

# INSIGHTS

## THE CORPORATE & SECURITIES LAW ADVISOR

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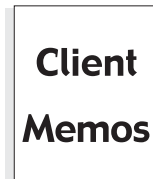
### Exclusive Forum Bylaws **Page 15**

WILLIAM M. LIBIT and TODD E. FREIER of Chapman and Cutler LLP explore exclusive forum bylaws, including the arguments in support and against them, the policies of institutional investors with respect to such provisions, and other related considerations.

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# CORPORATE LITIGATION

## Is It Time to Go (Forum) Shopping? Exclusive Forum Bylaws and Related Considerations

*Public companies increasingly face the risk of litigating the same or similar claims in multiple jurisdictions and thus are exploring exclusive forum bylaws. Such bylaws generally provide that the company's state of incorporation must be the exclusive forum for all intracorporate disputes. Companies contemplating such bylaws need to consider the pro and con arguments, the policies of institutional investors with respect to such provisions and other related matters.*

**By William M. Libit and Todd E. Freier**

Public companies face the risk of litigating the same (or substantially similar) claims in multiple jurisdictions, arguably consuming valuable financial and human resources. Exclusive forum bylaws (also referred to as exclusive venue or forum selection provisions) generally provide that a certain state, typically the company's state of incorporation, must be the exclusive forum for all intra-corporate disputes.<sup>1</sup> Although companies adopting such bylaws (or articles of incorporation provisions) argue that exclusive forum bylaws reduce litigation costs and increase the outcome predictability of certain litigation, some shareholders and corporate governance advocates counter that the bylaws inappropriately limit shareholders' fundamental right to pursue certain legal remedies.

This article (1) provides general information concerning exclusive forum bylaws (including a synopsis of arguments in support of and against

them), (2) summarizes the exclusive forum policies and practices of several of the largest asset managers and public pension funds, select proxy advisory firms and certain corporate governance advocates, and (3) presents other related considerations to facilitate boardroom and C-suite discussion.<sup>2</sup>

### Background

The volume of litigation in mergers and acquisitions (M&A) deals dramatically increased between 2005 and 2013. One study concluded that in 2013, shareholder lawsuits were filed in 98 percent of all U.S. public company M&A deals valued over \$100 million (up from 39 percent in 2005), with an average of nearly seven lawsuits filed per deal.<sup>3</sup> During that same period, plaintiffs' counsel began to increasingly pursue multi-forum litigation in those deals (purportedly in search of lucrative plaintiff-counsel fee awards), as 42 percent of corresponding lawsuits in 2013 were litigated in multiple jurisdictions (up from 8 percent in 2005).<sup>4</sup>

Some speculate that in response to the increase in multi-jurisdictional litigation, the Delaware Court of Chancery, in a 2010 opinion, stated that if boards of directors and shareholders "believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes."<sup>5</sup> Certain legal practitioners believe that this statement, in part, prompted companies over the ensuing years to adopt bylaws making Delaware the exclusive forum for intra-corporate disputes.

In June 2015, the Delaware legislature amended the Delaware General Corporation Law (DGCL) to clarify that Delaware companies may in fact designate Delaware (but not other jurisdictions) as the exclusive forum for adjudicating

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“internal corporate claims.”<sup>6</sup> This new statute, which became effective on August 1, 2015, does not, however, address the validity of provisions that select a jurisdiction other than Delaware as an additional forum in which internal claims may be brought, nor does it forbid companies from agreeing to exclusive non-Delaware forum provisions in a shareholder agreement or other writing signed by the shareholder against whom the provisions are to be enforced. Although exclusive forum provisions have been challenged, courts in California, Illinois, Louisiana, New York, Ohio and Texas have ruled that such provisions designating Delaware as the sole legal forum were enforceable, resulting in the dismissal of litigation filed in those jurisdictions.<sup>7</sup> An Oregon trial court, however, concluded that exclusive forum bylaws (of a Delaware company) were unenforceable

because the board had adopted them close in time to alleged wrongdoing by the board and in anticipation of a shareholder derivative suit.<sup>8</sup>

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***Shareholders and proxy advisors have expressed mixed views on exclusive forum bylaws.***

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**Arguments in Support of and Against**

There are conflicting views as to whether exclusive forum bylaws promote better corporate governance. Arguments in support of and against companies adopting such bylaws include, but are not limited to, the following:

