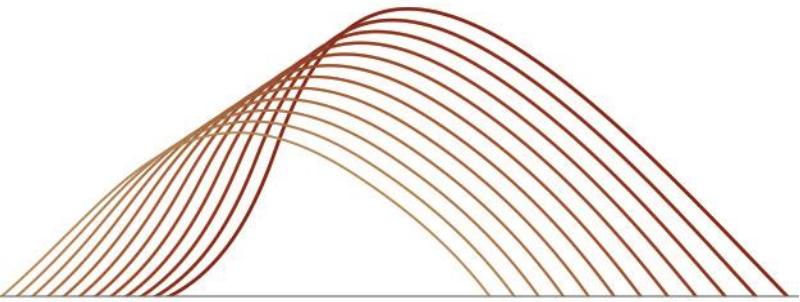


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Delaware Supreme Court Validates Federal Forum Provisions: A Solution to the Explosion of State Court Securities Act Litigation?

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Yesterday in *Salzberg v. Sciabacucchi*, No. 346, 2019, the Delaware Supreme Court upheld the facial validity of federal forum provisions in corporate charters requiring that claims arising under the Securities Act of 1933 (the "33 Act") be filed in federal court. The ruling reverses the Court of Chancery's December 2018 opinion holding that such provisions are invalid to the extent they prescribe the forum of an "external claim" that does not arise under Delaware corporate law. While there remain potential challenges to federal forum provisions, the Delaware Supreme Court's decision clears a path for corporations and their stockholders to take action to curb abuses from concurrent state and federal court litigation of '33 Act claims.

Background

In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), the United States Supreme Court unanimously held that federal and state courts have concurrent jurisdiction over class actions brought under the '33 Act. Unsurprisingly, *Cyan* brought about a surge of '33 Act litigation in state courts, many of which have lack the procedural protections, such as heightened pleading requirements or a stay of discovery, that apply in federal courts under the Private Securities Litigation Reform Act. Moreover, it has been common for identical '33 Act causes of action to be filed in both state and federal courts, leaving corporate defendants adrift without a procedural mechanism to consolidate or coordinate these parallel proceedings. Litigation costs and judicial inefficiencies multiplied. As a result, director and officer liability insurance premiums for '33 Act causes of action have skyrocketed over the last two years.

Borrowing from forum bylaws limiting internal corporate claims to the courts of a company's state of incorporation, some corporations and their stockholders included within corporate charters federal forum provisions to address the problem of '33 Act state court litigation. These federal forum provisions generally provide that, unless the company consents in writing to the selection of an alternative forum, a complaint asserting a cause of action arising under the '33 Act must be brought in a United States District Court.

A stockholder plaintiff challenged the federal forum provisions adopted by three Delaware corporations as violating Delaware corporate law. In the proceedings below, the Court of Chancery agreed with the plaintiff and invalidated the provisions. On appeal, the Delaware Supreme Court reversed.

Supreme Court Holds Federal Forum Provisions Are facially Valid

The Delaware Supreme Court found that federal forum provisions are facially valid under Section 102(b)(1) of the Delaware General Corporation Law (the "DGCL"). Section 102(b)(1) broadly authorizes a certificate of incorporation to include "**any** provision for the management of the business and for the conduct of the affairs of the corporation" or "**any** provision . . . limiting and regulating the powers of . . . the stockholders, or any class of stockholders, . . . if such provisions are not contrary to the laws of this State." The Court quickly dispensed with the notion that federal forum provisions do not fall within these broad categories. Indeed, a federal forum provision involves a type of securities claim arising out of the Board's disclosures in connection with an IPO or secondary offering, which disclosures are an "important aspect of a corporation's management of its business and affairs and of its relationship with its stockholders."

In emphasizing Section 102(b)(1)'s broad scope, the Delaware Supreme Court rejected the Court of Chancery's rationale that Section 102(b)(1) is limited by Section 115 of the DGCL. Section 115 essentially states that a company's certificate of incorporation or bylaws may provide that any and all internal corporate claims must be brought in the courts in Delaware. The Delaware Supreme Court held that when it adopted Section 115, the Delaware General Assembly did not amend Section 102(b)(1) to limit its reach.

The Delaware Supreme Court further held that the Court of Chancery narrowed the definition of the "internal affairs" doctrine recognized by the United States Supreme Court in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), and by the Delaware Supreme Court in *McDermott v. Lewis*, 531 A.2d 206 (Del. 1987). The Delaware Supreme Court explained "internal affairs" more properly refer to "matters which are peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders," aligning the United States and Delaware Supreme Courts' definitions of the term. As a result, the Delaware Supreme Court rejected the Court of Chancery's "binary" division between internal and external claims, holding there was a third category of "intra-corporate affairs" that extend beyond more traditional "internal affairs" but which fall short of being an external matter. While a '33 Act claim may not fall within most "internal affairs," such a claim could still be an "intra-corporate affair" falling within the purview of Section 102(b)(1).

Lastly, the Delaware Supreme Court concluded that a federal forum provision would not violate federal law or policy. In reaching this conclusion, the Court relied primarily on *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989), in which the United States Supreme Court held that federal law does not prohibit arbitration agreements for '33 Act claims. Indeed, the Supreme Court noted a number of factors lending greater support to the validity of federal forum provisions as compared to an arbitration agreement: (1) if included in a certificate of incorporation, such provisions must be approved by a stockholder vote; (2) Delaware generally enforces forum-selection provisions in a contract; and (3) sophisticated investors are free to bind themselves to a federal forum provision.

Looking Ahead

While *Salzberg* settles the facial validity of a federal forum provision pursuant to Delaware law, left for another day are: (1) any "as applied" challenges to a specific federal forum provision; (2) the deference other states would give to a federal forum provision; and (3) how federal courts will respond to federal forum provisions. Even though these challenges are for tomorrow, the Delaware Supreme Court has validated a potentially powerful tool for a corporation and its stockholders to close the door on burdensome and duplicative litigation of '33 Act claims left open by the United States Supreme Court's decision in *Cyan*.

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