

Cooley

July 17, 2013

On June 25, 2013, Chancellor Leo E. Strine, Jr. of the Delaware Court of Chancery upheld the validity of forum selection provisions of bylaws adopted by the boards of directors of Chevron Corporation and FedEx Corporation, each a Delaware corporation. The bylaw provisions required that stockholders suing the companies or its officers for breaches of fiduciary duty, in derivative suits, or for other corporate governance-related claims must file those suits in Delaware courts only. In a strongly worded opinion, Chancellor Strine upheld the forum selection provisions of the bylaws, determining that they are permitted by the Delaware General Corporation Law ("DGCL") since (i) those provisions govern disputes related to the 'internal affairs' of the corporations and are specifically permitted by Section 109(b) of the DGCL and (ii) the DGCL allows corporations to empower directors to adopt bylaws that bind stockholders.

Background

Most Delaware companies are headquartered in other states and many of those companies conduct business in multiple states. Thus, when litigation arises regarding corporate actions, companies often face lawsuits in multiple jurisdictions across the country ("multi-forum litigation"). Multi-forum litigation increases unnecessarily company costs, including hiring multiple sets of counsel and preparing and arguing motions in various courts, and subjects the corporation to the risk of inconsistent rulings from judges in different jurisdictions.

In 2010, Vice Chancellor Laster suggested in his opinion in *Revlon, Inc. Shareholders Litigation*, that corporations concerned about the costs and inefficiencies of multi-forum litigation "are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes." This statement spurred many companies to amend their charters or adopt bylaw provisions making Delaware the exclusive forum for stockholder suits. Since *Revlon*, more than 250 public companies have adopted forum selection clauses.

Among the companies that adopted forum selection provisions were Chevron Corporation and FedEx Corporation. The board of directors of both companies, without seeking stockholder approval, adopted forum selection provisions in the bylaws that made Delaware the exclusive forum for (i) any derivative action on behalf of the corporation, (ii) any action for breach of fiduciary duty against an officer or director, (iii) any action with claims under the DGCL, and (iv) any action asserting a claim governed by the internal affairs doctrine.

In response, stockholders sued Chevron and FedEx, among other companies, in the Delaware Chancery Court claiming that the bylaw provisions were statutorily and contractually invalid. Chevron and FedEx argued that their boards were authorized under the DGCL to adopt those provisions of the bylaws, and that the bylaws are contractually valid forum selection clauses.

Holding

Chancellor Strine held that the DGCL authorized the board of directors of those two companies to adopt unilaterally forum selection bylaw provisions. 8 *Del. C.* § 109(a) states that "any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors" The companies' charters granted their boards the power to adopt bylaws. 8 *Del. C.* § 109(b) states that "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." Chancellor Strine held that "[t]he forum selection bylaws, which govern disputes related to the

'internal affairs' of the corporations, easily meet these requirements." Thus, the forum selection bylaws are statutorily valid.

The Court next determined that the forum selection clauses are enforceable contractual provisions. Chancellor Strine clearly stated that a company's bylaws are a contract among the company and the stockholders that provides the company flexibility to amend the bylaws:

[T]he bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the DGCL. This contract is, by design, flexible and subject to change in the manner that the DGCL spells out and that investors know about when they purchase stock in a Delaware corporation. The DGCL allows the corporation, through the certificate of incorporation, to grant the directors the power to adopt and amend the bylaws unilaterally.

Accordingly, the Court rejected the plaintiffs' argument that the bylaw provision was not enforceable because it was adopted unilaterally by the directors. Instead, Chancellor Strine held that "a forum selection clause adopted by a board with the authority to adopt bylaws is valid and enforceable under Delaware law to the same extent as other contractual forum selection clauses." That is, forum selection bylaw provisions will be subjected to the same scrutiny as other contractual forum selection clauses articulated in the Supreme Court case *Bremen v. Zapata Off-Shore Company*, which held that forum selection clauses are presumed to be valid provided that they are "unaffected by fraud, undue influence or overweening bargaining power" (the "*Bremen* standard").

Chancellor Strine also rejected the plaintiffs' list of hypothetical scenarios in which plaintiffs argued that the bylaws *may* operate unreasonably. The Court stated that it is up to the plaintiff in a particular case to challenge the application of the bylaw to their unique situation under the *Bremen* standard.

