

Directors Digest

A Community Bank Directors Advisor

Issue #92 - February 2015

If You Must Sue...Do It Here

A discussion of the recent trend of adopting forum selection bylaws to avoid multijurisdictional suits by shareholders.

By Kenneth E. Moore and Michael K. Staub, STUART | MOORE Attorneys at Law

In a series of decisions by the Delaware Court of Chancery, the court has upheld the validity of corporate bylaws unilaterally adopted by boards of Delaware based corporations that select Delaware or even another logical forum, as the sole jurisdiction for shareholder litigation involving internal affairs claims.^[1] In June 2013, the Court of Chancery held in *Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corp., et al.*, and *IClub Inv. P'Ship v. FedEx Corp., et al.*, 73 A.3d 934 (Del Ch. 2013), that a board, if granted authority by the certificate of incorporation to adopt bylaws, has the power to adopt a bylaw requiring litigation relating to the corporation's internal affairs to be conducted exclusively in the Delaware courts, even if the shareholders did not vote to approve the bylaw. Then, in September 2014, the court expanded this concept to a situation where a Delaware bank holding company adopted a forum selection bylaw designating its subsidiary bank's principal place of business, rather than Delaware, as the sole jurisdiction for shareholder disputes thereby thwarting a shareholder action brought in Delaware to challenge the board's decision to enter into a merger agreement on the same day that it had adopted the forum-selection bylaw.^[2]

The applicability of these rulings is limited to suits involving a corporation's "internal affairs," such as derivative actions, fiduciary duty suits, and suits arising under the Delaware General Corporation Law (DGCL). They have no applicability to contract claims, tort claims, and lender liability matters which are governed by the terms of the documents at issue or other jurisdictional criteria. Accordingly, the benefits of such bylaws are most often realized in the context of significant corporate transactions like mergers and acquisitions, where the frequency of such litigation is startling. Shareholder litigation challenging mergers and acquisitions has more than doubled since 2005. Plaintiffs typically file these lawsuits shortly after merging companies announce the deals, and the companies often settle before the deal is closed. The practice of instituting shareholder litigation after the announcement of merger transactions is so widespread in deals over \$100 million in value (exceeding 90 percent!) that it is frequently a significant budget item in the transaction.^[3] Inasmuch, forum selection bylaws have become an important tool for Delaware corporations operating in other jurisdictions to avoid expensive multijurisdictional litigation and forum shopping by funneling litigation into a single forum, while also offering predictability of law and legal process in a forum well versed in corporate affairs.

The impact of these rulings has been to force boards for Delaware based corporations to at least consider the strategic adoption of forum selection bylaws in connection with major transactions, such as mergers. Many

boards have recently adopted such bylaw provisions.^[4] However, while the Delaware courts appear to have fully embraced this concept, other more plaintiff friendly jurisdictions may choose to retain jurisdiction in certain situations where a corporation has its principal place of business or significant contacts.^[5]

California Court Decisions Addressing This Issue

The Delaware Supreme Court ruled in 2005 that the “quasi-California corporation” statute found in Section 2115 of the Corporations Code violated “Delaware’s well-established choice of law rules and the federal constitution,” and found that the internal affairs of Delaware corporations (and, in particular, the voting rights of shareholders) are to “be adjudicated exclusively” in accordance with Delaware law.^[6] Thereafter, the quasi-California corporation statute was neither challenged nor repealed, leaving some uncertainty as to its continuing viability to trump a corporation’s state of incorporation on internal affairs issues. One California court looked at a Delaware forum selection bylaw prior to the rulings in *Chevron* and *First Citizens* and determined that it was not enforceable, at least not where it was adopted after the wrongdoing alleged in the suit had occurred.^[7]

In contrast, since the *Chevron* decision two California cases in 2014 provided support for the notion of enforceability of a Delaware forum selection bylaw in California. In *Groen v. Safeway Inc.* (May 2014) and then in *Brewerton v. Oplink Communications Inc.* (December 2014), the Superior Court of California for Alameda County recognized the validity of two Delaware forum selection bylaws which were each adopted at the same time as merger agreements were signed, and granted motions to dismiss each of these California cases. While not precedential, these Superior Court decisions certainly lend credence to the enforceability of a forum selection bylaw under California law.

