ALERT MEMORANDUM

Delaware Supreme Court Green Lights Federal-Forum Charter Provisions

March 20, 2020

On March 18, 2020, the Delaware Supreme Court issued an opinion in the closely watched appeal in *Sciabacucchi v. Salzberg*, a case involving a challenge to charter provisions of three Delaware corporations requiring stockholder plaintiffs to litigate claims under the Securities Act of 1933 (the "1933 Act") in federal court. The *en banc* Supreme Court unanimously upheld such provisions against the plaintiffs' facial challenge, reversing the Delaware Court of Chancery's prior decision in this case.[1]

The Supreme Court rejected the Court of Chancery's reasoning that because 1933 Act claims arise under federal law, they are "external" matters that may not be regulated by Delaware corporations' charters, noting that while 1933 Act claims are not "internal affairs," they are a form of "intra-corporate litigation," which Delaware corporations may regulate as to procedure.

The decision is a significant development for Delaware corporations, which should now strongly consider adopting federal-forum provisions in their charters or bylaws.[2] Such provisions should reduce the burdens and inefficiencies of 1933 Act litigation created by the U.S. Supreme Court's 2018 *Cyan* decision,[3] which has led to a marked increase in related securities class actions proceeding simultaneously in multiple federal and state courts.

A number of questions remain unresolved, however, including whether other state and federal courts will similarly uphold federal-forum provisions, and under what circumstances; whether such courts will reach the same conclusion with respect to federal-forum provisions adopted in a corporation's *bylaws*; and whether courts would similarly uphold a charter or bylaw provision mandating arbitration of 1933 Act (or other federal securities law) claims.

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[1] *Salzberg v. Sciabacucchi*, C.A. No. 2017-0931, (Del. Mar. 18, 2020) [hereinafter *Sciabacucchi II* or "Opinion"], https://courts.delaware.gov/Opinions/Download.aspx?id=303310, *rev'g Sciabacucchi v. Salzberg*, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018) [hereinafter *Sciabacucchi I*].

[2] *See infra* n.23 (discussing application of *Sciabacucchi II* to bylaw provisions).

[3] *See Cyan Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018).

Background

The relevant background is addressed in our prior Alert Memorandum discussing the Court of Chancery's decision in this case.[4]

To summarize, the 1933 Act allows any person acquiring a security in a registered offering to sue certain parties, including the corporation and its officers and directors, for false or misleading information included in a registration statement or prospectus.[5] In 2018, the U.S. Supreme Court held in *Cyan Inc. v. Beaver County Employees Retirement Fund*[6] that plaintiffs can file class actions under the 1933 Act in federal *or* state court (and if filed in state court, such actions are not generally removable to federal court under the 1933 Act's removal bar). That decision has led to a significant increase in 1933 Act claims being filed in state court, which has created inefficiencies and burdens for defendants, including the inability to consolidate multiple related cases and the risk of inconsistent rulings.[7]

In an effort to address these problems, Blue Apron Holdings, Inc., Stitch Fix, Inc. and Roku, Inc.—all Delaware corporations—each adopted a federal-forum provision ("FFP") in its charter in advance of their initial public offerings. These FFPs provided that federal court is the exclusive forum for litigation brought under the 1933 Act. Matthew Sciabacucchi, a purchaser of these three corporations' shares, brought an action in Delaware seeking a declaratory judgment that the FFPs were invalid under Delaware law, arguing that the 1933 Act claims the corporations sought to regulate were external claims outside the scope of permissible charter provisions.

In its December 19, 2018 decision, the Delaware Court of Chancery agreed with Sciabacucchi and held that the FFPs were invalid under Delaware law.[8] Reasoning that the FFPs could only be valid if they pertained to the "internal affairs" of a Delaware corporation, the Court of Chancery held that a securities law claim, such as one brought under Section 11 of the 1933 Act, was an "external" claim, akin to a tort or contract claim against a corporation brought by a non-stockholder plaintiff, that could not be governed by a FFP in a Delaware corporation's charter.[9]

The Delaware Supreme Court Decision

The Delaware Supreme Court, sitting *en banc*, unanimously reversed in an opinion by Justice Valihura.

