

En banc panel of Ninth Circuit enforces forum selection clause to dismiss derivative securities claims, confirming circuit split

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On June 1, 2023, an en banc panel of the U.S. Court of Appeals for the Ninth Circuit issued a much-anticipated decision in *Lee v. Fisher*,¹ enforcing a forum selection clause in Gap Inc.'s corporate bylaws that required "any derivative action or proceeding brought on behalf of the Corporation" to be adjudicated in the Delaware Court of Chancery. In so doing, the Ninth Circuit affirmed the district court's dismissal of derivative federal securities claims against Gap and its directors.

The court held that Gap's forum selection clause was valid and enforceable under the Securities Exchange Act of 1934 (Exchange Act) and the Delaware General Corporation Law (DGCL), and did not violate public policy. The decision is a welcome development for the many corporate issuers that have implemented — or will implement — similar forum selection clauses to ensure greater certainty as to where, and to what extent, they and their directors and officers may face derivative litigation.

Lee, however, revives a circuit split with the U.S. Court of Appeals for the Seventh Circuit, which just last year declined to enforce an analogous forum selection clause.

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In affirming dismissal on *forum non conveniens* grounds, the split 6-5 *en banc* panel in Lee prefaced its decision with the observation that the complaint was "consistent" with a "modern trend in which plaintiffs frame corporate mismanagement claims that normally arise under state law (including challenges to corporate policies relating to 'ESG [environmental, social, and governance] issues ... such as environmentalism, racial and gender equity, and economic inequality') as proxy nondisclosure claims under § 14(a), in order to invoke exclusive federal jurisdiction and avoid any forum-selection."

The panel went on to reject the three core arguments the plaintiff presented to overcome Gap's forum selection clause and invoke federal jurisdiction.

- (1) The plaintiff contended that Gap's bylaw violated the Exchange Act's anti-waiver provision, which provides that "[a]ny 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." The court held that the forum selection clause did not waive substantive compliance with the Exchange Act, i.e., compliance with the obligation not to make false or misleading statements in a proxy statement. The court explained that putative plaintiffs could enforce substantive compliance through direct claims that are outside the ambit of Gap's forum selection clause.
- (2) The plaintiff argued that enforcing the bylaw would violate the federal forum's strong public policy of allowing shareholders to bring derivative claims under Section 14(a) of the Exchange Act. But the court held that there is no such public policy and that a U.S. Supreme Court "jurisprudential shift" undermined the plaintiff's public policy argument. The court observed that "the [Supreme] Court now looks to state law rather than federal common law to fill in gaps relating to federal securities claims, and under Delaware law, a § 14(a) action is direct, not derivative." The court further observed that the Supreme Court "now views implied private rights of action with disapproval, construing them narrowly, and casting doubt on the viability of a corporation's standing to bring a § 14(a) action."
- (3) The plaintiff asserted that the bylaw was invalid as a matter of Delaware law under Section 115 of the DGCL. That statute provides that Delaware corporations "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." The plaintiff contended that because Gap's forum selection clause eliminates federal jurisdiction over her derivative Section 14(a) claim, it is not consistent with applicable

jurisdictional requirements and runs afoul of the statute. The court disagreed, reasoning that the “applicable jurisdictional requirements” mandate applies only to “internal corporate claims” — *i.e.*, state law claims — and does not include federal securities claims. Moreover, the court held that because Section 115 is permissive rather than restrictive, the statute’s silence on the issue of federal claims should not be interpreted as prohibiting the application of forum selection clauses to such claims.

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Five of the 11 members of the *en banc* panel joined in a dissent. The dissenting judges asserted that because “state courts lack jurisdiction to hear Exchange Act claims ... the bylaw provision is a

litigation bridge to nowhere, depriving shareholders of any forum in which to pursue derivative claims.”

Lee restores a circuit split between the Seventh and Ninth Circuits. In 2022, a panel of the Seventh Circuit in *Seafarers Pension Plan v. Bradway* declined to enforce a virtually identical forum selection clause in Boeing’s bylaws, over Judge Frank Easterbrook’s dissent. The *en banc* court in *Lee* described the reasoning of the majority in *Seafarers* as “flawed” and inconsistent with Delaware and federal precedent.²

This circuit split regarding whether state court forum selection clauses may preclude derivative claims under Section 14(a) of the Exchange Act in federal court is likely to continue to play out among the circuits. It may ultimately be resolved by the Supreme Court or the Delaware Supreme Court insofar as enforceability turns on the interpretation of the DGCL.

Notes

¹ No. 21-15923.

² The original *Lee* panel decision created a split with *Seafarers* but was vacated pending *en banc* review.

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