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**IN THE SUPREME COURT OF THE STATE OF DELAWARE**

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| ATP TOUR, INC., ETIENNE DE VILLIERS, CHARLES PASARELL, GRAHAM PEARCE, JACCO ELTINGH, PERRY ROGERS, and IGGY JOVANOVIC, | § | No. 534, 2013 |
| Appellants | § | |
| v. | § | Certification of Questions of Law from the United States District Court for the District of Delaware, C.A. No. 07-178 (GMS) |
| DEUTSCHER TENNIS BUND (GERMAN TENNIS FEDERATION), ROTHENBAUM SPORT GMBH, and QATAR TENNIS FEDERATION, | § | |
| Appellees. | § | |

# OPENING BRIEF OF APPELLANTS

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## NATURE OF PROCEEDINGS

The ATP Tour, Inc. ("ATP") is a not-for-profit Delaware nonstock membership corporation that operates a worldwide men's professional tennis tour (the "Tour"). A127. ATP's members are men's professional tennis players and men's professional tennis tournaments. *Id.* Two members, the Deutscher Tennis Bund ("DTB") and the Qatar Tennis Federation ("QTF"; and together with DTB, the "Federations"), jointly own and operate an ATP tournament in Hamburg, Germany. *Id.* The Federations commenced this action in the United States District Court for the District of Delaware against ATP and several of its Board members on March 28, 2007, challenging the Board's decision to restructure the Tour. In the restructuring, the Hamburg tournament was moved from the highest tier of tournaments to the second-highest tier within the Tour and from the spring to the summer season. *Id.*

Seeking to reverse those changes, the Federations asserted that ATP and its Board violated sections 1 and 2 of the Sherman Act (Counts I-IV of the complaint), breached their fiduciary duties (Counts V-VII), tortiously interfered with the Federations' contractual and business interests (Count VIII), and converted membership rights (Count IX). A127-28.

After a ten-day trial, the federal district court granted ATP's motions for judgment as a matter of law against the Federations' state law claims. A128. A

jury then found for ATP on the Sherman Act claims. *Id.* Thus, ATP defeated each of the Federations' claims at trial on the merits and the Federations obtained no relief whatever against ATP. Thereafter, the Court entered judgment for ATP on October 3, 2008, the Third Circuit affirmed the judgment in its entirety (610 F.3d 820 (3d Cir. 2010)), and the Supreme Court denied a petition for a writ of certiorari (131 S. Ct. 658 (2010)). *Id.*

On October 17, 2008, pursuant to Fed. R. Civ. P. 54 (d)(2), ATP timely moved to recover its legal fees, costs and expenses as authorized by Article 23.3(a) of ATP's bylaws. A128. On February 20, 2009, the district court denied ATP's motion on the ground that a contract-based award of attorneys' fees to a prevailing antitrust defendant would be contrary to the underlying policy of the federal antitrust laws. A44-45. The court further declined to award ATP any of the fees, costs, and expenses that it incurred in simultaneously defending against the Federations' state law claims, reasoning that the federal and state claims were "inextricably intertwined." A46 at n.5. Although not central to its holding, the court also questioned whether ATP's members could be bound by Article 23.3, which was adopted after they became members. A43. The court further questioned the timing of Article 23's adoption and whether it was intended to deter legal challenges to the restructuring. A45 at n.4.

ATP appealed to the Third Circuit. On May 11, 2012, the Third Circuit vacated the district court's order and remanded for further proceedings. The Third Circuit held that the constitutional issue of federal preemption was not ripe for decision because there had been no threshold determination of whether Article 23.3 was valid and enforceable under Delaware law. 480 F. App'x 124, 126-27. (A53-55). The Third Circuit noted a number of open questions and remanded for a determination of "whether Article 23.3 of ATP's by-laws creates an enforceable obligation under state law…." *Id*. at 127-28 (A54-55).

After remand to the district court, on motion by ATP, the district court certified four questions to this Court, reproduced in the four sections of the Argument below.

By Order dated October 8, 2013, the Delaware Supreme Court accepted those four questions and set a briefing schedule.

## SUMMARY OF ARGUMENT

I. Fee-shifting bylaws adopted by nonstock corporations are generally authorized by 8 *Del. C.* §109, because they are not inconsistent with law, and they relate to the business of the corporation, the conduct of its affairs, and the rights or powers of members to re-fight battles lost in Board meetings through meritless intramural litigation. The purposes of deterring such impositions and shifting costs to those who impose them are rational and amply support such bylaws. Thus, the answer to the first certified question should be "yes."

II. Such bylaws can be applied to the core cases justifying their adoption even if they might, someday, be misapplied. Delaware courts considering bylaw validity generally look at the context in which the bylaw is applied (here, plaintiffs lost on every claim), and ignore hypotheticals, considering the "concrete situation" in which the question arose. *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 949 (Del. Ch. 2013); *Ackerman v. Stemerman*, 201 A.2d 173, 176 (Del. 1964). *See also Stroud v. Grace*, 606 A.2d 75, 95 (Del. 1992); *Stroud v. Milliken Enters., Inc.*, 552 A.2d 476, 479-81 (Del. 1989). Thus, the answer to the second certified question should be "yes."

