

Delaware Supreme Court Finds Federal Forum Provisions Facially Valid

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Speed Read

On March 18, 2020, the Delaware Supreme Court issued a decision in *Salzberg, et al. v. Sciabacucchi*, No. 346, 2019 (Del. Sup. Ct. Mar. 18, 2020), upholding the validity of charter provisions or bylaws that require claims under the Securities Act of 1933 (the “1933 Act”) to be brought in federal court (“Federal Forum Provisions”). Many corporations adopted Federal Forum Provisions in reaction to the United States Supreme Court’s decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), holding that class actions under the 1933 Act could be brought in either state or federal court and, if filed in state court, could not be removed to federal court. While interest in implementing Federal Forum Provisions cooled after a December 2018 decision by the Delaware Court of Chancery that found them invalid, we expect to see substantial interest in adopting and enforcing Federal Forum Provisions following the Delaware Supreme Court’s reversal of that decision – particularly given the significant increase in parallel state and federal securities class actions after *Cyan*.

In its ruling, the Delaware Supreme Court held that Federal Forum Provisions are “facially valid” under Section 102(b)(1) of the Delaware General Corporation Law (the “DGCL”). Under Section 102(b)(1) of the DGCL, provisions for “the management of the business and for the conduct of the affairs of the corporation” or for “creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders” are enforceable if they are not contrary to Delaware law. Citing recent data showing a dramatic increase in the filing of parallel state and federal securities class actions, the Delaware Supreme Court observed that “the costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts are obvious.” It went on to explain that, by “directing 1933 Act claims to federal courts when coordination and consolidation are possible,” Federal Forum Provisions “classically fit the definition of a provision ‘for the management of the business and for the conduct of the affairs of the corporation.’” In addition, because they “prescribe where current and former stockholders can bring Section 11 claims,” Federal Forum Provisions are “defining, limiting and regulating the powers of the corporation, the directors, and the stockholders.” The Delaware Supreme Court went on to find that Federal Forum Provisions do not violate the policies or laws of Delaware because, among other things, “stockholder-approved charter amendments”—such as Federal Forum Provisions—“should be respected as a matter of policy.”

The Delaware Supreme Court rejected the argument that Section 115 of the DGCL—which provides that “no provision of the certificate of incorporation or the bylaws may prohibit bringing [internal corporate claims] in the courts of [Delaware]”—“reflects either prohibition [of Federal Forum Provisions] or implicit recognition that [Federal Forum Provisions] were never authorized by Section 102(b)(1) in the first place.” Specifically, the Delaware Supreme Court found that Section 115 applies only to “internal corporate claims,” which are limited to claims “based upon a violation of a duty by a current or former director or officer or stockholder in such capacity” or “as to which [the DGCL] confers jurisdiction upon the Court of Chancery.” The Delaware Supreme Court held that Section 115 does not apply to all other “intra-corporate litigation,” including at least certain suits under the 1933 Act.

The Delaware Supreme Court also rejected the Court of Chancery's conclusion that Section 102(b)(1) is limited to "internal affairs." It explained that the Court of Chancery misinterpreted *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), and *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013), by limiting intra-corporate litigation to internal affairs (*i.e.*, state law fiduciary duty claims) and distinguishing them from "'external' claims" (*e.g.*, tort claims). Instead, the Delaware Supreme Court observed that there is a category of intra-corporate litigation that is "situated on a continuum between the *Boilermakers* definition of 'internal affairs' and its description of purely 'external claims'" that encompasses at least some claims under the 1933 Act. That intra-corporate litigation is a proper subject of Federal Forum Provisions.

Although the Delaware Supreme Court has now upheld the validity of Federal Forum Provisions in the context of a facial challenge, we expect that securities plaintiffs will continue to challenge Federal Forum Provisions by arguing that not all suits under the 1933 Act fall within the definition of intra-corporate litigation. Corporations considering amending their charters or bylaws to incorporate Federal Forum Provisions will need to take steps to ensure that those provisions are able to withstand such challenges.

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