Shareholder Litigation and Forum Selection Provisions

By Jennifer L. Permesly and Stephanie Sado

In recent years, an increasing number of corporate boards have sought to avoid the risk of multi-forum shareholder litigation by adopting exclusive forum selection clauses in their corporate bylaws.[1] These provisions have been upheld by courts in Delaware, where over 50% of U.S. publicly traded companies are incorporated, and the Delaware legislature recently amended the state's General Corporations Law to expressly permit corporations to select Delaware as the exclusive forum for litigation of breach of fiduciary duty and other internal corporate claims.[2] Other recent case law developments suggest that provisions providing for arbitration as the exclusive forum for resolution of shareholder claims may be the next frontier for corporations. We review the state of the law regarding the enforceability of both types of forum selection provisions below.

I. Delaware Law Permits Corporate Boards to Adopt Exclusive Forum Selection Clauses in Their Bylaws

A. Delaware Courts Uphold a Corporation's Right to Impose an Exclusive Forum Selection Clause on Shareholders

In 2013, in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, the Delaware Chancery Court considered challenges brought by the shareholders of Delaware corporations FedEx and Chevron to forum selection clauses in those companies' bylaws choosing Delaware as the exclusive forum for litigation of internal corporate claims.[3] The court first established that the forum clauses were permitted under § 109(b) of the Delaware General Corporation Law (DGCL), which sets forth the permissible content of a corporation's bylaws,[4] because they address the "rights" of shareholders by regulating where shareholders can exercise their right to bring internal corporate claims.[5] The court went on to reject the shareholders' argument that their lack of consent to the bylaws rendered the forum provisions invalid as a matter of contract law.[6] Rather, the court held that the shareholders' purchase of shares in a Delaware corporation constituted their consent to the statutory framework of the DGCL as well as to the FedEx and Chevron public certificates of incorporation, which in turn provided that shareholders are bound by bylaws unilaterally adopted by the board.[7]

Another Delaware Chancery Court decision took *Chevron* one step further, by suggesting that Delaware corporations could also select an exclusive forum in a state other than Delaware.[8] In *City of Providence v. First Citizens Bancshares, Inc.*,[9] the court upheld a board-adopted forum selection bylaw exclusively selecting courts in North Carolina, where the corporation was headquartered but not incorporated.[10]

Courts in other states, including New York, have readily applied *Chevron* to uphold forum selection provisions in the bylaws of Delaware corporations.[11]

B. Delaware Legislature Codifies Existing Case Law but Limits a Corporation's Ability to Select a Forum Outside of Delaware

In August 2015, the Delaware legislature adopted several amendments to the DGCL, including DGCL § 115, which provides:

> The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State. "Internal corporate claims" means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.[12]

In line with *Chevron*, DGCL § 115 gives Delaware corporate boards the authority to unilaterally adopt a forum selection provision in the company's certificate of incorporation or bylaws, thereby requiring shareholders to litigate "internal corporate claims" exclusively in Delaware.

The statute leaves certain important questions unanswered. Importantly, under DGCL § 115, it appears that Delaware corporate boards cannot exclude Delaware as a potential forum. A Delaware board can apparently adopt a forum selection provision that directs litigation to a state other than Delaware, but only if it also includes Delaware courts as an option.[13] This is in contrast to the Delaware Chancery Court's Decision in *City of Providence*, and raises questions as to how Delaware courts will rule on forum selection provisions enacted prior to the statute's adoption but selecting fora other than Delaware.

Second, DGCL § 115 does not eliminate the possibility that corporations will face "as-applied" challenges based on the facts and circumstances of the board's adoption of the forum selection bylaws. Following *Chevron*, most courts have enforced forum selection bylaws even in circumstances where the shareholder claimed that the board adopted the bylaw only to avoid litigation in the face of corporate wrongdoing.[14] At least one state court, however,

has refused to uphold a forum selection clause adopted unilaterally by a board in anticipation of the very lawsuit in question. It therefore remains possible that shareholders will attempt to bring such as-applied challenges.[15]

Finally, corporations may still be forced to appear in a forum other than Delaware in order to move to dismiss or transfer a shareholder action filed in violation of the exclusive forum clause.[16] In *Edgen Group Inc. v. Genoud*, the Delaware Chancery Court recognized the validity of a forum selection clause but refused to issue an anti-suit injunction against shareholder litigation filed in Louisiana, deferring to the courts of that state to consider the enforceability of the forum selection clause in deciding the motion to dismiss made by the corporation in that court.[17] The court refused to issue the anti-suit injunction despite the fact that the timing of the Louisiana litigation might impede the corporation's pending merger.