III. Where the intention to deter meritless legal challenges and shift fees serves an equitable purpose and the directors who approved the bylaw amendments received no personal benefit from their adoption, the amendments should enjoy the

deferential review of the business judgment rule. Thus, the answer to the third certified question should be "no."

IV. Bylaws are generally enforceable against all members, including those who were members before adoption of the bylaw, especially where, as here, the bylaws expressly authorize the Board to amend or modify the Bylaws "at any time or from time to time." Thus, the answer to the fourth certified question should be "yes."

## STATEMENT OF FACTS

### A. The Parties

ATP Tour, Inc. ("ATP") is a not-for-profit Delaware nonstock corporation, whose members are men's professional tennis players and tournaments. A130. The ATP World Tour (the "Tour") is comprised of more than 60 member tournaments in 30 countries, plus a season-ending championship event. *Id*.

ATP is governed by a seven-member board of directors (the "Board"). *Id*. Three of the directors are elected by the tournament members, like the two Federations identified above. *Id.* Three directors are elected by player members. *Id*. The seventh Board member is ATP's Chairman/President. *Id.*

The Federations together operate an ATP tournament in Hamburg, Germany. A130. QTF also separately operates an additional ATP tournament in Doha, Qatar. *Id.* DTB and QTF joined ATP in 1990 and 1993, respectively. *Id*. The Federations remain members of ATP today. *Id.*

### B. Article 23.3 of ATP's Bylaws

As a condition of their membership in ATP, each of the Federations (and all other ATP members) entered into written agreements pursuant to which they agreed to be bound by ATP's Bylaws, as amended from time to time. A130. ATP's Certificate of Incorporation (at Article Eighth) and its Bylaws (at Article 22) expressly authorize the Board to amend, modify, or repeal the Bylaws

at any time or from time to time. A167. One such amendment was the addition of Article 23 to the Bylaws in 2006.

Article 23 was proposed in August 2006 and formally enacted by the requisite vote of the Board that October. A41. Entitled "LEGAL ACTION," it addresses a number of issues concerning litigation involving ATP, including jurisdiction and venue (Art. 23.1), applicable law (specifying Delaware law as governing law) (Art. 23.2), and "Litigation Costs" (Art. 23.3). *Id.* Among other things, Article 23 provides for reimbursement of reasonable legal fees, costs, and expenses with respect to unsuccessful claims initiated among ATP's members or between ATP and its members or Tournament Owners. Claimants are exposed under Art. 23.3 to paying the respondents' fees if they assert claims that are not substantially successful:

> In the event that (i) any [current or prior member or Owner or anyone on their behalf ("Claiming Party")] initiates or asserts any [claim or counterclaim ("Claim")] or joins, offers substantial assistance to or has a direct financial interest in any Claim against the League or any member or Owners (including any Claim purportedly filed on behalf of the League or any member), and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) <u>does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought</u>, then each Claiming Party shall be obligated jointly and severally to reimburse the League and any such member or Owners for <u>all fees, costs and expenses of every kind and description</u> (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) (collectively, "Litigation Costs") that the parties may incur in connection with such Claim.

A130-31 (emphasis added). Article 23.3(b) reciprocally requires ATP to reimburse fees and expenses if it unsuccessfully sues a member. A131 at n.2.

Thus, the bylaw bilaterally requires unsuccessful plaintiffs in intra-mural litigation between ATP and its members to shoulder the burden of the defendants' attorneys' fees, regardless of whether the claimant is the ATP or a member and regardless of the nature of the legal theories asserted. The provision is self-evidently aimed at deterring unmeritorious litigation among the ATP's members (and the ATP itself) and channeling disputes to resolution or less costly fora. It also tries to ensure that ATP and its members are not burdened with the costs of unsuccessful internal litigation over ATP decisions. Limiting and recovering such expenses is particularly important to a not-for-profit membership organization like ATP that uses its revenues and resources to enhance and improve the Tour for its members. Article 23.3 encourages members to use ATP's governance mechanisms – for example, the Player and Tournament Councils, as well as Board elections and member meetings – to debate and resolve internal disagreement over Tour operation or business issues.

C. The Federations' Claims and ATP's Successful Defense

In 2007, the ATP Board took a number of votes to modify the Tour format under a comprehensive strategy known as the "Brave New World" plan (the "Plan"). A131. Those votes were the culmination of nearly two years of study and

planning and thousands of hours of research, analysis and discussion. A73. As noted by the Third Circuit:

> The [P]lan was developed to make the ATP Tour more competitive with other spectator sports and entertainment products by improving the quality and consistency of its top-tier events. The modifications to the tour calendar, increase of investment, higher payments to players, and expanded geographic reach were all designed to improve the Tour.

*Deutscher Tennis Bund v. ATP Tour, Inc.*, 610 F.3d 820, 833 (3d Cir. 2010); *see also* A131.

