Recent Maryland State Court Decision Threatens To Close Courthouse Doors To Shareholders; Join Institutional Investor Effort to Protect Shareholder Rights

May 28, 2013

We write to alert you to a recent court ruling that threatens to undermine the ability of shareholders to hold corporate directors accountable, even for egregious fiduciary misconduct and securities fraud.

The case at issue is *Corvex Management LP, et al. v. CommonWealth REIT*, et al., No. 24-C-13-001111 (Md. Cir. Ct.) pending in Baltimore City Circuit Court. In this case, the Board of CommonWealth REIT ("CommonWealth" or the "Company") adopted - without seeking or obtaining shareholder approval - a bylaw that requires shareholders to privately arbitrate all claims (the "Arbitration Bylaw"). No court had ever before allowed directors to unilaterally take away their shareholders' right to bring a meritorious lawsuit in state or federal court regarding breach of fiduciary duty or securities law violations.

In early 2013, following years of the CommonWealth Board misdirecting hundreds of millions of shareholder dollars to the Company's controlling family, shareholders filed suit and sought to replace the Board. After the Board demanded arbitration based on a bylaw the Board had adopted on its own, without ever obtaining the consent of the shareholders, the Judge upheld the Arbitration Bylaw, effectively precluding nearly all CommonWealth shareholders from pursuing action to remedy the board's misconduct. As explained below, if the Maryland Court's ruling becomes more widely accepted, investors in many public companies could be foreclosed from pursuing their rights in any forum, regardless of the egregiousness of misconduct by directors or executives.

BLB&G is currently representing institutional and individual CommonWealth investors seeking to convince the Maryland court to revise or distinguish its opinion in the *Corvex* Action so as not to eviscerate the rights of more typical shareholders, like public pension funds, Taft-Hartley funds and individuals, to protect their rights through traditional public judicial proceedings. We are also in the process of advising investors around the country about the broader implications of court-approved mandatory arbitration clauses. We currently intend to file an affidavit to the Maryland Court on June 10, 2013 on behalf of a group of concerned institutional investors in order to educate the Court of the broader ramifications of its *Corvex* decision. If you are interested in joining this effort, please let us know by June 5, 2013.

Please note that even though the plaintiffs have represented that they cannot participate in any arbitration, the defendants have refused to stay the arbitration proceedings pending the Court's determination of whether all Commonwealth investors must submit to arbitration. While Commonwealth investors have moved the Court to stay the arbitration proceedings, if that stay is not granted, plaintiffs will be unable to proceed in Court and there will not be a submission on June 10, 2013.

Background on the CommonWealth Board's Misconduct and The *Corvex* Action

Over the last five years, the CommonWealth Board has paid hundreds of millions of dollars in corporate funds to the Company's founder, Barry Portnoy, and his son, Adam. In February 2013, hedge fund Corvex Management ("Corvex") purchased a nearly $270 million stake in the Company and initiated efforts to remove the incumbent Trustees through a consent solicitation. Corvex also filed a lawsuit.

As alleged in relevant court filings, the Board responded with a scorched-earth defense to prevent the Company's shareholders from using their long-established voting rights to remove the Trustees in favor of more loyal fiduciaries, while using the Arbitration Bylaw to prevent any court from rectifying these serious breaches of duty. Among other things, the Board (a) rewrote the Company's Bylaws to strip shareholders of their ability to initiate the removal process, (b) lobbied the Maryland Legislature to amend the state's corporation law to eliminate shareholders' right to remove Trustees without "cause," and (c) misled shareholders by asserting that they could no longer remove Trustees without cause despite the fact that the Maryland Legislature had just rejected the proposed amendment. The Board then demanded arbitration in order to prevent a judge from enjoining this misconduct.

Most recently, shareholders of CommonWealth and one of its former subsidiaries (a company called SIR, also run by the Portnoys), led by one of the world's largest institutional investors, CALPERS, overwhelmingly voted against the re-election of the CommonWealth Trustee and the SIR Trustee on the ballot. Showing contempt for the shareholder franchise, both CommonWealth and SIR immediately placed the rejected Trustees back on their respective Boards. In short, having been denied the right to nominate director candidates or remove the incumbent Board, and with their withhold votes being ignored with impunity, CommonWealth shareholders have no real say in who their trustees are or will be in the future, as only the current board can decide who will occupy those seats going forward.

