

Circuit Split: Ninth and Seventh Circuits Disagree Over Enforceability of Delaware Exclusive Forum Provisions

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In a recent decision,^[1] the Ninth Circuit split with a Seventh Circuit decision^[2] on the enforceability of exclusive forum provisions contained in a Delaware corporation's certificate of incorporation or bylaws as to derivative claims brought under the Securities Exchange Act of 1934 (Exchange Act). The Exchange Act provides exclusive jurisdiction to federal courts to hear claims filed under it. However, the organizational documents of many Delaware corporations designate Delaware state courts as the exclusive forum to hear internal company disputes, including derivative claims, whether brought under the Exchange Act or otherwise. The intersection of these concepts creates a question as to what happens when a derivative plaintiff files an Exchange Act claim on behalf of a Delaware corporation. What is the appropriate forum: state or federal? The answer to this question is critical, as the practical effect of enforcing an exclusive forum selection provision may be a total foreclosure of derivative claims under the Exchange Act. As discussed below, the circuit courts that have addressed this question have reached divergent results.

The Circuit Courts' Decisions

Both the Ninth Circuit's and Seven Circuit's decisions involved a derivative plaintiff filing suit in federal court for alleged violations of Section 14(a) of the Exchange Act, claiming material misrepresentations in each company's proxy materials. Each defendant, in turn, moved to dismiss for *forum non conveniens* based on company bylaws dictating that internal disputes fell under the Delaware Court of Chancery's jurisdiction.

In both of these cases, the district courts granted the defendants' motions and dismissed the suits. The plaintiffs in both cases appealed. On appeal, the Ninth and Seventh circuits reached different conclusions — the Ninth Circuit upheld the dismissal, and the Seventh Circuit reversed.

The Seventh Circuit: *Seafarers Pension Plan v. Bradway*

The Seventh Circuit held that the exclusive forum bylaw violated Delaware corporation law to the extent that it required Exchange Act claims to be litigated in the Delaware Court of Chancery. The court relied on Section 115 of the Delaware General Corporation Law (DGCL), which provides that “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.” Based on this language, the court reasoned that requiring an Exchange Act claim to be brought in the Delaware Court of Chancery was not “consistent with applicable jurisdictional requirements” because the Exchange Act provides exclusive jurisdiction over such claims to the federal courts. Moreover, it determined that Section 115 does not permit Delaware corporations from completely shuttering Exchange Act claims because the section applies to all courts “in” the state, as opposed to only courts “of” the state, thereby recognizing the U.S. Court for the District of Delaware as an appropriate forum for such disputes.

The Ninth Circuit: *Lee v. Fisher*

The Ninth Circuit reached the opposite result, holding the exclusive forum provision to be enforceable even as to Exchange Act claims. The court did so by applying the principles of *forum non conveniens*, finding that the plaintiff failed to meet her burden to show that the exclusive forum bylaw “would contravene a strong public policy” as evidenced by the law of the forum state. In so holding, the court determined that the anti-waiver provision of the Exchange Act did not dictate a contrary result. The court found that “strong federal policy in favor of enforcing forum-selection clauses ... supersede[s] antiwaiver provisions in state [and] federal statutes.” The court also found that the bylaws did not upset any policy related to the exclusive jurisdiction provision because they “do not force the Delaware Court of Chancery to adjudicate Lee’s derivative Section 14(a) claim[.] Rather, the bylaws result in this claim being dismissed in federal court.” For these reasons, the Ninth Circuit affirmed the trial court’s enforcement of the exclusive forum bylaw.

Takeaway

The circuit split created by the Ninth Circuit’s and the Seventh Circuit’s divergent rulings has injected some uncertainty into a common practice among Delaware corporations in the context of derivative claims brought under the Exchange Act. The Seventh Circuit’s decision, which is friendly to derivative plaintiffs, partially upsets standard practice in corporate affairs — that is, deciding where derivative internal corporate disputes should be heard. The Ninth Circuit’s decision, which is friendly to Delaware corporations, generates uncertainty by splitting with the Seventh Circuit. Naturally, would-be plaintiffs and defendants will likely forum shop to the extent possible and gravitate toward their respective safe harbors. This issue could become exacerbated to the extent other circuit courts contribute to the circuit split. In that event, the uncertainty would likely continue unless and until the Supreme Court has the opportunity to, and chooses to, resolve the burgeoning circuit split.

[1] *Lee v. Fisher*, 34 F.4th 777 (9th Cir. 2022).

[2] *Seafarers Pension Plan v. Bradway*, 23 F.4th 714 (7th Cir. 2022).

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