DEAL LAWYERS

Exclusive Forum Provisions: A New Item for Corporate Governance and M&A Checklists

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Public companies increasingly are adopting "exclusive forum" bylaws and charter provisions that require their stockholders to go to specified courts if they want to make fiduciary duty or other intra-corporate claims against the company and its directors.

Exclusive forum provisions can help companies respond to such litigation more efficiently. Following most public M&A announcements, for example, stockholders file nearly identical claims in multiple jurisdictions, raising the costs required to respond. Buyers also feel the pain, since they typically bear the costs and may even be named in some of the proceedings. Exclusive forum provisions help address the increased costs, while allowing stockholders to bring claims in the specified forum.

The recent surge in adoptions started last year, after the Delaware chancery court confirmed the general enforceability of exclusive forum bylaws for companies incorporated there. Perhaps more importantly, courts outside of Delaware also have been enforcing the provisions and dismissing claims brought outside the specified forums.

Exclusive forum provisions can be implemented by most companies in their bylaws by action of their board of directors, without stockholder approval, though some companies have sought (and generally obtained) stockholder approval. Companies may want to consider adopting these bylaws as part of their general corporate governance regime or when they see events, such as the arrival of activists or a potential M&A process, that portend greater potential for litigation ahead.

BACKGROUND

Response to Expanding Litigation Environment. Exclusive forum bylaws arose in response to the ever-increasing stockholder litigation against public companies. In the M&A context, stockholder litigation now is brought in virtually all public company transactions. Moreover, such litigation is frequently brought in multiple jurisdictions, so that the company has to defend against the same or very similar claims in different courts at the same time, resulting in higher costs (in terms of time as well as money) and exposure to potentially inconsistent rulings.

Exclusive forum bylaws attempt to address the problems associated with fighting similar claims in multiple jurisdictions by requiring potential plaintiffs to bring the claims in one specified court or jurisdiction. The specified courts are almost always in the company's jurisdiction of incorporation, and so for public companies more often than not are in Delaware. By focusing the litigation in such courts, the companies and other parties also get the benefit of having the cases heard by judges who are experienced in applying the law of that jurisdiction, which can enhance speed and predictability. Most exclusive forum provisions also allow the company to permit exceptions, where the board consents to allowing the litigation to proceed in another forum.

However, companies also should consider whether there may be strategic or other advantages in litigating in a jurisdiction outside their state of incorporation. For example, a company in some circumstances may prefer to litigate in the state where its headquarters is

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located, if it perceives a "home court" advantage based on local goodwill or other advantages. Depending on the kinds of litigation expected and its perception of the relative strength of such advantage, such a company may prefer not to adopt an exclusive forum bylaw.[1]

Scope of Litigation. The litigation subject to exclusive forum bylaws generally is limited to claims of breach of fiduciary duty and other matters relating to the incorporating jurisdiction's corporate law and other intra-company disputes.

Increasing Popularity. The number of companies adopting exclusive forum bylaws shows their popularity: In the first quarter of this year, about 40 public companies incorporated in Delaware adopted exclusive forum bylaws, and about 75% of Delaware corporations going public had adopted the provisions.

ENFORCING EXCLUSIVE FORUM BYLAWS

The Delaware Perspective

The Delaware chancery court in June 2013 found that exclusive forum provisions, even if not approved by stockholders, generally should be enforceable.[2] The court described a corporation's bylaws as part of the "contract" between the stockholders and the corporation. The court noted that stockholders were on notice that the board, under Delaware's corporate statute and the company's certificate of incorporation, could amend the bylaws without a stockholder vote (as is the case in most public companies), and that stockholders themselves could take action in response to the bylaws, such as by changing the bylaws to repeal the provision or even replacing the board of directors.

The court also noted that there might be some equitable limits on the enforcement of such bylaws, saying that while "in most internal affairs cases [exclusive forum] bylaws will not operate in an unreasonable manner," the application of the bylaws might be subject to review in any particular "real-world" situation.

Delaware courts have recognized, though, that the decision actually to enforce an exclusive forum bylaw should be made initially by courts in other jurisdictions, and have declined to enjoin plaintiffs from proceeding in other jurisdictions.[3] For the provisions to be of practical benefit, then, courts in other jurisdictions have to be willing to enforce them.

Courts Outside Delaware

Courts in several states that have been asked to consider exclusive forum bylaws that specified another court as the exclusive forum for a dispute have enforced the bylaws by dismissing the litigation in their courts, leaving the plaintiffs to bring claims in the courts specified in the exclusive forum bylaws. It remains to be seen, though, whether all courts will recognize the enforceability of these provisions, and whether these and other courts will place any limits on the enforceability in specific contexts.

California. In May, a California court enforced an exclusive forum bylaw adopted by Safeway in October 2013.[4] Safeway (according to its SEC filings) had received notices from an activist stockholder and had been approached by Albertsons about a potential acquisition, but had decided not to pursue the sale at that time. Later, Safeway pursued the sale, and in March 2014 agreed to be sold to Albertsons.

Plaintiffs filed multiple lawsuits in California state and federal courts and in Delaware, alleging breaches of the Safeway directors' fiduciary duties. Safeway moved to dismiss the litigation in the California state court, pointing to the exclusive forum bylaw, and the court agreed, noting the "contractual principles" underlying the Delaware court's analysis of such provisions in Boilermakers. The court further noted that the plaintiffs had not shown why enforcement of the provision might be unreasonable in this case, and that the record did not support an argument that the provision had been adopted after the "wrongdoing" had already occurred.

