Transforming the "Anywhere but Chancery" Problem into the "Nowhere but Chancery" Solution

Sara Lewis

Increasingly, plaintiffs' lawyers are bringing shareholder suits against directors and officers of Delaware corporations "anywhere but [Delaware] Chancery" court, in an effort to avoid the predictability of Delaware courts' application of their corporate law and the expedited and speedy trials available in Delaware courts. While this strategy benefits plaintiffs' lawyers by allowing them to extract greater settlement value out of even meritless "strike" suits, it harms shareholders by subjecting their managers and directors to considerable uncertainty in their corporate planning and decision making. As a proposed solution to the uncertainty and inefficiency that results from litigation "anywhere but Chancery," some lawyers and scholars have suggested that Delaware corporations include a provision in their bylaws or charter selecting Delaware as the exclusive forum for litigation of shareholder suits, thus ensuring the predictability and efficiency of Delaware judicial proceedings. This is a relatively new and untested proposal: only a few companies have tried it, the issue has yet to be litigated, and no legal scholarship has yet addressed the issue of whether a forum-selection clause of this sort would be enforceable.

This Note attempts to fill that void by examining, for the first time, the timely issue of whether a non-Delaware court, such as a California court, would enforce a Delaware forum-selection clause contained in the bylaws or charter of a Delaware corporation. I conclude that a California court would most likely enforce such a provision, regardless of whether the provision was in the charter or bylaws, for both direct and derivative suits,

and against both shareholders who purchased stock before and shareholders who purchased stock after the bylaw or charter amendment.

Introduction

Delaware dominates the market for incorporations of publicly traded firms, with about sixty percent of all publicly traded U.S. corporations incorporated there.[1] In part because of its large market share and in part as a cause of its large market share, the Delaware Chancery and Supreme Court have developed an extensive and thorough body of corporate law.[2] Delaware's judges typically have considerable expertise in corporate law matters, and Delaware courts provide litigants with an expedited process that results in speedier and more efficient resolutions of disputes.[3] Despite the obvious benefits to shareholders and management, plaintiffs' lawyers dislike predictable law and efficient litigation, because it fails to strike the necessary fear in the hearts of directors and officers that leads to greater settlement value. The risk of unpredictable outcomes and the prospect of long, drawn-out trials can cause directors and officers to settle even meritless "strike" suits. To achieve this unpredictability and inefficiency, plaintiffs' lawyers prefer to bring shareholder suits "anywhere but [Delaware] Chancery."[4]

Generally, when a lawsuit is brought in a non-Delaware court, the non-Delaware court applies Delaware corporate law in accordance with the internal affairs doctrine. The internal affairs doctrine replaces the standard conflict-of-laws principles and applies the law of the corporation's state of incorporation to the corporation's "internal affairs," regardless of the quantity or quality of contact the corporation has with its state of incorporation.[5] Although the application of well-settled and well-developed Delaware law by a non-Delaware court mitigates the problem of uncertainty in a suit brought "anywhere but Chancery," it does not

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[1] Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 391, 395 (2003).

[2] *See, e.g.*, Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1212 (2001).

[3] *See, e.g.*, Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 YALE L.J. 553, 588-59 (2002).

[4] *See* Ted Mirvis, *Anywhere But Chancery: Ted Mirvis Sounds an Alarm and Suggests Some Solutions*, 7 M&A J 17 (2007).

[5] *See* Edgar v. MITE Corp., 457 U.S. 624, 645 (1982); McDermott Inc. v. Lewis, 531 A.2d 206, 215 (Del. 1987); *see also* Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 LAW & CONTEMP. PROBS. 135, 137-38 (2004).

eliminate such problem entirely. This is because non-Delaware judges may be less familiar with Delaware law (resulting in misapplications or misunderstandings of the law) or even hostile to it (resulting in unexpected departures from well-settled rules). As one commentator explained, "[T]rying to argue fiduciary duty cases outside of Delaware is like taking Gallatoire's secret recipes and giving them to a Jack-in-the-Box short-order cook. It doesn't always work so well."[6] Moreover, the lack of expedited process in many non-Delaware courts may generate greater settlement value, since directors may be inclined to settle and get on with business, rather than litigate for years.

The "anywhere but Chancery" phenomenon is problematic for another reason: Not all courts strictly adhere to the internal affairs doctrine, sometimes applying their own corporate law to the internal affairs of Delaware-chartered corporations. A notable example is section 2115 of the California Corporations Code, which provides that if a Delaware corporation's securities are not traded on a national exchange, if it transacts more than half of its business in California, and if more than half of its voting stock is held by California residents,[7] then California—not Delaware—corporate law will govern a number of its fundamental corporate issues, such as annual election of directors, directors' standard of care, indemnification, distributions to shareholders, cumulative voting, and class voting for mergers.[8]

The outcome of any internal affairs litigation involving a Delaware corporation that falls under section 2115's purview is dependent upon where the plaintiff files the lawsuit. The Delaware Supreme Court, in *VantagePoint*, squarely held that section 2115 violates "well established choice of law rules and the federal constitution."[9] Therefore, in Delaware, a Delaware corporation will not be subject to California corporate law under any circumstances. However, if the plaintiff brings suit in California, California courts will likely apply their own corporate law to a section 2115 corporation. The California courts are not bound by Delaware's determination that section 2115 violated choice-of-law rules and the U.S. Constitution. In fact, prior to *VantagePoint*, the California Supreme Court explicitly

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[6] Mirvis, *supra* note 4.

[7] *Id.*

[8] CAL. CORP. CODE § 2115 (West 2006).

[9] VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1116 (Del. 2005) (citing *McDermott*, 531 A.2d 206 and CTS Corp v. Dynamics Corp., 481 U.S. 69 (1987)).

upheld section 2115 in the face of a constitutional challenge[10] and has reaffirmed the validity of section 2115 even after *VantagePoint*.[11] Therefore, to be careful, a Delaware corporation subject to section 2115 must comply with both Delaware *and* California corporate law—a sometimes impossible task due to conflicting legal rules.

