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The Multi-Jurisdictional Stockholder Litigation Problem and the Forum Selection Solution

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Delaware corporations litigating stockholder lawsuits are often confronted with the prospect of defending the same conduct against claims of breach of fiduciary duty simultaneously in multiple jurisdictions. Such litigation presents unique challenges that some corporations have attempted to avoid through bylaw or charter provisions requiring stockholders to bring their claims in the Delaware Court of Chancery. The enforceability of these provisions has not been settled by the courts—one court recently found a forum selection bylaw unenforceable in light of the particular circumstances of that case. However, given that the downside of these forum selection provisions is largely limited to questions surrounding their enforceability and the significant benefits such provisions offer, a Delaware corporation should give serious consideration to adopting such a provision either in its charter or in its bylaws.

Forum Shopping, 'Reverse Auction'

Recent developments in Delaware highlight the challenges that face a corporation litigating a multi-jurisdictional dispute involving stockholder claims of breach of fiduciary duty. Such litigation arises when plaintiffs' firms file lawsuits challenging the same conduct in different jurisdictions. The Delaware Court of Chancery has acknowledged that plaintiffs' lawyers do so as part of a rational business model ''to get a seat at the table . . . because it gives them a better shot at the action and better leverage in terms of fees.'' *In re Burlington N. Santa Fe S'holder Litig.*, C.A. No. 5043-VCL, at *34 (Del. Ch. Oct. 28, 2010) (Laster, V.C.) (transcript). The Court of Chancery has also recognized that multi-jurisdictional litigation is ''problematic'' because it (i) forces defendants to ''litigate the same case—often identical claims—in multiple courts,'' (ii) wastes judicial resources, and (iii) creates the possibility that two judges sitting in different states might apply the same law differently. *In re Allion Healthcare Inc. S'holders Litig.*, 2011 WL 1135016, at *4 (Del. Ch. Mar. 29, 2011) (Chandler, C.).

Corporations can try to ameliorate the difficulties of multi-jurisdictional litigation after a lawsuit is filed. The *Allion* Court indicated that its own preference for dealing with these challenges was for defense counsel to file motions in all jurisdictions where plaintiffs had filed complaints and ask those courts to confer and determine in which jurisdiction the case should proceed. *Id.* at *4 n.12. Frequently, however, the multi-jurisdictional issue is not so resolved and its complications continue to trouble corporations throughout the life of a lawsuit. In another recent and highly publicized development that emphasizes the persistence of such complications, the Court of Chancery appointed a special counsel to report on whether there was collusive behavior in connection with defendants' settlement of a class action lawsuit. *See Scully v. Nighthawk Radiology Holdings, Inc.*, C.A. No. 5890-VCL (Report of Special Counsel March 11, 2011).

The special counsel's report explains that, when settling a multi-jurisdictional dispute, ''unquestionably proper'' forum shopping by defense counsel can turn into a ''reverse auction'' in which a defendant can seek the lowest ''bidder'' among plaintiffs' firms challenging the same conduct in different fora, and, in the worst cases, can lead to a collusive settlement where a plaintiff's firm accepts a low-ball settlement offer in order to secure a fee. *Nighthawk Radiology* (Report of Special Counsel), at *2–*12. Although the special counsel concluded, and the Court later agreed, that there had been no collusion in the *Nighthawk Radiology* case, the special counsel's report highlights the challenges that face corporations when litigating multi-jurisdictional disputes. *Id.* at *41; *Scully v. Nighthawk Radiology Holdings, Inc.*, C.A. No. 5890-VCL (Del. Ch. April 12, 2011) (Laster, V.C.).

