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Trends in Shareholder Rights Bylaws and Other Hot Corporate Governance Topics

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Panelists

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Topics of Discussion

- Fee-Shifting Bylaw Provisions
- Exclusive Forum Selection Provisions
- Minimum-Stake-to-Sue Bylaws
- Proxy Access Bylaws
- Advance Notice Bylaws
- Recent Delaware Cases - *Aruba Networks* and *Riverbed Technologies* – Changes to M&A Litigation

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Fee-Shifting Bylaw Provisions

- In a typical shareholder lawsuit, each party bears its own legal fees and expenses regardless of the outcome of the litigation.
- A fee-shifting provision, typically found in a corporation’s charter or bylaws, provides that the shareholder plaintiff must reimburse the company for its legal fees and costs if the company is the prevailing party.

Delaware Bans Corporate Fee-Shifting Bylaws

- Delaware recently enacted new legislation to prohibit stock corporations from adopting fee-shifting bylaws and charter provisions.
- The new fee-shifting prohibition adds new Section 102(f) and amends Section 109 of the Delaware General Corporation Law (DGCL).

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Delaware Bans Corporate Fee-Shifting Bylaws

- 8 Del. C. § 102(f) states:

“The certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys’ fees or expenses of the **corporation** or any other party in connection with an internal **corporate** claim, as defined in § 115 of this title.”

- As defined in new Section 115 of DGCL, internal corporate claims are “claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.”

ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014)

- These DGCL amendments close a door that was previously opened by the Delaware Supreme Court in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), which held that "fee-shifting provisions in a non-stock corporation's bylaws can be valid and enforceable under Delaware law."
- The members of the Delaware Bar Association expressed concern that these fee-shifting provisions would deter stockholders from enforcing their rights in the courts, since "few stockholders will rationally be able to accept the risk of exposure to millions of dollars in attorneys' fees to attempt to rectify a perceived corporate wrong, no matter how egregious."
- The new fee-shifting law effectively limits the scope of the ATP decision to non-stock corporations.

Fee-Shifting Bylaws – Other Jurisdictions

- The laws of other jurisdictions may vary from those of Delaware.
- The Oklahoma legislature has adopted a provision mandating the shifting of fees in derivative suits.
- The Oklahoma provision specifically applies to derivative suits "instituted by a shareholder" where there is a "final judgment." In those circumstances, the court "shall require the non-prevailing party or parties to pay the prevailing party or parties the reasonable expenses, including attorney fees . . . incurred as a result of such action."

Authorization of Exclusive Forum Selection Provisions

- New Section 115 of the DGCL authorizes Delaware corporations to adopt provisions in their certificates of incorporation or bylaws that "require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State."
- Section 115 codifies the Delaware Court of Chancery's holding in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013), allowing Delaware corporations to designate courts in Delaware (including both the state courts and the federal courts) as the exclusive forums for litigation involving their internal affairs.

Authorization of Exclusive Forum Selection Provisions

- Section 115 of the DGCL mandates that "no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State."
- This portion of the law effectively overrules another Delaware Court of Chancery decision, *City of Providence v. First Citizens Bancshares, Inc.*, 99 A.3d 229 (Del. Ch. 2014), which had upheld a corporate bylaw designating a non-Delaware jurisdiction as the exclusive forum for litigation involving the company's internal affairs.

Authorization of Exclusive Forum Selection Provisions

- Section 115 does not expressly prohibit charter or bylaw provisions that select a forum other than the Delaware courts as an ***additional*** forum in which an internal corporate claim may be brought.
- The amendments do not prohibit a clause selecting a forum other than Delaware as the exclusive forum if placed in a stockholders agreement or other writing signed by a stockholder against whom the forum selection clause is sought to be enforced.
- The amendments do not shield from judicial review a claim that a forum selection provision operates unreasonably under the circumstances, or that the manner in which the provision was adopted was inequitable.

Exclusive Forum Selection – Other Jurisdictions

State of Incorporation	No. of Corps. with Exclusive Forum provision
DE - Delaware	959
MD - Maryland	95
NV - Nevada	28
PA - Pennsylvania	13
CA - California	10
NY - New York	9
IN - Indiana	8
FL - Florida	8
VA - Virginia	7
TX - Texas	6
NC - North Carolina	6
MA - Massachusetts	5
OH - Ohio	5
Foreign - Marshall Islands	4
OR - Oregon	4
MI - Michigan	4
MN - Minnesota	4
CO - Colorado	3
SC - South Carolina	2
UT - Utah	2
MS - Mississippi	2
RI - Rhode Island	2
NJ - New Jersey	2
TN - Tennessee	2
IL - Illinois	2
WA - Washington	2
WI - Wisconsin	2
KS - Kansas	2
IA - Iowa	1
AR - Arkansas	1
Foreign - Luxembourg	1
AZ - Arizona	1
DC - District of Columbia	1
SD - South Dakota	1
Foreign - Taiwan	1
OK - Oklahoma	1
MO - Missouri	1
Grand Total	1207

