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TRANSACTIONS

Forum selection bylaws are all the rage

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The forum selection bylaw is an elegantly simple solution to a vexing problem. Over the past decade or so, merger and acquisition litigation has increased so dramatically that nearly every announcement of a major transaction involving a publicly traded company results in stockholder lawsuits against its board of directors, often within hours.

Worse still, multiple suits in multiple jurisdictions (usually the jurisdiction in which the target company is domiciled and in which it is headquartered) have become the norm. Practitioners, courts and commentators have decried the rise of "multijurisdictional litigation." Vice Chancellor Sam Glasscock of the Delaware Court of Chancery, the leading forum for deal litigation, stated last year that "I hate, hate, the wastefulness and wheel spinning that is engendered by multijurisdictional class litigation." But with no procedural mechanism to consolidate cases pending in different states, the problem has persisted.

Enter the forum selection bylaw. Much like traditional forum selection clauses which are included in myriad contractual relationships, from complex commercial agreements to cruise line tickets, the forum selection bylaw designates in advance where future litigation must proceed. The typical forum selection bylaw requires all direct and derivative claims for breach of fiduciary duty against the company's directors and officers, along with other matters related to the company's internal affairs, be filed in the courts of the company's state of incorporation only. For Delaware companies, a forum selection bylaw helps assure access to the Court of Chancery, its experienced jurists, and its numerous procedures to help limit the costs and uncertainty associated with litigation. As observers like Professor Joseph Grundfest of Stanford Law School have catalogued, the boards of Delaware companies are adopting these bylaws with increasing frequency. To date, more than 100 public companies, including many in the S&P 500, have adopted forum selection bylaws.

One of the earliest tests for the bylaws came in the U.S. District Court for the Northern District of California. In *Galaviz v. Berg*, Oracle Corporation, which is a Delaware company headquartered in California, sought to dismiss a derivative suit based on its bylaw designating Delaware as the chosen forum for litigation. The court refused, pointing out that the permissibility of the bylaw as a matter of Delaware law was an open question and noting that the bylaw was adopted "after the majority of the purported wrongdoing is alleged to have occurred."

Two years later in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.,* the Delaware Court of Chancery held that bylaws like the one at issue in *Galaviz* were permissible as a matter of Delaware law. The court explained that regulating where litigation over internal affairs will proceed is an appropriate matter for a bylaw and that a board is free to enact such a bylaw, if the corporate charter gives it the permission to do so. The *Boilermakers* holding, however, was limited to the question of whether the bylaws adopted by Chevron and FedEx were facially valid under Delaware law. The court explained that whether enforcement of the bylaws is unreasonable or unjust in any individual case is a question left to non-Delaware courts conducting the situational review contemplated by the U.S. Supreme Court decision The *Bremen v. Zapata Off–Shore Co.*

After *Boilermakers* addressed the statutory validity of forum selection bylaws, most courts around the country have enforced them consistent with *Bremen*, including courts in New York, Illinois, Louisiana and California. For example, in *Groen v. Safeway Inc.,* the Alameda County Superior Court dismissed complaints challenging the merger of Safeway and Albertsons based on a director-adopted forum selection bylaw designating Delaware as the exclusive forum for stockholder suits. The court distinguished *Galaviz* on the basis that it predated the Court of Chancery's decision in *Boilermakers*.

Not all courts have enforced the bylaws, however. In August of this year, an Oregon state court refused to enforce a bylaw designating Delaware as the exclusive forum in a suit challenging the merger of TriQuint Semiconductor Inc. and RF Micro Devices Inc. The court's reasoning echoed *Galiviz*; explaining that the TriQuint board had adopted the bylaw in question at the "very same meeting that it officially recommended the merger" with RF Micro Devices, thereby "forcing the shareholders to accept the bylaw."

The Delaware Court of Chancery addressed the same timing question presented in *TriQuint* the very next month. In *City of Providence v. First Citizens BancShares Inc.*, Chancellor Andre Bouchard of the Delaware Court of Chancery was asked to enforce a Delaware-domiciled company's forum selection bylaw which designated North Carolina, where it is headquartered, as the exclusive forum. Much like the bylaw adoption in TriQuint, the First Citizens BancShares board adopted a forum selection bylaw on the same day it announced that it had entered into a merger agreement.

Bouchard applied *Bremen*, enforced the bylaw, and dismissed the complaint challenging the pending merger. He stated that the deferential business judgment rule presumptively applied to the board's adoption of bylaw and that presumption was not undermined by the timing of the bylaw's adoption. He explained, "[t]hat the Board adopted [the bylaw] on an allegedly 'cloudy' day when it entered into the merger agreement ... rather than on a 'clear' day is immaterial given the lack of any well-pled allegations ... demonstrating any impropriety in this timing." The chancellor's ruling implicitly rejects the reasoning of the *TriQuint* decision.

Despite increased acceptance of the bylaws in the boardroom and by the courts, proxy advisory firms remain cautious. For example, Glass Lewis & Co. generally recommends withhold votes against the chair of a company's governance committee when a board adopts a forum selection bylaw without stockholder approval. When the adoption of a forum selection bylaw is put to a vote, Institutional Shareholder Services makes its recommendations on a case-by-case basis. It considers whether the company has been materially harmed by stockholder litigation outside its jurisdiction of incorporation, based on disclosure in the company's proxy statement, and whether the company has certain "good governance features." As a result, boards considering whether to adopt a forum selection bylaw without stockholder approval, should take stockholder relations and the attitudes of proxy advisory firms into account.

Companies continue to weigh the costs and benefits of adopting a forum selection bylaw to address the multijurisdictional litigation problem. Meanwhile, the bylaws continue to gain the support of courts around the country with each application of *Bremen* and each clarification from the Delaware courts. But the battle is not over yet. A number of jurisdictions have yet to address the bylaws and a multitude of potential challenges await resolution. Nevertheless, for those companies that have yet to adopt such a bylaw, recent developments provide additional comfort that now may be a good time to consider doing so.

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