Because the choice of forum often determines what law is applied and how the law is applied, Delaware officers and directors currently face considerable uncertainty both before a lawsuit is brought (in their corporate decision making)[12] and after the lawsuit is brought (in their decision whether to settle and for how much). The applicable forum—and therefore the applicable law—often turns on nothing more than which shareholder won the "filing Olympiad"[13] and raced to the courthouse door to file her complaint faster than other shareholders.[14] This uncertainty benefits plaintiffs' lawyers at the expense of shareholders and makes it increasingly important to solve the "anywhere but Chancery" problem.

One proposed solution is a forum-selection clause in the corporate bylaws or certificate of incorporation (i.e., charter) of a Delaware corporation that names Delaware courts as the exclusive forum for any shareholder claims for breach of fiduciary duty.[15] At least a few Delaware corporations have done this. For example, Netsuite amended its charter to provide that Delaware would be the exclusive forum for any derivative action, any action claiming a breach of fiduciary duty, any action pursuant to Delaware's corporate law statute, or any action asserting a claim governed by the internal affairs doctrine.[16] Oracle, another Delaware corporation,

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[10] Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 858 (Ct. App. 1983).

[11] *See* Friese v. Superior Court, 36 Cal. Rptr. 3d 558, 569 (Ct. App. 2005). In another California Court of Appeals case, the Court adhered to the internal affairs doctrine but nonetheless reaffirmed section 2115's validity. *See* State Farm Mut. Auto Ins. Co. v. Superior Court, 8 Cal. Rptr. 3d 56, 69 (Ct. App. 2003). Most recently, the California Supreme Court dodged the issue and refused to expressly confirm or disconfirm *VantagePoint*'s holding. *See* Grosset v. Wenaas, 72 Cal. Rptr. 3d 129 (2008).

[12] *See VantagePoint*, 871 A.2d at 1112-13.

[13] *See In re* Topps Co. Shareholders Litig., 924 A.2d 951, 957, (Del. Ch. 2007); *see also In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 608 (Del. Ch. 2005).

[14] Courts generally give first-filed complaints preference in determining the forum, barring overriding considerations of policy or near contemporaneous filing. *See* McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co., 263 A.2d 281 (Del. 1970); *see also In re Topps*, 924 A.2d 951; Kurtin v. KRE, LLC, 2005 WL 1200188 (Del. Ch. May 16, 2005); IBP, Inc. v. Tyson Foods, Inc., 2001 WL 406292 (Del. Ch. 2001).

[15] Mirvis, *supra* note 4.

[16] The full text reads:

inserted a similar provision in its corporate bylaws, providing that the Delaware Chancery Court would be the exclusive forum for all derivative actions.[17]

Because the inclusion of a forum-selection clause in the corporate bylaws or charter is a novel idea, the enforceability of such a clause has not yet been litigated, and no legal scholarship currently addresses the issue of such a clause's enforceability. This Note attempts to fill that void by examining the timely issue of whether or not a *non-Delaware* court—specifically, a California court[18]—would enforce a provision in a Delaware corporation's bylaws or certificate of incorporation selecting *Delaware* as the exclusive forum for shareholder suits. For simplicity, I will assume that the case is litigated before a California Superior Court (i.e., a trial court) and that the issue is whether the California court should stay the California proceeding in favor of parallel proceedings in Delaware (as opposed to dismissing the case outright).[19] I conclude that a California court would likely enforce a forum-selection clause, regardless of whether the provision was in the charter or bylaws, for both direct and derivative suits, and against both shareholders who purchased stock before and shareholders who purchased stock after the bylaw or charter amendment was adopted. If enforceable, the inclusion of a forum-selection clause has the potential to bring the desired certainty and efficiency to shareholder litigation, thereby transforming the "anywhere but Chancery" problem into the "nowhere but Chancery" solution.

> 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, 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 DGCL [Delaware General Corporation Law], (iv) or any action asserting a claim governed by the internal affairs doctrine.

Netsuite, Inc. Certificate of Incorporation, Item 5.03 (amended Dec. 21, 2007), *available at* http://www.secinfo.com/d14D5a.u892e.htm.

[17] The provision states: "The sole and exclusive forum for any actual or purported derivative action brought on behalf of the Corporation shall be the Court of Chancery in the State of Delaware." Oracle, Corp. Bylaws, § 9.07 (amended July 10, 2006), *available at* http://www.oracle.com/corporate/investor_relations/bylaws.pdf.

[18] I chose California in particular, because section 2115 poses the most potential for conflict and thus the most interesting analysis.

[19] Unlike federal courts, state courts do not have an absolute right of transfer. *See* FED. R. CIV. P. 1404(a).

Part I of this Note outlines the relevant statutory and case laws that a *California* court would likely consider in determining the enforceability of a *Delaware* forum-selection clause contained in the bylaws or charter of a Delaware corporation. Part II of this Note examines the converse question of whether a *Delaware* court would enforce a *California* forum-selection clause contained in the bylaws or charter of a Delaware corporation.

I. Would a *California* Court Enforce a *Delaware* Forum-Selection Clause?

A. Applicable Law

First, it is important to determine whether the enforceability of the forum-selection clause would be governed by the laws of the forum (i.e., California) or the laws of the state of incorporation (i.e., Delaware), based on the forum's own choice-of-law rules.

There is a strong argument that Delaware law—not California law—would apply, given the internal affairs doctrine.[20] A forum-selection clause within a corporate governance document defines rights "peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders,"[21]

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[20] *See* State Farm Mut. Auto Ins. Co. v. Superior Court, 8 Cal. Rptr. 3d 56 (Ct. App. 2003).

