



Designating Delaware as the Exclusive Jurisdiction for Intra-Corporate Disputes

Posted by Charles M. Nathan, Latham & Watkins LLP, on Tuesday May 11, 2010

Editor's Note: [Charles Nathan](#) is Of Counsel at Latham & Watkins LLP and is co-chair of the firm's Corporate Governance Task Force. This post is based on a Latham & Watkins Corporate Governance Commentary by Mr. Nathan, [Laurie Smilan](#), [Michele Kyrouz](#), [Timothy FitzSimons](#) and [Derrick Farrell](#), and relates in part to the recent decision in *In re Revlon, Inc. Shareholders Litig.*, which is available [here](#).

As with real estate acquisitions, where intra-corporate disputes are concerned, the key to optimal results is "location, location and location."¹ The Delaware Chancery Court is widely regarded as the country's preeminent business court, with experienced jurists who have deep understanding of Delaware corporate law and long standing precedent regarding corporations' governance. Indeed, the enabling, practical approach of Delaware law, the extensive body of judicial precedent and the expertise and business savvy of the Delaware Court of Chancery are the reasons that most companies choose to incorporate in Delaware in the first place.

Unfortunately, plaintiffs' lawyers often file cases against Delaware companies under Delaware law in jurisdictions other than Delaware. Often, this is because plaintiffs' lawyers, particularly those with weak cases, hope that other, less experienced judges will misapply Delaware law, that the greater uncertainty of the outcome will increase the settlement value of the litigation² or that courts outside of Delaware are less likely to limit or reduce plaintiffs' attorneys' fee awards.³

In a recent decision, *In re Revlon, Inc. Shareholders Litig.*, newly-appointed Vice Chancellor Laster suggested a solution. In dicta, he endorsed a Delaware entity's right to mandate in its governance documents a chosen forum for the resolution of state law-based shareholder class actions, derivative suits and other intra-corporate disputes. Vice Chancellor Laster stated that "if boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter

¹ John Armour, Bernard Black & Brian Cheffins, *Is Delaware Losing Its Cases?* (European Corporate Governance Inst., Law Working Paper No. 151/2010, 2010); "Anywhere But Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions," *M&A Journal* (May 2007) (hereinafter cited as "Mirvis").

² Mirvis, *supra* note 1.

³ Armour, Black & Cheffins, *supra* note 1, at 28-30.

provisions selecting an exclusive forum for intra-entity disputes.”⁴ Presumably, the Vice Chancellor had Delaware in mind.⁵

The mandatory resolution of intra-corporate suits in the Delaware Court of Chancery offers numerous benefits to public companies and their shareholders, including:

- Defendant corporations and shareholders obtain the benefit of having disputes resolved by the nation’s preeminent forum (in terms of precedent, experience, focus and, many would say, quality) for the determination of disputes involving a company’s internal affairs.
- Delaware courts provide shareholders more certainty with respect to the outcome of intra-corporate disputes because of the well-developed body of case law and the unfortunate reality that other forums occasionally misapply Delaware law.⁶
- A forum selection charter or bylaw provision effectively precludes costly and duplicative litigation, as well as the risk of inconsistent outcomes, when two virtually identical cases proceed in both Delaware and another forum. Absent a forum selection provision, non-Delaware courts often decline to defer to a Chancery Court action, even where Delaware law applies.
- The Delaware Court of Chancery is typically able to resolve corporate disputes on an accelerated schedule relative to other forums, limiting the time, cost and uncertainty of protracted litigation.

Is a Provision for Exclusive Jurisdiction in Delaware Enforceable?

Delaware law is generally enabling, rather than prescriptive, regarding the management of the business and conduct of the corporation’s affairs.⁷ Delaware law also is deferential to corporate judgment⁸ and presumes that corporate bylaw and charter provisions, such as those relating to

⁴ *In re Revlon, Inc. S’holders Litig.*, 2010 WL 935626, at *19 n.8 (Del. Ch. Mar. 16, 2010); see also Armour, Black & Cheffins, *supra* note 1, at 32 – 33; Sara Lewis, *Note: Transforming the “Anywhere but Chancery” Problem into the “Nowhere but Chancery” Solution*, 14 Stanford J. L. Bus. & Fin. 199 (2008).

