

CLIENT ALERT

# Delaware Supreme Court Reverses Court of Chancery and Upholds Use of Exclusive Federal Forum Charter Provisions for Securities Act Claims

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On March 18, 2020, the Delaware Supreme Court issued its highly anticipated decision in *Salzberg v. Sciabacucchi*, reversing the Court of Chancery and holding that corporate charter provisions requiring stockholders to bring claims under the Securities Act of 1933 exclusively in federal court are facially valid. Although there remain lingering questions about the enforceability of such provisions outside of Delaware, there is no doubt that the decision gives corporations an important tool in stemming the tide of Securities Act class action claims brought in state courts, often in parallel with federal court lawsuits, following the United States Supreme Court's 2018 ruling in *Cyan, Inc. v. Beaver Cnty Employees Ret. Fund*.

In a December 2018 ruling, the Court of Chancery held that such exclusive federal forum provisions are invalid because, among other reasons, claims under the Securities Act are not "internal affairs" claims against a corporation's directors and officers and, therefore, fall outside the scope of a Delaware corporation's authority to adopt charter and bylaw provisions restricting the forum in which a stockholder may bring such claims. In so concluding, the Court of Chancery reasoned that claims under the Securities Act are created and defined by federal law and, as a result, do not turn on the rights of the shares, language in the corporation's charter or bylaws, or any provision in the Delaware General Corporation Law (the "DGCL").

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In reversing the Court of Chancery's ruling, the Delaware Supreme Court held that federal forum provisions are authorized under the "plain text" of the DGCL. In particular, the Supreme Court ruled that such provisions fall squarely within the scope of Section 102(b)(1) of the DGCL, which is "broadly enabling" and permits the adoption of charter provisions addressing, among other things, "the management of the business" and "the conduct of the affairs of the corporation." The Supreme Court found that the Court of Chancery had interpreted the statute too narrowly when it found that charter provisions could govern only "internal affairs" claims (such as breach of fiduciary duty), and not "intra-corporate" litigation (such as claims brought under the Securities Act).

The Delaware Supreme Court also addressed a number of policy arguments raised by the parties. It held that federal forum provisions are not contrary to Delaware public policy, which favors "flexibility and wide discretion for private ordering and adaptation to new situations." Such provisions, the Supreme Court recognized, offer corporations "certain efficiencies of managing the procedural aspects of securities litigation," including a way for corporations to avoid the all-too-common burden of confronting multiple, duplicative suits across state and federal courts. The Supreme Court further reasoned that federal forum provisions do not violate federal law or public policy, though it acknowledged that "the most difficult aspect of this dispute is . . . [the] question of whether [these provisions] will be respected and enforced by our sister states" when companies seek to enforce the provisions to dismiss state court cases. But the Supreme Court opined that, in its view, federal forum selection provisions do not "offend principles of horizontal sovereignty" because they are procedural and not substantive, and therefore should be upheld.

The Delaware Supreme Court also dismissed the concern raised by some commentators that, if federal forum selection provisions were permitted, the "next move" would be provisions requiring mandatory stockholder arbitration. The Court explained that such a provision would violate the DGCL, which states that "no provision . . . may prohibit bringing such claims in the Courts of this State."

The Delaware Supreme Court's decision reaffirms a number of core policies underlying Delaware's corporate laws and, in upholding the use of federal forum provisions, has provided Delaware corporations with a vital mechanism to manage the costs and risks posed by state court Securities Act class action lawsuits, particularly post-*Cyan*. As foreshadowed by the decision, it remains to be seen whether these charter provisions will be enforced by courts in other states faced with such claims or how those courts will react to *Salzberg*-based motions. There is, therefore, a risk of continued appeals or collateral challenges to this ruling outside of Delaware. The Delaware Supreme Court also indicated that although federal forum provisions are not facially invalid, they could still be challenged if applied in an inequitable manner in specific cases. Accordingly, clients should consult with counsel to determine the impact of the decision on a case-by-case basis.

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If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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