[21] Grosset v. Wenaas, 35 Cal. Rptr. 3d 58, 66 (2006) (citation omitted); *see also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302, cmt. a (1971); CTS Corp. v. Dynamics Corp., 481 U.S. 69, 89 (1987); Edgar v. MITE Corp., 457 U.S. 624, 645 (1981); McDermott Inc. v. Lewis, 531 A.2d 206, 214 (Del. 1987). Admittedly, the enforceability of forum-selection clauses is a question of contract law, and the "law of contracts" is generally considered outside the scope of the internal affairs doctrine. *See* Friese v. Superior Court, 36 Cal. Rptr. 3d 558 (Ct. App. 2005). However, contract law is only considered outside the scope of the internal affairs doctrine when it involves contract rights between the corporation and third parties external to the corporation; by contrast, contracts that involve only corporate participants (e.g., directors, officers, shareholders, employees) are generally considered within the scope of the internal affairs doctrine. *See generally* 19 C.J.S. CORPS. § 981 (2008).

Unfortunately, despite the appeal of this bright-line rule, confusion remains. For example, a stock issuance agreement has been deemed an internal affair in one state and a contract matter in another. *Compare* Yates v. Bridge Trading Co., 844 S.W.2d 56 (Mo. App. 1992) (internal affair), *with* Gries Sports Enters., Inc. v. Modell, 15 Ohio St. 3d 284 (1984) (contract law). Moreover, the analysis may be further complicated if a choice-of-law provision accompanies the choice-of-forum provision. For example, in determining the validity of a Texas forum-selection clause accompanied by a Texas choice-of-law clause in an LLC agreement, Vice Chancellor Strine avoided deciding whether to use Delaware or Texas law to determine its validity, stating: "Fortunately for me, the parties agree that there is no material

which is explicitly identified as an "internal affair" to be governed by the chartering state's law. In fact, California courts explicitly list "the adoption of by-laws" and "charter amendments" as examples of internal affairs.[22] Treating bylaws and charters as "internal affairs" makes sense as a policy matter, because, as the Restatement (Second) of Conflict of Laws points out, "[i]t would be impractical, for example, if . . . a charter amendment . . . were to be held valid in one state and invalid in another."[23] Even if the Delaware corporation was subject to section 2115, California corporate law would not govern the adoption or amendment of bylaws or certificates of incorporation, because section 2115 does not expressly include those matters within its scope.[24]

However, in determining whether the forum-selection clause contravenes public policy (one of the reasons for invalidating choice-of-forum provisions), a California court would likely look to its *own* public policy. In fact, the U.S. Supreme Court in *Zapata* explicitly stated: "A contractual choice-of-forum clause should be held unenforceable if enforcement would contravene a strong public policy of the *forum in which suit is brought.*"[25] Moreover, Delaware law itself provides that the policy of the *forum* is relevant to the validity of a forum-selection clause.[26] Consistent with this, a California Court of Appeal in *Hall* looked to California policy in deciding not to enforce a Nevada choice-of-forum provision in a limited partnership agreement, notwithstanding the fact that the choice-of-forum provision was accompanied by a Nevada choice-of-law provision.[27]

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difference between Texas and Delaware law regarding the issues before me." Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146, 1148 (Del. Ch. 2006).

[22] *Friese*, 36 Cal. Rptr. 3d at 568.

[23] RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 302, cmt. e (1971).

[24] *See* CAL. CORP. CODE § 2115(b) (West 2006).

[25] M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 16 (1972) (emphasis added).

[26] Bbdova, LLC v. Auto. Techs., Inc., 358 F. Supp. 2d 387, 390 (D. Del. 2005); *see also* Coastal Steel Corp. v. Tilghman Wheelabrator Ltd., 709 F.2d 190, 202 (3d Cir. 1983).

[27] *See* Hall v. Superior Court, 150 Cal. App. 3d 411 (1983); *accord* ABF Capital Corp. v. Osley, 414 F.3d 1061 (9th Cir. 2005) (applying California law to determine validity of New York choice-of-law clause in a limited partnership agreement). In defending a forum-selection clause, it is nonetheless possible to try to distinguish *Zapata*, *Hall*, and *ABF Capital* because none involved a forum-selection clause in a *corporate* governance document and therefore did not implicate directly the internal affairs doctrine, which expressly aims to "implement[] . . . the relevant policies of the state with the dominant interest in the decision of the particular issue," presumed to be the state of incorporation. RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 302, cmt. b (1971).

Fortunately, there is much overlap between Delaware and California law, due in part to two important U.S. Supreme Court decisions addressing forum-selection clauses.[28] Consistent with what I believe a California court would do, I will look to Delaware law generally for the applicable standards but will look to California public policy in application of the public policy standard.

B. Presumption of Enforceability

Generally speaking, Delaware law is quite lenient with regards to what content may be permissibly included in Delaware corporations' charters and bylaws. Delaware General Corporation Law section 109(b) states that "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."[29] Similarly, section 102(b) provides that any provision permitted to be included in the bylaws "may instead be stated in the certificate of incorporation," again making explicit that such provision may not be "contrary to the laws of this State."[30] Moreover, Delaware courts presume that bylaws are valid, with the burden on the contesting party to show that the bylaw is inconsistent with statutory or common law.[31]

In determining whether there is any law "inconsistent" or "contrary" to the inclusion of a forum-selection clause in the bylaws or charter, it is notable that the law on forum-selection clauses is also quite permissive. Since the U.S. Supreme Court's 1972 decision in *Zapata*, the modern trend is for courts to presume that forum-selection clauses are "prima facie" enforceable.[32] The party seeking to overturn the clause bears a "heavy burden of proof,"[33] and the presumption of enforceability can be overcome only if the forum-selection clause is "unreasonable" or "unjust" (i.e., "unfair") under the circumstances.[34] Courts have found forum-

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[28] *See* Carnival Cruise Lines v. Shute, 499 U.S. 585 (1991); *Zapata*, 407 U.S. 1.

[29] DEL. CODE ANN. tit. 8, § 109(b) (2008).

[30] *Id.* at § 102(b).

[31] *See* Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407 (Del. 1985).

