

In tight vote, Ninth Circuit applies forum selection clause to block Exchange Act derivative claims

June 6, 2023 | Client Update | 7-minute read

In an *en banc* 6-5 decision, the Ninth Circuit upheld a forum selection clause in Gap's bylaws that requires all claims brought on behalf of the company to be filed in Delaware state court. The court ruled that even though the provision effectively bars *any* derivative claim under the Securities Exchange Act of 1934, it is enforceable. The decision creates a circuit split with the Seventh Circuit, which reached the opposite conclusion in considering Boeing's bylaws.

On June 1, 2023, the Ninth Circuit held *en banc* that a forum selection clause requiring all derivative claims to be brought in Delaware state court—including federal securities claims that can only be maintained in federal court—is enforceable and requires dismissal of the federally filed suit. In so doing, it held that the forum selection clause did not violate the antiwaiver provisions of the Securities Exchange Act of 1934 (Exchange Act) or Section 115 of the Delaware General Corporation Law (DGCL). The court concluded that the requirement to bring derivative claims in Delaware state court did not modify Gap's *substantive* obligations under the Exchange Act, merely limiting shareholders' ability to invoke a particular *procedure* for enforcing those obligations. In particular, because the forum selection provision only impacted shareholders' ability to assert *derivative* claims in federal court, not direct claims, the forum selection did not interfere with the Exchange Act. The court also concluded that its reading was consistent with Delaware state law. This decision, *Lee v. Fisher*, creates a circuit split with the Seventh Circuit, which struck down a similar forum selection clause in Boeing's bylaws in *Seafarers Pension Plan v. Bradway*, 23 F.4th 714, 717 (7th Cir. 2022). Both decisions were accompanied by strongly worded, noteworthy dissents.

Factual background

Lee involved a claim that Gap's directors caused the company to file misleading proxy statements with the U.S. Securities & Exchange Commission (SEC) regarding Gap's efforts to "consider diversity in nominating directors and hiring executives." (Op. at 11.) The complaint, filed derivatively on behalf of Gap in federal court, alleged that the allegedly misleading proxy statements deprived shareholders of the opportunity to cast fully informed votes in violation of Section 14(a) of the Exchange Act and SEC Rule 14a-9.

While Section 14(a) claims can only be brought in federal court, Gap's bylaws contain a forum selection clause that provides that absent consent of the company, "the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for ... any derivative action or proceeding brought on behalf of the Corporation" (Op. at 10.) Based on this provision, the district court granted a motion to dismiss under the doctrine of forum non conveniens. A Ninth Circuit panel affirmed, before the court decided to rehear the case *en banc*. The *en banc* court, in an opinion authored by Circuit Judge Sandra Ikuta and joined by five other Circuit Judges, upheld the forum selection clause and affirmed the district court's dismissal. Five judges dissented, joining an opinion written by Circuit Judge Sidney Thomas.

Section 14(a) of the Exchange Act and the antiwaiver provision

Section 14(a) of the Exchange Act, together with Rule 14a-9, prohibits false or misleading statements in a company's proxy statements. In its 1964 decision in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), the Supreme Court implied a private right of action for claims arising under Section 14(a). Under Section 27(a) of the Exchange Act, federal courts have exclusive jurisdiction over Exchange Act claims (including implied causes of action). The Exchange Act also contains in Section 29(a) a so-called antiwaiver provision, which provides that any "condition, stipulation or provision" that allows any person to waive compliance with the statute shall be void.

In *Lee*, the *en banc* court rejected the plaintiff's argument that the forum selection clause was void because it violates the Exchange Act's antiwaiver provision. The court found that although the forum selection clause effectively forecloses any derivative action asserting Section 14(a) claims—i.e. because it requires such claims to be filed in Delaware state court even though federal courts have exclusive jurisdiction over them—the provision did not waive Gap's compliance with the statute. The court explained that the antiwaiver provision applies only when an agreement waives the "substantive obligations" or "statutory dut[ies]" imposed by the Exchange Act. Gap's forum selection clause did not satisfy this condition because it does not purport to relieve Gap from complying with Section 14(a) or Rule 14a-9 and does not eliminate shareholders' ability to enforce those provisions through civil suits. Key to the court's reasoning is that the provision does not purport to bar the filing of a *direct* (rather than derivative) action in federal court. (Op. at 15, 18–19.)

