VALIDITY OF BOARD-ADOPTED FORUM SELECTION BYLAW PROVISIONS FOLLOWING BOILERMAKERS LOCAL 154 RETIREMENT FUND V. CHEVRON CORP & ICLUB INVESTMENT PARTNERSHIP V. FEDEX CORP

By Timothy R. Dudderar and Christopher N. Kelly, Potter Anderson & Corroon LLP

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In the consolidated decision of *Boilermakers Local 154 Retirement Fund v. Chevron Corp*[1] and *ICLUB Investment Partnership v. FedEx Corp*,[2] Chancellor Leo E. Strine Jr. of the Delaware Court of Chancery held that a bylaw provision unilaterally adopted by the board of directors of a Delaware corporation providing that Delaware is the exclusive forum for resolution of certain disputes involving the internal affairs of the corporation is both statutorily and contractually valid.[3]

Chancellor Strine's decision is currently on appeal to the Delaware Supreme Court. If the decision is upheld, the obvious consequence will be the continued, and perhaps accelerated, adoption of forum selection bylaws by corporate boards with or without stockholder approval.

However, it also is reasonable to expect that boards of directors may implement other types of management-friendly bylaws to quell, or at least to alleviate the impacts of, meritless stockholder strike suits. Conversely, activist stockholders may, as Chancellor Strine's opinion mentions, mount campaigns to amend or repeal such bylaws, or even submit their own proposals to enact bylaw amendments that favor stockholders in the litigation context.

The story leading up to Chancellor Strine's highly anticipated decision upholding the forum selection bylaws adopted by the boards of directors of Chevron Corp and FedEx Corp began in 2006 when Oracle Corp became one of the first major companies incorporated in Delaware to adopt a forum selection bylaw requiring that "any actual or purported derivative action" on behalf of the corporation be brought exclusively in the Delaware Court of Chancery.[4]

Oracle's bylaw subsequently was challenged in a shareholder derivative action brought in federal court in California (where Oracle is headquartered), which, in 2011, declined to enforce the bylaw as a matter of federal common law, ruling that "Oracle has not shown federal law requires or even permits the federal courts to defer to any provision of state corporate law that might purport to give a corporation's directors the power to control venue".[5]

In so doing, the court avoided the underlying issue of the validity of the bylaw under Delaware corporate law.[6] The decision, however, owing mainly to the fact that it was the first decision by any court regarding a forum selection provision, was seen by many as a bad omen regarding the viability of such provisions.

This apparent setback, however, did not slow the speed at which corporate boards adopted such exclusive forum selection provisions. In fact, in the past three years, more than 250 publicly traded companies have adopted forum selection provisions requiring litigation relating to the internal affairs of the corporation be brought in the Delaware Court of Chancery.[7] Much of this can be attributed to a portion of Vice Chancellor J. Travis Laster's decision in *In re Revlon Inc Shareholders Litigation*[8] suggesting that, "if boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes."[9]

The conflicting rulings and breakneck pace at which boards of Delaware corporations were adopting exclusive forum selection provisions led to much speculation and debate among corporate law practitioners about the enforceability and validity of such provisions,[10] thus setting the stage for Chancellor Strine's landmark decision.

Background of the case

In 2010 and 2011, to "address what they perceive[d] to be the inefficient costs of defending against the same claim in multiple courts at one time",[11] the boards of directors of Chevron and FedEx each unilaterally adopted – i.e., without stockholder approval – bylaws requiring that litigation relating to each company's internal affairs be conducted in Delaware, the state where each company is incorporated.[12] Though their specific wording differed, these bylaws both provided that the following types of actions involving the corporation, its directors, officers or employees must be brought in Delaware:

1. derivative actions;
2. actions asserting claims for breach of fiduciary duties;
3. actions asserting claims arising under a provision of the Delaware General Corporation Law (DGCL); and
4. actions governed by the internal affairs doctrine.[13]