Minimum-Stake-to-Sue Bylaws

- Emergent Capital, Inc. (f/k/a Imperial Holdings, Inc.), Mexico Equity and Income Fund and the Special Opportunities Fund, have adopted a restrictive bylaw provision requiring consent of at least three percent (unless a lower percentage is authorized by an applicable statute) of the company's shareholders before a derivative lawsuit or class action could be filed.
- This provision is designed to ensure that any shareholder filing a lawsuit on behalf of the company or a class of shareholders has a minimum degree of shareholder support and adequately represents shareholders' interests.

Emergent Capital's Minimum-Stake-to-Sue Provision

- Representative Claims. Except where a private right of action at a lower threshold than that required by this bylaw is expressly authorized by applicable statute, a current or prior shareholder or group of shareholders (collectively, a "Claiming Shareholder") may not initiate a claim in a court of law on behalf of (1) the corporation and/or (2) any class of current and/or prior shareholders against the corporation and/or against any director and/or officer of the corporation in his or her official capacity, unless the Claiming Shareholder, no later than the date the claim is asserted, delivers to the Secretary written consents by beneficial shareholders owning at least 3% of the outstanding shares of the corporation as of (i) the date the claim was discovered (or should have been discovered) by the Claiming Shareholder or (ii), if on behalf of a class consisting only of prior shareholders, the last date on which a shareholder must have held shares to be included in the class.

Minimum-Stake-to-Sue Bylaws

- In implementing this provision, Emergent focused on the need for shareholder plaintiffs to adequately represent the general best interest of shareholders in litigation so that the corporation could be confident that once the lawsuit is resolved, it will be binding and final regarding the issue without the risk of re-litigation.
- Moreover, from a sense of fairness to the shareholders, the rules for governing intra-corporate litigation should ensure that shareholders purporting to act on behalf of all shareholders are genuinely acting in the best interest of all shareholders rather than for their selfish, personal benefit.
- Note that this bylaw provision has been adopted due to the efforts of Phillip Goldstein of Bulldog Investors, a noted activist.

Minimum-Stake-to-Sue Bylaws

- In a shareholder lawsuit against Emergent and its directors brought in the United States District Court for the Southern District of Florida, a shareholder plaintiff challenged the board's adoption of the minimum-stake-to-sue bylaws.
- The court dismissed the suit with prejudice and the lead plaintiff in the lawsuit stated: "after further investigation and the opportunity to meet with representatives of the board of directors, I now believe that they acted in good faith and did not engage in any improper behavior in adopting the bylaw or otherwise. Consequently, I have concluded that it is in the best interest of the Company and its shareholders that the case be dismissed."

Proxy Access Bylaws

- Proxy access has received a great deal of attention in the past year and many large corporations have faced shareholder campaigns to amend their bylaws to permit shareholders who own stock for a minimum period of time to nominate directors via the annual proxy statement.
- As of September 2015, 88 proposals were voted on (up from 18 in 2014), of which 59.1% passed (up from 27.8% in 2014).*

* This data is based on information from ISS and FactSet Shark Repellent.

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Trends in Proxy Access Bylaws

- Ownership Requirement
  - Generally 3% of the outstanding shares for 3 years to nominate directors
  - Formation of shareholder groups – Generally ranges from 1 shareholder to up to 20 shareholders can be counted to satisfy the 3% holding threshold.
- Cap on Nominees
  - Generally allowing shareholders to nominate candidates for up to 20% - 25% of the board
    - Issue of "creeping control" – Annual cap or lifetime cap
- Other Terms
  - Definition of ownership – Issue of loaned stock
  - Whether nominees who fail to receive a minimum level of support will be ineligible to be proxy access nominees in subsequent years
  - Whether shareholders who nominate candidates who fail to receive a minimum level of support will be ineligible to submit nominees for a period of time
  - Whether incumbent directors who were access nominees should count against the maximum number of nominees for a number of years after their election

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Advance Notice Bylaws

- **An advance notice bylaw typically requires that nominations for directors and other business proposals made by a shareholder be submitted to a corporation within a specified time period.**

- typically within 60 to 90 days before the first anniversary of the previous year's annual meeting.

- may require activist fund managers to provide specific details regarding any pay arrangements between the activist and the nominees as well as nominees' biographical information.

