

Corporate Boards Need Not Fear 7th Circ. Boeing Decision

By **Marcie Lape, Chuck Smith and Luke Mathers** (January 21, 2022)

Forum-selection provisions designate which courts can hear not just contractual disputes but also shareholder derivative litigation. Title 8 of the Delaware Code, Section 115, provides Delaware corporations with the option, "consistent with applicable jurisdictional requirements," to adopt an exclusive Delaware forum provision in their charter or bylaws.

Among other things, such an exclusive provision allows the corporation to direct "any or all" derivative claims to "any or all of the courts in" Delaware, with the Delaware Chancery Court being the most common specific selection.

But what if a shareholder brings just one derivative claim, and that claim is one that only federal courts have jurisdiction to hear; does an exclusive forum provision coupled with a lack of state court jurisdiction checkmate the shareholder's suit?

The answer, according to the U.S. Court of Appeals for the Seventh Circuit, is no. In *Seafarers Pension Plan v. Bradway*, the Seventh Circuit on Jan. 7 held that The Boeing Co. could not use its Delaware forum-selection bylaw to force a shareholder derivative claim alleging violations of Section 14(a) of the Securities Exchange Act into Delaware state court. Instead, the court held that the Section 14(a) claim could proceed in federal court notwithstanding the bylaw.

While the 2-1 split decision may encourage more shareholders to creatively plead derivative Section 14(a) claims to avoid exclusive forum provisions, *Seafarers* is no sea change in the law. Courts already have been enforcing provisions like Boeing's by severing and remanding state law claims to the Delaware Chancery Court while retaining jurisdiction over derivative Section 14(a) claims. And Delaware corporations still have tools available to avoid the risk of duplicative litigation.

Seafarers arose from Boeing's challenges with the 737 Max aircraft. The derivative shareholder plaintiffs alleged that the defendant directors and officers made false and misleading statements about the aircraft's development and operation in the company's proxy statements in violation of Section 14(a) of the Exchange Act.

The defendants moved to dismiss on forum non conveniens grounds, citing Boeing's forum-selection bylaw. That bylaw provides that the Delaware Chancery Court shall be the exclusive forum for shareholder derivative claims brought on behalf of the company.

The plaintiffs responded that the defendants could not enforce the bylaw against them. The Exchange Act both confers jurisdiction exclusively on federal courts and voids "[a]ny condition, stipulation, or provision binding any person to waive compliance" with the act. According to the plaintiffs, the bylaw would deprive them of a forum for their derivative Section 14(a) claim. The district court disagreed with the plaintiffs and dismissed the case.

On appeal, the Seventh Circuit reversed. But it was Delaware law, not federal law, that



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provided the rationale for the majority opinion authored by U.S. Circuit Judge David Hamilton.

The court began by pointing to two key phrases in Section 115, the Delaware statute authorizing exclusive forum provisions in charters and bylaws: "consistent with applicable jurisdictional requirements" and "courts in this State."

Legislative history intimated that Delaware lawmakers penned the first phrase, said the court, so as not "to authorize a provision that purports to foreclose suit in a federal court based on federal jurisdiction." And the second phrase — "courts in this State," not "courts of this State" — also signaled that Section 115 contemplates the availability of federal courts in Delaware to shareholder derivative plaintiffs.

The court acknowledged that, in the Delaware Chancery Court's 2013 decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, then-Chancellor Leo E. Strine Jr. rejected facial challenges to bylaws designating the Delaware Chancery Court the sole forum for derivative suits.

But that decision, the Seventh Circuit said, signaled "clearly enough that Delaware law would not look kindly on" Boeing's attempt to enforce its bylaw in this particular case. Namely, *Boilermakers* opines that a "plaintiff could argue" against a bylaw purporting to waive "the stockholder's rights under the Securities Exchange Act" on the ground that "such a waiver would be inconsistent with the antiwaiver provisions of that Act."

