WSGR ALERT

JANUARY 2011

RESTRICTING SHAREHOLDER DERIVATIVE SUITS TO DELAWARE: STOP, LOOK, AND LISTEN

Some prominent commentators recently have urged public companies incorporated in Delaware to adopt provisions requiring that shareholder derivative suits against them be litigated in the Delaware Court of Chancery. A few public companies have heeded that advice, most notably Oracle. On January 3, 2011, a federal judge declined to enforce the Oracle venue provision. The decision is the first on the issue, although it is not likely to be the last. In light of the uncertainty in the area and the substantial litigation likely to occur over such provisions, we think the prudent course for our clients is not to adopt such provisions at this time.

For years, the Delaware Chancery Court has enjoyed a well-deserved reputation for expertise on matters of corporate law. The vast majority of our clients are incorporated in Delaware. Our clients, like many other technology companies, frequently have litigated in the Delaware Chancery Court and appreciate the sophisticated nature of that court in reviewing issues relating to the internal affairs of the corporation.

Those who advocate venue-restriction clauses for shareholder suits contend that it is in the corporation's interest to have matters of Delaware corporate law decided by the Chancery Court, not by other courts applying Delaware law. They believe that companies can adopt either mandatory or permissive venue restrictions (i.e., requiring that suit be brought only in Delaware *versus* empowering the board to insist that a particular case proceed in Delaware). They contend that venue restrictions can be adopted as part of the company's articles of incorporation or bylaws.

These proposals raise serious policy concerns on a variety of levels. For example, notwithstanding the acknowledged expertise of the Chancery Court, other jurisdictions have put great effort into creating specialized courts to deal with corporate disputes (such as the Complex Case Division of the Santa Clara County Superior Court, which probably handles more Delaware corporate law issues than any court outside Delaware). Similarly, federal judges in diversity suits have vast familiarity with application of Delaware law and also regularly apply the law of different states with great effectiveness.

Apart from the question of whether the venue limitations are desirable or not, the legal validity of such limitations remains questionable. The advocates supporting this type of provision point to dictum in a recent Delaware decision discussing the possibility of such venue provisions—*In re Revlon, Inc. Shareholders Litigation*, 990 A.2d 940, 960 (Del. Ch. 2010)—but there is no actual judicial decision enforcing such a limitation outside of the partnership or LLC context. The broader policy issues with respect to the adoption of this type of provision had not been considered prior to the opinion in *Oracle*.

The new decision involving Oracle is by a federal judge in the Northern District of California. *Galaviz v. Berg,* Case No. C-10-3392-RS (N.D. Cal. Jan. 3, 2011); http://www.wsgr.com/PDFSearch/oracle0111.pdf. Oracle had purported to limit shareholder derivative suits against it to Delaware, through bylaw amendment. In the decision, the court held that the limitation was ineffective and rejected analogies to contractual venue-selection clauses, holding: "Under 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. . . . Oracle cannot persuasively contend that its bylaws are like any other contract . . . while simultaneously arguing that it was permitted under corporate law to amend those bylaws in a manner that it could not have achieved under contract law."

One might read the decision narrowly, as applying only where the bylaw change was adopted after the particular shareholder plaintiff purchased her stock or where the board adopted the amendment after the conduct that was being challenged in the lawsuit. On the other hand, one might conclude that the decision reflects a more fundamental skepticism about corporate attempts to limit shareholder lawsuits to any particular state. The court did not decide whether provisions in articles of incorporation (rather than bylaws) would be effective in limiting venue to the state of incorporation. Even as to such clauses, plaintiffs who sue in other states will raise serious public-policy arguments as to the validity of such provisions.

In light of the unsettled state of the law on this issue, we recommend that companies think twice before attempting to amend their bylaws to limit derivative suits to any particular forum or venue.

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Please feel free to contact any of the securities litigation partners at Wilson Sonsini Goodrich & Rosati to discuss this issue.

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