The certificates of incorporation of both companies empowered their boards to adopt, amend, and repeal bylaws without any action by the stockholders.[14]

Shortly following their adoption, institutional investors filed nearly identical complaints in the Delaware Court of Chancery against Chevron and FedEx challenging the forum selection bylaws.[15] The plaintiffs alleged, among other things, that the bylaws were "statutorily invalid because they go beyond the board's authority under" Section 109(b) of the DGCL,[16] and contractually invalid "because they were unilaterally adopted by the ... boards using their power to make bylaws" without approval by the stockholders whose rights allegedly were being adversely affected by the bylaws.[17] The plaintiffs sought a declaration that the bylaws were invalid and a breach of fiduciary duty.[18] The two cases were consolidated, and Chevron and FedEx moved for judgment on the pleadings with respect to the legal issues of the statutory and contractual validity and enforceability of the forum selection bylaws.[19]

The court's decision

Chancellor Strine began his analysis by articulating the appropriate standard of review for determining the defendants' motions: Because the plaintiffs challenged the facial validity of the forum selection bylaws – and not the enforceability of the bylaws as applied to the plaintiffs specifically – their burden was "a difficult one," requiring them to show that "the bylaws cannot operate lawfully or equitably under any circumstances."[20] Having established the standard of review, Chancellor Strine viewed "the appropriate question now [a]s simply whether the bylaws are valid under the DGCL, and whether they form facially valid contracts between the stockholders, the directors and officers, and the corporation."[21]

Chancellor Strine first held that the forum selection bylaws were statutorily valid under 8 Del. C. § 109(b).[22] Under Section 109(b), corporate bylaws "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".[23] As the court found, bylaws exceed the scope of Section 109(b) only if they did not relate to any of these subject matters.[24] The court determined that the forum selection bylaws here clearly related to the rights of the stockholders, "because they regulate where stockholders can exercise their right to bring certain internal affairs claims against the corporation and its directors and officers."[25]

The bylaws also "plainly relate[d] to the conduct of the corporation by channeling internal affairs cases into the courts of the state of incorporation, providing for the opportunity to have internal affairs cases resolved authoritatively by our Supreme Court if any party wishes to take an appeal."[26] Thus, the court concluded that, "because the forum selection bylaws address internal affairs claims, the subject matter of the actions the bylaws govern relates quintessentially to 'the corporation's business, the conduct of its affairs, and the rights of its stockholders [*qua* stockholders]'".[27]

In rejecting the plaintiffs' contention that forum selection is not a proper subject matter for bylaws because it is not traditionally covered by corporate bylaws, Chancellor Strine reasoned that forum selection is similar to traditional bylaw topics because it is of a "procedural, process-oriented nature," and Section 109(b) "has long been understood to allow the corporation to set self-imposed rules and regulations [that are] deemed expedient for its convenient functioning."[28] In the court's view, forum selection bylaws "fit this description," since they "are process-oriented, because 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".[29]

Chancellor Strine next held that the forum selection bylaws were contractually valid notwithstanding that they were unilaterally adopted by the Chevron and FedEx boards without stockholder approval.[30] This decision was based primarily upon the undisputed fact, noted above, that both Chevron's and FedEx's certificates of incorporation empowered their respective boards to adopt bylaws unilaterally; meaning that, as the Court held, both companies' stockholders assented to be contractually bound by bylaws unilaterally adopted by Chevron's and FedEx's boards, so long as those bylaws are valid under the DGCL.[31] Chancellor Strine described a corporation's bylaws as being "part of an inherently flexible contract between the stockholders and the corporation".[32] "[W]hen an investor buys stock in a Delaware corporation," he assents to be bound to that flexible contract.[33]

