

CLIENT MEMORANDUM

Delaware Chancery Court Holds Forum Selection Bylaws Are Facially Valid

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While forum selection clauses in contracts have long been upheld as valid, the fate of comparable forum selection provisions in a corporation's bylaws has been subject to much debate. Earlier this week, Chancellor Leo Strine, Jr. of the Delaware Court of Chancery provided much needed clarity on the validity of bylaws specifying Delaware as the sole and exclusive forum for disputes concerning a corporation's internal affairs. In *Boilermakers Local 154 Ret. Fund & Key West Police & Fire Pension Fund v. Chevron Corp.*, No. 7220-CS, slip op. (Del. Ch. June 25, 2013), Chancellor Strine found that such bylaws are facially valid under both statutory and contractual law. Delaware corporations herald this victory as a way to prevent forum-shopping and streamline duplicative multiform litigation.

In the last three years, over 250 publicly traded corporations have adopted a bylaw specifying an exclusive forum for resolving lawsuits related to their internal affairs. *Id.* at 12. Many corporations, including those in *Chevron*, choose Delaware as that forum because of its well-developed Delaware General Corporation Law ("DGCL") and the Delaware Court of Chancery's significant expertise in resolving disputes concerning Delaware corporate governance.

In *Chevron*, stockholders presented purely facial legal challenges to the validity of 12 corporations' forum selection bylaws. Ten of the corporations repealed their bylaws, rendering those suits moot and leaving *Chevron* and FedEx as the sole defendants. The bylaws at issue were unilaterally adopted by the boards of directors and designated Delaware as

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the exclusive venue for derivative, fiduciary duty, DGCL, and internal affairs lawsuits. The Court found the forum selection provisions valid and enforceable and rejected plaintiffs' hypothetical "parade of horrors" in which a literal application of the bylaws might be unreasonable.

First, Chancellor Strine held the bylaws statutorily valid under the DGCL. Under 8 Del. C. § 109, a corporation's certificate of incorporation may confer on the board of directors the power to unilaterally adopt procedural, process-oriented bylaws governing the business of the corporation, the conduct of its affairs, and the rights or powers of its stockholders. The Court held that bylaws designating Delaware as an exclusive forum for litigation relating to such internal affairs fall squarely within the statute as properly regulating "where," as opposed to "whether," stockholders may file suit. In support, Chancellor Strine stated that "the forum selection bylaws are designed to bring order to what the boards of Chevron and FedEx say they perceive to be a chaotic filing of duplicative and inefficient derivative and corporate suits against the directors and the corporations." *Id.* at 27.

Second, Chancellor Strine held the forum selection bylaws valid and enforceable under contract law. It is well settled in Delaware that the bylaws of a corporation are part of a larger contract between a Delaware corporation and its stockholders. Chancellor Strine stated, "In an unbroken line of decisions dating back several generations, our Supreme Court has made clear that the bylaws constitute a binding part of the contract between a Delaware corporation and its stockholders. Stockholders are on notice that, as to those subjects that are subject of regulation by bylaw under 8 Del. C. § 109(b), the board itself may act unilaterally to adopt bylaws addressing those subjects." *Id.* at 33. The Court confirmed that these bylaws may include a provision designating Delaware as the exclusive forum for litigation related to a corporation's internal affairs.

The holding that forum selection bylaws are facially valid does not mean that such bylaws are necessarily valid and enforceable as applied in every situation. As Chancellor Strine noted, stockholders may challenge the application of the bylaw provision in particular circumstances, just as they may challenge forum selection clauses in contracts. *Id.* at 46-47. Moreover, stockholders have the ability to repeal forum selection bylaws by majority vote. *Id.* at 34-35. Finally, a board has the power to waive the bylaw in a particular case either on its own accord or at the request of a prospective plaintiff. *Id.* at 46.

This ruling has implications for the many corporations incorporated in Delaware. Channeling stockholder suits into a single forum will decrease (a) the expense and inefficiency of defending multiple suits in multiple jurisdictions challenging the same transaction or conduct, (b) the risk of inconsistent judgments, (c) the ability of plaintiffs to forum-shop, and (d) the burden on the legal system of adjudicating duplicative suits. While it is likely that plaintiffs will appeal this ruling, Delaware corporations now have binding legal authority stating that these powerful provisions are facially valid.

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