Texas Courts Must Enforce Corp. Forum Selection Clauses

Law360, New York (February 11, 2014, 2:29 PM ET) -- Texas, with its low tax and regulatory environment, skilled workforce, and abundant natural resources, proudly boasts that it is home to a large number of publicly traded companies. But the majority of those Texas-headquartered companies choose to be incorporated outside of Texas, primarily in Delaware, with its well-developed body of corporate law.

By choosing to invest in Delaware corporations, shareholders expect that Delaware law will govern any issues concerning the "internal affairs" of the corporation. And, when lawsuits arise involving the internal affairs of a Delaware corporation — such as lawsuits involving extraordinary events like mergers and acquisitions or derivative actions alleging corporate misgovernance — Texas courts uniformly respect the shareholders' choice and apply Delaware law to the substantive legal issues.[1]

But why do shareholder-plaintiff attorneys asserting derivative or other claims involving the internal affairs of a Delaware corporation choose to file their lawsuits in Texas in the first place?

While some may claim that they choose to file in Texas out of convenience (arguing that the events in question occurred at the corporate headquarters in Texas), the more likely explanation for filing a lawsuit in Texas is that plaintiffs' lawyers believe they command better settlements by raising the litigation costs and the higher perceived threat of inconsistent decisions from trial courts that are less familiar with Delaware law (although, in the case of Texas, the state courts generally do a very good job of applying Delaware law[2]).

Whatever the justification, the result has been a proliferation of litigation outside of Delaware on these issues that are governed by Delaware law. As Delaware's Vice-Chancellor J. Travis Laster stated recently, "interforum dynamics ... have allowed plaintiffs' counsel to extract settlements in M&A litigation and … have generated truly absurdly high rates of litigation-challenging transactions."[3]

This is a problematic result for the state of Texas. There is no benefit to have its courts clogged with lawsuits involving the internal affairs of a company that pays incorporation fees to another state. And, if Texas-based companies face a proliferation of costly litigation over corporate issues that result from being headquartered in Texas, shareholders may instead choose to invest in companies headquartered elsewhere, thus hurting the ability of Texas-based companies to achieve optimal capital structures.

Fortunately for Texas, the Delaware courts have endorsed a solution to the problem. Two recent decisions from the Delaware Chancery Court have enforced forum selection provisions in the company's charter or bylaws that require shareholders to bring derivative and other lawsuits involving the company's internal affairs in Delaware courts.

Texas practitioners should be aware of these decisions and look for forum selection clauses when litigation arises involving the internal affairs of a Delaware corporation. This article will first discuss those decisions and then analyze whether Texas courts should and would enforce such

provisions.

Two Key Delaware Decisions Lay the Path for the Enforcement of Corporate Forum Selection Clauses

In the 2010 In re Revlon Inc. Shareholders Litigation decision, Laster suggested that boards of directors could adopt forum selection clauses in their corporate charters to avoid the problem of multiforum litigation.[4] As a result of this decision, many corporate practitioners have begun advising their clients to place forum selection clauses in their corporate bylaws or their charters.

Two recent cases, summarized below, have affirmed the enforceability of such provisions as a matter of Delaware law.

Importantly, however, while the Delaware courts have found that such agreements are enforceable, the Delaware courts have not been willing to enjoin litigation in other forums that was brought in violation of the forum selection clauses out of respect for interstate comity. As a result, it will likely be up to the courts outside of Delaware — for our purposes, Texas — to determine whether to enforce the forum selection clauses and send the litigation to Delaware.

Boilermakers Local 154 Retirement Fund vs. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013)

Boilermakers Local 154 involved a shareholder's challenges to a Delaware forum selection provision added by the board of directors to the corporate bylaws. In analyzing the issue, Chancellor Leo Strine held that a board with authority to adopt bylaws also has the authority under Delaware General Corporation Law to include a bylaw that selects the forum for lawsuits involving the corporation's internal affairs.

As the court reasoned, "8 Del. C. § 109(b) provides that the bylaws of a corporation '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.' The forum selection bylaws, which govern disputes related to the 'internal affairs' of the corporations, easily meet these requirements" because they regulate only lawsuits "brought by stockholders as stockholders in cases governed by the internal affairs doctrine."[5]

Strine further held that "the bylaws are valid and enforceable contractual forum selection clauses." This conclusion followed from a long line of Delaware law that holds that bylaws (together with the charter) are part of a broader contract among the directors, officers and stockholders of a Delaware corporation.[6]

Strine did leave the door open for plaintiffs to challenge the inclusion of forum selection clauses as themselves being a breach of fiduciary duty (with any such litigation occurring in Delaware).[7]

Edgen Group Inc. v. Genoud, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013)

Edgen Group Inc. v. Genoud, involved an attempt to enjoin litigation pending in Louisiana that challenged the merger of a Delaware corporation headquartered in Louisiana, and as such involved the internal affairs of a Delaware corporation. Laster entered an oral decision on a motion for a temporary restraining order that recognized that forum selection clauses in a Delaware corporation's charter were enforceable as a matter of Delaware law, but refused to issue an anti-suit injunction out of comity to the Louisiana court.

