

Delaware Supreme Court Rules Federal Forum Provisions for Securities Act Claims in Corporate Charters are Valid

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PRACTICES Securities and Shareholder Litigation

On Wednesday, the Delaware Supreme Court issued an important opinion in *Salzberg v. Sciabacucchi*, --- A.3d ---- (Del. Mar. 18, 2020) that has significant implications for securities class action litigation related to public offerings. The Delaware Supreme Court held that a provision in a corporate charter requiring that claims for violations of the federal Securities Act of 1933 (“Securities Act”) be brought exclusively in federal court is valid under Delaware law. This decision provides an avenue for corporations to avoid the consequences of the U.S. Supreme Court’s ruling in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), which opened the door for shareholders to bring Securities Act claims in state courts (see our coverage [here](#)). After *Salzberg*, corporations should strongly consider adopting an exclusive federal forum provision in their charters or bylaws.

Background and Analysis

The Securities Act grants private rights of action for false or misleading disclosures in the registration statement or prospectus for a public offering against the company, the officers and directors that sign the offering documents, and the underwriting banks. These claims are typically brought as class actions on behalf of purchasers in the offering. In February 2018, the U.S. Supreme Court ruled in *Cyan* that state courts have concurrent jurisdiction with federal courts over Securities Act claims and that actions asserting only Securities Act claims filed in state court could not be removed. Since *Cyan*, the number of Securities Act cases filed in state court has steadily increased.

Section 102(b)(1) of Delaware General Corporation Law allows a certificate of incorporation to include “[a]ny provisions for the management of the business and conduct of the affairs of the corporation” or “creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders.” In reaction to *Cyan*, several corporations, prior to their initial public offerings, adopted “federal forum provisions” in their certificates of incorporation that required shareholders to bring Securities Act claims exclusively in federal court. However, there were questions as to whether these provisions were valid and enforceable under Delaware law.

In *Salzberg*, a plaintiff brought an action in the Delaware Chancery Court challenging the facial validity of federal forum provisions adopted by three separate corporations. The Chancery Court held that federal forum provisions were invalid under Delaware law, reasoning that the “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.”

The Delaware Supreme Court reversed, holding that federal forums provision fit well within the bounds of Section 102(b). The Court stated: “[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 connection with an IPO or secondary offering. The drafting, reviewing, and filing of registration statements by a corporation and its directors is an important aspect of a corporation's management of its business and affairs and of its relationship with its stockholders. . . . [A] bylaw 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,' and is, thus, facially valid under Section 102(b)(1)."

Additionally, the Delaware Supreme Court found that federal forum provisions advance Delaware policy goals because they eliminate the prospect of wasteful multi-forum litigation. According to a study performed by Stanford Law School and cited by the Delaware Supreme Court, 45 percent of Securities Act cases filed in state court in 2019 had a parallel action filed in federal court asserting the same claims. Absent a procedural mechanism by which state and federal Securities Act cases can be consolidated, federal forum provisions facilitate consolidation of Securities Act cases in a single federal forum.

The Delaware Supreme Court further took the position that federal forum provisions in the charters of Delaware corporations should be enforced in other states' courts for several reasons. First, the Court noted that corporate charters are considered contracts among the corporation's shareholders, and contractual forum selection provisions are generally viewed as "presumptively valid," unenforceable only in narrow circumstances where enforcement would be "unreasonable and unjust," involve "fraud or overreaching," or "contravene a strong public policy of the forum in which suit is brought." Second, enforcement of federal forum provisions found in corporate charters complies with the internal affairs doctrine, a conflict of law principle that provides the law of the state of incorporation should govern questions regarding a corporation's internal affairs. Third, federal forum provisions are "process-oriented" and do not alter substantive rights created by other states' laws. And fourth, federal forum provisions are less restrictive than Delaware forum provisions for fiduciary duty claims that have been widely enforced by other states because a plaintiff may still bring a claim in the plaintiff's home state, albeit in federal court.

Implications of *Salzberg*

The implications of *Salzberg* are significant. *Salzberg* essentially allows a Delaware corporation to undo *Cyan* and force plaintiffs to litigate Securities Act claims in federal court. This helps avoid multi-forum litigation and inherent uncertainties associated with litigating Securities Act claims in state court, where rules and procedures are often less clear and less robust than their federal counterparts. Further, litigating Securities Act claims in federal court ensures that all provisions of the Private Securities Litigation Reform Act are enforced. Insurance carriers also may view federal forum provisions as reducing litigation risks associated with public offerings and adjust premiums accordingly.

For companies already facing actual or prospective Securities Act cases in state court, the ability to invoke a federal forum provision retroactively will no doubt be litigated after *Salzberg*. Questions will arise as to whether a federal forum provision is enforceable where it is adopted after Securities Act claims in state court have already been filed or after the offering has occurred, but before a lawsuit has been filed.

Even though *Salzberg* only deals with the validity of federal forum provisions for Delaware corporations, *Salzberg* will likely influence decisions on the validity of federal forum provisions adopted by non-Delaware corporations, given the influence that the Delaware Supreme Court has in this area and because many other states' courts look to Delaware law to interpret their own law.

After *Salzberg*, all corporations should strongly consider adopting a federal forum provision in their certificates of incorporation or corporate bylaws.