
CASE NOTE

REEVALUATING *GALAVIZ v. BERG*: AN ANALYSIS OF FORUM- SELECTION PROVISIONS IN UNILATERALLY ADOPTED CORPORATE BYLAWS AS REQUIREMENTS CONTRACTS

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INTRODUCTION

In the wake of a passing comment and footnote in *In re Revlon, Inc. Shareholders Litigation*,¹ Delaware practitioners have grappled with the enforceability of forum-selection provisions adopted in corporate charters and bylaws. After the Delaware Chancery Court decided *In re Revlon* in 2010, most practitioners concluded that such a provision would be enforceable under Delaware corporate law. However in 2011, in *Galaviz v. Berg*—a case of first impression—the Northern District of California rejected the contention in *In re Revlon* that forum-selection provisions adopted by Delaware corporations should be contractually enforceable.² The court in *Galaviz* instead held that a forum-selection provision contained in a bylaw unilaterally adopted by a board of directors was not binding on shareholders under federal procedural law governing forum-selection provisions.³ Still, given the uncertainty regarding the enforceability of forum-selection provisions

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¹ 990 A.2d 940, 960 & n.8 (Del. Ch. 2010).

² See *Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1174-75 (N.D. Cal. 2011) (“Under these circumstances, there is no basis for the Court to disregard the plaintiffs’ choice of forum . . .”).

³ *Id.*

in other jurisdictions, many practitioners continue to advise companies to adopt these provisions “just in case.”⁴ *Galaviz* is likely not the last word on the enforceability of forum-selection provisions in charters and bylaws. Depending on the contract analysis a federal court accepts, some courts may find forum-selection provisions contractually binding on shareholders while others, like the court in *Galaviz*, will not.⁵ The impact of *Galaviz* hinges on whether other courts choose to invalidate forum-selection clauses contained in bylaws, in which case corporations will need to find other ways to respond to costly shareholder litigation, or whether courts will reject the *Galaviz* contract analysis, enabling boards of directors to rely on the enforceability of the forum-selection provisions they adopt.

I argue in this Case Note that in spite of the *Galaviz* decision, under federal procedural law governing the enforceability of such provisions, forum-selection provisions in bylaws that are unilaterally adopted by a board of directors should be contractually binding on shareholders. In Part I, I describe the typical content of charters and bylaws of Delaware corporations, as well as the ways by which charters and bylaws can be amended, asking preliminarily whether amendments to charters and bylaws are contractually binding under Dela-

⁴ See, e.g., Stephen LaSala, *Risk Management Techniques for Today's M&A Transactions* (“[D]elaware corporations, particularly those that are publicly traded, should consider the adoption of a forum-selection bylaw.”), in *ADVISING CLIENTS IN MERGERS AND ACQUISITIONS*, 2011 ED., LEADING LAWYERS ON UNDERSTANDING RECENT LEGAL DEVELOPMENTS, HANDLING CROSS-BORDER M AND A DEALS, AND NAVIGATING THE CURRENT ECONOMIC CLIMATE 10 (2011).

⁵ See Brian v. Breheny et al., *Skadden 2011 Insights: Global M&A* (“It would not be surprising to see additional stockholder challenges testing the validity of such ‘choice of forum’ provisions in Delaware and other courts in 2011.”), in *PRACTISING LAW INSTITUTE, GLOBAL CAPITAL MARKETS & THE U.S. SECURITIES LAWS 2011: STRATEGIES FOR THE CHANGING REGULATORY ENVIRONMENT* 299, 308 (2011); LaSala, *supra* note 4, at 9 (“[C]ompanies should be advised that such clauses are a relatively new phenomenon, and their enforceability remains uncertain.”); Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 *DEL. J. CORP. L.* 57, 134 (2009) (“Even where they passed muster in a shareholder vote, the provisions would be tested by plaintiffs in litigation beyond Delaware. One state’s conclusion about the enforceability of the charter forum restriction would not be binding on another.”); Charles M. Nathan, *New Challenges and Strategies for Designating Delaware as Jurisdiction for Corporate Disputes*, *HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG.* (May 11, 2011, 9:31 AM), <http://blogs.law.harvard.edu/corpgov/2011/05/11/new-challenges-and-strategies-for-designating-delaware-as-jurisdiction-for-corporate-disputes> (“[*Galaviz*] is not the last word on the subject and additional cases will be needed to test the viability of exclusive jurisdiction bylaws before we know whether shareholder approval is required and whether exclusive jurisdiction provisions will be enforced by jurisdictions other than Delaware . . .”).

ware law. In Part II, I present the current state of the law on forum-selection provisions in contracts, and then examine the kinds of forum-selection provisions that have recently been incorporated into corporate charters and bylaws. In Part III, I describe Vice Chancellor Laster's dicta in *In re Revlon*, which set the stage for the California district court's contract analysis in *Galaviz v. Berg*, presented in Part IV. Finally, in Part V, I analyze the board of directors–shareholder relationship in terms of a requirements contract, and conclude that forum-selection provisions should be enforceable under federal procedural law governing such provisions.

