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New life for forum selection bylaws

By Eric Waxman and Virginia F. Milstead

On June 25, the Delaware Court of Chancery in the consolidated cases of *Boilermakers Local 154 Retirement Fund v. Chevron Corp., Del. Ch. C.A. No. 7220-CS*, and *ICLub Inv. Partnership v. Fedex Corp., Del. Ch. C.A. No. 7238-CS* (collectively, “*Chevron*”), rejected a facial challenge to the validity of so-called “forum selection bylaws,” which require claims related to the internal affairs of a corporation to be brought in the state of incorporation. Over the past few years, approximately 300 publicly traded companies have enacted forum selection bylaws, largely in response to an increase in duplicative shareholder litigation being filed in multiple forums and outside the state of incorporation. Since a 2011 decision of the U.S. District Court for the Northern District of California in *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011), that refused to enforce a forum selection bylaw, and a rash of lawsuits challenging the validity of such bylaws, boards of directors wishing to use this tool to limit the costs and waste associated with multi-forum litigation have faced uncertainty and litigation risk. (As explained in *Chevron*, the Berg court fundamentally misunderstood the contractual nature of bylaws and that, like any other contract, bylaws can be amended in accordance with their terms.) With the decision in *Chevron*, the court eliminated much of this uncertainty and risk, thereby strengthening a potentially powerful tool in ensuring that litigation involving the internal affairs of a corporation is confined to only one forum and that the court with the greatest expertise in the applicable law hears the case.

The shareholder plaintiffs in *Chevron* challenged the bylaws of Delaware corporations Chevron Corporation and FedEx Corporation. Each company’s

bylaws included a provision requiring that suits related to the internal affairs of the corporation, such as shareholder derivative suits, suits asserting breach of fiduciary duty by directors or officers, or suits alleging violations of the Delaware General Corporation Law, be brought in Delaware courts. Under the “internal affairs” choice of law doctrine, Delaware law governs such claims regardless of the forum in which they are brought. With re-

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gard to both *Chevron* and *FedEx*, the bylaw was unilaterally adopted by the company’s board of directors without prior shareholder approval, a procedure specifically allowed by the company’s charter and Delaware General Corporation Law Section 109(a).

In granting a motion for judgment on the pleadings, the court first concluded that the bylaw was facially valid under Delaware General Corporation Law Section 109(b). Section 109(b) provides that the bylaws of a corporation “may contain any provision, not inconsistent with law or 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.” The court found that “[a]s a matter of easy linguistics,” the forum selection bylaws were permitted by Section 109(b): “because the forum selection bylaws address internal affairs claims, the subject matter of the actions the bylaws govern relates quintessentially to ‘the corporations’ business, the conduct of its affairs,

and the right of its stockholders [*qua* stockholders].”

Second, recognizing that bylaws are a contract between the corporation and its shareholders, the court held that the bylaw was contractually valid. It rejected the plaintiffs’ argument that “a board-adopted forum selection bylaw cannot be a *contractual* forum selection clause because the stockholders do not vote in advance of its adoption to approve it.” Regardless of whether the shareholders approved the adoption of the bylaw in advance, they purchased stock in the company with the full knowledge that the charter and Delaware law permitted the board to adopt bylaws unilaterally. Thus, “the stockholders assent to not having to assent to board-adopted bylaws.”

The plaintiffs raised a number of hypothetical situations in which a forum selection bylaw could operate unreasonably, such as when there is a “stray defendant or two who is not subject to personal jurisdiction in the state of incorporation, but may be susceptible to service elsewhere.” The court declined to consider those situations. The court emphasized that it was deciding a facial challenge where, under well-established standards, the question was not whether the bylaws would be invalid in some situations, but whether they were invalid in all situations. The court declined to consider hypothetical facts that were not before it, concluding that “the time for a plaintiff to make an as-applied challenge to the forum selection clauses is when the plaintiff wishes to, and does, file a lawsuit outside the chosen forum.”

Thus, although the court shut the door on arguments that forum selection bylaws are invalid as a matter of law, the court’s decision does not necessarily mean that a forum selection bylaw will be enforced in every internal affairs case a shareholder files outside the state of incorporation. In

deciding whether to seek enforcement of a forum selection bylaw in any given case, a board must comply with its fiduciary duties. Although in most instances requiring a suit to be brought in the state of incorporation will be consistent with a board’s fiduciary duties and work no harm to shareholders, facts unique to a particular case may lead a board to a different conclusion.

Moreover, most likely through a motion to dismiss or transfer for improper venue, the company may have to demonstrate to the foreign court that enforcement is consistent with the standards for enforcing forum selection clauses generally. This is not a high standard — forum selection clauses are generally presumed valid and will be enforced unless they are affected “by fraud, undue influence, or overweening bargaining power.” *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 10 (1972) (citations omitted). However, whether a forum selection bylaw is enforced in any particular case may be determined by the foreign court under these or similar standards.

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