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March 17, 2015

Exclusive Forum Bylaws – New Research Shows Favorable Impact

In recent years, public companies have increasingly become targets of internal affairs litigation over the same corporate action in multiple jurisdictions. Multi-forum litigation can create significant problems, including unnecessarily redundant, inconvenient, costly and time-consuming lawsuits and inconsistent judicial decisions, requiring still further proceedings to resolve. As succinctly explained by Vice Chancellor Laster of the Delaware Court of Chancery in a recent multi-forum action: "This case really exemplifies the interforum dynamics that have allowed plaintiff's counsel to extract settlements in M&A litigation and that have generated truly absurdly high rates of litigation challenging transactions."[1] Indeed, we have seen Maryland-formed companies subjected to litigation in Maryland and simultaneously in states as far away as California and Arizona arising out of the same corporate actions. As a result, corporations and real estate investment trusts formed in Maryland, Delaware and other jurisdictions have adopted exclusive forum bylaw provisions requiring certain intracorporate disputes to be brought in the courts of the state of incorporation. Over the last few years, Delaware courts have repeatedly addressed the legitimacy and scope of these provisions and, as discussed below, a proposed amendment to the Delaware General Corporation Law (the "DGCL") that would codify the right to adopt an exclusive forum provision is currently under consideration in Delaware.

Now, an important new study demonstrates the beneficial impact of exclusive forum bylaws on reducing multi-forum litigation in large M&A transactions. According to a report by Cornerstone Research released just last month, shareholder lawsuits were filed in 93% of public company M&A transactions valued at over $100 million in 2014, with an average of more than four lawsuits filed per transaction – an increase from 54% in 2008. However, in 2014, only 40% of these transactions were challenged in more than one jurisdiction, and only four percent were challenged in more than two jurisdictions (the lowest number since 2007). This is a dramatic decrease from 2013, when 62% of these transactions were challenged in more than one jurisdiction and an average of over five lawsuits were filed per transaction. The author specifically states that this decline in multi-forum litigation is "likely a result of widespread adoption of forum selection clauses in corporate bylaws."[2]

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[1] *Edgen Group Inc. v. Genoud*, No. 9055-VCL (Del. Ch. Nov. 5, 2013). *See also* LEO E. STRINE, JR., LAWRENCE A. HAMERMESH & MATTHEW C. JENNEJOHN, *Putting Stockholders First, Not the First-Filed Complaint*, 69 BUS. LAW. 1, 8 (2013) ("In recent years, shareholder class actions challenging mergers and acquisitions have become more prevalent, and so have instances in which litigation of this sort has been brought more or less concurrently in multiple forums."). Internal affairs litigation is also common in contexts other than just M&A transactions.

[2] Olga Koumrian, *Shareholder Litigation Involving Acquisitions of Public Companies*, CORNERSTONE RESEARCH (February 2015).

Development under Delaware Law

The scope and enforceability of exclusive forum bylaw provisions have developed through several Delaware cases in the last few years. The seminal opinion was issued on June 25, 2013 in two consolidated cases, *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, Del. Ch. C.A. No. 7220-CS, and *IClub Investment Partnership v. FedEx Corp.*, Del Ch. C.A. No. 7238-CS (together "*Chevron*"). In *Chevron*, Chancellor Strine of the Delaware Court of Chancery (now Chief Justice of the Delaware Supreme Court) held that, with regard to a facial challenge to exclusive forum bylaw provisions enacted by Chevron and FedEx, (1) the venue for stockholder corporate and derivative litigation was a proper subject for regulation by bylaw, (2) exclusive forum bylaw provisions unilaterally adopted by directors are "valid and enforceable" as to stockholders and (3) hypothetical situations in which a particular bylaw *could* prove unreasonable did not make it facially invalid. While the court noted that exclusive forum bylaw provisions are always subject to as-applied challenges, *i.e.*, a board's adoption of the provision is still subject to scrutiny in the context of particular facts and circumstances, Chancellor Strine stated that "[s]uch circumstantial challenges are required to be made based on real-world circumstances by real parties, and are not a proper basis for the survival of the plaintiffs' claims that the bylaws are facially invalid under the DGCL."

