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BLOG

Delaware Supreme Court: Federal Forum Selection Provisions for Securities Act Claims Are Valid

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On March 18, 2020, the Delaware Supreme Court, reversing a December 2018 decision of the Delaware Court of Chancery, held that Delaware corporations may adopt federal forum selection charter provisions that require stockholders to bring all suits asserting violations of the Securities Act of 1933 (the Securities Act) in federal court.[1] As a result of the ruling in *Salzberg v. Sciabacucchi*, Delaware-incorporated companies are urged to consider, as appropriate, adopting forum selection provisions in their charters requiring a federal forum for Securities Act claims and to plan for their inclusion going forward when conducting IPOs. Indeed, the current economic climate provides a unique opportunity to do so, while IPO activity and secondary offerings remain suppressed due to the uncertainty and other fallout from the COVID-19 pandemic.

At issue in *Sciabacucchi* was the alleged facial invalidity of federal forum selection charter provisions adopted by three Delaware-incorporated public companies following the U.S. Supreme Court's 2018 ruling in *Cyan Inc. v. Beaver County Employees Retirement Fund*. *Cyan* upheld the ability of shareholders to file Securities Act class actions in either state or federal court and determined that such cases filed in state court could not be removed. This led to an explosion of state court class actions asserting violations of Sections 11 and 12 of the Act based on alleged misrepresentations or omissions in the offering documents for IPOs and secondary offerings. Indeed, companies increasingly found themselves litigating duplicative shareholder class actions brought by competing groups of plaintiffs' lawyers simultaneously in federal and state court. (State court is generally viewed by plaintiffs as the more hospitable forum for such cases given, among other things, the arguable inapplicability of various strict pleading requirements and procedural protections for defendants imposed at the federal level by the Private Securities Litigation Reform Act.)

In *Sciabacucchi*, the Delaware Supreme Court first determined that federal forum selection provisions are authorized by Section 102(b)(1) of the Delaware General Corporation Law (DGCL), which permits the adoption of charter provisions "for the management of the business and … conduct of the affairs of the corporation," as well as those "creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders, or any class of the stockholders," so long as "such provisions are not contrary to the laws of this state." Significantly, the Court reasoned that DGCL § 102(b)(1) authorization is not strictly limited to the so-called "internal affairs" of the corporation, but extends to a somewhat broader category of "intra-corporate affairs."

Determining that the federal forum provisions were not contrary to Delaware law or public policy, the Delaware Supreme Court held that they were not facially invalid.[2] The Court further held that the provisions comported with federal law and policy and, while recognizing that it was possible, concluded that it was unlikely that other states would view Delaware as overstepping its bounds by allowing Delaware-incorporated companies to prohibit stockholders from filing securities claims in other state courts.

Noting the absence of a procedural mechanism for consolidating competing federal and state lawsuits, the Delaware Supreme Court recognized that federal forum selection provisions would allow corporations to avoid the risk of inconsistent adjudications and other "costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts," which it characterized as "obvious." Indeed, in the wake of *Cyan*, parallel Securities Act class actions in federal and state court not only subjected corporations to onerous litigation burdens and the risk of inconsistent rulings, but also resulted in increased premiums for D&O insurance. While it remains to be seen, of course, whether courts in other states (for example, a Delaware corporation's headquarters jurisdiction) will enforce these provisions and, to the extent that a petition for *certiorari* is filed, whether the U.S. Supreme Court will take up the issue, in the meantime the Delaware Supreme Court's decision in *Sciabacucchi* is an important affirmation of the power of Delaware-incorporated public companies to manage such costs and risk.

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[1] *Salzberg, et al. v. Sciabacucchi*, No. 346, 2019 (Del. Mar. 18, 2020).

[2] The Court rejected the notion that a charter provision could require Securities Act claims to be resolved in arbitration, as violating DGCL § 115.

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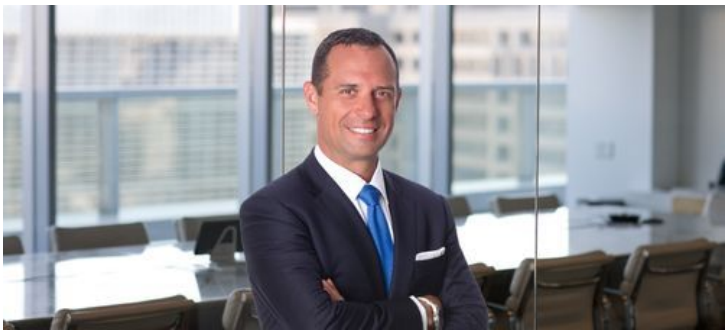

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