The court next rejected the plaintiff's two policy arguments. First, the court rejected the argument that enforcing the forum selection clause would violate a strong federal policy of allowing shareholders to bring Section 14(a) actions derivatively. The plaintiff had rooted this purported "strong public policy" in the Supreme Court's *Borak* opinion. (Op. at 24.) But, in a lengthy analysis of *Borak* and subsequent decisions, the Ninth Circuit concluded that *Borak*'s apparent acknowledgement of a shareholder right to bring a *derivative* Section 14(a) action was only dicta, and there was no strong federal public policy in favor of such actions that could trump an otherwise valid forum selection clause. (Op. at 26–28, 35 & n.16.) Second, the court rejected the plaintiff's argument that the Exchange Act's exclusive jurisdiction provision itself created a strong public policy that conflicted with Gap's forum selection clause. The Ninth Circuit pointed to Supreme Court decisions indicating that the exclusive jurisdiction provision at most was designed to prevent state court judges, who are not necessarily experts in federal securities law, from interpreting and enforcing the Exchange Act. The court found that Gap's forum selection clause would not lead to this problem because the Delaware court would simply dismiss any Section 14(a) claims that were brought there. (Op. at 36.)

Delaware General Corporate Law Section 115

The *Lee* decision also includes a lengthy analysis of DGCL Section 115. The Delaware General Assembly enacted Section 115 in 2015 to authorize forum selection clauses. It provides that a corporation's "bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State." In its 2020 decision in *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), the Delaware Supreme Court ruled that federal securities claims are not "internal corporate claims" that fall within the ambit of Section 115, and indicated that courts "must look elsewhere" to determine whether a forum selection bylaw applicable to federal securities claims is permissible.

In *Lee*, the court rejected the plaintiff's argument that the forum selection clause is invalid under Section 115. Relying on *Salzberg*, the court reasoned that (1) federal securities claims are not "internal corporate claims" that Section 115 addresses, and (2) Section 115 is a permissive, rather than restrictive, statute—meaning that its silence on federal

claims does not indicate a prohibition on applying an otherwise valid forum selection clause to such claims. (Op. at 46-49.)

Circuit split and dissent

The Ninth Circuit created a circuit split with the Seventh Circuit's 2022 decision in *Seafarers Pension Plan ex rel. Boeing Co. v. Bradway*. In rejecting a similar forum selection provision in Boeing's bylaws, the Seventh Circuit ruled that, because Section 115 states that a forum selection clause must be "consistent with applicable jurisdictional requirements," and Delaware state courts have no jurisdiction over federal securities claims, a forum selection clause requiring such claims to be brought in Delaware courts is invalid under Section 115. The Seventh Circuit also held that the forum selection clause violates the antiwaiver provision under the Exchange Act. (Op. at 50–52.)

Ninth Circuit Judge Thomas penned the dissent in *Lee*. The dissent described the forum selection clause as "a litigation bridge to nowhere" because state courts lack jurisdiction to hear Exchange Act claims. The dissent also emphasized that direct and derivative suits are "not interchangeable." (Op. at 56, 60.)

Key takeaways

Lee might further encourage Delaware-incorporated companies to adopt bylaws requiring derivative claims to be brought in Delaware state court. Such clauses have the potential to preclude plaintiff forum shopping and satellite litigation in multiple forums. Separately, the decision could incentivize shareholders to attempt to repackage derivative claims as direct ones, notwithstanding the fact that the nature of such claims may make it difficult for shareholders to succeed in alleging direct injury to shareholders (as opposed to generalized harm to the corporate entity). While the decision suggests that the particular claims at issue might have been better pled as direct, rather than derivative, claims, that may not always be the case. In all events, the circuit split that *Lee* creates between the Ninth and Seventh Circuits increases the likelihood of Supreme Court review.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Brian M. Burnovski

+1 212 450 4666

brian.burnovski@davispolk.com

Andrew Ditchfield

+1 212 450 3009

andrew.ditchfield@davispolk.com

Charles S. Duggan

+1 212 450 4785

charles.duggan@davispolk.com

Michael S. Flynn

+1 212 450 4766

michael.flynn@davispolk.com

Edmund Polubinski

+1 212 450 4695

edmund.polubinski@davispolk.com

Neal Potischman

+1 650 752 2021

neal.potischman@davispolk.com

Dana M. Seshens

+1 212 450 4855

dana.seshens@davispolk.com

Daniel J. Schwartz

+1 212 450 4581

daniel.schwartz@davispolk.com

Vincent Barredo

+1 650 752 2099

Vincent.Barredo@davispolk.com

Yao Chen

+1 650 752 2034

xueyao.chen@davispolk.com

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's [privacy notice](#) for further details.