The Court rejected plaintiffs' contention that the forum selection bylaws were prohibited by the "vested rights" doctrine, which holds that boards of directors may not modify bylaws so as to diminish or divest the pre-existing rights of stockholders without their consent.[34] On this point, Chancellor Strine held that the doctrine was inapplicable because, again, both Chevron's and FedEx's certificates of incorporation conferred on their respective boards the power to adopt or amend bylaws unilaterally and at any time.[35] Consequently, the forum selection bylaws would be enforced in the same manner other contractual forum selection clauses are enforced – i.e., in accordance with the principles established by the United States Supreme Court in The *Bremen v. Zapata Off-Shore Co*,[36] and expressly adopted by the Delaware Supreme Court in *Ingres Corp v. CA, Inc*.[37] Chancellor Strine determined that the board-adopted forum selection bylaws were reasonable and thus enforceable under those principles, citing a United States Supreme Court case involving a cruise ship passenger who was held to be subject to a forum selection clause that "was printed on the ticket she received after she purchased the passage".[38]

For these reasons, the Court of Chancery found that the challenged bylaws were statutorily valid under 8 Del. C. § 109(b) and contractually valid and enforceable as forum selection clauses, and thus granted the defendants' motions for judgment on the pleadings.

Conclusion

Plaintiffs in the *Boilermakers* case have appealed Chancellor Strine's decision to the Delaware Supreme Court. Because the decision upholding the bylaws at issue was a legal decision, and not a factual one, the Supreme Court will review it *de novo,* meaning that the higher court will review the legal issues presented on appeal as if they are being presented for the first time, unbound by the Court of Chancery's reasoning or ultimate holding. If, as expected, the briefing and argument of the appeal proceeds on the typical schedule, a decision should be issued later this year.

If Chancellor Strine's *Boilermakers* decision is affirmed, it is safe to assume that corporate boards will adopt forum selection bylaws, like those adopted by the boards of Chevron and FedEx, at a pace similar to that witnessed after Vice Chancellor Laster's Revlon decision. Because most public corporations' charters permit directors to adopt or amend bylaws without stockholder action, there will be no significant obstacle to such widespread adoption, especially if the Delaware Supreme Court affirms Chancellor Strine's *Boilermakers* decision. For those corporations whose certificates of incorporation do not authorize the board's unilateral adoption of bylaws, the rate of adoption is less certain.

At this time, the two major institutional advisory firms are skeptical of and/or generally disfavor forum selection bylaws. ISS recommends that stockholders vote on a case-by-case basis on forum selection proposals, taking into account whether the company:

1. has been materially harmed by shareholder litigation outside its jurisdiction of incorporation, based on the disclosure in its proxy; and

2. has certain good governance features, such as an annually elected board, a majority vote standard in uncontested director elections, and the absence of a poison pill (unless the pill was shareholder-approved).[39]

Glass Lewis generally will recommend that stockholders vote against any proposal to adopt an exclusive forum selection provision, but may support such a proposal in certain cases if the company:

1. offers a compelling argument as to why the exclusive forum provision would directly benefit shareholders;
2. provides evidence of abuse of legal process in other, non-favored jurisdictions; and
3. has a strong record of good corporate governance.[40]

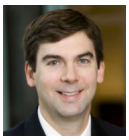
A small number of corporations have seen forum selection bylaws voted down by stockholders.

If the *Boilermakers* decision is affirmed, it also is reasonable to foresee corporate boards adopting other sorts of litigation-related bylaws aimed to check shareholder strike suits that fit within Chancellor Strine's concept of "process-oriented" bylaws that relate to disputes involving the internal affairs of the company and affect plaintiffs solely in their capacity as stockholders. For example, a board could seek to adopt a prevailing party fee-shifting provision in the corporation's bylaws that would require the losing party in derivative litigation (or other stockholder litigation involving the internal affairs of the company) to pay the winner's legal fees.[41]

It is important to note here also that Chancellor Strine's decision is not limited to bylaws proposed and adopted at the board's behest. Given that the power to adopt, amend or repeal bylaws is always retained by the stockholders, it is not difficult to imagine activist stockholders mounting their own campaigns to amend or repeal forum selection (or other) bylaws unilaterally adopted by a board of directors. Though less likely, activist stockholders could be emboldened by Chancellor Strine's decision and propose bylaw or charter amendments favoring stockholders in litigation with the corporation and/or the board.[42]

