KIRKLAND & ELLIS LLP

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Forum Selection Bylaws — Not So Fast?

A recent Federal decision in California, while certainly not the final word on this issue, provides important insight and guidance to companies considering adopting an exclusive jurisdiction bylaw and the potentially limited efficacy of such a provision.

In the aftermath of dicta in Vice Chancellor Laster's March 2010 *Revlon* decision, there was widespread commentary (taken up by some companies) recommending that Delaware companies strongly consider amending their organizational documents to provide that Delaware courts are the exclusive jurisdiction for settling intra-corporate disputes, including derivative and fiduciary duty claims. A recent Federal court decision in California, which refused to dismiss a derivative claim in that court against Oracle notwithstanding the company's bylaw providing Delaware as the exclusive jurisdiction for any such litigation, calls into question the effectiveness of these measures when evaluated by courts outside of Delaware.

The notion of exclusive forum clauses (the intellectual descendant of binding arbitration clauses in organizational documents of some U.S.-listed foreign companies, including Royal Dutch Shell) developed in response to a noticeable trend of plaintiffs bringing corporate claims against Delaware corporations in other jurisdictions, most often in the principal place of business of the company. Plaintiffs in doing so are likely seeking a "home-court" advantage and are trying to avoid what they perceive as a bias in favor of corporations in Delaware courts and an increasing Chancery Court skepticism of plaintiff attorney fee awards in settlements that deliver questionable value to shareholders. As a result, companies are losing the benefit of predictability and experience offered by the Delaware courts that regularly grapple with these issues and are often faced with the additional costs and complexity of litigation in multiple jurisdictions. VC Laster's commentary in support of exclusive forum clauses likely reflected an interest on the part of Delaware's judiciary in protecting its position as the pre-eminent forum for resolving corporate disputes involving Delaware companies.

While most observers believed that implementing such a provision by amending the certificate of incorporation, or charter, of the company would likely enhance its effectiveness, such a change requires shareholder approval. Given the uncertain prospects for shareholder approval, most of the companies preferred to effect such a change by amending their bylaws which only required approval by the board of directors. Because most courts recognize bylaws as having the status of a contract between the company and its shareholders, it was believed that a forum selection clause would be enforceable in courts outside of Delaware given the generally accepted principle of respecting forum selection clauses in binding agreements.

The recent *Oracle* decision raises some doubts about whether courts outside of Delaware will in fact respect such a bylaw provision. While the court acknowledged the bylaw-as-contract principle, it noted that the relevant "contract" term (i.e., the exclusive forum selection clause) was imposed unilaterally on shareholders by action of the company's board and therefore did not reflect a negotiated and mutually-agreed outcome. The court in this case was further troubled by the fact that the Oracle bylaw was adopted after the conduct in question in the litigation occurred and by the very same people (the directors) whose conduct was being challenged.

The court did note that the outcome could very well have been different had the forum clause been included in a charter amendment approved by stockholders, and did not directly address the question of whether a board-adopted bylaw could be enforceable as to shareholders who bought shares, or conduct that occurred, after the date of the bylaw amendment.

The *Oracle* decision, while certainly not the final word on this issue, provides important insight and guidance to companies considering adopting an exclusive jurisdiction bylaw and the potentially limited efficacy of such a provision. The decision sounds a cautionary note that courts outside of Delaware may not be so deferential in the face of these clauses, however crafted, in part in the interest of preserving their own "market-share" of corporate litigation.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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