Corporate Litigation:

Enforceability of Board-Adopted Forum Selection Bylaws

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Last year, the Delaware Court of Chancery in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*[1] confirmed the facial validity of board-adopted bylaws designating an exclusive forum for intra-corporate litigation. The court's influential decision has accelerated the rate of adoption of exclusive forum provisions among public companies seeking to reduce or eliminate the threat of multi-jurisdictional litigation. Since *Chevron*, more than 100 corporations have added exclusive forum provisions to their bylaws, and newly public companies are increasingly including these provisions in their charters prior to their initial public offering.

Post-Chevron decisions from other state courts—which, until August 2014, all upheld exclusive forum provisions—have provided additional reassurance about the enforceability of forum bylaws. In the last two months, however, two state courts addressing "as-applied" challenges to exclusive forum bylaws reached conflicting conclusions, reminding practitioners that some uncertainty remains regarding the enforceability of exclusive forum provisions. This column analyzes the recent Delaware and Oregon decisions, which demonstrate that the enforceability of an exclusive forum bylaw adopted concurrently with a significant transaction may hinge on a court's assessment of whether the complaint pleads facts indicating an improper motive behind the adoption of the provision.

The Chevron Decision

In last year's Chevron decision, then-Chancellor Leo E. Strine Jr. considered the facial validity of bylaws designating Delaware as the forum for litigation concerning the corporation's internal governance—specifically, derivative lawsuits, fiduciary duty suits, actions under the Delaware General Corporation Law (DGCL), and lawsuits pertaining to the relationships among or between the corporation and its current officers, directors and shareholders. Addressing the plaintiffs' facial challenge to the statutory validity of the bylaws, the court noted that under Section 109(b) of the DGCL, the bylaws of a corporation "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."[2]

The court concluded that the forum selection bylaws relate to the rights of stockholders as stockholders, "because they regulate where stockholders can exercise their right to bring certain internal affairs claims against the corporation and its directors and officers." Furthermore, the court explained, the forum selection bylaws "plainly relate to the conduct of the corporation by channeling internal affairs cases"—those most central to the relationship between a corporation's management and its shareholders—"into the courts of the state of incorporation, providing for the opportunity to have internal affairs cases resolved authoritatively by

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our Supreme Court if any party wishes to take an appeal." The court held that forum selection clauses governing disputes pertaining to the corporations' internal affairs are valid under Delaware statutory law.

The court similarly discounted the plaintiffs' argument that although the U.S. Supreme Court has held that contractual forum selection clauses are "prima facie valid," the forum selection bylaws at issue cannot be contractually binding because they were adopted by the companies' respective boards of directors without the approval of shareholders who would be affected by the bylaws. The court explained that under Delaware law, bylaws are part of a binding contract between a corporation and its shareholders, and where a company's certificate of incorporation authorizes the board to amend the bylaws unilaterally (as permitted by DGCL Section 109(a)), the shareholders are on notice that the board may, at any time, adopt binding bylaws consistent with DGCL Section 109(b).

A bylaw amendment made unilaterally by the board is not, therefore, extra-contractual; "rather it is the kind of change that the overarching statutory and contractual regime [that] the stockholders buy into explicitly allows the board to make on its own." Accordingly, the court held that a forum selection provision unilaterally added to a corporation's bylaws by the company's board pursuant to its authority under the certificate of incorporation is contractually "valid and enforceable under Delaware law to the same extent as other contractual forum selection clauses."

Delaware and Oregon

Last month, Chancellor Andre Bouchard extended the Chevron holding by deciding that (i) an exclusive forum bylaw provision is facially valid even if it selects a forum outside Delaware and (ii) the provision at issue was valid as-applied. *City of Providence v. First Citizens BancShares*[3] involved a bank holding company incorporated in Delaware and headquartered in North Carolina which announced that it had entered into a merger agreement.

On the same date, it adopted a bylaw provision selecting North Carolina as the exclusive forum for adjudicating all intra-corporate disputes. A shareholder of the company initiated litigation in Delaware against the company and its directors challenging the forum selection bylaw as "invalid as a matter of Delaware law or public policy." Days later, the plaintiff filed a second complaint in Delaware, asserting breach of fiduciary duty claims regarding the merger.

On the defendants' motion to dismiss both complaints, the court first addressed the facial validity of the exclusive forum provision, determining that under the same Delaware law analysis outlined in *Chevron*, the provision adopted by First Citizens BancShares (BancShares) was facially valid. The court noted that BancShares' bylaw provision was "functionally identical" to the bylaws at issue in *Chevron* "[i]n all but two respects," neither of which affected the validity of BancShares' bylaw.

First, the BancShares board chose North Carolina (rather than Delaware) courts as their forum. According to the court, however, "nothing in the text or reasoning of *Chevron* can be said to prohibit directors of a Delaware corporation from designating an exclusive forum other than Delaware in its bylaws." Thus, the selection of North Carolina, which was a "reasonable forum" considering that BancShares was headquartered and conducted most of its operations there, did not cast doubt on the facial validity of the bylaw.

Second, the court noted that BancShares' bylaw was by its own terms "applicable only 'to the fullest extent permitted by law.'" The court observed that this language "appears to carve out...a claim for relief, if any, that

may be asserted only in the Court of Chancery," and none of the plaintiff's common law claims regarding the merger fit into this category, preserving exclusive jurisdiction regarding certain claims.

Equally notably, the court rejected the plaintiff's as-applied challenge to the enforcement of BancShares' exclusive forum bylaw. The plaintiff had argued that enforcement of the bylaw under the circumstances "would be unjust because the Board's adoption of the Bylaw, which occurred simultaneously with the announcement of the unfair [proposed merger], goes well beyond [the plaintiff's] reasonable expectations."

