Delaware Amends its General Corporation Law to Authorize Exclusive Forum Provisions and Prohibit Fee-Shifting Provisions

A great deal of attention has been paid over the past few years to efforts made by corporations to control in which courts internal corporate claims may be brought or to compel unsuccessful plaintiffs in internal corporate claims to pay the defendant's attorneys' fees and costs. Recently enacted amendments[1] to the Delaware General Corporation Law (DGCL) address, among other things, two types of charter or bylaw provisions on these topics that some companies have adopted.

The amendments specifically authorize provisions that specify Delaware as the exclusive forum for internal corporate claims, defined as "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." However, the amendments ban fee-shifting provisions that would impose liability for attorneys' fees and costs on stockholders bringing unsuccessful internal corporate claims. The amendments to the DGCL become effective on August 1, 2015.

Exclusive Forum Amendment

Background. In *Boilermakers Local 154 Retirement Fund v. Chevron Corporation*, 73 A.3d 934 (Del. Ch. 2013),[2] the Delaware Chancery Court upheld the validity of bylaws requiring that litigation relating to the internal affairs of the corporation be brought only in courts (including a federal court) in Delaware. Courts in several states, including California, Illinois, Ohio, New York, Louisiana and Texas, have enforced forum selection provisions (although an Oregon state court refused to enforce a corporation's forum selection bylaw that was adopted at the same board meeting at which the board recommended a merger involving the company).

According to the legislative synopsis for the amendment, the new exclusive forum provision of the DGCL confirms the holding in *Boilermakers* that:

> the certificate of incorporation and bylaws of the corporation may effectively specify, consistent with applicable jurisdictional requirements, that claims arising under the DGCL, including claims of breach of fiduciary duty by current or former directors or officers or controlling stockholders of the corporation, or persons who aid and abet such a breach, must be brought only in the courts (including the federal court) in this State.[3]

DGCL Amendment. The amendment expressly authorizes Delaware exclusive forum provisions for internal corporate claims by adding to the DGCL a new Section 115, which states:

> The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought

solely and exclusively in any or all of the courts in this State.

In addition, new Section 115 expressly prohibits charter and bylaw provisions of Delaware corporations that exclude Delaware as a forum for internal corporate claims, specifying, "no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State."

Fee-Shifting Amendments

Background. In May 2014, in *ATP Tour Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014),[4] the Delaware Supreme Court answered a series of certified questions of law and upheld the facial validity of bylaws that shift attorneys' fees and costs to unsuccessful plaintiffs in intra-corporate litigation. According to this case, fee-shifting provisions *could be* enforceable under the DGCL in situations where they were adopted by appropriate corporate procedures for a proper purpose, at least in situations where the plaintiffs obtain no relief at all against the corporation. The *ATP* case involved a Delaware nonstock membership corporation, but the Delaware Supreme Court's reasoning in its opinion was sufficiently broad as to raise the possibility that the *ATP* decision might cover public corporations as well.

Promptly following the *ATP* decision, significant controversy arose surrounding fee-shifting provisions, with extensive lobbying both in favor of and against their enforceability. At least 70 public companies, including companies in the process of going public, adopted fee-shifting provisions following the *ATP* decision.[5]

DGCL Amendments. The amendments added new subsection (f) to Section 102 of the DGCL. The new subsection specifies that the certificate of incorporation of a Delaware corporation "may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim." "Internal corporate claim" has the same meaning as provided in the exclusive forum provision described above. Similarly, the amendments modified Section 109(b) of the DGCL to prohibit bylaws from containing "any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim."

According to the legislative synopsis, the prohibitions on charter and bylaw fee-shifting provisions are not intended "to prevent the application of such provisions pursuant to a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced."[6] Therefore, a fee-shifting provision could be included in a stockholders agreement to the extent that the stockholder against whom enforcement has been sought signs the agreement.

Section 114 of the DGCL was also amended to specify that the provisions prohibiting charter and bylaw fee-shifting provisions do not apply to nonstock corporations.

The fee-shifting amendments to the DGCL do not distinguish between public or private corporations. The ban on fee-shifting charter and bylaw provisions applies to all Delaware stock corporations, whether public or private.