[32] *See Zapata*, 407 U.S. at 10; *see also* Walter W. Heiser, *Forum Selection Clauses in State Courts: Limitations on Enforcement After* Stewart *and* Carnival Cruise, 45 FLA. L. REV. 361, 363 (1993).

[33] *Zapata*, 407 U.S. at 17.

[34] *See* Carnival Cruise Lines v. Shute, 499 U.S. 585 (1991); *Zapata*, 407 U.S..1. The Delaware courts have expressly adopted this standard. *See, e.g.*, Elia Corp. v. Paul N. Howard

selection clauses to be "unreasonable" or "unjust" when the clause was procured by "fraud or overreaching,"[35] was not "freely negotiated,"[36] would result in litigation in a forum "so gravely difficult and inconvenient that [the plaintiff would] for all practical purposes be deprived of his day in court,"[37] or contravenes "a strong public policy" of the forum.[38]

C. Analogy to a Forum-Selection Clause in an LLC Agreement

Arguably, the Delaware Supreme Court's decision in *Elf Atochem* is controlling here. In that case, the court upheld a contractual provision in an LLC agreement directing that all disputes be resolved exclusively by arbitration or court proceedings in California.[39] The court reasoned that because the Delaware LLC Act did not explicitly prohibit a forum-selection clause in the LLC agreement, it was permissible.[40]

Here, charters and bylaws serve much the same function for corporations as LLC agreements do for LLCs; both are general governance documents that set out the entities' ground rules and organizational structure. Moreover, just as the Delaware LLC Act did not expressly prohibit forum-selection clauses, so too the Delaware General Corporation Law does not expressly prohibit forum-selection clauses.

The present case is potentially distinguishable on a number of grounds, although ultimately, none of the distinctions are convincing. First, *Elf Atochem* required, first and foremost, arbitration—not litigation—in another forum. Although "[a]n agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause,"[41] both Delaware and California recognize a strong public

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Co., 391 A.2d 214, 216 (Del. Super. Ct. 1978); Alstom Power, Inc. v. Duke/Fluor Daniel Carribbean S.E., 2005 WL 407206, at *1 (Del. Super. Ct. Jan. 31, 2005); Double Z Enters., Inc. v. Gen. Mktg. Corp., 2000 WL 970718, at *2 (Del. Super. Ct. Jun. 1, 2000).

[35] *Zapata*, 407 U.S. at 15; Coastal Steel Corp. v. Tilghman Wheelabrator Ltd., 709 F.2d 190, 202 (3d Cir. 1983).

[36] *Carnival Cruise*, 499 U.S. at 591, 601.

[37] *Zapata*, 407 U.S. at 18; *accord Coastal Steel*, 709 F.2d at 202; *Alstom Power*, 2005 WL at *1, 3.

[38] *Zapata*, 407 U.S. at 15; *accord Coastal Steel*, 709 F.2d at 202; Bbdova, LLC v. Auto. Techs., Inc., 358 F. Supp. 2d 387, 390 (D. Del. 2005).

[39] *See* Elf Atochem North America, Inc. v. Jaffari, 727 A.2d 286 (Del. 1999).

[40] *Id.* at 287; *accord* Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146, 1148 (Del. Ch. 2006).

[41] Scherk v. Alberto-Culver Co., 417 U.S. 506, 519 (1974).

policy in favor of arbitration[42]—a policy arguably stronger than the policy in favor of contractual freedom to select a forum for full trial. However, although the Court in *Elf Atochem* twice mentions the strong policy favoring arbitration,[43] that policy does not appear to be central to its holding, since such statements are accompanied by a recognition of the more general policy in favor of honoring the contracting parties' wishes and expectations.[44]

Second and more convincingly, one could attempt to distinguish the issues by pointing to the strong policy in favor of contractual freedom in the context of LLCs, LPs, and other alternative entities—a policy that is present to a lesser degree in the context of corporations. Specifically, the Court in *Elf Atochem* emphasizes the fact that the Delaware LLC Act explicitly expresses a policy of giving "the maximum effect to the principle of freedom of contract . . . ."[45] This is consistent with the view held by many legal scholars that LLC law is merely a set of default rules that parties can freely contract out of, while corporate law limits contractual freedom by imposing certain mandatory rules,[46] a distinction which Delaware courts seem to accept.[47] On the other hand, other legal scholars do not accept such a distinction, claiming that like LLC and alternative-entity law, corporations are best understood as a nexus of contracts that allows parties to pick and choose through contract the rules that best suit their needs.[48] Moreover, even if one accepts that corporate law

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[42] *See, e.g.*, SBC Interactive, Inc. v. Corporate Media Partners, 714 A.2d 758, 761 (Del. 1998); Madden v. Kaiser Found. Hosps., 131 Cal. Rptr. 882 (1976).

[43] *Elf Atochem*, 727 A.2d at 292, 295.

[44] *See id.* at 290.

[45] *Id.* at 291 (citing DEL. CODE ANN. tit. 6, § 18.1101(b) (1994)); *see also* DEL. CODE ANN. tit. 6, § 17.1101(c) (2005) (stating a similar expression of policy in the context of limited partnership agreements).

[46] *See* Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595 (1997); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549 (1989).

[47] *See* Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146, 1149 (Del. Ch. 2006).

[48] *See* Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993). Furthermore, to the extent that a California court in this case would respect the internal affairs doctrine, it is generally accepted that the internal affairs doctrine is inherently built on the contractualist approach, since it encourages shareholders (and/or managers) to choose the state with the corporate law that best satisfies their needs. *See* Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661.

imposes certain mandatory rules, it is not obvious that the freedom to sue outside of Delaware would be one of those mandatory rules.

D. Not "Unjust" or "Unreasonable"

A court will invalidate a forum-selection clause if the contesting party overcomes her "heavy burden of proof" and establishes that the clause is "unjust" or "unreasonable" for one or more of the following reasons. It is important to note that the four considerations articulated below do not constitute a balancing test but rather are independent inquiries; if the forum-selection clause fails under any one of the four considerations, it is unenforceable, without regard to how well it fares under the other three considerations.

