Skadden

Charter-Based Forum-Selection Provisions Designed to Govern Claims Under the Securities Act Found Invalid

Contributors

Sarah T. Runnells Martin, Counsel

Shaivlini Khemka, Associate

> See page 3 for takeaways

In March 2018, the U.S. Supreme Court, in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), resolved a jurisprudential split among federal courts and held that certain federal securities claims may be brought in either state or federal court and that when brought in a state court, they cannot be removed to federal court. In the wake of that decision, companies have been attempting to adopt forum-selection provisions in their governing documents identifying an exclusive jurisdiction for federal securities claims. However, a recent Delaware court decision has found that such provisions are invalid under the Delaware General Corporation Law.

Specifically, Delaware's Court of Chancery ruled that charter-based forum-selection provisions that purport to require claims under the Securities Act of 1933 (the 1933 Act) to be brought solely in federal courts are invalid under Delaware law. The decision, *Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL (Del. Ch. Dec. 19, 2018), involved federal forum-selection provisions in the charters of nominal defendants Blue Apron Holdings, Roku and Stitch Fix. Stockholder plaintiff Sciabacucchi filed an action in the Court of Chancery seeking declaratory judgment that the companies' forum-selection provisions requiring stockholder-based federal securities claims to be brought exclusively in federal court are invalid. Vice Chancellor J. Travis Laster agreed with the plaintiff and held that because 1933 Act claims do not "arise out of the corporate contract and do[] not implicate the internal affairs of the corporation" but rather "arise[] from the investor's *purchase* of the shares," the constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum.

The Forum-Selection Provisions at Issue

The Roku and Stitch Fix certificates of incorporation, which contained substantively identical provisions, provided that "[u]nless the Company consents in writing to the selection of an alternative forum, the federal district courts of the United States of America shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933. Any person or entity purchasing or otherwise acquiring any interest in any security of the Corporation shall be deemed to have notice of and consented to [this provision]." (alteration in original)

Blue Apron's certificate of incorporation was slightly different and provided that "the federal district courts of the United States of America shall, *to the fullest extent permitted by law*, be the sole and exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933." (emphasis in original)

Origins of the Corporate Forum-Selection Phenomenon, the *Boilermakers* Decision and the 2015 Amendments to the Delaware General Corporation Law

The court traced the history of the development of corporate forum-selection provisions arising from the then-increasing trend of strike suits against corporations, often filed in multiple jurisdictions, and the court's recommendation in *In re Revlon, Inc. Shareholder Litigation*, 990 A.2d 940 (Del. Ch. 2010), where it suggested that "if boards of directors and stockholders believe that a particular forum would provide an efficient

and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes." The court noted that while only 16 publicly traded companies had charter- or bylaw-based forum-selection provisions prior to *Revlon*, by August 2014, 746 publicly traded companies had adopted such provisions.

In 2013, then Chancellor and now Chief Justice Leo E. Strine issued a seminal decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013), where he held that certain bylaw-based forum-selection provisions were valid because they related to *internal affairs* claims and emphasized that they concerned the rights of "stockholders *qua* stockholders." Chief Justice Strine also illustrated, by way of examples, causes of actions that a bylaw cannot regulate, such as a tort claim by a stockholder based on personal injury on the company's premises or a contract claim by a stockholder based on a commercial contract with the company. In deciding on the validity of the federal forum-selection provisions at issue here, Vice Chancellor Laster found the *Boilermakers* distinction between internal and external claims instructive because the DGCL provisions dealing with bylaws (*8 Del. C.* § 109(b)) and certificates of incorporation (*8 Del. C.* § 102(b)(1)) are largely parallel.

In 2015, Delaware's General Assembly codified the ruling in *Boilermakers* by enacting Section 115 to the DGCL, which provides: "The certificate of incorporation or the 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, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State." Internal corporate claims are further defined as "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery."

In applying the *Boilermakers* rationale to ascertain the validity of the federal forum-selection provisions at issue in *Sciabacucchi*, the court held that the forum-selection provisions concerned claims are "external" to the corporation and therefore invalid. In support of its conclusion that 1933 Act claims are external, the court provided the following reasons: (i) the nature of 1933 Act claims, which are based on a defective registration statement; (ii) the identity of possible defendants under a 1933 Act claim, which include broad categories of persons without regard to their director, officer or even employee status; (iii) the broad definition of "security" under the 1933 Act, which "could identify as few as fifty or as many as 369 different types of securities" of which shares are one type of security and shares of a Delaware corporation are merely one subset; and (iv) even where an investor purchases a share of stock, the predicate act for a 1933 Act claim is the purchase itself as opposed to stockholder status, and there exists no requirement of continuous ownership of shares.

Invalidity of the Forum-Selection Provisions Under First Principles

In addition to finding that the federal forum-selection provisions at issue were invalid under *Boilermakers*, the court found that application of first principles also supports the conclusion that Delaware cannot regulate claims external to a corporation, such as those under the 1933

Act. Specifically, the court looked to the fundamental concept of a "corporation," the "nature of its constitutive documents" and the plain language of *8 Del. C.* 102(b)(1). The court explained that the issuance of the corporate charter is a sovereign act and "[b]ecause the state of incorporation creates the corporation, the state has the power through its corporation law [here, the DGCL] to regulate the corporation's internal affairs." Therefore, "'there is no reason to believe that corporate governance documents, regulated by the law of the state of incorporation, can dictate mechanisms for bringing claims that do not concern corporate internal affairs, such as claims alleging fraud in connection with a securities sale'" (citation omitted). Accordingly, the state cannot assert authority over other types of claims because "the fact of incorporation is not a sufficient nexus to support applying the chartering state's law to external claims." Further, the court found that "consistent with the scope of what Delaware can regulate through the DGCL," the language of § 102(b)(1), which provides authority for a corporate charter to contain non-mandatory provisions, only governs "corporate management and the relations of stockholders *inter sese*."

Takeaways

- Under the *Sciabacucchi* decision, charter- or bylaw-based forum-selection clauses purporting to govern claims that are external to a corporation are invalid under Delaware law. The decision is still subject to an appeal, and a decision by the Delaware Supreme Court could provide further guidance to companies that have similar forum-selection provisions to the ones at issue in *Sciabacucchi*.
- While the *Sciabacucchi* decision focused on claims brought under the 1933 Act, it is possible that the same rationale might apply to claims under the 1934 Act as well.
- In combination with the U.S. Supreme Court's *Cyan* decision, the *Sciabacucchi* decision means that federal securities cases will continue to be brought in both federal and state courts.
- Nevertheless, forum-selection charter and bylaw provisions remain the most effective tool for requiring stockholders to file claims involving the internal affairs of a Delaware corporation (such as state law breach of fiduciary duty claims) in an exclusive forum. Companies interested in adopting a forum-selection provision are encouraged to seek advice from their counsel before doing so.