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Exclusive Forum Clauses Offer Few Issues, Lots of Upside in Protecting Deals: Experts

By Michael Greene

There might not be many drawbacks to adopting exclusive forum selection provisions, practitioners told Bloomberg BNA.

Accordingly, a growing number of corporations are making exclusive forum selection bylaws a staple of managing multi-jurisdictional litigation that arises from M&A deals.

''The rapid rate of adoption that we are witnessing, particularly among M&A targets, indicates that most advisers would say that exclusive forum provisions rarely would be seen as anything other than beneficial to the adopters,'' Lizanne Thomas, Jones Day's partner-in-charge for the Southern U.S. region and leader of the firm's corporate governance team, said in an e-mail to Bloomberg BNA.

Thomas and other attorneys interviewed by BBNA in the last month also discussed whether such bylaws properly balance the interest of shareholders and corporations, and the recent move by the Delaware legislature to ratify such provisions—and how corporations should draft such bylaws once the proposed bill becomes law.

Rise in Lawsuits. Issuers, practitioners and academics have all pointed to the rising number of lawsuits that arise from M&A deals as evidence of a surge in frivolous shareholder litigation. According to a Feb. 25 report by Cornerstone Research, stockholders challenged 93 percent of M&A deals valued at more than $100 million in 2014 (13 CARE 428, 2/27/15). Just this week, an Altera Corp. stockholder filed a class action lawsuit against the chipmaker and its board of directors in the Delaware Chancery Court, attacking its $16.7 billion deal to be purchased by rival Intel Corp. (13 CARE 1204, 6/5/15).

In response to this proliferation, many corporations have looked to exclusive forum bylaws for relief, with an uptick in adoption after the Delaware Chancery Court upheld their enforcement, according to a client alert from Gibson Dunn & Crutcher LLP's ''M&A Report'' (13 CARE 968, 5/8/15).

And Delaware legislators recently signed off on legislation that endorses these provisions when they make Delaware the exclusive forum (13 CARE 1322, 6/12/15). The bill awaits Gov. Jack Markell's (D) signature.

Balancing Interests. Thomas told BBNA that her firm believes that forum selection clauses strike a balance between curbing abusive litigation tactics and protecting the fundamental right of stockholders to file lawsuits, particularly with respect to M&A litigation.

In agreement, Jason A. D'Angelo, a partner at Herrick, Feinstein LLP, told BBNA in an e-mail that when such provisions are properly drafted, they ensure that litigation is resolved before a court that is most familiar with the applicable law, ''while also reducing the likelihood of companies being forced into undue settlements in order to avoid the cost of defending against the same allegations in multiple courts.''

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Stephen P. Lamb,
former Delaware Vice Chancellor and partner at Paul, Weiss

He added that ''non-litigant shareholders also have an interest in reducing frivolous lawsuits and improper litigation tactics by plaintiffs as shareholders have an interest in protecting their investment.''

''Shareholders' right to have their claims heard before a competent court remains intact, and shareholders are given advanced notice as to where such claims are likely to be heard,'' he continued. ''If a company selects a forum in its bylaws that a shareholder is unhappy with, the shareholder is free to sell his/her shares or otherwise make efforts to change the bylaws.''

Best Forum. The Delaware Court Chancery Court, where much of this M&A ligation will be channeled, also may be most qualified to hear these disputes, according to Richard Rosen, a partner at Paul, Weiss, Rifkind, Wharton & Garrison LLP and co-chair of the firm's securities litigation and enforcement group.

In an e-mail to BBNA, Rosen said that the Delaware court is ''more likely to be able to separate out meritorious from bogus cases at an early stage,'' and that ''the court has exhibited a healthy skepticism in reviewing fee applications from plaintiffs' counsel when the case settles, as so many of them do, in exchange for incremental disclosures.''

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Benefits to Not Adopting? Ultimately, although these clauses may not provide the perfect answer to reducing frivolous claims, the practitioners interviewed say there are few reasons that companies should forego adopting them.

Former Delaware Chancery Court Vice Chancellor Stephen P. Lamb, a current partner at Paul, Weiss, said in an e-mail to BBNA that he could not identify any benefit to not adopting forum selection clauses.

''In the right case, the board is free to agree to waive the protection of the bylaw to permit litigation to go forward in another forum, if it determines that is the right course to pursue. But, the presence of the bylaw should protect the corporation from the burden and expense of duplicative, multi-jurisdictional litigation in the clear majority of cases,'' he added.