1. Was the forum-selection clause the product of "fraud or overreaching?"

Consistent with basic contract-formation principles, a court will not enforce a forum-selection clause if it was procured through fraud, overreaching, or undue influence.[49] However, to justify non-enforcement, the procurement of the forum-selection clause itself—rather than the contract as a whole—must be the product of fraud or overreaching.[50]

Although it is possible to imagine a situation in which the board of directors procured a forum-selection clause in the bylaws or charter through fraud, it is certainly not inevitable. Consistent with the U.S. Supreme Court's analysis in *Carnival Cruise*, even procurement of a forum-selection clause in a form contract does not rise to the level of fraud, provided it is "fundamental[ly] fair[]."[51] There, the Court upheld a Florida forum-selection clause written on the back of a cruise ticket, noting that the cruise line did not choose Florida as a means of discouraging cruise passengers from pursuing legitimate claims. The facts that the cruise line's principal place of business was in Florida and that many of its cruises departed from Florida posts "belied" any "bad-faith motive."[52] Similarly, here, the facts that the corporation is incorporated in Delaware and that Delaware courts have an expedited process with knowledgeable expert judges is likely to provide evidence of "fundamental fairness" and lack of fraud or overreaching.

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[49] *See* M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 12-13, 15 (1972).

[50] *See* Double Z Enters., Inc. v. Gen. Mktg. Corp., 2000 WL 970718, at *3 (Del. Super. Ct. Jun. 1, 2000).

[51] Carnival Cruise Lines v. Shute, 499 U.S. 585, 595 (1991).

[52] *Id.*

2. Was the forum-selection clause not "freely negotiated?"

In *Zapata*, the U.S. Supreme Court indicated that a forum-selection clause would be unenforceable if the clause was not "freely negotiated,"[53] as for example, when one party exercises "overweening bargaining power."[54] However, the Court later made clear in *Carnival Cruise* that this was a lenient test. There, the Court stated that it is *not* the case that a forum-selection clause "in a form ticket contract is never enforceable simply because it is not the subject of bargaining."[55] Rather, the Court provided three reasons why the inclusion of a "reasonable forum clause in a form contract" was permissible in that case.

First, the Court recognized that the cruise line had a special interest in limiting the fora in which it could be subject to suit, given the mobility of its cruise ships.[56] Second, the clause dispelled confusion and saved litigants the time and expense of pretrial motions to determine the correct forum, thus conserving judicial resources.[57] Third and finally, the passengers buying the ticket benefited from reduced fares passed on to them from the cruise line's savings in anticipated litigation costs.[58]

All three factors are present in considering the enforceability of a forum-selection clause in a corporation's bylaws or charter. First, it is certainly true that corporations and their shareholders have the same need for certainty, given the multi-state and multi-national reach of corporations, leading to otherwise broad liability exposure in multiple national and global courts. Second, while all forum-selection clauses save time and expense by establishing the proper forum *ex ante*, it is perhaps especially valuable in the context of corporations, where litigants are willing to spend significant amounts of time and money to establish the proper forum, since the forum can affect the applicable law and the application of the law in a way that is often outcome determinative. Finally, corporations will undoubtedly save money by limiting liability in multiple fora and can pass those savings along to their shareholders and consumers. Consistent with *Carnival Cruise*'s reasoning, the

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[53] *Zapata*, 407 U.S. at 12.

[54] *Id.*

[55] *Carnival Cruise*, 499 U.S. at 593.

[56] *See id.* Similarly, the Court in *Zapata* recognized the need to prevent broad exposure to liability in a limitless number of potential fora, given the "present-day commercial realities" of businesses which have a national and global scope. *See Zapata*, 407 U.S. at 13, 15.

[57] *See Carnival Cruise*, 499 U.S. at 593-94.

[58] *See id.* at 594.

presence of these three factors would render irrelevant, for example, the fact that shareholders in a widely held company faced a collective action problem that put them at a relative bargaining disadvantage to the board.

Despite *Carnival Cruise*'s permissive gloss on forum-selection clauses, a plaintiff may nonetheless attempt to escape enforcement of the clause with the following arguments. None are likely to be successful.

i. Lack-of-Notice Arguments

The Court in *Carnival Cruise* emphasized that even though the passengers lacked relative bargaining power, they were nonetheless "given notice" of the clause and therefore "presumably retained the option of rejecting the contract with impunity."[59] At least two groups of shareholders could argue that lack of notice makes the forum-selection clause unenforceable against them. First, shareholders who purchased their shares *after* the amendment was made to the bylaws or charter could argue that they did not have actual notice of the amended clause at the time of purchase. Although it is certainly possible that many shareholders did not have actual notice, this will be a difficult argument to win, because a court would probably find constructive notice sufficient. The shareholders certainly had constructive notice of the clause, given the significance of the charter and bylaws to corporate governance and the wide availability of such documents on corporate websites and SEC's EDGAR. Significantly, even if a shareholder did not have actual notice of the forum-selection clause, if she bought shares of the corporation in an "open and developed" market, courts would assume she bought at a price that reflected the clause's value.[60] In fact, the Court in *Zapata* considered it relevant in deciding to enforce the forum-selection clause that the contract priced in the value of the clause.[61]

The same lack-of-actual-notice argument could be made for a second group of shareholders: shareholders who purchased shares *prior* to the amendment. In Delaware, charter amendments always require a shareholder vote,[62] but, of course, not all shareholders vote. Bylaw amendments require a shareholder vote unless the

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[59] *Id.* at 595.

[60] *See* Basic v. Levinson, 485 U.S. 224, 241 (1988) (utilizing the semi-strong efficient market hypothesis to assume that shareholders who bought shares in an "open and developed" market relied on the integrity of such a price).

[61] *See Zapata*, 407 U.S. at 14, 16.

