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Overturns Chancery Court decision invalidating certificate of incorporation provisions mandating federal courts as the exclusive forum for securities-law related claims

INTRODUCTION

In 2018, the Delaware Court of Chancery ("*Chancery Court*") confronted the question of whether a corporation could validly adopt an exclusive forum selection provision requiring that claims under the Securities Act of 1933 ("*Securities Act*") be brought in federal rather than state court. In *Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL, 2018 WL 6719718 (Del. Ch. Ct. Dec. 19, 2018) ("*Sciabacucchi I*"), Vice Chancellor J. Travis Laster granted summary judgment to a plaintiff who attacked three such forum selection provisions, opining that "[t]he 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." (For a discussion of *Sciabacucchi I*, *see* Robert S. Reder & Jona N. Mays, *Delaware Chancery Court Rejects Federal Forum Selection Clause for Securities Act Claims,* 72 VAND. L. REV. EN BANC 183 (2019).) However, on appeal in *Salzberg v. Sciabacucchi*, No. 346, 2019, 2020 WL 1280785 (Del. Mar. 18, 2020) ("*Sciabacucchi II*"), the Delaware Supreme Court reversed, determining that a federal forum selection provision for Securities Act claims "can survive a facial challenge under our law."

I. LEGAL BACKGROUND: FORUM SELECTION IN DELAWARE & SECURITIES ACT LITIGATION

A. Forum Selection in Delaware

In response to the explosion of merger-related and breach of fiduciary duty litigation, numerous Delaware corporations added forum selection clauses to their charter documents—either their certificates of incorporation or their bylaws—to steer stockholder litigation over the internal corporate affairs to Delaware courts. Activist stockholders attacked the earliest of these clauses, claiming they were ineffective under Delaware law. Subsequent decisions of the Delaware judiciary and amendments to the Delaware General Corporation Law ("*DGCL*") adopted by the state's legislature have clarified the rules of the road for

forum selection in connection with litigation over so-called "internal affairs claims."

As discussed in *Sciabacucchi I*, the Chancery Court in *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) ("*Boilermakers*") ruled that "a Delaware corporation can adopt a forum-selection bylaw for internal-affairs claims." Specifically, Section 109(b) of the DGCL, "which specifies what subjects bylaws can address, authorizes the bylaws to regulate 'internal affairs claims brought by stockholders *qua* stockholders.' " At the same time, the Chancery Court stressed that "Section 109(b) does *not* authorize a Delaware corporation to regulate external relationships." For example, the Chancery Court noted, a bylaw *may not* regulate forum selection by "a plaintiff, even a stockholder plaintiff, who sought to bring a tort claim against the company based on a personal injury she suffered . . . on the company's premises or a contract claim based on a commercial contract with the corporation."

The *Boilermakers* ruling subsequently was codified through adoption of Section 115 to the DGCL ("*DGCL Section 115*"). DGCL Section 115 authorized adoption of forum selection provisions in both certificates of incorporation and bylaws to the extent they govern "internal corporate claims," defined as "claims . . . (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 [the DGCL] confers jurisdiction upon the Court of Chancery." DGCL Section 115 does not, however, address forum selection in other types of litigation brought against Delaware corporations or their directors and officers.

B. Litigation Under the Securities Act

The Securities Act barred the offer and sale of securities except pursuant to a disclosure-laden registration statement approved by the Securities and Exchange Commission or in compliance with an exemption. To help enforce these registration and disclosure requirements, the Securities Act granted private rights of action to purchasers of securities. The Securities Act, as originally promulgated, also gave federal and state courts *concurrent jurisdiction* over claims by private plaintiffs, while barring defendants from removing actions filed in state court to federal court.

Subsequent legislation and litigation, however, created confusion over the Securities Act's jurisdictional allocation:

- As described in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006), The Private Securities Litigation Reform Act ("*PSLRA*"), enacted in 1995, sought to remedy "perceived abuses of the class action vehicle in litigation involving nationally traded securities." To this end, PSLRA imposed various procedural requirements for securities-related claims filed in federal court. Not surprisingly, PSLRA led plaintiffs' counsel to avoid federal courts (and PSLRA's procedural safeguards) by filing their claims in state court.