At the outset, Laster noted that Delaware courts have a comparative advantage in applying Delaware corporate law.[8] While "for many types of suits, suing where the company is headquartered makes perfect sense and could likely be quite preferable to suing in Delaware, but for suits against a board of directors where the suit is governed by Delaware law under the internal affairs doctrine, the concept of comparative advantage comes directly into play."[9]

The court thus recognized that plaintiffs' counsel choose to sue in non-Delaware forums to extract "rents" in the form of greater costs and correspondingly greater settlement leverage from the board of directors and therefore hurt the shareholders that they seek to represent.

"[T]he ability of plaintiff's counsel to sue in multiple forums is a factor that imposes materially increased costs on deals and effectively disadvantages stockholders as a whole."[10] He further recognized that corporations have included forum selection provisions in charters and bylaws "in an effort to reduce the ability of plaintiff's counsel to extract rents."[11]

In analyzing whether to enforce forum selection clauses in a corporate charter, the court recognized that as a matter of well-settled Delaware law, a charter "is a three-way contract among the corporation, all of its stockholders, and the state of Delaware, which creates [the corporation] and provides its key attributes."[12]

The court went on to hold that "[t]he forum selection provision in the charter is valid as a matter of Delaware corporate law."[13] Thus, "the [stockholder] here has facially breached the exclusive forum clause" by suing for alleged breaches of fiduciary duty outside of Delaware.[14]

The court, however, refused to enter an anti-suit injunction, out of a concern that it might have lacked personal jurisdiction over the plaintiff, but more importantly, because of comity with the Louisiana court that was considering the lawsuit. Thus, the Edgen decision squarely places the issue in the hands of Texas (or other state courts considering issues of Delaware law) to enforce forum selection provisions in corporate bylaws or charters.

Texas Courts Should Enforce Forum Selection Clauses In Corporate Charters and Bylaws

With these principles in mind, the question for Texas practitioners is how should a Texas court address the question of whether to enforce a forum selection clause in a company's charter or bylaws? Texas courts — as directed by the Texas Supreme Court — "employ the federal standard for analyzing forum selection clauses; thus, our analysis under federal law is substantively similar to state law, and we apply Texas procedural rules."[15]

As a matter of Texas law, "[f]orum selection clauses are generally enforceable, and a party

attempting to show that such a clause should not be enforced bears a heavy burden."[16] Moreover, the Texas Supreme Court has held that the improper refusal to enforce a forum selection clause warrants mandamus relief.[17]

The Texas Supreme Court has stated that a party may successfully oppose enforcement of a forum selection clause but only if it "clearly show[s] that (1) the clause is invalid for reasons of fraud or overreaching, (2) enforcement would be unreasonable or unjust, (3) enforcement would contravene a strong public policy of the forum where the suit was brought, or (4) the selected forum would be seriously inconvenient for trial."[18]

It is difficult, however, to see how any of these exceptions would apply in the situation of a forum selection clause located in a corporate charter or bylaws.

For one, it is unlikely that a forum selection clause that is found in the corporate charter and approved by the majority of the shareholders could be found to be fraudulent, overreaching or unfair. While a plaintiff's counsel would have a relatively stronger argument with respect to a provision adopted by the board of directors in the company's bylaws, there is a good argument that such provisions should still be enforceable as a matter of Texas law.

Importantly, as Strine recognized in Boilermakers Local, "[u]nlike Cruise ship passengers, who have no mechanism by which to change their tickets' terms and conditions, stockholders retain the right to modify the corporation's bylaws."[19] Thus, if a majority of shareholders disagreed with the bylaw, they could change it.

Similarly, there are no compelling public policy reasons to allow shareholders of a Delaware corporation, purporting to represent the company in the case of derivative litigation or purporting to represent the class of shareholders to bring their lawsuits in Texas.

The shareholders likely live around the world, so they would have no unique reason to expect that a Texas court would address the issue. Moreover, the Texas Supreme Court has been reluctant to find any special right to have a Texas court address issues even where the plaintiff is a Texas resident.

In In re Autonation, the Texas Supreme Court rejected the argument that a forum selection clause in a covenant not to compete involving a Texas resident violated fundamental public policy.[20] This argument is particularly strong where there is no doubt that Delaware law will govern the substantive issues in the litigation. And there is a strong public policy in protecting Texas businesses against litigation in a forum they did not agree to, and therefore encouraging more Delaware corporations to choose to be headquartered in Texas.[21]

For these reasons, if a Texas court was asked to enforce a Delaware forum selection clause in a corporate charter or bylaws, applying well-settled principles of deference to Delaware law and enforcement of forum selection clauses, the court likely would enforce the clause and send the case to Delaware (or require the suit be brought there).

