

Ninth Circuit En Banc Panel Doubles Down: Maintains Enforceability of Delaware Exclusive Forum Provision Foreclosing Stockholder's Derivative Securities Exchange Act Claim

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This June, the Ninth Circuit sitting en banc reheard argument in *Lee v. Fisher* — a case in which a three-judge panel of the court affirmed the enforceability of an exclusive forum provision contained in a Delaware corporation's bylaws. Noelle Lee, a stockholder of The Gap, Inc. (Gap), a Delaware corporation, brought a derivative action against the company and its directors for, among other things, a violation of Section 14(a) of the Securities Exchange Act of 1934 relating to allegedly misleading or false information in the company's proxy statements regarding diversity initiatives. Despite a provision in Gap's bylaws establishing the Delaware Court of Chancery as the exclusive forum for any derivative actions, Lee brought her complaint in the Northern District of California. Gap moved to dismiss the complaint on *forum non conveniens* grounds based on the exclusive forum provision, which the trial court granted and the Ninth Circuit affirmed. The practical effect of this decision was to foreclose Lee's ability to bring a derivative action under the Exchange Act, as the act provides exclusive jurisdiction to hear such claims to federal courts. We reported on this case, as well as the Seventh Circuit's split with the Ninth Circuit, in July of last year. For the full text of this article, please click [here](#).

The En Banc Panel's Decision

On rehearing, the panel entertained three main arguments from Lee: (1) that the exclusive forum provision is at odds with the Exchange Act's anti-waiver provisions; (2) that the exclusive forum provision cannot be enforced by the doctrine of *forum non conveniens* because it upsets strong public policies; and (3) that the exclusive forum provision violates Section 115 of the Delaware General Corporation Law (DGCL).

As to the first argument, the panel disagreed that the exclusive forum provision acted to waive any substantive component of the Exchange Act. According to the panel, by way of the forum clause, Gap did not waive compliance with Section 14(a) of the Exchange Act both on its face and in practice. Namely, nothing foreclosed Lee from bringing a *direct* action, either individually or on behalf of a class of stockholders, against Gap for violations of Section 14(a). Moreover, according to Supreme Court precedent, the Exchange Act's anti-waiver provisions only prohibit waiving substantive rather than procedural obligations — and the act's provision of exclusive jurisdiction over Section 14(a) claims to federal courts is procedural, not substantive.

The panel similarly dismissed Lee's second point, considering the strong public policy in favor of enforcing forum

selection clauses to trump any concomitant policy in favor of a stockholder's ability to bring derivative claims under the Exchange Act. In so finding, the panel initially distinguished dicta from the Supreme Court's decision in *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964). In that case, the Supreme Court had found an implied right of action for a stockholder to bring a direct Section 14(a) claim. However, it further commented on the ability of stockholders to bring derivative Section 14(a) claims. Since this comment was not necessary to decide the case, and because it had not been further developed in subsequent Supreme Court caselaw, the panel rejected that this evinced a strong public policy in favor of the ability to bring such claims. Next, the panel noted that the Delaware Supreme Court considered disclosure violations to cause direct injuries to stockholders, rather than derivative injuries to the corporation. And finally, according to the panel, the exclusive jurisdiction provisions of the Exchange Act did not exhibit a strong public policy because, as stated above, Lee could still bring a direct Section 14(a) action.

Third, the panel considered whether the exclusive forum provision violated Section 115 of the DGCL. It opined:

On its face, Section 115 is inapplicable here, because it does not address the validity of a forum-selection clause's effect on federal claims. Section 115 provides that a corporation's bylaws "may require ... that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State." 8 Del. C. § 115. According to [Delaware precedent], the phrase "internal corporate claims" in Section 115 refers to "claims requiring the application of Delaware corporate law, as opposed to federal law." ... By its terms, this language does not prevent a forum-selection clause from requiring that a federal claim, which is not an internal corporate claim, be brought in Delaware state court.

In addition, the panel noted that neither Delaware caselaw nor Section 109(b) of the DGCL limited the scope of permissible forum selection clauses. For these reasons, the panel upheld the exclusive forum provision of Gap's bylaws.

Distinguishing *Seafarers*

Before closing, the panel briefly distinguished the Seventh Circuit's decision in *Seafarers*. In *Seafarers*, the Seventh Circuit held that a similar exclusive forum provision in Boeing's bylaws violated Section 115 of the DGCL. Namely, it considered a derivative Section 14(a) action an "internal corporate claim" that must be "consistent with applicable jurisdictional requirements." The Ninth Circuit en banc panel rejected the Seventh Circuit's reasoning, claiming that it was flawed for its failure to consider Delaware precedent interpreting "internal corporate claim[s]" and Section 109(b). It also considered the Seventh Circuit's analysis of federal law incorrect in that it failed to consider the possibility of direct Section 14(a) actions and misread the import of *Borak*.

Takeaways

The panel's decision sets in stone the Ninth Circuit's understanding of the enforceability of Delaware exclusive forum provisions — that is, until the Supreme Court decides to take up the issue. As stated, the practical effect of this judgment is to, at least in the Ninth Circuit, foreclose a stockholder of a Delaware corporation from bringing a derivative claim under the Exchange Act. The Seventh Circuit's split with the Ninth Circuit, however, creates a level of uncertainty for Delaware corporations and stockholders alike, as two federal Circuit Courts of Appeals have reached opposite holdings. This uncertainty will continue to grow as other circuits enter the scene and will

only be cured if and when the issue hits the Supreme Court. Until then, these exclusive forum provisions will undoubtedly continue to be forum-shopped.

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