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LIMITING SHAREHOLDER SUITS IN MERGERS & ACQUISITIONS: POTENTIAL CORPORATE GOVERNANCE SOLUTIONS

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Shareholder litigation challenging mergers and acquisitions has become an inevitable fact and a cost of doing business. Cornerstone Research reports that lawsuits (sometimes called "strike suits") challenging mergers of public companies valued at over $100 million have more than doubled in the past seven years, with 94 percent of these transactions now being contested, up from 44 percent in 2007. It is almost assured that when a public company announces a merger, going private transaction or tender offer, litigation by a cadre of plaintiffs' attorneys will follow "like mushrooms follow the rain." Dias v. Purch, (Del. Ch. Oct. 1, 2012). Nonetheless, the rise of merger litigation may be peaking as public companies and the courts look to curb strike suits, which typically are settled with no payments made to shareholders and plaintiffs' attorneys being the only parties receiving remuneration.

It is not surprising to see companies and their boards of directors seeking to turn the tide against the increasing frequency of strike suits that cause the expenditure of significant legal fees and pose unfair settlement pressures. Indeed, companies are fighting back by implementing changes to their corporate charters and bylaws. This article will address two potential corporate governance solutions some companies are using to discourage shareholder suits challenging mergers: fee-shifting provisions and exclusive forum selection clauses.

One strategy companies are employing to combat the onslaught of merger objection litigation is adopting "loser-pays" or fee-shifting bylaws. Under the "American Rule," unless parties otherwise agree through contract or a statute giving rise to the cause of action entitles a prevailing party to attorneys' fees, each party in a lawsuit bears its own legal fees and costs. Further, bylaws and company charters, which are contracts between a company and its shareholders, are by design flexible and subject to change. As a result, a board of directors that has the power to amend corporate bylaws by the authority granted in the company's articles of incorporation can unilaterally adopt fee-shifting provisions as an exception to the American Rule.

These loser-pays provisions are intended to deter non-meritorious litigation by making a shareholder who files a lawsuit responsible for the company's legal fees and costs if the company prevails in the litigation. Such provisions are ultimately designed to discourage abusive derivative and securities law claims and reduce incentives for plaintiffs' firms to file such lawsuits.

The Delaware Supreme Court's recent opinion in ATP Tour, Inc. v. Deutscher Tennis Bund, though issued in the context of a fee-shifting provision adopted by a non-stock corporation, suggests that this may be a viable approach for public companies seeking to curb merger objection litigation. In ATP, a non-stock Delaware membership corporation adopted a bylaw providing that if any prior or current member brings an action against the company or any of its members and fails to obtain a judgment on the merits that substantially achieves the full remedy sought in the action, that member would be responsible for all attorneys' fees and costs the corporation incurred in connection with the suit. The court reasoned that because corporate bylaws are contracts between a corporation's shareholders, a fee-shifting provision contained in a "validly-enacted bylaw would fall within the contractual exception to the American Rule." The court also held that such provisions are not invalid per se, and indicated they would be enforceable as long as they were not enacted for an improper or inequitable purpose or would not have such a result. Significantly, the court noted that intent to deter litigation would not necessarily render a bylaw unenforceable.

In response to the ATP ruling, the Delaware Senate tried to enact legislation that would prohibit corporations from including fee-shifting provisions in their charters or bylaws. The bill met some resistance and has been tabled until 2015. In contrast, in May, Oklahoma enacted a fee-shifting provision stipulating that in a derivative action brought by a shareholder on behalf of a corporation, the court shall, upon final judgment, require the non-prevailing party to pay the prevailing party's reasonable costs and attorneys' fees incurred as a result of the action.

It is uncertain whether legislatures and courts in other states will follow the lead of ATP and Oklahoma, but the adoption of loser-pays provisions is likely to gain momentum in the near future as corporations increasingly enact these bylaws to stem the increase in strike suits. It is unclear, however, whether these provisions will apply to all shareholder suits, as there are certain cases where the bylaws might be preempted by federal securities laws that, for example, may contain fee-shifting provisions. This uncertainty is another aspect of this trend that will inevitably be tested in litigation.

A second strategy companies may employ to combat merger objection suits is to adopt exclusive forum selection clauses, which require that all shareholder suits or intracompany actions be brought in the state where the company is incorporated or, alternatively, the state where the company is headquartered. These provisions, which are intended to deter plaintiffs from forum shopping, specify an exclusive forum for shareholder disputes to reduce the burden and significant expense of defending the same suits by the same class of shareholders in multiple jurisdictions. These efforts have found support in the Delaware Chancery Court's decision in Boilermakers Local 154 v. Chevron Corp. and, more recently, in the Chancery Court's September 2014 ruling in City of Providence v. First Citizens Bancshares, Inc.

In Chevron, the court held valid and enforceable two sets of bylaws passed by the boards of directors of Chevron and FedEx, both Delaware corporations, which provided that any lawsuit involving a derivative action, any action alleging a breach of fiduciary duty owed by a director, officer or employee, any claim arising under the Delaware General Corporation Law, or any claim governed by the internal affairs doctrine could only be brought in the Delaware Chancery Court. The court reasoned that the provisions concerned subject matters properly addressed through bylaws because they were process-oriented in that they only regulated "where a stockholder may file suit, not whether the stockholder may file suit or the kind of remedy that the stockholder may obtain on behalf of herself or the corporation."

In First Citizens, the court expanded on Chevron to enforce an exclusive forum selection clause that was nearly identical to the provisions at issue in Chevron, except that the First Citizens bylaw opted for actions to be brought in the state in which it is headquartered, rather than its state of incorporation. First Citizens selected as its exclusive forum the U.S. District Court for the Eastern District of North Carolina or, if that court lacks jurisdiction, any North Carolina state court that has jurisdiction. Notably, First Citizens' board adopted the bylaw the same day it announced it had entered into a merger agreement to acquire another corporation. The court rejected the plaintiff's argument that the board had adopted the bylaw on "an allegedly 'cloudy' day" – the same day it entered into the merger agreement – rather than on a "clear" day, because the plaintiff did not provide any well-pled allegations showing impropriety in that timing.

Despite Chevron and First Citizens' tacit endorsement of exclusive forum selection provisions as a sensible way for corporations to avoid the pitfalls of multi-jurisdiction shareholder actions, such bylaw changes may not be a silver bullet. The cases leave open the possibility that, in the appropriate case, plaintiffs may attack the enactment of such bylaws itself as a breach of the directors' fiduciary duties or argue that the provisions were adopted for an "inequitable purpose and had an inequitable effect" and are, therefore, unenforceable. Moreover, these provisions have yet to be widely addressed in merger objection litigation, leaving some uncertainty about the provisions' enforceability in that specific context.

In considering whether to adopt fee-shifting and exclusive forum selection provisions, companies should carefully track developments in 2015 as these strategies are scrutinized by courts and state legislatures. They also should be cognizant of the potential impact such efforts may have on investor relations. It remains to be seen whether investors will view these provisions as stripping away traditional avenues for checking rogue corporate governance or as beneficial revisions that spare the company from incurring substantial legal fees defending meritless plaintiffs' attorney-driven strike suits. Thus, public companies should be cautious in implementing changes to their bylaws and tailor the amendments to make them less susceptible to challenge by showing that the board was acting in the shareholders' best interests.

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