Affirmance of the *Boilermakers* decision, however, will not provide the final word on the effectiveness of forum selection bylaws. Even if such bylaws are deemed presumptively valid by the Delaware Supreme Court, the real test of their usefulness will come as corporations with such bylaws in effect attempt to use them to stop stockholders from proceeding with litigation filed in jurisdictions other than Delaware. Forum selection bylaws' usefulness as a tool to prevent multiforum stockholder litigation will therefore depend as much upon decisions of courts in other such jurisdictions as upon the forthcoming decision by the Delaware Supreme Court. Courts in such other jurisdictions may not widely recognize such provisions as valid and instead may permit stockholder litigation to proceed notwithstanding such bylaws and their validity under Delaware law. In that event, forum selection bylaws will likely fall by the wayside as corporations seek other more effective ways to avoid litigating stockholder disputes in multiple jurisdictions.

ABOUT THE AUTHORS



Timothy R. Dudderar is a partner, and Christopher N. Kelly is an associate, with the Wilmington, Delaware law firm of Potter Anderson & Corroon LLP. The views expressed by the authors are not necessarily the views of Potter Anderson & Corroon LLP or any of its clients.

[1] C.A. No. 7220-CS, 2013 WL 3191981 (Del. Ch. June 25, 2013).

[2] C.A. No. 7238-CS, 2013 WL 3191981 (Del. Ch. June 25, 2013).

[3] 2013 WL 3191981, at *2, *19.

[4] Claudia H. Allen, *Delaware Corporations – Can Delaware Forum Selection Clauses in Charters or Bylaws Keep Litigation in the Court of Chancery?* (April 18, 2011).

[5] *See Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1175 (N.D. Cal. 2011).

[6] *Id*.

[7] 2013 WL 3191981, at *6.

[8] 990 A.2d 940 (Del. Ch. 2010).

[9] *Id*. at 960. Additionally, it is worth noting that Vice Chancellor Donald F. Parsons, Jr. of the Delaware Court of Chancery, upheld a forum selection clause in a stockholders' agreement providing for exclusive jurisdiction in the federal and state courts of Texas. *Baker v. Impact Holdings, Inc*., 2010 WL 1931032 (Del. Ch. May 13, 2010). Vice Chancellor Parsons reasoned that "there is no statute or other clear indication of a legislative intent to limit the scope of forum selection clauses with respect to corporations and Delaware courts routinely enforce such forum selection clauses, even where they mandate exclusive foreign jurisdiction." *Id*. at *2.

[10] *See, e.g.*, Sara Lewis, *Transforming the Anywhere but Chancery Problem into the Nowhere but Chancery Solution*, 14 Stan. J. L. Bus. & Fin. 199 (2008-2009); Peter L. Welsh & Martin J. Crisp, *Recent Decision Provides Guidance on the Enforceability of Exclusive Forum Selection Clauses*, INSIGHTS, Vol. 25, No. 2 (Feb. 2011).

[11] 2013 WL 3191981, at *6.

[12] *Id*. at *1.

[13] *Id*. at *2. Under Delaware law, a corporation's certificate of incorporation may confer the right to unilaterally adopt, amend or repeal bylaws upon the directors. *See 8 Del. C*. § 109(a). If this power is provided for in the certificate of incorporation, it does not divest the corporation's stockholders of the power to also adopt, amend or repeal bylaws. *Id*.

[14] *Id*. at *4.

[15] *Id*. at *6. Suits also were filed against 10 other corporations whose boards had unilaterally adopted forum selection bylaws; however, all of these other companies repealed the challenged bylaws and the suits were dismissed. *Id*.

[16] *Id*. at *12 n. 80.

[17] *Id*. at *13.

[18] *Id*. at *6.

[19] *Id*. at *8.