Practical Considerations—Forum Selection Provisions

Forum selection provisions have been growing in popularity and acceptance. Hundreds of corporations now have such provisions. According to sharkrepellent.net (a corporate governance research tool focused on takeover defense, corporate activism and proxy related issues), more than 200 Delaware corporations amended their bylaws between January 1, 2014 and June 15, 2015 to add exclusive forum provisions. Now that an exclusive forum provision is expressly authorized by the DGCL, as well as being the subject of favorable

decisions of courts in Delaware and other states, it is a provision that companies, especially those incorporated in Delaware, may want to adopt in order to avoid stockholder litigation in multiple jurisdictions and to ensure that litigation will be handled by courts that are familiar with the state law in question.

Public companies considering the adoption of an exclusive forum provision should take into account concerns of proxy advisory firms, such as Institutional Shareholder Services, Inc. (ISS) and Glass Lewis & Co. LLC (Glass Lewis), in addition to positions of their investors. For example, it is ISS's policy to generally recommend a vote against directors individually, committee members or the entire board if the board of directors amends the company's bylaws or charter without stockholder approval in a manner that materially diminishes stockholders' rights or that could adversely impact stockholders.[7] However, in February 2015 ISS issued an FAQ on this policy stating that ISS will generally not consider a provision that specifies the state of incorporation as the exclusive forum to be materially adverse.[8] ISS will take a case-by-case approach when an exclusive forum provision is submitted to stockholders for approval.

Glass Lewis will consider recommending against the chair of the governance committee if the board of directors adopts an exclusive forum provision without stockholder approval. If an exclusive provision is adopted by the board of directors prior to an initial public officering, Glass Lewis will recommend against the chair of the governance committee, or, if there is no such committee, the chairman of the board, who served at the time the provision is adopted. Glass Lewis will recommend that stockholders vote against an exclusive forum provision that a company submits for stockholder approval unless the company provides a compelling argument on why the provision would directly benefit stockholders, provides evidence of abuse of legal process in other, non-favored jurisdictions, narrowly tailors the provision to the risks involved and maintains a strong record of good corporate governance practices.[9]

Practical Considerations—Fee-Shifting Provisions

As a result of the recent statutory amendments, Delaware corporations are not allowed to adopt fee-shifting charter or bylaw provisions for internal corporate claims. The amendments do *not* provide for any "grandfathering," so there is no benefit in adopting such a provision before the effective date of the amendments or relying on a previously adopted provision. Fee-shifting charter and bylaw provisions are not available to Delaware corporations as a tool to reduce internal corporate claims litigation.

The debate over fee-shifting bylaws has been controversial. The U.S. Chamber of Commerce, for example, lobbied in favor of fee-shifting provisions as a response to the rise of litigation, including the very high percentage of litigation in connection with public company merger and acquisition transactions. In response to Delaware's enactment of the fee-shifting ban, the U.S. Chamber Institute for Legal Reform stated that it is "disappointed that Delaware chose not to enact measures to deter abusive merger-and-acquisition lawsuits while prohibiting an important and useful tool for combating these unjustified lawsuits."[10]

While the amendments to the DGCL only directly affect Delaware corporations, Delaware corporate law is very influential. Many courts outside of Delaware look to Delaware law in deciding cases to which their own corporate law applies. However, it is possible that other states may see Delaware's response to the fee-shifting issue as an opportunity to attract incorporation business to their states by adopting legislation that authorizes fee-shifting provisions. For example, Oklahoma adopted a law in 2014 mandating the shifting of fees in derivative lawsuits brought in that state. While that action may not have had much impact on corporations

outside of Oklahoma, it remains to be seen whether other state legislatures will adopt legislation permitting fee-shifting provisions and whether such action will lead to a meaningful increase in incorporations and re-incorporations in such states.

Another open question is the status of fee-shifting charter or bylaw provisions of corporations organized in jurisdictions that are silent on the permissibility of such provisions. Some of the companies that adopted fee-shifting provisions since the *ATP* decision are incorporated outside of Delaware. As long as the legislatures and courts in other states do not provide guidance on the enforceability of such provisions, companies incorporated outside of Delaware might decide to adopt fee-shifting provisions.