<b>Exclusive Forum Bylaws</b>	
<b>In Support of</b>	<b>Against</b>
<ul style="list-style-type: none"> <li>• prevents duplicative litigation in multiple jurisdictions, opportunistic forum shopping and inconsistent litigation outcomes</li> <li>• decreases litigation costs and prevents corporate waste, thereby increasing corporate profits (and, in turn, shareholder returns)</li> <li>• ensures litigation is resolved in a court most familiar with the applicable law</li> <li>• enables a company to better manage risk associated with intra-corporate disputes</li> <li>• is increasingly becoming common practice<sup>9</sup></li> <li>• is proving effective<sup>10</sup></li> </ul>	<ul style="list-style-type: none"> <li>• is not in the best interests of shareholders (as such bylaws limit shareholders’ access to the legal system, a fundamental shareholder right) and may deter shareholder suits brought in good faith</li> <li>• limits the company’s flexibility in terms of litigation forum or may require a formal board waiver of the bylaws</li> <li>• increases the possibility of public relations concerns</li> <li>• may lead to litigation (if state law does not provide for such bylaws, if directors acted in bad faith with respect to their adoption, etc.)</li> <li>• exposes directors to the risk of receiving negative vote recommendations from proxy advisory firms (if the bylaws are adopted unilaterally by the board)</li> </ul>

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## 2015 Proxy Season

Shareholders and proxy advisors have expressed mixed views on exclusive forum bylaws. During the 2015 proxy season, it has been reported that 25 companies put their exclusive forum bylaws to shareholder vote (up from 16 in 2014), with six proposals failing to receive majority shareholder support.<sup>11</sup> In previous years, relatively few management proposals to designate an exclusive forum have failed (e.g., at The Allstate Corporation in 2011 and at Cameron International Corporation and Suburban Propane Partners, L.P. in 2012).<sup>12</sup>

### Policies and Practices of Institutional Investors, Proxy Advisory Firms and Corporate Governance Advocates

Although boards and management need to implement corporate governance practices that are best for their companies and that will generate long-term value for their shareholders, it is important that they are aware of developments in connection with the exclusive forum policies and practices of (1) their company's largest institutional investors, (2) proxy advisory firms (given their influence on the proxy voting process) and (3) other corporate governance advocates. A select summary of those policies and practices follows:

#### Institutional Investors—Asset Managers

The current exclusive forum policies and practices, as the case may be, of five of the country's largest asset managers are as follows:

- *BlackRock, Inc.:*
  - does not explicitly address in its proxy voting guidelines; however, believes that shareholders should have the right to vote on amendments to governing documents (e.g., bylaws);
  - may vote “against” certain directors where changes to governing documents are not

put to a shareholder vote within a reasonable period of time, particularly if those changes have the potential to impact shareholder rights; however, may support such unilateral adoption if the changes promote cost and operational efficiency benefits for the company and its shareholders<sup>13</sup>; and

- based upon a review of its recently filed proxy voting record, generally votes “for” management proposals to adopt exclusive forum bylaws.<sup>14</sup>
- *The Vanguard Group, Inc.:*
  - does not explicitly address in its proxy voting guidelines; however, notes that the exercise of shareholder rights is a fundamental privilege of stock ownership that should not be unnecessarily limited by corporate charter or bylaw provisions;<sup>15</sup> and
  - based upon a review of its recently filed proxy voting records, generally votes “for” management proposals to adopt exclusive forum bylaws.<sup>16</sup>
- *State Street Global Advisors* generally supports exclusive forum provisions.<sup>17</sup>
- *The Bank of New York Mellon Corporation:*
  - does not explicitly address in its proxy voting guidelines; however, generally votes “against” management proposals if evidence suggests that such proposals would result in a reduction of shareholder rights;<sup>18</sup> and
  - based upon a review of its recently filed proxy voting record, appears to typically classify the adoption of exclusive forum bylaws as a reduction, as it generally votes “against” management exclusive forum proposals.<sup>19</sup>
- *JPMorgan Asset Management* generally votes “for” management proposals to make Delaware the exclusive forum for disputes if the company is incorporated therein;

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otherwise, votes on a case-by-case basis on proposals to make the state of incorporation, or another state, the exclusive forum for disputes.<sup>20</sup>

### **Institutional Investors—Public Pension Funds**

The current exclusive forum policies and practices, as the case may be, of several of the country's largest public pension funds are as follows:

