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## SECURITIES – DERIVATIVE ACTIONS

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**The United States Court of Appeals for the Ninth Circuit held that forum-selection clauses that require derivative actions be brought in state court are not in violation of the Securities Exchange Act or Delaware state law and are therefore enforceable. *Lee v. Fisher*, 70 F.4<sup>th</sup> 1129 (9<sup>th</sup> Cir. 2023).**

### Mollie Price

In *Lee v. Fisher*, the Ninth Circuit Court of Appeals discussed whether a forum selection clause in a corporation’s bylaws was valid under the Securities Exchange Act’s antiwaiver provision. The forum selection clause in question required all derivative actions to be brought in state court; this effectively prevented § 14(a) derivative actions under the Securities Exchange Act from being brought in any forum, as they can exclusively be heard by federal courts. The court also considered the potential public policy implications of this prohibition on derivative actions and whether Delaware’s Section 115, which prohibits certain types of forum-selection clause, would invalidate the clause in question.

The Gap, Inc. (“Gap”) is a clothing company that is headquartered in San Francisco and incorporated in Delaware. Its corporate bylaws contain a forum selection clause which dictates that, unless the Corporation consents in writing to an alternative forum, any derivative actions brought on behalf of the Corporation must be heard in the Court of Chancery of Delaware. Similar forum selection clauses are very common in modern corporate bylaws as a way of preventing multiforum litigation.

Noelle Lee (“Lee”), a Gap shareholder, filed a derivative action against Gap in a California district court. Lee’s complaint alleged that Gap had violated § 14(a) of the Exchange Act, SEC Rule 14a-9, and several state laws involving breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, abuse of control, and unjust enrichment. At the heart of Lee’s complaint was an accusation that, in 2019 and 2020 statements to the SEC, Gap misrepresented its devotion to diversity. According to Lee, Gap made false statements while engaging in discriminatory hiring and compensation practices, preventing the shareholders from making informed votes. Lee sought injunctive and equitable relief on Gap’s behalf.

Gap moved to dismiss the complaint due to the forum selection clause. The District Court granted Gap’s motion and indicated that the complaint should be filed in the Court of Chancery of Delaware in compliance with the bylaws. Lee appealed, and a panel of three judges affirmed the District Court’s decision. The Ninth Circuit Court of Appeals elected to re-hear this case *en banc* to consider the validity of the forum-

selection clause under both the antiwaiver provision of the Securities Exchange Act and Section 115 of the Delaware General Corporation Law, an issue that arose later in proceedings.

The antiwaiver provision is found in § 29(a) of the Security Exchange Act: “[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.”<sup>1</sup> The Ninth Circuit has interpreted this provision to only apply to waivers of the “substantive obligations” imposed by the Exchange Act.<sup>2</sup>

Lee’s first argument is that the antiwaiver provision invalidates the forum-selection clause. The court disagreed and concluded that Lee could still sue Gap in compliance with § 14(a) by bringing a direct action, rather than a derivative one. This is due to the particular facts of Lee’s claim; because her argument hinged on the idea that the shareholders were deprived of the right to a fully-informed vote, which can be and often is a direct claim, it could be brought directly on the basis of harm suffered by Lee as a shareholder, rather than on the basis of any harm that may have been suffered by Gap. Therefore, the court concluded that there was no basis for the argument that the forum selection clause functionally waives compliance with the Securities Exchange Act’s antiwaiver provision.<sup>3</sup> Because Lee still has the capacity to bring a claim under § 14(a), albeit directly instead of derivatively, the court found that the clause did not waive any “substantive obligations” imposed by the Exchange Act.<sup>4</sup>

The court then turned to Lee’s second argument, which was that enforcing the forum-selection clause “would violate the strong public policy of allowing a shareholder to bring a § 14(a) derivative action” as a matter of right.<sup>5</sup> Lee’s argument was largely based on *J.J. Case Co. v. Borak*, 377 U.S. 426 (1964). *Borak* found that a shareholder had the right to bring both direct and derivative actions under § 14(a). The Ninth Circuit concluded, however, that public policy surrounding federal securities claims has changed drastically since *Borak* was decided. Now, they asserted, private rights of action are now often construed very narrowly, casting doubt on the idea that there is still a strong public policy basis for § 14(a) derivative claims. Therefore, they rejected Lee’s second argument.

The court turned, finally, to the issue of Section 115 of the DGCL. The relevant portion of Section 115 states that “bylaws may require, consistent with applicable jurisdictional requirements, that any or all

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<sup>1</sup> 15 U.S.C. § 78cc(a).

<sup>2</sup> *Lee v. Fisher*, 70 F.4th 1129, 1141 (9th Cir. 2023).

<sup>3</sup> *Id.* at 1142.

<sup>4</sup> *Id.* at 1143.

