

Clients & Friends Memo

Delaware Supreme Court Rejects Challenge to Federal Forum Provisions Requiring Securities Act Claims to Be Brought in Federal Court

March 30, 2020

On March 18, 2020, the Delaware Supreme Court issued its unanimous decision in *Salzberg v. Sciabacucchi*,¹ authored by Justice Karen L. Valihura, in which it reversed the Court of Chancery and rejected a facial challenge to provisions in the charters of three Delaware corporations that require any claims brought against each company under the Securities Act of 1933 (the “1933 Act”) to be filed in federal court (“federal forum provisions” or “FFPs”). The decision has important implications for Delaware corporations, as it reopens a pathway to limiting inefficient, parallel federal and state court litigation of 1933 Act claims by allowing corporations to steer such actions to federal court, which then could permit defendants to attempt to consolidate all such cases in a single forum (at least for pre-trial purposes). While it remains to be seen whether and to what extent such provisions will be enforced by federal courts and the courts of other states, we expect that the decision will lead to a resurgence in the adoption of FFPs by Delaware corporations going forward.

Background

The 1933 Act requires corporations offering securities for sale to the public to file a registration statement² and creates a private right of action to enforce the Act’s registration and disclosure requirements, including with respect to materially false or misleading statements.³ Unlike claims under the Securities Exchange Act of 1934, which are subject to exclusive federal jurisdiction, claims under the 1933 Act may be brought in either federal or state court.⁴ The 1933 Act also bars the removal of such actions from state court to federal court.⁵

¹ *Salzberg v. Sciabacucchi*, No. 346, 2019, 2020 WL 1280785 (Del. Mar. 18, 2020).

² 15 U.S.C. § 77e.

³ 15 U.S.C. § 77k(a).

⁴ 15 U.S.C. § 77v(a).

⁵ *Id.*

In 2018, the United States Supreme Court held in *Cyan, Inc. v. Beaver County Employees Retirement Fund*⁶ that the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”),⁷ which prohibits the filing of a “covered class action” alleging securities fraud under state law, did not strip state courts of jurisdiction to adjudicate class actions alleging *only* 1933 Act violations and did not permit removal of such class actions to federal court.⁸

The decision in *Cyan* significantly accelerated the adoption of FFPs, setting the stage for the Court of Chancery to weigh in on their validity under Delaware law.⁹ As it happens, a challenge to three such provisions already was pending in the Court of Chancery, which issued a decision less than a year later.

In *Salzberg*, a plaintiff who bought shares in Blue Apron Holdings, Inc., Roku, Inc., and Stitch Fix, Inc., during or shortly after each company’s initial public offering sought a declaratory judgment in the Court of Chancery that the federal forum provisions adopted by those three companies were facially invalid. The FFPs adopted by Roku, Inc. and Stitch Fix, Inc. each stated:

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].¹⁰

Blue Apron, Inc. adopted a similar provision, except that it qualified its FFP to have effect only “to the fullest extent permitted by law.”¹¹

In an opinion by Vice Chancellor Laster, the Court of Chancery sustained the challenge, declaring the FFPs “ineffective and invalid.”¹² Relying principally on *Boilermakers Local 154 Retirement Fund*

⁶ *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061, 1066 (2018).

⁷ 15 U.S.C. § 77p(b).

⁸ 138 S. Ct. 1061, 1073 (2018).

⁹ See Aggarwal, Dhruv, Choi, Albert H., and Eldar, Ofer, *Federal Forum Provisions and the Internal Affairs Doctrine* 9 (February 2, 2020), forthcoming in Harvard Business Law Review, available at <https://ssrn.com/abstract=3439078> and <http://dx.doi.org/10.2139/ssrn.3439078> (“[T]he fraction of IPOs that included FFPs more than doubled almost immediately after *Cyan*, and continued increasing in the following months.”).

¹⁰ *Salzberg*, 2020 WL 1280785, at *3.

¹¹ *Id.*

¹² *Sciabacucchi v. Salzberg*, No. CV 2017-0931-JTL, 2018 WL 6719718, at *3 (Del. Ch. Dec. 19, 2018).

v. Chevron Corp.,¹³ which upheld the validity of a corporate bylaw that designated Delaware as the exclusive forum for certain types of stockholder litigation, the Court of Chancery held that FFPs may govern only “internal,” intra-corporate disputes, and not disputes that arise out of external relationships, such as tort or contract actions unrelated to the corporate contract.¹⁴ According to the Court of Chancery, “[f]or purposes of the analysis in *Boilermakers*, a 1933 Act claim” would “[a]t best . . . , resemble[] a tort or contract claim brought by a plaintiff who happens also to be a stockholder, but under circumstances where stockholder status is incidental to the claim,” and thus “[a] 1933 Act claim is an external claim that falls outside the scope of the corporate contract.”¹⁵

As such, Vice Chancellor Laster concluded that Section 102(b)(1) of the Delaware General Corporation Law (“DGCL”),¹⁶ which provides that a Delaware corporation’s certificate of incorporation “may” include certain matters, including any provision for the “management of the business and for the conduct of the affairs of the corporation,” did not authorize the adoption of FFPs concerning so-called external claims, including claims under the 1933 Act.¹⁷ The companies appealed.

