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Memorandum

Ninth Circuit: Affirms Dismissal of Derivative Suit Based on a Forum-Selection Clause in the Defendant Company's Bylaws

June 13, 2023

On June 1, 2023, a majority of the Ninth Circuit sitting en banc affirmed the dismissal of a putative derivative action that plaintiff brought in California district court against a retail clothing company incorporated in Delaware in light of a forum-selection clause[1] in the company's bylaws requiring any derivative action or proceeding to be brought in Delaware Chancery Court. *Lee v. Fisher*, 2023 U.S. App. LEXIS 13521 (9th Cir. 2023) (Ikuta, J.). The Ninth Circuit held that enforcement of the forum-selection clause: (i) did not violate the Exchange Act's antiwaiver provision, Section 29(a); (ii) would not violate a strong public policy of the federal forum; and (iii) was not contrary to Section 115 of the Delaware General Corporation Law ("DGCL"). By contrast, the Seventh Circuit considered the same issue in *Seafarers Pension Plan v. Bradway*, 2022 WL 70841 (7th Cir. 2022), and concluded that Section 115 of the DGCL does not authorize use of a forum-selection bylaw to avoid what should be exclusive federal jurisdiction over a case, particularly under the Exchange Act.[2]

Background

Plaintiff alleged that the company and certain directors violated Section 14(a) of the Exchange Act by making false or misleading statements to shareholders about the company's commitment to diversity. A three-judge panel of the Ninth Circuit affirmed the district court's dismissal on forum non conveniens grounds in 2022.[3] The Ninth Circuit's June 1 opinion follows its decision to rehear the case en banc to consider whether a forum-selection clause can require that all derivative actions be brought in a state court in the state of incorporation.

The Forum-Selection Clause Is Not Void Under the Exchange Act's Antiwaiver Provision

The court began its analysis with the text of Section 29(a), which provides that "any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, . . . shall be void." In *Shearson/Am. Exp. v. McMahon*, 482 U.S. 220 (1987), the Supreme Court interpreted Section 29(a) as prohibiting "only . . . waiver of the substantive obligations imposed by the Exchange Act." The Ninth Circuit then framed the issue as whether the forum-selection clause authorized the company to

[1] The forum-selection clause states that "Unless the Corporation consents in writing to the selection of an alternative forum, 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 . . . ."

[2] Please click here to read our discussion of the Seventh Circuit's 2022 decision in *Seafarers*.

[3] Please click here to read our discussion of the Ninth Circuit's 2022 decision in *Lee*.

waive compliance with the substantive obligation of Section 14(a) and Rule 14a-9 (*i.e.*, to not to make a false or misleading statement in a proxy statement).

On this issue, plaintiff argued that the forum-selection clause's enforcement would allow the company to waive compliance by precluding her from bringing a derivative Section 14(a) action in any forum because the Chancery Court would dismiss her action in light of the fact that federal courts have exclusive jurisdiction of Exchange Act violations. Rejecting this, the Ninth Circuit explained that plaintiff could still enforce the company's compliance with the substantive obligations of Section 14(a) by bringing a direct action in federal court. The court noted that the forum-selection clause does not impose any limitation on direct actions.

Enforcement Would Not Violate the Federal Forum's Strong Public Policy

In weighing whether to transfer a case based on a forum-selection clause, the Ninth Circuit explained that when the parties have agreed to a valid forum-selection clause, a district court should ordinarily transfer the case to the specified forum, unless plaintiff "can demonstrate 'extraordinary circumstances unrelated to the convenience of the parties that clearly disfavor a transfer.'" In *M/S Bremen v. Zapata Off-Shore*, 407 U.S. 1 (1972), the Supreme Court identified "[o]ne such extraordinary circumstance arises when the plaintiff makes a strong showing that 'enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or by judicial decision.'"

Plaintiff argued that Supreme Court's decision in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), reflects a strong public policy to give shareholders a right to bring both a direct and a derivative action to enforce Section 14(a). The Ninth Circuit rejected this, stating that "*Borak*'s statement that a shareholder could bring a derivative § 14(a) action, which was not necessary to decide that case, and not addressed in subsequent Supreme Court cases, does not establish a strong public policy in favor of such actions." Further, the Ninth Circuit explained that more recent jurisprudential shifts undermined the claim that there is a strong public policy favoring *Borak*'s dictum that shareholders can bring a derivative Section 14(a) action.

The Forum-Selection Clause Is Valid Under Section 115 of the DGCL

Section 115 of the DGCL, states 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." Section 115 defines "internal corporate claims" as those "that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity," and claims "as to which the DGCL confers jurisdiction."

The Ninth Circuit concluded that the forum-selection clause was valid under Delaware law because in *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), the Delaware Supreme Court indicated that federal claims like plaintiff's derivative Section 14(a) action are not "internal corporate claims" as defined in Section 115, and because no language in Section 115, the official synopsis, or *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73

A.3d 934 (Del. Ch. 2013)[4]—which Section 115 was intended to codify—"operates to limit the scope of what constitutes a permissible forum-selection bylaw under Section 109(b)[.]"

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[4] In *Boilermakers*, the Chancery Court "held that the forum-selection clauses at issue were authorized by the broad subjects that Section 109(b) of the DGCL permits bylaws to address," which Section 109(b) defines as those "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[.]"