⁵ There are literally only a handful of public companies incorporated in Delaware whose charter or bylaws contain Delaware Court of Chancery forum selection provisions.

⁶ See, e.g., *IT Litig. Trust v. Daniello slip op*, p. 19, n. 10 (D. Del. 2005) (Jordan, J.) disagreeing with the Third Circuit’s application of the business judgment rule and noting that the result in a case should not rest on whether a federal or state court decides an issue of Delaware law); *Conrad v. Blank*, 940 A.2d 28, 38 n.22 (refusing to follow Northern District of California’s decisions in similar stock options cases, finding that Delaware law had been misapplied.).

⁷ See 8 Del. C. § 102(b)(1) and 8 Del. C. § 109(b), each of which provides a corporation broad discretion within the bounds of Delaware law.

⁸ In an arguably analogous context, in 1990 the SEC refused to grant acceleration to a Pennsylvania corporation’s registration statement in connection with its initial public offering, citing the mandatory arbitration provisions in its governing documents. The staff was concerned, among other things, about the implied waiver of a shareholder’s right to litigate claims related to the purchase or sale of the company’s securities in a judicial forum, which the staff found inconsistent with anti-waiver provisions under federal securities laws. Carl W. Schneider, *Arbitration in Corporate Governance Documents: An Idea the SEC Refused To Accelerate*, Insights, May 1990, at 24. A notable difference between the mandatory arbitration provision in question in the 1990 episode and our proposed exclusive forum selection provision is that the latter by its terms covers only state law actions and not federal law actions, making the anti-waiver

forum selection, are valid and should be specifically enforced. A party seeking to resist such a provision can do so only if it can “clearly show that enforcement would be unreasonable and unjust, or that the provision was invalid for such reasons as fraud and overreaching.”⁹

In addition to Vice Chancellor Laster’s dicta in the recent *Revlon* case, Delaware courts have twice approved a forum selection provision in the related context of an LLC’s operating agreement.¹⁰ In each of *Elf Atochem* and *Douzinias* the court dismissed derivative suits on the basis of an arbitration provision in the LLC’s operating agreement. Moreover, in *Douzinias*, the court distinguished a case in which the Supreme Court had declined to enforce an arbitration clause contained in an underwriting agreement where the plaintiff’s breach of fiduciary duty claims were based on identical conduct to their breach of contract claims. The court noted that the fact that the “arbitration agreement was not contained in the basic contract of the entity — the corporation’s charter — clearly influenced the Supreme Court’s decision.” This statement supports the likelihood that Delaware courts will apply the line of cases upholding forum selection provisions in company charters outside the LLC context.

A potential argument against the validity of an exclusive forum selection provision might be that in order to be enforceable against shareholders, the shareholders must be deemed to have consented to the provision. However, case law firmly establishes that a company’s charter and bylaws are binding on all shareholders, whether the shareholders actually voted on the provisions or not.¹¹ Moreover, an argument that a forum selection provision requires affirmative consent of shareholders would improperly limit the broad grant of authority the Delaware General Corporation Law (DGCL) conveys on Delaware companies to enact charter and bylaw amendments.¹²

provisions in the federal securities law inapposite. Moreover, the recent initial public offering of Primerica, Inc. (whose Registration Statement became effective on March 31, 2010) was not denied acceleration by the SEC, although Primerica’s charter includes an exclusive forum provision quite similar to the model provision proposed in this article. This anecdotal event does not make clear whether the SEC has changed its view of exclusive forum selection provisions, or whether the more narrowly focused state law exclusive forum provision found in Primerica’s charter was viewed by the staff as being different in kind from the all encompassing mandatory arbitration provision in the 1990 situation.

