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Citing Boilermakers *ruling, court distinguishes between internal and external claims*

INTRODUCTION

One of the key early decisions facing civil plaintiffs and their legal counsel in the United States is choice of forum. A plaintiff's counsel may perceive that her client's claim may receive more favorable treatment in one jurisdiction versus another. Thus, a plaintiff's counsel must decide—subject to applicable principles of subject matter and personal jurisdiction—in which state's courts to bring the client's action, or whether a federal forum is preferable. For precisely the same reason, a defendant's counsel may perceive a disadvantage in the forum

selected by plaintiff's counsel and seek a change of venue or removal to state or federal court. Further, a corporation may seek to take the choice of forum away from potential plaintiffs by including a forum selection provision in one of its constitutive documents, either the certificate of incorporation (also known as the charter) or the bylaws.

Recently, the Delaware Court of Chancery (the "*Chancery Court*") confronted the validity of corporate forum selection clauses purporting to regulate claims brought under the Securities Act of 1933 (the "*1933 Act*"). In *Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL (Del. Ch. Dec. 19, 2018) ("*Sciabacucchi*"), Vice Chancellor J. Travis Laster granted summary judgment to a plaintiff who attacked three such forum selection clauses, 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."

I. LEGAL BACKGROUND

A. Forum Selection in Delaware

Both the Delaware judiciary and the state's legislature have sought to clarify the rules of the road for forum selection, principally in connection with litigation over so-called "internal affairs claims." In response to the well-documented explosion of merger-related litigation and other claims of breach of fiduciary duty, numerous Delaware corporations sought to add forum selection clauses to their charter documents to steer stockholder litigation over the internal affairs of the corporation into Delaware-situated courts, whether the Chancery Court or, when not available, federal courts located in Delaware.

In this day and age, a Delaware corporation with widely-held, publicly traded stock likely cannot convince holders of a majority of its outstanding shares to vote in favor of an amendment adding a forum selection clause to its certificate of incorporation. Accordingly, numerous boards of directors exercised their power unilaterally to amend their corporate bylaws to include forum selection provisions. Generally, these provisions applied to claims considered internal to the corporation: stockholder derivative suits, breach of fiduciary duty claims, suits under the Delaware General Corporation Law (the "*DGCL*"), and other actions regarding "matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders." Activist stockholders attacked the earliest of these amendments, claiming the provisions were ineffective under Delaware law.

This issue was put to rest by then-Chancellor (and now Delaware Supreme Court Chief Justice) Leo E. Strine, Jr. in *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) ("*Boilermakers*"). Discussing *Boilermakers*, the *Sciabacucchi* Court said 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 opinion stressed that "Section 109(b) does *not* authorize a Delaware corporation to regulate external relationships." For example, the Chancellor in *Boilermakers* 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." Significantly, the Chancellor also stressed that the challenged bylaws did not claim "in any way to foreclose a plaintiff from exercising any statutory right of action created by the federal government."

The *Boilermakers* ruling was subsequently codified through adoption of Section 115 to the DGCL. This new section 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." 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 1933 Act

In the wake of the 1929 U.S. stock market crash and the crushing depression that followed, Congress enacted the 1933 Act "to promote honest practices in the securities markets." The 1933 Act barred the offer and sale of securities except pursuant to a disclosure-heavy registration statement approved by the Securities and Exchange Commission (the "*SEC*") or in compliance with an exemption. To help enforce these registration and disclosure requirements, the 1933 Act granted private rights of action to purchasers of securities. The 1933 Act also gave state and federal 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 significant confusion over the 1933 Act's jurisdictional allocation:

- In 1995, Congress enacted the Private Securities Litigation Reform Act (the "*PSLRA*") to remedy "perceived abuses of the class-action vehicle in litigation involving nationally traded securities." To this end, the PSLRA imposed various procedural requirements for securities-related claims filed in federal court. While purporting to remedy class action abuse, however, the PSLRA led plaintiffs' counsel to avoid the federal forum (and the PSLRA's procedural safeguards) by filing their claims in state court.

- To remedy this unintended consequence of the PLSRA, Congress in 1998 enacted the Securities Litigation Uniform Standards Act (the "*SLUSA*"). The 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, the SLUSA modified the jurisdictional provisions of the 1933 Act to (i) provide for concurrent federal and state jurisdiction "except as provided" in the SLUSA, and (ii) prevent removal of state court claims asserting violations of the 1933 Act "[e]xcept as provided" in the SLUSA.

- Subsequently, a split developed among federal courts asked to address the impact of the SLUSA's amendments to the 1933 Act. Some circuits held that the SLUSA "only permitted the removal of covered class actions that raised state law claims" to federal court. Others held that the SLUSA permitted removal of all 1933 Act claims to federal court.

