

Exclusive Federal Forum Selection Provisions for Securities Act Claims Held to be Valid in Delaware



ALERT | March 19, 2020

Taylor B. Bartholomew | bartholomewt@pepperlaw.com

Matthew M. Greenberg | greenbergm@pepperlaw.com

Joanna J. Cline | clinej@pepperlaw.com

Pamela S. Palmer | palmerp@pepperlaw.com

Christopher B. Chuff | chuffc@pepperlaw.com

On March 18, in *Salzberg v. Sciabacucchi*, No. 346, 2019, the Delaware Supreme Court held that Delaware corporations may validly adopt forum selection provisions requiring that all claims arising under the federal Securities Act of 1933 (Securities Act) be filed *exclusively* in federal court.¹ This important decision enables Delaware corporations to manage multiforum and state litigation challenges in the wake of the U.S. Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, which held that federal and state courts have concurrent jurisdiction over Securities Act claims,

THIS PUBLICATION MAY CONTAIN ATTORNEY ADVERTISING

The material in this publication was created as of the date set forth above and is based on laws, court decisions, administrative rulings and congressional materials that existed at that time, and should not be construed as legal advice or legal opinions on specific facts. The information in this publication is not intended to create, and the transmission and receipt of it does not constitute, a lawyer-client relationship. Please send address corrections to phinfo@pepperlaw.com.

© 2020 Pepper Hamilton LLP. All Rights Reserved.

including section 11 claims often arising out of initial public offerings. After *Cyan*, state courts across the country saw an increase in section 11 filings in preference to filings in federal courts, where the rules impose hurdles designed to deter potentially meritless securities cases. The Delaware Supreme Court's decision in *Salzberg* upheld as facially valid under the Delaware General Corporation Law (DGCL) FFPs in the certificates of incorporation of three Delaware corporations. In so doing, the Delaware Supreme Court reversed the Court of Chancery's ruling to the contrary.

Background

In 2017, Blue Apron Holdings, Inc., Roku, Inc. and Stitch Fix, Inc. each adopted its own variation of an FFP to attempt to force stockholders to file in federal court Securities Act claims arising out of each corporation's contemplated initial public offering. A stockholder in each corporation brought suit, seeking declaratory judgment that the FFPs are invalid under Delaware law. The Delaware Court of Chancery agreed and held that the FFPs are invalid because the FFPs attempted to bind plaintiffs to a particular forum when the underlying claim does not involve rights or relationships established under Delaware law. The defendants appealed to the Delaware Supreme Court.

Analysis

In reversing the Delaware Court of Chancery's holding, the Delaware Supreme Court held that FFPs fall within section 102(b)(1) of the DGCL, which broadly authorizes the adoption of charter provisions "for the management of the business and for the conduct of the affairs of the corporation" and for "creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders." That is so, the court held, because FFPs seek to regulate the forum in which an "intra-corporate" litigation (such as a Securities Act claim) can be brought. The court concluded that FFPs, such as the ones adopted by Blue Apron, Roku and Stitch Fix, are therefore facially valid. The court also held that section 115 of the DGCL, which permits Delaware corporations to include in their organizational documents exclusive Delaware forum selection provisions for the regulation of "internal corporate claims,"² does not prohibit a Delaware corporation from adopting an FFP. Looking to prior precedent and the DGCL, the court derived a range of permissible and impermissible subjects of corporate regulation of affairs from narrow to broad, as follows: (1) "internal corporate claims," as defined in section 115 of the DGCL, which are permissibly regulated by a Delaware corporation since only the state of incorporation has the authority to regulate such claims; (2) "intra-corporate affairs," such as Securities Act claims, which are broader than "internal corporate claims" and are permissibly regulated under section 102(b)(1) of the DGCL; and (3) "external affairs," such as tort claims and commercial contract claims, which are not the proper subject of a bylaw or charter provision.

Takeaways

The court's decision in *Salzberg* provides Delaware corporations with the ability to manage — through the adoption of FFPs — litigation inefficiencies created by the concurrent jurisdiction of federal and state courts in Securities Act claims. As the court noted, this concurrent jurisdiction commonly results in Delaware corporations having to manage litigation in multiple jurisdictions, creating the risk of not only higher costs, but also inconsistent judgments. Boards of directors of public companies incorporated in Delaware should consult with their legal counsel to determine whether the adoption of an FFP would aid in the management of Securities Act claims in light of the Delaware Supreme Court's ruling.

Endnotes

- 1 We refer to such provisions herein as “FFPs” (federal forum provisions). An example of an FFP is as follows: “Unless 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 Company] shall be deemed to have notice of and consented to [this provision].”
- 2 “‘Internal corporate claims’ means 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 [Delaware] Court of Chancery.”