II. Courts May Uphold Arbitration Agreements in Corporate Bylaws

While Delaware law on forum selection clauses appears relatively settled, a question remains as to whether corporate boards may adopt mandatory arbitration clauses in their bylaws as an alternative to litigation. DGCL §115's direction that corporations cannot exclude Delaware as a forum for corporate claims suggests that corporations might be precluded from adopting an arbitration provision that would deny shareholders the right to sue in Delaware court. This would arguably contradict, however, the strong federal policy in favor of arbitration and could lead to a dispute regarding whether the Delaware statute is "preempted" by federal arbitration law. It would also undermine *Chevron*'s findings regarding a board's broad discretion to adopt and enforce bylaws.

The conflict between the imperatives of the Delaware statute and the binding nature of arbitration provisions could soon come to a head. Recent decisions suggest a trend towards the recognition of non-negotiated arbitration clauses, including those found in corporate bylaws. For example, in *AT&T Mobility LLC v. Concepcion*, the U.S. Supreme Court held that the Federal Arbitration Act (FAA) preempted California common law rendering unenforceable the inclusion of class action waivers in arbitration clauses in consumer contracts.[18] Similarly, in *Am. Express Co. v. Italian Colors Rest.*, the Supreme Court reasserted the extensive reach of the FAA, declining to invalidate a class arbitration waiver even where pursuing claims on an individual basis was cost-prohibitive.[19] State and federal courts have applied *AT&T* and *Am. Express. Co.* to uphold arbitration agreements in non-negotiated contracts, even where those agreements would strip claimants of protections such as the class action mechanism.[20]

In the shareholder dispute context, the case law remains limited, but a state court in Maryland recently enforced an arbitration clause in corporate bylaws, relying in part on *Chevron*'s general principle that the shareholders cannot invalidate a corporate bylaw based on their lack of consent.[21] The same court also pointed to *AT&T*'s recognition of the federal policy favoring arbitration to suggest that mandatory arbitration of shareholder disputes should be permitted.[22]

Similarly, the Southern District of New York recently enforced a mandatory arbitration clause adopted by the Brazilian state-owned oil company Petróleo Brasileiro S.A. ("Petrobras").[23] The court recognized that Brazilian law permits companies to adopt mandatory arbitration bylaws for claims arising from shares purchased on the Bovespa, the Brazilian Stock Exchange, and held that under Brazilian law, shareholders had constructively assented to the arbitration clause in Petrobras's bylaws when purchasing shares on the Bovespa.[24] The court dismissed the shareholders' Brazilian law claims on this basis.

These decisions suggest a growing tendency on the part of courts to look favorably upon mandatory arbitration provisions for shareholder disputes. The Securities and Exchange Commission has, however, taken a less favorable view. In 2012, the Carlyle Group, a private equity firm, sought to include a clause in its initial public offering documents prohibiting its shareholders from initiating class action lawsuits, instead directing all state law and federal law securities claims to individual arbitrations. Faced with vocal shareholder opposition, the Carlyle group ultimately dropped the provision when the SEC threatened to stall the IPO by refusing to accelerate the registration statement.[25]

III. Conclusion

The Delaware legislature has made clear that Delaware corporations can direct shareholder litigation to Delaware courts by including forum selection clauses in their corporate bylaws. Yet questions remain about whether Delaware corporations may direct their litigation outside of the exclusive forum of Delaware—whether it be to arbitration or to courts other than Delaware. Counsel for public companies and institutional shareholders alike should remain cognizant of this evolving legal landscape in considering the enforceability of an exclusive forum for shareholder litigation.

