

The Latest on Fee-Shifting Bylaws

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24 companies have adopted fee-shifting bylaws since May, according to Professor John Coffee in [his testimony](#) before the SEC Investor Advisory Committee. Fee-shifting bylaws impose a “loser pays” rule that transfers a company’s costs and expenses in shareholder litigation to the plaintiff shareholder if the plaintiff is unsuccessful.

The concept gained momentum after the Delaware Supreme Court upheld such a bylaw adopted by a Delaware non-stock corporation as “facially valid.” As Professor Coffee notes, even in that case (*ATP Tour, Inc. v. Deutscher Tennis Bund*), the court indicated that a legally permissible bylaw that is adopted for an improper purpose will not be enforceable. An intent to deter litigation, however, would not necessarily be improper since fee-shifting provisions, by their nature, serve that purpose.

Professor Coffee criticizes fee-shifting bylaws for being generally one-sided, reimbursing successful defendants but not successful plaintiffs, unlike the English Rule. In addition, the provisions have been drafted to require fee-shifting even if the cases were largely, but not entirely, successful for the plaintiffs (such as winning on the merits but ultimately losing on technicalities). He encourages the SEC to address at least the broader types of bylaws through using a number of practices consistent with the regulator’s past actions, such as refusing to accelerate registration statements that contained mandatory arbitration clauses or objecting to indemnification provisions on public policy grounds.

It appears that the SEC has not weighed in on fee-shifting bylaws so far. As described in this [Reuters blog](#), at least two IPOs with fee-shifting provisions have been completed. There has been [criticisms](#) not only about the substance of those provisions, but also the disclosure surrounding their existence.

The Delaware courts may have another opportunity to examine these types of bylaws. In *Robert Strougo v. First Aviation Services, Inc., et al.*, the plaintiff challenges, among other issues, a fee-shifting bylaw that was adopted following the announcement of a going-private transaction. The bylaw was not required to be publicly announced and the plaintiff only uncovered it during the course of formal discovery. The plaintiff argues that the bylaw is overly broad in requiring the plaintiff to pay fees, costs and expenses incurred by all of the defendants if the plaintiff fails to “obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought.” The plaintiff claims this is broader than, and conflicts with, Delaware indemnification law. In addition, the plaintiff alleges that the bylaws represent unfair dealing, since the directors stand on both sides of the transaction, in giving themselves a right to reimbursement that is non-reciprocal.

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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