- *California Public Employees' Retirement System* mentions that companies should not attempt to restrict the venue for shareholder claims by adopting charter or bylaw provisions that seek to establish an exclusive forum.<sup>21</sup>
- *California State Teachers' Retirement System*:
  - does not explicitly address in its corporate governance principles; however, expects a shareholder vote on the adoption of or amendments to the company's bylaws or articles, especially if it may materially affect or limit shareholder rights;<sup>22</sup> and
  - based upon a review of certain 2015 proxy vote disclosures, generally votes “against” management proposals to adopt exclusive forum bylaws<sup>23</sup>
- *New York State Common Retirement Fund*:
  - does not explicitly address in its proxy voting guidelines;<sup>24</sup> and
  - however, stated that it believes that exclusive forum bylaws restrict shareholder rights and therefore, generally votes “against” related proposals because such bylaws limit shareholders' ability to hold corporations accountable for their actions.<sup>25</sup>
- *Florida State Board of Administration*:
  - states that companies should not attempt to restrict the venue for shareholder claims by adopting charter or bylaw provisions that seek to establish an exclusive

judicial forum without shareholder approval; and

- generally votes “against” management proposals to establish exclusive forum and “for” shareholder proposals requesting that exclusive forum bylaws be approved by shareholders.<sup>26</sup>

### **Proxy Advisory Firms**

The current exclusive forum policies and practices, as the case may be, of two influential proxy advisory firms are as follows:

- *Institutional Shareholder Services Inc. (ISS)*:
  - recommends a vote on a case-by-case basis on bylaws that impact shareholders' litigation rights, taking into account factors such as (1) the company's stated rationale for adopting such provisions, (2) disclosure of past harm from shareholder lawsuits in which plaintiffs were unsuccessful or from shareholder lawsuits outside the jurisdiction of incorporation, (3) the breadth of application of the bylaws, including the types of lawsuits to which it would apply and the definition of key terms and (4) governance features such as shareholders' ability to repeal the provisions at a later date and to hold directors accountable through annual director elections and a majority vote standard in uncontested elections;<sup>27</sup>
  - generally does not consider unilaterally adopted exclusive forum bylaws to be materially adverse to shareholder rights and therefore, such bylaws are considered on a case-by-case basis with respect to board vote recommendations;<sup>28</sup> and
  - notably, does not specifically address exclusive forum provisions or the adoption thereof in its 2016 Policy Survey, so there may not be any forthcoming changes to its current position on the topic<sup>29</sup>
  - during the 2015 proxy season, reportedly opposed nearly all management proposals to adopt exclusive forum bylaws (as

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those companies failed to demonstrate past economic harm arising from multi-forum litigation).<sup>30</sup>

- *Glass, Lewis & Co., LLC*:
  - believes that articles or bylaws limiting a shareholder’s choice of legal venue are not in the best interests of shareholders (as such provisions may effectively discourage shareholder claims by increasing their associated costs and making them more difficult to pursue);
  - recommends that shareholders vote “against” any articles or bylaws amendment seeking to adopt exclusive forum provisions unless the company (1) provides a compelling argument as to why the provisions would directly benefit shareholders, (2) provides evidence of abuse of legal process in other, non-favored jurisdictions, (3) narrowly tailors such provisions to the risks involved and (4) maintains a strong record of good corporate governance practices; and
  - also considers recommending that shareholders vote “against” the governance committee chair, when during the past year the board adopted exclusive forum provisions without shareholder approval or if the board is seeking shareholder approval of such provisions pursuant to a bundled bylaws amendment rather than as a separate proposal.<sup>31</sup>

## Corporate Governance Advocates

The current exclusive forum positions of the following corporate governance advocates are as follows:

- *Council of Institutional Investors* (advocating on behalf of shareholders) believes that companies should not attempt to restrict the venue for shareholder claims by adopting charter or bylaw provisions that seek to establish an exclusive forum,<sup>32</sup>

- *U.S. Chamber of Commerce* (advocating on behalf of management) supports exclusive forum bylaws.<sup>33</sup>

## Considerations for Companies

To facilitate discussion in boardrooms and C-suites on whether to adopt exclusive forum bylaws, companies may consider the following.