Endnotes

1. *See* Olga Koumrian, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2014 M&A Litigation*, Cornerstone Research (2015), https://www.cornerstone.com/GetAttachment/897c61ef-bfde-46e6-a2b8-5f94906c6ee2/Shareholder-Litigation-Involving-Acquisitions-2014-Review.pdf (more than 300 publicly traded companies adopted forum selection bylaws in 2013 and 2014) (recent statistics suggest that multi-jurisdiction litigation was significantly reduced between 2013, when 60 percent of claims involving challenges to mergers and/or acquisitions were filed in more than one jurisdiction, and 2014, when approximately 40 percent of such litigation was filed in more than one jurisdiction.

2. *See* DELAWARE DEP'T OF STATE, About Agency, http://corp.delaware.gov/aboutagency.shtml (last visited Oct. 5, 2015); Del. Code Ann. tit. 8 § 115.
3. *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) (the court found it expeditious to resolve this issue for both cases in the same opinion because the same attorneys represented both groups of shareholders and filed nearly identical complaints addressing nearly identical bylaw provisions).
4. Del. Code Ann. tit. 8 § 109(b) (providing that the corporation may issue bylaws which "relat[e] 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").
5. *Chevron*, 73 A.3d at 950-51.
6. *Id.* at 954-55.
7. *See id.* at 956 (under Delaware statutory law, a corporation may, in its certificate of incorporation, give the board the power to unilaterally amend the corporate bylaws); *see* Del. Code Ann. tit. 8 § 109(a) ("Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors or, in the case of a nonstock corporation, upon its governing body. The fact that such power has been so conferred upon the directors or governing body, as the case may be, shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws.").
8. *See City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014) (addressing an issue of first impression: whether the board of a Delaware corporation may adopt a bylaw that designates an exclusive forum other than Delaware for intra-corporate disputes, and finding in the affirmative).
9. *Id.*
10. *See id.*
11. *See, e.g., Groen v. Safeway, Inc.*, No. RG14716641, 2014 WL 3405752, at *1 (Cal. Super. Ct. May 14, 2014); *Miller v. Beam, Inc.*, No. 2014 CH 00932, 2014 WL 2727089, at *1 (Ill. Cir. Ct. Mar. 5, 2014); *Hemg Inc. et al. v. Aspen University*, No. 650457, 2013 WL 5958388, at *1 (Sup. Ct. N.Y. Cnty. Nov. 4, 2013).
12. Del. Code Ann. tit. 8 § 115.
13. At least one commentator has suggested that this provision may prevent corporations from circumventing the Delaware statutory prohibition on fee-shifting, which went into effect at the same time as DGCL § 115. *See* Neil J. Cohen, *Does Pending Delaware Legislation Cover Fee Shifting in Securities Cases?*, BANK AND CORPORATE GOVERNANCE LAW REPORTER (June 15, 2015), http://corpgov.law.harvard.edu/2015/06/15/does-pending-delaware-legislation-cover-fee-shifting-in-securities-cases/.
14. *See, e.g., City of Providence*, 99 A.3d 229 (enforcing forum selection bylaw unilaterally adopted on the same day as the board announced a merger to which the shareholders objected); *Miller v. Beam, Inc.*, No. 2014 CH 00932, 2014 WL 2727089, at *1 (enforcing forum selection provision and finding no evidence that the board adopted the bylaw for a sinister purpose); *see also Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972) (applied in *City of Providence* and *Miller*) (under which a forum selection clause is presumed valid absent a showing that its enforcement "would be unreasonable or unjust, or that the clause was invalid for such reasons as fraud or overreaching").
15. *See Roberts v. Triquint Semiconductor Inc.*, No. 1402-02441, 2014 WL4147465, at *5 (Or. Cir. Ct. Aug. 14, 2014), *appeal docketed*, No. S062642 (Or. Dec. 17, 2014) ("Ultimately, 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, this court finds that enforcing the unilaterally enacted bylaw by dismissing this case would be unfair and unjust.").
16. *See City of Providence, supra* note 8 (noting that courts outside of Delaware are likely to grant a motion to dismiss, recognizing the exclusivity of the Delaware forum).