Finally, the court distinguished earlier U.S. Supreme Court and Seventh Circuit decisions that enforced forum-selection provisions in international contracts that deprived plaintiffs of fora for federal antitrust and securities claims. Those decisions, the court explained, hinged on "the international character" of the transaction or dispute — a factor not present in the row between Boeing and its shareholders. As a result, the court held that the plaintiffs may proceed with their derivative case in federal district court in Chicago.

In dissent, U.S. Circuit Judge Frank Easterbrook first highlighted that nothing in the application of Boeing's bylaw bars the plaintiffs from bringing a direct Section 14(a) claim in federal court — and that the U.S. Supreme Court has never suggested that a private plaintiff can bring a derivative Section 14(a) claim when a direct claim is an option.

Judge Easterbrook then noted that derivative suits arise under state law, regardless of any federal issues they broach, merely offering a procedure for later pursuing substantive relief on a corporation's behalf. Enforcing Boeing's bylaw as written would thus still permit relief under the Exchange Act: The plaintiffs could bring a direct Section 14(a) claim in Boeing's stead. Therefore, Judge Easterbrook argues, the majority was wrong to conclude that application of Boeing's bylaw frustrates the purposes of the Exchange Act.

Finally, Judge Easterbrook scrutinized the majority's prepositional fixation. The crucial part of Section 115 is not "courts in this State" but rather "any or all courts in this State." The majority understood the preposition "in" to require Boeing to open up both state and federal courts in Delaware to the plaintiffs, but that, as Judge Easterbrook explained, reads out the preceding phrase "any or."

As a matter of Delaware law, then, Boeing should have been entitled to funnel the plaintiffs' derivative claim to "any" court in Delaware — namely, the Delaware Chancery Court.

The validity of a private, derivative Section 14(a) cause of action aside, *Seafarers* is

consistent with how federal district courts have dealt with bylaws like Boeing's when faced with derivative Section 14(a) claims.

In the typical case, a shareholder derivative plaintiff alleges violations of both Delaware law and Section 14(a) in federal court. The defendant then moves to enforce an exclusive forum provision. The federal court, recognizing that Delaware state courts lack jurisdiction over Section 14(a) claims, enforces the provision by severing the state law claims and remanding them to Delaware state court while retaining jurisdiction over the Section 14(a) claim.

The outlier courts were the district courts in *Seafarers* and *Lee v. Fisher*, an April 2021 decision in the U.S. District Court for the Northern District of California. The *Lee* court, like the district court in *Seafarers*, dismissed a shareholder derivative suit alleging a Section 14(a) claim due to a forum-selection bylaw designating the Delaware Chancery Court as the sole forum for derivative claims. That ruling is currently on appeal before the U.S. Court of Appeals for the Ninth Circuit, where the prospect of reversal has no doubt increased since the Seventh Circuit issued its *Seafarers* decision.

Still, *Seafarers* — even assuming that the majority's rationale is adopted in other circuits — should be little cause for concern among corporate boards.

While some shareholder derivative plaintiffs may creatively plead Section 14(a) claims to circumvent an exclusive forum provision in a bylaw or charter, Delaware corporations that maintain such provisions can still insist that shareholders litigate derivative claims in Delaware — with the caveat that Section 14(a) claims will be heard separately in the U.S. District Court for the District of Delaware.

That may raise the prospect of duplicative litigation, but defendants have tools at their disposal to minimize the fallout. Those tools include:

- The Private Securities Litigation Reform Act's automatic stay of discovery;
- Discretionary stays pending Rule 23.1 motions, as in the U.S. District Court for the Southern District of New York's 2006 *In re: First Bancorp Derivative Litigation* decision; and
- When securities litigation is pending elsewhere (as is often the case), stays under the Delaware Chancery Court's 2012 decision in *Brenner v. Albrecht*, or the first-filed rule.

And, as always, boards may consider appointing special litigation committees to control the litigation decisions per the Delaware Supreme Court's 1981 ruling in *Zapata Corp. v. Maldonado*.

Correction: A previous version of this article misidentified the court for precedent cited in the Boeing decision and in Judge Easterbrook's dissent. The error has been corrected.

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