First, the Court examined whether an FFP is permissible under Section 102 of the Delaware General Corporation Law ("DGCL"), which defines the scope of matters that may be contained in a Delaware corporation's charter. After noting that Section 102(b)(1) authorizes two broad categories of charter provisions,[10] the Court held that FFPs "could easily fall" into either category and therefore were facially valid under Section 102(b)(1).[11] In so holding, the Court emphasized the broadly enabling nature of

[4] Cleary Gottlieb, *Sciabacucchi v. Salzberg* (Jan. 17, 2019), https://www.clearygottlieb.com/-/media/files/alert-memos-2019/20190117-delaware-court-of-chancery-holds-that-charter-provisions-requiring-plaintiffs-to-litigate-s.pdf.

[5] *See* 15 U.S.C. §§ 77k(a), 77l(a)(2), 77o(a) (2018).

[6] 138 S. Ct. 1061 (2018).

[7] *See* Opinion at 13, 52; *see also* Cleary Gottlieb, *Supreme Court Holds That Securities Act Class Actions May Be Brought In State Court* (Mar. 27, 2018), https://www.clearygottlieb.com/-/media/files/alert-memos-2018/supreme-court-holds-that-securities-act-class-actions-may-be-brought-in-state-court.pdf.

[8] *Sciabacucchi I*, 2018 WL 6719718, at *1.

[9] *Id.* at *15-18.

[10] *See* 8 Del. C. § 102(b)(1) (2019) ("[T]he certificate of incorporation may also contain any or all of the following matters: . . . 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, or any class of the stockholders, or the governing body, members, or any class or group of members of a nonstock corporation . . . .").

[11] Opinion at 11 (noting that an FFP involves securities claims related to the "management of litigation arising out of the Board's disclosures to current and prospective stockholders" and an "important aspect of a corporation's management of its business and affairs and of its relationship with its stockholders").

Section 102(b)(1), the policy of respecting stockholder-approved charter provisions such as the FFPs in question, and the "immense freedom for businesses" accorded by the DGCL.[12]

Second, the Court analyzed the impact of the addition of Section 115 to the DGCL in 2015. Section 115 permits, but does not require, Delaware corporations to adopt a charter or bylaw provision mandating that "internal corporate claims"—defined to mean claims "(i) that are based upon a violation of a duty by a current or former director or officer or stockholder acting in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery"—be litigated in Delaware court.[13] The Supreme Court disagreed with the Court of Chancery that this definition of "internal corporate claims" should guide the interpretation of Section 102(b)(1), noting that Section 115 did not purport to amend or repeal Section 102(b)(1), and therefore should not be read to impose a new "internal corporate claims" limitation on charter provisions that are outside the scope of Section 115. As FFPs are not governed by Section 115, the Court concluded they are permissible under the broader language of Section 102(b)(1).[14]

Third, the Court disputed the Court of Chancery's characterization of Section 11 claims—and therefore FFPs—as "external" affairs that fell outside the scope of Section 102(b)(1). The Supreme Court rejected the Court of Chancery's binary division between "internal affairs" and everything else. Instead, the Supreme Court concluded that there was a broader "continuum" between internal or intra-corporate and external affairs, and that there were matters that did not fit the strict definition of a corporation's "internal affairs" but that Delaware law nonetheless permitted to be regulated by a corporation's charter.[15]

In support, the Court cited its prior decision in *ATP Tour, Inc. v. Deutscher Tennis Bund*.[16] In *ATP*, in relevant part, the Court had held that a fee-shifting provision in the bylaws of a non-stock corporation for "intra-corporate" litigation (in that case, litigation between members of the corporation, on the one hand, and the corporation and its board, on the other hand) was facially valid under Delaware law, including under Section 102(b)(1).[17] Notably, the claims at issue in *ATP* included federal antitrust claims, and the Court in that case described the authority of a Delaware corporation to regulate procedure as extending to "intra-corporate litigation," a broader category than "internal affairs" litigation.[18]

