Delaware Court of Chancery Upholds North Carolina "Exclusive Forum" Bylaw

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In a closely watched case with implications for corporations across the nation, and particularly those based in North Carolina, the Delaware Court of Chancery has issued an opinion enforcing a forum selection bylaw that requires intra-corporate disputes involving a Delaware corporation to be brought in the North Carolina courts. Both Delaware and North Carolina, which recently enacted legislation allowing North Carolina corporations to designate North Carolina as the exclusive forum or venue for intra-corporate disputes, have now broadly sanctioned forum selection provisions as a means of managing the costs of shareholder litigation.

Background: The Scourge of Frivolous Merger Litigation

Merger litigation follows a predictable pattern. It begins as soon as a proposed merger is announced, whereupon multiple law firms announce they are investigating whether the board of directors of the target company breached their fiduciary duties to the company's shareholders in connection with the proposed merger. Lawsuits are soon filed alleging that the sale process leading to the proposed merger was flawed and that the disclosures relating to the proposed merger were inadequate. In most cases, these lawsuits quickly settle, because the companies involved do not want to run any risk of delaying the merger. Often the settlement consideration consists solely of additional disclosures made to shareholders in advance of the merger. Based on those additional disclosures, the lawyers for the shareholder plaintiffs then seek a six-digit award of attorneys' fees.

The combination of the strong incentive for defendants to settle quickly and the possibility of significant attorney fee awards leads to litigation over almost every public company merger (i.e., a merger in which the stock of the target company is publicly traded), regardless of the merits of such a suit. According to one study, in 2013 litigation was filed in connection with 94% of public company mergers. *See* Cornerstone Research, *Shareholder Litigation Involving Mergers and Acquisitions* (2014). Furthermore, there were an average of five lawsuits filed for each merger. *See id*. These lawsuits are often filed in multiple jurisdictions, forcing defendants to fight on multiple fronts. Multi-forum litigation adds extra expense, and extra stress given the tight timetable on which mergers operate.

One partial solution proposed for this problem was a forum selection provision in a company's articles of incorporation or bylaws. Such a provision would require any shareholder litigation regarding the company's internal affairs—which would include most merger-related shareholder claims—to be brought in the company's state of incorporation. While a forum selection provision would not eliminate the problem of frivolous merger lawsuits, it would at least reduce the associated expenses by consolidating all such lawsuits in a single forum.

The idea of a forum selection provision was suggested in dicta by Vice Chancellor Laster of the Delaware Court of Chancery in 2010, *see* **In re Revlon, Inc. Shareholders Litig.**, 990 A.2d 940, 960 n.8 (Del. Ch. 2010), and endorsed by commentators such as Professor Joe Grundfest at Stanford Law School. *See* Joseph A. Grundfest and Kristen A. Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 Bus. Law. 325 (Feb. 2013). But the only court squarely to address the issue, a federal district court in California, held that a forum selection bylaw was not a proper exercise of the board's authority and rejected a motion to dismiss based on such a bylaw. *See* **Galaviz v. Berg,** 763 F. Supp. 2d 1170 (N.D. Cal. 2011). Accordingly, adoption of such provisions was not initially widespread.

***Chevron*: Court of Chancery Upholds Delaware-Only Forum Selection Bylaws**

Then, in June 2013, the Delaware Court of Chancery confronted the issue directly, in the case of **Boilermakers Local 154 Retirement Fund v. Chevron Corp.**, 73 A.3d 934 (Del. Ch. 2013). In that case, both Chevron and Federal Express had added forum selection clauses to their bylaws. The two companies' bylaws were largely identical; the Chevron bylaw read as follows:

> 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].

Chevron, 73 A.3d at 942 (emphasis omitted). The plaintiffs, shareholders in the companies, brought suit seeking a declaratory judgment that this bylaw was invalid and unenforceable.