### Conduct Analysis

A company should conduct an analysis considering:

- the overall litigation profile of the company and its peers (as to the materiality, frequency, jurisdictions and types of lawsuits to which each is subjected);
- whether the benefits of adopting exclusive forum bylaws outweigh the related uncertainty and potential negative consequences (in part, upon evaluating the arguments in support of and against, discussed herein, and potential reaction from shareholders);
- whether state statutes and/or case law provides such authority (*e.g.*, for non-Delaware companies);
- directors’ fiduciary duties (as the board must evaluate whether such bylaws are in the best interests of the company and its shareholders); board minutes should reflect the process of the board’s deliberations and why the board believes, in its business judgment, that the bylaws are (or are not) in the best interests of the company and its shareholders;
- whether the board should adopt the bylaws unilaterally or seek shareholder approval;
- whether the company should amend its articles of incorporation (which amendment likely requires shareholder and board approval) or bylaws (which amendment may only require board approval);
- how such bylaws would interact with other governing provisions, practices and strategies of the company; and

- the timing of adoption of such bylaws (to avoid potential shareholder litigation, the bylaws should be adopted in the normal course of business and in accordance with other corporate governance practices and not prior to significant M&A activity or in response to any particular action; the company should also assess whether it is currently under scrutiny by shareholders and proxy advisory firms for other corporate governance practices (such as having a classified board, plurality voting standard or a shareholder rights plan without shareholder approval) that may be exacerbated by adopting exclusive forum bylaws).

### Consider Elements of Exclusive Forum Bylaws

If a board concludes that it is in the best interests of the company and its shareholders to adopt exclusive forum bylaws as part of its corporate governance practices (or, alternatively, present such bylaws for shareholder approval), elements of such bylaws for the board to consider include, but are not limited to:

- designating the state of exclusive jurisdiction (*e.g.*, state of incorporation versus where headquartered, if different states);
- identifying the types of cases that are bound by the exclusive forum bylaws (for companies in states that have not enacted an exclusive forum statute); and
- considering whether to include a waiver provision that would provide the board flexibility and allow it to decide, based upon a number of factors (including, for example, location of witnesses and documents, costs of litigating in another forum, public relations concerns, etc.) whether a different forum (as selected by a shareholder plaintiff) is preferable.

### Review Positions of Peers, Industry and Institutional Investors

Companies should determine and continue to monitor whether their exclusive forum positions

and practices are aligned with those of peer companies and the industry in which they operate (as outliers may become the target of activist shareholder campaigns), as well as with the positions and practices of their largest institutional investors. Companies also should review 2015 exclusive forum proxy proposal voting results of peers and others in their industry, if any, and gauge shareholder support relating thereto.

### Communicate Plan to Shareholders

If after conducting a comprehensive analysis a board concludes that it should adopt or recommend shareholders approve adoption of exclusive forum bylaws, the board (with management's assistance) should effectuate a shareholder outreach strategy that effectively communicates the board's rationale as to why it determined that adoption of such bylaws is in the long-term best interests of the company and its shareholders.

### Notes

1. Such intra-corporate disputes include, but are not limited to, (i) shareholder derivative actions, (ii) assertions of claims of a breach of fiduciary duty owed by a director or officer to the company or its shareholders and (iii) claims arising under the corporate law of the company's state of incorporation or its articles of incorporation or bylaws.
2. This corporate governance update does not provide an in-depth discussion regarding the history and evolution of exclusive forum case law and related issues, but focuses primarily on practical aspects that a company might consider in evaluating whether to adopt exclusive forum provisions. For ease of reference, this update focuses on bylaws as the primary means by which exclusive forum provisions are incorporated into a company's governing documents; however, as discussed herein, a company's articles/certificate of incorporation may also be used.
3. *Takeover Litigation in 2013*, Matthew D. Cain and Steven M. Davidoff (January 9, 2014).
4. *Id.*
5. *In Re Revlon, Inc. Shareholders Litigation*, Consol. C.A. No. 4578-VCL (March 16, 2010). See *Multi-Jurisdictional Litigation: Who Caused This Problem, And Can It Be Fixed?*, DELAWARE JOURNAL OF CORPORATE LAW, Edward B. Micheletti and Jenness E. Parker (2012) (noting that the Delaware Court in the *Revlon* decision signaled that exclusive forum charter (and bylaws) provisions might offer a solution to multi-jurisdictional litigation).

