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Delaware Court of Chancery Upholds the Facial Validity of Organic Exclusive Forum Provisions, But Future “As? Applied” Challenges Could be a Different Matter

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In June 2013 Chancellor Strine of the **Delaware Court of Chancery** (Delaware Chancery Court), in **Boilermakers Local 154 Retirement Fund v. Chevron Corporation and IClub Investment Partnership v. FedEx Corporation1**, significantly advanced the ball in an effort to combat the burgeoning costs, company distraction and potentially inconsistent judicial outcomes when Delaware corporations are forced to defend lawsuits commenced in multiple jurisdictions arising out of the same set of facts, circumstances and transactions. These multi?forum actions typically involve redundant allegations and theories of law, and often seek duplicative forms of legal and equitable relief.

In his judgment on the pleadings, Chancellor Strine, on both a statutory and contractual basis, upheld the facial validity of exclusive forum selection bylaws (“EFBs”) adopted unilaterally by the respective Boards of Chevron Corporation (“Chevron”) and FedEx Corporation (“FedEx”). In doing so, he likened the authority of Delaware directors to adopt EFBs to the well?settled authority of Delaware directors to **unilaterally adopt a stockholder rights plan ("poison pill")** as a reasonable and proportionate response to a validly perceived threat to corporate policy and effectiveness. The threats in this context instead being the adverse consequences and potential damage to a Delaware corporation of defending redundant litigation (the costs of which ultimately are borne by the corporation’s stockholders) and the possibility that a non?Delaware court may misconstrue or improperly apply Delaware statutory and common law to achieve an unfair or inequitable judicial result for the corporation.

The instances of multi?forum litigation promptly following the **public announcement of an extraordinary corporate transaction (such as a merger, business combination, recapitalization or corporate restructuring transaction**) have increased substantially in recent years. These parallel actions can be rather difficult to “stay” and it can take considerable time to consolidate the action brought outside the jurisdiction of incorporation with the “home court” action (especially if the home court action was not commenced first?in?time). Moreover, strike suits brought in non?Delaware courts against Delaware corporations have surged in the wake of the D**odd?Frank Act** alleging breach of fiduciary duty and materially misleading (proxy statement) disclosure in connection with say?on?pay advisory votes and proposed amendments to equity compensation and option plans for

which stockholder approval is sought at an annual meeting. In response to these litigation trends, various iterations of EFBs (and to a lesser extent, exclusive forum charter provisions) have been adopted to date by many S&P 500 and Russell 2000 corporations.

The EFBs adopted by Chevron and FedEx designated Delaware (their jurisdiction of incorporation) as the exclusive forum for stockholder derivative lawsuits, fiduciary duty lawsuits, lawsuits involving interpretations of the Delaware General Corporation Law ("DGCL"), and lawsuits implicating Delaware's internal affairs doctrine.

In response to plaintiffs' challenge to the statutory validity of Chevron's and FedEx's EFBs, Chancellor Strine concluded that the Boards' unilateral adoption thereof was well within the directors' statutory authority. He noted that for the plaintiffs' statutory challenge to have merit, the EFBs would need to fall outside the ambit of Section 109(b) of the DGCL and constitute an improper subject matter for a corporation's bylaws. Chancellor Strine cited to the text of Section 109(b), which expressly provides that the bylaws of a Delaware corporation may "contain any provision, not inconsistent with law or with the [corporation's] certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." He especially noted that the EFBs were procedural in nature and addressed only ? ? "where" ? ? certain enumerated types of litigation must be brought, not ? ? "whether" ? ? the enumerated categories of litigation (or, for that matter, any other type of litigation) can be brought. Chevron's and FedEx's EFB's did not seek to limit the nature of the claims or theories of law that can be asserted or the remedies available in any such litigation.