[62] DEL. CODE ANN. tit. 8, § 242 (2008).

corporation has provided in its charter that the board will also have the power to amend.[63] Therefore, in the case of bylaw amendments, it is possible that the shareholder either never had the opportunity to vote, or, again, simply did not. However, a lack-of-actual-notice argument probably will be unsuccessful here as well. For the same reasons as above, shareholders would have had constructive notice of the provision, particularly if they actually received a proxy statement. Furthermore, although the shareholder did not purchase her shares at a price that directly reflected the value of the clause, the shareholder arguably purchased at a price that reflected the possibility of the clause's enactment.

ii. Lack-of-Consent Arguments

It is also possible for shareholders wishing to escape the forum-selection clause to make various lack-of-consent arguments. Although *Carnival Cruise* assumed consent from the passengers' purchase of the ticket, some legal scholars have criticized *Carnival Cruise*'s permissive analysis, [64] and not all courts have been quite so lenient.[65] Therefore, any shareholder who did not vote for the forum-selection clause (or who did not vote for the board of directors who voted for the forum-selection clause) could argue that since she did not consent to the contract, the contract is unenforceable. There are several problems with this argument.

Significantly, Delaware courts generally view bylaws as binding on all shareholders, regardless of whether or not any single shareholder voted for any particular provision.[66] Bebchuk, however, argues that for midstream charter and bylaw amendments, [67] no contractual "consent" can be presumed absent a unanimous shareholder vote in favor of an amendment.[68] This is because, according to Bebchuk, a mere majority vote does not guarantee that an amendment is value-maximizing, and therefore, it is possible for a shareholder who buys shares prior to

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[63] *Id.* § 109(a).

[64] *See, e.g.*, Linda S. Mullenix, *Another Easy Case, Some More Bad Law:* Carnival Cruise Lines *and Contractual Personal Jurisdiction*, 27 TEX. INT'L L.J. 323 (1992).

[65] *See generally* 31 A.L.R. 4th 404 (2008).

[66] *See generally* Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401 (Del. 1985).

[67] Bebchuk distinguishes between midstream amendments, which he considers problematic, and initial bylaw and charter enactment, which he considers unproblematic. *See* Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989). Therefore, according to his view, a forum-selection clause in an initial charter or set of bylaws would not pose a consent issue. I will discuss the more controversial case of midstream amendments.

[68] *See id.* at 1828-29.

the amendment to lose and never recover part of his purchase price as a result of a value-decreasing amendment for which he did not himself vote.[69] Such a shareholder should not be seen as "consenting" to the amendment, Bebchuk claims.

Bebchuk's argument, however, is flawed for at least two reasons. First, as mentioned above, the shareholder's initial stock price arguably reflected the *possibility* of the amendment, and if so, no part of the stock purchase price is irrecoverably lost. Second, Bebchuk's argument that a majority vote is insufficient to guarantee a value-maximizing outcome is in conflict with the semi-strong efficient market hypothesis, endorsed by the courts.[70] As a policy matter, it is far more desirable for courts to enforce provisions approved by a majority of shareholders than to systematically second-guess the wisdom of the shareholders to enforce only those charter and bylaw amendments which the courts themselves believe are value-maximizing.

Shareholders in a direct cause of action might have a marginally stronger lack-of-consent argument than shareholders in a derivative cause of action. Shareholders in a derivative suit bring the suit on behalf of the corporation,[71] and the corporation is a signatory to both the bylaws and charter.[72] By contrast, shareholders in a direct cause of action bring suit on behalf of themselves, and thus may not be viewed as signatories to the contract. Some Delaware courts, for example, view the bylaws and charter as a contract between the corporation and the board of directors.[73] In that case, because the shareholders are not literally parties to the contract, they may argue that they did not consent to the contract. Nonetheless, in *Elf Atochem*, the Delaware Supreme Court held that a forum-selection clause in an LLC agreement was applicable to *both* direct and derivative claims.[74] This was true even though the LLC agreement was signed only by the members and not the corporation, such that the corporation was not a signatory to the contract in a

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[69] *See id.* at 1829.

[70] *See generally* Basic v. Levinson, 485 U.S. 224, 241 (1988).

[71] Shareholders in derivative suits have been described as "stand[ing] in the shoes" of the corporation. Schleiff v. Baltimore & Ohio R.R. Co., 130 A.2d 321, 326 (Del. Ch. 1955); *accord* Kamen v. Kemper Fin. Serv., 500 U.S. 90, 95 (1991).

[72] *See* Salaman v. Nat'l Media Corp., 1992 WL 808095, at *6 (Del. Super. Ct. 1992) ("Generally, corporate documents such as bylaws have the force of a contract between the corporation and the directors"). *But see* Centaur Partners v. Nat'l Intergroup, Inc., 582 A.2d 923, 928 (Del. 1990) (stating that bylaws are contract among the stockholders).

[73] *See supra* note 72.

[74] *See* Elf Atochem, 727 A.2d 286, 293-94 (Del. 1999).

derivative claim.[75] Arguably, the reverse logic would be true, such that shareholders could bring a direct action.

The Delaware Chancery Court further indicated that a forum-selection clause in the charter or bylaws would be binding on *all* shareholders when it explained the logic behind the court's holding in *Parfi*.[76] In *Parfi*, the Delaware Supreme Court held that an arbitration provision in an underwriting agreement was not enforceable for a breach of fiduciary duty claim.[77] According to the Chancery Court, the court in *Parfi* was "clearly influenced" by the fact that not all shareholders were parties to the underwriting agreement, a problem which the Chancery thought would have been solved if the arbitration agreement was "contained in the basic contract of the entity—the corporation's charter—that gave rise to the fiduciary relationship . . . ."[78]

iii. Vested-Interest Arguments

Finally, shareholders who purchased shares prior to the amendment could attempt to escape the forum-selection clause by arguing that they had a "vested" interest in suing outside of Delaware, as allowed implicitly by the lack of forum-selection clause in the previous bylaws or charter.[79] At least one Delaware case has held that "[t]he power to alter, amend, or repeal bylaws [or other corporate documents] cannot confer authority to make an amendment which amounts to the destruction or impairment of vested or contract rights."[80] For example, the court in *Salaman* held that a bylaw amendment changing director indemnification from mandatory to permissive could not act retroactively to deny indemnification to a director who already had been sued prior to the amendment.[81] Another more recent case, however, has been more skeptical of vested contract rights, clarifying that absent reliance and an interest that vests *prior* to the amendment,[82] a bylaw amendment will not be prohibited. The court stated in *Kidsco*: "Where a

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[75] *See id.* at 293.