Conclusion

We anticipate that more Texas-based corporations will adopt Delaware forum selection provisions in their charters or bylaws, and consistent with the Texas courts' respect for Delaware and the strong deference to forum selection clauses generally, there is good reason to believe that such provisions will be found to be enforceable in Texas.

—By Yolanda C. Garcia and Robert Velevis, Sidley Austin LLP

Yolanda Garcia is a partner and Robert Velevis is a counsel in Sidley Austin's complex commercial litigation group in Dallas. They both frequently represent companies and boards of directors in litigation involving mergers and acquisition and other shareholder-derivative litigation in courts across the country, particularly in Texas.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] See, e.g., Tex. Bus. Orgs. Code Ann. § 1.102; In re Parkcentral Global Litig., 3:09-CV-0765-M, 2010 WL 3119403 (N.D. Tex. Aug. 5, 2010).

[2] See, e.g., Connolly v. Gasmire, 257 S.W.3d 831, 848 (Tex. App.—Dallas 2008, no pet.) (applying Delaware law and rigorously enforcing Delaware's demand requirements); Shirvanian v. DeFrates, 161 S.W.3d 102, 112 (Tex. App. — Houston [14th Dist.] 2004, pet. denied) (applying Delaware law) (applying Delaware law and dismissing direct lawsuits that should have been asserted derivatively).

[3] Edgen Grp. Inc. v. Genoud, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013) ("Edgen Tr.") at 19:17-20).

[4] 990 A.2d 940 (Del. Ch. 2010) ("[I]f 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 provisions selecting an exclusive forum for intra-entity disputes.").

[5] 73 A.3d at 939.

[6] See, e.g., Airgas Inc. v. Air Prods. & Chems. Inc., 8 A.3d 1182, 1188 (Del. 2010).

[7] See 73 A.2d at 963 ("[A]s with the case of bylaws generally, the board's use of its powers under the bylaw is subject to challenge as inconsistent with its fiduciary duties in the event of an actual dispute.").

[8] "This is simply a question of what we do a lot, versus what other courts do a lot. I do Delaware mergers and acquisitions cases a lot. I therefore have a comparative advantage in

handling Delaware law M&A cases, because I am very familiar with that body of law. There are myriad types of cases where other courts would have a dramatically large comparative advantage over me." Edgen Tr. at 23:4-14.

[9] Edgen Tr. at 24:17-23.

[10] Id. at 20:7-10.

[11] Id. at 19:23-20:1.

[12] Id. at 29:1-5 (citing STAAR Surgical Co. v. Waggoner, 588 A.2d 1130, 1136 (Del.1991) ("[A] corporate charter is both a contract between the state and the corporation, and the corporation and its shareholders.")).

[13] Id. at 28:24-29:1.

[14] Id. at 31:1-2.

[15] In re Omega Protein Inc., NO. 01-08-00656-CV, 2009 Tex. App. LEXIS 419 (Tex. App. — Houston [1st Dist.] Jan. 20, 2009, orig. proceeding) (citing Michiana Easy Livin' Country Inc. v. Holten, 168 S.W.3d 777, 793 (Tex. 2005)).

[16] In re Int'l Profit Assocs. Inc., 274 S.W.3d 672, 675 (Tex. 2009).

[17] See In re AIU Ins. Co., 148 S.W.3d 109, 117 (Tex. 2004) (orig. proceeding).

[18] In re Int'l Profit Assocs. Inc., 274 S.W.3d at 675.

[19] 73 A.3d at 957-58.

[20] 228 S.W.3d 663, 670 (Tex. 2007) ("[W]e will not presume to tell the [49] other states that they cannot hear a noncompete case involving a Texas resident employee and decide what law applies, particularly where the parties voluntarily agree to litigate enforceability disputes there and not here.").

[21] We do note that there has been at least one case that has refused to enforce a Delaware forum selection clause. See Galaviz v. Berg, 763 F. Supp. 2d 1170, 1174-75 (N.D. Cal. 2011) ("[T]he venue provision was unilaterally adopted by the directors who are defendants in this action, after the majority of the purported wrongdoing is alleged to have occurred, and without the consent of existing shareholders who acquired their shares when no such bylaw was in effect. Under these circumstances, there is no basis for the court to disregard the plaintiffs' choice of forum.") This aspect of the decision was criticized by Strine in his Boilermakers Local 154 Retirement Fund, and ignores that shareholders may change the bylaws by vote. Galaviz did recognize, however, that "[c]ertainly were a majority of shareholders to approve such a charter amendment, the arguments for treating the venue provision like those in commercial contracts

would be much stronger, even in the case of a plaintiff shareholder who had personally voted against the amendment." Id. at 1175.