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# Delaware's Fee-Shifting Debate Set To Reignite Despite Ban

By **Matt Chiappardi**

*Law360, Wilmington (May 13, 2016, 4:45 PM ET)* -- Even though Delaware has banned corporate bylaws that force a litigation loser to pay both sides' costs, experts say the fervent debate over fee-shifting is about to be rekindled as some companies that have sought creative ways around the statute are already facing shareholder lawsuits in the Chancery Court over the workarounds.

Delaware enacted a law that banned fee-shifting bylaws in August 2015, about a year after the issue was thrust into the spotlight by the state's Supreme Court decision in ATP Tour v. Deutscher Tennis Bund finding that fee-shifting can be "valid and enforceable" for nonstock corporations.

The threat of stock corporations picking up the baton sparked an unusually passionate debate over the issue for Delaware, but experts say the law banning the practice, which was signed by Gov. Jack Markell in June 2015, hasn't entirely closed the book on fee-shifting — and some companies are already trying to push the law's boundaries.

"The statute left the door open for companies to experiment with bylaws and experiment with legal fees," said University of Pennsylvania corporate law professor Jill E. Fisch. "I think you see a really dynamic process going on with bylaws generally and litigation bylaws in particular. There's a move to see just what boards can do."

Within the past few weeks, at least two companies have been hit with Chancery lawsuits accusing them of trying to aggressively reach beyond the parameters of Delaware's law.

In one of the cases, lodged against a California-based company called StemCells Inc. in April, the suing shareholder targeted what's being called a "no-pay" bylaw that is argued would prevent stockholders from recovering legal costs even if they win.

Five days after the lawsuit was filed, StemCells announced in a filing with the U.S. Securities and Exchange Commission that it was repealing the bylaw. It is not clear whether the move was in response to the suit. Representatives for the company did not respond to a request for comment.

But the Chancery action pulled the curtain back on strategies corporations could use to get around the ban.

Morris James LLP partner and longtime Delaware corporate attorney Edward M. McNally says he's seen the no-pay bylaw "floating around" in board circles since the state's fee-shifting ban, but questions

whether it will pass muster when one is finally tested before the courts.

"There's some serious doubt there's validity in that bylaw," McNally said. "It's an attempt to violate what I think is public policy in Delaware."

Daniel B. Nunn Jr., a partner at Nelson Mullins Riley & Scarborough LLP, said that another tack a corporation might take is removing fee-shifting bylaws for internal actions such as breach of fiduciary duty claims, but keeping them for external matters such as securities fraud claims.

Delaware's law is narrowly constructed, and with enough wiggle room to perhaps not bury the fee-shifting practice altogether, he said.

"What you may see as the dust settles from the law is more corporations adopting fee-shifting bylaw provisions that do not apply to internal corporate claims as the statute defines it, but could apply in another context," Nunn said. "And I'd expect challenges to those bylaw provisions and the SEC might even weigh in."

Another Chancery lawsuit filed May 5 challenges a bylaw from Illinois-based payroll firm Paylocity Holding Corp. that purports to allow fee-shifting in litigation that takes place in jurisdictions other than the chosen one in the company's forum-selection bylaw. It's another issue that could be set to test just how broad or narrow Delaware's fee-shifting ban can be when applied, Nunn said.

Experts say these lawsuits are probably just the beginning of what might turn into the next front where the fee-shifting debate plays out, and the wider question over what's come to be termed as "The American Way" for dealing with legal costs — that is, the parties are expected to separately pay their own way throughout the course of a case.

"You can expect that people are going to be creative in trying to get what they want in their corporate governance documents, irrespective of the government's attempt to tell them how to run their corporations," said David Graff, co-chair of Anderson Kill PC's corporate and commercial litigation practice group.

Graff says he believes when the fee-shifting issues again reach the Chancery bench, it will "construe [the law] as narrowly as possible" and goes as far as arguing that such bylaws enacted before the law went into effect might still be defensible as valid in a challenge.

"Retroactively, you've basically unwound a good-faith negotiation," Graff said. "Governments are very rarely, especially in Delaware, inclined to interfere and inject themselves into internal corporate issues."

But many other practitioners were adamant that the law left no room to grandfather in prior fee-shifting bylaws, which would be found to be invalid for violating public policy, and that the battle would be fought with new corporate rules.

"Any Delaware corporation that has not already repealed a fee-shifting bylaw can expect to be sued — and potentially to pay the plaintiff's legal fees — if it tries to enforce it," said Kleinberg Kaplan Wolff & Cohen PC partner David Parker. "The fact that the bylaw may have been adopted before the effective date of the statute does not alter the fact that fee-shifting bylaws violate Delaware law."

Justin Smith, an attorney at legal research and investment service firm Xtract Research LLC, said it's not

only fee-shifting that may rear its head again, but all manner of tools to reduce what corporations believe are mostly frivolous lawsuits challenging their decisions.

"Because that's obviously the goal at the end of the day," Smith said. "Make it more difficult for these lawsuits to be brought."

Smith pointed to a bylaw for Florida-based specialty finance company Imperial Holdings Inc., now known as Emergent Capital Inc., that required written consent from at least 3 percent of the holders of its common stock to allow a derivative lawsuit to go forward.

"I would expect some movement in the direction of Imperial Holdings," Smith said. "For a certain segment of the market, they will take any precedent they can latch onto."

But McNally wondered whether there might be a market force running counter to corporations' desire to cut down on challenging litigation, frivolous or not, and that is what may ultimately decide where issues like fee-shifting and other protective measures land.

"Do you want to invest in companies that are attempting to restrict people from enforcing their rights when there's been a breach of fiduciary duties?" he said. "The argument, to me, is like saying you don't want anybody to go to court because sometimes people bring bad cases. Society has to allow a certain level of inefficiency."

--Editing by Rebecca Flanagan and Katherine Rautenberg.

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