Securities Litigation and Enforcement

Seventh Circuit Overrides a Forum Selection Bar in Federal Securities Lawsuits

By: Gabriel K. Gillett, Andrew J. Plague, and Howard S. Suskin

A recent ruling by the Seventh Circuit in *Seafarers Pension Plan v. Bradway* addresses the issue of where shareholder derivative lawsuits may be filed when the company at issue has a forum selection clause in its bylaws. The Seventh Circuit's decision is the latest in a string of high-profile decisions that analyze whether companies can require lawsuits to be brought in courts of their preference.[1] But unlike previous decisions, this decision may encourage shareholder plaintiffs to seek to bring derivative suits in courts within the Seventh Circuit notwithstanding bylaws that suggest otherwise.

Unlike a direct claim in which an individual seeks redress for directly suffered legal injuries, derivative lawsuits allow shareholders to use their stock ownership to bring—on behalf of the company itself—a suit against the company's directors and officers for alleged misdeeds against the company. In this case, the Seafarers Pension Plan, a shareholder of the Boeing Company, sued Boeing board members and executives in the Northern District of Illinois on behalf of Boeing for allegedly issuing false and misleading proxy materials to the shareholders related to two crashes involving Boeing's 737 MAX passenger jets and exposing Boeing to damages.

Boeing challenged the suit as violating its forum-selection bylaw[2] which restricts shareholder derivative claims to Delaware's Chancery Court. The shareholder countered that the 1934 Securities Exchange Act purports to give the federal courts exclusive jurisdiction over claims under Section 14(a) of the Securities Exchange Act of 1934, so the bylaw could not bar their federal suit.[3] The defendants acknowledged that the impact of the forum selection clause was to foreclose derivative suits under the 1934 Securities Exchange Act, such as the one brought by the Seafarers Plan.[4]

In a split ruling, the Seventh Circuit held that the forum selection clause was unenforceable in violation of Section 115 of the Delaware General Corporation Law.

The majority (Circuit Judges Diane Wood and David Hamilton) held that while Delaware corporation law gives companies "considerable leeway in writing bylaws," it does not authorize companies to "close the courthouse doors entirely" on derivative actions under federal claims that are subject to exclusive federal jurisdiction.[5] Specifically, the court focused on Section 115's text, which states 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."[6] The court found that the reference to courts *in* this state, as opposed to courts *of* this state, evinced the legislature's intent to include federal courts.[7] As such, the court concluded that Section 115 "does not authorize use of a forum-selection bylaw to avoid what should be exclusive federal jurisdiction over a case."[8] The enforcement of such a forum-selection bylaw, the majority explained, would be inconsistent with the anti-waiver provision of the Securities Exchange Act.[9]

In reaching that conclusion, the court rejected Boeing's assertion that past cases *M/S Breman v. Zapata Off-Shore Co.* and *Bonny v. Society of Lloyd's*,[10] decided by the US Supreme Court and the Seventh Circuit respectively, supported enforcing the bylaw. The court explained that the forum-selection clause in *Breman*, unlike the forum-selection clause at issue, was deemed valid because it involved a "purely private contractual dispute" and did not implicate a federal statute.[11] In *Bonny*, the court was satisfied that while the forum-selection provision foreclosed the plaintiff's claims under federal securities law, due to the international nature of the dispute, alternative relief was available to the

plaintiffs under English law.[12]

The majority was noticeably cautious in rejecting what they called the defendant's "preferred Catch 22 result" to bar derivative suits under Section 14(a) of the Securities Exchange Act "in *any* forum."[13] The court stressed that the decision was limited to the specific facts of this case,[14] and accepted that it was reading *dicta* from a Court of Chancery decision as "important guidance for this case."[15]

Writing in dissent, Judge Frank Easterbrook challenged the premise advanced by the majority that the defendants' position would result in a total bar to claims under Section 14(a) of the Securities Exchange Act.[16] Acknowledging that he was advancing an argument that was not proposed by the defendants, Judge Easterbrook argued that there is no federal statutory right to bring a derivative Section 14(a) claim, and that the Supreme Court has declined to extend private rights of action under the securities laws, so barring such claims is not inherently problematic. He also noted that derivative suits may begin in state court, cannot be removed to federal court (per 15 U.S.C. § 77p(f)(2)(B)), and as such federal courts do not actually have exclusive jurisdiction over derivative claims.[17] Moreover, Judge Easterbrook interpreted the exclusivity provision of the Exchange Act as applying only to claims arising under federal law, and not derivative suits based on state law, and read Delaware law as permitting a company to prohibit derivative suits or restrict where they could be filed (if at all).[18]

Looking ahead, the issue may remain in flux for a while, pending potential panel rehearing, rehearing en banc, or a petition for certiorari to the US Supreme Court. Other courts may weigh in as well. In the meantime, companies with forum selection bylaws should prepare for the increased likelihood of having to defend shareholder derivative suits in federal court and, in particular, in courts within the Seventh Circuit. Companies defending forum selection bylaws in federal court should consider raising and further developing the arguments offered by Judge Easterbrook, in conjunction with other arguments, to provide additional grounds for their bylaws to be enforced.

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[1] *See, e.g., Lee v. Fisher*, No. 20-cv-06163, 2021 WL 1659842 (N.D. Cal. Apr. 27, 2021), appeal pending, No. 21-15923 (dismissing shareholder suit against The Gap, Inc., because the company's bylaws designate the Delaware Court of Chancery as the exclusive forum); *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020) (holding that bylaw provisions designating federal courts as the exclusive forum for claims under the Securities Act are facially valid under Delaware law).
[2] The bylaw reads in relevant part: "With respect to any action arising out of any act or omission occurring after the adoption of this By-Law, unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for ... any derivative action or proceeding brought on behalf of the Corporation." *Seafarers Pension Plan v. Bradway*, No. 20-2244, 2022 WL 70841 at *1 (7th Cir. Jan. 7, 2022).
[3] 15 U.S.C.S. § 78aa.
[4] *Seafarers Pension Plan v. Bradway*, No. 20-2244, 2022 WL 70841 at *2 (7th Cir. Jan. 7, 2022).
[5] *Seafarers*, at *2, 7.
[6] *Seafarers*, at *4 (quoting 8 Del. C. § 115).
[7] *Seafarers*, at *5.
[8] *Seafarers*, at *5.
[9] *Seafarers*, at *7.
[10] *M/S Breman v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972); *Bonny v. Society of Lloyd's*, 3 F.3d 156 (7th Cir. 1993).
[11] *Seafarers*, at *8.
[12] *Seafarers*, at *9.
[13] *Seafarers*, at *11 (emphasis in original).
[14] *Seafarers*, at *2, 4, 7, 10.
[15] *Seafarers*, at *6.
[16] *Seafarers*, at *12 (Easterbrook, J., dissenting).
[17] *Seafarers*, at *12-13 (Easterbrook, J., dissenting).
[18] *Seafarers*, at *14 (Easterbrook, J., dissenting).