⁹ *Capital Group Companies, Inc. v. Armour*, 2004 WL 2521295, at *3 (Del. Ch. Oct. 29, 2004).

¹⁰ *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286 (Del. 1999); *Douzinias v. Am. Bureau of Shipping, Inc.*, 888 A.2d 1146, 1149 (Del. Ch. 2006).

¹¹ *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 234 (Del. 2008) (“Bylaws, by their nature, set down rules and procedures that bind a corporation’s board and its shareholders.”); *Centaur Partners, IV v. National Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) (“Corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply.”); *Jackson Walker LLP v. Spira Footware, Inc.*, 2008 WL 2487256, at *4 (Del. Ch. Jun. 23, 2008) (“A company’s bylaws are contractual in nature.”); *Blue Chip Capital Fund II Ltd. Partnership v. Tubergen*, 906 A.2d 827, 834 (Del. Ch. 2006) (“Blue Chip’s claimed right as a preferred stockholder to a larger distribution of the proceeds arises from contractual rights and obligations under the certificate of incorporation – a binding contract between the company and its preferred stockholders.”). See also *Coffee* 53 Brooklyn L. Rev. 919 (1988) (“[C]orporate law clearly considers the corporate charter to be a contract[.]”), and 18 C.J.S. *Corporations* § 165 (“By-laws ordinarily are binding on the stockholders or members whether they expressly consent to them or not.”).

¹² *Stroud v. Grace*, 606 A.2d 75, 93-94 (Del. 1992) (“Delaware corporations have broad authority to adopt charter provisions.”); *Jones Apparel Group, Inc. v. Maxwell Shoe Co., Inc.*, 883 A.2d 837, 845 (Del. Ch. 2004) (“[T]he Delaware corporation enjoys the broadest grant of power in the English-speaking world to establish the most appropriate internal organization and structure for the enterprise. Sections 102(b)(1) and 141(a) are therefore logically read as

A related, but even less persuasive, argument against the validity of a charter or bylaw provision establishing exclusive jurisdiction in the Delaware Court of Chancery could be based on a claim that holders who purchased shares prior to the amendment had a “vested” interest in their pre-existing right to sue outside of Delaware. However, the Delaware Court of Chancery has rejected this argument on the basis that where a company’s bylaws and charter provide that they are subject to change, reliance on a bylaw or charter provision that is subsequently amended is unreasonable.¹³

A final possible argument against enforcement of an exclusive Delaware Chancery forum selection provision might be that it imposes unfair *forum non conveniens*-type burdens on small shareholders distant from Delaware. However, even in the absence of an exclusive forum selection provision, plaintiffs typically can only establish personal jurisdiction in the state where the company is a citizen, namely: (i) its state of incorporation or (ii) its principal place of business.¹⁴ This accepted limitation on forum selection has done little to limit shareholder lawsuits. Moreover, forum non-conveniens motions seeking to transfer cases to Delaware or to stay actions in favor of parallel actions filed in Delaware are already possible, although the outcomes are not predictable.¹⁵ Finally, as those involved in these types of cases can attest, the actual plaintiff has little practical involvement in the suit, and therefore would not actually be burdened by a mandatory Delaware Chancery forum provision.

Placement of Forum Selection Provisions — Charter or Bylaws?

While it seems clear that a Delaware Chancery forum selection provision will be enforced if it appears in a company’s charter, there are no clear judicial pronouncements regarding whether a forum selection provision will be enforceable if contained in board (or shareholder) adopted bylaws. The DGCL contains an explicit provision that a company’s bylaws may contain any provision “relating to the business of the corporation, the conduct of its affairs, [or] its rights or power or the rights or powers of its stockholders,”¹⁶ so long as it is not inconsistent with law or the company’s charter. This provision mirrors an equally broad grant of authority with respect to a company’s charter.¹⁷ If the statutory enabling provision for charters is a sufficient foundation for

important provisions that embody Delaware’s commitment to private ordering in the charter. By their plain terms, they are sections of broad effect, which apply to a myriad of issues involving the exercise of corporate power.”).

