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Delaware Supreme Court Authorizes Inclusion of Federal Forum Provisions in Corporate Charters

The Delaware Supreme Court recently issued its highly anticipated decision in *Salzberg v. Sciabacucchi*, in which it unanimously held in an *en banc* opinion that federal forum provisions found in a corporate charter, or "FFPs," which require that stockholders file all claims arising under the Securities Act of 1933 (the "'33 Act"), in federal court are facially valid under the Delaware General Corporation Law ("DGCL"). Such FFPs have been adopted with increasing frequency in recent years in response to corporations being subjected to nearly identical '33 Act suits in both federal and state courts.

Factual and Procedural Background

The validity of FFPs has become an issue of significant importance following the March 2018 decision of the U.S. Supreme Court in *Cyan, Inc. v. Beaver County Employees Retirement Fund*,[1] which permitted stockholders to assert '33 Act claims in state courts, and held that such claims are not removable to federal court. Following that decision, stockholder plaintiffs flocked to state courts to file '33 Act claims, where plaintiffs argue that their suits are not subject to the provisions of the Private Securities Litigation Reform Act of 1995 ("PSLRA")—including the enhanced pleading standard and the automatic stay of discovery during the pendency of a motion to dismiss.[2] This migration to state court has also created the reality that corporate defendants are now regularly subject to parallel '33 Act claims in multiple jurisdictions, as there is no mechanism to consolidate that redundant litigation. These developments have increased litigation costs, subjected defendants to potentially inconsistent rulings on the same claims, and have contributed to a rise in insurance premiums.

The nominal defendants in *Salzberg* were three early adopters of FFPs, as each included an FFP in their corporate charters in connection with their respective IPOs.[3] The plaintiff, an individual stockholder of all three defendants, sought a declaratory judgment that the defendants' FFPs were facially invalid under Delaware law. Relying on interpretations of the DGCL and "first principles" of Delaware law, Vice Chancellor Travis Laster of the Court of Chancery concluded that the FFPs were "ineffective and invalid." In particular, the Court of Chancery held that '33 Act claims were "external" claims because they arose under federal law and that Delaware corporations therefore could not properly enact forum selection provisions governing such external claims. The Court of Chancery also awarded the plaintiff's attorneys $3 million in fees.

Delaware Supreme Court Decision

In reversing the Court of Chancery, the Delaware Supreme Court emphasized the high bar the plaintiff faced in asserting a facial challenge to the FFPs, as he was required to "show that the charter provisions cannot operate lawfully or equitably ***under any circumstances***." The Supreme Court then held that the challenged FFPs were authorized under DGCL Section 102(b)(1) and thus facially valid under Delaware law. In so holding, the court conducted a "plain language" statutory analysis, concluding that the FFPs applied to "intra-corporate claims," which are governed by the "broad, enabling text of [DGCL] Section 102(b)(1)," which authorizes (1) "*any* provision for the management of the

[1] 138 S. Ct. 1061 (2018).

[2] The Delaware Supreme Court cites data showing a 55% increase in state court '33 Act filings in 2018, and an additional 69% increase in 2019. The court also notes that, since *Cyan*, 43 actions have been filed in multiple jurisdictions under the '33 Act regarding the same public disclosures.

[3] As the Delaware Supreme Court noted, one of the defendants, Blue Apron, had a slightly different provision than the other two defendants, as its FFP stated that it applied only "***to the fullest extent permitted by law***."

business and for the conduct of the affairs of the corporation," and (2) "any provision . . . regulating the powers of the corporation, the directors, and the stockholders." The court held that FFPs could "easily fall within" either of these far-reaching categories.

