

Client Alert

September 2014

The Latest on Exclusive Forum Bylaws: DE Court Enforces Bylaw Requiring Stockholder Litigation to Be Brought Outside of Delaware

On September 8, 2014, in *City of Providence v. First Citizens Bancshares, Inc.*, the Delaware Court of Chancery upheld an exclusive forum bylaw adopted by the board of directors of a Delaware corporation that required corporate disputes to be brought exclusively in North Carolina courts.¹ The court also dismissed the stockholder-plaintiff's claim that the board of directors acted inequitably by adopting the bylaw concurrently with the approval and announcement of a merger. The decision answers an issue of first impression — whether a board of directors of a Delaware corporation can designate an exclusive forum other than a Delaware court. In this case, the corporation's primary business was in North Carolina, which led the court to find that it was a reasonable forum. The decision also reaffirms generally the facial validity of exclusive forum bylaws under Delaware law.

Take-Aways

- The facial validity of exclusive forum bylaws was upheld in 2013 by the Court of Chancery in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.* The plaintiffs did not pursue an appeal of the *Chevron* ruling.
- Since *Chevron*, exclusive forum bylaws continue to gain traction to prevent multi-forum litigation.
- Several courts outside of Delaware have enforced exclusive forum bylaws and dismissed litigation brought in contravention of them.
- In the most recent case, *First Citizens*, the Court of Chancery upheld an exclusive forum bylaw of a Delaware corporation that required stockholder litigation to be brought in North Carolina courts. Although the vast majority of exclusive forum bylaws adopted by Delaware corporations select the Court of Chancery as the designated venue, some companies may decide to place venue in a different court.
- *First Citizens* also rejected the plaintiff's claim that the exclusive forum bylaw was improper because it was adopted in connection with the announcement of a merger agreement.
 - “That the Board adopted [the exclusive forum bylaw] on an allegedly ‘cloudy’ day,” the court wrote, “rather than on a ‘clear’ day is immaterial given the lack of any well-pled allegations ... demonstrating any impropriety in this timing.”
- We expect more Delaware corporations will adopt exclusive forum bylaws.
- We also believe that sophisticated institutional investors should recognize the benefits of an exclusive forum bylaw to prevent the corporate waste and opportunistic forum-shopping associated with multi-forum litigation.

¹ *City of Providence v. First Citizens Bancshares, Inc.*, Consol. C.A. No. 9795-CB (Del. Ch. Sept. 8, 2014).

A Recap on Exclusive Forum Bylaws

Since 2010, numerous Delaware corporations have adopted so-called “exclusive forum bylaws,” which require derivative lawsuits, stockholder class actions, and other intra-corporate disputes to be brought in a specified venue — namely, the Delaware Court of Chancery or a federal district court sitting in Delaware. These bylaws were adopted to curb the rising problem of “multi-forum litigation” in which stockholders file suit in different venues challenging the same transaction or subject matter.² Multi-forum litigation is wasteful to the corporation and allows for opportunistic forum-shopping by plaintiffs.³ It also risks inconsistent outcomes in different courts.

The first challenge to an exclusive forum bylaw came in a California federal court in *Galaviz v. Berg*.⁴ There, the district court refused to dismiss the litigation, but it focused on the fact that most of the challenged misconduct occurred before the bylaw was adopted. Then, in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, then-Chancellor (now Chief Justice) Leo E. Strine, Jr., upheld the facial validity of exclusive forum bylaws under Delaware law.⁵ The *Chevron* plaintiffs initially filed an appeal with the Delaware Supreme Court, but that appeal was withdrawn and the trial court’s decision remains in effect.

Since *Chevron*, numerous Delaware corporations have adopted exclusive forum bylaws.⁶ By one count, 105 exclusive forum bylaws were adopted in the four-month period following *Chevron*.⁷ A handful of non-Delaware corporations have also adopted exclusive forum bylaws, including in:

- Maryland,
- Pennsylvania,
- Nevada,
- Oregon,
- Florida,
- South Carolina, and
- Virginia.⁸

Moreover, a Maryland court has upheld a bylaw requiring that investors in a real estate investment trust submit their claims to arbitration.⁹

² Vice Chancellor J. Travis Laster gave momentum to exclusive forum bylaws in his decision in *In re Revlon, Inc. S’holders Litig.*, 990 A.2d 940, 960-61 (Del. Ch. 2010), where he suggested 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.”