¹³ *Kidsco Inc. v. Dinsmore*, 674 A.2d 483 (Del. Ch. 1995) (“Where a corporation’s by-laws put all on notice that the by-laws may be amended at any time, no vested rights can arise that would contractually prohibit an amendment,” because in such a case, reliance on the previous bylaws is not justified.).

¹⁴ See, e.g., *Rabkin v. Philip A. Hunt Chem. Corp.*, 547 A.2d 963, 965 (Del. Ch. 1986) (Delaware lacked jurisdiction over Virginia corporation with principal place of business in Connecticut).

¹⁵ *Armour, Black & Cheffins*, *supra* note 1, at 32 (noting intra-corporate disputes filed outside of Delaware court be transferred to Delaware through a *forum non conveniens* motion).

¹⁶ 8 Del. C. § 109(b).

¹⁷ 8 Del. C. § 102(b)(1) (permitting charters to include: “Any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders...if such provisions are not contrary to the laws of [Delaware]”).

the validity of an exclusive Delaware forum selection charter provision, the parallel statutory enabling provision for bylaws should likewise be a sufficient foundation for the validity of an exclusive forum selection provision in a company's bylaw.

Moreover, the two Delaware cases squarely upholding forum selection provisions involved LLC agreements, which while sharing elements of both corporate charters and corporate bylaws, like bylaws and unlike charters do not have to be filed with the Secretary of State.¹⁸ Likewise, there is nothing in the case law to suggest that a bylaw provision mandating Delaware Chancery as the exclusive forum for resolution of intra-corporate disputes would not be enforced or that including such a provision in a company's bylaws as opposed to its charter would be ineffective.¹⁹ While the DGCL explicitly requires that any provision that limits directors' broad statutory power must be contained in its charter as opposed to its bylaws,²⁰ directors' fundamental powers are not affected by a forum selection clause. Finally, there is no apparent public policy reason to find a charter provision enforceable and a board-adopted bylaw provision not, other than the absence of a shareholder vote for the latter. But this absence of a shareholder vote is equally true of every other board-adopted bylaw provision none of which are subject to challenge on that ground.²¹

Additional Considerations

Other issues that may arise in connection with adoption of an exclusive Delaware Court of Chancery forum selection provision include:

- *Risk of inconsistent results.* Because a forum selection provision will require enforcement in forums outside of Delaware, there is a risk that courts will not consistently enforce it. However, the consequences of misapplying Delaware law by declining to enforce a forum selection clause is no worse than having a court misapply Delaware substantive law. Moreover, the likelihood of resolution before the Delaware Court of Chancery is far

¹⁸ See, e.g., 18 Del. C. § 101(7) defining "limited liability company agreement." See also 8 Del. C. § 102 and 8 Del. C. § 109 regarding the provisions of a corporation's charter and bylaws. While an LLC agreement (like a corporate charter) typically sets forth the ownership and rights of the company's equity securities (as opposed to an LLC's certificate of formation), the LLC agreement also typically addresses many of the mechanical functions related to the operation of the company (e.g. mechanics of equity holder meetings). The dual role played by an LLC agreement complicates attempts to analogize an LLC agreement to a charter or bylaws alone.

¹⁹ Indeed, Vice Chancellor Laster's decision in *Revlon* suggests by negative implication forum selection provisions in bylaws would be proper in that he notes that at least one public company has a forum selection provision in their bylaws and expresses no reservations on that score. *In re Revlon, Inc. S'holders Litig.*, 2010 WL 935626, at *19 n.8 (Del. Ch. Mar. 16, 2010); see also Mirvis, *supra* note 2 (noting that a forum selection clause in a company's bylaws appears to be permissible); 8 Del. C. § 109(b).

²⁰ *AFSCME Employees Pension Plan*, 953 A.2d at 233-34 (invalidating bylaw amendment, but noting it could be included in the certificate of incorporation).

