

Seventh Circuit: Reverses Bylaw-Based Dismissal of a Derivative Suit Under Section 14(a) of the Exchange Act (Securities Law Alert)

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On January 7, 2022, a split Seventh Circuit panel reversed a derivative suit's dismissal based on a company forum-selection bylaw requiring derivative actions be filed in the Court of Chancery of Delaware. [Seafarers Pension Plan v. Bradway](#), 2022 WL 70841 (7th Cir. 2022) (Hamilton, J.). The court held that the "forum bylaw cannot be applied to this derivative action asserting a claim that is subject to exclusive federal jurisdiction." The court explained that if the bylaw were so applied then plaintiff's derivative action could not be heard in any forum because the Exchange Act gives federal courts exclusive jurisdiction over actions under it. Further, the court stated that this "result would be contrary to Delaware corporation law, which respects the non-waiver provision in Section 29(a) of the federal Exchange Act, 15 U.S.C. § 78cc(a)."

Background and Procedural History

Following two fatal plane crashes involving the same aircraft model, plaintiff filed this derivative suit in 2019 under Section 14(a) of the Exchange Act in the Northern District of Illinois where the plane manufacturer is headquartered. Plaintiff alleged that the company's officers and directors made materially false and misleading public statements about the development and operation of this model in the company's proxy materials. Without addressing the merits, the district court dismissed on forum non conveniens grounds after applying a company bylaw^[1] requiring that any derivative actions be filed in the Delaware Court of Chancery.

Delaware Corporation Law and the Exchange Act Bar Application of the Bylaw

The court began by stating that the "most straightforward resolution of this appeal is under Delaware corporation law, which we read as barring application of the [company's] forum bylaw to this case invoking non-waivable rights under the federal Exchange Act." After noting that plaintiff's chosen forum in the federal district where the company is headquartered "seems appropriate" the court pointed out that if the bylaw is applied, it "will force plaintiff to raise its claims in a Delaware state court, which is not authorized to exercise jurisdiction over Exchange Act claims." The court observed that it would be difficult to reconcile this result with Section 29(a) of the Exchange Act, which deems void contractual waivers of compliance with the requirements of the Act.

After parsing the statutory text of Section 115^[2] of the Delaware General Corporation Law, which addresses bylaws that impose choices of forum for litigation involving derivative claims, the court stated that “we conclude that Section 115 does not authorize use of a forum-selection bylaw to avoid what should be exclusive federal jurisdiction over a case, particularly under the Exchange Act.” In particular, the court focused on the “consistent with applicable jurisdictional requirements” phrase in Section 115. The court concluded that as applied here, the company’s forum bylaw violates Section 115 because it is inconsistent with the jurisdictional requirements of the Exchange Act.

Judge Easterbrook Dissents

While agreeing that Section 27(a) of the Exchange Act provides for exclusive jurisdiction of claims arising under it and the SEC’s rules, Judge Easterbrook stated that, however, “a derivative suit arises under state law even if a federal issue may come to the fore eventually.” He also pointed out that in *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987), the Supreme Court treated exclusivity under Section 27(a) as a right that may be waived. Writing in support of the bylaw’s application, Judge Easterbrook described it “just another forum-selection clause.” In response to concerns that plaintiff would be denied relief, Judge Easterbrook responded that “Delaware will provide whatever substantive relief is appropriate[.]”

Judge Easterbrook concluded that “if there is no such thing as a derivative § 14(a) claim divorced from state corporate law, if derivative suits are proper in state courts, and if exclusivity under § 27(a) is waivable—indeed, if any one of these three propositions holds—then there is no problem with litigating plaintiff’s claim in the courts of Delaware.”

[1] The bylaw provided 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”

[2] Section 115 provides 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.” 8 Del. C. § 115.

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