New Tools to Manage the Problem of Nuisance Shareholder Litigation: Delaware Emphatically Upholds Forum Selection Bylaws with Reasoning that May Support Bylaws for Reimbursement of Attorney's Fees

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Plaintiffs' counsel instigated shareholder litigation against corporate defendants has markedly increased in recent years. For example, the plaintiff's bar now files suit in almost every large merger transaction. In 2011, 96% of all mergers and acquisitions valued at over $500 million were subject to litigation, representing an increase of 43 percentage points over the proportion of transactions garnering litigation in 2007.[1] These suits are profitable for the plaintiff's firms sponsoring the litigation. The New York Times reported that corporations agreed to pay plaintiff's legal fees of about $1.2 million on average for suits filed in 2010 and 2011.[2] But the benefit to shareholders nominally behind these suits is less clear. Five percent of these settlements produced more cash for shareholders, while more than 80% of the suits required only additional disclosures. Of the 162 transactions in which litigation was settled on a disclosure only basis, only two were later voted down by stockholders. One leading securities professor noted: "Unless one believes that 'disclosure only' settlements truly benefit shareholders and justify million dollar fee awards (in which case this author would like to sell you a bridge to Brooklyn at a very cheap price), then such litigation gives off at least a faint odor of collusion . . . with shareholders ultimately bearing the costs of both sides" of the litigation.[3]

More recently, these collusive lawsuits have found another attractive target: advisory say-on-pay votes on executive compensation which began in 2011 pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. These suits seek to enjoin an upcoming shareholder vote and thereby pressure the company to settle the suit without regard to the merits of the complaint, provided that the price of the settlement is less than the cost that would be incurred by rescheduling the vote and litigating the challenge. Settlement payments in these suits to plaintiffs have ranged between $125,000 and $450,000 (and more).

Shareholder litigation is generally characterized by multiple suits filed by separate law firms, and suits filed in multiple jurisdictions. In 2011, mergers encountered an average of six lawsuits and, in 2011, 90% of merger litigation against Delaware corporations included suits filed outside Delaware. This trend has been explained based on the analytics of plaintiff's counsel that Delaware courts are generally less favorable to plaintiffs in awarding fees and non-Delaware jurisdictions generate increased delay and uncertainty. This delay and uncertainty can be used to gain leverage in settlement negotiations and apportionment of settlement proceeds among competing law firms.

Forum selection provisions in a corporation's charter or bylaws are designed as a tool to reduce the likelihood of, or increase the defenses against, multi-jurisdiction litigation of intra-corporate disputes such as shareholder litigation against corporations and corporate directors and officers. A forum selection bylaw is a provision in a corporation's bylaws that designates a forum, typically Delaware for a Delaware corporation, as the exclusive venue for certain stockholder suits against the corporation, its directors and officers. The recently upheld forum selection bylaw adopted by Chevron reads as follows:

1 This article refers to the data and analysis contained in Grundfest and Savelle, "The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis", 68 Bus. Law. 325 (Feb. 2013). Readers desiring more detail should refer to that article.

2 Daines and Koumrian, "Merger Lawsuits Yield High Costs and Questionable Benefits", N.Y. Times Dealbook (June 8, 2012).

3 Grundfest and Savelle, supra note 1, at note 46, citing Coffee, "Forum Selection Clauses and the Market for Settlements", N.Y.L.J., May 17, 2012.

> Unless the Corporation consents in writing to the selection of an alternative forum, the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) 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 stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine shall be a state or federal court located within the state of Delaware, in all cases subject to the court's having personal jurisdiction over the indispensable parties named as defendants. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this [bylaw].

These provisions provide a tool to discourage or obtain dismissal of intra-corporate suits filed outside the designated forum, thereby reducing expenses associated with such suits. These suits can still be filed in the designated forum, or outside the designated forum subject to the risk of a motion to dismiss and recovery of attorneys' fees for filing suit in violation of the bylaw.

Forum selection provisions may be adopted by public corporations through action of the board of directors without stockholder approval through a bylaw amendment. Board adoption of forum selection bylaws, however, may be subject to challenges and costs. Until recently, the legality of adoption of forum selection bylaws by Delaware corporations was in doubt. This resulted in numerous challenges to the validity of board adopted forum selection bylaws, which in turn resulted in many corporations voluntarily withdrawing such bylaws once challenged to avoid the expense of defending such litigation. On June 25, 2013, the Delaware Chancery Court decided B*oilermakers Local 154 Retirement Fund v. Chevron and IClub Investment Partnership v Fedex Corporation*, which emphatically comes down in favor of the authority of a board of a Delaware corporation to adopt a forum selection bylaw.[4] While this decision was being appealed to the Delaware Supreme Court, the plaintiffs in that action voluntarily withdrew their appeal on October 18, 2013, possibly because of the strong arguments articulated in the opinion supporting a board's authority to adopt a forum selection bylaw without shareholder approval. This decision should remove what was an important impediment to board action to adopt a forum selection bylaw.

