

UPDATES

# Delaware Supreme Court Upholds Federal Forum Provisions

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## Delaware Supreme Court Upholds Federal-Forum Provisions

On March 18, 2020, the Supreme Court, in *Salzberg v. Sciabacucchi*, upheld the validity under Delaware law of “federal-forum provisions,” in which Delaware corporations mandate that claims brought under the Securities Act of 1933 be filed in a federal court.

The highly anticipated opinion, reversing a Chancery Court decision, underscores Delaware’s preference for private ordering and confirms that corporate managers and stockholders have significant latitude in choosing the fora for certain types of litigation. While the decision confirms the facial validity of this particular type of forum provision, other ramifications of this decision remain unclear, and this topic will undoubtedly be the subject of further litigation or possibly legislative action.

## Background and the Delaware Court of Chancery Decision

*Sciabacucchi* arose from the 2017 initial public offerings of three Delaware corporations, each of which had adopted a federal-forum provision in its respective certificate of incorporation, requiring that any claim brought under the Securities Act of 1933 be filed in a federal district court rather than a state court. The provisions did not restrict filing to a federal district court of any particular state.

The Delaware Court of Chancery held that these provisions were invalid, finding that Section 102 of the Delaware General Corporation Law (DGCL) permitted corporations to regulate through their bylaws and charters “internal” claims but not “external” claims. The Court of Chancery held that 1933 Act claims were the latter because they were not required to be brought by a stockholder in his or her capacity as a stockholder; for instance they could be brought by a former stockholder. Accordingly, the court concluded that federal-forum provisions were invalid and unenforceable. This outcome was consistent with the court’s alternative analysis focused on “first principles” of Delaware law, that is, the genesis of a corporation’s power and authority. A corporation is “created through the sovereign power of the state,” which has limits; the court thus concluded that 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 Reverses and Upholds Federal-Forum Provisions**

The Delaware Supreme Court reversed the lower court's decision, holding that the federal-forum provisions were facially valid under Delaware law. In so concluding, the Delaware Supreme Court confirmed that the DGCL, including Section 102(b)(1) governing the contents of a certificate of incorporation, is flexible and authorizes provisions governing intra-corporate matters (e.g., provisions "creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders"). The Delaware Supreme Court held that 1933 Act federal securities claims constitute "intra-corporate claims," within the scope of Section 102(b)(1).

The court was strongly influenced by its conclusion that upholding the federal-forum provisions would generate efficiencies in the wake of the United States Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, which held that 1933 Act claims that are brought in state court may not be removed to federal court. The Delaware Supreme Court explained that "federal-forum provisions" adopted in response to *Cyan* would properly consolidate 1933 Act actions against Delaware corporations in federal court. More fundamentally, the court concluded that the private ordering reaction to *Cyan* reflected that "the DGCL allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance, and governance of their enterprise."

### ***Sciabacucchi's* Implications**

The immediate effect of *Sciabacucchi* is that a Delaware corporation is permitted to require, through its charter, that a claim against it under the 1933 Act be litigated in a federal court. But the holding was rendered in connection with a "facial challenge," meaning plaintiffs challenged the federal forum provision in the abstract rather than on an "as applied" basis. Thus, although the court held that such provisions are not facially invalid, the court left open the "down the road" question of whether federal-forum provisions in the charters of Delaware corporations will be respected and enforced by other states while noting its view that sister states should enforce these provisions. That issue is set to be litigated in state courts outside Delaware in the coming months, particularly in California where similar 1933 Act cases have been stayed in anticipation of this decision from the Delaware Supreme Court. Resolution of this issue is the necessary next step toward reversing the growing trend of parallel 1933 Act litigation in state and federal court.

The flexibility *Sciabacucchi* exemplifies leaves open the potential adoption of other alternative forum provisions. Some have hypothesized this could extend as far as mandatory arbitration provisions governing certain securities claims. In the wake of the *Sciabacucchi* decision, corporations and directors should discuss with their counsel the possibility of these and other specific forum provisions designed to facilitate the efficient resolution of intra-corporate disputes.

Another topic of likely interest for many public, or hoping to be public, Delaware companies is what effect this decision will have on the cost of insurance. The premiums for D&O insurance as well as the size of retention limits has increased in the past several years in part due to the increased litigation costs of parallel litigation and concerns about litigating securities claims in state courts. The *Cyan* effect on insurance rates is only one factor leading to increased premiums; larger monetary derivative settlements and increased potential for claims have also contributed to increased premiums.

## CONTACTS

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