceable against all members of the non-stock corporation, including members who joined before the by-law was enacted, citing last summer's decision in Boilermakers Local 154 Retirement Fund v. Chevron Corporation for the principle that a corporation's stockholders will be bound by by-laws adopted unilaterally by the board of directors if, as is typical, the directors are permitted under the corporation's charter and by-laws to adopt by-laws without stockholder approval.

The decision also implies that the Delaware Supreme Court would uphold a unilaterally adopted forum-selection by-law were that issue brought before it. The Delaware Supreme Court never ruled on this question in the Chevron case, because the plaintiffs dropped their appeal of the Court of Chancery's decision. However, the Delaware Supreme Court's reference to Chevron in its ATP decision suggests that it would uphold a forum-selection by-law adopted unilaterally by boards of directors if given the chance.

The practical implications of the ATP decision remain to be seen, but we would expect corporate boards to consider adopting fee-shifting by-laws to deter class action lawsuits that are routinely brought in an estimated 95% of all public M&A deals. Although boards of directors of both public and private companies may wish to consider the adoption of fee-shifting by-laws, boards of public companies also should bear in mind that proxy-

advisory firms will likely disapprove of such by-laws unless they are presented to and approved by the corporation's stockholders.

Moreover, the State Bar of Delaware will consider a proposed amendment to the DGCL to prohibit fee-shifting by-laws in stock corporations. The legislation is expected to be presented to the Delaware General Assembly before the end of its current session on June 30, 2014 and, if passed, to become effective on August 1, 2014. It is not clear what affect the legislation would have on a fee-shifting by-law adopted before the passage of the amendment.

***Transactions with Controlling Stockholders***

In Kahn v. M&F Worldwide Corp., No. 334, 2013 (Del. Mar. 14, 2014), the Delaware Supreme Court held that a buyout transaction sponsored by a controlling stockholder would be reviewed under the ordinary business judgment rule, rather than the stricter entire fairness standard if, and only if: (i) the controlling stockholder conditions the transaction on the approval of both a properly functioning, independent special committee of the board of directors and a majority of the minority stockholders, (ii) the special committee is authorized to select its own advisors and to reject the controlling stockholder's proposal on the corporation's behalf, (iii) the special committee meets its duty of care in negotiating a fair price, (iv) the vote of the majority of the minority stockholders is informed, and (v) there is no coercion of the minority stockholders.

The Court further held, however, that if, after discovery, triable issues of fact remain about whether the dual procedural protections - approval by both a special committee and a majority of minority stockholders - were established or were effective, the case will proceed to a trial in which the court will conduct an entire fairness review.

***Contractual Limits on Statute of Limitations***

In another recent decision - ENI Holdings, LLC v. KBR Group Holdings, LLC (Del. Nov. 27, 2013) - the Delaware Court of Chancery provided guidance with respect to the use of survival clauses to shorten the applicable statute of limitations for breaches of representations and warranties often contained in acquisition agreements and merger agreements and on the interaction between the survival clause, the procedures for indemnification for breach of contract, and any exceptions to, and limitations on, indemnification obligations.

The disputed stock purchase agreement (SPA) contained a number of provisions that are commonly contained, in one form or other, in acquisition agreements involving a private company target, including a survival clause that stated that the representations and warranties of the seller would survive closing and terminate on a specific date approximately 15 months after the closing under the SPA, except in the case of certain defined fundamental representations. The SPA also contained a provision stating that, subject to certain limitations, the seller agreed to indemnify the purchaser for any damages resulting from breaches of representations or warranties or covenants in the SPA. The parties agreed to a deductible and a cap for indemnification claims, except with respect to certain excluded matters, such as claims arising from fraud or relating to fundamental representations. The SPA contained another common provision stating that except with respect to claims relating to fraud and except as to the right to seek specific performance, the parties' sole and exclusive remedy with respect to any and all claims relating to the SPA was recourse to the SPA's indemnification provisions. Another provision of the SPA prescribed the procedures for bringing and resolving indemnification claims, which required the purchaser to give written notice of a claim for indemnification (but providing that the failure to provide notice of the claim would not relieve the seller of liability as long as the seller was not prejudiced thereby). To the extent that any claim was disputed, the SPA required the parties to negotiate in good faith to resolve the dispute. Finally, the SPA also contained a provision governing the release of amounts from escrow, which provided that, at the end of the survival period for most claims, the escrow agent would release to the seller the escrow balance less any amounts for which the purchaser had timely made a claim for indemnification pursuant the SPA.

The Court analyzed the effect of these common provisions on the parties' disputed claims and, among other findings, upheld the seller's argument that the counterclaims relating to non-fundamental representations and warranties should be dismissed because the survival clause acted as a contractual statute of limitations to cut off such claims. The Court also confirmed its holding in GRT, Inc. v. Marathon GTF Technology, LTD that, under Delaware law, a survival clause is a contractual statute of limitations and cuts off any claims that are not filed (rather than merely noticed) before the end of the survival period.

***Update on Forum-Selection By-laws***

As we write this, courts in at least three states - Illinois, Louisiana and New York - have dismissed stockholder complaints based on last summer's ruling by the Delaware Chancery Court in Boilermakers Local 154 Retirement Fund v. Chevron Corporation upholding forum selection by-laws. We also are aware of cases pending in Oregon state and federal courts in which the courts are being asked to dismiss stockholder claims based on the defendant corporation's Delaware forum selection by-law.

If you would like to know more about these recent decisions, please contact Dale E. Short or any of our Corporate Department members.