[76] Parfi Holding AB v. Mirror Image Internet, Inc., 817 A.2d 149 (Del. 2002).

[77] *See id.*

[78] *See* Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146, 1149 (Del. Ch. 2006).

[79] It is important to note, again, that this argument would apply only to what Bebchuk terms "midstream" amendments—as opposed to inclusion of a forum-selection clause in the initial bylaws or charter.

[80] Salaman v. Nat'l Media Corp., 1992 WL 808095, at *6 (Del. Super. Ct. Oct. 8, 1992).

[81] *Id.*

[82] *See* Kidsco, Inc. v. Dinsmore, 674 A.2d 483, 492 & n.6 (Del. Ch. 1995).

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,"[83] because in such a case, reliance on the previous bylaws is not justified. The *Kidsco* court did acknowledge, however, that vested rights could arise in exceptional circumstances, such as when an amendment denies "any remedy . . . against any corporation or its officers for any liability which shall have been *previously* incurred."[84]

Arguably, a forum-selection clause operates to deny a remedy for a liability, but the amendment only prohibits retroactive application for a liability *previously* incurred. Therefore, at the very least, the amendment would allow suits outside of Delaware *only* for breaches of fiduciary duty occurring before the amendment. More likely, however, the forum-selection clause would deny even those lawsuits arising out of a breach of duty occurring before the amendment if those suits were not actually filed prior to the amendment. For example, in *Kidsco*, the court held that there was no reliance on, and thus no vested interest in, the previous bylaws requiring a special meeting within thirty-five days of demand when no demand had been filed prior to the amendment.[85]

3. Would enforcement of the forum-selection clause result in litigation in a forum "so gravely difficult and inconvenient that [the plaintiff would] for all practical purposes be deprived of his day in court?"

A court will not enforce a forum-selection clause if litigation in the contractual forum will be "so gravely difficult and inconvenient that [the plaintiff would] for all practical purposes be deprived of his day in court."[86]

First, it is notable that a court will never consider it inconvenient for a plaintiff to litigate in the state of her residence. In derivative suits, the plaintiff is technically the corporation,[87] and a Delaware-chartered corporation is considered a

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[83] *Id.* at 492 (citation omitted).

[84] *Id.* (citing Folk et al., *Folk on the Delaware General Corporation Law*, § 394.2.2) (emphasis added).

[85] *Id.*

[86] M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 18 (1972); *see also* Alstom Power, Inc. v. Duke/Fluor Daniel Carribbean S.E., 2005 WL 407206, at *1, 3 (Del. Super. Jan. 31, 2005).

[87] *See* Kamen v. Kemper Fin. Serv., 500 U.S. 90, 95 (1991); *see also* Schleiff v. Baltimore & Ohio R.R. Co., 130 A.2d 321, 327 (Del. Ch. 1955).

"resident" of Delaware. Arguably, then, a derivative suit will never be stayed for inconvenience.

For direct suits (or for derivative suits where courts do not find the above argument convincing), the threshold is high for a court to find inconvenience substantial enough to warrant non-enforcement of a forum-selection clause. Courts have little tolerance for arguments that the forum is inconvenient when the inconvenience was "foreseeable" at the time of negotiating the contract and selecting the forum.[88] Delaware courts technically apply a *forum non conveniens* analysis to the issue, but require a "strict, heavy burden of a particularized showing of overwhelming hardship," an extremely high standard which it equates with the "gravely difficult" standard used by the U.S. Supreme Court.[89] Here, it is likely that the shareholder suit will be a class action, involving plaintiffs from various states (and perhaps countries). As a result, it will be difficult to show that Delaware is any less convenient for the shareholders than California. Moreover, the mere fact that a corporation's headquarters are outside of Delaware has been held insufficient to make Delaware an inconvenient forum.[90]

In light of the concern that a plaintiff will "for all practical purposes be deprived of his day in court," some courts also consider whether the forum of choice is a court of competent jurisdiction that would provide adequate remedies to the case at hand.[91] In this case, Delaware is certainly a court of competent jurisdiction with adequate remedies, particularly given its extensive body of corporate law, expert judges, and expedited procedure.

4. Would enforcement of the forum-selection clause contravene a "strong public policy" of the forum?

Finally, a court will not enforce a forum-selection clause if doing so contravenes a "strong public policy" of the forum (i.e., California).[92] If the Delaware corporation has little contact with California, it is unlikely that California has a "strong public policy" against litigation in Delaware.

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[88] *See Zapata*, 407 U.S. at 16-18.

[89] Aveta, Inc. v. Colon, 942 A.2d 603, n.7 (Del. Ch. 2008).

[90] *See, e.g., Alstom Power*, 2005 WL 407206, at *1, 3.

[91] *See* Carnival Cruise Lines v. Shute, 499 U.S. 585, 595 (1991).

[92] *Zapata*, 407 U.S. at 15; *accord Coastal Steel*, 709 F.2d at 202; Bbdova, LLC v. Auto. Techs., Inc., 358 F. Supp. 2d 387, 390 (D. Del. 2005).