Takeaways

- **Federal Forum Provisions May Be Adopted in a Delaware Corporation’s Charter and Are Facially Valid.** The Delaware Supreme Court reversed the Court of Chancery, holding that because “FFPs involve a type of securities claim related to the management of litigation arising out of the Board’s disclosures to current and prospective stockholders in connection with an IPO or secondary offering,” an FFP “is a provision that addresses the ‘management of the business’ and the ‘conduct of the affairs of the corporation,’ and is, thus, facially valid under Section 102(b)(1).”¹⁸ According to the Court, “[t]he drafting, reviewing, and filing of registration statements by a corporation and its directors is an important aspect of a corporation’s management of its business and affairs and of its relationship with its stockholders.”¹⁹ In the

¹³ 73 A.3d 934 (Del. Ch. 2013).

¹⁴ *Sciabacucchi*, 2018 WL 6719718, at *11, 19-20.

¹⁵ *Id.* at *18.

¹⁶ Under Section 102(b)(1), a Delaware corporation’s certificate of incorporation may include “[a]ny 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 of the corporation, the directors, and the stockholders, or any class of the stockholders, or the governing body, members, or any class or group of members of a nonstock corporation; if such provisions are not contrary to the laws of this State. Any provision which is required or permitted by any section of this chapter to be stated in the bylaws may instead be stated in the certificate of incorporation.” 8 *Del. C.* § 102(b)(1).

¹⁷ *Sciabacucchi*, 2018 WL 6719718, at *21-23.

¹⁸ *Salzberg*, 2020 WL 1280785, at *4.

¹⁹ *Id.*

wake of *Salzberg*, we expect to see a resurgence in the number of Delaware corporations adopting such provisions.

- **The Delaware Supreme Court Emphasized the “Broad, Enabling” Scope of Section 102(b)(1), Holding That Its “Outer Limit” Was Not Defined by the Internal Affairs Doctrine.** Throughout its opinion, the Delaware Supreme Court stressed the “[b]road, [e]nabling [t]ext”²⁰ of Section 102(b)(1), which authorizes the adoption of any charter provision addressing the “affairs” of the corporation—not merely the “internal affairs”—and noted that prior decisions did not purport to define the “outer limit” of what could be adopted thereunder.²¹ The Court explained that the scope of Section 102(b)(1) is broader than the “internal affairs doctrine,”²² which does not encompass federal securities claims under the 1933 Act, holding that “by creating a binary world of only ‘internal affairs’ claims and ‘external’ claims, the Court of Chancery superimposed the ‘internal affairs’ doctrine onto and narrowed the scope of Section 102(b)(1)—contrary to its plain language.”²³

Rather than limit the scope of Section 102(b)(1) to “internal affairs,” the Court identified “a category of matters that is situated on a continuum between” “internal affairs” and purely “external” claims,²⁴ which it termed Section 102(b)(1)’s “Outer Band.”²⁵ Because it determined that “[t]here are matters that are not ‘internal affairs,’ but are, nevertheless, ‘internal’ or ‘intracorporate’ and still within the scope of Section 102(b)(1),” and that “FFPs are in this Outer Band,” the Court concluded that the FFPs were facially valid.²⁶

- **The Court Reaffirmed the “Immense Freedom” Available under the DGCL.** The Court also emphasized the general public policy at both the state and federal level favoring freedom of contract with respect to forum selection clauses, and took the view that federal forum clauses in corporate charters are essentially contractual in nature.²⁷ The Court took the opportunity to once again reaffirm that “the DGCL allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance, and governance of their enterprise.”²⁸ Thus,

²⁰ *Id.*

²¹ *Id.* at *11.

²² The internal affairs doctrine is a choice of law rule that “governs the choice of law determinations involving matters *peculiar* to corporations, that is, those activities concerning the relationships *inter se* of the corporation, its directors, officers and shareholders.” *Salzberg*, 2020 WL 1280785, at *15 (*McDermott Inc. v. Lewis*, 531 A.2d 206, 214 (Del. 1987)).