The Court of Chancery granted the defendants' motion for judgment on the pleadings, and in so doing vigorously affirmed the right of Delaware corporations to adopt forum selection bylaws or charter provisions. The court explained that the Delaware

General Corporate Law gives a corporation the right, in its certificate of incorporation, to confer upon the board of directors the ability to adopt or amend bylaws. Del. Code Ann. tit. 8, § 109(a) (West 2010). Chevron and FedEx had done so in their certificates of incorporation. Delaware law provides that a company's 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." *Id.* § 109(b). The court held that a provision specifying the forum for intra-corporate disputes fits squarely within this description of the appropriate subjects for corporate bylaws.

The Court of Chancery went on to explain that the bylaws of a Delaware corporation are a contract among the directors, officers, and shareholders. Accordingly, forum selection provisions in corporate bylaws are valid and enforceable to the same extent as forum selection provisions in other contracts. Under Delaware (and federal) law, such provisions are enforceable as long as (i) the provision was not affected by fraud or undue influence, (ii) trial in the specified forum would not be so inconvenient that the plaintiff, for practical purposes, would be deprived of his day in court, and (iii) enforcement of the clause would not be contrary to a "strong public policy" of the forum in which the suit is brought.

The court further held that the bylaws "contract" is designed to be flexible and subject to change by the board of directors, and shareholders know and assent to this flexibility when they purchase stock in the company. It is therefore irrelevant whether an investor purchased stock before or after a forum selection provision is added to the bylaws. The court specifically rejected the "vested rights" theory, which is the idea that a board of directors cannot unilaterally modify corporate bylaws in a manner that diminishes pre-existing shareholder rights.

The plaintiffs in the **Chevron** case asserted, in the alternative, that even if a forum selection bylaw could theoretically be valid, in this case the adoption of the forum selection bylaw was a breach of the directors' fiduciary duties. The Court of Chancery did not resolve this claim in its decision, because it was not included in the defendants' motion for judgment on the pleadings. The court's opinion, however, strongly suggested that adoption of such a provision is likely not a breach of fiduciary duty because (i) the provision is a reasonable response to the threat of multi-forum litigation, and (ii) the provision does not have any effect by itself but rather is made effective only if invoked by motion in a given case, and the company must decide in any particular case whether to invoke the provision.

The court indicated, however, that even if *adoption* of a forum selection bylaw is not a breach of fiduciary duty, it theoretically could be a breach to *enforce* the bylaw in a given case. The court compared such a provision to a shareholder rights plan, which a company generally has the right to adopt but the use of which in response to a given takeover threat must be evaluated on a case-by-case basis. The court held that even though there may be situations in which it would be improper to enforce the forum selection bylaw—either under the general principles regarding forum selection clauses outlined above or based on a fiduciary duty analysis—that theoretical possibility does not make such a bylaw invalid on its face. Under Delaware law, bylaws are presumed to be valid. If enforcement of a bylaw would be improper in a given case, an affected shareholder would be free to challenge it in the context of that particular case.

The General Assembly Affirms Forum Selection Bylaws for North Carolina Corporations

The Court of Chancery's opinion in the **Chevron** case applied only to Delaware corporations, leaving open the question whether a North Carolina corporation could adopt a similar provision requiring intra-corporate disputes to be litigated exclusively in North Carolina. North Carolina law closely parallels Delaware law both as to the board's authority to adopt bylaws and as to the contractual nature of such bylaws, and therefore it seemed likely that a North Carolina corporation could permissibly adopt a forum selection bylaw. But in the absence of any authoritative ruling on the issue, there remained some risk to North Carolina companies in adopting such bylaws.

In August 2014, the General Assembly removed any doubt as to the ability of a North Carolina corporation to include a forum selection provision in its bylaws or articles of incorporation. The North Carolina Commerce Protection Act of 2014 amended the Business Corporation Act to add the following provision:

> **§ 55-7-50. Exclusive forum or venue provisions valid.**
> A provision in the articles of incorporation or bylaws of a corporation that specifies a forum or venue in North Carolina as the exclusive forum or venue for litigation relating to the internal affairs of the corporation shall be valid and enforceable.