I. CHARTERS AND BYLAWS

Before evaluating the contractual enforceability of provisions contained in charters and bylaws, it is necessary to understand what relationships these documents govern and how the documents can be amended under Delaware corporate law. The primary governing document of any corporation is the corporate charter, sometimes referred to as the corporation's Articles of Incorporation or Certificate of Incorporation. Under Delaware law, the charter must set forth the name and address of the corporation, the nature of the business to be conducted, and any preferred stock the corporation intends to issue in addition to its common stock.⁶ The charter may also contain a provision conferring upon the board of directors the power to adopt, amend, and repeal bylaws.⁷

Bylaws are the secondary governing documents of a corporation. Bylaws delineate “the rules and regulations or private laws enacted by the corporation to regulate, govern and control its own actions, affairs and concerns and its shareholders or members and its directors and officers with relation to each other and among themselves in their relation to the corporation.”⁸ 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.”⁹ Bylaws are, unlike shareholder resolutions,¹⁰

⁶ DEL. CODE ANN. tit. 8, § 102(a)(1)–(4) (2011).

⁷ *Id.* § 109(a).

⁸ WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 4166, at 655 (Carol A. Jones ed., 2010).

⁹ Tit. 8, § 109(b).

¹⁰ See Edward D. Herlihy, *Takeover Law and Practice 2009* (“A board of directors has no legal obligation under state or federal law to accept or act upon precatory share-

binding on a board of directors, although subsidiary to any provisions included in the charter.

A. *Are Charters Contracts?*

A charter defines the relationship between the board of directors and the shareholders in a corporation. However, the manner by which charters (and bylaws) may be amended is a function of the corporate law of the state in which a corporation is incorporated.¹¹ Further, the procedures by which charters (and bylaws) are amended may or may not comport with the requirements of contract law. In Delaware, provisions find their way into a charter in one of two ways: (1) a provision may be placed in a charter at the time of incorporation,¹² or (2) a provision may be incorporated into the charter upon the adoption of a resolution by the board of directors and a majority vote of the shareholders.¹³ Because a charter amendment requires both a resolution by the board of directors and a shareholder vote, charters have more “contractual force” than bylaws, which is why “variations from the conventional model of corporate governance” are usually included in charters rather than bylaws.¹⁴ Still, even where rights are delineated in a charter, those rights differ from contractual rights.¹⁵

holder proposals that receive the vote of a majority of the outstanding shares entitled to vote.”), in PRACTISING LAW INST., CONTESTS FOR CORPORATE CONTROL 2010: CURRENT OFFENSIVE AND DEFENSIVE STRATEGIES IN M&A TRANSACTIONS 339, 365 (2010).

¹¹ See *infra* notes 13, 16-18, and accompanying text.

¹² Tit. 8, § 102.

¹³ *Id.* § 242(b)(1); see also Steven M. Davidoff, *A Litigation Plan That Would Favor Delaware*, N.Y. TIMES DEALBOOK (Oct. 26, 2010, 9:30 AM), <http://dealbook.nytimes.com/2010/10/26/a-litigation-plan-that-would-favor-delaware> (suggesting that including a provision in a charter at the time of incorporation is easier than submitting a resolution to a shareholder vote).

¹⁴ G. Richard Shell, *Arbitration and Corporate Governance*, 67 N.C. L. REV. 517, 542 n.166 (1989); see also LATHAM & WATKINS LLP, CORPORATE GOVERNANCE COMMENTARY: DESIGNATING DELAWARE’S COURT OF CHANCERY AS THE EXCLUSIVE JURISDICTION FOR INTRA-CORPORATE DISPUTES: A NEW “MUST” FOR DELAWARE COMPANY CHARTER OR BYLAWS 1 (2010), available at http://www.lw.com/upload/pubContent/_pdf/pub3510_1.pdf (“Subject to the complications of a shareholder approval process, amending a company’s charter to include a forum selection provision is generally preferable to amending its bylaws.”).

¹⁵ See Jennifer B. Poppe & Alithea Z. Sullivan, *Could the Supreme Court’s Enforcement of Arbitration in Concepcion Reverberate in the Securities Litigation Sphere?*, SEC. LITIG. REP., Sept. 2011, at 1, 3 (“The most obvious distinction between contractual and shareholder rights is that only the latter may be altered without consent [E]ven when a majority vote by shareholders is required, dissenting shareholders have far less recourse than

B. *Are Bylaws Contracts?*

Under Delaware law, bylaws may be adopted in one of three ways. First, initial incorporators may unilaterally adopt, amend, or repeal bylaws before stock in the corporation has been sold.¹⁶ Second, after stock has been sold, stockholders entitled to vote may adopt, amend, or repeal bylaws by majority vote.¹⁷ Finally, as noted above, a charter may authorize a board of directors to unilaterally adopt, amend, and repeal bylaws without shareholder vote, subject to the limitation that this power “shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws.”¹⁸ This third option is available to most, but not all, corporations.¹⁹

Subject to Section 109(b)’s limitation on appropriate subjects for bylaws,²⁰ Delaware law considers bylaws adopted by any of these methods to be binding on both the board of directors and the shareholders.²¹ While “bylaws are often described as a contract among the members of a corporation,”²² the analysis in Delaware centers not on whether the method by which a bylaw is adopted creates a contractually binding relationship between the board of directors and shareholders,

a party to a conventional contract.”); Stevelman, *supra* note 5, at 132 (explaining that “consent” is conceptualized differently in corporate law than in contract law, since in corporate law consent means “a vote of the majority of shares is binding on the rest”). *But see* SAMUEL C. THOMPSON, JR., *MERGERS, ACQUISITIONS AND TENDER OFFERS: LAWS AND STRATEGIES* § 5:2.8 (2011) (emphasizing that forum-selection provisions affect only intra-company litigation, in which both parties involved in the litigation are parties to the board of directors–shareholder relationship).

¹⁶ See tit. 8, § 109(a).