- Without an advance notice requirement, shareholders can nominate directors and other proposals at an annual meeting without prior notice to the corporation.

Second-generation Advance Notice Bylaws

- In recent years, many companies have adopted more extensive advance notice bylaws ("second-generation advance notice bylaws"). These enhanced bylaws typically include the following requirements:

  (i) completion of company drafted director nominee questionnaires;

  (ii) submission of broad undertakings by nominees to comply with company policies (including a confidentiality policy that includes a confidentiality obligation for stockholder-designated directors;

  (iii) minimum size and duration of holding requirements;
  (iv) continuous disclosure of derivative positions; and

  (v) disclosure of any arrangements related to the nomination or election (including voting agreements.

- Note that advance notice bylaws may be enjoined in the event of "inequitable circumstances."

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Recent Changes to M&A Litigation

Background

- In 2013, plaintiffs filed lawsuits challenging 97.5% of deals valued at more than $100 million, and each of those transactions, on average, triggered seven separate lawsuits. [1]
- Almost all the cases that survive a motion to dismiss are quickly settled without any money being paid to stockholders.
- In 81% of the lawsuits filed in 2012, the defendants settled by agreeing only to provide supplemental disclosure in the merger-related proxy statement. [2]
- In great majority of disclosure-only settlements, the plaintiff's lawyers are the greatest beneficiaries, receiving an average fee of approximately $500,000. [3]

[1] Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2013*, Moritz Coll. Of Law Ctr. For Interdisciplinary Law and Policy Studies, Public Law and Legal Theory Working Paper Series No. 236, 2014, available at http://ssrn.com/abstract=2377001.

[2] Robert M. Daines & Olga Kopumrian, Cornerstone Research, *Shareholders Litigation Involving Mergers And Acquisitions*, available at http://cornerstone.com/Publications/Reports/shareholder-Litigation-Involving-Mergers-and-Acqui.

[3] Jill E. Fisch, Sean J. Griffith and Steven Davidoff Solomon, *Confronting The Peppercorn Settlement in Merger Litigation: An Empirical Analysis and A Proposal For Reform*, 93 Tex. L. Rev 557, 568 (February 2015).

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Greater Judicial Scrutiny of Disclosure-Only Settlements

- Several recent Delaware Chancery Court rulings, including *In re Riverbed Technology, Inc. Stockholder Litigation* (Del. Ch. September 17, 2015), have taken a new step toward curbing frivolous litigation in mergers and acquisitions.
  - Plaintiffs, stockholders of Riverbed, sought to enjoin company's acquisition by Thoma Bravo for approximately $3.6 billion, alleging the sale process undervalued the company.
  - Shortly after filing the claim, the parties executed a settlement agreement pursuant to which:
    - » The company made supplemental disclosures in the SEC filings prior to the stockholders' vote on the merger;

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Greater Judicial Scrutiny of Disclosure-Only Settlements

» Defendants received a broad release of all known and unknown potential claims arising from the transaction; and

» Plaintiffs' counsel were awarded a fee of $500,000.

– However, in *Riverbed*, a Fordham law professor who has written about the merger litigation problem, purchased stock in the company and objected to both the settlement and award of attorney's fees.

– The court concluded that the supplemental disclosures were worth little more than a "peppercorn," but approved the settlement nonetheless because the value of the released claims was even less, "more like a mustard seed."

Issues Raised in *Riverbed*

- Potential divided loyalties facing the plaintiff's lawyer;
- Conflicted and somewhat counter-intuitive interest of defendants; and
- The Vice Chancellor approved the settlement "given the past practice of this court"; however, sent a loud and clear message that this reliance on past practice will not carry the day in the future.

Greater Judicial Scrutiny of Disclosure-Only Settlements

- In *re Aruba Networks, Inc. Stockholder Litigation* (Del. Ch. October 9, 2015), the Delaware Chancery Court rejected the proposed disclosure-only settlement of litigation that had been filed objecting to Hewlett-Packard's $2.7 billion acquisition of Aruba Networks.
- In rejecting the proposed settlement, Vice Chancellor Laster cited a number of factors:
  - The case was not meritorious when filed;
  - The plaintiffs' lawyers' discovery was "weak";
  - The plaintiffs' proposed release to the defendants was expansive; and
  - The representations of plaintiffs' counsel was "one-sided."

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Takeaways from *Aruba Networks/Riverbed*

- Plaintiff's lawyers and defense counsel can no longer rely on the Chancery Court's formerly settled practice of routinely approving disclosure-only settlements with global releases.
- The dubious benefits that stockholders receive from these settlements will no longer support the historical legal fees awarded to plaintiff's counsel.