The Supreme Court further held that the 2015 amendments to the DGCL—which enacted Section 115 to authorize exclusive Delaware forum selection bylaws for "internal corporate claims" while precluding charter or bylaw provisions from ***excluding*** Delaware as a forum for or from imposing fee-shifting in connection with such claims—did not require a different a result because "Section 102(b)(1) is unquestionably broader than, and is not circumscribed by, Section 115's definition of 'internal corporate claims.'" The court explained that while Section 115 applies solely to "internal corporate claims," Section 102(b)(1) encompasses "intra-corporate" matters that are not necessarily limited to "internal affairs." Here, the court noted that neither its decision in *ATP Tour, Inc. v. Deutscher Tennis Bund*[4] nor the Court of Chancery's 2013 decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation*[5] defined the outer bounds of Section 102(b)(1).

After concluding that Section 102(b)(1) authorized the defendants' FFPs, the Supreme Court held that the FFPs did not violate either federal or inter-state public policy. The court reaffirmed that "the DGCL allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance, and governance of their enterprise." Notably, the court explained that "[p]erhaps the most difficult aspect of the 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 [Delaware's] sister states." While other state courts will need to determine whether to enforce similar FFPs, the Supreme Court noted that "there are persuasive arguments that could be made . . . that a [FFP] does not offend horizontal sovereignty." In describing Delaware's view of corporate charters to be "contracts among the corporation's stockholders," and articulating additional policy bases for its ruling, the Supreme Court provided defendants with the arguments they will need to enforce FFPs when they are subject to challenge in other state courts.

Key Takeaways

Although the *Salzberg* decision is in some senses narrow because it applies to a facial challenge to three particular FFPs, we believe this holding has key lessons for corporate practitioners. First, given the Supreme Court's expansive reading of Section 102(b)(1) and its application to the FFPs challenged in this litigation, we think it likely that similar FFPs would survive an as-applied challenge in Delaware if they were used to force a '33 Act plaintiff to assert its claims in federal court. Second, the Supreme Court's review of Section 115 confirms that it applies only to classic "internal affairs" claims. Third, the Supreme Court expressly considered whether corporations will now be able to incorporate charter provisions requiring stockholders to arbitrate internal corporate claims, concluding that such a provision would violate Section 115. The decision, however, does not address the highly contentious and heavily debated issue of whether a charter provision could validly require that '33 Act claims—or other "intra corporate" claims that are not "internal" under Section 115—be subject to arbitration.

The *Salzberg* decision also leaves open certain key questions that merit further consideration. First, as the Supreme Court acknowledged, the critical question of whether Delaware's sister states will enforce FFPs in future '33 Act cases filed in other state courts remains. It is uncertain how other states will resolve this question, but recent history suggests that they may be inclined to adopt the Delaware Supreme Court's holding. For example, in the years following the Court of Chancery's holding in *Boilermakers* which ruled that exclusive forum selection bylaws pertaining to "internal corporate governance" claims were appropriate, almost every jurisdiction that considered a challenge to those bylaws followed the *Boilermakers* decision and enforced the challenged forum selection provision. Second, in its analysis, the Supreme Court emphasized that the challenged FFPs were "stockholder approved." To avoid the cost and disruption associated with duplicative litigation, we believe that an FFP should be a standard feature of the charter of a company that is going

[4] 91 A.3d 554 (Del. 2014).
[5] 73 A.3d 934 (Del. Ch. 2013).

public, whether incorporated in Delaware or otherwise. The *Salzberg* decision appears to suggest—but does not conclusively find—that a bylaw amendment, unilaterally adopted by the board of an already public company, may also survive challenge under Delaware law. Indeed, the decision noted that forum-selection bylaws are "facially valid," and explained that in *Boilermakers*, the Court of Chancery held that the challenged forum bylaws in that action "were valid under Section 109(b) 'because they regulate where stockholders may file suit.'" This, of course, is exactly the intent and function of FFPs. Whether a board should adopt an FFP in its bylaws, or whether it should propose an FFP as a charter amendment, will depend on a company's individual circumstances and will require it to weigh both legal and practical factors. And, of course, we expect that companies that adopt FFPs through corporate bylaws without stockholder approval will face stockholder litigation challenging the validity of such FFPs.