¹⁷ *Id.*

¹⁸ *Id.*; see also Frederick H. Alexander & Daniel D. Matthews, *The Multi-Jurisdictional Stockholder Litigation Problem and the Forum Selection Solution*, BNA’S CORP. COUNSEL WKLY., May 11, 2011, at 2, 3 (“Assuming the corporation’s charter authorizes its board to amend the bylaws, the board can adopt such a provision without stockholder action. The stockholders would, however, retain the unilateral authority to amend the bylaws.” (citations omitted)).

¹⁹ See R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* Form 1.5 (3d ed. 1998) (“[T]he Board of Directors of the corporation is expressly authorized to make, alter and repeal the bylaws of the corporation, subject to the power of the stockholders of the corporation to alter or repeal any by-law whether adopted by them or otherwise.”); Stevelman, *supra* note 5, at 132 (noting that it “is often the case” that a charter grants a board of directors the power to unilaterally amend bylaws).

²⁰ See tit. 8, § 109(b).

²¹ See LATHAM & WATKINS LLP, *supra* note 14, at 2 (noting that because Delaware law is “deferential to corporate judgment,” the Court of Chancery typically “presumes that corporate bylaw and charter provisions . . . are valid and should be specifically enforced”).

²² See FLETCHER, *supra* note 8, § 4166, at 653.

but instead on whether the method by which a bylaw is adopted is authorized under state law. Practitioners' documents frequently warn against reading literally courts' contract-analysis language.²³

II. FORUM-SELECTION PROVISIONS

Provisions specifying the forum in which a dispute among contracting parties must be brought are common in commercial contracts. They are, however, a recent phenomenon in the world of corporate governance.

A. *Forum-Selection Provisions in Contracts*

Forum-selection provisions specify the forum where, in the event of breach, a contracting party may file suit. Commercial agreements often contain forum-selection clauses, including thirty-nine percent of contracts appended to Form 8-Ks and roughly eighty-seven percent of public company merger agreements.²⁴ Since *The Bremen v. Zapata Off-Shore Company*,²⁵ forum-selection provisions in contracts are presumptively enforceable, provided that the choice of forum is reasonable.²⁶ In determining the enforceability of forum-selection clauses in contracts, federal courts consider, among other things, (1) "whether the

²³ See *id.* § 4166, at 654 (noting that the "language of a contract used by the courts should not mislead the practitioner into believing that courts will actually treat bylaws exactly as they would a contract," especially when bylaw provisions are contrary to state law or when enforcement would cause "unreasonable hardship to the other shareholders"); see also 6 AM. BAR ASS'N SECTION ON LITIGATION, BUSINESS AND COMMERCIAL LITIGATION IN FEDERAL COURTS § 72:19 (Robert L. Haig ed., 3d ed. 2011) (describing *Kirleis v. Dickie McCamey & Chilcote PC*, 560 F.3d 156 (3d Cir. 2009), which held that a shareholder must have explicitly assented to a bylaw provision requiring arbitration for that bylaw to apply to her, and noting that "the Third Circuit chose not to apply the well-settled corporate principle that members of the corporation are presumed to know and understand the corporation's bylaws").

²⁴ See Joseph A. Grundfest, Stanford Law Sch. & The Rock Ctr. for Corporate Governance, Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches, slide 2 (Oct. 6 2010), available at <http://ssrn.com/abstract=1690561> (describing the "demographics" of forum-selection clauses and the dramatic recent increase in their usage).

²⁵ 407 U.S. 1 (1972) (analyzing the enforceability of a forum-selection clause in an international towage contract).

²⁶ See 14D CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 3803.1, at 51-52 (3d ed. 2007) ("Today, the common understanding is that these provisions are prima facie valid and should be enforced unless enforcement is shown to be unreasonable under the circumstances of the particular contract.").

challengers were aware of their potential liability,” (2) “whether the challengers were experienced business people,” (3) “whether the forum-selection clause was hidden,” (4) “whether enforcement of the forum-selection clause would deprive the challenger of his or her ‘day in court,’” and (5) “whether any related case was pending in the selected forum.”²⁷

B. *Forum-Selection Provisions in Charters and Bylaws*

Forum-selection provisions appear in corporate charters and bylaws in two forms: mandatory provisions, which state that litigation must be brought in the state of incorporation, and elective provisions, which state that the corporation has the option to keep litigation in the state of incorporation or to litigate a claim brought in another state if it so elects.²⁸ The law firm Latham and Watkins has suggested that corporations adopt the following elective provision in their bylaws:

The Court of Chancery of the State of 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 or officer of the Corporation to the Corporation or the Corporation’s stockholders, (iii) any action asserting a claim against the Corporation arising pursuant to any provision of the [Delaware General Corporation Law], or the Corporation’s Certificate of Incorporation or Bylaws, or (iv) any action asserting a claim against the Corporation governed by the internal affairs doctrine.²⁹

The circumstances enumerated in this model provision seek to apply the forum-selection provision to all disputes between the board of directors and the shareholders.³⁰

²⁷ See 1A FEDERAL PROCEDURE, LAWYER’S EDITION § 1:697 (2002). *But see* WRIGHT, *supra* note 26, § 3803.1, at 69 (“There is no requirement, beyond notice, that the forum clause be the subject of bargaining.”).

²⁸ See Davidoff, *supra* note 13 (explaining that forum-selection provisions in bylaws can be phrased either “as a requirement that all shareholder litigation would occur in the jurisdiction of incorporation or as an option for the corporation to elect that all shareholder litigation would occur in the state of incorporation”); Grundfest, *supra* note 24, at slide 6 (describing the difference between mandatory and elective provisions).