Fourth, the Court also held that FFPs do not violate federal law or sister-state sovereignty.[19] In support, the Court cited federal case law enforcing various forum-selection clauses in contracts, including *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[20] in which the U.S. Supreme Court had upheld an arbitration clause that precluded state (and federal) court litigation of claims under the 1933 Act.[21] The Court similarly found that FFPs do not offend the sovereignty of other states, citing the deference accorded by other states to contractual forum-selection clauses, among other considerations.[22]

Takeaways

The Delaware Supreme Court's reversal of the Court of Chancery's decision in this case should prompt Delaware corporations to consider (or reconsider) adopting FFPs in their charters or bylaws.[23] The

[12] *Id.* at 14-16.

[13] 8 Del. C. § 115 (2019).

[14] Opinion at 18-23.

[15] *Id.* at 41-42 & fig.1.

[16] 91 A.3d 554 (Del. 2014).

[17] Opinion at 23-28 (citing *ATP*, 91 A.3d at 554, 557-59).

[18] *Id.* at 26-28.

[19] *Id.* at 43.

[20] 490 U.S. 477 (1989).

[21] Opinion at 43; *see also id.* at 44 (citing *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972) (presumption in favor of enforcing forum-selection clause); *Ingres Corp. v. CA, Inc.*, 8 A.3d 1143, 1146 (Del. 2010) (same)).

[22] *Id.* at 46-51.

[23] Although *Sciabacucchi II* only addressed FFP provisions adopted as part of a corporation's charter, we think that FFPs adopted as part of a corporation's bylaws should similarly be permissible. Section 109 of the DGCL, which governs bylaw provisions, is—like Section 102(b)(1)—

benefits of doing so are, in the Delaware Supreme Court's words, "obvious" and include promoting "certainty and predictability, uniformity, and prompt judicial resolution" of 1933 Act claims after *Cyan*.

It is important to note, however, that the decision did not address a number of questions that may need to be considered, including:

- Whether the courts of other states, or federal courts, will follow the Delaware Supreme Court's decision in *Sciabacucchi II*, or instead refuse to enforce FFPs adopted by Delaware corporations as against federal or other states' policies.
- Whether, and under what circumstances, a court (in Delaware or elsewhere) will decline to enforce an FFP as "unreasonable or unjust" on an "as applied" challenge (a possibility *Sciabacucchi II* expressly left open).[24]
- Whether Delaware corporations may adopt charter provisions requiring *arbitration* of 1933 Act (or other securities law) claims.
- Whether corporations incorporated outside Delaware would be similarly authorized to adopt federal-forum provisions in their organizational documents.[25]

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broad enough to permit FFPs. *See* 8 Del C. § 109(b) ("The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."). Moreover, the Delaware Supreme Court's *ATP* decision, upon which *Sciabacucchi II* heavily relied, involved a bylaw provision. That said, an FFP provision approved by the stockholders—whether as part of the corporation's charter or bylaws—may be less likely to be subject to an "as applied" challenge than such a provision unilaterally adopted by the board. *See infra* n.24.

[24] Opinion at 49 ("'[A]s applied' challenges are an important safety valve . . . ."). By way of example, it remains to be seen how a court would decide an as-applied challenge to an FFP in the context of a corporation seeking to remove an already pending 1933 Act lawsuit from state to federal court on the basis of an FFP adopted after the lawsuit was filed. Although courts may give more scrutiny to an FFP in such circumstances, we think Delaware corporations can make a persuasive argument that there is nothing "unreasonable or unjust" about requiring 1933 Act lawsuits pending in state court to proceed in federal court instead, in light of the increased efficiencies and reduced burdens (to corporate defendants and the corporation's stockholders alike) of litigating such claims exclusively in federal court, as discussed above.

[25] This Alert Memorandum was prepared with the assistance of Soo Jee Lee.