2014 N.C. Sess. Laws. 110. This legislation, which is believed to be the first of its kind in the country, confirms the right of North Carolina corporations to adopt forum selection bylaws similar to the kind approved in **Chevron** for Delaware corporations.

***First Citizens*: Court of Chancery Upholds Forum Selection Bylaws Specifying a State Other Than Delaware**

Most companies based in North Carolina are incorporated in either Delaware or North Carolina. Between the **Chevron** decision and the new N.C.G.S. section 55-7-50, it was clear that the companies incorporated in Delaware could designate Delaware courts as the exclusive forum for intra-corporate disputes, and that companies incorporated in North Carolina could designate North Carolina courts. But what if a company incorporated in Delaware wanted to designate North Carolina courts as its exclusive forum? That was the issue addressed by the Delaware Court of Chancery in September 2014, in the case of **City of Providence v. First Citizens BancShares, Inc.**, 99 A.3d 229 (Del. Ch. 2014).

First Citizens Bank is a Delaware corporation with its headquarters in Raleigh. The bank announced in June 2014 that it had amended its bylaws to include a forum selection clause requiring intra-corporate disputes to be brought, to the fullest extent permitted by law, in the federal district court for the Eastern District of North Carolina or, if the federal court lacks jurisdiction, in the state courts of North Carolina. At the same time, it announced that it had entered into an agreement to acquire First Citizens Bancorporation, Inc. (FC South), a South Carolina holding corporation with overlapping controlling shareholders with First Citizens Bank. The shareholder plaintiff challenged both the forum selec-

tion bylaw and the fairness of the proposed merger with FC South, arguing that the bylaw was invalid on its face and "as applied" to plaintiff's merger-related claims.

The Court of Chancery, in a case of first impression, rejected both of plaintiff's arguments. As to the plaintiff's facial challenge to the bylaw, the Court of Chancery confirmed that the logic and reasoning of **Chevron** applies equally to the validity of bylaws that specify non-Delaware forums. With respect to the "as applied" challenges, the Court of Chancery found that the bylaw was not unreasonable merely because it had been enacted in connection with the proposed acquisition of FC South: "That the Board adopted it on an allegedly 'cloudy' day when it entered into the merger agreement with FC South rather than on a 'clear' day is immaterial given the lack of any well-pled allegations . . . demonstrating any impropriety in timing."

The Court of Chancery also rejected the plaintiff's "as applied" challenge based on the existence of a controlling stockholder, which, as a practical matter, prevented the minority shareholders from repealing the forum selection bylaw. The **First Citizens** ***opinion*** flatly states that the fact that a controlling shareholder may favor a forum selection bylaw "does not make it *per se* unreasonable to enforce the bylaw," and that to conclude otherwise would "be tantamount to rendering questionable all board adopted bylaws of controlled corporations."

The Court of Chancery's opinion in **First Citizens** should reassure Delaware corporations of their ability to choose forums other than Delaware for the litigation of intra-corporate disputes, as long as there is a logical connection to that other forum. Controlled corporations have the same rights in this regard as non-controlled corporations. Further, absent well-pleaded facts demonstrating some impropriety by the corporation's board of directors, the fact that a bylaw is enacted in connection with a proposed transaction that may result in shareholder litigation is irrelevant.

Conclusion

As a result of **Chevron**, N.C.G.S. section 55-7-50, and **First Citizens**, North Carolina companies have a well-established right to adopt a forum selection provision, and flexibility regarding whether to designate Delaware (if incorporated there) courts or North Carolina courts as their designated forum for intra-corporate litigation. Companies adopting such a provision need to think carefully about not only the state selected, but also the designated court(s) within the selected state (e.g., whether to include federal courts, whether to designate a particular county or district), keeping in mind that intra-corporate disputes in North Carolina state courts are automatically removable to the North Carolina Business Court. Care also needs to be given to the exact wording of the provision, which involves strategic decisions that must be made on individualized basis. But done properly, a forum selection provision can be a powerful corporate risk management tool.

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