²⁹ LATHAM & WATKINS LLP, *supra* note 14, at 5. *But see id.* at 6, n.24 (“[W]e do not recommend including a clause concerning deemed notice or consent, such as ‘Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this Article’”).

³⁰ See Alexander & Matthews, *supra* note 18, at 2 (describing the circumstances under which forum-selection provisions do and do not apply); *see also* LATHAM & WATKINS LLP, *supra* note 14, at 1 (explaining that forum-selection clauses are useful “for

III. IN RE REVLON, INC. SHAREHOLDERS LITIGATION

In *In re Revlon, Inc. Shareholders Litigation*, Vice Chancellor Laster addressed the question of whether the lead counsel in a shareholder action should be replaced for failing to advocate adequately on behalf of its clients.³¹ The Vice Chancellor balanced the possibility that disqualification could incentivize law firms to provide more diligent representation against the likelihood that shareholders might respond to such disqualifications by bringing suits outside of Delaware to avoid the risk of having counsel removed.³² In dicta, Vice Chancellor Laster commented that Delaware corporate law might permit corporations to adopt forum-selection provisions in their charters:

Perhaps greater judicial oversight of frequent filers [of derivative suits] will accelerate their efforts to populate their portfolios by filing in other jurisdictions. If they do, and if 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.³³

While the Vice Chancellor referred explicitly to forum-selection provisions adopted in charters, the accompanying string cite³⁴ carried the implicit suggestion that forum-selection provisions could be adopted in bylaws as well.³⁵

the resolution of all intra-corporate disputes including claims asserting breach of fiduciary duty or seeking, under state law, to overturn directors' business judgments concerning matters ranging from the routine to potential M&A or other transformative transactions"); Davidoff, *supra* note 13 (explaining that forum-selection provisions would apply only to state law claims, and would not affect federal claims, such as SEC enforcement actions).

³¹ 990 A.2d 940, 942 (Del. Ch. 2010).

³² *Id.* at 960.

³³ *Id.* (emphasis added) (citations omitted).

³⁴ *Id.* at 960 n.8. The string cite included: DEL. CODE ANN. tit. 8, § 102(b)(1) (2011) (describing the limits of what kinds of provisions can be adopted in corporate charters); *Elf Atochem N. Am. Inc. v. Jaffari*, 727 A.2d 286, 287 (Del. 1999) (allowing an LLC agreement to select arbitration as its exclusive forum for litigating disputes); *Douzinis v. Am. Bureau of Shipping, Inc.*, 888 A.2d 1146, 1149 (Del. Ch. 2006) (enforcing a provision in an LLC agreement requiring that all intra-entity disputes be arbitrated); *Stevelman*, *supra* note 5, at 133-35 (arguing that forum selection provisions contained in charters and bylaws should be enforced under Delaware law); Sara Lewis, Note, *Transforming the "Anywhere but Chancery" Problem into the "Nowhere but Chancery" Solution*, 14 STAN. J.L. BUS. & FIN. 199 (2008) (same).

³⁵ See AM. BAR ASS'N SECTION ON LITIGATION, *supra* note 23, § 72:19 (interpreting *In re Revlon* to mean that forum-selection provisions could be adopted not only in

A. *Why Keep Cases in Delaware?*

When corporations adopt forum-selection provisions in their charters or bylaws, they generally do so to ensure that derivative suits are brought in Delaware. Requiring that matters be decided by the Delaware Court of Chancery affects settlement value in derivative suits both by providing increased certainty in outcomes³⁶ and by eliminating the increased costs of litigating in multiple forums.³⁷ Some practitioners, however, have argued that an “out-of-Delaware trend” has led to the strategic filing of derivative suits in forums other than Delaware in order to exploit the increased settlement value.³⁸ Adopting a forum-selection provision in a corporation’s charter or bylaws is one effective way to counteract strategic filings, a solution undoubtedly endorsed by Vice Chancellor Laster in response to these concerns.

charters, but in all governance documents); *see also* Grundfest, *supra* note 24, at slide 19 (“Because forum-selection provisions both relate to shareholder power and limit shareholder power, forum-selection provisions are appropriately included either in the bylaws or charter.”).

³⁶ *See* LaSala, *supra* note 4, at 9 (“A [] clause that requires a lawsuit to be resolved by the Delaware Chancery Court takes advantage of Delaware’s well-developed body of corporate case law, the court’s expertise in handling these types of cases, and its general reluctance to delay or enjoin transactions [which] can significantly limit [] uncertainty and cost . . .”); LATHAM & WATKINS LLP, *supra* note 14, at 2 (explaining that the Delaware Chancery Court is the “nation’s preeminent forum” regarding precedent, experience, focus, and quality, which makes interpretation and application of the law more predictable); SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES, 2011 INSIGHTS 53 (2011) (arguing that settlement value is lowered in Delaware because “the Court of Chancery does not pose the risk of a jury trial or punitive damages if the case proceeds past a preliminary injunction phase”); Lewis, *supra* note 34, at 201-02 (suggesting that outcomes are more uncertain when other states apply their own corporate laws in spite of the internal affairs doctrine, which would require application of Delaware corporate law).

³⁷ *See* LATHAM & WATKINS LLP, *supra* note 14, at 2 (arguing that forum-selection provisions prevent cases from being litigated in multiple forums at once, which reduces litigation costs).