Public companies adopting fee-shifting provisions outside of Delaware are likely to face consequences from proxy advisory firms and potentially from investors. This is true whether the companies are incorporated outside of Delaware or they are Delaware corporations seeking to re-incorporate outside of Delaware and adopt a fee-shifting provision as part of that process. ISS will generally recommend against re-electing individual directors, committee members or the entire board if the board unilaterally amends the corporation's bylaws or charter to adopt a litigation rights provision. In the above-referenced FAQ, ISS identified fee-shifting bylaws that require a suing stockholder to bear all costs of a legal action that is not 100 percent successful as an example of a materially adverse unilateral amendment. Similarly, while ISS will generally evaluate litigation rights provisions submitted for stockholder approval on a case-by case basis, it is the general policy of ISS to vote against provisions that mandate fee-shifting whenever plaintiffs are not completely successful on the merits. And, Glass Lewis has stated that it strongly opposes fee-shifting bylaws and will recommend voting against the governance committee if such a provision is adopted without stockholder approval. In addition, any fee-shifting provision adopted by directors without stockholder approval may give rise to a stockholder proposal seeking repeal of such provision at a subsequent meeting of stockholders.

Practical Considerations—Other Litigation-Related Provisions

In October 2014, Imperial Holdings, Inc., a Florida corporation, adopted a novel minimum support provision precluding stockholders from bringing suit on behalf of the corporation or any class of stockholders against the corporation or its directors or officers without written consents by beneficial stockholders owning at least 3 percent of the outstanding shares of the corporation. While such a provision would not expressly be barred by the new Delaware statute, that does not mean that a Delaware court would necessarily enforce such a provision. Imperial Holdings and its directors have been sued over this provision and, as of the date of this Legal Update, that litigation is continuing.

Imperial Holdings adopted a strategy that is useful to consider, even in the context of other types of litigation-related provisions. Following discussions with ISS, Imperial Holdings submitted its minimum support bylaw provision to its stockholders for an advisory vote at its annual meeting and committed to rescind the bylaw if the stockholders did not approve it. In addition, prior to filing and mailing its proxy materials, Imperial Holdings invited the lead plaintiff in the litigation against the minimum support bylaw provision to submit a statement in opposition to the bylaw amendment proposal. Although the plaintiff did not a submit statement of opposition until after the company's proxy materials were mailed, the company nevertheless agreed to distribute the plaintiff's statement. At the annual meeting on May 28, 2015, the stockholders of Imperial Holdings voted to approve the minimum support bylaw amendment.

A minimum support provision, such as the one adopted by Imperial Holdings, is currently an uncommon provision, but it does reflect continued interest in innovative ways to reduce litigation brought by stockholders with small stakes in the company. As a result of the costs and prevalence of stockholder litigation, it is worthwhile for public companies to consider and evaluate evolving, new ideas. Even if a company does not find a relatively untested provision appropriate for it to adopt, it is useful to follow the reaction and impact of developments in litigation-related charter and bylaw provisions.

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Endnotes

[1] http://legis.delaware.gov/LIS/lis148.nsf/vwLegislation/SB+75/$file/legis.html?open

[2] http://courts.delaware.gov/opinions/download.aspx?ID=190990.

[3] http://legis.delaware.gov/LIS/lis148.nsf/vwLegislation/87E715E89A8C4EE785257E2F00641F25?Opendocument

[4] http://courts.delaware.gov/opinions/download.aspx?ID=205490

[5] http://www.cii.org/files/issues_and_advocacy/legal_issues/5-13-15%20Fee-Shifting%20Bylaws.pdf.

[6] http://legis.delaware.gov/LIS/lis148.nsf/vwLegislation/87E715E89A8C4EE785257E2F00641F25?Opendocument

[7] See the ISS United States Summary Proxy Voting Guidelines for 2015 at http://www.issgovernance.com/file/policy/1_2015-us-summary-voting-guidelines-updated.pdf.

[8] See 2015 Benchmark U.S. Proxy Voting Policies—Frequently Asked Questions on Selected Topics at http://www.issgovernance.com/file/policy/2015faquspoliciesonselectedtopics.pdf.

[9] See the Glass Lewis Guidelines 2015 proxy season at http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf.

[10] http://www.instituteforlegalreform.com/resource/us-chamber-disappointed-in-enactment-of-delawares-anti-fee-shifting-law/.