Forum Selection Provisions

A corporation faced with the complications associated with multi-jurisdictional litigation could rationally conclude that the corporation and its stockholders would benefit from avoiding this multi-jurisdictional predicament altogether. Adopting a charter or bylaw provision naming Delaware the exclusive forum for litigating stockholder claims may be a solution. Such provisions generally apply to four main categories of actions: (1) any derivative action brought on behalf of the corporation; (2) any action asserting a claim for breach of fiduciary duty by a director, officer, or other employee of the corporation; (3) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law (the ''DGCL'') or the corporation's governing documents; and (4) any action asserting a claim governed by the ''internal affairs'' doctrine (i.e., the conflict of laws doctrine holding that certain issues are so fundamental to corporate governance that they must be governed by the law of the corporation's jurisdiction of incorporation).

Over the last year, many corporations have adopted forum selection provisions following a suggestion by the Delaware Court of Chancery that

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a forum selection provision contained in a charter would be valid. *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 960 (Del. Ch. 2010) (Laster, V.C.) (''If boards of directors and stockholders 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.''). Despite its suggestion, the Court did not expressly hold that an exclusive forum provision would be valid and reserved ''[t]he issues implicated by an exclusive forum selection provision [for] resolution in an appropriate case.'' *Id.* at 961 n.8.

Charter vs. Bylaws

A Delaware corporation that has decided to adopt an exclusive forum selection provision could place that provision in either its charter or its bylaws. The Court of Chancery's remark in *Revlon* related to a forum selection provision in a charter, but because stockholder approval is required for a Delaware corporation to amend its charter, most public corporations that have adopted a forum selection provision have done so in their bylaws. Assuming the corporation's charter authorizes its board to amend the bylaws, the board can adopt such a provision without stockholder action. *See* 8 DEL. C. § 109(a). The stockholders would, however, retain the unilateral authority to amend the bylaws. *Id.* Prominent corporations that have adopted a forum selection bylaw following the *Revlon* decision include Chevron Corporation, Berkshire Hathaway Inc., and FedEx Corporation. *See* CLAUDIA H. ALLEN, *Study of Delaware Forum Selection in Charters and Bylaws*, at xv to xvi (July 1, 2010, revised April 7, 2011).

While most public corporations that have adopted a forum selection provision have opted to do so through a bylaw, two S&P 500 corporations (DIRECTV and Life Technologies Corporation) have sought and obtained stockholder approval of forum selection charter provisions at their 2011 annual meetings. *See id.* at v; Life Technologies Corporation, Current Report on Form 8-K filed on April 28, 2011; DIRECTV, Current Report on Form 8-K filed on May 3, 2011. At least two other public corporations (The Allstate Corporation and Altera Corporation) are seeking stockholder approval of forum selection charter provisions at their upcoming 2011 annual meetings. ALLEN at v.

A corporation evaluating whether to put a forum selection charter provision to a stockholder vote should keep in mind that proxy advisory firms may recommend that stockholders vote against such proposals. Institutional Shareholder Services (''ISS'') has adopted a preliminary policy recommending votes against exclusive forum selection provisions unless the corporation has (i) an annually elected board, (ii) a majority vote standard in uncontested director elections, (iii) a right for 10 percent of its stockholders to call special meetings without ''onerous restrictions on topics and timing,'' and (iv) no poison pill that has not been approved by the stockholders. *See* ISS Report for DIRECTV 2011 Annual Meeting, at 14–15 (April 11, 2011). ISS recommended an against vote on DIRECTV's exclusive forum selection proposal because of a 25 percent demand threshold for stockholders to call special meetings. *Id.* at 13–15.

ISS recommended that stockholders approve the Life Technologies forum selection charter provision, but only because it was bundled with a proposal to declassify the board. ISS Report for Life Technologies Corporation 2011 Annual Meeting, at 11–12 (April 11, 2011). Absent the bundling, ISS would have recommended stockholders vote against the Life Technologies proposal because the Life Technologies stockholders do not have the right to call special meetings. *Id.* ISS also noted that in the future it may recommend against votes on an exclusive forum selection proposal and director elections if a corporation bundles a forum selection proposal with any other proposal. *Id.*

On the other hand, approximately 40 public corporations have adopted (or have proposed to adopt) forum selection provisions in their initial charters in connection with their initial public offerings or emergence from bankruptcy. Examples include Booz Allen Hamilton Holding Corporation (IPO), LinkedIn Corporation (IPO), U.S. Concrete, Inc. (emergence from bankruptcy), and General Growth Properties, Inc. (emergence from bankruptcy). *See* ALLEN at 5, 13, 19, 29.

