

## Delaware Law Status of Bylaws Regulating Litigation of Federal Securities Law Claims

As one commentator recently observed, “There has been renewed interest in whether the SEC should allow a U.S. company to conduct a registered initial public offering if its bylaws require shareholders to arbitrate federal securities claims.”<sup>1</sup> Responding to that interest, SEC Chairman Jay Clayton correctly observed that the validity of such bylaws “involves our securities laws, matters of other federal and state law, an array of market participants and activities, as well as matters of U.S. jurisdiction.”<sup>2</sup>

This submission focuses on only one of the elements identified by Chairman Clayton, namely the validity of such a bylaw under state law – and more specifically, Delaware corporate law.<sup>3</sup> The signatories to this submission hold a wide range of differing views regarding the utility of federal securities class actions. What they hold in common, however, is the view that Delaware corporate law does not permit a corporate bylaw (or charter provision, for that matter) to require that claims arising under the federal securities laws be resolved in arbitration or indeed in any specified venue. The reasoning supporting that view is set forth below.<sup>4</sup>

The efficacy of a charter or bylaw provision purporting to affect federal securities class actions must be determined under Delaware case law interpreting the scope of Sections 102(b)(1) and 109(b) of the Delaware General Corporation Law (DGCL). The leading authorities in this regard are the opinion of then Chancellor Leo E. Strine, Jr. in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,<sup>5</sup> and the Delaware Supreme Court’s subsequent opinion in *ATP Tour v. Deutscher Tennis Bund*.<sup>6</sup> Relying on the concept that the DGCL and a corporation’s charter and bylaws constitute a “flexible contract” to which the stockholders are a party,<sup>7</sup> those opinions uphold bylaw provisions

---

<sup>1</sup> Andrew Rhys Davies, *The Legality of Mandatory Arbitration Bylaws*, Sep. 13, 2018, available at <https://corpgov.law.harvard.edu/2018/09/13/the-legality-of-mandatory-arbitration-bylaws/>.

<sup>2</sup> Letter to Hon. Carolyn Maloney from Chairman Jay Clayton, April 24, 2018, available at <https://maloney.house.gov/sites/maloney.house.gov/files/MALONEY%20ET%20AL%20-%20FORCED%20ARBITRATION%20-%20ES156546%20Response.pdf>.

<sup>3</sup> The substance of this submission is drawn largely from a post by Lawrence A. Hamermesh and Norman M. Monhait on June 29, 2015, available at <http://blogs.law.widener.edu/delcorp/2015/06/29/fee-shifting-bylaws-a-study-in-federalism/#sthash.hh7my2nZ.sB2182Nx.dpbs>. This submission does not address the separate question of whether a corporation’s articles or bylaws may be viewed as a contract for the purposes of the Federal Arbitration Act (FAA), 9 U.S.C. §1, et seq., enacted February 12, 1925.

<sup>4</sup> A similar issue of Delaware corporate law was recently argued in the Delaware Court of Chancery, on motions for summary judgment regarding the validity of bylaws adopted by Roku Inc., Stitch Fix Inc., and Blue Apron. Those bylaws purport to require that claims under the Securities Act of 1933 be litigated in federal court, rather than in a state court.

<sup>5</sup> 73 A.3d 934 (Del. Ch. 2013).

<sup>6</sup> 91 A.3d 554 (Del. 2014).

<sup>7</sup> *Chevron*, 73 A.3d at 940 (“bylaws, together with the certificate of incorporation and the broader DGCL, form part of a flexible contract between corporations and stockholders, in the sense that the certificate of incorporation may authorize the board to amend the bylaws’ terms and that stockholders who invest in such corporations assent to be bound by board-adopted bylaws when they buy stock in those corporations.”).

requiring that claims arising under the DGCL and Delaware corporate law be litigated in a specified forum, and that attorney’s fees and expenses in such litigation must be borne by unsuccessful plaintiff stockholders.<sup>8</sup> Those opinions clarify, however, that Sections 102(b)(1) and 109(b) cannot be read, despite their breadth and the presumptive validity of provisions adopted pursuant to them, to authorize provisions regulating litigation under the federal securities laws.

In *Chevron*, what the court endorsed was a bylaw that specified a forum (Delaware) for litigating “the kind of claims most central to the relationship between those who manage the corporation and the corporation’s stockholders” – namely, “suits brought by stockholders as stockholders in cases governed by the internal affairs doctrine.”<sup>9</sup> In contrast, the court went out of its way to distinguish a bylaw regulating “external” matters, such as “a bylaw that purported to bind a plaintiff, even a stockholder plaintiff, who sought to bring a tort claim against the company based on a personal injury she suffered that occurred on the company’s premises or a contract claim based on a commercial contract with the corporation.”<sup>10</sup> A bylaw regulating selection of a forum to litigate such external claims “would be beyond the statutory language of 8 Del. C. 109(b)” for the “obvious” reason that it “would not deal with the rights and powers of the plaintiff-stockholder *as a stockholder*.”<sup>11</sup>

By the same token, a bylaw purporting to regulate the litigation of claims under Rule 10b-5 “would not deal with the rights and powers of the plaintiff[] *as a stockholder*,” and would therefore not be within even the broad scope of Section 109(b). As the Delaware Court of Chancery has observed, “[a] Rule 10b-5 claim under the federal securities laws is a personal claim akin to a tort claim for fraud. The right to bring a Rule 10b-5 claim is not a property right associated with shares, nor can it be invoked by those who simply hold shares of stock.”<sup>12</sup> Accordingly, regulation of the venue for (or other aspects of) a claim under Rule 10b-5 is beyond the subject matter scope of the charters and bylaws of Delaware corporations.

