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Implementing Exclusive Forum Bylaws

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Late last month, in an important decision, the Delaware Court of Chancery held that boards of directors of Delaware corporations may validly adopt exclusive forum bylaws, also known as forum selection bylaws, under Delaware law. Exclusive forum provisions in corporate charters and bylaws are a recent innovation intended to address the problem of duplicative shareholder litigation, which has increased substantially in recent years. In light of this decision, boards of Delaware companies should consider adopting exclusive forum bylaws without waiting for the outcome of any appeal to the Delaware Supreme Court.

Exclusive forum provisions protect companies from defending shareholder lawsuits in multiple jurisdictions but do not affect other cases brought against the corporation in other contexts. The bylaw provisions affect four specific areas of shareholder litigation: derivative suits, fiduciary duty suits, claims under the Delaware General Corporation Law, and other claims regarding internal affairs of the corporation. These lawsuits arise in a variety of contexts, most commonly—though not exclusively—in connection with mergers and acquisitions transactions. The provisions do not eliminate any shareholder causes of action or prevent shareholders from bringing claims but are designed solely to consolidate litigation in a single jurisdiction. Should a shareholder file suit in another jurisdiction, the company will be able to invoke the exclusive forum provisions in its motion to dismiss. These provisions offer numerous benefits to corporations with little, if any, downside.

'Boilermakers Local 154 v. Chevron'

In the recent decision, **Boilermakers Local 154 Retirement Fund v. Chevron**,[1] Chancellor Leo E. Strine addressed challenges by stockholders of both Chevron and FedEx to the exclusive forum bylaws adopted by the boards of those companies. The plaintiffs challenged the bylaws on statutory grounds—claiming that adopting the bylaws exceeded the boards' authority under Delaware law—and on contractual grounds—claiming that the unilateral adoption of the bylaws by the board was a violation of the implied contract between the board and its shareholders. The plaintiffs also claimed that the boards of both companies breached their fiduciary duties by adopting the exclusive forum bylaws. The cases were consolidated for efficiency.

The bylaws at issue in the case are nearly identical. They provide that, unless the corporation consents in writing to the selection of an alternate forum, Delaware courts would be the sole and exclusive forum for the following actions: derivative actions; allegations of breach of fiduciary duty by the directors and executive officers; claims arising under any provision of the Delaware General Corporation Law; or claims governed by the internal affairs doctrine.[2] The bylaws state that any acquirer of stock in the corporation will be deemed to have had notice of and consented to its provisions.

Chancellor Strine upheld the statutory validity of the bylaws on the basis of §109 of the Delaware General Corporation Law, which provides in pertinent part that a corporation's bylaws "may contain any provision, 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 stockholders, directors, officers or employees."[3] Because the bylaws govern disputes related to the "internal affairs" of the corporations, Strine found that they "easily meet" the requirements of §109.[4]

The court further upheld the bylaws as valid and enforceable under contract law. Chancellor Strine pointed out that a corporation's bylaws are part of a larger, binding contract among the directors, officers and stockholders under the rubric of the Delaware General Corporation Law, which permits a corporation, through its charter, to grant directors the power to adopt and amend bylaws unilaterally.[5] Both Chevron and FedEx explicitly provide the board with this authority in their certificates of incorporation; therefore the ability of the board to adopt a binding bylaw was part of the contract that shareholders accepted when they acquired stock in the corporation.

Notably, the plaintiffs in the consolidated cases made facial validity challenges to the bylaws at issue, challenging their legality at a fundamental level. The court affirmed their validity as a categorical matter. However, Strine observed in his opinion that even a statutorily and contractually valid bylaw may be challenged as operating inequitably as applied in a particular situation.[6]

Exclusive Forum Provisions

Chancellor Strine took the opportunity, after dispensing with the challenges to the bylaws' validity, to review the background and purpose of exclusive forum provisions. Both Chevron and FedEx adopted their bylaws in an attempt to minimize the amount of multiforum litigation to which they would be subjected. Because corporations may be sued in their state of incorporation as well as the state in which they are headquartered, and in both federal and state courts in each such state, multiple lawsuits against a company may be filed in various jurisdictions even when all of the lawsuits concern a single corporate act. Moreover, since shareholder class actions and derivative lawsuits may be brought by multiple shareholders, each claiming to be the appropriate representative of the class or corporation, various plaintiffs may file lawsuits regarding the same set of claims contemporaneously and in different courts. If these suits were all filed in a single jurisdiction, they would easily be consolidated before a single judge; when they are filed in different courts, there is no mechanism for doing so. Thus the cases proceed independently and may even yield different results.

