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Corporate Governance Group Client Alert: Court of Chancery Holds that Forum Selection Bylaws are Statutorily and Contractually Valid

In the consolidated decision of *Boilermakers Local 154 Retirement Fund v. Chevron Corporation, et al.*¹ and *ICLUB Investment Partnership v. FedEx Corporation, et al.*², Chancellor Strine held that the unilateral adoption by a board of directors of a forum selection bylaw that "designates a forum as the exclusive venue for certain stockholder suits against the corporation, either as an actual or nominal defendant, and its directors and employees" is both statutorily valid under the Delaware General Corporation Law ("DGCL") and contractually valid³.

BACKGROUND

In an effort to "address what they perceive to be the inefficient costs of defending against the same claim in multiple courts at one time", the boards of Chevron Corporation and FedEx Corporation each unilaterally adopted without stockholder approval forum selection bylaw provisions in 2010 and 2011, respectively. As initially adopted by each company, the forum selection bylaw provision provided that:

"Unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by

¹ C.A. No. 7220-CS (June 25, 2013).

² C.A. No. 7238-CS (June 25, 2013).

³ It should be noted that this decision only addresses the purely legal issues of whether forum selection bylaws are statutorily and contractually valid. The Court has not yet addressed the plaintiffs' other counts involving "fiduciary duty claims and arguments about the ways in which the forum selection clauses could be inequitably adopted or applied in particular situations".

any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this [bylaw]."

These forum selection clauses were intended, therefore, to cover only four types of lawsuits, all of which related to claims brought by stockholders as stockholders⁴:

- *Derivative suits* relating to "whether a derivative plaintiff is qualified to sue on behalf of the corporation and whether that derivative plaintiff has or is excused from making demand on the board is a matter of corporate governance";
- *Fiduciary duty suits* regarding the "relationships between directors, officers, the corporation, and its stockholders";
- *DGCL suits* regarding how, under the DGCL, a corporations is governed; and
- *Internal affairs*⁵ *suits* regarding those "matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders."

The plaintiffs complaints were "nearly identical" and alleged that forum selection bylaws are (i) "statutorily invalid because they go beyond the board's authority under" the DGCL and (ii) contractually invalid "because they were unilaterally adopted by the... boards using their power to make bylaws" without approval by the stockholders whose rights were allegedly being diminished by such bylaw.

THE COURT'S ANALYSIS

Chancellor Strine held that the forum selection bylaws in question were statutorily valid because (i) the boards of both companies were "empowered in their certificates of incorporation to adopt bylaws under DGCL Section 109(a), which provides that any "corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors...." and (ii) the forum selection bylaws addressed a proper subject matter under DGCL Section 109(b), which section provides that a bylaw

⁴ As opposed to a "tort claim against the company based on a personal injury" a stockholder may suffer that "occurred on the company's premises or a contract claim based on a contractual contract" with the company, each of which would "not deal with the rights and powers of the plaintiff-stockholder *as a stockholder*".

⁵ The "'internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders – because otherwise a corporation could be faced with conflicting demands.'"

"may contain any provision, not inconsistent with law or with 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."

Chancellor Strine noted that "bylaws of Delaware corporations have a 'procedural, process-oriented nature'" and that Section 109(b) of the DGCL "has long been understood to allow the corporation to set 'self-imposed rules and regulations [that are] deemed expedient for its convenient functioning'". In the Court's view, forum selection bylaws fit squarely within this construct and are therefore a proper subject matter under DGCL Section 109(b) because such bylaws "are process-oriented" as they "regulate *where* stockholders may file suit, not *whether* the stockholder may file suit or the kind of remedy that the stockholder may obtain on behalf of herself or the corporation."

Addressing the plaintiffs' second argument that forum selection bylaws are not contractually valid because the affected stockholders did not vote in advance to approve such bylaw, Chancellor Strine noted that in each of the *Chevron* and *FedEx* cases, the stockholders in question knew in advance of acquiring stock that the corporation's certificate of incorporation conferred on the board the power to adopt bylaws unilaterally. Each group of stockholders, therefore, assented to be "bound by bylaws that are valid under the DGCL" that are unilaterally adopted by the board, as such unilateral board rights are "an essential part of the contract agreed to when an investor buys stock in a Delaware corporation." In light of a board's power to unilaterally adopt bylaws, the Court described bylaws in general as "part of an inherently flexible contract between the stockholders and the corporation". Continuing along with the "flexible contract" depiction, the Court noted that stockholders also "have powerful rights they can use to protect themselves if they do not want board-adopted forum selection bylaws to be part of the contract between themselves and the corporation", such as repealing board-adopted bylaws or having the annual opportunity to elect directors.⁶

CONCLUSION

In the last three years, "over 250 publicly traded corporations have adopted" similar forum selection bylaw provisions. While this decision may be appealed, leaving the final say on this matter to the Delaware Supreme Court, Chancellor Strine's decision

⁶ Perhaps in anticipation of further legal challenges to its decision, the Court went to some length to describe the similarities between forum selection bylaws and contractual forum selection clauses and how the United States Supreme Court has held that contractual forum selection clauses are contractually valid (which decisions have been adopted by the Delaware Supreme Court).

increases the legal coverage for boards looking to adopt forum selection bylaws because they share defendants' beliefs that multiforum litigations impose "high costs" on the corporation and hurt investors by causing costs to be borne by stockholders that are not "justified by rational benefits for stockholders from multiforum filings". It is reasonable to assume, therefore, that forum selection bylaws may become more prevalent in the very near term, and, if and when the Delaware Supreme Court affirms this holding, common practice.

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