Thomas observed that in many instances where companies have declined to adopt such provisions, it may be ''because the issue simply hasn't become a priority because the company doesn't see itself as vulnerable to multi-jurisdictional claims, or because of other issues it is facing, the company wishes to avoid adopting a provision that some describe as less than shareholder-friendly.''

''But there is no 'magic bullet' and we do not see a legislative solution that would helpfully discriminate between cases that should proceed and those that should not.''

RICHARD ROSEN,
PARTNER AT PAUL, WEISS

No Magic Bullet. Despite the benefits of adopting these bylaws, some have criticized the pending Delaware legislation, which includes restrictions on fee-shifting bylaws, as not going far enough to combat abusive litigation (13 CARE 981, 5/8/15).

According to Rosen, although forum selection clauses are not a perfect solution, there may not be much more the Delaware legislature can do.

''Over the very long term, the case law that develops may discourage the filing of frivolous cases,'' Rosen stated. ''But there is no 'magic bullet' and we do not see a legislative solution that would helpfully discriminate between cases that should proceed and those that should not.''

The Delaware legislation has also been criticized because it will not allow Delaware corporations to adopt bylaws that designate an exclusive forum outside of Delaware, partially overturning a recent Chancery Court ruling (12 CARE 1123, 9/12/14).

When asked about the rational behind this limitation, Lamb stated that ''[t]he proposed legislation is premised on the principle that stockholders of Delaware corporations should have the freedom to litigate internal affairs issues in a Delaware forum. That ability is a key component of stock ownership in a Delaware corporation.''

However, he noted that Delaware corporations could still designate a forum in addition to Delaware.

Challenges. Moreover, the practitioners warned that even though the proposed legislation ratifies such provisions, shareholders can still challenge them.

Lamb noted that stockholders can challenge a provision ''based on the particular circumstances of its adoption and could prevail if it could be shown that the directors acted in bad faith or for an improper purpose in adopting the bylaw or that the application of the bylaw to the case at hand was unreasonable.''

Thomas observed that these provisions ''should only be adopted by a company's board in careful exercise of its duties, with a deliberative process and care that no decision-maker has a personal interest in having a particular forum for any ensuing litigation.''

Seeking Dismissal. Practitioners also noted that the existence of the provision doesn't prevent shareholders from filing lawsuits in other jurisdictions, leaving the company to seek a dismissal based on the provision.

''It is important to keep in mind that forum selection clauses do not enforce themselves and that a court other than the one selected in the bylaws will be making the determination as to whether or not such a clause should be enforced,'' D'Angelo said.

He added that ''[a]s a result, it is important for companies to do what they can to limit the strength of any challenges. For example, a company should adopt bylaws calling for a particular forum before a dispute arises and before deals that are likely to trigger litigation are contemplated. Failing to do so may increase the risk that the forum selection provision was not added in good faith, but instead to negatively impact shareholders' rights.''

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JASON A. D'ANGELO,
PARTNER, HERRICK, FEINSTEIN

Flexibility. D'Angelo also suggested that corporations may want to consider adopting provisions that give the board the right to consider whether to invoke a Delaware forum selection clause.

''Best practice would probably be to consider including a waiver provision that would give the board flexibility and allow the board to decide whether, based on a variety of factors (including, for example, location of witnesses and documents, costs of litigating in another forum, etc.), a different forum, as selected by a shareholder plaintiff, is preferable,'' he said.

D'Angelo noted that the Delaware legislation does not address this approach and that given the intent of such a provision, it likely would survive any shareholder challenge.

Thomas agreed that as long as the provision does not bar claims from being brought in Delaware, the pending bill would not prevent that kind of flexibility. How-

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ever, she said that preserving this kind of discretion ''raises considerable opportunity for complexity and a new battleground.''

''At first blush, I'm not sure this flexibility would achieve the judicial economy at the heart of the proposal,'' she said. ''Also, as a practical matter, litigants can always elect strategically to waive an available defense, such as improper venue. The defense lawyer may thus be in a position to exercise that flexibility even without such a provision.''

To contact the reporter on this story: Michael Greene in Washington at mgreene@bna.com

To contact the editor responsible for this story: Ryan Tuck at rtuck@bna.com