³ See generally Joseph A. Grundfest & Kristen Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325 (2013); Joseph A. Grundfest, *The History and Evolution of Intra-Corporate Forum Selection Clauses: An Empirical Analysis*, 37 DEL. J. CORP. L. (2012); Claudia H. Allen, *Trends in Exclusive Forum Bylaws*, Director Notes—The Conference Board (Jan. 2014).

⁴ *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011).

⁵ *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

⁶ Several companies have also included exclusive forum provisions in their certificates of incorporation in connection with their initial public offerings.

⁷ See Allen, *supra*, at 3.

⁸ See *id.*

The certainty associated with exclusive forum bylaws has also been bolstered by several non-Delaware decisions dismissing claims brought in violation of them, including in California, Illinois, New York, and Texas.¹⁰ Nevertheless, this continues to be an evolving area. In a post-*Chevron* ruling, for example, an Oregon state court refused to enforce an exclusive forum bylaw that was adopted in connection with the announcement of a merger.¹¹ Like the *Galiviz* case in California, the Oregon court focused on the fact that the alleged wrongdoing occurred prior to the bylaw's adoption. In addition, in *Edgen Group Inc. v. Genoud*, Vice Chancellor J. Travis Laster declined to issue an anti-suit injunction and expressed concern over the Court of Chancery's jurisdiction to enjoin a non-Delaware resident stockholder who had filed a complaint in Louisiana.¹² The Louisiana court ultimately granted the defendants' motion to dismiss.

Background of First Citizens Litigation

The most recent Delaware decision addressing exclusive forum bylaws is *City of Providence v. First Citizens Bancshares, Inc.* It involved a lawsuit brought by a stockholder of First Citizens Bancshares, Inc. (the "Bank"), which is a Delaware bank holding company headquartered in North Carolina. Although the Bank operated in 17 states, over 60% of its branches and over 70% of its deposits are in North Carolina. The Bank is controlled by a family that owns 52% of its voting stock.

On June 10, 2014, the Bank announced that it had entered into a merger agreement with another bank. Nearly a majority of that other bank's voting stock was owned by the same family that controlled the Bank. The Bank also announced that its board of directors adopted an exclusive forum bylaw that required derivative and fiduciary duty lawsuits to be brought in the federal district court for the Eastern District of North Carolina or, if the federal court lacked jurisdiction, any North Carolina state court.¹³ Shortly afterwards, a Bank stockholder filed suit challenging the merger and claiming that the bylaw was invalid and adopted in breach of the directors' fiduciary duties.

The Court's Opinion

In dismissing the lawsuit, the court relied on *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, which, as noted above, upheld the facial validity of an exclusive forum bylaw requiring stockholder claims

⁹ See *Katz v. Commonwealth REIT*, Case No. 24-C-13-001299 (Md. Cir. Ct. Feb. 19, 2014); see also *Corvex Mgmt. LP v. Commonwealth REIT*, Case No. 24-C-13-001111 (Md. Cir. Ct. May 8, 2013). For a thorough discussion of arbitration bylaws, see Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes*, 39 DEL. J. CORP. L. (forthcoming 2014).

¹⁰ See *Daugherty v. Ahn*, Cause No. CC-11-06211 (Cnty. Ct. No. 3, Dallas Cnty. Tex., Feb. 15, 2013); *HEMG Inc. v. Aspen. Univ.*, No. 650457/13 (N.Y. Sup. Ct. Nov. 4, 2013); *Miller v. Beam*, No. 2014 CH 00932 (Ill. Cook Cnty. Mar. 5, 2014); *Groen v. Safeway Inc.*, No. RG14716641 (Cal. Sup. Ct. Order May 14, 2014).

¹¹ *Roberts v. TriQuint Semiconductor, Inc.*, C.A. No. 1402-02441 (Cir. Ct. Or. Aug. 14, 2015); see also *In re Facebook, Inc., IPO Sec. & Deriv. Litig.*, 922 F. Supp. 2d 445 (S.D.N.Y. 2013) (declining to enforce an exclusive forum provision in a certificate of incorporation, but reasoning that the provision was not yet in effect when plaintiffs purchased their shares in an IPO).