- The Securities Litigation Uniform Standards Act ("*SLUSA*") was enacted in 1998 to remedy this unintended consequence of PSLRA. As summarized in *Sciabacucchi I, SLUSA* forced plaintiffs who wished "to pursue class-wide relief involving publicly traded securities on a fraud-based theory, regardless of whether the cause of action invokes federal or state law," to sue in federal court, while permitting defendants in state actions to remove certain class actions to federal court. Relatedly, SLUSA modified the jurisdictional provisions of the Securities Act to (i) provide for concurrent federal and state jurisdiction "except as provided" in SLUSA, and (ii) prevent removal of state court claims asserting violations of the Securities Act "[e]xcept as provided" in SLUSA.

- Subsequently, a split developed among federal courts over the impact of SLUSA on the Securities Act's jurisdictional allocation. Some circuits held SLUSA "only permitted the removal of covered class actions that raised state law claims" to federal court. Others held SLUSA permitted removal of *all* Securities Act claims to federal court.

On March 20, 2018, the United States Supreme Court resolved this split in *Cyan, Inc. v. Beaver Cty. Empls. Ret. Fund,* 138 S. Ct. 1061 (2018) ("*Cyan*"). As noted in *Sciabacucchi I,* the *Cyan* Court ruled that "class actions filed in state court which asserted violations of the 1933 Act could not be removed to federal court." As a result, both federal and state courts continue to have concurrent jurisdiction over Securities Act claims brought by private plaintiffs. Further, defendants may not remove Securities Act actions filed in state court to federal court.

II. FACTUAL BACKGROUND: FEDERAL FORUM PROVISIONS CHALLENGED

A. Delaware Corporations Turn to Federal Forum Provisions

In the wake of *Boilermakers,* Delaware issuers sought to check the ability of plaintiffs' counsel to circumvent PSLRA by bringing their Securities Act claims in state court. These issuers added forum selection clauses to their charter documents requiring plaintiffs to bring their Securities Act claims in federal court ("*Federal Forum Provisions*"). Among these were three privately-held corporations—Blue Apron Holdings, Inc., Roku, Inc., and Stitch Fix, Inc.—each of which added a Federal Forum Provision to its certificate of incorporation in contemplation of an initial public offering. Generally, these Federal Forum Provisions read 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 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].

Matthew Sciabacucchi ("*Mr. Sciabacucchi*") bought shares in each of these corporations, "either in the initial public offering or a short time later," giving him standing to sue for potential disclosure and other violations under the Securities Act. To facilitate bringing his claims in state rather than federal court, Mr. Sciabacucchi sought a declaratory judgment from the Chancery Court declaring the Federal Forum Provisions invalid.

B. Chancery Court Invalidates Federal Forum Provisions

In *Sciabacucchi I,* Vice Chancellor Laster granted summary judgment in favor of Mr. Sciabacucchi, declaring the Federal Forum Provisions "ineffective and invalid." Giving the concept of "internal corporate claims" used in *Boilermakers* and DGCL Section 115 a narrow reading, the Vice Chancellor observed that "a Delaware corporation cannot use its charter or bylaws to regulate the forum in which parties bring external claims." From the Vice Chancellor's perspective, "[t]he distinct nature of a claim based on a defective [Securities Act] registration statement demonstrates its external status." The Vice Chancellor listed a number of factors supporting his conclusion, including:

- "There is no necessary connection between a 1933 Act claim and the shares of a Delaware corporation."
- "The cause of action does not arise out of or relate to the ownership of the share, but rather from the purchase of the share."
- "At the moment the predicate act of purchasing occurs, the purchaser is not yet a stockholder and does not have any relationship with the corporation that is governed by Delaware corporate law."
- "For purposes of the analysis in *Boilermakers*, a 1933 Act claim resembles a tort or contract claim brought by a third-party plaintiff who was not a stockholder at the time the claim arose."
- Amendments to DGCL Sections 102 and 109 codifying *Boilermakers* "reinforce the conclusion" that the Delaware legislature "only believed that the charter and bylaws could regulate internal corporate claims."