Chancellor Strine was not persuaded by plaintiffs' **"lack of privity" argument** that, as a contractual matter, the EFBs should not be enforceable against stockholders who did not have an opportunity to affirmatively vote for their adoption and that the stockholders acquired a preexisting, vested interest in the bylaws that were in effect at the time of their investment. He noted that EFBs are analogous to the forum selection covenants of other contracts and that, consistent with Section 109(b) of the DGCL, Chevron's and FedEx's certificate of incorporation expressly authorized the Board of each corporation to adopt bylaws unilaterally (i.e., without stockholder approval). Therefore, he reasoned that whenever a stockholder invests in a corporation whose certificate of incorporation permits the Board to adopt bylaws unilaterally, such stockholder has been put on notice that the bylaws can be amended by the Board at any time and from time to time without advance notice and without first seeking stockholder approval.

Of course, unlike a charter amendment (which requires both Board approval and subsequent stockholderadoption), bylaw provisions are subject to repeal or amendment by unilateral stockholder action.

The Chevron and FedEx decisions do not preclude, and will not necessarily deter, future litigation (in Delaware and elsewhere) alleging that the adoption, use or application of EFBs in a particular circumstance is unreasonable, unfair or inequitable. It is entirely possible that the application of EFB's in a particular context could constitute a breach of the directors' fiduciary duty. Indeed, Chancellor Strine cautioned that his decision addressed only the facial validity of the EFBs and that the enforceability thereof in any future action or dispute would be subject to judicial review on a case?by?case basis, under the reasonableness standard applicable to "choice of forum" clauses announced by the U.S. Supreme Court in The Bremen v. Zapata Off?Shore Co.[2]

It is not entirely certain how the Delaware Supreme Court may rule if and when it addresses a challenge to either the statutory or contractual validity, or the application, of EFBs similar to those

adopted by Chevron and FedEx. An appeal taken by the plaintiffs in the Chevron and FedEx litigations was voluntarily withdrawn in October 2013, ultimately depriving the Delaware Supreme Court of an opportunity to address the Delaware Chancery Court's decision. However, Chancellor Strine's decision and analyses was likely drawn sufficiently narrow (i.e., facial validity) to be affirmed by the Delaware Supreme Court and the plaintiffs presumably decided not to risk an adverse precedent (affirmation) of the Delaware Supreme Court that could be more difficult to sidestep in a future challenge to the EFBs brought by the plaintiffs in a non?Delaware forum. Notwithstanding the overwhelming national respect for decisions of the Delaware Chancery Court, a ruling on this subject by the Delaware Supreme Court ? ? the ultimate arbiter of Delaware law ? ? could likely have a more powerful res judicata impact. It is also possible (although, to date, there has been no announced legislative initiative) that the Delaware General Assembly could pick up the pen and weigh in on the subject in the future.

Most recently, in **Edgen Group Inc. v. Genoud, C.A.** No. 9055?VCL (Del. Ch. Nov. 5, 2013), Vice Chancellor Laster (in a transcript decision on plaintiff's motions for a temporary restraining order (TRO) and expedited proceedings) declined to grant Edgen's application to temporarily enjoin a breach of fiduciary duty lawsuit commenced in a Louisiana state court against Edgen and its directors. Edgen previously had adopted at the time of its IPO, in its certificate of incorporation, an exclusive forum provision for actions involving breach of fiduciary duty, derivative actions, interpretations of the DGCL and Delaware's internal affairs doctrine. Edgen, a Delaware corporation headquartered in Louisiana, recently had announced that it entered into an agreement to sell Edgen to Sumitomo Corporation of America in an all?cash merger transaction and plaintiff?Genoud challenged the transaction in Louisiana. After Edgen filed a motion requesting the Louisiana state court to dismiss or stay the action (but before the Louisiana court ruled on Edgen's motion), Edgen petitioned the Delaware Chancery Court to temporarily restrain the Louisiana action on the basis that such litigation was precluded by Edgen's charter provision. Edgen argued, among other things, that it would suffer irreparable harm if it were forced to litigate the validity of the exclusive forum provision outside of Delaware.