²³ *Salzberg*, 2020 WL 1280785, at *13.

²⁴ *Id.* at *13.

²⁵ *Id.* at *18.

²⁶ *Id.*

²⁷ *Id.* at *19 (citing, *inter alia*, *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972)).

²⁸ *Id.* at *6.

beyond the immediate issue of FFPs, the decision suggests that the Delaware Supreme Court will continue to be receptive to the private ordering of corporate affairs in future cases.

- **Once Again, a Delaware Court Took Efficiency into Account, Citing “Escalated” Post-*Cyan* 1933 Act Filings as an Important Basis for Its Ruling.** The Court was not coy about the fact that its decision effectively negated the holding in *Cyan* for Delaware corporations that implement FFPs, justifying that result in part by the goal of achieving what it termed “Post-*Cyan* Efficiencies.”²⁹ As the Court noted, absent an FFP, “[w]hen parallel state and federal actions are filed, no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court,” and “[t]he costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts are obvious.”³⁰ The Court observed that following *Cyan*, 1933 Act filings increased 59 percent, with a 69-percent increase in state-only filings.³¹ In light of the “escalated” filings, the Supreme Court held that attempting to consolidate such actions in a single federal forum via FFPs “classically fit” within the scope of Section 102(b)(1).³² Thus, as with the Court of Chancery’s prior ruling in *Trulia*,³³ the Court took action to enhance the efficient administration of caseloads.
- **While the Court Left Open the Possibility of an As-Applied Challenge to an FFP, Such a Challenge Is Unlikely to Succeed in the Context of 1933 Act Claims Brought against the Company by Shareholders.** At the outset, the Court set a high bar for the plaintiff’s challenge to the FFPs, noting that because he brought a facial challenge, the plaintiff was required to show that the FFPs “cannot operate lawfully or equitably *under any circumstances*,” because they “do not address proper subject matters” under Section 102(b)(1) and thus “can never operate consistently with law.”³⁴ Thus, it was sufficient to reject the facial challenge for the Court to conclude that the FFP would be validly applied if, “[f]or example, existing stockholders could assert that a prospectus relating to shares of stock the directors were selling in a registered offering, signed by the directors of a Delaware corporation, contained material misstatements and omissions.”³⁵ As Vice Chancellor Laster’s opinion for the Court of Chancery had argued, there could hypothetically be applications that would not fit this description, and which might arguably push the limits of the newly defined “Outer Band”—for example, where the claim is not brought by a current shareholder, is not brought against the officers or directors of the company, and relates to securities other than shares of the

²⁹ *Id.* at *5.

³⁰ *Id.*

³¹ *Id.* (citing Stanford Law Sch. Secs. Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings 2019 Year in Review 4* (2020)).

³² *Id.*

³³ *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884 (Del. Ch. 2016).

³⁴ *Salzberg*, 2020 WL 1280785, at *4 (citations and quotation marks omitted).

³⁵ *Id.* at *13.

corporation's common stock.³⁶ While such an as-applied challenge may at some point be made, in the main, the decision places FPPs on solid ground with respect to typical shareholder litigation under the 1933 Act—notably, including with respect to shareholder claims against the company's officers and directors arising out of an IPO, which falls squarely within the scope of Section 102(b)(1).³⁷

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Jason Halper	+1 212 504 6300	jason.halper@cwt.com
Nathan Bull	+1 212 504 5752	nathan.bull@cwt.com
Matthew Karlan	+1 212 504 6169	matthew.karlan@cwt.com
Charles Hurley	+1 212 504 6237	charles.hurley@cwt.com

³⁶ As noted in Vice Chancellor Laster's opinion below, the potential defendants in a 1933 Act case are not strictly limited to the company's officers and directors, as they may include, for example, accountants or other professionals, as well as underwriters. *See Sciabacucchi*, 2018 WL 6719718, at *16-17 (citing 15 U.S.C. § 77k(a)). Nor are 1933 Act cases limited to offerings of common stock. *See id.* (citing 15 U.S.C. § 77b(a)(1)).

³⁷ The Court also considered, but rejected, the argument that FPPs were contrary to federal policy, *see Salzberg*, 2020 WL 1280785, at *18-19, relying on *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 482-83 (1989), which upheld an arbitration provision in a brokerage firm's customer agreement that precluded state court litigation of 1933 Act claims, characterizing the provision as "in effect, a specialized kind of forum selection clause" that "should not be prohibited under the Securities Act, since they, like the provision for concurrent jurisdiction [of federal and state courts], serve to advance the objective of allowing buyers of securities a broader right to select the forum for resolving disputes, whether it be judicial or otherwise."