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Forum Selection Provisions: Choose Your Own Adventure

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The governing documents of many publicly traded issuers organized as Delaware corporations include provisions requiring certain claims to be brought in a specific court or courts. These provisions are commonly referred to as "forum selection", or "exclusive forum", provisions. One variation of forum selection provisions adopted by issuers designates the Delaware Court of Chancery as the sole and exclusive forum for "any derivative action or proceeding brought on behalf of" the issuer.

As a result of a recent split between the United States Court of Appeals for the Seventh Circuit (the "Seventh Circuit") and the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit"), it is unclear whether this variant of forum selection provision can be enforced to prohibit an issuer's stockholders from bringing derivative claims under the Securities Exchange Act of 1934 (the "1934 Act"). Given this uncertainty, issuers (and the counsel advising them) face a decision point regarding whether (and how) to address 1934 Act derivative claims in a forum selection provision. Described below are four possible approaches to address this uncertainty, as well as some of the potential risks posed.

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Background of Forum Selection Provisions and 1934 Act Derivative Claims

- ***Forum Selection Generally.*** The Delaware courts and legislature have, within the last ten years, upheld and permitted provisions of a corporation's governing documents that require certain types of claims to be heard in a specific court or courts (i.e., forum selection, or exclusive forum, provisions).

  - *Internal Forum Provisions*. In the 2013 *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013), decision, the Court of Chancery first upheld the validity of forum selection provisions requiring certain internal claims, including fiduciary duty claims and derivative claims, to be brought in the Court of Chancery.[1] Following this decision, in 2015, the Delaware legislature enacted Section 115 of the Delaware General Corporation Law (the "DGCL"), which expressly permits a provision requiring all claims based upon a violation of a duty by a current or former director or officer or stockholder in such capacity or as to which the DGCL confers jurisdiction upon the Court of Chancery to be brought solely and exclusively in any or all courts in Delaware.[2] These are referred to herein as "Internal Forum Provisions."

- *1933 Act Forum Provisions*. In the 2020 *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), decision, the Delaware Supreme Court upheld the facial validity of so-called federal forum selection provisions, holding that a charter provision requiring that all claims arising under the Securities Act of 1933 (the "1933 Act"), over which the 1933 Act grants state courts concurrent jurisdiction with the United States federal district courts, be brought in one of the United States federal district courts (rather than in a state court) was permissible under Section 102(b)(1) of the DGCL.

  Section 102(b)(1) allows a charter to include any provision (i) "for the management of the business and for the conduct of the affairs of the [issuer]" and (ii) "creating, defining, limiting and regulating the powers of the corporation, the directors and stockholders . . ., if such provisions are not contrary to the laws of [Delaware]." The Court observed that this type of forum selection provision involves a type of securities claim related to the management of litigation arising out public offering disclosures. Reasoning that a charter provision "that seeks to regulate the forum in which such 'intra-corporate' litigation can occur is a provision that addresses the 'management of the business' and the 'conduct of the affairs of the [issuer],'" the Court concluded that the challenged forum selection provision was facially valid under Section 102(b)(1) of the DGCL. [3] This type of forum selection provision is referred to herein as a "1933 Forum Provision."

- ***1934 Act Derivative Claims.*** In a recent development, the Seventh Circuit and the Ninth Circuit have split regarding whether an Internal Forum Provision, which requires that "all derivative claims" be brought in the Court of Chancery, can be enforced to prevent stockholders from bringing derivative claims under the 1934 Act, over which the 1934 Act grants the United States federal district courts exclusive jurisdiction.

  - *Seventh Circuit*: *Seafarers Pension Plan v. Bradway*, 23 F.4th 714 (7th Cir. 2022).

    - In litigation involving 1934 Act derivative claims resulting from the crashes of two 737 MAX airplanes, Boeing moved to dismiss such claims, arguing that its forum selection provision, which required that any derivative action or proceeding be brought in the Court of Chancery, could effectively preclude derivative claims under the 1934 Act because Delaware state law provided alternative forms of relief for disclosure claims (i.e., claims asserting that the directors and/or officers breached their fiduciary duty of disclosure and claims under the Delaware blue sky laws).

    - In a 2-1 decision, a divided panel of the Seventh Circuit denied Boeing's motion to dismiss, concluding that such a provision is not enforceable to prohibit stockholders from bringing 1934 Act derivative claims, because such a result would be contrary to federal securities law[4] and Delaware corporate law. But, the majority opinion leaves open the possibility that a forum selection provision covering any derivative action or proceeding can require 1934 Act derivative claims to be brought in Delaware federal court.[5]

  - *Ninth Circuit*: *Lee v. Fisher*, 70 F.4th 1129 (9th Cir. 2023).