To implement the Plan, ATP sought applications from members seeking positions in the restructured Tour's highest tier of events. A74. After reviewing applications from Hamburg and others, the Board did not place Hamburg in the Tour's highest tier, but voted instead to categorize Hamburg in the second-highest tier within the Tour. A131. In doing so, the Board also voted to move the Hamburg event from the spring to the summer portion of the Tour calendar. *Id.*

ATP also reviewed applications from the QTF and others for a spot in ATP's second-highest tier in the Tour's Asia swing. ATP ultimately did not select the QTF for such a spot and, instead, selected the Dubai tournament for the spot. All these changes were implemented in accordance with the Bylaws. A74.

To reverse ATP's decisions, the Federations sued ATP and six of the seven individual ATP Directors. The Federations alleged a host of legal theories, including federal antitrust claims under sections 1 and 2 of the Sherman Act and Dela-

ware state law claims for conversion, tortious interference with contract, and breach of fiduciary duty. A131-32. The Federations sought $80 million in compensatory damages, plus trebled damages under the federal antitrust laws, punitive damages under Delaware state law, injunctive relief to prevent the implementation of the Plan, and attorneys' fees and costs. A132.

ATP defeated each of the Federations' claims at trial on the merits (including dismissal of multiple theories before submission to the jury). The Federations obtained no relief against anyone on any claim or theory. *Id.* The Court entered judgment, the Third Circuit affirmed, and the Supreme Court denied further review. A128.

The Federations were given timely notice of the enactment of Article 23, including in November 2006, six months before they filed their complaint against the ATP. A119; A123-26. The Federations did not object or challenge Art. 23.3's facial validity, and indeed had quoted in their Complaint from the venue provisions of Article 23 (which were enacted together with the fee-shifting provisions as part of the new Article well before commencement of this action). A119.

## ARGUMENT

### I. THE FIRST CERTIFIED QUESTION SHOULD BE ANSWERED "YES"

#### A. The First Certified Question

May the Board of a Delaware nonstock corporation lawfully adopt a bylaw (i) that applies in the event that a member brings a claim against another member, a member sues the corporation, or the corporation sues a member (ii) pursuant to which the claimant is obligated to pay for "all fees, costs, and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses)" of the party against which the claim is made in the event that the claimant "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought"?

#### B. Standard and Scope of Review

Certified questions of law are decided de novo. *Lambrecht v. O'Neal*, 3 A. 3d 277, 281 (Del. 2010). Review is based on the facts in the Order of Certification. Del. Sup. Ct. R. 41(c)(iv); *Waters v. United States*, 787 A.2d 71, 72 (Del. 2001); *E.I. Du Pont de Nemours & Co. v. Fla. Evergreen Foliage*, 744 A.2d 457, 458 (Del. 1999). Factual assertions not set forth in the order of certification and disputed are disregarded. *Shaw v. Agri-Mark, Inc*., 663 A.2d 464, 465 n. 2 (Del. 1995); *Farahpour v. DCX, Inc*., 635 A.2d 894, 896 (Del. 1994).

C. Merits of the Argument

The Court should answer the first certified question "yes." Delaware corporate law expressly empowers nonstock (membership) corporations to adopt bylaws "not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of" its "members."[1] 8 *Del. C.* § 109(b). That provision has been characterized as "broad authorizing language." *Boilermakers*, 73 A.3d at 953. Bylaws "are presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws." *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985).

Bylaws that aim to deter enterprise-related litigation by the corporation against its members, by members against the corporation, and inter se, between the members of such corporations – by providing that claimants who do not substantially prevail shall reimburse the fees of those against whom they unsuccessfully waged litigation – are squarely authorized by § 109(b), because they are not inconsistent with any law, and they clearly relate "to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its" members.

[1] Under 8 *Del. C.* § 114, except as otherwise provided (no part of which is applicable here), all the provisions of §109(b) "shall apply to nonstock corporations in the manner specified in" § 114 (a)(1)-(4), and all references there to "stockholders" shall be deemed to refer to "members of the corporation."

In a recent decision addressing the propriety under Delaware law of bylaws decreeing where litigation concerning the internal affairs of Chevron and FedEx could (and could not) be conducted, the Court of Chancery addressed the way to analyze the validity of such bylaws, and concluded that the forum-selection bylaws adopted by both corporations were facially valid under 8 *Del. C.* § 109(b). *Boiler-makers*, 73 A.3d at 939. That decision is strong support for the validity of the fee-shifting bylaw challenged here, and the framework it employed in structuring its analysis is useful here in considering fee-shifting bylaws instituted by Boards of nonstock corporations such as ATP.

1. Delaware law provides that bylaws may address any subject "not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its [members]." 8 *Del. C.* §109(b). That provision is part of the broader Delaware General Corporation Law ("DGCL"), which "is intentionally designed to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation," subject to fiduciary duty principles. *Hollinger Int'l v. Black*, 844 A.2d 1022, 1078 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005).