Mandatory vs. Elective Provisions

When drafting a forum selection provision, counsel should be mindful of the distinction between mandatory and elective provisions. First generation forum selection provisions were mandatory provisions that required any litigation they covered to be litigated in the specified forum. ALLEN at v to vi. In order to preserve flexibility, second generation forum selection provisions are normally elective provisions that permit a corporation to consent to the selection of an alternative forum. *Id.*; *see also* JOSEPH A. GRUNDFEST, *Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches*, at 8, 14–16 (Oct. 8, 2010). One issue that commentators and practitioners have generally not focused upon is what standard of review a court will apply to an election as to which forum to litigate in. *See generally* GRUNDFEST at 17. There is a strong case for the application of the business judgment rule, i.e., mere rationality review, but a court might be persuaded to scrutinize the exercise of a forum selection provision for reasonableness along the lines of *Unocal* on the theory that the directors' choice as to where to litigate claims against them brought on behalf of the corporation raises concerns parallel to the entrenchment issues addressed by *Unocal* and its progeny. *See id.*

Which Forum? A Case for Delaware

Before adopting an exclusive forum selection provision, a corporation must determine which state it will select as the exclusive forum for litigating stockholder lawsuits. Although specifying any jurisdiction as the exclusive forum for litigating intra-company disputes might avoid the difficulties of multi-jurisdiction litigation that the *Allion* Court recognized, several rationales support a Delaware corporation naming Delaware as the exclusive litigation forum for stockholder disputes. First, Delaware courts have consistently been ranked as among the best in the nation. *See, e.g.*, U.S. Chamber of Commerce, State Liability Systems Survey (2010) (ranking Delaware's court system first among all 50 states for every year from 2002–2010, considering factors such as judges' impartiality and competence, overall treatment of tort and contract claims, and handling of class action lawsuits). Second, the Delaware courts are able to handle corporate litigation, particularly expedited proceedings, efficiently given their repeat experience with these cases. *In re Compellent Techs., Inc., S'holder Litig.*, C.A. No.

6084-VCL, at *15 (Del. Ch. Jan. 13, 2011) (Laster, V.C.) (transcript) (''Expedited deal litigation, in particular, is something where we develop substantial expertise.''); William H. Rehnquist, Chief Justice of the United States, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice* (Sept. 18, 1992), *in* 48 BUS. LAW. 351, 354 (1992) (''Corporate lawyers across the United States have praised the expertise of the Court of Chancery . . . .''). The Delaware courts' efficiency in handling these lawsuits may result in cost savings for the litigants. *See State Liability Systems Survey*, at 15 (ranking Delaware first in timeliness of summary judgment or dismissal and first in the discovery process).

Validity and Enforceability

In light of the challenges presented by multi-jurisdictional litigation, an exclusive Delaware forum selection provision offers significant benefits to a Delaware corporation and its stockholders. Although no court has yet construed the validity of a charter or bylaw forum selection provision as a matter of Delaware corporate law, the broad enabling language of the DGCL appears to authorize such provisions. Under the DGCL, a corporate charter can contain ''[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders . . . if such provisions are not contrary to the laws of this State.'' 8 DEL. C. § 102(b)(1). The DGCL states that the bylaws ''may contain any provision, not inconsistent with law or with the 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.'' 8 DEL. C. § 109(b).