    - In litigation involving 1934 Act derivative claims relating to allegedly false disclosures in Gap's proxy materials about its failure to consider diversity in nominating directors and hiring executives, the plaintiff stockholder argued that the forum selection provision requiring all derivative claims to be brought in the Court of Chancery was, among other things, "void" under federal law because it violated the anti-waiver provisions of the 1934 Act and "invalid" under Section 115 of the DGCL.

- The Ninth Circuit concluded that the forum selection provision could be enforced to prevent stockholders from bringing 1934 Act derivative claims. [6] First, the court concluded that enforcement would not violate the anti-waiver provision because it would not effect a waiver of the issuer's compliance with the substantive obligations imposed under the 1934 Act, including because the plaintiff could have brought such a claim as a direct action in federal court. Turning to Delaware law, the Court held that, "because no language in *Boilermakers*, Section 115, or the official synopsis operates to limit the scope of what constitutes a permissible forum-selection bylaw under Section 109(b) [of the DGCL] . . ., Gap's forum-selection clause is valid under Delaware law."[7]

Practical Considerations in Implementing Forum Selection Provisions

- ***Decision 1: Whether to Implement Forum Selection Provisions.*** Outside counsel routinely advises Delaware issuers to implement Internal Forum Provisions to ensure, at a minimum, that claims involving the issuer's internal affairs (i.e., issues of Delaware corporate law) are litigated in the Court of Chancery. Even with an Internal Forum Provision, there remains some uncertainty regarding whether a court outside of Delaware would enforce such provision and dismiss a stockholder's claims in all circumstances, such as where the foreign court concludes such enforcement would deprive a citizen stockholder of a fundamental right guaranteed by such jurisdiction, such as the right to a jury trial.[8]

  In addition, although there is some uncertainty regarding whether courts outside of Delaware would enforce a 1933 Act Forum Provision,[9] if an issuer anticipates potential exposure to 1933 Act claims as a result of securities offerings (e.g., an initial public offering, a secondary offering or a bond offering), outside counsel generally advises the issuer to adopt such a provision.

  Specifically, (i) the possibility of avoiding costly parallel state and federal actions, with no way to consolidate or coordinate the suits, and potentially inconsistent judgments and rulings, and (ii) increasing the likelihood that 1933 claims will heard in federal courts, which have the most experience adjudicating such claims, counsels in favor of adopting such a 1933 Act Forum Provision and designating the federal courts (or a specific federal court) as the exclusive forum for 1933 Act claims.[10]

- ***Decision 2: Whether to Cover 1934 Act Derivative Claims.*** Issuers that are adopting a new Internal Forum Provision, or updating an existing provision, should consider whether (and how) to address 1934 Act derivative claims. Given the federal Circuit Court split and the potential for the Supreme Court of the United States to address the issue, issuers face uncertainty in navigating this decision. Described below are four potential options:

  - *Carve Out Provision*: The first option is to include an Internal Forum Provision that selects the Delaware Court of Chancery as the exclusive jurisdiction for covered claims (including "all derivative claims") and which expressly provides that such provision does not apply to 1934 Act derivative claims. This is the most conservative approach, and would allow stockholders to bring 1934 Act derivative claims in any federal district court, thereby avoiding any potential disputes over the enforceability or validity of such provision.

  - *Seventh Circuit Provision*: The second option is to include an Internal Forum Provision that selects the Delaware Court of Chancery as the exclusive jurisdiction for covered claims (including "all derivative claims"), but designates the United States District Court for the District of Delaware as an alternative forum in the event the Court of Chancery lacks jurisdiction. As suggested by the majority opinion

in *Bradway*, this provision would require 1934 Act derivative claims to be brought exclusively in the United States District Court for the District of Delaware.

- *Ninth Circuit Provision*: The third option is to include an Internal Forum Provision that selects the Delaware Court of Chancery as the exclusive jurisdiction for covered claims (including "all derivative claims"), to the fullest extent permitted by law, without designating an alternative federal forum in the event the Court of Chancery lacks jurisdiction. Under the *Fisher* decision, this provision would prohibit stockholders from bringing 1934 Act derivative claims altogether.

  Hybrid Provision: The fourth and most novel option is to include an Internal Forum Provision that selects the Delaware Court of Chancery as the exclusive jurisdiction for covered claims (including "all derivative claims") with a proviso that would permit a stockholder to bring a 1934 Act derivative claim in the United States District Court for the District of Delaware if, and only if, designating the Court of Chancery as the exclusive forum for such claims would violate applicable law.