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1 A company may also choose to designate its headquarter state as the exclusive forum for intra-litigation. In a recent decision, the Delaware chancery court affirmed the validity of a bylaw provision in which a North Carolina-based Delaware corporation designated North Carolina as the exclusive forum for intra-corporate disputes. *See City of Providence v. First Citizens Bancshares, Inc.*, C.A. No. 9795-CB (Del. Ch. Sept, 8, 2014). While the court expressed the view that Delaware was "the most obviously reasonable forum" for litigation involving a Delaware corporation, it explained that "the fact that the Board selected … North Carolina—the second most obviously reasonable forum given that [the company] is headquartered and has most of its operations there—rather than … Delaware as the exclusive forum for intra-corporate disputes does not … call into question the facial validity of the Forum Selection Bylaw." *Id.* It should be noted, however, that such provisions must account for the fact that Delaware law grants the Delaware chancery court exclusive jurisdiction over certain stockholder actions—such as statutory books and records proceedings.

2 *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

3 *See, e.g., Edgen Group Inc. v. Genoud*, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013).

4 *Groen v. Safeway*, No. RG14716641, 2014 WL 3405752 (Cal. Super. May 14, 2014).

The decision is all the more significant because it declined to follow a California federal court that three years previously had refused to enforce an exclusive forum bylaw.[5] The Safeway court noted that the earlier case had been decided before Boilermakers, and had involved allegations of wrongdoing prior to adoption of the bylaw.

Illinois. An Illinois court recently dismissed litigation that had been filed in Illinois against Beam after it agreed to be acquired by Suntory.[6] Beam had adopted an exclusive forum bylaw in December 2013, about a month after being approached by Suntory, and a month before agreeing to be acquired. The court noted the contractual rationale of Boilermakers, and that the complaint did not allege that any "wrongdoing" had occurred by the time of adoption of the bylaw or that the board had adopted the bylaw with a "sinister purpose."

New York. In November 2013, in one of the first cases relying on Boilermakers, the New York Supreme Court dismissed all of the derivative claims that had been brought against Aspen University by its stockholder and former CEO, citing the company's exclusive forum provision.[7] Among other things, the court specifically rejected the plaintiff's claim that an exclusive forum bylaw needed to be approved by the company's stockholders in order to be binding.

PROXY ADVISOR POSITIONS & STOCKHOLDER REACTIONS

Proxy advisory services tend to recommend against exclusive forum bylaws that are put to a stockholder vote, though, as noted below, most stockholders don't seem to be following their advice.

Both ISS and Glass Lewis state in their 2014 proxy voting guidelines that they make recommendations on how stockholders should vote on exclusive forum provisions on a case-by-case basis. Both also look for some showing of harm to the adopting corporation from other litigation and to otherwise good governance at the adopting company. Moreover, Glass Lewis says in its guidelines that it will recommend that stockholders vote against an adopting company's governance committee chair, if during the past year the board approved an exclusive forum bylaw without stockholder approval.

However, the results of votes on the bylaws that have been put to stockholders and director elections suggest that the majority of stockholders approve of such provisions:

- ISS recommended against approval by stockholders of 11 exclusive forum provisions that have been put to stockholders this year (as of early June). Nonetheless, each passed (and one other against which they recommended is still pending).
- Glass Lewis recommended against reelection of the chairman of SEACOR Holdings' nominating and governance committee after the board adopted an exclusive bylaw provision. The director nonetheless was reelected by a comfortable margin, with only about 5% of the shares voted being voted against his reelection.

TIMING

Relative to Alleged Wrongdoing. Companies seeking the benefits of exclusive forum bylaws should consider carefully the timing of their adoption. While courts have enforced such bylaws, several have noted the potential for additional questions, at least, if the bylaws are adopted after "wrongdoing" that may be the subject of litigation has occurred or appear to be adopted for an improper purpose.

In the M&A context, then, it may be best, if possible, to adopt such a provision early in the process, or even before beginning the process, before the board starts making the acquisition-related decisions that are likely to be the subject of stockholder claims. The California and Illinois courts in the examples noted above both involved adoption of exclusive forum bylaws after the company was approached by the eventual buyer, but before the company was committed to the sale and before the board had completed its process. Several companies have adopted exclusive forum bylaws concurrent with or soon before entering into a sale agreement or around the time that activists seemed to be taking positions in the stock, but courts have not yet ruled definitively on the enforceability of the bylaws in those contexts. In any event, it may be better to adopt such a provision at such a time than not at all.

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

6 *Miller v. Beam Inc.*, No. 2014 CH 00932 (Ill. Ch. March 5, 2014).

7 *Hemg v. Aspen Univ.*, No. 650457/13, 2013 WL 5958388 (N.Y. Sup. Nov. 4, 2013).

Effect of Public Announcement. Adoption of an exclusive forum bylaw, as an amendment to the bylaws, must be announced publicly via an SEC filing. Companies thus should be ready to respond to questions about the implications of the adoption. Given the number of companies currently adopting the provisions after recent court decisions, however, such an adoption may be seen as less of a signal than it might have been previously.

CONCLUSION

Exclusive forum provisions are an increasingly popular response to the costs of multi-forum stockholder litigation. Public companies should consider whether such provisions would be beneficial to them and their stockholders. Companies that anticipate substantial litigation, such as those contemplating a sale or facing aggressive activist involvement, may want to implement such provisions sooner rather than later,