As a matter of plain language, bylaws that require member-claimants who institute litigation against the nonstock corporations in which they participate to

bear the burden of a prevailing defendants' legal fees address the "rights" of members to institute burdensome litigation (and impose defense costs on the defendants) in order to get their way through litigation when they have not prevailed by normal (Board) means. Basic economics teaches that absent fee-shifting bylaws there will be more such unmeritorious litigation, whereas there will be less of it if claimants must shoulder the risk of paying the winner's fees if the litigation does not succeed. Similarly, absent such fee-shifting bylaws, the members and key participants of nonstock corporations are considerably more exposed to unexpected legal costs from quarrelsome insiders, whereas the adoption of such fee-shifting bylaws reduces the risk of such unexpected costs and burdens.

Fee-shifting bylaws also plainly relate to the business of the corporation and the conduct of its affairs. If policies and plans adopted by valid vote of the Board or its members are subject to groundless litigation without shifting the defendants' fees onto the shoulders of losing claimants, the scarce financial and managerial resources of the nonstock corporation are likely to be diverted for long periods of time away from the intended operations and into expensive adversarial litigation. Such litigation, and the enmities it provokes, make it harder for the members of a nonstock corporation like ATP to pull together and act for their common good. By deterring key players (ATP itself and its members) from undertaking unwanted, unmeritorious litigation, and imposing the costs of defending such litigation on

those who instigated and pressed it, bylaws such as Art. 23.3 aim to influence members' conduct in the operation of the nonstock entity, and free up members to assess enterprise decisions on the merits. Absent such bylaws, members are more likely to consider initiatives with an eye to whether the economic and managerial costs of a legal challenge might warrant adoption of policies that are second-best (but less likely to spawn litigation).

Bylaws that discourage intra-mural litigation and channel disagreement into less costly fora make obvious good sense for non-profit, nonstock corporations, given the distinctive nature of such entities, which include charitable and religious organizations, homeowners and community associations, political organization, trade associations, fraternal organizations, and sports leagues or associations. To be sure, in any given nonstock corporation, the members (or Board) may choose to adopt – or to not adopt – such fee-shifting rules. But it is hard to identify any interest that Delaware would have in categorically forbidding nonstock corporations from making that choice, and no Delaware statute reflects any such policy.

Fee-shifting bylaws are particularly useful for sports organizations such as ATP, which as the Third Circuit has recognized (shortly after upholding the verdict in this matter) are subject to the constant threat of litigation because of their structure and the need for decisionmaking among members regarding rules, format, player eligibility, and other aspects of their business. *Race Tires Am. v. Hoosier*

*Racing Tire Corp.*, 614 F.3d 57, 80 (3d Cir. 2010). Recognizing in particular that antitrust claims are often very costly and burdensome to defend, the Third Circuit there observed that if an organization is deterred from taking procompetitive actions by the threat of crippling litigation costs from disgruntled members, there may be a net anticompetitive impact on consumers who are deprived of innovation, expansion, or improved quality of the sports offering. *Id*. In short, members of sports organizations such as ATP have a strong interest in adopting bylaws to protect the organization from the risk of incurring huge fees and costs (and effective extortion) to prove that their actions are lawful.

The underlying dispute here is instructive. ATP's business entailed, among other matters, figuring out how to restructure the Tour to improve it and make it more competitive with other sports and entertainment products, and required hard decisions about where, when, and how its tournaments would occur. The Federations' litigation was aimed squarely at disrupting and reversing the key decisions that ATP had carefully and thoughtfully made through the procedures established in the Articles of Incorporation and bylaws. It had the intention, and obvious effect, of seeking to pressure the other members and the Board to undo the decisions that had been made in accord with required processes by imposing on them the substantial costs of lengthy, fact-intensive litigation. And of course the very bringing of such litigation highlights to all the other members (and the Board) that

the litigation costs could be quickly avoided if only the Board (or members) reversed the decisions that the Federations were challenging.

2. Any argument that fee-shifting bylaws imposed by nonstock corporations are categorically beyond the scope of §109 would necessarily be based on an impermissibly cramped view of the proper subject of bylaws. *See Boilermakers*, 73 A.3d at 951-52; *Hollinger*, 844 A.2d at 1078-79 & n.128 ("The DGCL is intentionally designed to provide directors and stockholders with flexible authority [to adopt bylaws], permitting great discretion for private ordering and adaptation.").

Fee-shifting bylaws such as the one here have the core function of bylaws generally, which is "not to mandate how the board should decide specific substantive business decisions, but rather, to define the process and procedures by which those decisions are made." *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 234-35 (Del. 2008). They are not directives as to what outcomes the Board will take on particular substantive matters, or limitations on Board discretion to manage the enterprise, but "self-imposed rules and regulations deemed expedient for its convenient functioning . . . ." *Gow v. Consol. Coppermines Corp.*, 165 A. 136, 140 (Del. Ch. 1933). Like bylaws governing subjects such as unanimity, unanimous attendance, and the content of specified notices, all of which have been routinely upheld, fee-shifting bylaws are "purely procedural" means for

enhancing a corporation's "functioning." *See, e.g.*, *CA, Inc.*, 953 A.2d at 234-35. They "establish[] or regulate[] a process for substantive director decision-making," and do not mandate the decision itself. *Id.* The same considerations that have led courts to uphold bylaws "that help organize what could otherwise be a chaotic stockholder meeting" apply to fee-shifting bylaws such as that here, which help organize and channel disagreements among members and other key participants (owners) by encouraging more discussion (in and out of Board meetings) and deterring meritless litigation. *Boilermakers*, 73 A.3d at 952.