The volume of multiforum litigation, which is by nature duplicative and costly, has increased dramatically in recent years. One recent study found that shareholder lawsuits were filed in 96 percent of U.S. public company deals valued over $500 million in 2012, with an average of more than five lawsuits filed per deal. By comparison, the same study found that shareholder lawsuits were filed in 53 percent of U.S. public company deals valued over $500 million in 2007.[7]

The wastefulness inherent in multiforum litigation harms both shareholders and corporations. Furthermore, when decisions in different jurisdictions produce inconsistent judgments, multiforum litigation weakens the rule of law by reducing predictability generally and by compelling specific litigants to attempt to comply with incompatible decisions. The beneficiaries and drivers of this trend are the plaintiffs' lawyers. A recent analysis of over 1,000 takeovers during the period 2005-2011 found that "entrepreneurial plantiffs' attorneys" have generated jurisdictional competition for corporate litigation by bringing suits in jurisdictions that are known to award more favorable judgments and higher attorneys' fees. According to the analysis, these lawyers are abetted by states that wish to attract more corporate litigation and therefore increase judgments and fee awards in such cases.[8] This dynamic, in combination with the fact that attorneys' fees generally are awarded only to the lead plaintiffs' counsel, has spurred aggressive plaintiffs' lawyers to rush to file in multiple jurisdictions to increase their chances of being appointed lead counsel and pocketing a large fee.

Exclusive forum provisions in a company's organizational documents were first proposed in 2007 as a response to the increase in multiforum litigation by New York lawyer Theodore N. Mirvis.[9] Many companies have adopted exclusive forum charter provisions prior to going public in order to avoid a shareholder vote on the issue or a

notice-and-consent argument by subsequent stock purchasers.[10] After the Delaware Court of Chancery mentioned exclusive forum bylaws in 2010 as a possible solution to the problem of duplicative litigation,[11] companies began to adopt them more broadly. A 2011 case in California federal district court held that a company's exclusive forum bylaw was unenforceable; however, the facts were unusual and involved alleged malfeasance by the directors.[12] Nonetheless, this case gave plaintiffs' lawyers hope that the bylaws would be generally disfavored by the courts, and in 2012, shareholders sued 12 Delaware corporations challenging the exclusive forum bylaws that their boards had unilaterally adopted. Ten of the subject companies repealed their bylaws rather than engage in litigation; only Chevron and FedEx defended their bylaws in court. The litigation may have had a chilling effect on the adoption of such bylaws while companies waited to see what the Delaware Court of Chancery would decide.[13]

The Proper Use of Bylaws

Chancellor Strine devoted a portion of his opinion to discussing the proper subject matters of bylaws. The plaintiffs argued that Delaware corporations' bylaws should be limited in scope to matters concerning stockholder meetings, the board and board committees, and officerships.[14] Strine agreed that bylaws typically are procedural rather than substantive in nature, but found that exclusive forum bylaws are themselves process-oriented, "because they regulate *where* stockholders may file suit, not *whether* the stockholder may file suit or the kind of remedy that the stockholder may obtain...."[15] Moreover, he noted that exclusive forum bylaws regulate internal affairs cases governed by state corporate law—"the kind of claims most central to the relationship between those who manage the corporation and the corporation's stockholders."[16] So long as the bylaws address the rights and powers of plaintiff-stockholders as stockholders (rather than as individuals or employees, for example), their adoption falls well within the purview of corporate power granted in §109(b) of the Delaware General Corporation Law.[17]

The court drew an analogy to the advance notice bylaw, a provision that similarly regulates the manner in which stockholders may exercise their rights. Both the advance notice bylaw and the exclusive forum bylaw, Chancellor Strine observed, are designed to create an orderly process for the conduct of corporate affairs, and both have a proper relationship to the business of the corporation.[18] Though they may be outside the scope of traditional bylaw subject matters, the Chancellor found that they nonetheless constitute proper exercises of corporate authority under Delaware law.

Strine also used the example of the shareholder rights plan, or poison pill, to demonstrate that novel uses of statutory authority would not necessarily be invalidated in Delaware. Historically, Delaware has taken the view that its corporate law—and permitted uses of statutory authority by corporate actors—would evolve in response to changes in the outside world. Accordingly, the fact that Delaware law may be silent as to

a particular matter does not indicate that corporate action in that area would be prohibited.[19] The opinion analogized the authority of the board to protect against hostile takeovers to the authority of the board to protect against duplicative litigation.

Predictably, exclusive forum bylaws have been attacked by shareholder activists as an infringement of shareholder rights. Institutional Shareholder Services (ISS) takes a case-by-case approach to recommendations on exclusive forum provisions, taking into account whether the company has been materially harmed by shareholder litigation outside the state of incorporation, as well as certain features of the company's governance practices.[20] As a practical matter, however, ISS opposes these provisions. Glass Lewis takes the default position of recommending against any exclusive forum provision, but the updated version of their guidelines states that it may change that recommendation if a company puts forth a compelling argument as to how the provision would benefit shareholders, provides evidence of abusive litigation in other jurisdictions and has strong corporate governance practices generally.[21] The AFL-CIO and the Council of Institutional Investors have each expressed their opposition to exclusive forum provisions.[22]

Though a board may indeed adopt an exclusive forum bylaw unilaterally, Chancellor Strine's opinion highlights the fact that, under Delaware law, any bylaw may be repealed by a simple majority vote of shareholders. Recent history suggests that, despite activists' best efforts to the contrary, shareholders actually approve of exclusive forum provisions. During the 2012 proxy season, the two shareholder proposals to repeal exclusive forum provisions that were brought to a vote were rejected, receiving less than 40 percent support notwithstanding ISS' recommendation for repeal in each case. Similarly, nine out of 10 companies whose management proposals to adopt exclusive forum provisions were brought to a vote in 2012 received shareholder approval of the proposals, contrary to ISS' recommendations in each case.

