LOS ANGELES & SAN FRANCISCO

Daily Journal

www.dailyjournal.com

TUESDAY, JUNE 20, 2023

GUEST COLUMN

Navigating the choppy waters of bylaw forum-selection clauses after *Seafarers*

By Wesley Sze and Michael D. Celio

It is well established that corporations may adopt bylaws requiring derivative claims to be brought exclusively in a designated state forum. After all, derivative claims belong to the corporation, corporations have broad discretion to direct their internal affairs, and the right to bring a derivative claim is a function of state law. Given how costly and time consuming it can be to defend against derivative lawsuits, it makes sense that many corporations will want derivative claims to be litigated in a forum that can most efficiently and effectively handle the disputes, such as in the Delaware Court of Chancery. Accordingly, courts routinely uphold these exclusive forum provisions. *See Boilermakers Loc. 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

But what about derivative claims that can only be brought in a federal forum? For example, stockholders sometimes bring derivative claims based on Section 14(a) of the Securities Exchange Act of 1934 (and Rule 14a-9 promulgated thereunder), which prohibits misleading statements in a company's proxy materials. But federal courts have exclusive jurisdiction over claims arising under the Exchange Act. *See* 15 U.S.C. § 78aa(a). Can a bylaw's exclusive forum provision mandate that derivative claims be filed in a state venue that may lack jurisdiction to hear such federal claims?

It seems the tides pull in different directions. Last year, in *Seafarers Pension Plan v. Bradway*, 23 F.4th 714 (7th Cir. 2022), a divided panel of the 7th Circuit held that an exclusive forum bylaw was unenforceable when applied to such derivative claims. Apparently motivating the 7th Circuit's decision was its belief that "applying the bylaw … would mean that plaintiff's derivative Section 14(a) action may not be heard in any forum" – a result the court thought would be contrary to the "non-waiver provision … in the federal Exchange Act." *Id.* at 717. But just a few months later, the 9th Circuit reached the opposite conclusion in *Lee v. Fisher*, 34 F.4th 777 (9th Cir. 2022), where it held that such a provision *was* enforceable, creating a circuit split on this issue.

And although some speculated that the 9th Circuit's granting of en banc review was a sign that the circuit split would be short lived, those speculations have been put to rest. Rather than resolving the circuit split, the 9th Circuit's en banc decision has deepened it, affirming the court's prior ruling in *Lee* and holding that a bylaw's exclusive forum provision is valid and enforceable—even if it means a shareholder may be without a proper forum for a derivative Exchange Act claim. *See Lee v. Fisher*, No. 21-15923, – F.4th —, 2023 WL 3749317 (9th Cir. June 1, 2023) (en banc). In particular, the en banc court found there was no violation of the Exchange Act's non-waiver provision, since the bylaw did not "waive [the company]'s compliance with any substantive obligation … imposed by the Exchange Act." *Id.* at *8. Moreover, the plaintiff failed to carry her "heavy burden" of showing "exceptional circumstances that would justify disregarding a forum-selection clause," and there is no legitimate federal public policy that would be undermined by enforcing the provision. *Id.* at *14.

So what's on the horizon for Section 14(a) litigation? We offer a few thoughts.

While these derivative claims may have dried up in the 9th Circuit, *Seafarers* remains the law in the 7th Circuit, and courts elsewhere will feel the tug and pull of these dueling decisions. The 9th Circuit's decision may encourage plaintiffs to set their sights on other courts – especially courts like the District of Delaware, which is another forum that has traditionally been a hotspot for derivative Exchange Act litigation.

Additionally, notwithstanding *Lee*, the Securities Exchange Commission continues to have authority to enforce the Exchange Act, including Section 14(a). Indeed, that is the primary enforcement mechanism that Congress contemplated, as the Exchange Act actually makes no mention of a private right of action at all. The idea that Section 14(a) contains an implied private right of action is a judicial creation – and one that is not even on particularly solid footing in the first place. As the 9th Circuit observed, the Supreme Court dicta from 1964 supposedly acknowledging an im-

Wesley Sze *is an associate attorney and* **Michael D. Celio** *is a partner in the securities litigation practice group at Gibson, Dunn & Crutcher LLP. The opinions expressed in this article are those of the authors and do not necessarily reflect the views of the firm or its clients.*

plied private right to bring a derivative Section 14(a) action "was not well-explained or well-reasoned," and "did not square with the Supreme Court's jurisprudence regarding derivative actions." *Lee*, 2023 WL 3749317, at *10–11 (citing *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964)).

The 9th Circuit's decision may also place more pressure on Delaware courts to explain the meaning of Section 115 of the Delaware General Corporation Law, which the Delaware General Assembly enacted in 2015 to authorize corporations to enact bylaws that "require … that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State." Two questions come to mind: Are derivative claims under Section 14(a) of the Exchange Act "internal corporate claims?" And does the term "courts in this State" refer only to Delaware state courts – or does it mean that a forum-selection provision must also open the doors to federal courts in Delaware? The 7th and 9th Circuits reached two different conclusions on the meaning of this statute, although it is unlikely that either will have the last word.

Finally, given how important this question is for so many publicly-traded companies, it seems it is only a matter of time before the Supreme Court wades in to resolve the issue once and for all. But until then, companies, boards, and shareholders alike may have to brace for some murky waters ahead.