ALERT MEMORANDUM

Sciabacucchi v. Salzberg

January 17, 2019

On December 19, 2018, the Delaware Court of Chancery issued an opinion holding that Delaware law does not permit corporations to use charter provisions to require stockholders to litigate certain claims brought under the federal securities laws in a specific forum. In *Sciabacucchi v. Salzberg*, Vice Chancellor Laster determined that such forum-selection provisions are invalid and unenforceable to the extent that they require any claim under the Securities Act of 1933 (the "1933 Act") to be filed only in federal court.[1]

The decision built on case law providing that a corporation may include forum-selection clauses in its governing documents where the claims involve intra-corporate disputes stemming from the rights and relationships established under Delaware corporate law (including between corporations and stockholders), but may not do so for claims that are external to the corporate relationship, like those based on tort, contract, labor or environmental law. The decision may have implications for the use of other forum-selection provisions that mandate arbitration or contain class action waivers.

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[1] *Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018), *available at* https://courts.delaware.gov/Opinions/Download.aspx?id=282830 (*hereinafter*, "Opinion").

Background

Section 11 of the 1933 Act allows purchasers of a security in a registered offering to sue certain parties when false or misleading information is included in a registration statement.[2] As originally enacted, the 1933 Act created concurrent jurisdiction in federal and state court for claims under Section 11, and barred the removal to federal court on the basis of federal question jurisdiction of any claims filed in state court.[3] Subsequent amendments to the 1933 Act created ambiguity about whether those jurisdictional and removal provisions applied to class actions, which the Supreme Court resolved last year in *Cyan Inc. v. Beaver County Employees Retirement Fund*, holding that class actions under the 1933 Act can be pursued in state court.[4]

When nominal defendants Blue Apron, Roku and Stitch Fix went public in 2017, they each included forum-selection provisions in their charters stating that federal court would be the exclusive forum for litigation under the 1933 Act (the "Federal Forum Provisions"). As we have discussed in previous alert memos, the general goals of forum-selection provisions include the "elimination of the risk of litigation in multiple courts and the resulting risk of multiple and potentially inconsistent decisions and increased litigation costs," as well as "adjudication by judges with relevant expertise and experience and prompt hearings, trials and appeals."[5]

The Court of Chancery established in *Boilermakers* that Delaware corporations may adopt forum-selection provisions for internal corporate claims.[6] That ruling was then codified by the Delaware General Assembly by adding Section 115 to the Delaware General Corporation Law to explicitly permit the adoption of forum-selection provisions for internal corporate claims, and amending Sections 102 and 109. Section 115 defined "internal corporate claims" as "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 Court of Chancery."[7]

However, federal securities claims were not expressly addressed in the amendments. Thus, Plaintiff Matthew Sciabacucchi sought declaratory judgment that the Federal Forum Provisions were invalid, arguing that the 1933 Act claims they sought to regulate were actually external claims, rather than internal corporate claims.

The Sciabacucchi Decision

For several reasons, Vice Chancellor Laster agreed with Sciabacucchi that the Federal Forum Provisions were invalid under Delaware law.

First, looking to the reasoning from *Boilermakers*, the Court decided that the Federal Forum Provisions could only be valid if they pertained to the internal affairs of the corporation. The Court noted that charter and bylaw provisions "can only address internal-affairs claims," and found that "a securities law claim is not an 'internal corporate claim' within the meaning of the amendments" adding Section 115 and amending

[2] See 15 U.S.C. § 77k(a) (providing for liability where "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading").

[3] See § 22(a), 48 Stat. 86 ("The district courts of the United States ... shall have jurisdiction[,] concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title"); *Id.*, at 87 ("No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States").

[4] *Cyan, Inc. v. Beaver Cty. Empls. Ret. Fund*, 138 S. Ct. 1061 (2018).

[5] Cleary Gottlieb, Should Your Company Adopt A Forum Selection Bylaw? (June 27, 2013), *available at* https://www.clearygottlieb.com/-/media/organize-archive/cgsh/files/publication-pdfs/should-your-company-adopt-a-forum-selection-bylaw.pdf.

[6] *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) (Strine, C.).

[7] 8 Del. C. § 115.

Sections 102 and 109.[8] The Court also stated that a previous decision by the Delaware Supreme Court regarding the facial validity of fee-shifting bylaws, *ATP Tour, Inc. v. Deutscher Tennis Bund*, was focused on intra-corporate litigation and "did not suggest that the corporate contract can be used to regulate other types of claims."[9]

Then, again based on the reasoning from *Boilermakers*, the Court determined that a "1933 Act claim is an external claim that falls outside the scope of the corporate contract."[10] The Court found that 1933 Act claims are external for several reasons: (1) federal statute, not Delaware law, creates the claim and defines the elements of the claim, (2) plaintiffs who are not stockholders can bring and maintain such claims, (3) plaintiffs may sue defendants beyond the officers and directors of the corporation, and (4) the "predicate act" covered by the statute is the purchase of the share, rather than ownership of the share.[11] In other words, a "1933 Act claim resembles 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."[12] Accordingly, the Court concluded that "[a] charter-based forum-selection provision cannot govern [1933 Act] claims because the provision would not be addressing 'the rights and powers of the plaintiff-stockholder *as a stockholder*.'"[13]

The Court went on to explain that "first principles" about "the concept of the corporation and the nature of its constitutive documents" would lead to the same result.[14] Also, perhaps anticipating the possibility of an appeal, the Court included multiple citations to public remarks by current Chief Justice Leo Strine and former Chief Justice Myron Steele opining that federal securities laws should not be considered internal corporate claims.[15]

The final outcome of the case may also take on additional significance because, although not actually at issue, some commentators, including Professor Ann Lipton from Tulane, consider it to be an indicator of what Delaware courts will say about the validity of charter provisions that would require stockholders to arbitrate federal securities claims.[16]

[8] Opinion at 29-31 (citing Lawrence A. Hamermesh & Norman M. Monhait, *Fee-Shifting Bylaw: A Study in Federalism*, Institute of Delaware Corporate and Business Law (June 29, 2015), *available at* http://blogs.law.widener.edu/delcorp/2015/06/29/fee-shifting-bylaws-a-study-in-federalism/).

