CLEARY GOTTLIEB

ALERT MEMORANDUM

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Should Your Company Adopt A Forum Selection Bylaw?

In a much anticipated decision, the Delaware Chancery Court upheld on June 25, 2013 the validity of the forum selection bylaws adopted by the boards of directors of FedEx Corporation ("FedEx") and Chevron Corporation ("Chevron"). Such bylaws provide that stockholders bringing derivative claims or claims alleging breaches of fiduciary duties, arising from the Delaware General Corporate Law (the "DGCL") or otherwise implicating the internal affairs of the corporation be brought exclusively in Delaware state or federal courts. In rendering his opinion, Chancellor Leo Strine found that specifying the forum for litigating such matters is well within the statutorily permitted scope of bylaw provisions under Section 109(b) of the DGCL. Further, the Court found that these unilateral board actions to adopt such bylaws without the consent of stockholders were nonetheless contractually binding on stockholders because Section 109(b) of the DGCL allows a corporation, through its certificate of incorporation, to grant directors the power to adopt and amend bylaws unilaterally (which was the case here). When FedEx and Chevron stockholders invested in the respective corporations, they were deemed under Delaware law to be put on notice that the board could amend the bylaws to include provisions such as the one at issue.

The Court acknowledged that there could be circumstances in which the application of forum selection bylaws would have inequitable or unreasonable consequences for the rights of stockholders. However, the Court refused to engage in analyzing future hypothetical scenarios. Rather, in addition to reminding stockholders of their statutory right to adopt and amend bylaws (including repealing any forum selection bylaw adopted by the board of directors), the Court noted the right of stockholders to challenge a forum selection bylaw if actually confronted with what they believed to be an unfair or unreasonable result in a specific context or when its application by the board (which has the ability under the bylaws to consent to an alternative jurisdiction) would represent a breach of fiduciary duties.

There are over 200 U.S. corporations with forum selection provisions in their charters or bylaws already, with a majority of those provisions having been adopted in connection with IPOs, restructurings or reincorporations in Delaware. With the Chancery Court's validation of board-adopted forum selection provisions, we expect more Delaware corporations to adopt such provisions through board action, resuming a popular trend that had come to a standstill with the onset of FedEx and Chevron legal challenges.

The principal benefit of a forum selection bylaw is the elimination of the risk of litigation in multiple courts and the resulting risk of multiple and potentially inconsistent decisions and increased litigation costs. Other potential benefits include adjudication by judges with relevant expertise and experience and prompt hearings, trials and appeals. Plaintiffs would continue to be able to bring suit in the jurisdiction of its choosing with respect to claims not covered by the forum selection bylaw. Therefore, this restriction would not apply to disclosure claims arising under federal securities laws, tort claims or general commercial litigation, even with plaintiffs who are stockholders.

It remains to be seen how stockholders will react to this decision and subsequent board adoption of such provisions. In 2012, four stockholder proposals (the first of their kind) were put forth seeking to repeal board-adopted forum selection bylaws. Two of the companies involved repealed those bylaws prior to a stockholder vote. The proposals at the other two companies (one of which was Chevron), despite support by the two leading proxy advisory firms, were defeated by a two-to-one margin. The companies' victory in these cases may have been the result of their good governance records, including majority voting for directors, annual election of all directors and the absence of poison pill rights plans. While some stockholders likely appreciate the potential benefits to companies (and to non-litigious stockholders themselves) of such provisions (and therefore possibly improved share value), others view the right to bring suit in a jurisdiction of their choosing to be a fundamental stockholder right.

Directors, of course, should act in what they believe is good faith in the best interests of the company. But it is not surprising that in doing so, directors often take into account known or perceived views of significant numbers of their stockholders and the possible distraction that could result from significant stockholder criticisms or a stockholder proposal to repeal a board-adopted forum provision. Accordingly, in considering whether to adopt such provisions, boards may wish to consider their investor profile and the views of the proxy advisory firms. The current policy of Institutional Shareholder Services ("ISS") is to recommend on a case-by-case basis whether to approve forum selection proposals, taking into account (i) whether the company has been materially harmed by stockholder litigation outside its jurisdiction of incorporation and (ii) whether the company has adopted certain good governance practices (i.e., board declassification, majority voting and absence of any board-approved poison pill). Glass Lewis will generally recommend against any proposal to adopt forum selection provisions and will also generally recommend a withhold vote against the chair of the Corporate Governance Committee if the board has adopted a forum selection bylaw without a stockholder vote. Glass Lewis says, however, that it may not follow these general policies if the company: offers a compelling argument as to why the exclusive forum provision is necessary; how the provision would directly benefit stockholders; and maintains a record of good corporate governance practices.

The Delaware Chancery Court's decision has given Delaware boards the green light to adopt forum selection provisions. Barring an uprising of stockholders against such provisions, we would anticipate that many more boards will do so, as we believe many should in view of the benefits of such provisions and the absence of negatives for most companies.[1] While some companies may wish to wait and see if the Chancery Court decision is appealed, given the well-reasoned opinion, we do not believe there are strong reasons to await the outcome of an appeal. There may be circumstances, however, where for stockholder relationship reasons, issues to be addressed at the upcoming annual meeting, or otherwise, it may not make sense for the board of particular companies to adopt such bylaws, at least at this time. In any event, even if management is not planning to propose that the board approve (or the governance committee recommend) adoption of a forum selection bylaw at this time, the General Counsel and other senior management may wish to address the issue with the board proactively or at least be prepared to answer likely questions.

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Please feel free to call any of your regular contacts at the firm or any of our partners and counsel listed under "Corporate Governance" in the Practices section of the website if you have any questions.

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[1] In connection with such adoption, consideration should be given to taking steps suggested by the Chancellor's opinion to assure that all officers who could be named in lawsuits consent to Delaware court jurisdiction (as, by statute, directors and certain specified officers are deemed to have done).

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