The court, however, explained that at the time they purchased BancShares' stock, BancShares' stockholders were on notice that the board could unilaterally amend the company's bylaws at any time; thus, the "reasonable expectation" of a BancShares stockholder should have been that the board "may adopt a forum selection bylaw that...designates a court outside Delaware as the exclusive forum for intra-corporate disputes." The court concluded that the fact that 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."

One month earlier, an Oregon state court reached a different conclusion about the significance of the timing of the bylaw's adoption. The facts of *Roberts v. Triquint Semiconductor*[4] have parallels to those of *City of Providence*. As in *City of Providence*, the board of defendant Triquint Semiconductor (a Delaware corporation headquartered in Oregon) agreed to a merger with another company, and at the same meeting at which it formally recommended the merger, the board adopted a bylaw designating Delaware as the exclusive forum for corporate litigation.

The plaintiffs in *Roberts* alleged, however, that the proposed merger was a reaction to a public announcement by a group of activist shareholders that they intended to try to oust the board at the next shareholder meeting. The plaintiffs asserted that the board adopted the exclusive forum bylaw because it clearly anticipated litigation to follow the merger's announcement. As the court put it, "[w]hile it may be true that in today's corporate climate...mergers usually prompt lawsuits, Plaintiffs' allegations seem to be that the board expected not just litigation in the abstract, they expected this exact litigation."[5]

While acknowledging *Chevron's* holding that unilaterally adopted forum selection bylaws are facially valid, the court in *Roberts* found the bylaw in the case before it to be unenforceable. The court held that given "the closeness of the timing of the bylaw amendment to the board's alleged wrongdoing, coupled with the fact that the board enacted the bylaw in anticipation of this exact lawsuit, and keeping in mind that its enforcement will have the effect—and Defendants knew it would have the effect—of forcing the shareholders to accept the bylaw," enforcing the bylaw "would be unfair and unjust."

The court allowed that the bylaw would have been enforceable had the board "adopted it prior to any of its alleged wrongdoing, and with ample time for the shareholders to accept or reject the change." This observation appears to distinguish *Roberts* from circumstances where a board merely adopts a forum bylaw concurrently with approval of a significant transaction but the bylaw adoption was not a targeted response to a specific litigation threat.

Implications

City of Providence extends the Chevron decision by confirming the facial validity of board-adopted forum selection bylaws that designate a state other than Delaware as the exclusive forum for intra-corporate litigation. The Delaware Court of Chancery is aligned with state courts in New York, California, Louisiana,

Illinois and Texas, each of which issued post-Chevron rulings enforcing bylaws that provide exclusive jurisdiction to states other than the court's home state. It bears mention, however, that because the exclusive forum provision in *City of Providence* selected North Carolina, where the company was headquartered and conducted much of its business, it is possible that a challenge to a bylaw provision selecting a venue with less substantial corporate nexus could yield a different outcome under Delaware law. The Delaware court has not yet addressed the argument that enforcement of a bylaw requiring intra-corporate litigation to be brought in a state with an attenuated relationship to the corporation would be unreasonable or unjust.

The different outcomes in *City of Providence* and *Roberts* on fact-specific as-applied challenges to bylaws underscore that some uncertainty remains regarding whether a particular state court will enforce an exclusive forum provision adopted on a "cloudy day," i.e., when a specific litigation threat is apprehended. As the Chevron court was concerned only "with the facial statutory and contractual validity of the bylaws" and not with "how the bylaws might be applied in any future, real-world situation," *City of Providence* provides, for the first time, Delaware's view that adopting an exclusive forum bylaw concurrently with the challenged merger does not in itself impair the bylaw's enforceability.[6]

On the other hand, the Oregon court in *Roberts* opined that the timing of the bylaw's adoption rendered its enforcement "unfair and unjust."[7] There may be a meaningful distinction, as the Roberts court suggested, between a board anticipating "imminent litigation" regarding the transaction because of certain events leading up to the merger—as in *Roberts*—and expecting, as BancShares likely did, "litigation in the abstract" given that shareholder litigation follows announcement of the vast majority of mergers and acquisitions.[8] It remains to be seen whether the divergent conclusions reached by the two courts simply indicate a difference of judicial opinion regarding the validity of exclusive forum bylaws adopted at a time when litigation was on the horizon. Three weeks ago, in *North v. McNamara* an Ohio federal court expressly rejected the Oregon ruling, holding that a "forum-selection bylaw does not become unenforceable simply because it was adopted after the purported wrongdoing."[9]

Accordingly, corporations considering a forum selection bylaw should, where practicable, adopt such provisions on a "clear day," to defuse fairness-based challenges to enforcement. Where corporations adopt exclusive forum provisions concurrently with entering into a major transaction, their boards and advisers should remember that even in Delaware, the court could find an exclusive forum provision to be inequitable under certain circumstances. The enforceability of an exclusive forum provision may depend not only on the adjudicating court, but on the court's perception of the circumstances surrounding the provision's adoption.

Endnotes:

1. 73 A.3d 934 (Del. Ch. 2013).
2. Id. at 950 (quoting 8 Del. C. § 109(b)).
3. 2014 WL 4409816 (Del. Ch. Sept. 8, 2014).
4. No. 1402–02441, slip op. (Ore. Cir. Ct. Aug. 14, 2014).
5. Id. at 9.
6. *Chevron*, 73 A.3d at 948.
7. *Roberts*, supra note 5, at 10.
8. Id. at 9-10.
9. 2014 WL 4684377 (S.D. Ohio Sept. 19, 2014).