On this basis, Vice Chancellor Laster concluded, "[u]nder existing Delaware authority, a Delaware corporation does not have the power to adopt in its charter or bylaws a forum-selection provision" governing external claims related to alleged violations of the Securities Act. The three corporate issuers whose Federal Forum Provisions had been challenged by Mr. Sciabacucchi appealed this decision to the Delaware Supreme Court.

III. THE DELAWARE SUPREME COURT'S ANALYSIS

In *Sciabacucchi II*, the Delaware Supreme Court rejected Vice Chancellor Laster's invalidation of the Federal Forum Provisions. Initially, the Court explained that Mr. Sciabacucchi, to prevail on his "facial challenge" to the Federal Forum Provisions, "must show that the charter provisions 'cannot operate lawfully or equitably *under any circumstances*.' " The Court determined, for a number of reasons, that Mr. Sciabacucchi had not satisfied this high bar.

First, the Court noted that Section 102(b)(1) of the DGCL ("*DGCL Section 102(b)(1)*") "authorizes two broad types of provisions" in a certificate of incorporation:

- "*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, . . . if such provisions are not contrary to the laws of this State."

A Federal Forum Provision, according to the Court, "could easily fall within either of these broad categories." Specifically, the Securities Act claims targeted by the Federal Forum Provisions "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 addition, a charter provision "that seeks to regulate the forum in which such 'intra-corporate' litigation can occur is a provision that addresses the 'management of the business' and the 'conduct of the affairs of the corporation.' "

Second, the Court found that the Federal Forum Provisions did not violate Delaware law. While DGCL Section 115 was "intended, in part, to codify *Boilermakers*," "*Boilermakers* did not establish the outer limit of what is permissible under . . . Section 102(b)(1)," nor is DGCL Section 115 "properly viewed as modifying Section 102(b)(1)." Further, DGCL Section 115, "read fairly, does not address the propriety of forum-selection provisions applicable to other types of claims." Simply stated, because Securities Act claims are not "internal corporate claims" contemplated by DGCL Section 115, that Section "does not apply" to a Federal Forum Provision. Rather, "we must look . . . to Section 102(b)(1) . . . to determine whether the provision is permissible."

Third, the Court rejected Vice Chancellor Laster's narrow construction of "intracorporate litigation" to be "synonymous with only state law fiduciary duty claims." According to the Court, not only did *Boilermakers* "not address external claims," but "dicta in *Boilermakers* . . . suggests that its definition of 'external' claims would exclude 'intra-corporate' claims which . . . do fall within Section 102(b)(1)'s broad scope." The Court further reasoned that the two varieties of external claims cited in *Boilermakers*—personal injury tort claims and commercial contract claims—"do not relate to the 'affairs' of the corporation or the 'powers' of its constituents." Unlike the Securities Act claims subject to the Federal Forum Provisions, such tort and contract "claims are unrelated to the corporation-stockholder relationship." Accordingly, Federal Forum Provisions "are not 'external,' and *Boilermakers* does not suggest that they are."

Fourth, building on this distinction, the Court recognized "a category of matters that is situated on a continuum between the *Boilermakers* definition of 'internal affairs' and its description of purely 'external' claims." Along this continuum are "provisions governing certain types of 'intracorporate' claims that" while "not strictly within *Boilermakers*' 'internal affairs,' can be within the boundaries of the DGCL, and specifically Section 102(b)(1)." Although the "internal affairs doctrine has no applicability in these situations" for purposes of *Boilermakers*, DGCL Section 102(b)(1) nevertheless is broad enough to encompass "matters *peculiar* to corporations, that is, those activities concerning the relationships *inter se* of the corporation, its directors, officers and shareholders." Such *inter se* relationships include Securities Act claims brought against a corporation or those fiduciaries. In short, DGCL Section 102(b)(1) "is unquestionably broader than, and is not circumscribed by, Section 115's definition of 'internal corporate claims.' "

Fifth, the Court rejected the distinction drawn in *Sciabacucchi I* between claims that "arise from the purchase of shares, as opposed to share ownership," recognizing that "various provisions of our DGCL regulate certain transactions by which one can become a stockholder." For example, the Court cited amendments to DGCL Section 111 "empower[ing] the Court of Chancery to interpret, apply, enforce or determine the validity of agreements pertaining to sales of stock by the corporation." Similarly, the jurisdiction of the Chancery Court "was expanded again . . . to include stock purchase agreements whereby one or more stockholders of the corporation sells or offers to sell their stock, and to which the stockholder or holders and the corporations are parties." This provision "could include claims [under provisions of the DGCL] involving transactions with persons who are not yet stockholders, but who are parties to a stock purchase agreement where jurisdiction is based upon Section 111."

