# Join $2 Trillion in Institutional AUM Supporting Ban on "Fee-Shifting" Bylaws and Charter Provisions

December 19, 2014

On November 24, 2014, institutional investors managing nearly $2 trillion in assets petitioned the Delaware legislature and major proxy advisors regarding an issue of critical importance to shareholders' rights. A copy of the letter sent to Delaware Governor Jack Markell is available by clicking on this link. As discussed further below, the Delaware Supreme Court recently held in *ATP Tour v. Deutscher Tennis Bund* ("ATP Tour") that fee-shifting corporate bylaws adopted unilaterally by directors (i.e., without stockholder approval) are valid and enforceable under Delaware law. Such bylaws seek to eliminate the feasibility of investor suits for misconduct, no matter how egregious, by shifting a corporation's entire legal bill onto any shareholder that brings a legal action against the corporation, its officers or directors.

Following the Delaware Court's decision in *ATP Tour*, numerous corporate boards adopted sweeping bylaws or amended their corporate charters to include provisions that impose all legal fees, costs, and expenses on suing shareholders who do not obtain "substantially all" of the relief sought in the complaint. These bylaws and charter provisions make it prohibitively risky for shareholders to bring suit, thereby effectively immunizing corporate executives and boards from civil liability.

We are requesting additional support from the institutional investor community to petition the Delaware legislature and the major proxy advisors to oppose fee-shifting provisions through an amendment to Delaware's General Corporation Law. Click on this link to review the letters we ask you to support in this crucial and historic effort.

**How *ATP Tour* impacts the institutional investor community**

On May 8, 2014, the Delaware Supreme Court issued its decision in *ATP Tour*. The Court's highly controversial decision has sparked intense public debate, and was recently the subject of an article by Gretchen Morgenson of *The New York Times* (to view the article, click here). The fee-shifting bylaw at issue in *ATP Tour*, and approved by the Delaware Supreme Court, has been described by legal experts as a "nuclear weapon against shareholders." The bylaw requires suing shareholders to personally cover the corporation's entire legal bill in virtually all cases, including cases involving blatant violations of federal securities laws and breaches of fiduciary duties by corporate executives.

Under the *ATP Tour* bylaw, which the board adopted unilaterally, a suing shareholder must fund the company's legal fees and expenses, absent a "judgment on the merits that substantially achieves, in substance and amount, the full remedy sought." In other words, the suing shareholder must foot the corporation's entire legal bill unless it wins at trial on all claims and for all of the damages sought. Given the realities of litigation--in which plaintiffs rarely recover all of their claimed damages or equitable relief sought--the bylaw approved by the Delaware Supreme Court effectively requires suing shareholders to pay the corporation's legal bill in every shareholder dispute.

The Delaware Supreme Court's decision in *ATP Tour* poses a grave threat to institutional investors. Within weeks of the Delaware Supreme Court's decision, dozens of boards of publicly held companies, including Smart & Final and Alibaba Group, enacted sweeping fee-shifting provisions. Legal experts anticipate that more corporations will do

the same. As Columbia Law School Professor John C. Coffee Jr. warned, if swift action is not taken to prohibit such bylaws, they "will predictably become widely prevalent." Professor Coffee also expressed concern that the *ATP Tour*opinion could trigger a "race to the bottom" among states soliciting re-incorporation in their jurisdiction to increase corporate franchise taxes.

The potential impact of fee-shifting provisions on investors' rights and the integrity of our capital markets cannot be overstated. Defrauded investors confronted with a fee-shifting bylaw or charter provision will rationally decide not to bring shareholder lawsuits against corporate wrongdoers, even when the misconduct is egregious and the legal claims are strong. Among other things, the longer a case continues and the more expensive the lawyers retained by the defendants, the greater the personal exposure becomes, effectively increasing the pressure to drop or settle the case without regard to merit. Indeed, *ATP Tour*-type bylaws likely would have disincentivized many suing shareholders from bringing landmark cases that returned billions of dollars to shareholders and exposed massive corporate frauds at companies such as Enron, Tyco, and WorldCom. Put simply, unless swift action is taken to stop fee-shifting provisions from spreading, meritorious shareholder litigation may soon become a thing of the past.

**Efforts to stop corporations from enacting fee-shifting provisions**

Securities regulators have been slow to recognize the gravity of the threat to stockholders, and to the capital markets in general, posed by the increasing popularity of fee-shifting bylaws and charter provisions in corporate America. After months of silence, the Securities and Exchange Commission recently held an Investor Advisory Committee hearing specifically devoted to issues concerning fee-shifting provisions. At the hearing, legal experts such as Professor Coffee urged the regulator to take strong action "or concede the decline of private enforcement" of America's securities laws.

The Delaware Corporation Law Council, a non-partisan group of representatives from both the defense and plaintiff bars, has voiced its serious concerns about the *ATP Tour* decision and its potential impacts on our capital markets. Shortly after the Court's decision in *ATP Tour*, the Council drafted a proposed amendment to the Delaware General Corporation Law to prohibit stock corporations from imposing fee-shifting. The Delaware legislature was set to vote on the new amendment on June 10, 2014, but the U.S. Chamber of Commerce successfully lobbied to delay any consideration of the matter until well into 2015. Meanwhile, more companies adopt these nefarious bylaws and charter provisions every week.

**We request your support**

We believe that it is critical that the institutional investor community take the strongest possible stance against fee-shifting provisions. To this end, working with the heads of corporate governance at several major institutions, other shareholder advocates and law firms representing institutional investors, we respectfully ask that you join this growing coalition of investors who signed or support the November 24, 2014 letters to the Delaware legislature and the major proxy advisors. The letter we ask you to support makes clear that investors oppose fee-shifting provisions and support the Delaware Corporation Law Council's proposed ban on fee-shifting bylaws and corporate charter provisions. The Delaware legislature, in particular, needs to know that investors are outraged about the trampling of their core stockholder rights.

If your fund or financial institution is willing to join this important cause, please let BLB&G partner Mark Lebovitch (markl@blbglaw.com) know by email as soon as possible, but no later than **January 9, 2015**. There are no costs or

expenses associated with supporting the letters. If you have any questions, please contact Mr. Lebovitch at 212-554-1519.