On May 8, 2013, Judge Carrion upheld the validity of the Arbitration Bylaw as to Corvex, forcing the hedge fund to arbitrate its claims against CommonWealth. Investors have expressed concern, however, because Judge Carrion held that Corvex assented to the arbitration provision merely by purchasing CommonWealth stock. According to the Court, because each share certificate of CommonWealth bears a legend stating that the shares are subject to the Company's bylaws and any amendment thereto, Corvex had constructive knowledge of the Arbitration Bylaw and was bound by whatever terms the Board placed in the bylaws from time to time. Of course, shareholders buying shares on national stock exchanges rarely, if ever, actually receive the underlying stock certificates, and other than seeking judicial intervention, have no way to protect themselves from even the most radical director-sponsored bylaw revisions.

In a related class action filed by BLB&G on behalf of certain of its clients, CommonWealth shareholders are similarly seeking to rectify the Board's egregious fiduciary breaches. The CommonWealth Trustees responded by invoking the Arbitration Bylaw. Notably, the Arbitration Bylaw prohibits shareholders from seeking any attorneys' fee award or reimbursement of expenses. As a result, shareholders who decide to pursue arbitration would be required to bear the millions of dollars of costs and legal fees needed to prosecute complex corporate litigation out-of-pocket, regardless of the outcome of the proceedings. Unlike Corvex - a multi-billion dollar hedge fund with a massive investment in the Company -other CommonWealth shareholders are not in a position to justify the millions of dollars in out-of-pocket costs associated with arbitrating a complex corporate dispute like the underlying matter.

The Troubling Implications of Applying the *Corvex* Court's Decision To All Shareholders

The Maryland court's decision upholding of the Arbitration Bylaw may have consequences extending far beyond this individual case. If accepted by other courts, corporate directors across the country will no doubt unilaterally adopt mandatory arbitration bylaws structured to foreclose shareholder litigation challenging fiduciary misconduct and securities laws violations.

Allowing the boards of U.S. corporations to unilaterally deny access to the courts to all shareholders would provide a strong incentive for abusive conduct, and could have a negative effect on the valuations of U.S. corporations. Moreover, in cases like the CommonWealth matter, where a board's misconduct requires expedited injunctive relief, even a shareholder willing to bear the cost of a complex arbitration is harmed by the inability of arbitrators to provide relief as quickly as a court could through injunctive proceedings. Without the deterrent effect posed by the prospect of meaningful shareholder litigation, corporate governance practices will steadily erode and fiduciary misconduct will increase.

The ruling also raises concerns for directors and corporate advisors acting in good faith. Corporate fiduciary law has been extremely dynamic over time, evolving rapidly along with market practices. Corporate advisors, directors and managers are also typically responsive to the latest relevant judicial rulings and applications of fiduciary duty principles, altering industry practices to accommodate court rulings about what conduct is consistent with fiduciary duties and what conduct violates those duties. If shareholder litigation is relegated to confidential arbitrations, the state of the law will become frozen in time, leaving even well-meaning directors and advisors to struggle to know the evolving ground rules of what conduct is acceptable and what is not.

Notably, a separate case pending case in Delaware - home to a significant majority of the largest public companies in the country - could pave the way for widespread adoption of arbitration bylaws in Delaware corporations. In that case, energy company Chevron unilaterally adopted a bylaw requiring that shareholder litigation against its board proceed only in the Chancery Court. If Chevron's bylaw is enforced, despite the absence of shareholder approval, there is a far greater risk that unilaterally imposed bylaws effectively precluding class or derivative litigation and mandating confidential arbitration against corporate directors and officers will be immune from legal challenge.

If you are interested in joining other institutional investors in efforts to prevent mandatory arbitration clauses from becoming commonplace in corporate America, including by submitting an affidavit to the Maryland court opposing the Arbitration Bylaw, please let us know by June 5, 2013.

For further information, please contact the BLB&G partner handling the CommonWealth matter, Mark Lebovitch, who can be reached at 212-554-1519, or at markl@blbglaw.com.