Exclusive Forum Selection Bylaws: Enforceability and Effectiveness

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On September 8, 2014, the Delaware Chancery Court upheld a newly adopted bylaw of a Delaware corporation that designated an exclusive forum outside Delaware for litigating intra-company disputes (See *City of Providence v. First Citizens Bancshares, Inc., et al.*, C.A. No. 9795-CB (Del. Ch. 2014)). This case is the most recent holding in a line of decisions that validate corporate actions to minimize the costs and uncertainty of multi-state litigation by establishing an exclusive forum to litigate increasingly common lawsuits arising out of M&A transactions, while still preserving stockholder rights.

Exclusive Forum Selection Provisions

In the current M&A market, stockholder litigation against a company for violating fiduciary duties, or various other corporate duties, is brought in nearly every public M&A transaction. For example, of the M&A transactions with a transaction value in excess of $100 million, that involved public targets, and were completed in 2013, 94% resulted in stockholder litigation, averaging five lawsuits per transaction. More often than not, these lawsuits are "strike suits" brought by stockholder activists. Strike suits are those aimed primarily at obtaining a settlement from a selling company that includes attorneys' fees and some additional disclosures, but rarely result in a higher purchase price. In order to increase settlement amounts and attorneys' fees, nearly identical lawsuits are often filed in multiple jurisdictions, resulting in a selling company having to defend the same suit in different locations. Given this increasingly hostile environment, exclusive forum selection provisions are becoming an ever more popular mechanism to prevent the waste of corporate time and assets by consolidating all suits to a single jurisdiction.

Typically, an exclusive forum selection provision designates the state of incorporation (*e.g.*, Delaware) as the jurisdiction where all lawsuits relating to intra-company disputes must be brought. However, as discussed below, the *First Citizens* decision may open the door for companies to choose other reasonable jurisdictions, such as the location of a company's headquarters, as the exclusive forum. In addition to the costs saved by not having to litigate similar disputes in multiple parts of the country, a forum selection provision provides the added benefit of having disputes heard by experienced judges in communities where several of the stakeholders of the company are located.

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In general, forum selection clauses are limited to: (i) any derivative action or proceeding, (ii) any claim of breach of a fiduciary duty, (iii) any claim under the state of incorporation's General Corporation Laws, and (iv) any claim governed by the internal affairs doctrine. In addition, the vast majority of forum selection clauses allow the board of directors to waive the exclusive forum if such waiver is in the best interest of the company. Such ability to waive the exclusive forum provision provides the opportunity for the board of directors to maximize the cost savings potential in the event one location is more beneficial than another to litigate a dispute.

If a board of directors has the authority to modify a company's bylaws, then it can typically add an exclusive forum provision to the bylaws by unilateral action. This reduces administrative issues with implementing the provision, while not decreasing the likelihood of enforceability. While various stockholder advocacy groups such as Institutional Shareholder Services have generally issued negative opinions of exclusive forum selection clauses, their positions have softened over the previous year. Even institutional investors, such as T. Rowe Price, have begun to support these provisions due to the realization that strike suits effectively diminish investments without providing actual return to stockholders.

Enforceability of Provision

The increasing prevalence of using forum selection as a defensive measure arose from the 2013 Delaware Chancery Court decision *Boilermakers Local 154 Ret. Fund v. Chevron Corp.* (See *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. 2013)). In *Chevron*, the Court upheld a unilaterally adopted bylaw provision by a Delaware corporation's board of directors declaring Delaware as the exclusive jurisdiction where a stockholder could bring an action against the company. Since the *Chevron* decision, only one state court has disallowed the enforcement of an exclusive forum selection provision (See *Roberts v. Triquint SemiConductor, Inc.*, No. 1402-02441 (Or. Cir. Ct. 2014)). In *Roberts*, the Oregon Circuit Court held that, while generally enforceable, a forum selection provision cannot be enacted if adopted after any alleged "wrongdoing" (*i.e.*, as part of the M&A transaction being challenged). The main concern of the *Roberts* Court was that a board of directors should not be able to enact a forum selection provision when the company is under the threat of impending litigation or as part of a transaction from which litigation is sure to arise. The Court held that modifying the bylaws to include a forum selection clause on the same day a merger was announced resulted in an unenforceable provision. This decision, while an outlier, provides potentially persuasive precedent for a stockholder challenge in a state other than Delaware.

First Citizens expands the flexibility of a board even further by allowing it to both: (i) adopt a provision that establishes exclusive jurisdiction in a state other than the state of incorporation and (ii) adopt this forum selection provision during the transactional process. In *First Citizens*, the board of directors of First Citizens Bancshares, Inc., a Delaware corporation, announced a merger and modified its bylaws to mandate all stockholder litigation be brought in the Eastern District of North Carolina, both on the same day. The Court, citing, *Chevron*, held that a forum selection clause "should be upheld unless enforcement is shown by the resisting

party to be 'unreasonable.'" Declaring that North Carolina was the "second most obviously reasonable forum" due to the location of the company's headquarters, the Court had no issue in dismissing the claim that the forum choice was unreasonable. Further, the Court specifically disregarded the decision in *Roberts*, holding the timing of enacting an exclusive forum provision is irrelevant, so long as an improper purpose is not demonstrated.

Conclusion and Certain Recommendations

Any public company considering a sale, or a company that is at risk of stockholder activism litigation, should consider including an exclusive forum selection provision in its bylaws. As discussed above, not including such a provision leaves a company at risk of defending similar stockholder lawsuits in multiple jurisdictions at an increased cost for the company. Since the *Chevron* decision, there has only been one case (*Roberts*) that has held a board approved forum selection bylaw amendment unenforceable, and that holding was solely due to the timing of the adoption of the amendment.

Despite the general trend towards enforceability, courts have suggested there are limitations to the enforceability of these provisions. Even though *First Citizens* held that the timing of amendments is irrelevant, since the majority of states have not ruled on this issue, it is still in a company's best interest to amend its bylaws to include an exclusive forum selection provision prior to beginning any M&A transaction. This will help ensure that a potential stockholder cannot use the *Roberts* precedent to challenge the enforceability of these provisions. There will be certain situations when a company has no option but to amend its bylaws simultaneously with a M&A transaction. In such a situation, the provision may still be enforceable so long as it is not done with improper purpose.

If a company makes a strategic decision that it would rather litigate disputes in a jurisdiction other than its state of incorporation, it should make sure its forum selection is "reasonable". While *First Citizens* stated in dictum that "in the appropriate case, a foreign forum selection provision may not withstand scrutiny", it also provides that a forum selection in the location of a company's headquarters where it has substantial operations will likely be enforceable.

Overall, a forum selection provision for stockholder lawsuits is an effective defensive measure that can help protect company assets in the event of a lawsuit and still provide stockholders an opportunity to redress issues. Following the *First Citizens* and *Chevron* precedents, many state courts will likely continue to enforce these provisions. While there is some uncertainty, as some states may look to the *Roberts* holding, a reasonable provision that is not enacted as part of a challenged M&A transaction carries a strong possibility of enforcement.

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