³⁸ For example, during an acquisitions deal, shareholders of the target often bring opportunistic suits for their settlement value, though these suits “rarely prevent deals from going through.” *See* LaSala, *supra* note 4, at 9. These suits are considered an unavoidable cost of doing a deal because there is relatively little a corporation can do to prevent them. Forum-selection provisions, however, can decrease settlement value by increasing certainty in outcomes. *But see* John Armour, Bernard S. Black & Brian Cheffins, *Delaware’s Balancing Act* 22-28 (Univ. of Cambridge Legal Stud. Res. Paper Series, Working Paper No. 37/2011, 2011) (explaining that since 2001, cases have been moving out of Delaware, but arguing that because other forums have always been uncertain, the cause of the “out-of-Delaware” trend might be that Delaware judges have become overly skeptical of the plaintiffs’ bar).

B. Reaction to *In re Revlon*

Forum-selection provisions in charters and bylaws first surfaced in the early 1990s, but between 1991 and 2010 only sixteen corporations had such provisions in place.³⁹ In 2010, significantly more corporations began adopting forum-selection provisions in their bylaws and charters in response to Vice Chancellor Laster's dicta in *In re Revlon*.⁴⁰ After the decision, at least twenty-three corporations adopted forum-selection provisions.⁴¹ While Vice Chancellor Laster's comment referred to provisions adopted in charters, most corporations responded by adopting such provisions in their bylaws, because doing so does not require a shareholder vote.⁴² As of May 2011, at least thirty-seven corporations had forum-selection provisions in their charters, and eleven others included charter or bylaw proposals in proxy materials for their 2011 meetings.⁴³ With the recent surge in the adoption of forum-selection provisions in bylaws, practitioners have circulated memoranda speculating about whether these provisions will be enforceable.⁴⁴

³⁹ See Davidoff, *supra* note 13 (describing the emerging trend of corporations adopting forum-selection provisions); see also Grundfest, *supra* note 24, at slide 3 (demonstrating that from the *In re Revlon* decision to September 2010, this number increased from sixteen to thirty-nine). There was also a period in 2006 during which forum-selection provisions were added to bylaws, including Netlist, Inc.'s and Oracle Corp.'s provisions, the subject of *Galaviz*. See Davidoff, *supra* note 13.

⁴⁰ See *Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1172 (N.D. Cal. 2011) ("Such bylaws are reportedly a recent phenomenon, apparently occasioned by a passing comment in *In re Revlon, Inc. . . .*"); Grundfest, *supra* note 24, at slide 3 (terming the adoption of forum-selection provisions the "*Revlon* effect"); Breheny, *supra* note 5, at 308 ("A number of prominent companies already have adopted such provisions."); Lawrence A. Cunningham, *A New Legal Theory to Test Executive Pay: Contractual Unconscionability*, 96 IOWA L. REV. 1177, 1229 (2011) (noting that "dozens" of corporations adopted forum-selection provisions in their bylaws in response to *In re Revlon*); LaSala, *supra* note 4, at 9 (claiming that the adoption of forum-selection provisions is a "rapidly growing trend," and noting the connection to *In re Revlon*).

⁴¹ See Davidoff, *supra* note 13.

⁴² As explained in more detail below, Delaware Code Section 109(a) obviates the need for a shareholder vote when the charter contains a provision authorizing the board of directors to amend the bylaws unilaterally. See Alexander & Matthews, *supra* note 18, at 3.

⁴³ See Nathan, *supra* note 5.

⁴⁴ See, e.g., Breheny, *supra* note 5, at 308 (discussing the *Galaviz* decision and the possibility of future challenges to forum-selection provisions); Patrick E. Gibbs, *Hot Topics in Corporate Governance Litigation: Recent Developments in the Delaware Court of Chancery* (speculating about the effect of Vice Chancellor Laster's dicta in *In re Revlon*), in PRACTISING LAW INSTITUTE, SECURITIES LITIGATION AND ENFORCEMENT INSTITUTE 2010, at 715 (2010); LaSala, *supra* note 4, at 9 (urging the adoption of forum-selection provisions based on *In re Revlon* and in spite of *Galaviz*); Nathan, *supra*

IV. GALAVIZ V. BERG

In 2011, the District Court for the Northern District of California addressed—for the first time—whether a shareholder could bring a breach of fiduciary duty claim in federal court despite a forum-selection provision in the corporation’s bylaws requiring that derivative suits be brought in Delaware.⁴⁵ The court in *Galaviz v. Berg* held that, under federal procedural law applying contract principles to forum-selection provisions, such a provision contained in a bylaw that was unilaterally adopted by a board of directors was not binding on shareholders.⁴⁶

Because *Galaviz* addressed a derivative suit that included a federal cause of action, federal law, and not Delaware law, applied. In deciding the case under federal law, the *Galaviz* court implicitly accepted the defendant’s argument that contract law was an appropriate lens through which to examine the relationship between boards of directors and shareholders.⁴⁷ The plaintiff-shareholders argued in their opposition to the defendant-board’s motion to dismiss that no contract existed between the shareholders and board of directors because the shareholders did not consent to be bound by the provision.⁴⁸ The court found, in agreement with the plaintiffs, that bylaw provisions adopted by a board of directors without a shareholder vote were not contractually binding on shareholders, because the shareholders did

note 5 (predicting that *Galaviz* will not be the only response to the trend in Delaware of adopting forum-selection provisions in bylaws).

⁴⁵ *Galaviz*, 763 F. Supp. 2d at 1172 (quoting Oracle’s forum-selection provision: “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”).

⁴⁶ *Id.* at 1174-75.