6. DGCL Section 115 (Forum selection provisions). In June 2015, Delaware also enacted legislation to invalidate any provision in a company's certificate of incorporation or bylaws that shifts the company's or any other party's attorney's fees or expenses to the shareholder in an "internal corporate claim." DGCL Section 102(f) and Section 109(b).
7. *Exclusive Forum Bylaws Are Going Mainstream: What's Next, Bylaws Eliminating Shareholder Class Actions?*, BOSTON BAR JOURNAL, Matthew C. Baltay (April 22, 2015).
8. *Roberts v. TriQuint Semiconductor, Inc.*, No. 1402-02441, 2014 WL 4147465 (Or. Cir. Ct., August 14, 2014). This case is currently pending before the Oregon Supreme Court (docket no. S062642).
9. For the period 2013 through 2014, more than 300 companies adopted exclusive forum provisions. *Shareholder Litigation Involving Acquisitions of Public Companies—Review of 2014 M&A Litigation*, Cornerstone Research (February 25, 2015).
10. In 2014, (i) 60% of M&A litigation was filed in only one jurisdiction (a reversal from the 2009 to 2013 period when multi-jurisdictional litigation prevailed), which is likely a result of the adoption of exclusive forum bylaws, and (ii) only 4% of M&A deals were challenged in three or more jurisdictions, down from a peak of 20% in 2011. *Shareholder Litigation Involving Acquisitions of Public Companies*, Cornerstone Research, *supra* note 9.
11. Exclusive forum management proposals at Avery Dennison Corporation, Bristol-Myers Squibb Company, Caleres, Inc., Commercial Vehicle Group, Inc., DSP Group, Inc. and Novavax, Inc. failed, while a proposal at American Water Works Company, Inc. received 52% shareholder support but only after the company adjourned the annual meeting to solicit additional votes. *2015 Proxy Season Review*, THE ADVISOR, Shirley Westcott (August 2015).
12. *Id.* Since 2011, 18 of 20 Russell 3000 companies with management proposals to adopt Delaware as the exclusive forum for resolving certain disputes had those proposals approved by their shareholders. Letter from Jeff Mahoney, General Counsel of Council of Institutional Investors to Norman M. Monhait, Chair, Section of Corporation Law, Delaware State Bar Association (November 25, 2014).
13. *Proxy Voting Guidelines for U.S. Securities*, BlackRock (February 2015).
14. BlackRock Form N-PX filed with the Securities and Exchange Commission ("SEC") on August 26, 2015.
15. *Vanguard's Proxy Voting Guidelines*, Vanguard (2015).
16. Vanguard Forms N-PX filed with the SEC on August 28, 2015.
17. *Proxy Voting and Engagement Guidelines—United States*, SSGA (March 2015).
18. *Summaries of Selected Proxy Voting Guidelines*, BNY Mellon (January 15, 2014).
19. BNY Mellon Form N-PX filed with the SEC on August 20, 2015.
20. *Global Proxy Voting Procedures and Guidelines*, JPMorgan (April 1, 2015).
21. *Global Governance Principles*, CalPERS (March 16, 2015).
22. *Corporate Governance Principles*, CalSTRS (April 3, 2015).
23. CalSTRS Proxy Vote Disclosure at <http://www.calstrs.com/proxy-voting-0>.
24. *Proxy Voting Guidelines*, NYSCRF (January 2015).
25. *Allowing Firms to Restrict Suits to Delaware to Change Legal Landscape*, THE WALL STREET JOURNAL, Peg Brickley (July 7, 2013).
26. *2015 Corporate Governance & Proxy Voting Guidelines*, SBA (2015).
27. *United States Summary Proxy Voting Guidelines: 2015 Benchmark Policy Recommendations*, ISS (March 4, 2015).
28. *2015 Benchmark U.S. Proxy Voting Policies, Frequently Asked Questions on Selected Topics*, ISS (February 19, 2015).
29. *ISS 2016 Policy Survey*, ISS (August 4, 2015). The ISS 2016 Policy Survey closed on September 4, 2015. Final policies are expected to be implemented on or about February 1, 2016.
30. *2015 Proxy Season Review*, Shirley Westcott, *supra* note 11.
31. *Proxy Paper Guidelines 2015 Proxy Season: An Overview of the Glass Lewis Approach to Proxy Advice (United States)*, Glass Lewis (November 6, 2014).
32. *Corporate Governance Policies*, CII (April 1, 2015).
33. See, for example, *U.S. Chamber Policy Accomplishments for 2014* (January 2015) (noting that the Chamber of Commerce helped pass legal reform in North Carolina that codified North Carolina case law recognizing the validity of exclusive forum provisions in the articles of incorporation or bylaws of a corporation).