  Under this approach, an issuer can take the position that stockholders are not permitted to bring 1934 Act derivative claims unless and until a decision from the Supreme Court of the United States or the Delaware Supreme Court or legislation by the federal or Delaware legislatures renders this application of an Internal Forum Provision unenforceable. Thereafter, the proviso of the Internal Forum Provision would effectively convert the "Hybrid Provision" into a "Seventh Circuit Provision," by requiring stockholders to bring 1934 Act derivative claims in the United States District Court for the District of Delaware.

- ***Current Risks.*** Currently, the issue of whether an Internal Forum Provision can prevent stockholders from bringing 1934 Act derivative claims is a question of enforceability, not of validity, as demonstrated by the *Bradway* majority opinion. To succeed on a "facial validity" challenge, a plaintiff must show that the provision "cannot operate lawfully or equitably *under any circumstances*."[11] And, as noted above, the Delaware courts have held that Internal Forum Provisions are facially valid. Thus, to survive dismissal, a challenge to an Internal Forum Provision on the grounds that it improperly prevents stockholders from bringing 1934 Act derivative claims should be plead as an "as applied" challenge to the enforceability of the provision.

  The Delaware courts have held that an "as applied" challenge of a bylaw or charter provision "should be addressed when the issue is actually ripe."[12] Therefore, if a stockholder challenges the adoption of a Ninth Circuit Provision or a Hybrid Provision before the issuer has tried to enforce the provision to preclude a 1934 Act derivative claim, the issuer could attempt to seek dismissal of the challenge on ripeness grounds and assert that there is no "real-world circumstances giv[ing] rise to a genuine, concrete dispute requiring judicial resolution."[13]

- ***Future Risks.*** If a decision from the Supreme Court of the United States or the Delaware Supreme Court or federal or Delaware legislation would render application of an Internal Forum Provision to prohibit 1934 derivative claims unenforceable in the future, issuers that have adopted a Ninth Circuit Provision will be left wondering whether such provision leaves them open to strike suits seeking removal of the provision.

  Although such suits are possible, an issuer would be able to argue that, because the Ninth Circuit Provision, on its face, can still operate lawfully and equitably in most circumstances (i.e., with respect to internal corporate claims), any challenge to such a provision would need to be brought on an "as applied" basis. And, because there would be no live controversy (i.e., no allegation that the issuer

had nonetheless attempted to enforce the provision to block 1934 Act derivative claims), such suit should be dismissed on ripeness grounds. In addition, the inclusion of savings language (e.g., "to the fullest extent permitted law") in an Internal Forum Provision allows an issuer assert that the provision only covers claims permitted by applicable law.[14]

- ***Decision 3: Location of Provision.*** Issuers also need to consider whether to include a forum selection provision in the certificate of incorporation or the bylaws. If the provision is included in the certificate of incorporation, stockholders would not have the ability to unilaterally eliminate such provision. In addition, if the provision is implemented after an issuer has gone public, a stockholder vote would be required to amend the certificate of incorporation, which imposes some uncertainty with respect to the ability to obtain the requisite approval.

  On the other hand, including the provision in the bylaws would allow a board of directors to unilaterally amend the provision as needed (which, given recent developments in this area, may be desirable to issuers), but, would also give stockholders the same ability to unilaterally amend the provision.[15] Ultimately, there is no universally correct answer, and this decision requires issuers and their advisors to engage in a cost-benefit analysis.[16]

Notes

1. The Court upheld the forum selection bylaws of two separate issuers in this opinion. At the time the Court issued its opinion, one of the challenged provisions designated only the Court of Chancery as the exclusive forum and the other designated any state or federal court in Delaware with subject matter and personal jurisdiction.

2. The claims covered by the provisions upheld by the Court of Chancery in *Boilermakers* and those covered by the language of Section 115 of the DGCL are not identical. Relevant to this discussion, only a "*Boilermakers*" Internal Forum Provision designates the Court of Chancery as the exclusive forum for "any derivative action or proceeding brought on behalf of" the issuer.

3. *Salzberg*, 227 A.3d at 114. Although *Salzberg* involved charter provisions, the Court's Delaware statutory validity analysis focused on the private ordering flexibility provided under Section 102(b)(1), the language of which is largely identical to Section 109(b) of the DGCL governing permissible bylaw provisions. Section 109(b) allows an issuer's bylaws to contain "any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." Given this, practitioners have grown comfortable including 1933 Act Provisions in an issuer's bylaws.

