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Client Alert Commentary

Securities Litigation & Professional Liability Practice

March 19, 2020 | Number 2622

Delaware Supreme Court Confirms Validity of Federal Forum Selection Bylaws for Securities Act Claims

The decision is a positive development for Delaware corporations seeking to reduce duplicative state court litigation arising from public securities offerings.

On March 18, 2020, the Delaware Supreme Court issued its long-awaited decision in *Salzberg v. Sciabacucchi*,[1] holding that federal forum selection bylaws and charter provisions for claims arising under the Securities Act of 1933 are facially valid under Delaware law. Such forum selection provisions were broadly implemented in the wake of the United States Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees' Retirement Fund*,[2] in which the Court held that claims arising under the federal Securities Act of 1933 could be filed either in state or federal court. Through bylaw and charter provisions, many companies sought to avoid the implications of *Cyan* by requiring Securities Act claims be brought exclusively in federal (not state) courts.

While the Delaware Court of Chancery had rejected the validity of federal forum selection bylaws, the Delaware Supreme Court has now concluded otherwise. This decision is a significant and positive development for Delaware corporations seeking to stem the tide of duplicative state court litigation arising from public securities offerings.

Background

Appellee Matthew Sciabacucchi filed a complaint for declaratory judgment against three companies — StichFix, Roku, and BlueApron — that had adopted federal forum selection provisions before their 2017 IPOs. In his complaint, the plaintiff alleged that federal forum selection clauses are facially invalid (*i.e.*, invalid in all circumstances) under Section 102(b)(1) of the General Corporate Law (GCL), which governs matters contained in a corporation's certificate of incorporation. On a motion for summary judgment, the Court of Chancery found federal forum selection provisions facially invalid because:

- Section 102(b)(1) permits regulation only of "internal affairs claims brought by stockholders *qua* stockholders," such as breach of fiduciary duty claims under state law.
- Federal forum selection provisions address matters "external" to the corporation, such as claims arising under federal statutes based on trading of securities.[3]

Defendants appealed to the Delaware Supreme Court.

Analysis

The Delaware Supreme Court reversed the Court of Chancery, rejecting the notion that Section 102(b)(1) is limited to "internal affairs" of the corporation. Applying a textualist approach, the Court first held that the plain language of Section 102(b)(1) broadly authorizes corporations to make "*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 of the corporation, the directors, and the stockholders."[4] It further held that federal forum selection provisions could "easily fall within either of these broad categories" because Securities Act claims are related to the management of litigation arising out of public offerings of securities, and the drafting, reviewing, and filing of securities registration statements — the acts underlying Securities Act claims — are an "important aspect of a corporation's management of its business and of its relationship with its stockholders."[5] The Court characterized Securities Act claims as "intra-corporate" matters clearly within the scope of Section 102(b)(1).[6]

The Court's characterization of Securities Act claims as "intra-corporate" matters is significant in two respects. First, it clarifies that the reach of Section 102(b)(1) is not limited by the "internal affairs" doctrine articulated in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,[7] and other cases. In *Boilermakers*, the Court of Chancery validated forum selection clauses that require claims relating to the internal affairs of Delaware corporations to be brought in the Court of Chancery. In reaching this conclusion, the Court of Chancery distinguished lawsuits involving "internal affairs" — *which it defined as* lawsuits that "plainly relate to the business of the corporations, the conduct of their affairs, and regulate the rights and powers of their shareholders" — from wholly "external matters" such as a tort claim for personal injury suffered by a plaintiff or a contract claim involving a commercial contract.[8] The Delaware General Assembly subsequently codified the holding in *Boilermakers* at Section 115 of the General Corporate Law.

Here, the Court of Chancery's opinion below read *Boilermakers* and Section 115 as limiting Section 102(b)(1) to "internal affairs" of the corporation — based on what it called "first principles" of Delaware corporate law. The Delaware Supreme Court rejected this limitation as unsupported by the plain text of Section 102(b)(1) and inconsistent with Delaware precedent — principally, *ATP Tour, Inc. v. Deutscher Tennis Bund*,[9] which held that fee-shifting provisions in corporate bylaws are valid under Section 102(b)(1) as matters regarding "intra-corporate litigation."[10] The Supreme Court further limited *Boilermakers* and Section 115 to the specific issue that case and statute address: whether a forum selection bylaw that *only* implicates internal affairs claims is permissible under Delaware law.[11] However, neither *Boilermakers* nor Section 115 "establish[es] the outer limit of what is permissible under either Section 109(b) or Section 102(b)(1)."[12]