The Court of Chancery recently held in *Boilermakers* that boards "have the statutory authority to adopt a bylaw to protect against what they claim is a threat to their corporations" and stockholders. *Id*. at 953. That power directly supports the bylaw here, adopted to deter unmeritorious litigation whose economic and other burdens can swamp non-profit corporations with limited revenues, just as the forum selection bylaws at issue in *Boilermakers* were intended to deter duplicative (and thus unnecessarily expensive and burdensome) litigation.

As was true of the forum selection bylaws upheld in *Boilermakers*, fee-shifting bylaws such as ATP's carry with them additional safeguards strengthening the case for holding them authorized by § 109(b). First, they are subject to the most direct form of attack by members who do not favor them: repeal by the members "entitled to vote." § 109(a). *See Boilermakers*, 73 A.3d at 954. Second, those

opposed can also replace their board representatives. Third, judicial supervision is always at hand, because fees are not awardable except by a court. As with the forum selection bylaws at issue in *Boilermakers*, "the board must voluntarily submit the [fee-shifting provision] to the scrutiny of the courts if a plaintiff does not comply with it." *Id*.

Finally, contractual agreements to shift fees to prevailing parties under specified circumstances are a recognized, commonly upheld exception to the American Rule, recognized by Delaware (*see, e.g., Mahani v. Edix Media Grp., Inc.*, 935 A.2d 242, 245 & n.9 (Del. 2007) (Delaware recognizes that contractual fee-shifting agreements are enforceable), as well as other states, *e.g., Glenridge Mews Condominium v. Kavi*, 933 N.Y.S.2d 730 (2d Dep't 2011) (enforceability of fee-shifting agreements extends to condominium bylaws); *Trope v. Katz*, 902 P.2d 259, 262-63 (Cal. 1995); *Total Recycling Servs. of Conn. v. Conn. Oil Recycling Servs., LLC*, 63 A.3d 896, 904-05 (Conn. 2013).

*Sternberg v. Nanticoke Memorial Hospital, Inc.*, 62 A.3d 1212 (Del. 2013), upholding a hospital's fee-shifting bylaw, strongly supports an affirmative answer to the first question. The fee-shifting bylaw there was comparable to that here, providing that "if notwithstanding" provisions affording opportunity to be heard and to appeal internally, "an individual institutes legal action and does not prevail, he or she will reimburse the Hospital and any member of the Medical Staff named

in the action for all costs incurred in defending such legal action, including reasonable attorney's fees." *Id*. at 1216. In upholding a resulting fee award, this Court asked whether "any national or state public policy precludes the fee shifting bylaw at issue here," implicitly recognizing that the private ordering was otherwise presumptively compliant with law. *Id*. at 1217. Finding that the complaining doctor had not identified any such policy and that there was none, this Court concluded that "private parties are free to contract" for fee-shifting by bylaw until and unless the General Assembly chooses to create such a limitation. *Id*. at 1218.

## II. THE SECOND CERTIFIED QUESTION SHOULD BE ANSWERED "YES"

### A. The Second Certified Question

May such a bylaw be lawfully enforced against a member that obtains no relief at all on its claims against the corporation, even if the bylaw might be unenforceable in a different situation where the member obtains some relief?

### B. Standard and Scope of Review

See Section I.B above.

### C. Merits of the Argument

The Court should answer the Second certified question "yes" because where, as here, a challenge to a bylaw arises in a particular factual context – not in a pre-adoption or even post-adoption attempt to secure an advisory opinion – Delaware courts consider the validity of challenged bylaws in the context presented, and Rule 41(b) so requires. Ignoring hypotheticals, courts consider a bylaw's validity in the "concrete situation," *Ackerman v. Stemerman*, 201 A.3d 173, 176 (Del. 1964) and *Boilermakers*, 73 A.3d at 949, and do not invalidate the bylaw just because some hypothetical circumstances could render it unenforceable.

In *Stroud v. Grace*, 606 A.2d 75, 95 (Del. 1992), for example, this Court held it error to invalidate a bylaw "upon some hypothetical abuse," and that courts should consider the operative facts, not "invoke some hypothetical risk of harm." "It is not an overstatement to suggest that every valid by-law is always susceptible

to potential misuse. Without a showing of abuse in this case, we must . . . uphold the validity" of the challenged bylaw. *Id*. at 96. *See also, e.g., Openwave Sys., Inc. v. Harbinger Capital Partners*, 924 A.2d 228, 240 & n. 46 (Del. Ch. 2007) (same); *Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, 728 A.2d 25, 40 (Del. Ch.) ("the guiding principle is reasonableness, not perfection"), *aff'd*, 721 A.2d 1281 (Del. 1998); *cf. Stroud v. Milliken Enters., Inc.*, 552 A.2d 476, 479-81 (Del. 1989). "Delaware courts should exercise caution when invalidating corporate acts based upon hypothetical injuries . . . ." *Stroud*, 606 A.2d at 79.