- On March 20, 2018, the United States Supreme Court resolved this split by ruling in *Cyan, Inc. v. Beaver Cty. Empls. Ret. Fund,* 138 S. Ct. 1061 (2018) ("*Cyan*") that (as described by the Sciabacucci court) "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 have concurrent jurisdiction over 1933 Act claims brought by private plaintiffs, and defendants may not remove 1933 Act actions filed in state court to federal court.

II. FACTUAL BACKGROUND— FEDERAL FORUM PROVISIONS CHALLENGED

As noted above, a plaintiff's counsel may seek to avoid the protections afforded by the PSLRA to corporate issuers by bringing their claims in state court. In the wake of *Boilermakers*' approval of Delaware forum selection clauses, several corporate issuers added forum selection clauses to their charter documents requiring plaintiffs to bring 1933 Act claims in federal court ("*Federal Forum Provisions*"). These included three privately held corporations—Blue Apron Holdings, Inc., Roku, Inc., and Stitch Fix Inc.—each of whom added Federal Forum Provisions to their certificates of incorporation in contemplation of their initial public offerings.

Matthew Sciabacucchi bought shares in each of these corporations, giving him the right to sue for potential disclosure and other violations under the 1933 Act. To facilitate bringing any such claim in state court, Sciabacucchi sought a declaratory judgment from the Chancery Court that the Federal Forum Provisions were invalid.

III. THE VICE CHANCELLOR'S ANALYSIS

Vice Chancellor Laster granted summary judgment in favor of the declaration sought by Mr. Sciabacucchi. In so ruling, the Vice Chancellor looked both to "existing law" as well as "first principles" in concluding that the Federal Forum Provisions were "ineffective and invalid."

A. Delaware Law Defeats the Federal Forum Provisions

Vice Chancellor Laster explained initially that the reasoning in *Boilermakers*, which allowed for a forum selection clause in a corporate bylaw, "applies equally to a charter-based provision." In so concluding, the Vice Chancellor explained that "[t]he language of Section 109(b) dealing with the subject matter of bylaws parallels in large measure the language of Section 102(b)(1) dealing with what may be included in a certificate of incorporation." (quoting 1 David A. Drexler et al., *Delaware Corporation Law and Practice* § 9.03, at 9-5 to -6 (2018))

This parallelism in turn led the Vice Chancellor to observe that the distinction recognized in *Boilermakers* "between internal and external claims applies equally to charter-based provisions . . . indicat[ing] 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 [1933 Act] registration statement demonstrates its

external status." The Vice Chancellor then listed a number of factors supporting this 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 relate or 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 bylaw could regulate internal corporate claims."

On this basis, the Vice Chancellor concluded that "[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 1933 Act.

B. "First Principles" Dictate a Similar Result

Vice Chancellor Laster also observed that as a matter of "first principles," the "internal affairs doctrine" dictates that "[n]o matter where the corporation conducts its operations or locates its headquarters, the law of the state of incorporation governs the entity's internal affairs." By the same token, "the state of incorporation cannot use corporate law to regulate the corporation's external relationships." Recognizing that states do regulate "numerous ... issues that affect a corporation's business," the Vice Chancellor explained that they do so only on the basis of their "authority over actors and activities within their territorial jurisdictions (or which have a sufficient nexus with their territorial jurisdictions)." But this authority derives from "territorial principles" rather than "the terms of the corporate charter of the law of the state of incorporation ...."

Applying these principles to the Federal Forum Provisions, the Vice Chancellor saw "no reason to believe that corporate governance

documents, regulated by the law of the state of incorporation, can dictate mechanisms for bringing claims that do not concern internal corporate affairs, such as claims alleging fraud in connection with a securities sale." For the Vice Chancellor, this analysis "generate[d] the same result as applying *Boilermakers*": Delaware corporations "lack authority to use their certificates of incorporation to regulate claims under the 1933 Act," rendering the Federal Forum Provisions "ineffective and invalid."

CONCLUSION

In *Sciabacucchi*, Vice Chancellor Laster reasoned that the precedent established by *Boilermakers*, along with first principles guiding corporate power and authority, compelled his decision that "a Delaware corporation cannot use its charter or bylaws to regulate the forum in which parties bring external claims," including claims relating to violations of the 1933 Act. The distinction long drawn by Delaware courts between "internal and external claims" has real meaning. Going forward, while Delaware courts will continue to be permitted to utilize their constitutive documents to regulate forum selection when it comes to litigation over such internal affairs matters as satisfaction of director, officer, and stockholder fiduciary duties, this authority will not extend to litigation over matters outside the internal affairs rubric. Specifically, in the case of 1933 Act litigation, the Vice Chancellor was not prepared to upset the concurrent jurisdictional scheme established under the SLUSA as construed in *Cyan*.