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Implementing Exclusive Forum Selection Clauses: Now or Never?

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Over the past year, a significant number of companies have adopted forum selection provisions in their corporate governing documents establishing that derivative actions and other actions against the corporation may only be brought in the state of incorporation. This practice gained popularity among corporations following a recent opinion by the Delaware Court of Chancery suggesting that corporations may adopt charter provisions that establish an exclusive forum for intra-company disputes. [1] Despite the increasing popularity of exclusive forum selection clauses, the enforceability of these clauses remains unclear, particularly if the clause is adopted by a company without shareholder approval. While shareholder approval is likely to enhance the enforceability of these clauses, obtaining that approval may become increasingly difficult as shareholder activists and institutional proxy advisory firms harden their opposition to the adoption of these clauses.

Forum Selection Clauses: A Sensible Solution to Duplicative Litigation

Implementation of exclusive forum selection clauses is a direct response to the growing number of plaintiffs bringing claims outside of a corporation's state of incorporation, often in the state of its headquarters or in multiple jurisdictions. Delaware corporations are particularly susceptible to multiforum litigation strategies as most of these corporations have headquarters outside of that state. Litigation outside of Delaware may appeal to plaintiffs seeking to gain control of a foreign jurisdiction action, recover attorneys' fees and avoid the Chancery Court's efforts to aggressively monitor settlement costs. The out-of-Delaware litigation trend is of particular concern in the M&A context, where acquisition-related litigation is likely to accompany a transaction and often involves multiple lawsuits.

Implementing a Forum Selection Clause

Exclusive forum selection clauses may help a corporation avoid the excessive costs resulting from the duplicative litigation of shareholder lawsuits and other intra-company disputes. These clauses vary in scope but generally require any dispute to be brought in the state of incorporation for claims that arise out of a derivative action, claims of breach of fiduciary duty by a director or an officer, and claims under the applicable state corporation law or the corporation's governing documents. An exclusive forum provision reduces incentives for plaintiffs' counsel to engage in out-of-Delaware and multiforum litigation strategies, because it affords corporations the right to have litigation in foreign courts dismissed or stayed in favor of litigation in the state of incorporation.

The majority of public companies that have implemented exclusive forum selection clauses have done so prior to their initial public offering process by including the provision in their charters or through bylaw amendments adopted by the board of directors after the company has gone public; only a few have subjected these clauses to a charter amendment vote by their shareholders. Although established companies continue to use bylaw amendments to adopt exclusive forum selection provisions, there is growing indication that forum selection provisions adopted in this manner may not be

continued next page

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enforceable. This concern first surfaced in early 2011 following a decision in which a federal district court, applying federal law, determined that a provision in the corporation's bylaws that required all derivative suits to be filed in a particular jurisdiction was not sufficient to warrant a dismissal for improper venue because the clause at issue was unilaterally adopted by the defendant directors.[2]

Concerns about the enforceability of these clauses have intensified as lawsuits have been filed in the Delaware Court of Chancery challenging the forum selection bylaws of nearly a dozen corporations.[3] The majority of the companies sued have since repealed the challenged bylaw provisions and the claims have been dismissed for mootness. Chevron Corporation has opted to defend the litigation, but revised its forum selection bylaw provision to restrict its application solely to cases where the court has personal jurisdiction over the indispensable parties named as defendants.[4]

In addition to the threat of litigation over the adoption of these clauses, companies may also be faced with shareholder proposals calling for the repeal of exclusive forum provisions. At least four public companies have been targeted this year with shareholder proposals calling for such repeals.[5] Management recommendation and adoption of bylaws with exclusive forum clauses can also have repercussions in subsequent proxy seasons, as institutional investors have clearly indicated that they will oppose board of director candidates who have adopted exclusive forum clauses without shareholder approval. Proxy advisory firm Glass Lewis & Co. has taken a similar hard stance and has announced its intention to recommend against governance committee chairs at companies that adopt a forum selection provision without shareholder approval, or do so before going public.

The Challenge of Obtaining Shareholder Approval

In light of the uncertain enforceability of exclusive forum bylaw provisions and the recent backlash against them, any corporation looking to implement an exclusive forum clause should consider doing so by seeking shareholder approval of a charter amendment. No court has yet ruled on the validity of those provisions, but the Delaware Court of Chancery and at least one court outside of Delaware have suggested that charter amendments with exclusive forum provisions are likely enforceable.

Whether a particular company's shareholders would ultimately approve a proposal to add an exclusive forum selection clause depends on a number of factors, including the composition of the company's shareholder base and whether the provisions are standalone proposals or included within broader charter amendments. During the 2011 proxy season, six public companies proposed charter amendments with exclusive forum selection clauses and five of them passed. These types of results, however, may become more unusual given the strong opposition to these clauses by proxy advisory firms and the Council of Institutional Investors.

In 2012, several companies have sought shareholder approval for a charter amendment including an exclusive forum clause. Of those companies, at least one[6] is already the subject of a lawsuit challenging the adequacy of the disclosure related to the exclusive forum charter amendment in its proxy statement and another[7] has chosen to withdraw its proposal. The policies against exclusive forum selection clauses adopted by proxy advisory firms, investor firms and shareholder activists, coupled with the recent flurry of litigation on this issue, show a growing resistance to the implementation of these clauses.

Consequently, any corporation planning to propose a charter amendment with an exclusive forum provision should carefully weigh the costs and risks of litigation against the benefits of the provision. Those corporations that remain intent on implementing such a clause should consider moving swiftly to seek shareholder approval before opposition to these clauses becomes more prevalent.

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[1] In re Revlon, Inc. Shareholders Litigation, 990 A.2d 940, 960 (Del. Ch. 2010).

[2] Galaviz v. Berg, 763 F. Supp. 2d 1170, 1175 (N.D. Cal. 2011).

[3] Navistar International Corp., AutoNation, Inc., Chevron Corp., SPX Corp., Superior Energy Services, Inc., Franklin Resources, Inc., Curtiss-Wright Corp., Danaher Corp., Solutia Inc., FedEx Corp. and Air Products and Chemicals, Inc.

[4] Chevron Corp.'s amended bylaws are available at www.chevron.com/documents/pdf/chevronbylaws.pdf.

[5] Proponent Amalgamated Bank filed such shareholder proposals for Roper Industries, Inc., Chevron Corp., United Rentals, Inc. and Superior Energy Services, Inc. (withdrawn after the company agreed to repeal the exclusive forum selection clause).

[6] Cameron International Corp. In response to the litigation the company made a few additional clarifications in its proxy statement, please see www.sec.gov/Archives/edgar/data/941548/000104746912004443/a2208934zdefa14a.htm.

[7] Fairchild Semiconductor International, Inc.