⁴⁷ The corporation cited the following for its argument that bylaws should be treated as a contract between the board and the shareholders:

See, e.g., *Stolow v. Greg Manning Auctions Inc.*, 258 F. Supp. 2d 236, 249 (S.D.N.Y. 2003) (relying on the contractual nature of bylaws to dismiss for lack of standing a third party’s claim that an association had failed to comply with its own bylaws); *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 239 (Del. 2008) (characterizing a bylaw that shareholders proposed to adopt as an “internal governance contract,” and holding it to be an impermissible limitation on directors’ obligation to exercise certain fiduciary duties); *see also* *Andrews Farms v. Calcot, Ltd.*, 258 F.R.D. 640, 648 (E.D. Cal. 2009) (“It is generally accepted that corporate bylaws are to be construed according to the general rules governing the construction of statutes and contracts.”).

763 F. Supp. 2d at 1174.

⁴⁸ *See* Plaintiff’s Opposition to Nominal Defendant Oracle’s Motion to Dismiss at 7, *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011) (No. 10-4233), 2011 WL 5189617.

not assent to the terms of the bylaw.⁴⁹ The court reasoned that “[u]nder contract law, a party’s consent to a written agreement may serve as consent to all the terms therein, whether or not all of them were specifically negotiated or even read, but it does not follow that a contracting party may thereafter unilaterally add or modify contractual provisions.”⁵⁰ Thus, the court focused on the contractually binding effect of bylaw amendment procedures authorized under Delaware state law.

The importance of the *Galaviz* decision lies in its potential effect on how practitioners should advise boards of directors seeking to adopt forum-selection provisions in bylaws. If shareholders file federal claims in the Northern District of California, then the court will follow *Galaviz* and refuse to enforce a forum-selection provision adopted unilaterally by the board. But what if shareholders file in other districts? If the consensus among federal courts is that forum-selection provisions in bylaws are unenforceable under contract principles, then a board of directors will have to find some other way of addressing the problems posed by shareholder suits brought in courts outside of Delaware. I argue in the next Part, however, that other federal courts should not follow the *Galaviz* reasoning, and should instead find that forum-selection provisions in corporate bylaws are contractually binding on shareholders. As a consequence, boards of directors should continue to adopt these provisions as a response to shareholders who strategically file suit outside of Delaware.

⁴⁹ 763 F. Supp. 2d at 1174. The scope of this holding might be limited to instances in which bylaws are adopted by the same board implicated in the wrongdoing that forms the subject of the derivative suit and adopted after the alleged wrongdoing occurred. See *id.* at 1171 (suggesting that the holding in *Galaviz* is limited to the specific facts of the case); Lasala, *supra* note 4, at 101 (explaining that the court might have found the forum-selection provision enforceable if it had been adopted by a different board); Adam M. Turteltaub, et al., *California Court Rejects the Enforceability of a Delaware Forum Selection Clause in Corporate Bylaws*, METROPOLITAN CORP. COUNS., Mar. 2011, at 15 (“Had Oracle’s bylaws included a forum selection clause prior to any alleged wrongdoing and/or the purchase of shares in Oracle by the plaintiffs, the district court may have come to a different conclusion.”). However, the fact that a board must adopt bylaws in good faith should not affect the contract analysis with respect to mutual assent, and thus supports the view that the *Galaviz* holding should not be so narrow.

⁵⁰ *Galaviz*, 763 F. Supp. 2d at 1174.

V. THE BOARD OF DIRECTORS: SHAREHOLDER RELATIONSHIP
AS A REQUIREMENTS CONTRACT

The court in *Galaviz* found that a forum-selection provision contained in a bylaw unilaterally adopted by a board of directors was not binding on shareholders because the shareholders did not assent to the provision.⁵¹ In so holding, the court conceptualized the contract formed between the shareholders and board of directors at the time the shareholders purchased stock as a static set of rights and obligations between the two parties, in which all terms were specified at the time of assent. In this case, any amendment to the terms would create a contract—in the case of a unilaterally adopted bylaw, this new contract would be invalid for lack of mutual assent. However, this analysis fails to recognize that a corporate charter explicitly and intentionally leaves some terms open by allowing shareholders and the board of directors to unilaterally adopt, amend, and repeal bylaws.⁵² The *Galaviz* court noted that Oracle's forum-selection provision was not present in the "existing contract terms" at the time the plaintiff-shareholders purchased stock.⁵³ While this may be true, it is also the case that the possibility of a forum-selection provision was "present in the original agreement."⁵⁴

Because the charter intentionally leaves some terms open, it is not accurate to analyze the contract as a static picture of the state of the corporate charter and bylaw amendments in place at the time an individual shareholder purchased her shares. The contract, instead, is an exchange of all the rights afforded to shareholders as defined by the charter and state corporate laws in consideration for the shares' pur-

⁵¹ *Id.* at 1174.

⁵² See BALOTTI & FINKELSTEIN, *supra* note 19, at Form 1.5 ("[T]he Board of Directors of the Corporation is expressly authorized to make, alter and repeal the by-laws of the Corporation, subject to the powers of the stockholders of the Corporation to alter or repeal any by-law whether adopted by them or otherwise." (emphasis added)). Note that shareholders also have the authority to adopt shareholders agreements without the consent of the board of directors. See Gibbs, *supra* note 44, at 718 ("Corporate charters and bylaws would seem to confer benefits on stockholders no less than corporate shareholders agreements confer benefits on directors; if nothing else, it would seem that shareholders foresee being bound by them."); *Federal Courts Needn't Honor Delaware Venue-Choice Bylaw*, *Judge Says*, 28 WESTLAW J. COMPUTER & INTERNET 7, 7 (2011) (citing Professor Joseph Grundfest's argument that even though directors are typically the party to adopt forum-selection provisions in the bylaws, shareholders could vote to amend the bylaws to choose a different forum or to repeal a forum-selection provision).

