Adopting Exclusive Forum Provisions: 
*Implications at Your Annual Meeting*

Executive Summary

Since last year, more than 200 companies have adopted exclusive forum provisions. Most companies have implemented these provisions during their IPO process or through board adopted bylaw amendments. To date, only a handful of companies have sought shareholder approval of a charter amendment with an exclusive forum provision. The explosion in the adoption of these provisions has been met with swift criticism by some key players in the corporate governance arena, who consider forum selection to be an important shareholder right. As a result, the proxy landscape is evolving quickly, as shareholders, shareholder activists, the Council of Institutional Investors (“CII”) and institutional proxy advisory firms have all placed stakes in the ground signaling opposition to companies that unilaterally adopt these provisions or seek shareholder approval.

Observations on the Current Environment:

- Institutional proxy advisory firms (ISS & Glass Lewis) are likely to recommend against a standalone management proposal seeking approval of an exclusive forum provision.
- The results of the few management proposals to date have shown significant shareholder opposition – with one failed vote; even with the benefit of broker discretionary voting on the proposal.
- Some institutional investors will vote against directors at companies that have adopted exclusive forum provisions without shareholder approval.
- Glass Lewis will recommend against the chair of the corporate governance committee at any company that adopts an exclusive forum provision without shareholder approval, including an IPO company.
- The 2012 proxy season will include the first shareholder proposals targeting companies that have adopted exclusive forum provisions without shareholder approval.
The Council of Institutional Investors (“CII”) has issued a formal policy against the adoption of exclusive forum provisions.¹

Shareholders have recently filed several class action lawsuits in the Delaware Court of Chancery, which challenge exclusive forum provisions adopted without shareholder approval.

What Is an Exclusive Forum Provision and Why Have Some Companies Sought Shareholder Approval?

An exclusive forum provision is a clause inserted into a corporate bylaw or charter which would bind shareholders to resolve certain kinds of shareholder disputes in a single court. Interest in the exclusive forum provision exploded after the Delaware Court of Chancery mused on these provisions in a footnote of a March 2010 opinion.² The court theorized that designating an exclusive forum, such as Delaware, would help to reign in frivolous suits, and reduce litigation costs.

The 2011 California district court opinion of *Galaviz v. Berg* has led some law firms to suggest that shareholder approval would be more likely to hold up in court.³ Recently, and perhaps in a coordinated fashion, shareholders have filed several class action lawsuits, which challenge exclusive forum provisions adopted without shareholder approval.⁴

Through the end of 2011, five issuers sought shareholder approval to adopt exclusive forum provisions as standalone proposals. To date in 2012, there has been one management proposal seeking shareholder approval. How many other companies that seek shareholder approval in 2012 remains to be seen, but those companies that do will need a keen understanding of how their particular shareholder profile will impact the vote. Voting results to date indicate the potential for significant opposition from institutional shareholders and proxy advisory firms.

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¹ Section 1.9 Judicial Forum. Available at [http://www.cii.org/CouncilCorporateGovernancePolicies](http://www.cii.org/CouncilCorporateGovernancePolicies)
² *In Re Revlon, Inc. Shareholders Litigation*, 990 A.2d 940, 960 (Del.Ch. 2010)
Voting Results on Exclusive Forum Management Proposals

The results of the six standalone management proposals seeking approval of exclusive forum provisions were as follows:

<table>
<thead>
<tr>
<th>Company</th>
<th>% of Outstanding</th>
<th>% of Shares Voted</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allstate Corporation</td>
<td>41.7%</td>
<td>48.9%</td>
<td>FAIL</td>
</tr>
<tr>
<td>Altera Corporation</td>
<td>53.2%</td>
<td>59.2%</td>
<td>PASS</td>
</tr>
<tr>
<td>DirecTV</td>
<td>50.3%</td>
<td>59.5%</td>
<td>PASS</td>
</tr>
<tr>
<td>Internet Patents Corp</td>
<td>90.3%</td>
<td>96.7%</td>
<td>PASS</td>
</tr>
<tr>
<td>Lighting Science Group</td>
<td>89.6%</td>
<td>99.9%</td>
<td>PASS</td>
</tr>
<tr>
<td>Sally Beauty Holdings</td>
<td>73.0%</td>
<td>75.5%</td>
<td>PASS</td>
</tr>
</tbody>
</table>

All of the companies listed above received against recommendations on their exclusive forum proposals from both ISS and Glass Lewis. Numerous institutional investors unaffiliated with the proxy advisory firms also voted against them. These results become more significant in light of the fact that the proposals were eligible for discretionary broker voting. Based on recent NYSE broker voting rule reversals on certain governance proposals, there is ample reason to expect that exclusive forum proposals will not retain discretionary voting privileges for much longer.