Chancellor Strine clearly intends his opinion to have far-reaching effects for Delaware corporations. In explaining why he was ruling on the motions prior to completion of discovery, he stated that "[a] decision as to the basic legal questions presented by the plaintiffs' complaints will provide efficiency benefits to not only the defendants and their stockholders, but to other corporations and their investors." He also expects his opinion to be followed by courts outside of Delaware, "because a foreign court that respects the internal affairs doctrine, as it must, when faced with a motion to enforce the bylaws will consider, as a first order issue, whether the bylaws are valid under the chartering jurisdiction's domestic law."

Impact

Although the decision is expected to be appealed to the Delaware Supreme Court, this opinion provides Delaware corporations with additional support to adopt bylaw provisions making Delaware the exclusive forum for internal affairs litigation. As discussed, such bylaw provisions can be important tools to protect corporations from the cost of multi-forum litigation that could arise as a result of a challenged corporate action, such as an acquisition or a merger. Such provisions can not only make such litigation less costly to defend, but also less costly to settle when a settlement is warranted.

Boards of Delaware corporations whose charters allow them to amend the company's bylaws should strongly consider adopting a forum selection bylaw provision. When determining whether doing so is in the best interests of the company and its stockholders, the Board should consider the policies and preferences of their institutional stockholders and the proxy advisory firms that influence them. ISS and Glass Lewis generally favor submitting forum selection bylaw provisions to a stockholder vote, but unilateral Board adoption of an exclusive forum bylaw will not, by itself, cause ISS to recommend voting against or withholding votes from directors (although ISS will highlight the action in its report with vote recommendations for a company's next meeting of stockholders). Glass Lewis takes a more aggressive approach and will recommend withholding votes from the chair of the governance committee at the next meeting of stockholders following Board adoption of an exclusive forum bylaw without stockholder approval.

Depending on the company's situation, the Board may also consider submitting an exclusive forum provision to a vote of its stockholders. When such bylaw provisions are put to stockholder votes, the stated policies of the proxy advisory firms are to make case-by-case recommendations based on specific factors; however, in practice ISS and Glass Lewis very rarely—if ever—recommend supporting these proposals. The formal policy of ISS is to consider whether the company has been materially harmed by stockholder litigation outside its jurisdiction of incorporation and whether the company has adopted certain good governance practices, which in this context ISS defines as annual board elections, a majority vote standard in uncontested director elections and the absence of a non-stockholder approved poison pill. Glass Lewis generally recommends that stockholders vote against these proposals unless a company provides a compelling argument on why the provision would directly benefit stockholders, provides evidence of past abuse of legal process in other non-favored jurisdictions, and maintains a strong record of good corporate governance practices. However, despite the practice of ISS and Glass Lewis in opposing forum provisions, during the last few years, eight of 14 proposals submitted to stockholders passed despite such opposition. That discrepancy is attributable to differences in the composition of each company's particular stockholder base and, in some cases, to the targeted efforts made by the company to overcome the negative vote recommendation.

Finally, private companies planning to go public should seriously consider whether the best interests of the corporation and its stockholders would be served by adoption of an exclusive forum provision in their post-IPO certificate of incorporation, which will solidify the forum requirement from the moment of the company's debut on the public market. Such provisions have been adopted in connection with IPOs by leading companies such as Facebook, LinkedIn and Yelp.

Cooley has advised many of its clients on the proper approach to implementing exclusive forum provisions. If you are interested in discussing whether an exclusive forum provision is right for your company and understanding the details of the provision, contact one of Cooley's attorneys named in this *Alert*.

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Key Contacts

Kenneth Guernsey San Francisco	kguernsey@cooley.com +1 415 693 2091
Eric Jensen Palo Alto	ejensen@cooley.com +1 650 843 5049

Tom Coll San Diego	collta@cooley.com +1 858 550 6013
Ryan Naftulin London	rnaftulin@cooley.com +44 (0) 20 7556 4540
Nancy Wojtas Palo Alto	nwojtas@cooley.com +1 650 843 5819
Francis Wheeler Colorado	fwheeler@cooley.com +1 720 566 4231
David Peinsipp San Francisco	dpeinsipp@cooley.com +1 305 724 0538
Charlie Kim San Diego	ckim@cooley.com +1 858 550 6049
Brent Siler Washington, DC	bsiler@cooley.com +1 202 728 7040

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