Delaware Court of Chancery Upholds Statutory and Contractual Validity of Exclusive Forum-Selection Bylaws

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Yesterday, Chancellor Leo E. Strine, Jr. of the Delaware Court of Chancery upheld the statutory and contractual validity of bylaws separately adopted by the boards of directors of Chevron and FedEx that designated the Delaware courts as the exclusive forum for disputes regarding the internal affairs of the respective companies.[1] The ruling should help clear the way for boards of directors to adopt exclusive forum-selection bylaws as a means to address the ever-increased and well-documented problem of multi-forum stockholder and derivative litigation. However, uncertainties remain (including, most notably, whether non-Delaware courts consistently will enforce such bylaws) that may cause some boards to await further developments before adopting such provisions.

Over the last few years, over 250 public corporations, including Chevron and FedEx, have adopted exclusive forum-selection provisions. These provisions have become the subject of legal challenge (in California federal court and in Delaware), shareholder proposals, criticism from leading proxy advisory firms, and considerable debate. In February 2012, roughly a dozen complaints were filed against Chevron, FedEx and other corporations that had adopted such provisions in their bylaws without stockholder approval, alleging that the bylaws were statutorily invalid (because they are beyond the board's authority), contractually invalid (because they were adopted without stockholder consent), and constituted breaches of fiduciary duty on the part of the directors. The overwhelming majority of these corporations subsequently repealed their bylaws, but Chevron and FedEx defended the merits of their respective bylaws.

At the outset of his 47-page opinion, Chancellor Strine carefully framed the issues properly before the Court concerning the facial validity of the challenged provisions. Chancellor Strine held that for the plaintiffs to successfully invalidate the bylaws on statutory grounds, they were required to establish that the bylaws do not address a proper subject matter under Section 109(b) of the Delaware General Corporation Law (DGCL) and can *never* operate consistently with law. The Court readily concluded that the bylaws addressed a proper subject matter since they regulate the internal affairs of the corporation and related to "the corporation's business, the conduct of its affairs, and the rights of its stockholders [*qua* stockholders]," as required by Section 109(b) of the DGCL, in the most fundamental sense.

The Court also found that the bylaws were contractually valid under the framework established by the DGCL. Chancellor Strine reasoned that Section 109(a) of the DGCL provides corporations with the right to empower boards to adopt bylaws unilaterally. Thus, when an investor buys stock in a corporation whose charter provides this authority, the stockholder is on notice that the bylaws may change and therefore contractually assents to be bound by any such changes. Moreover, stockholders have the ability to check the board's authority by repealing bylaws, withholding board votes at annual elections, and/or challenging particular exercises of this power as in breach of the board's fiduciary duties.

Throughout the opinion, the Court noted that the plaintiffs must show that the bylaws cannot operate consistently with law under *any* circumstances and that it was not enough for the plaintiffs to allege

[1] The companion cases in which the decision was issued are captioned *Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corp., et al.*, C.A. No. 7220-CS, and *Iclub Inv. P'ship v. FedEx Corp., et al.*, C.A. No. 7238-CS.

hypothetical, fact-specific situations challenging their enforceability. However, Chancellor Strine emphasized that the bylaws—like any other forum-selection clause in a commercial contract—remain subject to as-applied challenges by plaintiffs who are affected by the actual operation of the clauses and who believe that the clauses operate in a situationally unreasonable or unlawful manner. Moreover, as is the case with all corporate bylaws, the invocation of exclusive forum-selection bylaws could be challenged as inconsistent with a board's fiduciary duties under specific facts and circumstances.

Thus, although the ruling confirms that Delaware boards of directors may adopt exclusive forum-selection bylaws, meaningful uncertainties remain. Most importantly, only time will tell the extent to which non-Delaware courts will enforce an exclusive forum-selection bylaw to dismiss an internal affairs lawsuit filed in such courts. For example, in January 2011, a U.S. district court for the Northern District of California, applying federal common law, found that a board-adopted Delaware exclusive forum-selection bylaw was not enforceable and allowed the claim to proceed. However, that case might have been decided differently had there been specific Delaware precedent to the contrary (as there is now) and the bylaw in that case was adopted by the board following the occurrence of the events that gave rise to the litigation.

In addition, the adoption of these bylaws also may attract unwanted investor scrutiny in the form of a stockholder proposal to repeal the bylaw or seek stockholder approval. The proxy advisory firms are likely to favor these stockholder proposals, although the decisions are subject to a case-by-case analysis. For example, ISS requires companies to disclose actual harm suffered from multi-forum litigation (to explain the basis for adopting a forum-selection bylaw). In addition, Glass Lewis has indicated in its policy that it may issue a negative vote recommendation against the chairman of the governance committee if the company adopts an exclusive forum-selection bylaw without stockholder approval. While 11 of the 14 management proposals to adopt exclusive forum *charter* provisions that went to a vote passed by relatively small margins, many companies have chosen to repeal their forum-selection bylaws in the face of stockholder pressure and litigation.[2] Lastly, some corporations may conclude that it is in their best interests not to commit themselves to any one forum for litigation, but rather to maintain optionality.

Whether to adopt an exclusive forum-selection bylaw will require a case-by-case evaluation by each company that will depend on its particular circumstances. We believe that, after thoroughly considering these factors, adopting a forum-selection bylaw may well be the right step for some companies. However, particularly given the potential for shareholder restiveness and the uncertainty as to whether non-Delaware courts will enforce exclusive forum-selection bylaws, a "wait and see" approach may be more appropriate for others.

See a copy of Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corp., et al., C.A. No. 7220-CS, and Iclub Inv. P'ship v. FedEx Corp., et al., C.A. No. 7238-CS.

[2] Note that the decision does not address the validity of exclusive forum-selection provisions contained in corporate charters. Presumably, the Court would find such provisions to be valid.

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