

KING & SPALDING

Public Company Advisor

Practical Insights for Public Company Counsel

May 10, 2012

King & Spalding's Public Company Practice Group periodically publishes the Public Company Advisor to provide practical insights into current corporate governance, securities compliance and other topics of interest to public company counsel.

What You Need To Know About Exclusive Forum Provisions

Overview

There is a recent, yet rapidly evolving, debate in Delaware surrounding exclusive forum provisions — charter or bylaw provisions mandating that intra-corporate disputes (such as stockholder derivative actions) be brought exclusively in a particular forum, typically in the corporation's jurisdiction of incorporation. Delaware corporations have adopted these provisions in their charters or bylaws with increasing frequency in the past two years, but when sixteen separate board-adopted bylaw provisions (or proposals for charter amendments) were recently challenged in Delaware Chancery Court, nearly all were voluntarily removed or abandoned.

Two large-cap companies — Chevron and FedEx — are defending their board-adopted exclusive forum provisions in cases being closely watched by corporations, investors and corporate governance experts, and all of this is happening against the backdrop of a 2011 California federal court decision refusing to enforce a similar exclusive forum bylaw provision adopted by Oracle's directors. And in a development that highlights the very issues at the core of this debate, Chevron's bylaws are now subject to a separate challenge in the very same California district court that refused to enforce Oracle's.

This issue of *The Public Company Advisor* contains an up-to-date analysis of the issues and practical advice for companies that have already adopted an exclusive forum provision and companies currently considering one.

What Is An Exclusive Forum Provision?

An exclusive forum provision is a charter or bylaw provision specifying a particular forum (typically a court in the corporation's jurisdiction of incorporation) as the exclusive forum in which stockholder derivative suits, fiduciary claims and other intra-corporate actions may be brought. Of the Delaware corporations adopting these provisions to date, a substantial majority have included them in their charters, usually in the context of an IPO, spin-off, reincorporation or reorganization. The remainder have amended their bylaws by board action to include such a provision. These provisions can specify Chancery and/or other courts as the exclusive forum,

and can be mandatory or can be elective — providing the corporation the ability to elect to proceed in the specified forum or in plaintiff's chosen forum. For reference, we have included Chevron's and FedEx's exclusive forum provisions on Annex A.

Why Have Exclusive Forum Provisions Become So Popular?

Delaware corporations are seeking to manage multi-jurisdictional M&A and stockholder litigation in a way that minimizes expense, reduces potential settlement costs and provides them with the stability and predictability of the Delaware courts — a key factor in their incorporating in Delaware in the first place. After a deal is announced, a race to the courthouse typically ensues, with plaintiffs' counsel in multiple jurisdictions vying for their motions for expedited proceedings and preliminary injunction to be heard first. Defendants in these cases often file a "one forum motion" with multiple jurisdictions requesting that the litigation proceed only in one forum and be dismissed or stayed in the other court(s). Whether or not a one forum motion is granted depends on the case, the jurisdictions and the judges. A denial means concurrent litigation — and litigation expense — in separate forums and the possibility of inconsistent rulings on procedural motions such as expedited discovery. This, along with a perceived uncertainty when non-Delaware judges are interpreting Delaware law, may lead plaintiffs' lawyers to take a more robust view of the settlement value of their claim.

None of this went unnoticed in the Chancery Court or in general counsel's offices. Following Vice Chancellor Laster's March 2010 suggestion in dictum that "if boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes",¹ Delaware companies rushed to adopt exclusive forum provisions.

Is An Exclusive Forum Provision Valid Under Delaware Law?

The answer to this question will have to await the decisions (and likely appeals) in the pending cases, but it is worth noting that the Chevron and FedEx provisions being challenged are board-adopted bylaw provisions, not stockholder-approved charter provisions. The latter was referenced explicitly with approval by Vice Chancellor Laster as noted above. In both Chevron's and FedEx's case, the plaintiffs claim that their bylaws are invalid and unenforceable for a number of reasons, including that they apply to persons not subject to bylaw regulations (i.e., former stockholders), violate statutory limits on the Court of Chancery's subject matter jurisdiction and conflict with Federal statutes and impermissibly impinge on Federal jurisdiction.

Both Chevron and FedEx answered their plaintiff's complaints in the respective Delaware cases before Chancellor Strine by asserting that their validly-adopted bylaw simply require issues of internal affairs to be litigated in Delaware, thus benefitting their stockholders by ensuring Delaware judges adjudicate issues of Delaware law and by eliminating duplicative litigation (and litigation costs). Briefs have not yet been filed.

