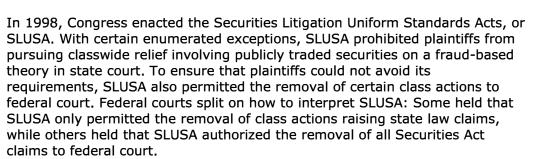
Why Chancery Nixed Delaware Forum Selection Provisions

By Cliff Gardner, Kenton King, Allison Land and Edward Micheletti (January 31, 2019, 12:03 PM EST)

On Dec. 19, 2018, the Delaware Court of Chancery held that forum selection provisions contained in the certificate of incorporation of Delaware corporations are invalid to the extent that they require any claim under the Securities Act of 1933 to be filed only in federal court.

Congress enacted the Securities Act of 1933 after the stock market crash of 1929. The Securities Act requires a company offering securities to the public "to make full and fair disclosure of relevant information" by filing a registration statement with the U.S. Securities and Exchange Commission. In order to ensure compliance with the Securities Act, Congress created private rights of action for investors, and permitted such actions to be filed in either state or federal courts. Congress also prohibited removal of such actions from state to federal court.



Last year, the U.S. Supreme Court addressed this split. In Cyan Inc. v. Beaver County Employees Retirement Fund,[1] the Supreme Court held that state courts continue to have concurrent jurisdiction over Securities Act claims by private plaintiffs and that class actions filed in state court asserting violations of the Securities Act could not be removed to federal court.

In Sciabacucchi v. Salzberg CA,[2] the Delaware Court of Chancery addressed for the first time the validity of forum selection provisions contained in a certificate of incorporation purporting to regulate claims brought under the Securities Act. Prior to their respective initial public offerings, three Delaware corporations — Blue Apron Holdings Inc., Roku Inc. and Stitch Fix Inc. — included in their certificate of incorporation a forum selection provision requiring any claim under the Securities Act to be filed only in federal court. Stockholder plaintiffs challenged the validity of those provisions in the Delaware Court of Chancery.

According to the Court of Chancery, these forum selection provisions are invalid to the extent that they require any claim under the Securities Act to be filed only in federal court. The court explained that, although the Delaware General Corporation Law, or DGCL, expressly permits a Delaware corporation to adopt a forum selection provision in its certificate of incorporation or bylaws



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regulating claims related to internal corporate affairs, such forum selection provision may not regulate external claims.

Securities Act claims are external claims because federal law, not Delaware law, creates the claim, defines the elements of the claim and specifies who can be a plaintiff or a defendant. The "state of incorporation cannot use corporate law to regulate the corporation's external relationships."

Further, "[a] claim under the [Securities] Act does not turn on the rights, powers, or preferences of the shares, language in the corporation's charter or bylaws, a provision in the DGCL, or the equitable relationships that flow from the internal structure of the corporation." Instead, "the predicate act" for a claim under the Securities Act is "the purchase of the share," not "the ownership of the share":



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At the moment the predicate act of purchasing occurs, the purchaser is not yet a stockholder and does not yet have any relationship with the corporation that is governed by Delaware corporate law.[3]

Thus, a "charter-based forum-selection provision" of a Delaware corporation cannot govern claims brought under the Securities Act "because the provision would not be addressing 'the rights and powers of the plaintiff-stockholder as a stockholder."

For now, Sciabacucchi v. Salzberg (in combination with Cyan Inc. v. Beaver County Employees Retirement Fund) allows plaintiffs to maintain Securities Act claims in state courts, despite a company's or defendant's preference for a federal forum set forth in a forum selection provision. It is possible, however, that this decision will be appealed to the Delaware Supreme Court.

Notably, the Sciabacucchi v. Salzberg ruling does not affect the validity of forum selection provisions in the certificate of incorporation or bylaws of a Delaware corporation that require "internal corporate claims" (such as stockholder derivative suits, fiduciary duty claims and claims arising out of or relating to the DGCL, the company's certificate of incorporation or bylaws) to be litigated in the Delaware courts.

These provisions were held to be valid in Boilermakers Local 154 Retirement Fund v. Chevron Corp., [4] which holding has been codified at 8 Del. C. § 115.[5] Adopting a forum selection provision designating the Delaware Court of Chancery as the exclusive jurisdiction for intracorporate disputes remains an effective way to reduce the burden and significant expense associated with multijurisdictional stockholder litigation.

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- [1] Cyan Inc. v. Beaver County Employees Retirement Fund 🕡 , 138 S. Ct. 1061 (2018).
- [2] Sciabacucchi v. Salzberg CA , No. 2017-0931-JTL, slip op. (Del. Ch. Dec. 19, 2018).
- [3] The court pointed out that the Securities Act regulates an offer or sale of a wide range of financial products, and that shares in a Delaware corporation are but one type of those regulated financial products. The court discussed the Securities Act's use of the term "security," and observed that, "[d]epending on how one counts the cross-referenced categories," there are "as many as 369 different types of securities. Shares are just one of these many types of securities, and shares of a Delaware corporation are only one subset of that one type."
- [4] Boilermakers Local 154 Retirement Fund v. Chevron Corp. 🕡 , 73 A.3d 934 (Del. Ch. 2013).

[5] Section 115 provides that the certificate of incorporation or bylaws of a Delaware corporation (1) may include an exclusive forum clause requiring that lawsuits asserting "internal corporate claims" be brought exclusively in any or all courts of the State of Delaware, and (2) may not contain a provision prohibiting such claims from being brought in the courts of the State of Delaware. The term "internal corporate claims" is defined to mean claims, including claims in the right of the corporation, (1) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (2) as to which the DGCL confers jurisdiction upon the Court of Chancery.

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