Companies were also able to obtain shareholder approval of exclusive forum provisions by including them within broader charter amendments. Life Technologies, Inc. put forth a proposal to amend its charter that

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Internet Patents Corp (formerly InsWeb) and Lighting Science Group are each closely held companies.
contained, among other things, a provision to declassify the board, as well as the adoption of an exclusive forum. Separately, several other companies have received shareholder approval of exclusive forum provisions within proposals to reincorporate into Delaware.

**ISS and Glass Lewis Sentiment on Management Proposals to Approve Exclusive Forum Provisions**

ISS used strong language in recommending against these proposals in 2011. While its guidelines have been updated for 2012 to recommend case-by-case on these proposals, a favorable recommendation to a management proposal will likely be the exception. In order to receive a favorable recommendation from ISS in 2012, a company would need to meet the following criteria:

- Annually elected board
- A majority vote standard for directors in uncontested elections
- Absence of a poison pill, unless the pill was approved by shareholders
- Disclosure in the proxy statement that the company has been materially harmed by shareholder litigation outside its jurisdiction of incorporation.

For companies that have adopted the prescribed governance attributes, we believe that substantive disclosure in the proxy statement on material harm will be the key to a favorable recommendation from ISS.

Unlike ISS, Glass Lewis has established a blanket policy to recommend against management proposals to adopt exclusive forum provisions. The advisory firm lists the following points as the basis for its policy:

- These provisions are not in the best interests of shareholders
- They will discourage the use of shareholder derivative claims
- Shareholders should be wary without compelling evidence that an exclusive forum will benefit shareholders.

Glass Lewis separately identified the practice of including an exclusive forum provision in a bundled proposal that amends several sections of the corporate charter. In these cases, Glass Lewis will recommend a withhold vote on the governance committee chair.
Four companies have already been targeted in 2012 with shareholder proposals calling for the repeal of exclusive forum provisions. Both ISS and Glass Lewis will recommend FOR these shareholder proposals, and targeted companies should be aware of how their particular shareholder profile will impact the final vote. We expect that as more companies adopt these provisions, we will see more shareholder proposals to remove them.

Implications of Adopting Exclusive Forum Provisions Without Shareholder Approval

Companies that adopt exclusive forum provisions without shareholder approval should expect opposition to some board nominees. A number of institutional investors have indicated they will vote against certain directors at companies that have adopted exclusive forum provisions without shareholder approval. Since this is a corporate governance issue, we expect institutions are more likely to target members of the governance committee.

Moving forward, ISS will accommodate some of its clients’ wishes by highlighting in its recommendation reports if a company has adopted the exclusive forum provision without shareholder approval. Also, Glass Lewis will recommend against the chair of the governance committee (or against the chairman of the board if no governance chair is designated) at companies, including IPO companies, that have adopted exclusive forum provisions without shareholder approval. Glass Lewis began implementing this policy in 2011 and established it formally in its 2012 proxy voting guidelines.

These are noteworthy developments and the opposition is strong evidence of a growing trend and how quickly sentiment is changing on this issue. If the current pace of adoption (without shareholder approval) continues, it is not out of the question for institutions, or even ISS, to adjust their voting guidelines prior to next year’s proxy season.

Future Outlook of Exclusive Forum Provisions

The environment from both a legal and a proxy perspective is evolving quickly. A company currently considering the adoption of exclusive forum provisions may find that the environment will only worsen as the subject matter gets more attention.
We will continue to monitor this situation and keep you posted as appropriate. Should you have any questions about this or any other corporate governance related issues, please do not hesitate to contact Morrow & Co., LLC at (203) 658-9400.