Even If It Is Valid In Delaware, Will Another Jurisdiction Enforce It?

The answer is unclear, but following a California federal court's January 2011 decision in the *Galaviz* case,² it appears an exclusive forum provision in a stockholder-approved charter

¹ *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 961 n.8 (Del. Ch. Mar. 16, 2010).

² *Galaviz v. Berg*, 763 F.Supp.2d 1170 (N.D. Cal. Jan. 3, 2011).

amendment would have a much greater likelihood of enforcement than a board-approved bylaw amendment. In *Galaviz*, the court refused to enforce an exclusive forum provision adopted by Oracle's board and denied defendant's motion to dismiss for improper venue. In particular, the court noted that the exclusive forum provision was adopted by the board after the alleged misconduct took place and by the directors who were then-named defendants in the case. Had Oracle's directors adopted their exclusive forum provision prior to such alleged misconduct, would the court's opinion have been different? Those facts have yet to be tested. The *Galaviz* court did, however, contrast a unilateral bylaw adoption with dicta stating that "were a majority of stockholders to approve such a charter amendment, the arguments for treating the venue provision like those in commercial contracts would be much stronger, even in the case of a plaintiff shareholder who had personally voted against the amendment."³

In a challenge to Chevron's bylaw filed in California federal court on March 30, 2012,⁴ plaintiffs are seeking both an injunction against enforcement of the exclusive forum provision and declaratory judgment that the exclusive forum bylaw provision is invalid under Delaware law. The facts, and plaintiffs' claims, are very similar to the case now pending before Chancellor Strine. Chevron's reply — and the interesting potential for a "one forum motion" — will be watched with great interest.

What Has Been The Reaction of Proxy Advisory Firms and Institutional Stockholders?

ISS and Glass Lewis are both vocally opposed to exclusive forum provisions and will likely recommend "against" any stand-alone proposal. For the 2012 proxy season, Glass Lewis has adopted a flat "against" policy, while ISS's policy is case-by-case consideration where a favorable recommendation is likely to be the exception. Glass Lewis will recommend an "against" vote for the chair of the corporate governance committee at any company that adopts an exclusive forum provision without stockholder approval (including a newly-public company). Further, the Council of Institutional Investors has issued a formal policy against the adoption of exclusive forum provisions.

In the 2011 proxy season, three large-cap companies proposed charter amendments to adopt exclusive forum provisions. Two of these passed, narrowly achieving the majority-of-the-outstanding needed for a charter amendment to be approved, and one failed.

What Are Other Companies Doing?

Momentum appears to be shifting against exclusive forum provisions, at least in the immediate term. Companies whose bylaw provisions are not subject to challenge by plaintiffs or stockholders appear to be awaiting Chancellor Strine's decisions before taking next steps, as there may be (assuming such provisions are found to be valid) necessary refinements to them based on the decision and legal analysis. As noted above, the board of directors of almost every corporation whose exclusive forum provision has been challenged in court has voluntarily removed it. Of the four stand-alone proposed charter amendments to implement exclusive forum provisions this proxy season, two have been withdrawn as of the date of publication of this article.

³ Id. at 1175. Earlier in the opinion, the *Galaviz* court noted that exclusive forum provisions in contracts were enforceable except in limited circumstances. Id. at 1173.

⁴ *Bushansky v. Armacost et. al.*, case no. 4:2012cv01597 (N.D. Cal.)

Following the initiation of the plaintiff's suit, Chevron amended its exclusive forum provision, replacing the Chancery Court as the exclusive forum with "a state or federal court located within the state of Delaware, in all cases subject to the court's having personal jurisdiction over the indispensable parties named as defendants." Similar limiting language regarding "indispensible parties" previously has been adopted by a small number of Delaware companies.

What Should You Be Doing Now?

Because momentum has shifted (at least temporarily) against the trend of adopting exclusive forum provisions, public companies yet to propose or adopt an exclusive forum provision may conclude that a wait-and-see approach is prudent. This avoids a potential showdown with plaintiffs' firms and/or activist stockholders. On the other hand, a bylaw provision validly adopted by a company's board of directors in the absence of any prior alleged misconduct has yet to be held invalid or unenforceable, so a company may conclude to adopt such a provision now, and modify, withdraw, or propose it as a charter amendment later if need be.

