

The Trend for Fee-Shifting Bylaws

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The numbers keep changing, but the latest [report](#) indicates that six public (or soon-to-be-public) companies have adopted fee-shifting provisions in charters and bylaws since the Delaware court ruling in May that such provisions may be valid, in a case involving a non-stock company.

All are small, and none are in the Russell 3000 index at the moment. Two of the companies have only recently filed IPO registration statements, with the information contained in risk factors or general information disclosure and those incorporation documents are not available yet. One company just went public in June as a limited partnership.

Only Biolase Inc. appears to be rated by ISS QuickScore. Biolase is one of two companies that has adopted these bylaws after facing litigation over board composition this year. Echo Therapeutics settled its suit with a dissident in February, but litigation continues for Biolase. In mid-June, Biolase lost a notable case regarding whether an oral resignation by a director was sufficient notice. The Delaware Supreme Court confirmed in that case that a writing is not mandatory, since the statute indicates that a director “may resign” upon notice given in writing or by electronic transmission, which was also the language used in the company’s bylaws. In the context of numerous discussions, questions and debates about the resignation, the operative words uttered by the director as evidencing his intent to leave, as cited in the court opinion, were “Okay, I agree, I go along with that.” That led to at least one open vacancy filled by a candidate supported by a dissident shareholder and ultimately the CEO’s termination.

The company’s former CEO and chairman initiated a books and records case near the end of June. Around the same time, the company modified its bylaws so that anyone claiming on behalf of a current or former director (a Claiming Director) who does not obtain a judgment on the merits that achieves the purposes of the suit shall be obligated to reimburse the company for “all fees, costs and expenses of every kind and description (including all reasonable attorneys’ fees and other litigation expenses)” incurred by the company.

This chain of events may mean that the appropriateness of the fee-shifting bylaw also gets reviewed soon by the courts in the next round of Biolase litigation. According to a [report by Reuters](#), lawyers for the company’s former CEO and chairman stated that he intends to challenge the validity of the fee-shifting bylaw. It will be interesting to see whether the bylaw adopted by Biolase is upheld for public companies, as it is also slightly different and possibly more limiting than other examples, including as adopted by LGL Group, which defines a “Claiming Party” as any current or prior stockholder.

The Delaware State Bar Association had prepared possible legislation to prohibit such bylaws in May, but in response to concerns from the Chamber of Commerce and other business groups, a resolution asking for continued examination of the measures that would address fee-shifting was approved by the Delaware legislature instead. It is expected that the earliest vote on any legislation will not occur until January 2015.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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