⁵³ *Galaviz*, 763 F. Supp. 2d at 1174.

⁵⁴ *Id.*

chase price and an agreement to be bound by the corporate charter and bylaws, incorporating the mutual understanding that the bylaws, and in more limited circumstances the charter, are subject to adoption, amendment, and repeal. The shareholder, in purchasing her shares, agrees to be bound by the corporate charter and the provisions therein defining the relationship between the shareholder and the board of directors.⁵⁵ She agrees to be bound by the terms of the charter, including any provision that allows the board of directors to amend the bylaws unilaterally, because she knows that the board is confined by fiduciary duties and the shareholders' ability to repeal or amend any bylaw by majority vote.

Under the Uniform Commercial Code (U.C.C.) § 2-204, a contract with open terms is valid if the contracting parties intend to be bound by such terms and there is a reasonably certain basis for remedy.⁵⁶ When a shareholder purchases shares in a corporation, she clearly intends to be bound by the corporate charter and bylaws and expects the board likewise to be bound. In the case of a forum-selection provision, the certain basis for remedy is specific enforcement—in other words, the dismissal of any suit brought outside of the forum specified.

Further, a shareholder's agreement to be bound by a board's subsequent unilateral adoption of a bylaw containing a forum-selection provision is comparable to a requirements contract in which key terms are left open in order to adapt to market fluctuations.⁵⁷ Under U.C.C.

⁵⁵ See *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 492 (Del. Ch. 1995) (“[A]lthough the by-laws are a contract between the corporation and its stockholders, the contract was subject to the board’s power to amend the by-laws unilaterally.” (citations omitted)).

⁵⁶ See U.C.C. § 2-204 (3) (2009) (“Even if one or more terms are left open, a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.”).

⁵⁷ See Allen Blair, “*You Don’t Have to Be Ludwig Wittgenstein*”: *How Llewellyn’s Concept of Agreement Should Change the Law of Open-quantity Contracts*, 37 SETON HALL L. REV. 67, 75 (2006) (“Most of modern contract law, the law of open-quantity agreements included, can be seen as developing from a need, arising in the late nineteenth and early twentieth centuries, to address contingencies occasioned by new forms of commerce and industry.”); *id.* at 76 n.25 (“Large-scale production and expanding markets create[d] greater uncertainties and more business hazards To meet [the demand of more complex allocations of risk] many types of contracts have come into use containing various provisions for the fixing of terms with reference to future events.” (quoting Harold C. Havighurst & Signey M. Berman, *Requirement and Output Contracts*, 27 ILL. L. REV. 1, 1 (1932) (first alteration in original))).

The law of requirements contracts provides special insight into the relationship between a board of directors and shareholders for two reasons. The first is that a board of directors is constrained by its fiduciary duties to shareholders such that even when a board of directors unilaterally acts to amend bylaws or makes other business judg-

§ 2-306, a contract is valid even when a quantity of goods is not specified, so long as the actual goods the purchaser ends up requiring in good faith from the seller turn out to be reasonable in light of what the parties estimated from prior dealings.⁵⁸ In the “contract” between the board of directors and a shareholder, the unspecified terms include all of the bylaws that a board of directors might unilaterally

ments, it must do so in good faith and with the best interests of the shareholders in mind. *Compare* *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (explaining that the duty of good faith is a component of a board of directors’ fiduciary duty of loyalty), *with* Shelley Smith, *A New Approach to the Identification and Enforcement of Open Quantity Contracts: Reforming the Law of Exclusivity and Good Faith*, 43 VAL. U. L. REV. 871, 877 (2009) (noting that requirements contracts allow a buyer to reduce his requirements to zero only if he does so in good faith), *and id.* (explaining that the duty of good faith eliminates the need for requirements contracts to be exclusive and provides a gauge for when a requirements contract has been breached). Nevertheless, a board of directors must make business decisions in response to changing conditions in the corporate market and therefore requires the discretion to react to conditions unanticipated by the parties upon the formation of the shareholder-board relationship. *Compare* DEL. CODE ANN. tit. 8, § 141(a) (2011) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .”), R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS* § 4.16[D], at 4-146 (3d ed.) (Supp. 2011) (describing the duties of an independent board of directors, which include seeking advice on fluctuating market conditions in the industry), *and* D. Gordon Smith et al., *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 174 (2011) (“In a system in which private ordering is encouraged, corporate bylaws, through experience and adaptation, become solutions to common governance problems faced by corporations.”), *with* WILLIAM D. HAWKLAND, 1 UNIFORM COMMERCIAL CODE SERIES § 2-306:1 (explaining that requirements contracts allow parties to adapt to the problem of over- and underproduction when needs change in a fluctuating market), *and* S. Smith, *supra*, at 883 (identifying changes in consumer preferences, advances in technology, and market fluctuations as factors affecting the terms in a requirements contract). Second, a provision in the charter granting the board of directors authority to amend the bylaws without a shareholder vote reflects an “allocation of discretion,” which is reflected in the price paid by the shareholder for her shares. *Compare* D. G. Smith et al., *supra*, at 128 (proposing reforms that would allow shareholders to amend bylaws more easily in order to “produce more diversity and experimentation in corporate governance” in response to changing market conditions), *with* Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith*, 35 U.C. DAVIS L. REV. 319, 327 (2002) (illustrating that in a requirements contract, one party’s “freedom to alter the quantity taken [is] typically circumscribed to take into account [the other party’s] reliance,” and that one party’s freedom to alter terms allows the other party to negotiate for more consideration).