There are other important considerations which directors should take into account when deciding whether or not to adopt a forum selection bylaw. First, proxy advisory firms, including Glass Lewis and ISS, have generally recommended voting against proposals that establish an exclusive forum for shareholder disputes. Neither of these proxy advisory firms has articulated the reasoning behind that position. In addition, Glass Lewis has stated that it will generally recommend against voting for election of the director who is the chair of a company's governance committee if that company adopts a forum selection clause without obtaining shareholder approval. Also, the adoption of such a bylaw may prompt shareholders to make proposals to repeal board adopted forum selection bylaws. Both Chevron and United Rentals faced such shareholder proposals, but achieved shareholder votes in excess of 60% against adopting those proposals to repeal the forum selection bylaw. Boards also should be aware that adoption of a forum selection provision will still require litigation on the validity of the bylaw and its application in a particular context should a shareholder nevertheless file suit outside the selected forum.

In the *Chevron* case, the Delaware Chancery Court had no trouble finding forum selection bylaws adopted by the boards of Chevron and Federal Express without shareholder approval to be valid on their face, subject to review of the appropriateness of the bylaw in any particular proceeding on a case-by-case basis. The boards of both companies had been empowered in their charters to adopt bylaws without shareholder approval under Section 109(a) of the Delaware General Corporation Law ("DGCL"). The Court also found that, under judicial precedent, the bylaws of a corporation are presumed to be valid and the court should construe the bylaws in a manner consistent with law rather than strike down the bylaws. The Court also found that the bylaws addressed a proper subject matter under Section 109(b) of the DGCL by addressing the internal affairs of the corporation (namely, claims of stockholders as stockholders of the corporation),

4 73 A. 3d. 934, C.A. No. 7220-CS, 2013 W.L. 3191981 (Del. Ch. June 25, 2013).

and the process by which a stockholder, as a stockholder, may address those affairs. The Court also determined that, under long-standing precedent, stockholders have no vested right requiring their consent to modification of matters properly subject to being addressed in an amendment of a corporation's bylaws.

Even where, as decided in *Chevron*, board adoption of forum selection bylaws is valid, any particular suit filed outside the selected forum remains subject to review of the application of the bylaw to that suit on a case-by-case basis on two grounds: the board's determination, in accordance with its fiduciary obligations, that application of the bylaw to that suit is appropriate, and the court's determination that the bylaw may be enforced in that jurisdiction under applicable law.

In *Chevron*, the Court determined that the application of the forum selection clause to any particular suit will, in each instance, be subject to the board fulfilling its fiduciary duty in deciding whether or not to enforce the forum selection provision in a particular case filed outside the selected forum. Therefore, a board will be subject to fulfilling its duty of care and loyalty in deciding whether or not to grant its consent to the foreign-filed suit or not seek to dismiss a suit filed outside the jurisdiction of the selected forum. This suggests that a board, or duly constituted committee of the board, should meet to consider the relevant facts and circumstances in deciding how to respond to such an action. In the typical case, a board will have a substantial good faith basis upon which to conclude that application of the forum selection provision is in the best interests of the corporation and its stockholders. In a normal case, a fiduciary challenge to enforcement of a forum selection provision to require suit in Delaware is a difficult argument to sustain. In addition to the problem of nuisance litigation, directors may reason that Delaware is the most qualified jurisdiction to litigate fiduciary claims against the corporation and its directors and officers. A challenge to that reasoning would require a plaintiff to prevail in an argument that the Delaware judiciary is not an appropriate tribunal to decide the application and interpretation of Delaware law and enforce Delaware's own fiduciary duties of directors.

The general federal rule on application of a forum selection provision is that forum selection is valid and should be enforced unless enforcement is shown by the resisting party to be unreasonable under the circumstances. Unreasonableness generally requires showing that (1) the forum selection provision was induced by fraud or other overreaching, (2) trial in the selected forum would be so gravely difficult and inconvenient that the plaintiff would be deprived of its day in court, or (3) enforcement would contravene a strong public policy of the forum in which the suit is brought. Therefore, the general rule would support application of the forum selection clauses in the vast majority of cases.