As an additional safeguard of shareholder rights, Chancellor Strine notes, exclusive forum provisions—whether in charters or bylaws—that are invoked in practice will be necessarily subject to judicial scrutiny in order to be effective. If a plaintiff files suit elsewhere despite the provisions, the company must raise the issue as a jurisdictional defense if it wishes to seek dismissal, thereby inviting review of the exclusive forum provision's application in a particular instance.[23]

Delaware as Choice of Forum

The result in this case is likely to be appealed to the Delaware Supreme Court, but Strine's well-reasoned opinion is likely to stand. Directors of Delaware companies should take this opportunity to discuss the issue and consider whether an exclusive forum bylaw would be advisable. A company may not wish to adopt an exclusive forum bylaw at this time if, knowing its shareholder base, taking such an action would cause a

distracting and unpleasant controversy. However, in most other circumstances, there is no downside to adopting a bylaw now, and the ideal time to adopt the bylaw is before the company finds itself subject to multiforum litigation.

In the case of *Boilermakers Local 154 v. Chevron*, the Delaware Court of Chancery once again has demonstrated why it is the preferred forum for incorporation and for adjudicating shareholder litigation. Strine's opinion is thorough, sensible and focused on the efficient and fair administration of justice. The resolution of this litigation is a clear example of how Delaware corporations would benefit from exclusive forum provisions to direct that their shareholder litigation be handled, to the extent possible, in Delaware.

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Endnotes:

1. C.A. No. 7220-CS (Del. Ch. June 25, 2013), available at courts.delaware.gov/opinions/download.aspx?ID=190990.

2. See By-Laws of Chevron Corp., As Amended March 27, 2013, available at www.chevron.com; FedEx Amended and Restated Bylaws, Adopted and Effective as of Sept. 26, 2013, available at www.fedex.com.

3. Del. Gen. Corp. L. §109(b).

4. Boilermakers Local 154 v. Chevron, at 3.

5. *Boilermakers Local 154*, at 4; Del. Gen. Corp. L. §109(a).

6. Boilermakers Local 154, at 22.

7. See Robert M. Daines and Olga Komrian, "Shareholder Litigation Involving Mergers and Acquisitions: Review of 2012 M&A Litigation/Settlements/Plaintiff Attorney Fees/New Lawsuits Challenging Annual Proxies," Cornerstone.com, Feb. 2013, at 1, available at www.cornerstone.com.

8. See Matthew D. Cain and Steven M. Davidoff, "A Great Game: The Dynamics of State Competition and Litigation," (Jan. 2013), available at SSRN: http://ssrn.com/abstract=1984758.

9. Theodore N. Mirvis, "Anywhere But Chancery," The M&A Journal, May 2007. Mr. Mirvis is a partner at Wachtell, Lipton, Rosen & Katz, the firm with which the authors of this article are affiliated.

10. See Claudia H. Allen, "Exclusive Forum Provisions: Putting on the Brakes," Bloomberg BNA Corp. Accountability Report, 10 CARE 1286, Dec. 14, 2012, available at www.ngelaw.com.

11. *In re Revlon S'holders Litig.*, 990 A. 2d 940, 960-61 (Del. Ch. 2010).

12. *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011).

13. See Allen, supra.

14. Boilermakers Local 154, at 25.

15. Id. at 26 (emphasis in original).

16. Id. at 26.

17. Id. at 27.

18. Id. at 27.

19 Id. at 28-29.

20. ISS 2013 U.S. Proxy Voting Summary Guidelines, Jan. 31, 2013, at 24.

21. See John F. Olson, "ISS, Glass Lewis, and the 2013 Proxy Season," The Harvard Law School Forum on Corporate Governance and Financial Regulation, Feb. 11, 2013, available at blogs.law.harvard.edu/corpgov/2013/02/11/iss-glass-lewis-and-the-2013-proxy-season/.

22. AFL-CIO Proxy Voting Guidelines Section D.16 at 20 (2012), available at www.aflcio.org/content/download/12631/154821/proxy_voting_2012.pdf; Council of Institutional Investors Corporate Governance Guidelines Section 1.9, available at www.cii.org/corp_gov_policies.

23. Boilermakers Local 154, at 30.