[20] *Id*. at *9. The Court also noted that, under Delaware law, bylaws are presumed to be valid, and "the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws." *Id*. (internal quotation marks and footnote omitted).

[21] *Id*.

[22] *Id*. at *10-*13.

[23] 8 *Del. C*. § 109(b).

[24] 2013 WL 3191981, at *10.

[25] *Id*.

[26] *Id*.

[27] *Id*. (quoting 8 *Del. C*. § 109(b)).

[28] *Id*. at *11 (internal quotation marks and footnote omitted).

[29] *Id*.

[30] *Id*. at *13-*15.

[31] *Id*. at *15.

[32] *Id*. at *14.

[33] *Id*. at *15.

[34] *Id*. at *14.

[35] *Id*.

[36] 407 U.S. 1 (1972). Under this precedent, forum selection clauses are valid provided that they are "unaffected by fraud, undue influence, or overweening bargaining power," and such provisions will be enforced unless enforcement is shown to be "unreasonable." *Id*. at 10.

[37] 8 A.3d 1143 (Del. 2010).

[38] 2013 WL 3191981, at *15 (citing *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991)). As further support for this conclusion, Chancellor Strine noted: "Unlike cruise ship passengers, who have no mechanism by which to change their tickets' terms and conditions, stockholders retain the right to modify the corporation's bylaws." *Id*.

[39] ISS 2013 U.S. Proxy Voting Summary Guidelines, at 24 (Jan. 31, 2013), *available at* http://www.issgovernance.com/files/2013ISSUSSummaryGuidelines1312013.pdf.

[40] Glass Lewis also has recommended previously that stockholders withhold votes from the chair of the corporate governance committee of any company with a board-approved forum selection bylaw.

[41] At first blush, such a provision appears even-handed. However, because of the "corporate benefit doctrine," which allows a litigant to receive reimbursement from a corporate defendant for attorneys' fees when the litigant's efforts produce a benefit to stockholders or the corporate enterprise, *see, e.g., In re PAETEC Holding Corp. S'holders Litig*., 2013 WL 1110811, at *4 (Del. Ch. Mar. 19, 2013), the corporation already typically pays a stockholder-plaintiff's attorney fees when the stockholder-plaintiff prevails in the litigation. Consequently, there is little downside for the corporation. Based on Chancellor Strine's decision, Delaware corporate law would appear to permit such a bylaw. A fee-shifting bylaw also likely would be enforced as a matter of Delaware contract law, *SIGA Techs., Inc. v. PharmAthene, Inc*., 67 A.3d 330, 352 (Del. 2013), but the amount of fees requested must be reasonable. *Mahani v. Edix Media Grp., Inc*., 935 A.2d 242, 245-46 (Del. 2007). It is possible that a stockholder-plaintiff would argue that a fee-shifting bylaw provision is void as against public policy, in light of the disparities in bargaining power and sophistication between, for example, a retail stockholder and a large, publicly traded corporation. Consequently, it is worth noting that Delaware courts have upheld fee-shifting provisions in employment contracts, where similar concerns are at play. *See, e.g., All Pro Maids, Inc. v. Layton*, 2004 WL 1878784, at *12-*13 (Del. Ch. Aug. 9, 2004); *Research & Trading Corp. v. Pfuhl*, 1992 WL 345465, at *14-*15 (Del. Ch. Nov. 18, 1992).

[42] For example, in 2012, a Chevron stockholder submitted a proposal to repeal the company's forum selection bylaw. It did not receive a majority vote, garnering only 38% approval. Another example would be stockholder proposals – such as those submitted recently by stockholders of AIG, Exxon Mobil, Lowe's, Marsh & McLennan, Motorola, Northrop Grumman, and Staples, among others – requesting that the company reincorporate in a more stockholder-friendly state, such as North Dakota. A third example would be the stockholder proposal received by Monsanto to amend its bylaws to limit (or eliminate) director indemnification (and advancement of expenses).