In *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 238 (Del. 2008), a decision involving a facial challenge to a bylaw that had not yet even been adopted, much less applied, this Court stated that, by contrast, "in the course of litigation involving the application of the Bylaw to a specific set of facts, we would start with the presumption that the Bylaw is valid and, if possible, construe it in a manner consistent with the law. The factual context in which the Bylaw was challenged would inform our analysis, and we would 'exercise caution [before] invalidating corporate acts based upon hypothetical injuries . . . ."[2] (internal citations omitted).

[2] Unlike here, there was no specific factual context in *CA* for the court to consider in connection with the facial validity of the bylaw in question. Moreover, the proposed bylaw there would have forced the board of directors to reimburse stockholders for expenses incurred in connection with nominating candidates to the board in any contested election. Because it improperly restricted the board's power to deny inappropriate reimbursement, this Court ruled it invalid under 8 *Del. C.* §141(a).

The case from which the certified questions come to this Court arises in a "concrete situation" (a specific fee application predicated exclusively on the bylaw) and entails an indisputable "set of facts" (claimants' failure to obtain any relief on any claim). If bylaws providing for reciprocal fee-shifting are ever valid, cases like this one, where claimants asserted multiple claims and failed on all of them, present the strongest possible case for enforcement. Hypotheticals that might be imagined – hard cases where some relief but not all the relief sought is afforded – properly await another day. There is no difficulty in application here, where the policies underlying the bylaw are clearly and directly served; the claims taken to court were comprehensively rejected; and claimants obtained no relief at all, after litigating in both the district court and on appeal. The claimants' wholly unmeritorious claims unmistakably and directly caused the very harm and imposed the very unfair burdens that the bylaw aimed to avoid.

Even assuming, arguendo, that this Court might under extraordinary circumstances consider Article 23.3's application in hypothetical circumstances had the case been brought as a facial, affirmative challenge upon the enactment of Art. 23.3 – say, by an ATP member considering litigation wanting to better understand its risks – there is no need to do so here, where the case arises in a real concrete context, namely ATP's fee application following the Federations' prosecution of litigation and their total loss on each of their claims.

The certified facts present a clear question with square corners. If the answer to the first two certified questions is "yes," then Art. 23.3 is authorized by Delaware law and the case would return to the federal courts for resolution of the federal antitrust preemption issue. Further assessment as to whether such a bylaw would be enforceable in other circumstances – such as when a member obtains a judgment achieving significant relief (but less than all that it sought) – would entail a range of hypotheticals as to both substance (what if a substantial injunction is obtained but damages are denied?) and amount (how much of the amount sought affords substantial achievement of the full remedy sought?). Consideration of those imagined scenarios is beyond the scope of Rule 41, since "facts material to the issue . . . [would be] in dispute" within the meaning of Rule 41(b), and cannot in any event be usefully undertaken in the abstract.

## III. THE THIRD CERTIFIED QUESTION SHOULD BE ANSWERED "NO"

### A. The Third Certified Question

Is such a bylaw rendered unenforceable as a matter of law if one or more Board members subjectively intended the adoption of the bylaw to deter legal challenges by members to other potential corporate action then under consideration?

### B. Standard and Scope of Review

See Section I.B above.

### C. Merits of the Argument

The Court should answer the Third certified question "no," when the intention to deter legal challenges and to shift unnecessary litigation expenses to those responsible for causing them serves a self-evidently equitable purpose (as it does here), and when the board of directors that adopted such a bylaw stood to receive no material, personal gain from its application. Absent such (or comparable) circumstances, the bylaw must be evaluated under the deferential standard of the business judgment rule and the board's decision should not be disturbed if it can be attributed to a rational business purpose.

#### 1. Application of the Business Judgment Rule to the Board's Decision to Adopt the Bylaw

When adopting a bylaw, a board of directors must, as with all corporate action, exercise its fiduciary duties of care and loyalty. *Underbrink v. Warrior*

*Energy Services Corp.*, 2008 WL 2262316 (Del. Ch. May 30, 2008). The appropriate starting place in evaluating the board's compliance with its fiduciary duties "is with the well-established presumption of the business judgment rule, which reflects and promotes the role of the board of directors . . . as the appropriate body to manage the business and affairs of the corporation." *Wayne Cnty. Emps. Ret. Sys. v. Corti*, 2009 WL 2219260, at *10 (Del. Ch. July 24, 2009), *aff'd*, 996 A.2d 795 (Del. 2010). When applying this standard, the court "will not substitute its judgment for that of the board if the [board's] decision can be 'attributed to any rational business purpose.'" *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 36 (Del. Ch. 2010) (quoting *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985)).

There are a number of ways in which the business judgment presumption may be rebutted, including by showing that the majority of directors who approved the action (1) had a personal interest in the subject matter of the action or were dominated or controlled by a materially interested director, *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1167-68 (Del. 1995), (2) did not act in good faith in approving the action, *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989), or (3) were not fully informed. *Id*.