<sup>5</sup> *Id.*

internal corporate claims shall be brought solely and exclusively in any or all of the courts in this state.”<sup>6</sup> Internal corporate claims are defined, broadly, as any claims based on a violation of duty by a director, officer, or stockholder acting in their capacity and any claims “to which [the DGCL] confers jurisdiction.”<sup>7</sup> Section 115 is accompanied by an official synopsis which provides that the section is “not intended to authorize a provision that purports to foreclose suit in a federal court based on federal jurisdiction.”<sup>8</sup> While the synopsis is construed as a valid expression of legislative intent, it is generally only consulted if “statutory language is ambiguous and requires interpretation.”<sup>9</sup> Lee argued that the wording of Section 115, read in conjunction with the official synopsis, creates an inference that Section 115 invalidates forum-selection clauses that would require exclusively federal suits to be brought in state court.

The Ninth Circuit rejected Lee’s argument. They based this rejection largely on the findings in *Salzberg v. Sciabacucchi*, a Delaware Supreme Court case.<sup>10</sup> In *Salzberg*, the Court found that Delaware’s legislature did not intend for “internal corporate claims” to encompass federal claims and that Section 115 is merely intended to prohibit clauses that would prevent plaintiffs from bringing state-law claims in Delaware courts.<sup>11</sup> Section 115 may allow for clauses that make Delaware the only available venue for some claims, but it should never exclude Delaware as a venue from any state law claims. Because the forum-selection clause prevents an action from being heard in federal court, not in Delaware state court, the Ninth Circuit found that Gap’s forum-selection provision did not run contrary to Section 115.

The Seventh Circuit had recently heard a similar case involving very similar facts and a virtually identical forum selection clause. In *Seafarers Pension Plan ex rel. Boeing Co. v. Bradway*,<sup>12</sup> the Seventh Circuit concluded that a derivative § 14(a) action was an “internal corporate claim” and thus fell under the purview of Section 115, asserting that Section 115 did not allow the use of forum selection clauses to circumvent

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<sup>6</sup> 8 Del. C. § 115.

<sup>7</sup> *Id.*

<sup>8</sup> S.B. 75, 148<sup>th</sup> Gen. Assemb., Reg. Sess.(Del. 2015) (synopsis).

<sup>9</sup> *Lee*, 70 F.4<sup>th</sup> at 1152 (quoting *Bd. of Adjustment of Sussex Cnty. v. Verleysen*, 36 A.3d 326, 332 (Del. 2012)).

<sup>10</sup> 227 A.3d 102 (Del. 2020).

<sup>11</sup> *Lee*, 70 F.4<sup>th</sup> at 1153.

<sup>12</sup> 23 F.4<sup>th</sup> 714 (7<sup>th</sup> Cir. 2022).

exclusive federal jurisdiction over certain cases.<sup>13</sup> The court also found that the forum-selection clause ran afoul of § 29(a) and the Supreme Court's ruling in *Borak*, thereby concluding that the right to bring a derivative § 14(a) suit was non-waivable.<sup>14</sup> The Ninth Circuit Court of Appeals expressed its disagreement with the Seventh Circuit's holding and analysis on both issues, and they explicitly declined to follow their holding in *Seafarers*.

In conclusion, the Ninth Circuit Court of Appeals found that Gap's forum selection clause was valid under both the Exchange Act and Delaware law.<sup>15</sup> The dissent, authored by Judge S.R. Thomas, disagreed with the Ninth Circuit's ruling that the forum-selection clause in Gap's bylaws did not violate the Exchange Act because Lee was still able to bring a direct action.<sup>16</sup> The dissent argued that there are meaningful differences between derivative and direct suits; preventing Lee from bringing a derivative action did, therefore, interfere with the "substantive obligations" of the Act.<sup>17</sup> Furthermore, the dissent argued that finding the forum selection clause valid was contrary to public policy, pointing to the plain text of the Exchange Act and the holding in *Borak*, which has never been overturned, as an indication that the law favors a strong policy of utilizing the federal forum for Exchange Act claims and places importance on the private right to bring both derivative and direct § 14(a) claims.<sup>18</sup>

The Ninth Circuit's ruling on this issue created a circuit split. Depending on the jurisdiction a suit may be brought in, forum-selection clauses like the one present in Gap's bylaws may or may not be considered valid under the Exchange Act and Delaware law. The decision in *Lee v. Fisher* validates forum-selection clauses that require derivative suits to be settled in state court, thereby effectively preventing derivative § 14(a) claims; when possible, it may be best to do as the court suggests and bring similar claims under § 14(a) directly.

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<sup>13</sup> *Lee*, 70 F.4<sup>th</sup> at 1156.

<sup>14</sup> *Id.* at 1157.

<sup>15</sup> *Id.* at 1159.

<sup>16</sup> *Id.* at 1161.

<sup>17</sup> *Id.* at 1160–61.

<sup>18</sup> *Lee*, 70 F.4<sup>th</sup> at 1164.