Delaware Supreme Court Upholds Validity of Provisions Designating Federal Courts as Exclusive Forum of 1933 Act Claims

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In *Salzberg v. Sciabacucchi*, No. 346, 2019 (Del. Mar. 18, 2020), the Delaware Supreme Court upheld the validity of corporate charter provisions designating federal courts as the exclusive forum for the litigation of claims under the Securities Act of 1933. The opinion may provide a tool for tempering the wave of state court 1933 Act claims post-*Cyan*.

Background

In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, No. 15-1439 (U.S. Mar. 20, 2018), the U.S. Supreme Court held that federal and state courts have concurrent jurisdiction over class actions based on claims brought under the 1933 Act, and that such claims are not removable to federal court. Following *Cyan*, the filing of 1933 Act cases in state courts escalated. In response, corporations began adopting forum selection provisions in their charters that designated the federal courts as the exclusive forum for such claims.

The Court of Chancery's Opinion in *Sciabacucchi v. Salzberg*

In December 2017, a stockholder of Blue Apron Holdings, Inc., Roku, Inc. and Stitch Fix, Inc. 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.

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]."

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."

On December 19, 2018, in *Sciabacucchi v. Salzberg*, C.A. No. 2017-093-JTL (Del. Ch. Dec. 19, 2018), the Delaware Court of Chancery held that such charter provisions were invalid because "constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware's corporate law," and that federal forum selection provisions attempted to accomplish that and were therefore invalid. Skadden discussed the Court of Chancery's opinion in the December 21, 2018, client alert, "Delaware Court of Chancery Invalidates Forum Selection Provisions Regulating Claims Under the Securities Act of 1933."

The Delaware Supreme Court's Opinion

On appeal, the Delaware Supreme Court reversed the Court of Chancery, and held that federal forum provisions (FFPs) are facially valid under Delaware law.

The court began by analyzing 8 Del. C. § 102, which governs matters contained in a corporation's charter. Section 102(b)(1) authorizes two broad types of charter provisions: "any provision for the management of the business and for the conduct of the affairs of the corporation" and "any provision creating, defining, limiting and regulating the powers

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of the corporation, the directors, and the stockholders, or any class of the stockholders ... if such provisions are not contrary to the laws of this State." The court held that an FFP "could easily fall within either of these broad categories, and thus, is facially valid."

The court also remarked that such provisions "can provide a corporation with certain efficiencies in managing the procedural aspects of securities litigation following the United States Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*." The court pointed to the escalation of 1933 Act claims being brought in state courts post-*Cyan* and remarked that:

> When parallel state and federal actions are filed, no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court. The costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts are obvious. The possibility of inconsistent judgments and rulings on other matters, such as stays of discovery, also exist. By directing 1933 Act claims to federal courts when coordination and consolidation are possible, FFPs classically fit the definition of a provision "for the management of the business and for the conduct of the affairs of the corporation."

The court then looked to the 2015 amendments to the DGCL to add Section 115, which explicitly allowed corporations to adopt forum selection provisions designating Delaware as the exclusive forum for internal corporate claims. The court found that the amendments further supported the view that FFPs are valid under Delaware law, and that Section 115 did not implicitly amend Section 102(b)(1).

The court also held that FFPs do not violate the policies or laws of Delaware, given that the DGCL "allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance and governance of their enterprise." The court further held that FFPs do not violate federal law or policy. The court referred to the U.S. Supreme Court's decision in *Rodriguez de Quijas v. Shearson/American Express, Inc.*, where the U.S. Supreme Court held that federal law has no objection to provisions that preclude state litigation of Securities Act claims. The Delaware Supreme Court remarked, "The holding in *Rodriguez* provides forceful support for the notion that FFPs do not violate federal policy by narrowing the forum alternatives available under the Securities Act."

The Delaware Supreme Court also discussed the implications of its decision, something that the parties had extensively briefed. The court noted that "the most difficult aspect of this dispute is not with the facial validity of FFPs, but rather, with the 'down the road' question of whether they will be respected and enforced by our sister states." The court remarked that the question of enforceability is a separate analysis that should not drive the initial facial validity inquiry but recognized it as a "powerful concern," remarking:

> Delaware historically has, and should continue to be, vigilant about not stepping on the toes of our sister states or the federal government. But there are persuasive arguments that could be made to our sister states that a provision in a Delaware corporation's certificate of incorporation requiring Section 11 claims to be brought in federal court does not offend principles of horizontal sovereignty — just as it does not offend federal policy.

The court ultimately concluded its opinion by stating:

> FFPs are a relatively recent phenomenon designed to address post-*Cyan* difficulties presented by multi-forum litigation of Securities Act claims. The policies underlying the DGCL include certainty and predictability, uniformity, and prompt judicial resolution to corporate disputes. Our law strives to enhance flexibility in order to engage in private ordering, and to defer to case-by-case law development. Delaware courts attempt "to achieve judicial economy and avoid duplicative efforts among courts in resolving disputes." FFPs advance these two goals.

Takeaways

- The Delaware Supreme Court's opinion may provide a tool for companies to avoid duplicative litigation of securities claims in certain federal and state courts and to temper the wave of claims under the 1933 Act brought in state court.
- Private companies that are considering going public should evaluate amending their charter to include similar federal forum provisions.
- Public companies whose charters contain such federal forum provisions should consider raising the provision as a defense early on in state court litigations.
- The provisions at issue in *Salzberg* were contained in the corporations' charters, and the court's opinion largely turned on the interpretation of 8 Del. C. §102(b)(1), which governs the contents of corporate charters. Moreover, amendments to corporate charters must be approved by a stockholder vote. Thus, it remains to be seen whether such provisions would be valid if they were solely in the corporation's bylaws, which are governed by a different provision of the DGCL and which do not, in general, require a stockholder vote to be amended.
- *Salzberg* involved a facial challenge to the validity of forum selection charter provisions. While the court found that such provisions are facially valid, an "as applied" challenge to such provisions may be possible. To that end, the court remarked in its opinion that "charter and bylaw provisions that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose."
- Companies should consult with outside counsel regarding the appropriate form of FFP, whether the FFP should be in a charter or bylaw, and other related issues before adopting such a provision.