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PERSPECTIVE

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Avoiding California law as a Delaware corporation

By Marc Boiron

Most shareholders and many attorneys representing the corporations owned by those shareholders are unaware that a private corporation incorporated in the State of Delaware, with a majority of its stock held by California residents and a majority of its property owned, payroll paid and sales made in the State of California (a "California-based Delaware corporation"), generally must satisfy the requirements of both Delaware corporate law and many aspects of California corporate law. The corporation's failure to comply with California corporate law may lead to unexpected and undesirable results with respect to certain significant matters, such as the election and removal of directors, indemnification of directors, payment of dividends and voting rights of shareholders.

Delaware corporate law has long been recognized as the premier corporate law in the world because of, among other things, the certainty it offers corporations. However, after Section 2115 of the California General Corporation Law (CGCL) became effective in 1977, California-based Delaware corporations have been subject to certain provisions of the CGCL, which eliminates many of the benefits of being a Delaware corporation, including the certainty of Delaware corporate law. Although strong arguments exist against the constitutionality of Section 2115, California courts generally have found that California-based Delaware corporations must comply with California corporate law. Nonetheless, the perception that California-based Delaware corporations are unable to benefit fully from Delaware corporate laws is flawed.

Recent developments in California and Delaware law have created a path for a California-based Delaware corporation to avoid becoming subject to California corporate law by taking one of two actions:

One: The board of directors and the stockholders of the California-based Delaware corporation approve an amendment to the certificate of incorporation of the corporation to adopt a forum-selection provision that selects Delaware courts as the exclusive forum for claims related to, among other things, breaches of fiduciary duties and the internal affairs of the corporation; or

Two: The board of directors (if empowered by the certificate of incorporation) or the stockholders of the California-based Delaware corporation approves an amendment to the bylaws of the corporation to adopt the forum-selection provision described above.

Taking one of the two actions should give the California-based Delaware corporation the right to cause litigation related to most, if not all, of the provisions covered by Section 2115 to be litigated only in a Delaware court, which will apply only Delaware law to the internal affairs of a Delaware corporation. To achieve this outcome, the following four conditions must be satisfied: (i) a Delaware corporation must be permitted to include a forum-selection provision in its certificate of incorporation or bylaws, (ii) California courts must uphold the forum-selection provision, (iii) California courts must decide that it is not against California public policy for the forum-selection provision to circumvent rights afforded under Section 2115, and (iv) Delaware courts must refuse to apply California corporate law to a California-based Delaware corporation.

First, a relatively recent amendment to the General Corporation Law of the State of Delaware (DGCL), which added Section 115 to the DGCL, explicitly permits a Delaware corporation to adopt in its certificate of incorporation or bylaws a requirement that all "internal corporate claims" be brought exclusively in the courts of the State of Delaware. Therefore, a forum-selection provision that selects a Delaware court as the forum for, among other things, litigation related to the internal affairs of the corporation is permissible under the DGCL.

Second, several California courts have considered, and more recently enforced, forum-selection provisions in the bylaws of Delaware corporations. Since *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011), the first and only decision in which a California court refused to enforce a forum-selection provision in bylaws, and *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013), the Delaware Court of Chancery's first decision upholding forum-selection provisions in bylaws, both California state and federal courts have decided that forum-selection provisions in bylaws are valid. Therefore, California courts have been consistently upholding forum-selection provisions in bylaws and is even more likely to do so since DGCL Section 115 was enacted.

Third, none of the decisions of California courts considering the enforceability of forum-selection provisions in bylaws determined that they are against public policy. In *Galaviz*, the court decided that it would not violate any fundamental California public policy to require shareholder derivative actions to be litigated in the corporation's state of incorporation. Similarly, in *In re CytRx Corp. Stockholder Derivative Litigation*, CV 14-6414-GHK-PJW (C.D. Cal. Oct. 30, 2015), the U.S. District Court for the Central District of California held that there was no California public policy reason for invalidating the forum-selection provision in a corporation's bylaws even though the corporation was headquartered in California and the plaintiff lived in California because the substantive claims were governed by Delaware law, California courts have recognized that the Delaware Court of Chancery has expertise in corporate law and forum-selection bylaws help avoid inefficient derivative litigation in multiple forums.

The California Court of Appeal, in its most recent discussion of CGCL Section 2115, has suggested that Section 2115 conflicts with the internal affairs doctrine, which requires the laws of a corporation's state of incorporation to apply to issues relating to its internal affairs. In *Lidow v. Superior Court*, 206 Cal. App. 4th 351 (2012), the California Court of Appeal indicated that several of the provisions of the CGCL that purportedly apply to California-based Delaware corporations, including voting rights of shareholders, payments of dividends and procedural requirements of derivative suits, involve matters of internal corporate governance that fall within the internal affairs doctrine. Although the applicability of the internal affairs doctrine to those issues were simply observations of the California Court of Appeal, *Lidow* suggests that circumventing several of the key rights afforded under Section 2115 would not violate California public policy.

Fourth, the Delaware Supreme Court has refused to apply California corporate law to a California-based Delaware corporation. In 2005, the Delaware Supreme Court held, in *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108 (Del. 2005), that Section 2115 violates the internal affairs doctrine. Therefore, the Delaware Supreme Court refused to apply California corporate law to a California-based Delaware corporation, applying instead Delaware law.

Based on the foregoing developments, if a California-based Delaware corporation that has adopted in its certificate of incorporation or bylaws a forum-selection provision selecting Delaware courts as the forum for litigation related to the internal affairs of the corporation is sued in the State of California, a California court should (at least when certain, if not all, of the key rights afforded under Section 2115 are at issue) upon the corporation's request, transfer the lawsuit to the State of Delaware. If the plaintiff argues in Delaware court that California law applies to the California-based Delaware corporation, then the corporation may cite the Delaware Supreme Court's decision in *VantagePoint* to the contrary, and the Delaware court should refuse to apply California corporate law. The result is that a California-based Delaware corporation may protect itself from the application of California law to important corporate issues by adopting a forum-selection provision in its certificate of incorporation or bylaws.

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