²¹ We obviously exclude from this observation provisions that by statute must be contained in the charter, as well as provisions in derogation of the charter. Another version of a potential public policy argument would focus of the "unfairness" of binding shareholders by an exclusive forum provision adopted without a shareholder vote. However, unless there were some qualitative difference in an exclusive forum selection provision that distinguished it in kind from all other valid board adopted bylaw provisions — and we can think of none — this argument would have to rest on a notion that existing shareholders cannot be bound by a board adopted bylaw. The latter, as noted above, is simply not the law.

greater if a clear forum selection provision stipulates that the Chancery Court will resolve all intra-company disputes. Such a provision provides a company with substantially greater certainty that intra-corporate claims arising under Delaware law will be heard by the Chancery Court, rather than being filed in and entertained by jurisdictions other than Delaware.

- *Reaction of corporate governance community.* An amendment to a company's charter will bring direct and focused attention on the proposed exclusive forum provision in the context of the required shareholder vote. This novel provision apparently has been adopted by only a handful of public Delaware companies, and we are not aware of any voting policies of institutional investors or proxy advisory firms, such as RiskMetrics Group, with respect to adoption of an exclusive Delaware Court of Chancery forum selection provision. It is possible that some members of the corporate governance community might voice concern about perceived governance implications of an exclusive Delaware Court of Chancery forum, presumably based on a *forum non conveniens*-type argument, focusing on assumed hardship for individual plaintiffs having to bring suit in Delaware. As noted earlier, we believe this argument is weak on its own terms. More important from a governance point of view, it ignores the numerous positive benefits to the company and its shareholders generally of requiring all intra-company disputes to be litigated in what is virtually universally viewed as the pre-eminent jurisdiction for this type of litigation.
- *Choosing between a charter and bylaw exclusive forum selection provision.*
 - One practical difference between a charter amendment and a bylaw amendment, of course, relates to the process for adoption. A charter provision requires a shareholder vote in addition to a board vote, whereas for most Delaware companies, a bylaw can be implemented by board action alone. Similarly, amendment or repeal of a charter provision requires board action followed by a shareholder vote, whereas a board-adopted bylaw can always be amended or repealed by board action. The relative procedural simplicity of using a board-adopted bylaw to implement forum exclusivity in Delaware Chancery, as well as the flexibility to amend the provision if circumstances change in the future, argue for choosing the board-adopted bylaw route.
 - On the other hand, while a board-adopted bylaw does not entail the complications of a mandatory shareholder vote, a bylaw amendment would be subject to future amendment or repeal by a shareholder vote triggered either

under an advance notice bylaw or by a shareholder proposal under SEC Rule 14a-8.²²

- At this juncture, we do not foresee a strong shareholder reaction against a Delaware Chancery exclusive forum provision, nor do we believe that institutional shareholders would vote with “retail” or other shareholders who might seek an unlimited right to forum selection.²³
 - Accordingly, we think the choice of using a bylaw or charter amendment should focus on timing of implementation, the arguably stronger case for validity of a charter amendment based on existing precedent, the relative ease of shareholder amendment or repeal of a bylaw provision and the company’s perception regarding whether activist shareholders or corporate governance activists might try to seize on the exclusive forum provision as a possible point of leverage in an unrelated controversy with the company.
- *Drafting Considerations.* We recommend companies adopt the following draft forum selection provision.²⁴

“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 or officer of the Corporation to the Corporation or the Corporation’s stockholders, (iii) any action asserting a claim against the Corporation arising pursuant to any provision of the DGCL or the Corporation’s

²² A related consideration is that if shareholders were to amend or repeal a board-adopted bylaw, the board would have the authority to reverse the shareholder action by a subsequent bylaw amendment. However, having the authority and using it to countermand a shareholder vote are very different, particularly in today’s world of corporate governance insistence on boards being accountable to shareholders.