¹² *Edgen Group Inc. v. Genoud*, C.A. No. 9055-VCL, trans. ruling (Del. Ch. Nov. 5, 2013).

¹³ The full bylaw in *First Citizens* provided as follows: "Exclusive Forum for Certain Disputes: Unless the corporation consents in writing to the selection of an alternative forum, the United States District Court for the Eastern District of North Carolina or, if such court lacks jurisdiction, any North Carolina state court that has jurisdiction, shall, to the fullest extent permitted by law, be the sole and exclusive forum for (1) any derivative action or proceeding brought on behalf of the corporation, (2) 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 shareholders, (3) any action asserting a claim arising pursuant to any provision of the General Corporation Law of the State of Delaware, and (4) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring or holding 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 8."

to be brought in Delaware. Among other things, the *First Citizens* court explained that, under *Chevron*, an exclusive forum bylaw “relates quintessentially to ‘the corporation’s business, the conduct of its affairs, and the rights of its stockholders [qua stockholders]’” and is thus valid. It continued that “the fact that the Board selected the federal and state courts of North Carolina — the second most obviously reasonable forum given that [the Bank] is headquartered and has most of its operations there — rather than those of Delaware ... does not, in my view, call into question the facial validity of the Forum Selection Bylaw.”

The court rejected the plaintiff’s claim that the board of directors breached its duties in adopting the exclusive forum bylaw. It noted that the bylaw “plainly does not insulate the Board’s approval of the proposed merger from judicial review” but, rather, “simply requires that such review take place in a court based in North Carolina.” The court also observed that the plaintiff had not alleged any facts “to call into question the integrity of the federal and state courts of North Carolina or to explain how the defendants are advancing their ‘self-interests’ by having claims arising from their approval of the proposed merger adjudicated in those courts.” The court further held that the bylaw was neither unreasonable nor unjust nor did Delaware have a significant interest in the litigation such that the exclusive forum bylaw should not be enforced.

The court also rejected the plaintiff’s claim that the bylaw was improperly adopted in connection with the announcement of a merger agreement. “[T]he reasonable expectation a stockholder of [the Bank] should have,” the court wrote, “is that its Board may adopt a forum selection bylaw that, subject to challenge on an as-applied basis, designates a court outside Delaware as the exclusive forum for intra-corporate disputes.” It continued:

That the Board adopted [the exclusive forum bylaw] on an allegedly “cloudy” day when it entered into the merger agreement ... rather than on a “clear” day is immaterial given the lack of any well-pled allegations ... demonstrating any impropriety in this timing.

The court concluded with the observation that, “[i]f Delaware corporations are to expect, after *Chevron*, that foreign courts will enforce valid bylaws that designate Delaware as the exclusive forum for intra-corporate disputes, then, as a matter of comity, so too should this Court enforce a Delaware corporation’s bylaw that does not designate Delaware as the exclusive forum.”

What’s Next for Exclusive Forum Bylaws?

Implications of First Citizens

First Citizens is an important decision reaffirming the enforceability of exclusive forum bylaws under Delaware law. In particular, the bylaw was not deemed improper simply because it was adopted in connection with the announcement of a merger agreement. Such bylaw amendments have become increasingly common since *Chevron*, given the high likelihood of multi-forum litigation in connection with a merger. Moreover, the court’s holding is contrary to positions taken by certain courts outside of Delaware.¹⁴ Specifically, the court did not require that the bylaw be adopted on a so-called “clear day.” This aspect of the opinion will serve as important precedent going forward.

First Citizens also demonstrates the flexibility of exclusive forum bylaws, which can require that disputes be brought in jurisdictions other than Delaware that have a reasonable nexus to the corporation. One of the key justifications for adopting exclusive forum bylaws is to have a Delaware court adjudicate Delaware law issues. Nevertheless, Delaware corporations might decide that there are benefits to choosing a non-Delaware forum, such as the location of the corporation’s headquarters and the proximity of directors and officers to the selected forum.

¹⁴ See, e.g., *Roberts v. TriQuint Semiconductor, Inc.*, C.A. No. 1402-02441 (Cir. Ct. Or. Aug. 14, 2015).