⁵⁸ See U.C.C. § 2-306 (1) (“A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate . . . or otherwise comparable prior output or requirements may be tendered . . .”); *see also* *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949) (recognizing the enforceability of requirements contracts under federal law, although suggesting that some requirements contracts may be anticompetitive).

adopt after a shareholder has purchased her shares, subject to the mandate that all such bylaws be free of language designed to deprive shareholders of their power to adopt bylaws of their own.⁵⁹ The U.C.C. confines these terms by imposing two requirements: the terms, once specified by one of the parties (the board of directors), must be made in good faith (in compliance with the directors' fiduciary duties),⁶⁰ and the terms must be in reasonable accordance with the estimations of the other party (the shareholder).⁶¹

Thus, the following question emerges: could shareholders reasonably foresee a board of directors unilaterally adopting a forum-selection provision in the corporation's bylaws? The answer is not entirely clear. On one hand, a charter provision explicitly authorizing the board of directors to adopt a forum-selection provision in the bylaws would alert a reasonable shareholder to the possibility that the board could identify Delaware as the sole forum for derivative suits. It is less obvious, however, that a broader charter provision, authorizing a board to adopt bylaws in general, alerts shareholders to the possibility of the board adopting a bylaw containing a forum-selection provision. Still, a shareholder ought to foresee that a board with the authority to amend bylaws unilaterally might determine that keeping litigation in Delaware is in the best interests of the corporation.

This argument—that the basis of a contract between a shareholder and corporation is the shareholder's assent to the charter provision empowering the board of directors to amend the corporation's bylaws—responds to Sara Lewis's argument in her Note *Transforming the "Anywhere but Chancery" Problem into the "Nowhere but Chancery" Solution*.⁶² Addressing whether shareholders have a vested interest in their ability to bring suits in forums other than Delaware, Lewis focuses on whether a bylaw provision is binding in terms of notice. Shareholders who purchase shares after the bylaws are amended lack actual notice but have constructive notice of the additional bylaw. Even absent actual notice, purchasing in an "open and developed market" means that a shareholder bought "at a price that reflected the clause's value."⁶³

⁵⁹ See *supra* text accompanying note 18.

⁶⁰ See Goldberg, *supra* note 57, at 324 (emphasizing the need for "devices for constraining discretion").

⁶¹ U.C.C. § 2-306 (1).

⁶² Lewis, *supra* note 34.

⁶³ See Lewis, *supra* note 34, at 211; see also LATHAM & WATKINS LLP, *supra* note 14, at 3 (arguing that shareholders do not have a vested interest in litigating claims outside of Delaware because shareholders are aware of the possibility of bylaw amendments).

While notice of an amendment certainly is not the same as assent to it,⁶⁴ Lewis's argument emphasizes the fundamental fairness in binding shareholders to subsequent bylaws. For shareholders not wishing to be bound by future bylaws, a share in a corporation that lacks such a charter provision would be more valuable. It is particularly fair for board-adopted bylaws to bind shareholders because shareholders have at least two protections from undesirable amendments: they can either repeal the bylaw with a majority vote,⁶⁵ or can bring a derivative suit for breach of fiduciary duty if the adoption of a bylaw would not be protected as a valid business judgment. Further, a shareholder may, in an open market, sell her shares in exchange for shares in a corporation without such a forum-selection provision. While this is not a contract remedy, since selling one's shares would not provide restitution damages to compensate for fluctuations in the market price of the share between the time of purchase and sale, it does suggest that shareholders can "vote with their feet" to affect the availability of certain bylaw provisions, such as forum-selection provisions, in the Delaware corporate market. When shareholders assent to the terms of a charter providing that shareholders will be bound by future bylaws adopted by the board, shareholders should be contractually bound by such provisions in board-adopted bylaws.

CONCLUSION

The *Galaviz* holding that forum-selection provisions in bylaws unilaterally adopted by a board of directors do not bind shareholders under federal procedural law governing forum-selection provisions is just one possible response to Vice Chancellor Laster's dicta in *In re Revlon, Inc. Shareholders Litigation*. As this Note argues, shareholders should be bound by such bylaw amendments. This Note urges future

⁶⁴ Lewis claims that a dissenting shareholder can only be presumed to have assented if a business judgment, like a board's unilateral adoption of a bylaw, maximizes the value of a corporation. Lewis, *supra* note 34, at 213. She then argues that it should not be left to the courts' discretion to determine whether a business judgment in fact maximized the corporation's value, and thus a court should not attempt to determine whether a shareholder necessarily assented to a bylaw provision. *Id.* This argument does not answer the question of whether a shareholder in fact assented to a bylaw provision, and the corollary question of whether there is a binding contract between the shareholder and the board of directors. A more satisfying answer is the one I have proposed in this Note—that even dissenting shareholders can be said to have assented to a bylaw amendment when that amendment was authorized in the charter to which the shareholder did in fact assent.

⁶⁵ See DEL. CODE ANN. tit. 8, § 109(a) (2011).

federal courts to look past the narrow contract analysis of *Galaviz* and uphold forum-selection provisions in bylaw amendments. While *Galaviz* may have been the first word on the subject, it is certainly not the last.

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