For companies that have already adopted exclusive forum provisions:

- Compare your provision to the latest technology. As noted above, Chevron amended its exclusive forum provision in connection with pending litigation before Chancellor Strine. Consider whether these or other changes would enhance the enforceability of, or otherwise improve, your company's exclusive forum provision. Obviously, any change should be thoughtfully considered with counsel — FedEx did not amend its bylaws in connection with its Delaware proceedings.
- Talk to your proxy advisor and key stockholders. As always, it is critical to maintain close contact with your stockholder base, especially as proxy season is now in full swing. Even if the adoption of an exclusive forum charter provision is not on the agenda for your meeting, the fact that your company may have already implemented such a provision (for example in a bylaw amendment, or an IPO or recapitalization) might influence stockholder voting and ISS/Glass Lewis recommendations on director elections, in particular for members of the corporate governance committee. Early and often contact is the best way to identify and address these issues.
- Plan your response to a potential lawsuit or stockholder proposal. Plaintiffs' recent success in forcing boards of directors to remove exclusive forum bylaw provisions may lead to additional suits against other Delaware companies and an emboldened stockholder base. A small number of non-binding proposals to repeal board-adopted exclusive forum provisions have been reported this proxy season, and on March 19, 2012 the staff of the SEC issued its first no-action letter on exclusive forum provisions, denying a request to exclude a stockholder proposal seeking to repeal a board-adopted exclusive forum bylaw provision.⁵ With the SEC's view now clear that stockholder proposals under Rule 14a-8 seeking repeal of board-adopted bylaws cannot be excluded, companies should be prepared that more such proposals may follow. Notably, Chevron's stockholders will have an opportunity to voice their opinion, as a stockholder

⁵ Available at: <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/amalgamatedbank032912-14a8.pdf>

proposal requesting that Chevron's board remove its exclusive forum bylaw provision is on the ballot.

- Consider whether now is the time to take preemptive action. Given the current uncertainty surrounding exclusive forum provisions, we believe most companies will conclude the prudent course for now is to await resolution of these matters in Delaware court. There are, however, a number of alternatives available:
 - *Amend board-adopted bylaws.* A clarifying amendment to bring exclusive forum provisions up-to-date with the latest technology may be desirable, but directors may not want the attention that such a new bylaw amendment might attract when the proxy season is in full swing. Note, however, that as seen in the *Galaviz* case, timing may be very important in board adoption of exclusive forum bylaw provisions.
 - *Propose a charter amendment.* For a company with an existing exclusive forum bylaw provision wishing to provide maximum likelihood of enforceability, an amendment to the charter to include the exclusive forum provision could be considered. However, garnering the requisite stockholder vote may be challenging depending on the company's stockholder base, and, in practical terms, may only be possible in many circumstances if the company otherwise has (or is adopting) stockholder-friendly governance provisions. As noted earlier, two of four stand-alone proposals have already been withdrawn this proxy season. In addition, if the proposed charter provision fails to pass, this could put pressure on the company's board to repeal the existing bylaw provision. As a result, we believe very few companies will pursue this path in the near term, unless following discussions with their proxy advisor they believe that their particular stockholder base would be amenable to such a provision.
 - *Repeal exclusive forum bylaw provisions unilaterally.* Some companies may consider repealing their exclusive forum bylaw provisions. However, absent a stockholder lawsuit challenging the provision or a concern that the chair of the governance committee or other members of the governance committee will be subject to a successful withhold vote campaign, there likely is greater benefit for a company to retain its existing exclusive forum provision.

Please contact us at the number below with any questions on this important topic.

About King & Spalding's Public Company Practice Group

King & Spalding's Public Company Practice Group is a leader in advising public companies and their boards of directors in all aspects of corporate governance, securities offerings and regulatory compliance and disclosure.

About King & Spalding

Celebrating more than 125 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 800 lawyers in 17 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters

in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality and dedication to understanding the business and culture of its clients. More information is available at www.kslaw.com.

The Public Company Advisor provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice. For more information on this issue of the Public Company Advisor, please contact:

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Annex A

Sample Exclusive Forum Provisions

(Chevron, as of March 28, 2012)

Unless the Corporation consents in writing to the selection of an alternative forum, the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine shall be a state or federal court located within the state of Delaware, in all cases subject to the court's having personal jurisdiction over the indispensable parties named as defendants. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this Article VII.

(FedEx, as of September 26, 2011)

Unless the corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (a) any derivative action or proceeding brought on behalf of the corporation, (b) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the corporation to the corporation or the corporation's stockholders, (c) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (d) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the corporation shall be deemed to have notice of and consented to the provisions of this Section.