4. The majority opinion cited *Boilermakers* in support of its conclusion that enforcing an Internal Forum Provision to prohibit 1934 Act derivative claims would violate the anti-waiver provisions of the 1934 Act: "the Court of Chancery said that the defendant corporations would run into trouble under the [1934] Act's anti-waiver provision in Section 29 if they tried to apply their forum-selection provisions to foreclose entirely claims under the [1934] Act." *Bradway*, 23 F.4th at 727-28. However, this suggestion in *Boilermakers* should not be viewed as authoritative guidance from a Delaware court because (i) the statement should be considered dicta, as it was not essential to the Court's facial validity ruling, and (ii) the Court caveated its statement with the following disclaimer: "[b]ut, the court declines to wade deeper into imagined situations involving multiple 'ifs' because rulings on these situationally specific kind of issues should occur *if and when* the need for rulings is actually necessary." *Boilermakers*, 73 A.3d at 962 (emphasis in original).

5. *See Bradway*, 23 F.4th at 720 ("[Section 115 authorizes provisions requiring internal corporate claims to be brought exclusively 'in the courts in this State.'] [F]ederal courts in Delaware are courts 'in' that State, as distinct from courts 'of' that State . . . The United States District Court and Bankruptcy Court for the District of Delaware are certainly, in the statute's words, 'courts in this State' of Delaware. In [*Salzberg*], the Delaware Supreme Court addressed Section 115 and said it presumed that the reference to 'courts in this State' included federal courts located in the state.").

6. In *Sobel v. Thompson*, 2023 WL 4356066 (W.D.Tex. July 5, 2023), the United States District Court for the Western District of Texas, Austin Division, reached the same conclusion as the Ninth Circuit, holding that enforcing the Internal Forum Provision at issue to prevent stockholders from bringing 1934 Act derivative claims did not violate a strong federal policy or the anti-wavier provision of the 1934 Act. In reaching this conclusion, the Court acknowledged the Seventh Circuit's *Bradway* decision, but declined "to adopts its reasoning given the binding authorities [discussed earlier] . . . which hold that enforcement of a valid forum-selection clause does not violate the [1934 Act's] anti-waiver provision." *Id.* at *6.

7. *Fisher*, 70 F.4th at 1156.

8. *E.g., EpicentRx, Inc. v. Superior Court of San Diego County*, 313 Cal.Rptr.3d 782, 790 (Cal. Ct. App. 2023), *as modified on denial of reh'g* (Oct. 10, 2023) (declining to enforce Internal Forum Provision concluding that (i) such provision impermissibly waived plaintiff's fundamental right to jury trial with respect to claims to which such right attached and (ii) trial court did not err in declining to dismiss claims to which such right did not attach (e.g., breach of fiduciary duty) to avoid subjecting plaintiff to costly multi-forum litigation and potential inconsistent findings).

9. *Compare Wong v. Restoration Robotics, Inc.*, 293 Cal. Rptr. 3d 226 (Cal. Ct. App.2022) (upholding enforceability of 1933 Act Provision under California law) *with Salzberg*, 227 A.3d at 134 ("The question of enforceability is a separate, subsequent analysis that should not drive the initial facial validity inquiry. But we recognize that it is a powerful concern that has infused much of the briefing here. The fear expressed in some of the briefing is that our sister states might react negatively to what could be viewed as an out-of-our-lane power grab.").

10. *Cf. Salzberg*, 227 A. 3d at 115, 120.

11. *Salzberg*, 227 A.3d at 113 (emphasis in original).

12. *Boilermakers*, 73 A.3d at 952 n.80.

13. *Id.* at 949 n.62.

14. Query whether such savings language is necessary to make such an argument considering that, in interpreting provisions of governing documents, the Delaware courts "prefer[] a reading of the instruments that would be consistent with the requirements of the applicable corporate law governing [the issuer] to a reading that would conflict with that law." *Rohe v. Reliance Training Network, Inc.*, 2000 WL 1038190, at *1 (Del. Ch. July 21, 2000). In addition, the vast majority of Internal Forum Provisions include a second type of savings language, which expressly permits the issuer to consent to an alternative forum.

15. One way issuers address the possibility of amendment adopted unilaterally by stockholders is to require a supermajority stockholder vote to take such action.

16. Among the factors an issuer should consider is the potential investor relations impact of this decision (either as to the issuer's specific stockholder base or potential responses from the proxy advisory firms).