Sixth, the foregoing lines of reasoning led the Court to "the inevitable conclusion that there is a category of matters that is situated on a continuum between the *Boilermakers* definition of 'internal affairs' and its description of purely 'external' claims." The Court characterized a segment of this continuum as the "Outer Band" of "matters that are not 'internal affairs,' but are, nevertheless, 'internal' or 'intracorporate' and still within the scope of Section 102(b)(1)." The Federal Forum Provisions "are in this Outer Band, and are facially valid under Delaware law." In other words, DGCL Section 102(b)(1) "makes room" for Federal Forum Provisions "in the Outer Band," regardless of their being "outside the more traditional realm of 'internal affairs.' "

Finally, the Court regarded Federal Forum Provisions as consistent with both federal and state policy considerations. According to the Court, "federal law has no objection to provisions that preclude state litigation of Securities Act claims." Moreover, relevant federal precedent "requires courts to give as much effect as possible to forum-selection clauses, and to 'only deny enforcement of them to the limited extent necessary to avoid some fundamentally inequitable result or a result contrary to positive law.' " For example, *Cyan* recognized that forum-selection provisions "can provide a corporation with certain efficiencies in managing the procedural aspects of securities litigation," including mitigating the "costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts" and avoiding "[t]he possibility of inconsistent judgments and rulings." And, lastly, while Delaware "has, and should continue to be, vigilant about not stepping on the toes of our sister states or the federal government," there exist "persuasive arguments that could be made to our sister states that a provision in a Delaware corporation's certificate of incorporation requiring [Securities Act] claims to be brought in a federal court does not offend principles of horizontal sovereignty—just as it does not offend federal policy."

The only limit placed by the Court on Federal Forum Provisions, consistent with a similar caveat in *Boilermakers*, was its recognition that "we are addressing a facial challenge, we are not considering hypothetical, contextual situations regarding the adoption or application of [Federal Forum Provisions]." In such cases, " 'as applied' challenges are an important safety valve in the enforcement context." Specifically, the Court described "three bases on which forum-selection provisions might be invalidated," not on a facial challenge such as that brought by Mr. Sciabacucchi, but "on an 'as applied' basis":

- if enforcement "would be 'unreasonable and unjust' ";
- the presence of factors such as, or equivalent to, "fraud or overreaching"; or
- "if they 'contravene[d] a strong public policy of the forum in which suit is brought.' "

CONCLUSION

In sum, the *Sciabacucchi II* Court found Federal Forum Provisions to be legitimate devices designed "to address the post-*Cyan* difficulties presented by multi-forum litigation of Securities Act claims."

Recognizing that "Delaware courts attempt 'to achieve judicial economy and avoid duplicative efforts among courts in resolving disputes,' " the *Sciabacucchi II* Court applauded Federal Forum Provisions for promoting Delaware policy goals of fostering "certainty and predictability, uniformity, and prompt judicial resolution of corporate disputes." As a result, Delaware corporations will be able to continue to adopt Federal Forum Provisions in response to plaintiff attorney attempts to evade the protections of PSLRA in the federal securities law arena.

Of course, *Sciabacucchi II* applies only to corporations organized under Delaware law. It will be interesting to see, therefore, whether other states will (i) honor Federal Forum Provisions adopted by Delaware corporations and (ii) follow the *Sciabacucchi II* Court's lead in validating Federal Forum Provisions for corporations incorporated in those states. And, finally, there remains a possibility that the Chancery Court, if faced with particularly egregious facts, could invalidate a specific corporation's Federal Forum Provision in an "as applied" challenge.