Delaware Business Court Insider

# 'Sciabacucchi': Federal Forum Selection Clauses a Year Later

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By **Sameer Advani and Alexander Cheney** | May 26, 2021

In March 2020, the Delaware Supreme Court issued its landmark decision in *Salzberg v. Sciabacucchi* holding that forum selection clauses in corporate charters requiring that stockholder claims under the Securities Act of 1933 be brought exclusively in federal court are facially valid and enforceable. While *Sciabacucchi* definitively answered that question under Delaware law, it left at least one question unanswered: would courts in other states enforce such federal forum provisions (FFPs) in the charters of Delaware corporations? Now that a little more than a year has passed, and despite some pointed criticism of the *Sciabacucchi* decision by other state courts, the answer—at least so far—appears to be yes.

## The 'Sciabacucchi' Decision

In *Sciabacucchi*, stockholders who had purchased shares of three companies in their initial public offerings (Apron Holdings, Roku and Stitch Fix) sought declaratory judgment that FFPs adopted in each company's charters were invalid under Delaware law. The Delaware Court of Chancery agreed, holding that, because Securities Act claims do not involve the "internal affairs" of the corporation, a Delaware corporation cannot restrict the forum in which a stockholder may litigate claims under that federal statute.

However, the Delaware Supreme Court reversed. It found that the challenged FFPs fell within the "broadly enabling" scope of Section 102(b)(1) of the Delaware General Corporation Law (the DGCL), and were not contrary to Delaware public policy, federal law or federal public policy. Section 102(b)(1) authorizes two types of provisions: "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." The FFPs were facially valid, the court held, because they could "easily fall within either of those broad categories."

In reaching this decision, the court recognized that there had been a significant escalation of Securities Act class action lawsuits filed in state courts following the U.S. Supreme Court's 2018 ruling in *Cyan v. Beaver County Employees Retirement Fund*, which held that state and federal courts have concurrent jurisdiction over Securities Act claims. The court also acknowledged the resulting costs, inefficiencies, and possibility of inconsistent judgments and rulings when plaintiffs file parallel state and federal actions. Given this reality, the court reasoned that charter provisions directing Securities Act claims to federal courts "classically fit" the definition of a business management provision authorized under Section 102(b)(1), as well as one regulating the powers of stockholders.

Ultimately, the *Sciabacucchi* holding has been crucial in enabling Delaware corporations to adopt provisions to protect themselves from being dragged by different plaintiff groups into costly, multiforum Securities Act litigation. However, *Sciabacucchi* left unanswered whether courts outside of Delaware would enforce FFPs in Delaware corporate charters or how they would address *Sciabacucchi*-based dismissal motions. As the Delaware Supreme Court acknowledged, "perhaps the most difficult aspect of this dispute is not with the facial validity of FFPs, but rather, with the 'down the road' question of whether they will be respected and enforced by our sister states." Now that slightly more than a year has passed since *Sciabacucchi*, the indications are that other state courts will enforce these FFPs, at least on a case-by-case basis.

## State Court Enforcement of Federal Forum Provisions Since 'Sciabacucchi'

Since *Sciabacucchi*, four cases outside of Delaware have ruled on the enforceability of FFPs in Delaware corporate charters with respect to Securities Act claims—and they are all in California. In *Shen v. Casa Systems*, (Mass. Super. Jan. 11, 2020), the Superior Court of Massachusetts considered, but did not decide, the question of whether the defendant issuer's FFP was valid in the context of a stockholder's Massachusetts state court lawsuit under the Securities Act. Instead, the court dismissed the plaintiffs' claim for failure to state a claim upon which relief may be granted. The court did, however, indicate in dicta that the FFP was "likely" facially valid. In each case, the court upheld the FFP.

The first case to substantively address this issue was *Wong v. Restoration Robotics,* (Cal. Super. Ct. Sept. 1, 2020). There, Restoration Robotics, a Delaware corporation with its principal place of business in California, adopted an FFP in its amended and restated certificate of incorporation in connection with its initial public offering (IPO). After a stockholder brought a Securities Act claim in California state court, defendants filed a motion to dismiss for forum non conveniens seeking enforcement of the FFP.

Although describing the holding in *Sciabacucchi* as "basically irrelevant" to the question of whether the FFP was valid and enforceable under California or federal law, the court

nevertheless undertook a detailed analysis of the Delaware Supreme Court's decision. In particular, the court was critical of the Delaware Supreme Court's reasoning that FFPs do not violate federal public policy, noting that the Delaware Supreme Court provided "no actual analysis of whether the FFP was contrary to federal law," and that the decision "jumbled" together different cases with different tests to reach that conclusion. The *Restoration Robotics* court also disagreed with the Delaware Supreme Court's suggestion that the issue of FFP enforceability is comparable to that of an arbitration clause or a settlement release, instead finding the provision "most akin to a contractual forum selection clause."

Applying California law with respect to the enforceability of contractual forum selection clauses, the *Restoration Robotics* court held that the plaintiffs failed to satisfy their burden of showing that the provision was unfair or unreasonable. As the court reasoned, "there is no disruption of the substantive rights of the shareholders to all protections provided by the Securities Act of 1933—only the procedural aspect of state versus federal forum. There is no procedural loss of Due Process, as they can present their federal law claims to a federal court, in a state or province of a state close to their residence, have the opportunity for discovery, and trial by jury. There is even greater authority in federal court to obtain personal jurisdiction over defendants, and to subpoena witnesses to trial."

