

# COMBATTING MULTIFORUM SHAREHOLDER LITIGATION: A FEDERAL ACCEPTANCE OF FORUM SELECTION BYLAWS

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## INTRODUCTION

The leading phenomenon in modern corporate takeovers is the escalation of multiforum shareholder litigation.<sup>1</sup> Delaware corporations are predisposed to multiforum litigation because a virtual majority of them qualify as out-of-state incorporators with headquarters in another state.<sup>2</sup> A study of 195 forum selection provisions exclusive to Delaware that were adopted or proposed through the end of December 2011 found that less than one percent of Delaware corporations had their principal places of business in the state of Delaware.<sup>3</sup> Consequently, Delaware corporations face exceptional circumstances because in most cases their shareholders can effortlessly obtain jurisdiction in at least three fora: the incorporation state courts, the headquarters state courts and federal courts.<sup>4</sup> In what this comment will verify, forum selection clauses are patently the best way to combat this phenomenon.<sup>5</sup>

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1. Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2013*, at 3 (Jan. 9, 2014), available at <http://ssrn.com/abstract=2377001>; see also Peter B. Ladig, *Multi-Jurisdictional Litigation a Rich Vein of Issues for Chancery Court*, DELAWARE BUSINESS COURT INSIDER (Apr. 20, 2011), available at <http://www.morrisjames.com/newsroom-articles-77.html>.

2. See Claudia H. Allen, *Study of Delaware Forum Selection in Charters and Bylaws*, at 3, 17 (Jan. 25, 2012), available at <http://www.ngelaw.com/files/Uploads/Images/StudyofDelawareForum012512.pdf>.

3. *Id.* at 3, 17.

4. Minor Myers, *Fixing Multi-Forum Shareholder Litigation*, BROOKLYN LAW SCHOOL LEGAL STUDIES RESEARCH PAPERS ACCEPTED PAPER SERIES, at 483 (Jun. 2013), available at <http://ssrn.com/abstract=2285485>.

5. For clarification, “forum selection” and “exclusive forum” are used interchangeably throughout this comment.



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efficiency with which they resolve complex business disputes, judicial expertise and the well-developed body of state corporate law.<sup>57</sup>







The plaintiffs based their claims on two arguments. First, the bylaws were statutorily invalid because they are beyond the board's authority under the Delaware General Corporation Law.<sup>85</sup> Second, the bylaws were contractually invalid and therefore cannot be enforced like other contractual forum selection clauses<sup>86</sup> under the test adopted by the Supreme Court in *The Bremen v. Zapata Offshore, Co.*<sup>87</sup> The Delaware Chancery Court held at the end of the day that the challenged bylaws are both statutorily and contractually valid and therefore enforceable.<sup>88</sup>

First, the bylaws at issue were held statutorily valid under D.G.C.L. § 109(b).<sup>89</sup> The court had to determine whether the adoption of forum selection bylaws was beyond the board's authority in the sense that they do not address a proper subject matter, i.e., if "[t]he 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."<sup>90</sup> Simply stated, the proper inquiry is whether the bylaws are invalid because they do not relate to the business of the corporations, the conduct of their affairs, or the rights of the stockholders.<sup>91</sup>

address the “rights” of the stockholders because they regulate where stockholders can exercise their right to bring certain internal affairs claims against the corporation and its directors and officers.<sup>94</sup>

The court also said the forum selection bylaws “plainly relate to the conduct of the corporation by channeling internal affairs cases into the

boards.<sup>101</sup> Hence, when shareholders similarly situated to those in *Boilermakers* who have authorized a board of directors to unilaterally adopt bylaws, it follows that the bylaws are not contractually invalid simply because the board-adopted bylaw lacks the contemporaneous assent of the shareholders.<sup>102</sup>