At an expedited hearing on Edgen's motion for a TRO, Vice Chancellor Laster found that there was a reasonable probability that Edgen would successfully establish on the merits that plaintiff?Genoud breached Edgen's exclusive forum provision and that Edgen would indeed suffer irreparable harm if the validity and enforceability thereof was not enforced by the Louisiana state court. Nevertheless, the Vice Chancellor declined to grant Edgen's application for the TRO because (citing principles of interstate comity) because he believed it was more appropriate for the Louisiana state court to first rule on the enforceability of Edgen's charter provision than for the Delaware Chancery Court to intervene in an anti? suit injunction action at that stage of the pending Louisiana litigation. In addition, Vice Chancellor Laster observed that, although not necessarily dispositive of whether the Delaware Chancery Court had personal jurisdiction over Genoud, there was a triable issue as to whether such jurisdiction existed due to the absence of an express "consent to personal jurisdiction" clause in Edgen's exclusive forum charter provision. The Vice Chancellor referenced the fact that Edgen's charter provision itself illuminated this issue by expressly stating that the exclusive forum provision was "subject to [the Delaware Chancery Court] having personal jurisdiction over the indispensable parties named as defendants." It nonetheless remains unclear after the Edgen decision whether the inclusion of an express consent to jurisdiction clause is an important practical requirement when bringing an anti?suit injunction case (or alternative action) in the Delaware Chancery Court. Accordingly, the Vice Chancellor concluded that the "balance of the equities" (one of the three tests, together with the aforementioned "irreparable harm" and substantial likelihood of success" tests, used by the Delaware courts when determining whether an injunction should be issued) did not weigh in favor of granting Edgen's motion for a TRO.

While Vice Chancellor Laster's decision in Edgen certainly reinforces Chancellor Strine's decisions in Chevron and FedEx that properly tailored exclusive forum charter or bylaw provisions are facially valid (as a statutory and contractual matter), the Vice Chancellor suggested that as a procedural matter Edgen should have first waited for the Louisiana state court to rule on Edgen's motion to dismiss or stay Genoud's breach of fiduciary duty action before requesting the Delaware Chancery Court to intervene and hear Edgen's application for an anti?suit TRO. As of this writing the Louisiana state court has scheduled a hearing on Edgen's motion to dismiss in mid?December 2013.

The Vice Chancellor specifically noted that Edgen's anti?suit injunction strategy was the most aggressive procedural path to take (vis a vis other procedural options available to Edgen) and that Edgen's approach raised significant issues of interstate comity and judicial deference. In dicta, he offered (without detailing a precise roadmap) that, alternatively, Edgen might have sought to obtain a default judgment in the Delaware Chancery Court (to the extent Genoud failed to appear in the selected Delaware forum) and have that judgment entered by the Louisiana state court on principles of res judicata. Vice Chancellor Laster did note, however, that there nevertheless may be circumstances in a future case where it would be appropriate to file, in the first instance, a motion for an anti?suit injunction in the Delaware Chancery Court. Perhaps, a future decision of the Delaware Chancery Court might further clarify the procedural alternatives available to a Delaware corporation when seeking enforcement in the Delaware Chancery Court of an organic exclusive forum provision.

As is evident from the Chevron, FedEx and Edgen decisions, the adoption by Delaware corporations and the facial validity of organic exclusive forum provisions by no means puts to bed all of the issues that may arise with respect to the willingness of litigants and of non?Delaware courts to respect the facial validity of such provisions, or whether the use of such provisions in a particular context ultimately would be upheld as fair, reasonable and equitable in an "as?applied" challenge brought in a Delaware or non? Delaware court.

Indeed, much like the aforementioned analogy drawn by the Delaware Chancery Court to the validity of the adoption of a poison pill, a challenge outside of Delaware to the facial validity of a properly drafted exclusive forum provision may present less of an issue than actions challenging the use thereof in a particular set of fact and circumstances. In the latter context plaintiffs almost certainly would challenge the enforceability and use of such provisions by alleging a breach of the directors' fiduciary duty and by seeking to engage the court in a substantive review of the directors' duties of care and loyalty, in addition to a determination of the overall reasonableness and fairness of such provisions and of whether the provisions were applied equitably in a fact?specific setting. The fiduciary analyses could be more fact? intensive where the exclusive forum clause is permissive or elective ?? where the provision expressly permits the corporation to consent in writing to the selection of an alternate, non?designated forum ?? as opposed to a mandatory (more self?executing) exclusive forum provision.

