

## CORPORATE ALERT

June 28, 2013

### IS IT TIME TO ADOPT A FORUM SELECTION BYLAW?

On June 25, 2013, the Delaware Court of Chancery upheld the facial validity of forum selection bylaws unilaterally adopted by the boards of directors of Chevron Corporation and FedEx Corporation.<sup>1</sup> The decision is welcome news for many public companies that have been sitting on the sidelines waiting for additional clarity on the validity of these types of provisions before proceeding with their own such bylaws.

Many publicly traded Delaware corporations have adopted forum selection bylaws designating Delaware as the exclusive venue for stockholder derivative suits and certain other stockholder suits. The purpose of these provisions is to reduce the high cost of duplicative, multi-forum suits challenging corporate actions and help ensure that the matters in dispute will be heard relatively swiftly by a knowledgeable and highly regarded judiciary. However, the validity of these types of bylaw provisions had been in doubt. In 2011, a federal court in California applying federal common law refused to enforce an exclusive forum provision that was adopted by the board of directors of a Delaware corporation without stockholder approval.<sup>2</sup> In addition, in 2012, a dozen Delaware corporations whose boards had adopted forum selection bylaws were sued in Delaware. Ten of these companies capitulated and repealed their bylaws, but Chevron and FedEx decided to fight and requested that the Chancery Court hear a consolidated action on the facial validity of their forum selection bylaws.

Chancellor Strine granted defendants' motion and ruled that, on their face, the bylaws in question were within the power of the board of directors to adopt under the Delaware General Corporation Law (the "**DGCL**") and were contractually valid and enforceable. The bylaw provisions adopted by Chevron and FedEx require that stockholder derivative suits, as well as suits alleging breach of fiduciary duties, claims under the DGCL and claims governed by the internal affairs doctrine, must be brought in Delaware unless the corporation otherwise consents.

In deciding that the forum selection clauses are statutorily valid, Chancellor Strine relied on DGCL § 109(b), which 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 ruled that the "forum selection bylaws, which govern disputes related to the 'internal affairs' of the corporations, easily meet these requirements."<sup>3</sup>

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<sup>1</sup> *Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corporation, et al.*, C.A. No. 7220-CS and *IClub Investment Partnership v. FedEx Corporation, et al.*, C.A. No. 7238-CS (Del. Ch. June 25, 2013).

<sup>2</sup> *Galaviz v. Berg*, 763 F.Supp. 2d 1170 (Jan. 3, 2011).

<sup>3</sup> *Boilermakers, supra* at p. 3.

The court also held that the bylaw provisions are contractually valid and enforceable because the DGCL allows corporations, through their certificates of incorporation, to grant directors the power to adopt and amend the bylaws unilaterally, and the certificates of incorporation of Chevron and FedEx so authorized their boards. Consequently, “stockholders who invest in such corporations assent to be bound by board-adopted bylaws when they buy stock in those corporations”.<sup>4</sup> Therefore, the court concluded, the forum selection bylaws were valid and enforceable under Delaware law to the same extent as other contractual forum selection clauses, meaning that they will be enforced in accordance with the principles set forth by the U.S. Supreme Court in *The Bremen v. Zapata Off-Shore Co.*<sup>5</sup> Under *Bremen*, forum selection clauses are valid provided they are “unaffected by fraud, undue influence, or overweening bargaining power” and should be enforced unless shown to be “unreasonable”.<sup>6</sup> In addition, the application of a forum selection bylaw remains subject to challenge in any specific situation on grounds that the board breached its fiduciary duties.