The court also rightfully rejected plaintiffs' "parade of horrors" challenge to the bylaws saying they are facially invalid by conjuring up hypothetical as-applied challenges in which a literal application of the bylaws might be unreasonable.<sup>103</sup> Forum selection bylaws, as explained by the unbroken history of other forum selection clauses, are not facially invalid because they might operate in a problematic way in some future situation, but are presumed valid until real-world concerns arise in real-world disputes that would trigger a *Bremen* analysis.<sup>104</sup> After the chancery court decided *Boilermakers*, plaintiffs timely appealed to the Delaware Supreme Court and later withdrew the appeal on October 15, 2013 fearing that a likely affirmation from a higher level court would make it much more difficult to succeed on an "as applied" challenge to the enforcement of a forum selection bylaw.<sup>105</sup>

#### IV. PROPOSED ACCEPTANCE OF BOILERMAKERS IN FEDERAL COURTS

To this day, no federal court has held a unilaterally adopted forum selection bylaw to be valid.<sup>106</sup> Given that such provisions are relatively new, the importance of this cannot be understated as future battles between plaintiff shareholders and corporations are likely to take place in courts outside Delaware.<sup>107</sup> Even though shareholders do not give explicit approval, federal courts need to accept the validity and presumptive enforceability of forum selection bylaws because it is in the best interests of shareholders, corporate officers, directors, the corporations themselves and courts alike. The reasons for federal acceptance of unilaterally adopted forum selection bylaws are three-fold: they are contractually valid, valid on the condition that the choice of law is correct and valid as a matter of public policy.

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101. *Id.* at 955-56.

102. *Id.* at 956.

103. *Id.* at 958.

104. *Id.* at 963.

105. Allen, *supra* note 11, at 2.

106. *See id.* at 5-6.

107. *Id.* at 5.

A. *The Contractual Perspective*

From a contract perspective, forum selection bylaws are undeniably

*constructive* knowledge but no express knowledge. A principal will be bound by his agent's actions when he has implied actual authority, or even apparent authority. When bylaws operate as contracts between shareholders and corporations, it follows logically that express assent to a bylaw is not required for a shareholder to be bound by one.<sup>115</sup>

In addition, *Galaviz* should not be followed because the court also relied on the fact that the forum selection bylaw was adopted after the majority of the alleged wrongdoing occurred.<sup>116</sup> This concern surprisingly did not prompt the court to engage in a *Bremen*





for alleged violations of the False Claims Act; a federal statute that allows a private individual with knowledge of fraud committed on the United States government to sue on behalf of the government to recover civil penalties and triple damages.<sup>128</sup>

Although the inclusion of federal claims in *Galaviz* seemingly was proper, this illustrates how a plaintiff's attorney filing in federal court can partially insulate himself from dismissal by adding a federal cause of action.<sup>129</sup> A federal court will be conceivably reluctant to dismiss litigation under any discretionary doctrine when no other court will have jurisdiction over some of the claims.<sup>130</sup> Federal securities law, for example, has broadened over time to take in more and more of corporate internal affairs, so that much behavior is covered by the two overlapping systems (federal and state incorporation law), and participants may be able to pursue one action over another for strategic reasons.<sup>131</sup> Ordinarily, federal law should not be applied to determine the validity of forum selection bylaws similar to those at issue in *Galaviz* and *Boilermakers* because the bylaws do not limit any federal shareholder right, but only channel internal affairs cases governed by Delaware law to the Delaware Court of Chancery.<sup>132</sup>

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from their shareholders.<sup>153</sup>



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threat to Delaware's ability to determine its own corporate law.<sup>185</sup> Without these bylaws, the result is an increased likelihood that certain cases will present opportunities to develop new precedents that will be missed by Delaware courts, thus compromising Delaware's responsiveness to new events.<sup>186</sup> An inexperienced court also might be more likely to approve too large a fee award or misapply incorporation state law.<sup>187</sup>

A misapplication of Delaware state law is precisely one of the flaws in the *Galaviz* decision. The case likely would have been decided on different

Federal courts should follow the *Boilermakers* decision and extinguish the position articulated in *Galaviz* for several reasons. First, the Delaware Chancery Court's reasoning in *Boilermakers*