However, if the Delaware corporation is subject to the terms of section 2115, it is possible that California would refuse to stay the action. California courts have made clear that the policy behind section 2115 is, in part, motivated by a belief that California has the largest stake in protecting resident shareholders and other stakeholders (e.g., employees) and that this interest is greater than any incorporating state's right to regulate internal affairs.[93] Section 2115's policy of protecting California shareholders and stakeholders will not be effected if the case is stayed to Delaware, because the Delaware Supreme Court has squarely held that section 2115 violates conflict-of-laws principles and the U.S. Constitution.[94] Thus, if California considers the policy of protecting California shareholders and stakeholders by applying its own corporate law to be "strong," it will not enforce a Delaware forum-selection clause contained in the bylaws or charter of a Delaware corporation subject to section 2115.

II. Would a *Delaware* Court Enforce a *California* Forum-Selection Clause?

Although a less practical question in terms of solving the "anywhere but Chancery" problem, an interesting theoretical question is whether a *Delaware* court would enforce a forum-selection clause in the bylaws or charter of a Delaware corporation that selected a *non-Delaware* forum (such as California). For the most part, the analysis would be the same as above. However, because Delaware would apply its own policy to determine whether the forum-selection provision violates a "strong public policy" of the forum, the outcome might be different.

Arguably, Delaware has a "strong public policy" of interpreting and advancing its own corporate law, particularly with regard to novel and emerging questions of law. For example, in *Topps*, the Chancery Court stated that the "chartering state has a powerful interest in ensuring the uniform interpretation and enforcement of its corporation law, so as to facilitate economic growth and efficiency."[95] It explained that this "important policy interest"[96] is particularly strong for "new" and "emerging" corporate law issues.[97] This policy can best be effected if Delaware's law is interpreted by an "informed group of judges who are repeat

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[93] *See, e.g.*, Wilson v. La.-Pac. Res., Inc., 187 Cal. Rptr. 852, 858 (Ct. App. 1983); *see also* CAL. CORP. CODE § 2115 (West 2006) (Legislative Committee Comments).

[94] *See* VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 (Del. 2005).

[95] *In re* Topps Co. Shareholders Litig., 924 A.2d 951, 951 (Del. Ch. 2007).

[96] *Id.* at 960.

[97] *Id.*

players on matters of corporate law"[98] – not by "a variety of state and federal judges who only deal episodically with [Delaware] law."[99] The policy of advancing its own corporate law would not be fulfilled if Delaware enforced a California forum-selection clause.

On the other hand, it is possible to read *Topps* as primarily emphasizing a policy in favor of contractual freedom and fulfilling shareholder expectations. For example, the court states: "What is most important is . . . that the stockholders [the plaintiff] seek to represent have their legitimate expectations upheld,"[100] and "[t]hose stockholders invested on the understanding that Delaware law would govern their relations with the firm."[101] Where shareholders explicitly agree to a forum-selection clause, their expectations are arguably altered.[102] This appears to be part of the rationale behind *Elf Atochem*, where the court opted in favor of contractual freedom over Delaware's interest in application of its own LLC law. Although there is perhaps a particularly strong policy in favor of contractual freedom in the context of LLCs,[103] Delaware courts have also acknowledged a more general policy, applicable outside the LLC context, of "giv[ing] effect to the terms of private agreements to resolve disputes in a designated judicial forum out of respect for the parties' contractual designation."[104]

Delaware's policy interest in resolving questions of its own corporate law is all the stronger when the corporation is subject to section 2115. Clearly, Delaware has expressed a strong belief that section 2115 violates the important policy goals of the internal affairs doctrine (i.e., predictability and reasonable expectations of investors and management), as well as "federal due process, commerce clause and

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[98] *Id.* 956 n.24.

[99] *Id.* at 959.

[100] *Id.* at 956.

[101] *Id.* at 962.

[102] It is possible that a Delaware court would find that the shareholders expected litigation in Delaware despite a forum-selection clause specifying otherwise. For example, the Court in *Rosenmiller v. Bordes*, 607 A.2d 465, 468-69 (Del. Ch. 1991), held that the stockholders in a Delaware corporation expected Delaware law to apply notwithstanding a choice-of-law provision to the contrary. The Court also emphasized Delaware's strong interest in applying its own law to a Delaware corporation, notwithstanding the fact that the corporation had selected the law of its headquarters and principal place of business. *See id.* Of course, it is possible to distinguish this case, because absent a choice-of-law provision, Delaware law would apply (*almost* without exception), but absent a choice-of-forum provision, shareholders would not expect litigation only in Delaware courts.

[103] *See* DEL. CODE ANN. tit. 6, § 18.1101(b) (2005).

[104] Troy Corp. v. Schoon, 2007 WL 949441, at *2 (Del. Ch. 2007) (citation omitted).

full faith and credit considerations."[105] While a Delaware court would not want to enforce a forum-selection clause if doing so meant that a Delaware corporation would be subject to California corporate law, generally, the Delaware courts have assumed that California courts will apply Delaware law "where Delaware law clearly is applicable," as, for example, in light of the "vitality and constitutional underpinnings of the internal affairs doctrine."[106]

Conclusion

The validity of a forum-selection clause in the bylaws or charter of a Delaware corporation will likely be resolved by litigation sometime in the near future.[107] This Note concludes that a court both would and should enforce such a provision. If forum-selection clauses contained within corporate bylaws or charters are enforceable, they have the potential to transform the current "anywhere but Chancery" problem into the "nowhere but Chancery" solution.

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[105] *Rosenmiller*, 607 A.2d at 468; *see also VantagePoint*, 871 A.2d 1108.

[106] Draper v. Paul N. Gardner Defined Plan Trust, 625 A.2d 859, 867 (Del. 1993).

[107] However, as a potential deterrent for plaintiffs' lawyers to test the waters, Delaware courts have held that the breach of an enforceable forum-selection clause entitles the defendant to damages, just like any other breach of contract. *See* Cornerstone Brands, Inc. v. O'Steen, 2006 WL 2788414, at *4 (Del. Ch. 2006) (citing El Paso Natural Gas Co. v. TransAmerican Natural Gas Corp., 669 A.2d 36, 40 (Del. 1995)). In particular, damages may include the defendants' attorneys' fees in defending the validity of the forum-selection clause. *Id.*