As a result of *Chevron*, over 600 public corporations and real estate investment trusts, including over 60 Maryland public companies, have adopted exclusive forum provisions. Indeed, these provisions have become mainstream since the *Chevron* decision.

Following *Chevron*, Chancellor Bouchard in *City of Providence v. First Citizens Bancshares, Inc.*,[3] held that Chancellor Strine's analysis in *Chevron* would apply to exclusive forum bylaw provisions dictating a forum other than the state of incorporation. The bylaw in question was, according to the court "[i]n all but two respects . . . functionally identical to the bylaws . . . challenged in *Chevron*." The two differences concerned (a) language stating that the bylaw is applicable only "to the fullest extent permitted by law" (a difference which was not addressed) and (b) designating North Carolina, the state where the company was headquartered, as the exclusive forum for litigation, rather than Delaware (the state of incorporation).

The *Providence* court upheld the exclusive forum bylaw provision in question, stating that "nothing in the text or reasoning of *Chevron* can be said to prohibit directors of a Delaware corporation from designating an exclusive forum other than Delaware in its bylaws." Further, the court added that the company's decision to designate North Carolina, the "second most obviously reasonable forum given that [the company] is headquartered and has most of its operations there . . . does not . . . call into question the facial validity of the Forum Selection Bylaw." The court went on to hold that it did "not discern an overarching public policy of [Delaware] that prevents boards of directors of Delaware corporations from adopting bylaws [requiring] stockholders to litigate intra-corporate disputes in a foreign jurisdiction."

[3] C.A. No. 9795-CB (Del Ch. Sept. 8, 2014).

Plaintiffs in *Providence* also challenged the timing of the adoption of the exclusive forum bylaw provision at issue. In *Providence*, the board of directors of First Citizens Bancshares, Inc. approved the exclusive forum bylaw provision at the same meeting the board approved a merger with First Citizens Bancorporation, Inc. In addition to the challenges discussed above, the plaintiffs claimed that enforcing the bylaw would be "unjust" and "goes well beyond [plaintiffs'] reasonable expectations" given the timing of adoption. The court disagreed and stated: "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."

Finally, the Delaware Supreme Court, in an opinion by Chief Justice Strine, has recently reaffirmed the validity of board-adopted exclusive forum bylaw provisions.[4]

Enforceability under Maryland Law

Although there is no controlling Maryland case on point, the Court of Appeals of Maryland (our highest state court), the Court of Special Appeals (our intermediate appellate court) and our trial courts, as well as other courts interpreting Maryland law, "have historically found Delaware law in matters involving business law highly persuasive."[5] Thus, we think that *Chevron* and its progeny provide strong authority supporting the validity and enforceability of an exclusive forum bylaw provision in Maryland.

Delaware Statutory Developments

Earlier this month, the Corporation Law Council of the Delaware State Bar Association announced its proposed amendments to the DGCL for 2015, which include a new Section 115 that would, if adopted, codify a corporation's right to include an exclusive forum provision in its certificate of incorporation or bylaws. Any exclusive forum provision would apply only to "intracorporate claims," as defined in the proposed amendment. Further, Delaware corporations would be required to specify Delaware as the exclusive forum for any intracorporate claims, thus overruling *Providence* in part and disallowing a forum other than the state of incorporation. The full text of the proposed amendment to the DGCL is attached hereto as Exhibit A.

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As always, we and our colleagues are available at any time to discuss these or other matters of Maryland law.

Jim Hanks
Dan Mendelsohn

[4] *See United Tech. Corp. v. Treppel*, No. 127, 2014 (Del. Dec. 23, 2014) (*en banc*).
[5] *In re Nationwide Health Properties, Inc. Shareholder Litigation*, No. 24-C-11-001476, slip op. at 16 (Md. Cir. Ct. May 27, 2011) (opinion of Berger, J., now a judge of the Court of Special Appeals of Maryland).

This memorandum is not intended to provide legal advice or opinion. Such advice may only be given when related to specific fact situations for which Venable LLP has accepted an engagement as counsel.

EXHIBIT A

PROPOSED AMENDMENT TO THE DGCL

§ 115. Forum selection provisions.

The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all intracorporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State. "Intracorporate claims" means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.