'Galaviz' Decision

While corporate law principles support the validity and enforceability of forum selection bylaws, a corporation considering adopting a forum selection bylaw should be aware that such provisions are a recent development and their enforceability may be subject to challenge. Illustrating this point is a recent case from the Northern District of California in which the Court applied federal common law and refused to enforce Oracle Corporation's (''Oracle'') forum selection bylaw against a stockholder who had purchased his shares prior to the bylaw's adoption. *Galaviz v. Berg*, 2011 WL 135215 (N.D. Cal. Jan. 3, 2011). In *Galaviz*, plaintiff stockholders alleged that the Oracle directors had breached their fiduciary duties in connection with an overbilling scheme by Oracle that took place between 1998 and 2006. In 2006, after most of the challenged conduct had transpired but before the lawsuits were filed, the Oracle board adopted a forum selection bylaw that read: ''The sole and exclusive forum for any actual or purported derivative action brought on behalf of the Corporation shall be the Court of Chancery in the State of Delaware.'' *Id.* at *1.

The Court analyzed the bylaw under contract law principles and concluded that it was not enforceable because the board had unilaterally adopted the forum selection bylaw without the approval of stockholders who had purchased shares prior to the date of the bylaw's adoption and after the majority of the alleged wrongdoing by the directors had occurred. *Id.* at *2–*4. The Court distinguished well-known U.S. Supreme Court precedent holding that forum selection provisions in contracts, even contracts of adhesion, are generally valid and enforceable. *See id.*; *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991) (holding that a contractual venue provision in a contract of adhesion was enforceable subject to review only for ''fundamental fairness''). By contrast, in *Galaviz*, the board had unilaterally adopted the bylaw that the directors now claimed required the stockholder plaintiffs to litigate the fiduciary duty lawsuit in Delaware after the events in question had transpired. *Galaviz*, 2011 WL 135215, at *4 (''Here, in contrast, the venue provision was unilaterally adopted by the directors who are defendants in this action, after the majority of the purported wrongdoing is alleged to have occurred, and without the consent of existing shareholders who acquired their shares when no such bylaw was in effect.'').

The *Galaviz* decision found that under such circumstances a forum selection bylaw was unenforceable as a matter of contract law. It is, however, unclear whether that decision should be read as a broad critique of the enforceability of forum selection bylaws or narrowly cabined to its facts. Although the Court highlighted several factors, the Court did not indicate whether any one of these was dispositive on the issue of enforceability or whether different factual circumstances might lead to a different result. *Id.* at *4.

Notably, the *Galaviz* opinion focuses on the absence of stockholder consent and the adoption of the bylaw after plaintiffs had purchased Oracle stock, which was the Court's main ground for distinguishing it from the U.S. Supreme Court's holding in *Carnival Cruise* that forum selection clauses in contracts of adhesion are enforceable, but the *Galaviz* Court did not determine whether the provision would be enforceable against a stockholder who acquired his shares after adoption of the bylaw. *Id.* at *1, *4. In dicta, the Northern District of California also indicated that it would be more open to enforcing a forum selection provision if it were contained in the charter. *Id.* at *4 (''Certainly were a majority of shareholders to approve such a charter amendment, the arguments for treating the venue provision like those in commercial contracts would be much stronger, even in the case of a plaintiff shareholder who had personally voted against the amendment.'').

Conclusion

Regardless of lingering questions as to the enforceability of a forum selection bylaw raised by the *Galaviz* decision, there is little downside to adopting such a provision. Pre-IPO, a corporation should consider adopting a forum selection provision in its charter. Even a publicly traded corporation may wish to consider whether to seek stockholder approval of a forum selection charter provision. If a public corporation does not wish to seek stockholder approval of a forum selection provision, the corporation should consider adopting a forum selection bylaw. Following any of these approaches has little downside other than possible negative perception by investors and proxy advisory firms and the litigation costs associated with defending the enforceability of a forum selection provision. These minor drawbacks should be weighed against the significant benefits that an exclusive Delaware forum selection provision may offer in avoiding the challenges and costs associated with multi-jurisdictional litigation.

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