Applying the foregoing principles to the adoption of the bylaw presented in the first certified question, the third certified question should be answered in the

negative, absent some factual pleading (not asserted in attacking the fee requested here) which, if proven, would reflect a conflict of interest by a majority of the board, personal interest in the bylaw itself or the fee application underlying it, or a showing that the Board adopted the bylaw in other than an informed, good faith basis. Absent such a showing (none of which is present here), the bylaw adoption is protected by the business judgment rule, even if one or more Board members had in mind not only the virtues of deterrence generally, but also that the bylaw might deter the challenge that claimants eventually brought.

(1) *Independence*. In evaluating the personal interests of the directors, it is important to note that no member of the board would benefit directly from the application of the bylaw and there has been no allegation that any board member would directly benefit from application of the bylaw.

(2) *Good Faith*. If a majority of the board approved the bylaw with the purpose of "advancing the best interests of the corporation," without the "intent to violate applicable positive law," and without "intentionally fail[ing] to act in the face of a known duty to act, demonstrating a conscious disregard for [its] duties," then the business judgment rule's application to the adoption of the bylaw could also not be rebutted. *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006) (quoting *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006)).

(3) *Full Information*. Lastly, if the board acted on a fully informed basis in evaluating the corporate action under consideration and in adopting the bylaw, the business judgment rule could not be rebutted.

The existence of a "subjective intent" to deter legal challenges to potential corporate action then under consideration does not alter this result, when such an intent brings no material personal benefit to the directors in accordance with the principles described above, the intent was not possessed in bad faith, and the board arrived at that intent on a fully informed basis.[3]

2. Separate Inquiry Under *Schnell v. Chris-Craft Indus.*

Even where a board of directors is legally permitted to take a particular action, the action will not be countenanced if it works an inequity to the corporation's stockholders. *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971). In *Schnell*, the board attempted "to utilize the corporate machinery" inequitably to obstruct "the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management." *Id*. Under the *Schnell* standard, "the court asks the question whether the directors' purpose [in approving the bylaw] is 'inequitable'" and designed to manipulate the corporate machinery. *Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1121 (Del. Ch. 1990).

[3] Moreover, the subjective intent to deter legal challenges cannot, as a practical matter, have any application where the legal challenge was never, in fact, deterred. Notably, the adoption of Article 23.3 did not deter the Appellees, each of which had actual knowledge of the bylaw, from challenging the restructuring plan and litigating the challenge all the way to the Supreme Court.

But because "[t]he invocation of equitable principles to override established precepts of Delaware corporate law must be exercised with caution and restraint," this Court has observed that "[*Schnell's*] application, or that of similar concepts, should be reserved for those instances that threaten the fabric of the law, or which by an improper manipulation of the law, would deprive a person of a clear right." *Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 258 (Del. 1991); *see also Dolgoff v. Projectavision, Inc.*, 1996 WL 91945, at *7 (Del. Ch. Feb. 29, 1996) (*Schnell* "must be invoked sparingly and only when circumstances make relatively clear that inequitable behavior or manipulation is present"). Thus, reliance on *Schnell* and its progeny to invalidate board action has generally been limited to circumstances involving the directors' interference with the shareholder franchise. *Stroud*, 606 A.2d at 91.

To apply *Schnell* to the adoption of the bylaw at issue here would require an extension of its principles far beyond the limited context of threats to the stockholder franchise. To reach that result, it must be found that the directors utilized the corporate machinery to obstruct the legitimate efforts of the corporation's members and the bylaw, if permitted to stand, must threaten the fabric of Delaware corporate law. There is no possible basis for any such finding on the basis of the Certification Order (or any of the decisions below).

3. Enforcement of Similar Litigation-Driven Bylaws

Delaware courts have a long history of enforcing fee-shifting agreements (see *supra* at 18-19), and of upholding litigation-driven bylaws as both facially enforceable, *Boilermakers*, 73 A.3d at 950-54, and, as-applied, protected by the business judgment rule, *Underbrink v. Warrior Energy Services Corp.*, 2008 WL 2262316 (Del. Ch. May 30, 2008); *see also Orloff v. Shulman*, 2005 WL 5750635 (Del. Ch. Nov. 23, 2005). In *Underbrink*, for example, the board's decision to adopt a mandatory, retroactive advancement bylaw under the "imminent threat of litigation" was analyzed under the business judgment rule and upheld by the court. 2008 WL 2262316, at *12. Because the plaintiff was "'challeng[ing] the adoption of a bylaw that require[d] the corporation to advance litigation costs sometime in the future rather than challenging the directors' decision to advance particular litigation expenses,'" the court concluded that the bylaw "would be valid unless it was 'unreasonable.'" *Id*. at *13 (quoting *Orloff*, 2005 WL 5750635, at *13).

Accordingly, if (as in *Underbrink* and *Orloff*) the business judgment rule protects a board's decision to adopt a bylaw pursuant to which the *directors* received the personal benefit of advancement, it follows that the board's decision to adopt a bylaw which offers the directors *no* direct material benefit, must likewise be viewed with deference. Because the board's decision is attributable to a rational business purpose (*see supra* at 13-15, 25, 28), the third certified question should be answered in the negative.

