

Analyzing the Delaware Court Decision to Uphold Exclusive Forum-Selection Bylaw Provisions

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The Delaware Court of Chancery upheld the facial validity of exclusive forum-selection bylaw provisions in a recent decision. As we explain in our [memo](#), the opinion is notable for both its scope and limitations. Scott Luftglass from our litigation practice and pmills from our M&A practice explain the key aspects of exclusive forum-selection provisions and the opinion from Chancellor Leo E. Strine Jr.

What is the purpose of exclusive forum-selection bylaws?

Shareholder and derivative litigation against companies and/or their boards of directors often can be brought in multiple jurisdictions since companies have several places of operations. When parallel suits proceed in multiple jurisdictions (for example, in the state in which a company is incorporated and in the state in which the company is headquartered), the parties run the risk of inconsistent rulings, and the defendants bear the additional costs and burdens of having to litigate the same facts and issues in two jurisdictions.

The governing law in both cases will be the law of the state in which the company is headquartered (which is Delaware for most large public companies). Exclusive forum-selection provisions usually designate the state of incorporation (in most cases, Delaware) as the single forum for derivative lawsuits, lawsuits brought under the Delaware General Corporation Law and other lawsuits involving companies' internal affairs, in order to better control the costs, inefficiencies and risk of inconsistent rulings arising from defending the same claim in multiple jurisdictions. In the last three years, over 250 public companies have adopted forum-selection bylaws.

What did the lawsuits allege?

Complaints against about a dozen companies were filed in February 2012 alleging that the adoption of exclusive forum-selection bylaws were beyond the boards' authority and therefore statutorily invalid, and since they were also adopted without stockholder approval, the bylaws were also alleged to be contractually invalid. Many companies repealed the bylaws in the face of the lawsuits, but Chevron and FedEx proceeded with the litigation. Their bylaws provided that the Delaware courts would be the sole and exclusive forum for derivative actions brought on behalf of the corporation, breach of fiduciary duty claims, claims arising under the Delaware General Corporation Law or claims governed by the internal affairs doctrine. The companies could waive the provision and allow litigation in another forum under certain circumstances.

What was the finding by the Delaware Court of Chancery?

Chancellor Strine agreed with Chevron and FedEx that the exclusive forum-selection bylaws that their boards adopted were facially valid. The bylaws were deemed valid on statutory grounds because they addressed a proper subject matter regulating the internal affairs of the company. In addition, the bylaws were contractually valid because the boards of Chevron and FedEx had the right to adopt bylaws unilaterally, and investors were aware of that power when they bought stock in those companies.

Are there limitations to the Court's opinion?

Yes, the opinion emphasized that the bylaws remain subject to later challenges by plaintiffs who may be affected by the operation of the bylaws in specific circumstances and that plaintiffs may argue that the invocation of the bylaws in certain circumstances is inconsistent with a board's fiduciary duties. While the Chancellor declined to engage in "what-if" scenarios in upholding these bylaws, he acknowledged that future litigation may challenge whether the bylaws may be found to operate in an unreasonable or unlawful manner (as is the case with any forum-selection provision in a commercial contract).

What uncertainties remain about board-adopted exclusive forum-selection provisions?

A number of meaningful uncertainties still exist after this case. It is unclear how courts *outside of Delaware* will enforce exclusive forum-selection bylaws if a suit is brought in another jurisdiction. Investors may question boards who elect to adopt these types of bylaws as a governance matter, including the possibility of submitting shareholder proposals seeking their repeal. Finally, some companies may decide that they would rather retain flexibility in terms of litigation forums.

How common is it to get a shareholder proposal to repeal the provision and what has been the advisory firms' positions?

It has not been common to get a shareholder proposal to repeal the provision, especially since the lawsuits began. Chevron received one in 2012 that went to a vote, which garnered 22% in support of repealing the provision. However, it is likely that proponents have been waiting for this decision, and may submit more proposals for the 2014 season. Contrary to the initial expectations of a good number of commentators, there is a greater risk that the proxy advisory firms will favor these stockholder proposals than anticipated, although the decisions are subject to a case-by-case analysis. For example, ISS requires companies to disclose actual harm suffered from multi-forum litigation (to explain the basis for adopting a forum-selection bylaw). In addition, Glass Lewis has indicated in its policy that it may issue a negative vote recommendation against the chairman of the governance committee if the company adopts an exclusive forum-selection bylaw without stockholder approval.

Have companies sought shareholder approvals to include exclusive forum-selection provisions in their charters instead?

Since 2011, about 12 companies have sought shareholder approval to include the provision in their charters. ISS recommended against the proposals in each instance. All but two passed and one was withdrawn. Some were fairly close votes and several of the companies where the proposal passed had fairly high insider ownership, especially in 2013. Given that a company proposal to amend the charter would probably face a negative recommendation from proxy advisory firms, current sentiment is that it would be difficult for companies without any kind of significant insider ownership to be certain the proposal would pass.

What are the pros and cons for including this provision in the charter instead of as a board-adopted bylaw?

Seeking shareholder approval should insulate the company from criticism that the board acted unilaterally. Particularly given this recent decision upholding board-adopted bylaws, a charter provision likely would be upheld by the Delaware courts. Moreover, shareholders seeking to challenge these provisions will face an uphill battle arguing they are not in the shareholders' best interests.

However, as we noted above, in most cases, for broadly held public companies, it would likely be difficult for the proposal to win. If such a management proposal to amend the charter does not receive majority support from shareholders, it may be more difficult for the board to then adopt a bylaw in the face of votes from shareholders indicating that they disfavor the provision. Even if a charter provision is a possibility, it would also be more difficult to amend or repeal once it is in the charter instead of the bylaws.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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