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En Banc Ninth Circuit Upholds Delaware-Forum Bylaw That Prevents Assertion of Federal Proxy Claim in Derivative Action

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The *en banc* Court of Appeals for the Ninth Circuit affirmed the dismissal of a shareholder derivative action in light of an exclusive-forum bylaw requiring assertion of derivative claims in the Delaware Court of Chancery, even though the plaintiff had pled a federal claim that was subject to exclusive federal jurisdiction and could not have been litigated in the Delaware court. The June 1, 2023 ruling in *Lee ex rel. The Gap, Inc. v. Fisher* could further encourage the adoption of similar forum-selection provisions and could discourage shareholders' efforts to circumvent state-forum provisions by filing derivative actions alleging federal-law proxy claims in federal court.

However, the decision confirms a split with the Seventh Circuit's recent ruling in another derivative action challenging a similar forum-selection clause and could lead to Supreme Court review. The decision also might be read to raise questions about whether a private right of action under § 14(a) should exist at all.

Factual Background

The *Lee* case alleges that The Gap and its directors "failed to create meaningful diversity within company leadership" and that the company made misrepresentations in its proxy statements about its diversity achievements. A shareholder of The Gap, which is a Delaware corporation, filed a derivative action in federal court asserting a proxy-law violation under § 14(a) of the Securities Exchange Act as well as violations of state law.

The Gap had previously adopted a forum-selection bylaw requiring that "any derivative action or proceeding brought on behalf of the Corporation" be adjudicated only in the Delaware Court of Chancery. The plaintiff argued that the bylaw was unenforceable because it violates the Exchange Act's anti-waiver provision (§ 29) and would prevent her from asserting her § 14(a) proxy claim at all, inasmuch as, under Exchange Act § 27, such claims can be litigated only in federal court.

The district court dismissed the case based on the forum clause, and a panel of the Ninth Circuit affirmed. The full court decided to rehear the case, and the *en banc* majority affirmed the district court's ruling in a 6-to-5 decision.

The *En Banc* Court's Decision

The appeal raised three issues: (*i*) whether the forum-selection clause "is void because it violates the Exchange Act's anti-waiver provision," (*ii*) whether the clause is unenforceable under federal law because "enforcement would violate a strong public policy of the federal forum," and (*iii*) whether the bylaw is invalid under Delaware law. The majority answered all three questions in the negative.

First, the court first held that the Delaware-forum bylaw did not violate the Exchange Act's anti-waiver provision even though the bylaw effectively would preclude assertion of a derivative claim under § 14(a), which could not be litigated in the Delaware Court of Chancery. The court said that Exchange Act § 29's anti-waiver provision applies only to the Act's substantive provisions, and the bylaw did not preclude enforcement of § 14(a)'s substantive obligations because it did not prevent the plaintiff from bringing a *direct* § 14(a) action in federal court. "An agreement to use a particular procedure for bringing a claim – . . . a direct action instead of a derivative action – does not constitute a waiver of a substantive obligation for purposes of § 29(a)."

Second, the court held that enforcement of the forum-selection bylaw would not violate any "strong [federal] public policy" of allowing shareholders to assert § 14(a) claims derivatively. The court did not read Supreme Court case law as properly finding any such public policy. It also held that enforcement of the bylaw would not undermine the policy reasons underlying Exchange Act § 27's exclusive-jurisdiction provision – promoting uniform construction of federal law – because the Delaware Court of Chancery would need to dismiss the plaintiff's § 14(a) derivative claim for lack of jurisdiction, rather than adjudicate it on the merits.

Third, the court held that the forum-selection clause was valid under Delaware law. In 2015, Delaware enacted § 115 of its Corporation Law to authorize forum-selection clauses for "internal corporate claims," such as derivative claims. Section 115 did not apply here, because the Delaware Supreme Court has construed "internal corporate claims" to means "'claims requiring the application of Delaware corporate law, as opposed to federal law.'" The Ninth Circuit *en banc* majority held that § 115 is merely permissive, not restrictive, and that its limitation to Delaware-law claims "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." The court also did not see anything else in Delaware law that would prohibit such a clause.

Accordingly, the Ninth Circuit affirmed the dismissal of the derivative action based on the forum-selection bylaw. The court recognized that its ruling expressly disagreed with the Seventh Circuit's 2022 decision in *Seafarers Pension Plan ex rel. Boeing Co. v. Bradway*, involving a similar Delaware-forum provision, but the court concluded that the Seventh Circuit had misconstrued both Delaware and federal law on the permissibility of anti-waiver provisions in derivative actions.