Pertinent Rulings in Other Western States

The only other recent Western state decision addressing the enforceability of a forum selection clause was the Oregon case of *Roberts v. TriQuint SemiConductors, Inc.*^[8] In *Roberts*, the court refused to enforce a corporate bylaw designating Delaware as the exclusive forum for intra-corporate litigation. While the Oregon court acknowledged the Delaware Chancery Court’s decision in *Chevron*, the court held that TriQuint’s bylaw would not be enforced because the bylaw was enacted at the same board meeting in which the board approved the merger which was the subject of the litigation. The court suggested that the bylaw would have been enforced “had the board...adopted it prior to any alleged wrongdoing, and with ample time for shareholders to accept or reject the change.” In contrast, the Delaware Chancery Court in *First Citizens* did not seem to find any problem with a board adopting the forum selection bylaw on the same day as approving the merger agreement, so we can only chock this up to jurisdictional inconsistency. As a result, TriQuint was forced to continue defending the same shareholder suit in both Oregon and Delaware.

Conclusion

Matters to consider when contemplating the adoption of such forum selection bylaws include: whether the company’s governing documents permit the board to unilaterally adopt bylaws, whether a forum selection bylaw is appropriate for the company, the proper forum to be designated in the bylaw^[9], relative risk exposure to such suits, the likelihood that such a forum selection bylaw will be respected in the corporation’s home jurisdiction, and timing of the adoption.

As the case law of other jurisdictions interpreting the Delaware decisions would indicate, other state courts appear willing to enforce these bylaw provisions, particularly when the exclusive forum provision is adopted without specific pretense, before the company sees the prospect of litigation on the horizon. Ideally, boards should consider the adoption of forum selection bylaws prior to or early in the transaction process to maximize their potential enforceability. However, where this is not possible, the TriQuint decision may be an anomaly and the majority of courts facing the question have enforced exclusive forum bylaw provisions even when they were enacted on or near the date a transaction is approved by the board. While a forum selection bylaw will not

prevent suits challenging significant corporate transactions, they may allow the corporation to control where such suits are brought and prevent forum shopping or multijurisdictional litigation.

[1] *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 951 (Del. Ch. 2013).

[2] *City of Providence v. First Citizens Bancshares, Inc., et al.*, Consol. C.A. No. 9795-CB.

[3] In 2010 and 2011, shareholder lawsuits targeted 91 percent of all deals valued at more than \$100 million, compared to 39 percent in 2005. Andrew J. Pincus, *The Trial Lawyers' New Merger Tax-Corporate Mergers and Mega Million Dollar Litigation Toll on Our Economy 2* (U.S. Chamber Inst. For Legal Reform, Oct. 2012). The number of suits remained steady for major transactions at 91.7 percent in 2012, but jumped to 97.8 percent in 2013 according to an article entitled *Takeover Litigation in 2013* by Matthew D. Cain and Steven M. Davidoff.

[4] First Citizens BancShares, Inc.'s Form 8-K reported approval of a North Carolina forum selection bylaw and a merger transaction on the same day in June 2014; U.S. Bancorp's Form 8-K reported adoption of a Delaware forum selection bylaw in December 2013; Consolidated Communications Holdings Inc.'s Form 8-K reported approval of a forum selection bylaw and a merger transaction on the same day in June 2014; Hittite Microwave Corp.'s Form 8-K disclosed approval of a forum selection bylaw one day before approving a merger in June 2014.

[5] Most lawsuits brought in other state courts were filed in California, Texas, and New York. Texas had the highest average number of lawsuits per deal at 4.4 according to Baines & Koumarian, *Recent Developments in Shareholder Litigation Involving Mergers and Acquisitions – March 2012* at pg. 8 (Cornerstone Research, Mar. 2012).

[6] *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005), decided on other grounds.

[7] In *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (2011), the District Court denied nominal defendant Oracle Corporation's motion to dismiss as an issue of first impression, based upon a forum selection clause designating Delaware as the sole jurisdiction for derivative actions where the suit involved a claim of a corporate overbilling scheme which had allegedly taken place several years before the forum selection clause was adopted by the Board.

[8] No. 1402-02441 (Or. Cir. Ct. Aug. 14, 2014)

[9] While designating the bank's principal place of business as the jurisdiction for intra-corporate disputes appear more economical for the corporation and its representatives, in some cases these benefits may be outweighed by Delaware's extensive body of corporate law and the Delaware court's experience and familiarity with resolving corporate disputes.

Kenneth E. Moore is a partner in and Michael K. Staub is of counsel to STUART | MOORE (www.stuartmoorelaw.com), a law firm with offices in San Luis Obispo, California and Washington, DC that specializes in the representation of financial institutions. They can be reached at (805) 545-8590.