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Ninth Circuit Upholds Delaware Forum-Selection Clause, Dismisses Federal Derivative Action

June 8, 2023

On June 1, 2023, the US Court of Appeals for the Ninth Circuit held in a split *en banc* decision that forum-selection clauses requiring shareholders to file derivative claims in the Delaware Court of Chancery are enforceable as applied to claims asserted derivatively under Section 14(a) of the Securities Exchange Act of 1934. Because Section 14(a) claims can only be brought in federal court, the upshot of this decision is that shareholders cannot assert derivative claims under Section 14(a) in **any** court.

As the Ninth Circuit observed, its decision in *Lee v. Fisher* relates to a "modern trend" in which plaintiffs file derivative claims "that normally arise under state law" in federal court "in order to invoke exclusive federal jurisdiction and avoid any forum-selection clause pointing to a state forum." This highly awaited decision is significant because a shareholder filing a derivative suit within the Ninth Circuit can no longer avoid forum-selection provisions by tacking on Section 14(a) claims. The majority opinion also admittedly created a split with the Seventh Circuit, which last year held that a similar forum-selection clause was unenforceable.

Background

This decision, which terminated a Gap shareholder's lawsuit, follows several years of litigation regarding the enforceability of forum-selection clauses. In 2013, the Delaware Chancery Court held that forum-selection provisions relating to the "internal affairs" of the corporation (including derivative claims), are valid under Delaware General Corporation Law Section (DGCL) 109(b), which broadly permits bylaws "relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." The court explained that forum-selection provisions "plainly relate to the conduct of the corporation by channeling internal affairs cases into the courts of the state of incorporation" and are "designed to bring order to what the boards … say they perceive to be a chaotic filing of duplicative and inefficient derivative and corporate suits against the directors and the corporations." Two years later, Delaware codified this holding in DGCL Section 115. Most recently, in *Salzberg v. Sciabacucchi*, the Delaware Supreme Court upheld the validity of forum-selection provisions requiring shareholders to bring claims under the Securities Act of 1933 in federal court, but indicated that forum-selection provisions would not be enforceable or valid in all circumstances.

In this case, Gap's bylaws contain a forum-selection clause providing that the Delaware Chancery Court is the "sole and exclusive forum" for derivative actions. Noelle Lee, a putative Gap shareholder, filed a derivative action in California federal court alleging that Gap and its directors violated Section 14(a) of the Exchange Act and SEC Rule 14a-9 by making false and misleading statements about the company's commitment to diversity in certain proxy statements. The district court upheld Gap's forum-selection clause and dismissed the case. A panel of the Ninth Circuit affirmed – and, in doing so, created tension with another federal appeals court. Just last year, the Seventh Circuit held in *Seafarers Pension Plan v. Bradway* that a similar forum-selection provision was invalid, reasoning that enforcing the provision would prevent the plaintiffs from bringing their federal derivative claims in any forum. In light of this tension, the Ninth Circuit elected to rehear the case *en banc*.

The decision

In upholding Gap's forum-selection provision, an *en banc* majority of the Ninth Circuit concluded the following:

1. Gap's forum-selection clause does not violate the Exchange Act's anti-waiver provision.

The US Supreme Court has explained that the anti-waiver provision of the Exchange Act, Section 29(a), prevents waiver of the substantive obligations imposed by the Exchange Act.

Lee argued that the forum-selection provision would prevent her from bringing a derivative Section 14(a) claim in any forum, thus waiving Gap's compliance with the substantive obligations imposed by Section 14 of the Exchange Act. The *en banc* majority rejected this argument, reasoning that because the forum-selection provision only applies to derivative actions, Lee could still bring a direct Section 14(a) claim in federal court.

2. Gap's forum-selection clause does not violate the federal public policy of providing a forum for shareholders to bring federal Section 14(a) derivative claims.

In the Ninth Circuit, forum-selection provisions are enforced unless certain exceptional circumstances apply – for example, where enforcing the forum-selection clause will contravene a strong public policy of the forum where the suit is brought. The Ninth Circuit rejected Lee's attempts to invoke this exception and held that she did not show the extraordinary circumstances required to disregard Gap's forum-selection provision.

3. Gap's forum-selection clause is valid and enforceable under Delaware law.

The Ninth Circuit also rejected Lee's argument that the forum-selection provision was invalid under Delaware law. Specifically, DGCL Section 115 permits bylaws that require a plaintiff to bring internal corporate claims in "the courts in [Delaware]," "consistent with applicable jurisdictional requirements," and disallows bylaws that forbid a plaintiff from bringing such claims in Delaware state courts. The majority concluded that Section 115 does not apply to Section 14(a) claims because, according to the Delaware Supreme Court, federal claims are not "internal corporate claims." As a result, Section 115 does not prohibit forum-selection clauses that require federal claims be brought in Delaware state court.

The Ninth Circuit majority noted its disagreement with the Seventh Circuit's *Seafarers* opinion and acknowledged that its conclusion would create a split between the two circuits. In contrast, the *en banc* dissent echoed aspects of *Seafarers*, observing that as a result of the majority's decision, the federal claims at issue could not be asserted derivatively in any forum.

Significance

As a result of this decision, a shareholder filing a derivative suit within the Ninth Circuit can no longer skirt forum-selection provisions requiring derivative actions to be filed in Delaware by bringing federal claims under Section 14(a). At the same time, this decision creates considerable uncertainty as to whether forum-selection clauses will be upheld in other jurisdictions and tees up an important question that appears ripe for review by the US Supreme Court.

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