## IV. THE FOURTH CERTIFIED QUESTION SHOULD BE ANSWERED "YES"

### A. The Fourth Certified Question

Is such a bylaw enforceable against a member if it was adopted after the member had joined the corporation, but where the member had agreed to be bound by the corporation's rules "that may be adopted and/or amended from time to time" by the corporation's Board, and where the member was a member at the time that it commenced the lawsuit against the corporation?

### B. Standard and Scope of Review

See Section I.B above.

### C. Merits of the Argument

The Court should answer the Fourth certified question "yes" because such duly adopted bylaws are binding on members regardless of whether the bylaws were adopted before or after the member joins the corporation.

Delaware law, in 8 *Del. C.* § 109(a), provides that "any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors." *See CA, Inc.*, 953 A.2d at 231 ("[T]he DGCL empowers both the board of directors and the shareholders of a Delaware Corporation to adopt, amend, or repeal the corporation's bylaws."). Boards so authorized have the power to adopt bylaws independent of the shareholders. *Id*. ("both the board and the shareholders of CA, independently and concurrently, possess the power to adopt,

amend and repeal the bylaws"). Duly adopted bylaws constitute a binding part of the contract between a Delaware corporation and its members. *See Boilermakers*, 73 A.3d at 939; *cf. CA, Inc.*, 953 A.2d at 234 ("Bylaws, by their very nature, set down rules and procedures that bind a corporation's board and its shareholders.")

When a member joins a nonstock corporation whose board has the power to adopt or amend bylaws at any time or from time to time, that member is on notice that, as to subjects that are subject to regulation by bylaw under 8 *Del. C.* § 109(b), the board may adopt or amend such bylaws unilaterally. *See Boilermakers*, 73 A.3d at 941. *See also Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 492 (Del. Ch. 1995) (although bylaws "are a contract between the corporation and its stockholders, the contract [is] subject to the board's power to amend the by-laws unilaterally.") This governing arrangement allows the board to amend and repeal bylaws, and adopt new ones, "quickly and expeditiously without the delay incident to going to the stockholders." *See* 1 Folk On The Delaware General Corporation Law § 109.2.

Section 109 and the cases enforcing it presuppose that properly adopted, authorized bylaws are generally binding, and that whether a particular member joined the corporation before or after the board adopted a bylaw has no impact on that bylaw's enforceability. Members of corporations do not hold "vested rights" that are immune from bylaw modifications. This Court long ago abandoned the vested rights doctrine, *see, e.g., Fed. United Corp. v. Havender*, 11 A.2d 331, 339

(Del. 1940) (holding that preferred stockholders did not have a "vested" right to accrue dividends), under which a shareholder could assert that "'boards cannot modify bylaws in a manner that arguably diminishes or divests pre-existing shareholder rights absent stockholder consent.'" *See Boilermakers*, 73 A.3d at 955 (quoting Joseph A. Grundfest & Kristin A. Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions*, 68 Bus. Law. 325, 376 (2013)). "[W]here a corporation's by-laws put all on notice that the by-laws may be amended at any time, no vested rights can arise that would contractually prohibit an amendment." *Kidsco*, 674 A.2d at 492; *cf. Roven v. Cotter*, 547 A.2d 603, 608 (Del. Ch. 1988) (directors lack vested rights in bylaws because the statute puts them "on notice that the bylaws may be amended at any time by the shareholders").

The proposition that board-adopted bylaws require an additional layer of consent from existing members in order to bind those members is contrary to basic principles of Delaware corporate law. When the statute intends to require member consent for changes to bylaws, it makes such requirements explicit. Certain types of bylaws must be approved by stockholders. *See, e.g.*, 8 *Del. C.* § 141(d) (permitting classification of the board of directors by bylaw only where the "bylaw [is] adopted by a vote of the stockholders"). There is no Delaware statute that would impose such a requirement with regard to the adoption of fee shifting bylaws.

If board-adopted bylaws required the consent of existing members to be binding, "'then much of standard corporate law practice regarding the amendment of bylaws must fall, and much larger bodies of corporate law must be rewritten.'" *Boilermakers*, 73 A.3d at 956 (quoting Grundfest & Savelle, 68 Bus. Law 325 at 407). Such an arrangement would "create multiple categories of investors, some bound and others not bound, by various bylaw provisions. The practical effect would be to eliminate the ability of the board to amend bylaws without shareholder action. But this conclusion would clearly be contrary to the statutory design of the corporate governance regime which, on its face, allows boards to amend bylaws without prior stockholder approval." *See* Grundfest & Savelle, 68 Bus. Law 325 at 379.

As noted in *Boilermakers*, 73 A.3d at 956-57, pursuant to 8 *Del. C.* §109(a), members may not be divested of their right to adopt, amend or repeal bylaws. Recourse for a member dissatisfied with a board-adopted bylaw is to seek to amend or repeal that bylaw in concert with other members – not to seek the invalidation of the bylaw by claiming that it never consented to (or by dint of early arrival is not bound by) the bylaw, notwithstanding that it expressed its consent to board-adopted bylaws when it joined the corporation.

## CONCLUSION

For all the foregoing reasons, questions 1, 2, and 4 should be answered "yes," and question 3 should be answered "no."

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