Nothing in *ATP* altered this analysis. Addressing the principal certified question in that case, the Court was necessarily focused on “suits brought by stockholders as stockholders in cases *governed by the internal affairs doctrine*.”<sup>13</sup> In the underlying litigation, the plaintiffs alleged “Delaware fiduciary duty claims,” as well as antitrust claims. There is no indication in the *ATP* opinion that the Supreme Court questioned former Chancellor Strine’s view that the “flexible contract” formed by the statute, charter, and bylaws could not extend to any litigation other than “suits brought by

---

<sup>8</sup> The latter proposition, set forth in *ATP*, was legislatively overruled in 2015. 80 Del. Laws, c. 40, §§ 2-3. <sup>9</sup> 73 A.3d at 952.

<sup>10</sup> *Id.* In cases involving such external claims, the stockholders indirectly bear the costs of the litigation to the corporation, but *Chevron* makes clear that this circumstance does not convert the matter into one within the internal affairs of the corporation and therefore subject it to regulation by the charter or bylaws of the corporation.

<sup>11</sup> *Id.* (emphasis in original).

<sup>12</sup> *In re Activision Blizzard Inc. Stockholder Litigation*, C.A. No. 8885-VCL (Del. Ch. May 21, 2015), slip op. at 50.

<sup>13</sup> 91 A.3d at 556 (emphasis added).

stockholders as stockholders in cases governed by the internal affairs doctrine.” Indeed, if the underlying litigation had involved only antitrust claims, the Court would have concluded (consistent with *Chevron*) that the bylaw could not have provided for fee-shifting in relation to the claims presented. And having been asked merely to opine about the overall facial validity of the bylaw, the Court had no occasion to parse the facts to determine whether the bylaw could require shifting fees that might have been solely attributable to the antitrust claims.

In sum, the “flexible contract” identified in *Chevron* and *ATP*, and established by the governing corporate statutes, the certificate of incorporation, and the bylaws, encompasses a great deal – the subject matter scope of Sections 102(b)(1) and 109(b) is broad. But it is not limitless, as *Chevron* expressly teaches. And in our view, it does not extend so far as to permit the charter or the bylaws to create a power to bind stockholders in regard to the venue for federal securities class actions. In summary, Delaware law does not permit bylaws to restrict the forum for federal securities actions, because the right to bring such actions is not a property right associated with shares of corporate stock, and it thus falls outside of the scope of what Delaware law permits the corporate charter and bylaws to regulate.

**Lucian A. Bebchuk**

James Barr Ames Professor of Law, Economics, and Finance  
Director, Program on Corporate Governance  
Harvard Law School

**John C. Coates IV**

John F. Cogan Professor of Law and Economics  
Harvard Law School

**John C. Coffee Jr.**

Adolf A. Berle Professor of Law and Director of the Center on Corporate Governance  
Columbia Law School

**Wendy Gerwick Couture**

Professor of Law  
University of Idaho College of Law

**James D. Cox**

Brainerd Currie Professor of Law  
Duke University School of Law

**Lawrence A. Hamermesh**

Professor Emeritus  
Widener University Delaware Law

**Michael J. Kaufman**  
Dean and Professor of Law  
Loyola University Chicago School of Law

**Donald C. Langevoort**  
Thomas Aquinas Reynolds Professor of Law  
Georgetown Law

**Ann M. Lipton**  
Michael M. Fleishman Associate Professor in Business Law and Entrepreneurship  
Tulane University Law School

**Joshua Mitts**  
Associate Professor of Law  
Columbia Law School

**Frank Partnoy**  
Professor of Law  
Berkeley Law, University of California

**Brian JM Quinn**  
Associate Professor  
Boston College Law School

**Joel Seligman**  
Professor and Former President  
University of Rochester

**Dean D. Gordon Smith**  
J. Reuben Clark Law School  
Brigham Young University

**James C. Spindler**  
The Sylvan Lang Professor  
Professor, UT McCombs School of Business  
University of Texas School of Law

**Marc I. Steinberg**  
Radford Professor of Law  
SMU Dedman School of Law

**Randall S. Thomas**  
John S. Beasley II Professor of Law and Business  
Vanderbilt Law School

**Robert B. Thompson**

Peter P. Weidenbruch, Jr. Professor of Business Law  
Georgetown Law

**Urska Velikonja**

Professor of Law  
Georgetown Law

**David H. Webber**

Professor of Law  
Boston University School of Law

**Verity Winship**

Professor of Law  
University of Illinois College of Law