17. *Edgen Group Inc. v. Genoud*, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013) (Tr.) (noting the Court's general reluctance to issue anti-suit injunctions to a foreign court for reasons of comity, and also pointed to the fact that the Delaware Supreme Court had only recently approved the use of anti-suit injunctions to enforce forum selection clauses between private parties. The court was hesitant to extend that approval to the shareholder forum selection clause context.).
18. *AT&T Mobility, LLC v. Concepcion*, 131 S. Ct. 1740 (2011) (overruling *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005)).
19. *Am. Express Co. v. Italian Colors Rest*, 133 S. Ct. 2304 (2013), (reversing *In re Am. Express Merchants' Litig.*, 554 F.3d 300 (2d Cir. 2009)) (reversing the Second Circuit's finding that *AT&T* was inapplicable and the class arbitration waiver was unenforceable).
20. *Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2d Cir. 2013) (the Second Circuit enforced an arbitration agreement with a class-action waiver, acknowledging that its prior holding in *Am. Express Co.* had been reversed by the U.S. Supreme Court. Earlier this year, a lower appellate court in New York, citing *AT&T*, held that New York's statutory prohibition against mandatory arbitration clauses in consumer contracts was displaced by the FAA); *see Schiffer v. Slomin's Inc.*, 48 Misc. 3d 15 (N.Y. Sup. Ct. App. Term, 2d Dep't 2015).
21. *See Katz v. CommonWealth REIT*, Case No. 24-C-13-001299 (Md. Cir. Ct. Balt. Cty. Feb. 19, 2014).
22. *See id.; see also Corvex Mgmt. LP v. CommonWealth REIT*, Case No. 24-C-13-001111, 2013 WL 1915769 (Md. Cir. Ct. Balt. Cty. May 8, 2013).
23. *See In re Petrobras Sec. Litig.*, No. 14-cv-9662, 2015 WL 4557364, at *1 (S.D.N.Y. Jul. 30, 2015).
24. *See id.* at *18 (finding that shareholders who purchased Petrobras shares on both the Brazilian and the U.S. market could not be required to arbitrate their *U.S. securities law claims* in arbitration in Brazil, holding that the consent to arbitration did not extend this far).
25. *See, e.g.*, Letter from Interested Organizations to The Honorable Mary L. Shapiro, Chairman, U.S. Securities and Exchange Commission (Feb. 3, 2012); Kevin Roose, *Carlyle Drops Arbitration Clause From I.P.O. Plans*, N.Y. Times, Feb. 3, 2012. Similarly, there is considerable pushback from consumer organizations and the plaintiffs' bar as to the use of arbitration clauses to strip class action rights from plaintiffs who typically have unequal bargaining power, such as consumer groups or employees of large corporations. These considerations also apply in the shareholder context, and it remains to be seen whether the ongoing legislative efforts to curb the use of arbitration clauses that do not permit class actions will influence corporations considering adopting such clauses.

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Postscript

In Section I.B , we refer to an Oregon state Circuit Court decision that invalidated a Delaware forum selection clause on the basis that the board had "unjustly" adopted the bylaw in anticipation of merger litigation. *See* Section I.B., fn. 15, citing *Roberts v. TriQuint Semiconductor, Inc.*, No. 1402-02441, 2014 WL4147465, at *5 (Or. Cir. Ct. Aug. 14, 2014). In December 2015, just before this article went to print, the Oregon Supreme Court overturned the Circuit Court and enforced the Delaware exclusive forum bylaw despite the timing of its adoption. *See Roberts v. TriQuint Semiconductor, Inc.,* 358 Or. 413 (2015). The Court applied the reasoning of an earlier Delaware court decision, *City of Providence v. First Citizens BancShares, Inc.*, 99 A. 3d 229 (Del. Ch. 2014), in finding that the plaintiffs had not shown that the Board had acted in its own interests or breached any fiduciary duty by directing claims to a Delaware forum, which would be well equipped to adjudicate any shareholders' claims. This decision accords with a line of Delaware authorities invalidating "as applied" challenges to exclusive forum bylaws that are based on the timing of the adoption of the bylaw.

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