Proxy Advisor and Shareholder Views on Exclusive Forum Bylaws

Proxy advisory firms have not been receptive to exclusive forum bylaws, and some institutional investors have come out against them. Under its 2014 voting guidelines, Institutional Shareholder Services issues recommendations on exclusive venue proposals on a “case-by-case” basis, taking into account:

- whether the company has been materially harmed by shareholder litigation outside its jurisdiction of incorporation, based on disclosure in the company’s proxy statement; and
- whether the company has the following good governance features: (i) an annually elected board; (ii) a majority vote standard in uncontested director elections; and (iii) the absence of a poison pill, unless the pill was approved by shareholders.¹⁵

Glass Lewis & Co. takes an even firmer approach. It recommends against all exclusive forum provisions and also “will recommend voting against the chairman of the governance committee, or, in the absence of such a committee, the chairman of the board, who served during the period of time when the provision was adopted.”¹⁶

Still, we believe that traditional investors are increasingly appreciating the value associated with combatting multi-forum litigation and opportunistic forum-shopping.¹⁷ Shareholder proposals to rescind exclusive forum bylaws have subsided significantly and, generally speaking, directors who have adopted exclusive venue bylaws do not appear to have experienced any meaningful increase in “against/withhold” votes when they next stood for reelection.

Considerations

Exclusive forum provisions continue to gain traction, particularly now that several courts in and outside of Delaware have weighed in on the issue. Of course, new issues may be identified as these bylaws are enforced or subjected to “as applied” challenges. For example, in *Genoud*, noted above, the court expressed concern over its ability to issue an anti-suit injunction against a non-Delaware resident who filed a lawsuit in another state. Similarly, the *First Citizens* plaintiff argued that the bylaw was inconsistent with certain provisions of the Delaware General Corporation Law that vest the Court of Chancery with exclusive jurisdiction. Although the *First Citizens* court was skeptical of this argument,¹⁸ it refused to rule on any “hypothetical” challenges since those statutory provisions were not at issue. The court might also have reached a different result if the plaintiff could have shown that North Carolina courts lacked jurisdiction over the Bank’s directors, officers, and employees.

Nevertheless, we expect more Delaware corporations will adopt exclusive forum bylaws — at both publicly-held and privately-held companies. Many corporations took a “wait and see” approach after *Chevron* to see how this issue evolved. To those corporations, *First Citizens* — which was authored by the newest member of the Court of Chancery, Chancellor Andre Bouchard — reiterates Delaware’s position that these bylaws are facially valid. It goes further by rejecting the challenge to the timing of the bylaw’s adoption and also by holding that a non-Delaware venue can be permissible.

¹⁵ Institutional Shareholder Services, *2014 U.S. Proxy Voting Summary Guidelines*.

¹⁶ Glass Lewis & Co., *Proxy Paper Guidelines: 2014 Proxy Season*.

¹⁷ See, e.g., Richard H. Koppes, *A Proposal to Repeal Exclusive Forum at Chevron*, May 30, 2012, available at <http://blogs.law.harvard.edu/corpgov/2012/05/30/2012-proxy-season-a-shareholder-proposal-on-forum-selection-and-a-fortune-ten-company/#more-29316> (former general counsel of CalPERS suggesting deference on this issue at companies with strong records of good governance and shareholder rights).

¹⁸ See *First Citizens*, mem. op. at 11 (citing *IMO Daniel Kloiber Dynasty Trust*, 2014 WL 4071326, at *13 (Del. Ch. Aug. 6, 2014)).

Boards should consider with care the advantages and disadvantages of adopting an exclusive forum bylaw. For Delaware and non-Delaware corporations, the benefits of an exclusive forum bylaw include avoiding duplicative and wasteful litigation and providing certainty with respect to which court will hear intra-corporate disputes. Delaware corporations may also cite the expertise of the Court of Chancery in applying Delaware law, although some Delaware corporations may decide that a non-Delaware venue is desirable. A non-Delaware corporation implementing an exclusive forum bylaw may cite the benefits of having a court in its state of incorporation adjudicate intra-corporate disputes. That court presumably has a comparative advantage over other courts in interpreting its state's laws. In any event, boards should document the reasons why they adopt an exclusive forum bylaw. Although it is clear that these bylaws are facially valid in Delaware, they are still susceptible to "as-applied" challenges in Delaware and elsewhere.

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