

# Delaware Passes Legislation Prohibiting Fee-Shifting Bylaws and Validating Exclusive Forum Selection Bylaws for Stock Corporations

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The ***Delaware General Assembly (DGA)*** recently approved a bill that amends the Delaware General Corporation Law (DGCL) and, on June 24, 2015, Delaware Governor Jack ***Markell*** signed the bill into law. The DGCL amendments, among other things:

- prohibit fee-shifting provisions related to “internal corporate claims” (for example, breaches of fiduciary duties) in the charters and bylaws of Delaware stock corporations; and
- statutorily validate charter and bylaw provisions that require any or all “internal corporate claims” to be brought solely and exclusively in any or all of the Delaware state and federal courts (these provisions are generally referred to as forum selection provisions).

These amendments will become effective on August 1, 2015.

As the amendments relate only to the DGCL and apply to Delaware corporations, they do not impact Delaware limited liability partnerships, limited liability companies and similar creatures of contract.

## Fee-Shifting Provisions Prohibited

The amendments prohibit charters and bylaws from including provisions that “would impose liability on a stockholder for the attorneys’ fees or expenses of the corporation or any other party in connection with an internal corporate claim.” As a result, neither boards nor stockholders may vote to adopt such provisions in charters or bylaws.

The amendments define “internal corporate claims” to mean “claims, including claims in the right of the corporation [that is, derivative actions], (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.” Examples of internal corporate claims include “claims arising under the DGCL, including claims of breach of fiduciary duty by current or former directors or officers or controlling stockholders of the corporation, or persons who aid and abet such a

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breach.” As a result, fee-shifting charter or bylaw provisions applicable to the most significant and costly stockholder litigation facing Delaware corporations involving mergers, acquisitions and corporate governance are prohibited.

The amendments were initially proposed in response to the Delaware Supreme Court’s *ATP Tour, Inc. v. Deutscher Tennis Bund* decision upholding the facial validity of a bylaw provision adopted by a non-stock membership corporation shifting attorneys’ fees and expenses to unsuccessful plaintiffs in intra-corporate litigation. As the fee-shifting prohibition applies only to stock corporations, non-stock corporations may adopt such fee-shifting provisions in accordance with *ATP Tour*.

The amendments do not invalidate fee-shifting provisions in a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced (for example, stock purchase agreements). Although potentially useful for some private Delaware corporations, this exception to the prohibition will likely have limited utility for public Delaware corporations.

The amendments do not address whether the fee-shifting prohibition applies retroactively. Clarification on this issue will likely only arrive via future litigation involving attempted application by a Delaware corporation of such fee-shifting provisions in litigation filed after adoption of such provisions but before the amendments’ adoption.

By adopting this fee-shifting prohibition, the DGA is leaving the policing of the all too frequent and costly litigation against corporations over internal corporate claims to the Delaware courts.

## **Forum Selection Provisions Validated**

Despite prohibiting fee-shifting provisions for stock corporations, the amendments statutorily validate forum selection provisions. The amendments allow, consistent with applicable jurisdictional requirements, charters and bylaws to include provisions that require any or all “internal corporate claims” to be brought solely and exclusively in any or all of the Delaware state and federal courts. However, as is currently the case, forum selection provisions remain subject to challenge on an “as-applied” basis based on the facts and circumstances surrounding their adoption.

Interestingly, the amendments *prohibit* charter and bylaw provisions that select the courts of another state or an arbitral forum as the *exclusive* forum for internal corporate claims. By prohibiting charter and bylaw provisions that select a non-Delaware venue as the *exclusive* forum for internal corporate claims, the amendments appear to effectively overturn the Delaware Chancery Court’s decision in *City of Providence v. First Citizens BancShares, Inc.*, which upheld the validity of a Delaware corporation’s bylaw provision that selected North Carolina, where the corporation was headquartered, as the exclusive forum for internal corporate litigation. The amendments do not address the validity of a charter or bylaw provision that selects a non-Delaware forum as an *additional forum* in which internal corporate claims may be brought.

The amendments do not prevent the application of any such forum selection provision in a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced.

Despite being legislatively validated, the ultimate enforceability of forum selection provisions in charters and bylaws of Delaware corporations will rely on the “internal affairs” doctrine, which generally requires courts to respect the laws of the state of incorporation as to a company’s internal affairs (for example, governance matters). However, the internal affairs doctrine is not immutable.

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Although most courts outside of Delaware considering forum selection bylaws adopted by Delaware corporations designating Delaware as the exclusive forum have enforced such bylaws, the risk remains that courts outside of Delaware will not enforce the forum selection provisions.

Also, it will be interesting to see whether the decision to invalidate forum selection clauses exclusively designating the state and federal courts outside of Delaware that would otherwise have jurisdiction, while validating provisions designating Delaware as the exclusive jurisdiction, will draw a constitutional attack. Moreover, as a leading treatise on federal jurisdiction has noted, the “overwhelming majority of federal courts addressing the issue conclude that federal courts need not follow state law on enforceability of forum selection clauses in diversity cases,” with federal policy favoring access to courts being found to outweigh state interests.

## Other DGCL Amendments

The amendments also, among other things:

- clarify the requirements for board approval of stock to be issued in one or more future transactions, including to clarify that boards may authorize stock to be issued in “at-the-market” programs without having to separately authorize each individual stock issuance pursuant to the program; and
- clarify and broaden the DGCL’s procedures for statutorily ratifying stock or corporate acts that would be void or voidable due to a “failure of authorization.”

The amendments related to board approval of future stock issuances will be effective August 1, 2015. The amendments related to ratifying defective acts will be effective only with respect to defective corporate acts and proposed issuances of putative stock ratified or to be ratified by resolutions adopted by a board of directors on or after August 1, 2015.

## No Amendments to Curb Appraisal Right Abuses

The bill does not include the Council’s proposed amendments to limit appraisal rights as discussed in a prior client alert.

## Practical Considerations

In light of the amendments, Delaware stock corporations should:

- ***Remove any previously adopted fee-shifting charter or bylaw provisions to comply with the amendments.*** Doing so also would eliminate the potential adverse effect on the advice of proxy advisory firms going forward. Those firms have shown a universal disdain for fee-shifting provisions.
- ***Consider adopting or amending a Delaware forum selection bylaw.*** If a forum selection bylaw has not been previously adopted, boards should consider adopting one. As with any other board action, careful consideration should be given to whether such a bylaw is in the corporation’s best interest and the timing of adoption. Before proceeding, boards should consult with outside counsel and evaluate the current voting policies or positions of

institutional investors and proxy advisory firms with respect to forum selection provisions.

If a forum selection provision was previously adopted and such provision identifies a non-Delaware forum as the exclusive forum for internal corporate claims or otherwise would prohibit litigation of internal corporation claims in Delaware courts, boards should, after consulting with outside counsel, amend the provision to provide that such claims may only be brought in Delaware instead of, or in addition to, the currently selected forum.

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