[9] Opinion at 27-28 (citing *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 557 (Del. 2014)). Vice Chancellor Laster also cites an article by then-Justice Henry duPont Ridgely describing the *ATP* ruling as addressing a bylaw involving "an intra-corporate suit." Opinion at 28 n.83.

[10] Opinion at 37-38.

[11] Opinion at 34-37; *see also* Opinion at 2 ("A claim under the 1933 Act does not turn on the rights, powers, or preferences of the shares, language in the corporation's charter or bylaws, a provision in the DGCL, or the equitable relationships that flow from the internal structure of the corporation.").

[12] Opinion at 37.

[13] Opinion at 34 (emphasis in original) (quoting *Boilermakers*, 73 A.3d at 952).

[14] Opinion at 38-42 and nn.111-125.

[15] *See* Myron T. Steele, *Sarbanes-Oxley: The Delaware Perspective*, 52 N.Y.L. Sch. L. Rev. 503, 506-07 (2008) ("[T]he focus of the federal lane has always been, and should always be, market fraud and disclosure. On the other hand, monitoring the structure of internal corporate governance is the focus of the state lane."); Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 Del. J. Corp. L. 673, 674 (2005) (noting that certain aspects of a broad-based company law in the European context, "like competition law, labor law, trade, *and requirements for the filing of regular disclosures to public investors*, are not part of Delaware's corporation law") (emphasis added).

[16] Ann Lipton, *Litigation Limits, Corporate Governance, and Securities Law - A New Hope*, Business Law Prof Blog (Dec. 19, 2018), https://lawprofessors.typepad.com/business_law/2018/12/litigation-limits-corporate-governance-and-securities-law-a-new-hope.html#comments.

Takeaways

In SEC filings made shortly after the opinion was released, Stitch Fix and Roku each wrote that they were "currently assessing whether to appeal this case to the Delaware Supreme Court." [17] An appeal would give the Delaware Supreme Court a chance to provide guidance on this important issue.

An appeal would also provide the Defendants with the opportunity to persuade the Delaware Supreme Court that there are substantial differences between Section 11 claims and the external contract and tort claims referred to in *Boilermakers*.[18] As argued in the briefing, Section 11 claims are based on the circumstances creating the stockholder relationship, because they necessarily "involve the relationship between 'those who manage the corporation and the corporation's stockholders' insofar as they hold managers and directors accountable for the representations they make to stockholders pursuant to a registration statement."[19] Defendants might also argue that internal claims are not synonymous or co-extensive with the "intra-corporate litigation" referred to in *ATP*. After all, the underlying fee-shifting bylaw at issue in that case purported to extend to any claim, and the case was certified to the Delaware Supreme Court to determine whether the fee-shifting bylaw could apply to a federal antitrust claim. Defendants might further argue that, had the Delaware Supreme Court thought that a charter provision could not ever apply to an antitrust claim, then that should have led to a finding that the provision was invalid. This suggests that a charter provision relating to a federal claim could be valid if the circumstances giving rise to it also make it an intra-corporate claim—in other words, a claim based on the relationship between the corporation and its stockholders *qua* stockholders. In any event, an appeal would provide an opportunity for the Delaware Supreme Court to clarify the meaning of *ATP* and resolve these questions.

In the meantime, corporations may want to review their existing forum-selection provisions in light of the decision to determine if any amendments are necessary.

If affirmed, Vice Chancellor Laster's ruling means that corporations will have one less tool to avoid the specter of duplicative securities class actions being filed simultaneously in federal and state court. This would increase the importance of other techniques for dealing with multi-jurisdictional securities class actions that we have identified in previous alert memos – including methods for coordinating related litigation across federal and state courts, or moving to stay some of the proceedings or for consolidation.[20] Together with *Cyan*, the ruling could potentially prompt Congress to revise existing legislation to grant federal courts either exclusive or removal jurisdiction over securities class actions alleging 1933 Act claims.

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[17] See Roku, Inc., Form 8-K (Dec. 21, 2018); Stitch Fix, Form 8-K (Dec. 21, 2018).

[18] The external claims referenced in *Boilermakers*—albeit in dicta, as the case involved only internal corporate matters—did not involve an aggrieved party because of its stockholder relationship to the corporate entity; rather the claims were described as those of "a plaintiff, even a stockholder plaintiff, who sought to bring a tort claim against the company based on a personal injury she suffered that occurred on the company's premises or a contract claim based on a commercial contract with the corporation." In an appeal, Defendants may point out the difference between such external tort and contract claims, and Section 11 claims that do implicate the stockholder relationship, through the lens of truthful disclosure.

[19] The Stitch Fix and Roku Defendants' Opening Brief in Support of Their Cross-Motion for Summary Judgment, 2018 WL 2322331 (May 16, 2018).

[20] Cleary Gottlieb, Supreme Court Holds That Securities Act Class Actions May Be Brought In State Court (March 27, 2018), *available at* https://www.clearygottlieb.com/-/media/files/alert-memos-2018/supreme-court-holds-that-securities-act-class-actions-may-be-brought-in-state-court.pdf.