Directors Given More Authority to Limit Multi-Forum Litigation

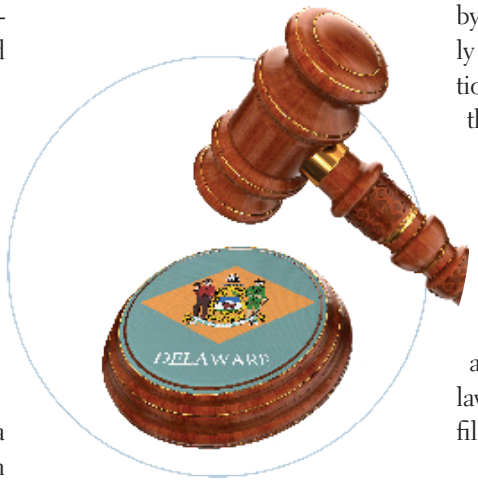
A recent decision affirms that directors have clear authority to require shareholder suits be filed in a single state.

By Francis G.X. Pileggi

Most corporate directors disdain the fact that multiple shareholder suits—often contesting the same transaction—can be filed within days of each other in different jurisdictions. A recent decision in Delaware provides further support for directors that choose to fix this problem by amending their bylaws to require that virtually all stockholder suits be filed in the courts of only one state.

In *City of Providence v. First Citizens Bancshares, Inc.*, the Court of Chancery upheld a bylaw provision of a Delaware corporation that required most stockholder suits be filed in North Carolina, where the company's headquarters is located. A prior Delaware decision had upheld a similar bylaw—a forum selection clause that required most stockholder suits be filed in Delaware. This latest decision reaffirms the ability of directors to limit the risk of multiple suits being filed in different states. Now, directors have clear authority to require those suits to be filed in a single state other than Delaware.

Giving rise to this decision was First Citizens Bancshares, whose business is mostly done in North Carolina though it is a Delaware entity. The essence of the challenged transaction was that a controlling shareholder group forced the company to do a deal with an affiliated entity at an unfair price to the detriment of minority shareholders. On the same day that the merger agreement was approved, the board also approved a bylaw amendment that required almost all stockholder claims to be filed in North Carolina.



The court began its analysis with the basics. Bylaws are viewed within the framework of the Delaware General Corporation Law (DGCL) as a contract among the directors, officers, and stockholders of a corporation. DGCL Section 109(a) gives directors the authority to adopt, amend, or repeal bylaws. DGCL Section 109(b) allows bylaws to govern the rights and powers of stockholders, directors, officers, and employees.

Stockholders are considered to be on notice that directors can unilaterally adopt bylaws within the scope of the DGCL. The specific claims that the bylaws in this case required stockholders to file exclusively in North Carolina included: 1) derivative claims; 2) breach of fiduciary duty claims; and 3) claims governed by the internal affairs doctrine.

Other than the state in which suits are required to be filed, the bylaw provision was substantially the same as the forum selection bylaw provision upheld in the Chancery decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corp*. The same reasoning that upheld the forum selection bylaw in that case, which required suits to be filed only in Delaware, also applied to uphold the bylaw provision requiring suits to be filed in North Carolina.

Several aspects of the reasoning that supports the decision deserve special attention. First, as an understatement, the court explained that there was no basis in the record to demonstrate that the courts of North Carolina were not able to fairly and competently decide the issues presented to them. Moreover, the DGCL provisions that in some instances refer to the exclusive jurisdiction of the Court of Chancery merely refer to intrastate courts and could not prohibit other state or federal courts from hearing matters involving Delaware law in appropriate cases.

The enforceability of forum se-

lection bylaw provisions is not without exception. In order for the forum selection clause to be enforced it must be shown that the provision is not unreasonable and not the result of fraud or overweening bargaining power.

More amorphously, however, the bylaw would not be enforced if it would be inequitable as applied, even if technically legal. This exception is based on a bedrock principle of Delaware corporate law that "inequitable action does not become permissible simply because it is legally possible." This quintessential Delaware standard of broad application was announced in the Delaware Supreme Court decision in *Schnell v. Chris-Craft Industries, Inc.*, and relies on a factually determinative analysis that prevents the unqualified conclusion that these bylaw provisions will be enforceable in all cases.

The enforceability of forum selection bylaw provisions is not without exception. ... "[I]nequitable action does not become permissible simply because it is legally possible."

Forum selection bylaws are designed, appropriately, to address the chaotic filing of overlapping suits in many states against directors and the corporation. By comparison, such a forum selection bylaw is not allowed in an LLC. Section 109(d) of the Delaware LLC Act limits the ability of an LLC to mandate a foreign jurisdiction for intra-entity disputes. A forum selection clause for an LLC, therefore, could only require Delaware as the exclusive forum for suits.

The court rejected the argument that because the bylaw was adopted on a "cloudy" day, (i.e., the day of the merger), the bylaw was tainted. That it was not adopted on a "clear" day was regarded by the court as immaterial because there was no well-pled allegation that the timing was improper, nor that the directors advanced their self-interests by having their claims adjudicated in a court outside of Delaware. The equitable prerequisite that the forum selection bylaw must satisfy, according to the court, is a "powerful lens" through which the as-applied validity of a forum selection bylaw is viewed. Further, the court concluded that the plaintiffs in this case did not explain why it would be inequitable to require stockholders to litigate their claims in the state or federal courts of North Carolina.

The importance of judicial comity provided additional support for the court's reasoning. That is, in order for states in our federal system to interface with each other in a workable manner, there must be mutual respect for the authority of other states. If Delaware expects other states to recognize the enforceability of a forum selection clause requiring suits to be filed in Delaware, then Delaware courts should recognize and enforce provisions requiring suits to be filed other states. A colloquial phrase to describe this concept would be that Delaware chose to "stay in its lane." Directors should take advantage of this opportunity to both limit their litigation costs and more effectively manage their exposure to duplicate suits filed simultaneously in multiple states by amending their bylaws.

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