While the Chancery Court’s decision resolves the core issues of the facial statutory validity and contractual enforceability of forum selection bylaws there are nevertheless several considerations that boards of directors should take into account in deciding whether to move forward with the adoption of such a provision:

- *Potential Appeal.* Chancellor Strine’s opinion is subject to appeal to the Delaware Supreme Court.
- *Reaction of Courts in Other Jurisdictions.* It remains to be seen whether courts in other jurisdictions will honor forum selection bylaws adopted by the boards of Delaware corporations and dismiss intra-corporate suits brought in non-Delaware jurisdictions. As previously mentioned, in 2011, a federal court in California refused to enforce such a provision that had been adopted by a board without stockholder approval. That decision, however, was made without the benefit of the precedent of Chancellor Strine’s decision. In addition, the board in that case was seeking to invoke the bylaw with respect to claims regarding events that occurred prior to the bylaw’s adoption.
- *Stockholder Reaction.* It may be difficult to gauge stockholder reaction to the adoption of a forum selection provision. Since the beginning of the 2011 proxy season, fewer than 15 management proposals to amend corporate charters to add exclusive forum provisions have gone to a vote, and, in almost all instances, the amendments passed, generally by a narrow margin, except in instances where there was sizable insider ownership. In addition, in 2012, two stockholder proposals seeking repeal of forum selection bylaw provisions went to a vote and both proposals failed. Now that opponents of forum selection provisions have lost on key challenges in the Chancery Court, they may focus more of their efforts on introducing stockholder proposals seeking repeal of such provisions

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<sup>4</sup> *Id.* at 5.

<sup>5</sup> 407 U.S. 1 (1972).

<sup>6</sup> *Boilermakers*, *supra* at 35-36.

during next year's proxy season. The Council of Institutional Investors and the AFL-CIO both have policies against the adoption of forum selection provisions.<sup>7</sup>

- *Proxy Advisory Firm Positions.* The major proxy advisory firms generally oppose forum selection provisions. In late 2012, Glass Lewis, which historically had uniformly opposed such provisions, revised its policy to provide that it will consider recommending in favor of a forum selection provision if the company (i) has a compelling argument as to why the provision would directly benefit stockholders, (ii) provides evidence of abuse of legal process in other, nonfavored jurisdictions, and (iii) maintains a strong record of good corporate governance practices. ISS states that it reviews forum selection proposals on a case-by-case basis, taking into account whether the company has a specified set of good governance practices<sup>8</sup> and whether the company discloses in its proxy statement that it has been materially harmed by stockholder litigation outside its jurisdiction of incorporation. Notwithstanding its stated policy indicating that, at least in some circumstances, a forum selection proposal can pass muster, it is clear that ISS sets a high bar. For example, in 2012, ISS supported a stockholder proposal to repeal a forum selection bylaw at United Rentals, Inc., even though the company had good corporate governance practices and included disclosure in its proxy materials about prior and pending multi-jurisdictional lawsuits. ISS stated that it was unable to determine whether the company had been "materially" harmed by the litigation.
- *Form of Provision.* In crafting a forum selection bylaw, a company would be wise to consider the forms of the Chevron and FedEx bylaws since they have passed judicial muster in Delaware. The forms of the Chevron and FedEx bylaws are attached to this alert. Note that Chevron and FedEx initially adopted identical forum selection bylaws, but Chevron, apparently in response to arguments raised by the plaintiffs, amended its bylaw provision to address certain situations regarding subject matter and personal jurisdiction.
- *Documentation.* In light of the risk of potential litigation, a board of directors adopting a forum selection bylaw should make sure that the board minutes accurately and fully reflect the board's deliberations and the reasons why the board believes the provision is in the best interests of the corporation and its stockholders.

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<sup>7</sup> Council of Institutional Investors Corporate Governance Guidelines Section 1.9; AFL-CIO Proxy Voting Guidelines Section D.16 (2012).

<sup>8</sup> Specifically, an annually elected board, majority voting and the absence of a non-shareholder approved poison pill.

## CORPORATE ALERT

### APPENDIX

#### **FedEx Forum Selection Bylaw**

Unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this [bylaw].

#### **Chevron Amended Forum Selection Bylaw (with changes in italics)**

Unless the Corporation consents in writing to the selection of an alternative forum, the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine shall *be a state or federal court located within the state of Delaware, in all cases subject to the court's having personal jurisdiction over the indispensable parties named as defendants*. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this [bylaw].

## Contact Information

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