Five judges dissented, opining that the forum-selection bylaw here was "a litigation bridge to nowhere" because the shareholders could not pursue their § 14(a) derivative claim in Delaware state court. In the dissenters' view, "a judge-made federal policy in favor of enforcing forum-selection clauses cannot supersede the clear anti-waiver provision enacted by Congress in the Exchange Act, which voids such a provision."

Implications

The Ninth Circuit's ruling could have a number of ramifications.

First, the decision could further encourage companies to draft broad forum-selection provisions that cover even claims that are subject to exclusive federal jurisdiction. Such provisions have proliferated in recent years, and they generally have been upheld. The Seventh Circuit's prior decision might have raised questions about those clauses, but the Ninth Circuit's decision could reignite enthusiasm for them.

Second, the question whether forum-selection clauses can preclude assertion of federal claims that are subject to exclusive federal jurisdiction could be headed for the Supreme Court in light of the direct split between the Seventh and Ninth Circuits. The Ninth Circuit's ruling itself was a closely divided 6-5 decision, illustrating the strong differences of opinion on this issue.

Third, the Ninth Circuit's ruling might encourage challenges to whether a private right of action exists at all under § 14(a). The *en banc* majority's opinion contains a fair amount of language disparaging the Supreme Court's 1964 decision in *J.I. Case Co. v. Borak*, which allowed shareholders to bring private actions under § 14(a) despite the lack of express statutory authorization for such actions. Although *Borak* was not a derivative action, the Supreme Court – in the course of holding that shareholders could bring *direct* actions under § 14(a) – also stated that "a right of action exists as to both derivative and direct causes." The Ninth Circuit majority criticized that ruling, observing that, "[e]ven at the time *Borak* was decided, these statements did not square with the Supreme Court's jurisprudence regarding derivative actions" and that subsequent legal developments "further undermine that case's reasoning."

Although the Ninth Circuit's opinion questioned *Borak*'s apparent authorization of private rights of action under § 14(a) for *derivative* claims, one cannot help but wonder whether the majority was also skeptical of *Borak*'s current viability even as to *direct* claims under § 14(a). This issue got some attention a few years ago in *Emulex Corp. v. Varjabedian*, a case argued in the Supreme Court in 2019. The Court had taken the case to review a Circuit split on the liability standard under Exchange Act § 14(e), which regulates tender offers rather than proxy statements. Along the way, however, the petitioner argued that a private right of action does not exist at all under § 14(e) – an issue that had not been raised in the lower courts. That issue occupied a large portion of the oral argument, with the parties and the Justices exploring whether the Court should entertain the previously unraised issue and, if so, what the outcome should be.

One week later, the Court dismissed the writ of certiorari as improvidently granted. The Court therefore did not rule on any issues involving § 14(e). But during oral argument, certain Justices made comments that could extend beyond the § 14(e) context and implicate § 14(a) because at least some Justices seemed to reveal doubts about *Borak*'s continuing viability.

Chief Justice Roberts appeared expressly to question *Borak*'s validity in light of the significant change in the Court's jurisprudence on implied rights of action in the more than half-century since *Borak* was decided. He observed that "we now know that that was not the right approach [in *Borak*]," that "*Borak* would not be decided the same way today," and that, "from today's perspective, what we did back then was a mistake." In response, the plaintiff's counsel conceded that "*Borak* may not be decided the same way today" and that "maybe *Borak* was wrongly decided," although he sought to differentiate § 14(e) from the *Borak* rationale.

Several other Justices also wondered whether any difference should exist as to the availability of a private right of action under § 14(a) versus under § 14(e), inasmuch as corporate transactions can be accomplished either through mergers (implicating § 14(a)) or through tender offers (implicating § 14(e)). Those comments collectively suggested that attacks on private rights of action under § 14(e) could cause litigants to raise the same questions about § 14(a) and ask the Court to overrule *Borak*.

Whether the Ninth Circuit *en banc* majority is headed in that direction is unclear, but the tone of the opinion does not suggest much satisfaction with *Borak*. We will see whether litigants try to use the *Lee v. Fisher* decision about § 14(e) to launch direct attacks on private rights of action under § 14(a).

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