Further, the court found that, even if it analyzed the FFP like it would an arbitration provision, the FFP nonetheless would be valid. Under California law, a party opposing enforcement of a valid arbitration provision has the burden of demonstrating that the provision is both procedurally and substantively unconscionable. The *Restoration Robotics* court explained that the FFP was procedurally unconscionable because it was unilaterally adopted without arm's length negotiation, solely benefited the company and was "buried" in dense public filings. However, the court found that the plaintiffs failed to show, as they must, that the FFP was substantively unconscionable given that it "does not take away the rights of the parties to litigate in court, or to have a jury trial, or to appeal, etc." The *Restoration Robotics* court briefly discussed—though declined to decide—the plaintiffs' assertion that Section 102 of the DGCL is unconstitutional under the Commerce Clause and the Supremacy Clause of the U.S. Constitution, finding that question "was not the proper subject of a California court adjudication of a motion to dismiss for forum non conveniens."

Accordingly, notwithstanding its view that FFPs are a means to "circumvent" Congress, the Securities Act, and the *Cyan* decision, the court exercised its discretion under California law to enforce the provision and dismiss the case against the company and its officers and directors. The court denied, however, parallel motions to dismiss filed by, among others, the underwriters in the company's IPO on the grounds that those defendants were neither parties nor signatories to the certificate of incorporation and, therefore, could not seek to enforce the FFP.

The second case to address FFPs was *In re Uber Technologies Securities Litigation*, No. CGC-19-579544 (Cal. Super. Ct. Nov. 16, 2020), which involved motions to dismiss Securities Act claims arising out of Uber's IPO on the basis of an FFP in the company's charter. As

in *Restoration Robotics*, the court applied California law regarding contractual forum selection provisions to assess the validity and enforceability of the FFP.

As a threshold matter, the court rejected the plaintiffs' argument that the FFP was not a valid contractual obligation because it was adopted without negotiation, holding that "California law does not require forum selection clauses to be freely negotiated." Similarly, the court ruled that the provision was not "unlawful" under the Securities Act's concurrent jurisdiction and anti-removal protections (as interpreted by *Cyan*) because the defendants never attempted to remove the case, and *Cyan's* holding of concurrent jurisdiction did not address whether corporations can select federal courts as the exclusive forum.

On the question of whether the plaintiffs had met their burden of showing that enforcement of the FFP would be unreasonable or unfair, the court's analysis was largely consistent with *Restoration Robotics*. Specifically, the court found that certain elements of the FFP—including the lack of negotiation and that the FFP was "buried" in SEC filings—were sufficient to constitute procedural unconscionability. It also declined to find substantive unconscionability because the FFP did not "eliminate the substantive protections provided by the Securities Act itself." Unlike *Restoration Robotics*, however, the *Uber* court granted the dismissal motion filed by the underwriter defendants, even though they were not parties to the charter, because the FFP applied to "any complaint" asserting Securities Act claims and to hold otherwise would "permit a plaintiff to sidestep a valid forum selection clause."

The next case to address the enforceability of an FFP was *In re Dropbox Securities Litigation*, No. 19-CIV-05089 (Cal. Super. Ct. Dec. 4, 2020). Shortly after, in *In re Sonim Technologies Securities Litigation*, No. 19-CIV-05564 (Cal. Super. Ct. Dec. 7, 2020), the same judge granted a motion to dismiss based on forum non conveniens, holding that the stockholders were bound by the FFP in Sonim's charter. However, in reaching this determination, the court relied entirely on the *Dropbox* ruling, finding that it "applies equally to the parties here, including the joinder of the underwriting defendants." In that case, Dropbox adopted an FFP in its bylaws and filed a forum non conveniens motion seeking dismissal of Securities Act litigation on the basis of the FFP and the *Sciabacucchi* ruling.

In granting the motion to dismiss, the court first addressed the plaintiffs' argument that stockholders had an "absolute" right to litigate Securities Act claims in state court under *Cyan* and the statute's anti-waiver provision. As in *Uber*, the court rejected that argument, finding ample support under both California law and U.S. Supreme Court precedent for the proposition that stockholders could waive their right to have Securities Act claims adjudicated in state court. Moving next to the question of enforceability, the court held that the plaintiffs failed to meet their burden of demonstrating that the FFP was unfair or unreasonable. In particular, the lack of negotiation or individual assent by stockholders to the FFP was insufficient to show that it was "outside their reasonable expectations." Nor did the court find that the FFP was unenforceable on the grounds of unconscionability. Like the courts in *Restoration Robotics* and *Uber,* the court acknowledged that the FFP was drafted by Dropbox and presented on a take-it-or-leave-

it basis and, therefore, contained "some procedural unconscionability." However, as in the prior cases, the provision was not found to be substantively unconscionable because Dropbox articulated a "legitimate business need" for its adoption—the avoidance of unnecessary costs and burdens of duplicative litigation—and the plaintiffs could not identify the loss of any substantive rights under the Securities Act if they were required to litigate in federal court. Although the court also dismissed the claims against the underwriters and other non-company defendants, it did so without addressing the issue of whether those defendants, as non-parties, could enforce the FFP. Rather, the court exercised its discretion to dismiss the entire action "on the grounds of economy and efficiency."

## Conclusion

Thirteen months after the *Sciabacucchi* decision, the California trial courts to address the issue have all enforced FFPs in Delaware charters or bylaws. While this is no doubt welcome news for corporations that have adopted FFPs, and it suggests that the concerns raised in *Sciabacucchi* about sister states potentially refusing enforcement of such provisions were perhaps overstated, it remains to be seen whether the trend toward enforcing FFPs will continue, particularly in other states that have yet to address the issue.

It also remains to be seen whether the Delaware Supreme Court's interpretation of Section 102 of the DGCL will be challenged as unconstitutional for violating the commerce and supremacy clauses of the U.S. Constitution. As discussed above, that argument was raised by the various plaintiffs in the California cases, and it would not be surprising if this issue is eventually addressed by the federal courts.

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