Second, the Supreme Court rejected the Court of Chancery's characterization of all Securities Act claims as inherently "external" to the corporation. Instead, the Supreme Court ruled that Securities Act claims are "internal" — or "intra-corporate" — because they "arise from internal corporate conduct on the part of the Board and, therefore, fall within Section 102(b)(1)."[13] The Court distinguished Securities Act claims from the examples of "external" claims discussed in *Boilermakers* (and on which the Court of Chancery relied in this case) — personal injury tort claims and breach of contract claims — on grounds that "no Board action is present as it necessarily is in Section 11 claims, and those claims are unrelated to the corporation-stockholder relationship."[14] Notably, the Court limited its holding to the facial challenge before it and rejected that challenge because "it is possible to have a scenario where [a federal forum selection provision] could apply to an intra-corporate claim."[15] But considering that the Supreme Court's discussion of Securities Act claims focused on the claims most typically filed (Section 11 and 12 claims arising from a company's IPO or secondary securities offering), it is difficult to imagine a Securities Act claim that would *not* be deemed "intra-corporate" under the Supreme Court's analysis.

Having determined that federal forum selection provisions for Securities Act claims are facially valid under Delaware law, the Delaware Supreme Court then addressed whether these provisions violate federal law or policy. Holding in the negative, the Court first relied upon the United States Supreme Court's decision in *Rodriquez de Quijas v. Shearson*,[16] which held that Securities Act claims may be subject to binding arbitration, as expressing "no objection to provisions that preclude state litigation of Securities Act claims."[17] The Court further cited *M/S Bremen v. Zapata Off-Shore Co.*,[18] as requiring courts to enforce forum selection clauses unless necessary to avoid a fundamentally inequitable result or as contrary to positive law.[19]

Notably, Sciabacucchi had argued that the United States Supreme Court's *Cyan* decision expressed a federal policy in favor of state court litigation of Section 11 claims. The Court rejected that argument, refusing to accept that *Cyan* abrogated either *Rodriguez de Quijas* or *Bremen* without expressly discussing those cases.[20]

Finally, the Delaware Supreme Court addressed whether its holding would conflict with the policies of other states by purporting to limit the jurisdiction of other state courts to adjudicate Securities Act claims. The Court found that such considerations would be better addressed in the context of an "as-applied" challenge to a specific federal forum selection provision (rather than the facial challenge at issue), but that Delaware had a strong interest in regulating the forum in which Securities Act claims may be brought — first, because Section 11 claims "closely parallel state law breach of fiduciary duty claims"; and second, because federal forum selection provisions are "procedural mechanisms" that do not offend constitutional principles.[21]

Implications

The Delaware Supreme Court's decision marks a significant and positive development for Delaware corporations seeking to stem the tide of duplicative state court litigation, and represents the Delaware courts' final word on this issue. But it remains to be seen whether courts in other states will recognize the enforceability of Delaware forum selection bylaws or charter provisions, or whether courts will permit companies incorporated outside Delaware to enact valid federal forum selection provisions. This decision may open the door for other provisions that affect litigation to be added to corporate charters, given the Delaware Supreme Court's rejection of a limited reading of Section 102(b)(1) of the GCL

In the meantime, companies that are considering an initial public offering should strongly consider adopting a federal forum selection provision in their corporate bylaws or charter. Public companies that do not already have such provisions likewise may begin to evaluate whether federal forum selection provisions should be added to corporate bylaws in advance of subsequent stock offerings or other events that may expose them to Securities Act liability. While the *Sciabacucchi* opinion is silent as to whether recently adopted forum selection bylaws will be enforceable, the decision in *City of Providence v. First Citizens BancShares, Inc.*,[22] addressing late-added state forum selection bylaws suggests that these, too, will be valid.

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Endnotes

1 C.A. No. 346, 2019.

2 138 S. Ct. 1061 (2018).

3 *Sciabacucchi v. Salzberg,* C.A. No. 2017-0931-JTL, 2018 WL 6719718, at *11, 19-20 (Del. Ch. Dec. 19, 2018).

4 Slip Op. at 11.

5 *Id.*

6 *Id.*

7 73 A.3d 934 (Del. Ch. 2013).

8 *Id.* at 952.

9 91 A.3d 554 (Del. 2014).

10 *Sciabacucchi*, Slip Op. at 24.

11 *See* Slip Op. at 26 ("*Boilermakers* only held that the forum-selection bylaw (which addressed only internal affairs) easily fell within Section 109(b) [the parallel to Section 102(b)(1) addressing corporate bylaws].").

12 *Id.* at 27.

13 Slip Op. at 28.

14 *Id.* at 30.

15 *Id.*

16 490 U.S. 477 (1989).

17 Slip Op. at 43.

18 407 U.S. 1, 15 (1972).

19 Slip Op. at 44.

20 Slip Op. at 44.

21 *See* Slip Op. at 46-51.

22 99 A.3d 229 (Del. Ch. 2014).