

Forum Selection Provisions Upheld By Delaware Chancery Court

On June 25, 2013, the Delaware Chancery Court upheld the validity of forum selection provisions in the bylaws of Delaware corporations adopted without shareholder approval.¹ Forum selection provisions are located in either a corporation's charter or bylaws and designate specific courts as the exclusive forum where certain types of litigation may be brought. This decision was the first time a Delaware court addressed the validity of these provisions and was welcome news to many Delaware corporations and their management due to the benefits that these provisions can provide.

Background

In recent years, lawsuits against Delaware corporations and their officers and directors have increasingly been brought and decided outside of Delaware. For example, lawsuits against Delaware public company directors went from being decided in Delaware approximately 80% of the time in the mid-90s down to an average of 31% from 2005 to 2009.² This "flight from Delaware" has been driven by plaintiffs' attorneys who perceive the Delaware courts as being more management and corporate defendant friendly, more consistent in their interpretation of Delaware corporate law, more predictable in their decisions and more likely to reduce oversized attorneys fees.³ In addition, public corporations have increasingly become subject to multiple lawsuits in different jurisdictions relating to essentially identical claims brought by the same class of plaintiffs at the same time. Often, consolidating these

multiple lawsuits into one single action can be difficult if not impossible. Duplicative, concurrent multi-forum lawsuits are detrimental to corporations and their shareholders because they significantly increase the costs of litigation, expose corporations to the risk of receiving multiple and potentially conflicting decisions and increase the uncertainty of outcomes and the risk of misapplication of Delaware law by courts in other jurisdictions.

In an effort to address these issues, many corporations began adopting forum selection provisions in their charters or bylaws, especially following a 2010 decision by the Delaware Court of Chancery that suggested in *dicta* that corporations should consider adopting forum selection clauses to protect themselves and their shareholders from "frequent filer" law firms that do not serve the shareholders' best interests.⁴ To date, more than 300 public companies have adopted forum selection provisions in their organizational documents.⁵ However, the pace at which corporations were adopting these provisions stalled during the past year following the commencement in February 2012 of shareholder lawsuits against 12 Delaware corporations whose boards had amended their bylaws without shareholder approval to add forum selection provisions challenging the validity of such provisions.⁶ Most of the defendants quickly repealed their bylaws, making the lawsuits moot. Two of the defendants, Chevron and FedEx, defended their forum selection bylaws, and their cases were consolidated to allow the Delaware Chancery

Court to decide the facial validity of these provisions generally.

Delaware Chancery Court Decision

In their complaints, the plaintiff shareholders argued that forum selection provisions were (i) statutorily invalid because their adoption exceeded the board's authority under the Delaware General Corporate Law ("DGCL"), and (ii) contractually invalid because they were adopted without shareholder assent. With respect to the first claim, the Chancery Court held that the plain language of the forum selection provisions are statutorily valid because DGCL Section 109(b) permits bylaws "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." The court reasoned that since the forum selection provisions at issue were limited in nature and focused on disputes related to the company and the relationships between shareholders, officers and directors, these provisions clearly fell within the scope of permissible bylaws provisions as prescribed by DGCL Section 109(b). The court added, however, that forum selection provisions would not be statutorily valid if they limited the types of lawsuits that could be brought, or specified a forum for claims that are not related to the internal matters of the corporation or rights of its shareholders.

With respect to the second claim, the court held that the forum selection provisions are contractually valid and enforceable for two reasons. First, the certificate of incorporation for both Chevron and FedEx, similar to most Delaware corporations, expressly grants the company's board the power to unilaterally adopt bylaws. Second, these provisions put shareholders on notice that bylaws could be amended at any time by the board without prior notice to, or approval of, the company's shareholders. In the court's view, the shareholders effectively consented to the

possibility of new bylaws being adopted without their consent when they bought stock of corporations governed by such charters. If shareholders did not like any amendments to the bylaws unilaterally adopted by the board, the court reasoned that the shareholders always have the power to repeal such amendments through a majority vote.

The court refused to address a "parade of hypothetical horrors" posed by the plaintiffs to argue that the forum selection bylaws could potentially conflict with law or have unreasonable or inequitable consequences, stating such hypothetical situations did not present a genuine controversy based on concrete facts. However, the court did acknowledge that while forum selection provisions are valid as a matter of Delaware corporate law, they are nonetheless still subject to challenge. Shareholder plaintiffs, the court explained, can always sue in their preferred forum and respond to defendant's motion to dismiss for improper venue by arguing, based on actual facts, that the forum selection provisions should not be respected because their application would be unreasonable or that such provisions were being used for improper purposes inconsistent with the directors' fiduciary duties.