Dicta in the *Chevron* case can be read to support other corporate tools to manage nuisance shareholder litigation. For example, in deciding against plaintiff's argument that a forum selection bylaw placed plaintiffs in the unsupportable predicament of deciding whether to file a foreign forum-based suit and risk potentially breaching the bylaws and thereby becoming liable to the corporation for damages, the court stated that the plaintiffs are fully capable of evaluating for themselves the relevant merits of their claim. The Court could be argued to be suggesting that it is not inappropriate for the plaintiff to be charged with the corporation's costs of defending an improperly filed foreign forum-based suit in violation of the bylaw. The Court also relied on general common law upholding contractual forum selection provisions to support a forum selection bylaw provision. And the Court favorably cited a Supreme Court case, C*arnival Cruise Lines v Shute*,[5] in which a cruise ship operator's forum selection provision, which was printed on a ticket, received after purchase of the ticket, was found reasonable and enforceable. This dicta supports arguments in favor of adding to bylaws provisions shifting the responsibility to bear the prevailing party's legal fees in shareholder litigation to the non-prevailing party. Such a fee shifting bylaw could serve to compensate a corporation for the damages it incurs in defending nuisance shareholder litigation.

The enforceability of fee shifting attorney's fees provisions in bylaws has not, to our knowledge, been addressed by a Delaware court. Such a provision, while unusual, is not unprecedented in the bylaws of corporations.[6] Some considerations in support of fee shifting bylaws include:

5 *Carnival Cruise Lines v. Shute, 499 U.S. 585 (1991).*

6 See, for example, Coachmen Industries, Inc., Five Star Quality Care, Inc. and Perma-Fix Environmental Services, Inc.

- Data supports in general the problems public companies encounter in defending nuisance shareholder litigation, and a fee shifting provision directly addresses part of that problem by providing a tool to offset the costs incurred by corporate shareholders in defending against such litigation.
- Fee shifting provisions may cause plaintiff's counsel to more carefully evaluate the merits of their claim before initiating litigation and thereby risk a plaintiff having to reimburse defendant's legal fees. The common law recognizes the validity of contractual provisions assigning to the non-prevailing party the responsibility to pay the legal fees of the prevailing party in litigation, even in situations in which the counterparty has relatively little bargaining leverage to actually negotiate such attorney's fee reimbursement provisions.
- Bylaws adopted by a board of directors are normally entitled to be presumed to be adopted in good faith and to be valid.

There are a number of considerations against adoption of fee shifting bylaw provisions:

- Given the absence of case law supporting the validity of fee shifting bylaws, a corporation adopting such a bylaw can anticipate challenges to the bylaw, including both legal challenges seeking either to cause the company to voluntarily withdraw the bylaw or judicial invalidation of the bylaw, and shareholder proposals to repeal the bylaw as well as potentially other actions by proxy advisory firms and shareholders seeking to influence directors not to adopt fee shifting bylaws.
- To the extent that fee shifting provisions of such a bylaw would apply to lawsuits against directors and officers of the corporation, such a bylaw could be viewed as a conflict of interest transaction making adoption of the bylaw subject to enhanced scrutiny and providing a basis for assertions that adoption violates a director's duty of loyalty to shareholders.
- Because of sensitivities associated with a fee shifting bylaw, corporations may prefer to have adoption of such a bylaw approved or ratified by shareholders or adopt the provision as a charter amendment requiring shareholder approval.
- Bylaws which impact lawsuits claiming violations of securities laws could be argued to violate the provisions of federal law making waivers of securities laws invalid.

Depending upon the characteristics of a given corporation and predilections of its board of directors, adoption of a fee shifting bylaw or charter provision may merit consideration. For example, fee shifting provisions may merit inclusion in a corporation's charter before that corporation goes public. For existing public companies, such provisions may merit adoption by shareholders or the board of directors. In considering the type of provision to adopt, the scope of the fee shifting provision could be tailored to any particular set of facts to accommodate particular concerns. One fee shifting provision might cover all shareholder initiated litigation. More narrowly tailored provisions might address, for example, express provisions added to forum selection bylaws for shifting the corporation's legal fees to shareholders violating the forum selection provisions who do not prevail in a motion to dismiss the foreign forum-based suit. Another narrowly tailored but more general provision might be adopted by analogy to the law providing that corporations shall reimburse a shareholder's legal expenses in a derivative action that provides a benefit to shareholders of the corporation. Specifically, a bylaw might be adopted to the effect that a non-prevailing shareholder in an intra-corporate lawsuit which the court determines results in a detriment to the corporation shall bear the corporation's expenses in defending the lawsuit.

The *Chevron* case provides corporate boards of directors tools to manage potentially detrimental shareholder lawsuits against the corporation. Boards of directors would be well advised to take into account both the benefits and potential costs of these tools in evaluating their application to their companies.

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