

Delaware Supreme Court Rules Federal-Forum Provisions Survive Facial Challenge Under Delaware Corporate Law

On March 18, 2020, the Delaware Supreme Court unanimously held in *Salzberg v. Sciabacucchi*, 2020 WL 1280785 (Del. Mar. 18, 2020), that federal-forum provisions — clauses in a corporation’s certificate of incorporation requiring that any cause of action against the corporation arising under the federal Securities Act of 1933, as amended (the Securities Act), be brought in a federal district court — do not violate Delaware corporate law, overruling a previous decision by the Delaware Court of Chancery. Writing for the Court, Justice Karen Valihura held that such provisions fall within 8 *Del. C.* § 102(b)(1) and do not frustrate state public policy. The closely-watched decision is likely to increase the number of Delaware corporations adopting federal-forum provisions to reduce parallel securities litigation in state courts.

I. Background

In 2018, the U.S. Supreme Court’s decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), held that federal and state courts have concurrent jurisdiction over claims brought under the Securities Act and that such cases may not be removed from state court to federal court. That decision significantly increased the number of Securities Act cases filed in state court; according to one analysis, there were 55% more state-only filings than federal-only filings following *Cyan* in 2018, and the number of state Securities Act filings increased by 40% from 2018 to 2019.¹ The same analysis found an increase in concurrent state and federal filings, which, post-*Cyan*, left defendants with “no procedural mechanism. . . available to consolidate or coordinate multiple suits in state and federal court.”² Many commentators have suggested that, because of these trends, the costs of directors’ and officers’ (D&O) insurance have risen considerably.³

In response to these trends, corporations began inserting federal-forum provisions into their certificates of incorporation, requiring that any claim arising under the Securities Act be brought in federal court. In 2017, three Delaware corporations — Blue Apron Holdings, Inc., Roku, Inc., and Stitch Fix, Inc. — adopted such provisions before their respective initial public offerings (IPOs). Roku and Stitch Fix adopted substantively identical provisions:

Unless the Company consents in writing to the selection of an alternative forum, the federal district courts of the United States of America shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933. Any person or entity purchasing or otherwise acquiring any interest in any security of [the Company] shall be deemed to have notice of and consented to [this provision].⁴

The plaintiff in this case, Matthew Sciabacucchi, bought shares of common stock of each company, and subsequently filed a putative class-action complaint seeking a declaratory judgment that the federal-forum

¹ *Salzberg v. Sciabacucchi*, 2020 WL 1280785, at *5 (Del. Mar. 18, 2020) (citing Stanford Law Sch. Secs. Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings 2018 Year in Review* (2019)).

² *Id.*

³ See, e.g., Ivan J. Dolowich, Esq., et al., *The Impact of Cyan on Public Companies and the D&O Insurance Marketplace*, Thomson Reuters, https://www.kdvlaw.com/wp-content/uploads/2018/05/Westlaw_5-10-18_Cyan_Case_KDV.pdf.

⁴ *Sciabacucchi v. Salzberg*, 2018 WL 6719718, at *6 (Del. Ch. Dec. 2018). While Blue Apron’s provision differed slightly, the Delaware Supreme Court held that such difference in language was “immaterial” to its decision. *Salzberg v. Sciabacucchi*, 2020 WL 1280785, at *3 n.25 (Del. Mar. 18, 2020).

provisions were invalid under Delaware law. The Delaware Court of Chancery ruled for the plaintiff, and the defendant corporations and their officers appealed.

II. The Delaware Supreme Court Upholds the Federal-Forum Provisions

Reversing the opinion of the Court of Chancery, the Delaware Supreme Court ruled that the federal-forum provisions did not violate Delaware law. The Court took a textualist approach to the issue and first examined whether such provisions are valid under Delaware General Corporation Law (DGCL) Section 102, which governs the matters contained in a corporation's certificate of incorporation. Section 102(b)(1) authorizes:

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. . . if such provisions are not contrary to the laws of this State.⁵

Finding that 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 investors,” the Court held that they could “easily fall within either of these broad [Section 102(b)(1)] categories,” and that such provisions were therefore facially valid under Delaware law.⁶ The Court overruled the lower court’s attempt to narrow Section 102(b)(1) in a manner that would prohibit federal-forum provisions, rejecting its reasoning that a Securities Act claim is “external to the corporation.”⁷ Instead, relying on Delaware Supreme Court precedent, the Court determined that federal-forum provisions could govern “intra-corporate claims” or disputes between stockholders and directors that are “within the boundaries of the DGCL, and specifically Section 102(b)(1).”⁸ The Court further determined that the 2015 amendments to the Delaware General Corporation Law did not modify the broad scope of Section 102(b)(1).⁹

In addition, the Court held that the federal-forum provisions also survived a facial challenge as a matter of public policy. The Court noted that the DGCL aims to promote certainty, uniformity, and prompt judicial resolution to corporate disputes, and that federal-forum provisions “advance these goals.”¹⁰ While the Court expressed some concern that specific, future federal-forum provisions might not be enforced by other states, it concluded that such provisions did not offend principles of horizontal sovereignty as a facial matter.¹¹ The Court therefore concluded that the federal-forum provisions were valid as a matter of both Delaware corporate law and state public policy.

⁵ *Salzberg v. Sciabacucchi*, 2020 WL 1280785, at *4 (Del. Mar. 18, 2020).

⁶ *Id.* While the Court determined that federal-forum provisions survived a facial challenge, it left open the possibility that specific provisions might be invalid under an as-applied challenge. *Id.* at *21 (noting that the court was “not considering hypothetical, contextual situations regarding the adoption or application of FFPs.”)

⁷ *Sciabacucchi v. Salzberg*, 2018 WL 6719718, at *1 (Del. Ch. Dec. 19, 2018).

⁸ *Salzberg v. Sciabacucchi*, 2020 WL 1280785, at *13 (Del. Mar. 18, 2020) (relying on *ATP Tour, Inc. v. Deutscher Tennis Brand*, 91 A.3d 554 (Del. 2014)).

⁹ *Id.* at *7.

¹⁰ *Id.* at *23.

¹¹ *Id.*

III. Implications

The Delaware Supreme Court's decision in *Salzberg* is likely to incentivize pre-IPO Delaware corporations to adopt federal-forum provisions in their certificates of incorporation to avoid the risk of duplicative Securities Act litigation in both state and federal court. Mature companies may also look to amend their bylaws to include federal-forum provisions. If such widespread adoption occurs, the potential reduction in concurrent state and federal securities litigation may create downward pressure on the rates for directors' and officers' liability insurance.

While the decision conclusively determines the facial validity of federal-forum provisions under Delaware law, plaintiffs retain the ability to bring as-applied challenges. The Court specifically noted in its opinion that federal-forum provisions might be invalidated if they are unreasonable and unjust, fraudulent or over-reaching, or if they are applied in a manner that contravenes Delaware public policy.¹² We can expect to see a substantial number of as-applied challenges to such provisions in the near future.

Finally, it also remains to be determined whether other state courts outside of Delaware will reach similar conclusions on this issue.

* * *

If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Joel Kurtzberg at 212.701.3120 or jkurtzberg@cahill.com; or Benjamin Lash at 212.701.3312 or blash@cahill.com; or email publications@cahill.com.

¹² *Id.* at *21 (citing *M/S Bremen v. Zapata Off-Shore Co.*, 401 U.S. 1, 15 (1972)).