To be sure, the adoption of an organic exclusive forum provision (of the type facially validated, to date, by the Delaware Chancery Court) is not a "one?size?fits?all" exercise for every Delaware corporation. As with all significant corporate decisions, and especially those involving organic change, corporate governance policy and extraordinary transactions, context is key and the decision should be made by the Board on a well?informed basis (with the best available information requested and reviewed by the directors and with a well?documented record of the Board's deliberative process) in light of all prevailing facts and circumstances. To determine whether the adoption of an organic exclusive forum provision is fair to and in the best interests of the corporation and its stockholders, directors should, at a minimum, carefully examine with management and legal counsel the relative corporate merits and risks involved, and pay particular attention to the corporation's past

history with multi?forum fiduciary duty and derivative actions (and litigation involving Delaware internal affairs matters), the composition and institutional concentration of the corporation's stockholder base (and the corporation's relationship with significant investors), the corporation's governance scorecard, and whether the corporation has principal offices and significant operations in jurisdictions outside of Delaware (to help assess whether there is a real world probability of future multi?forum or non?Delaware litigation).

As part of any Board decision on these matters it is also important to take the temperature and review the historical voting patterns and, if available, published investment guidelines of the corporation's institutional stockholders. A fair number of the largest institutional investors (e.g., traditional asset managers, index funds and non?activist funds) may tend to understand the cost? efficiencies and other advantages of exclusive forum requirements, whereas other institutional investors may perceive such requirements as an attempt to disenfranchise stockholders and eliminate substantive rights. Institutional Shareholder Services ("ISS") announced earlier this year a case?by?case review policy with respect to exclusive forum proposals, taking into account whether the corporation has suffered past material harm in a litigation outside the corporation's jurisdiction of incorporation and whether the corporation follows good corporate governance practices (i.e., according to ISS: no classified Board, no "poison pill" in effect that was not approved by stockholders, and a majority voting standard for the election of directors). Glass?Lewis & Co. also has announced a case?by?review policy, but noted it will recommend that stockholders vote against any proposal to adopt an organic exclusive forum requirement unless the corporation provides a compelling argument why such requirement would directly benefit stockholders, the corporation maintains a strong record of good corporate governance practices, and the corporation provides evidence that it has been subject to an abusive legal process in litigation outside the corporation' state of incorporation.

In view of the foregoing, we continue to recommend that Delaware corporations should carefully consider the appropriateness of adopting organic exclusive forum selection provisions to mitigate the threat of having to concurrently defend against parallel litigation in multiple jurisdictions and to increase the likelihood that only a Delaware court will adjudicate future breach of fiduciary duty disputes, derivative actions, litigation implicating Delaware's internal affairs doctrine and actions involving the interpretation of Delaware statutory and common law as it relates to the corporation. If deemed fair to and in the best interests of the corporation and its stockholders under all of the circumstances, adoption by means of bylaw amendment can be implemented exclusively by the Board, subject to the repeal and amendment thereof by subsequent stockholder action. Implementation by means of charter amendment would require both Board approval and subsequent adoption by the requisite vote of the corporation's stockholders. Interestingly (although stockholder approval would be required in the first instance), it would seem that the charter method ultimately is the less stockholder?friendly (less flexible) approach because a subsequent stockholder proposal to amend or repeal the charter provision would merely be precatory (i.e., advisory and not binding) in nature. As a practical matter, when used, the charter method is overwhelmingly used at the time of a corporation's formation or initial public offering.

We are continuing to monitor the adoption and use of organic exclusive forum provisions in jurisdictions outside of Delaware. Such non?Delaware activity has been less robust (depending in part on the corporation law statutes of the state in question and whether the courts of the relevant state review and find persuasive decisions of the Delaware Chancery Court), but to date a number of significant Maryland corporations and corporations in other non?Delaware jurisdictions have adopted various iterations of Chevron's and FedEx's EFBs.

1 C.A. No. 7220?CS (Del. Ch. June 25, 2013); C.A. No. 7238?CS (Del. Ch. June 25, 2013).

2 407 U.S. 1 (1972)

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