²³ We recognize that plaintiffs’ lawyers outside of Delaware might feel threatened by an exclusive Delaware forum selection provision and might try to rally opposition among the corporate governance community. By the same token, however, Delaware-based plaintiffs’ lawyers views might be expected to cancel out the views of their out-of-state colleagues.

²⁴ The suggested provision is similar to varying degrees to those appearing in the charters of the public companies that have adopted Delaware Chancery Court forum selection provisions. The most notable exception is that we do not recommend including a clause concerning deemed notice or consent, such as “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 Article X, Section Y.” First, as we noted above, Delaware law is abundantly clear that a charter or bylaw provision is binding on shareholders, whether they acquired their shares before or after adoption of the provision. Moreover, the deemed notice and consent language implies that the forum selection provision may not be binding on shareholders who purchased their shares prior to the amendment, which is plainly contrary to the purpose and desired effect of the forum selection provision. Finally, including this sentence only with respect to one particular bylaw or charter amendment, unnecessarily distinguishes this provision from all other charter and bylaw amendments that do not contain such a “deemed” consent provision.

Certificate of Incorporation or Bylaws,²⁵ or (iv) any action asserting a claim against the Corporation governed by the internal affairs doctrine.²⁶

Conclusion

Adoption of a charter or bylaw provision selecting the Delaware Court of Chancery as the exclusive forum for the resolution of all intra-corporate disputes appears to be valid under the law. While it is not certain that courts outside of Delaware would uniformly enforce such a provision and while the Delaware precedent supporting such provisions is limited, we believe the vast benefits a forum selection provision would offer to publicly traded companies outweigh any risks. Accordingly, we recommend that Delaware companies consider adopting mandatory Delaware Chancery forum selection provisions in their charter or bylaws in connection with their regular review of governance practices.

²⁵ Though not as broad as we propose, certain Delaware companies have specified the Delaware Court of Chancery as the exclusive forum for litigation between the Company and its indemnitees regarding the indemnitee's right to indemnification or advancement of expenses. Consistent with our recommendations, we believe Chancery to be the appropriate forum for the resolution of such disputes and recommend the specific reference to a company's Charter and Bylaws to ensure the proper forum for the resolution of such disputes.

²⁶ The sample provision does not deal with lawsuits that raise legal issues not covered by clauses (i) through (iv). An obvious example would be federal law disclosure claims under the Securities and Exchange Act which are subject to the exclusive jurisdiction of the federal courts. Moreover, there may be issues about the ability of the company to avoid federal diversity jurisdiction even with respect to state law claims, especially in a situation where there is only "deemed" consent as to the forum selection provision. Forum selection provisions in contracts have been upheld as a valid waiver of the right to remove due to diversity. See e.g., *Four River Exploration, LLC v. Bird Resources, Inc.*, 2010 WL 216369 (D.N.J. Jan. 15, 2010) (remanding case to state court based on forum selection clause); *Weener Plastics, Inc. v. HNH Packaging, LLC*, 2009 WL 2591291 (E.D.N.C. Aug. 19, 2009) ("A defendant may waive the right to remove, and thereby be precluded from itself removing or consenting to removal by another defendant, through entry into a valid and enforceable forum selection clause that mandates a state court as the forum for a case.") (collecting cases); *Guenther v. Crosscheck Inc.*, 2009 WL 1248107 (N.D. Cal. Apr. 30, 2009) ("Where such a clause selects state court as the appropriate forum and is mandatory rather than permissive, remand is required in order to enforce the clause."); *Fleming & Hall, Ltd. v. Cope*, 30 F. Supp.2d 459 (D. Del. 1998) (remanding case based on Delaware Court of Chancery forum selection clause). Of course, it remains to be seen whether federal courts will treat a charter or bylaw provision as having the same effect as a traditional contractual forum selection provision where the only possible basis for federal jurisdiction is diversity of the parties. Plaintiffs asserting securities law claims under the Exchange Act, must file those claims in federal court. However, there is no reason not to try to seek the benefits of an exclusive Delaware Chancery forum selection provision.