Forum Selection Provisions

Forum selection provisions for Delaware corporations typically prescribe Delaware as the exclusive forum to govern four types of litigation: (i) any derivative action or proceeding brought on behalf of the corporation, (ii) any action asserting a claim for breach of a fiduciary duty owed by any director, officer or other employee to the corporation or the corporation's shareholders, (iii) any action asserting a claim arising pursuant to any provision of the DGCL, the certificate of incorporation or the bylaws of the corporation or (iv) any action asserting a claim governed by the internal affairs doctrine. Forum selection provisions generally limit their scope to these categories because (a) they are the

types of litigation that can be brought by any shareholder in a representative capacity on behalf of all shareholders or on behalf of the corporation and (b) they are limited to matters that are governed by Delaware law. Accordingly, these provisions do not limit the ability of plaintiffs to bring actions in the forum of their choosing outside of Delaware with respect to claims that do not fall within the scope of the forum selection provision, such as claims based on violations of federal securities law or tort claims.

Proxy Advisors on Forum Selection Provisions

Some boards may seek shareholder approval of forum selection provisions to insulate themselves from potential shareholder challenges. Obtaining shareholder support can prove difficult because proxy advisors generally advise shareholders to vote against forum selection provisions, viewing the right of shareholders to bring suit in any forum of their choosing to be fundamental. In the past two years, a dozen companies sought shareholder approval to add forum selection provisions to their charters. Institutional Shareholder Services (ISS) and Glass Lewis recommended against all of them; nine eventually passed, two were rejected, and one was withdrawn. In addition, during 2012 there were four stockholder proposals to repeal forum selection provisions that were unilaterally adopted by the board and all of these proposals were supported by ISS and Glass Lewis. Despite this support, two of these shareholder proposals were defeated.

ISS does not separately factor in forum selection bylaws in its corporate governance score.⁷ However, when considering recommending against forum selection provisions up for vote in a proxy, ISS will consider whether a company has proxy disclosure that it has been materially harmed by litigation in a jurisdiction outside its state of incorporation and what governance “best practices” the corporation does have in

place (e.g. annually elected board, majority voting for uncontested elections, shareholder approved poison pill).⁸

Similarly, Glass Lewis is skeptical of forum selection provisions, which it views as a means of discouraging shareholder derivative actions, but it may support them if a corporation can show the provision will directly benefit shareholders, provides evidence that the corporation has been the victim of frequent frivolous lawsuits or misapplications of Delaware law, and otherwise maintains good corporate governance practices.⁹ In addition, if a forum selection provision is part of a bundled proposal to change a company’s charter or bylaws, Glass Lewis will weigh the positive and negative changes to determine their net effect for shareholders.¹⁰

Still, if a new public company has a forum selection provision in place, Glass Lewis will recommend voting against the chairman of the corporate governance committee, and if no such chairman exists, the chairman of the board.¹¹ Glass Lewis also recommends voting against the chairman of the nominating and corporate governance committee if a company adopted an exclusive forum provision without shareholder approval in the last year or is currently seeking approval for one as part of a bundled proposal to amend the company’s charter or bylaws.¹²

What’s Next?

On the heels of the *Chevron-FedEx* decision, we will likely see an increase in the adoption of forum selection provisions by corporations that do not already have them due to their obvious benefits of reducing duplicative multi-forum litigation along with the risks and corporate waste that such litigation entails. In addition, the expertise and predictability of the Delaware courts weigh in favor of Delaware companies adopting a forum selection provision. While *Chevron-FedEx* provides clarity on the fundamental premise that forum selection provisions in bylaws are facially valid, boards

should always be mindful of their ever-present fiduciary duties and make sure that the adoption and application of forum selection provisions are always being made in the best interest of the corporation and its shareholders.

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Endnotes

- 1 *Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corp., et al.*, C.A. No. 7220-CS (Del. Ch. June 25, 2013); *Iclub Inv. P'ship v. FedEx Corp.*, C.A. No. 7238-CS (Del. Ch. June 25, 2013).
- 2 Thomas T. McClendon, *The Power of a Suggestion: The Use of Forum Selection Clauses by Delaware Corporations*, 69 Wash. & Lee L. Rev. 2067, 2072 (2012).
- 3 *Id.* at 2076-2078.
- 4 *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940 (Del. Ch. 2010).

- 5 Joseph A. Grundfes and Kristen A. Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 Bus. Law 325 (2013).
- 6 Claudia H. Allen, *Exclusive Forum Provisions: Putting on the Brakes*, Corporate Accountability Report, 10 CARE 1286, Dec. 14, 2012.
- 7 ISS Governance QuickScore, Institutional Shareholder Services, Inc. (2013), available at: <http://www.issgovernance.com/files/ISSGovernanceQuickScoreTechDoc.pdf>.
- 8 2013 SRI U.S. Proxy Voting Guidelines, Institutional Shareholder Services, Inc. (2013), 3a-17, available at: <http://www.issgovernance.com/files/2013ISSSRIUSPolicy.pdf>.
- 9 Glass Lewis & Co., Proxy Paper Guidelines: 2013 Proxy Season (2012), section 5, available at: http://www.sec.gov/Archives/edgar/data/33934/000139834413001180/fp0006524_ex99votereg.htm.
- 10 *Id.*
- 11 *Id.* at Section 2.
- 12 *Id.*

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