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Delaware Supreme Court Upholds Forum Selection Clause Provisions For Securities Act Claims

On March 18, 2020, the Delaware Supreme Court issued its decision in *Sciabacucchi v. Salzberg*, which held that forum selection clauses contained within corporate charters requiring that certain securities claims be brought in federal court were facially valid under Delaware law. The decision has significant implications for securities actions going forward. First, the decision will likely stem the tide of securities class actions being filed in state court following the United States Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*. Second, the decision may serve as a roadmap for proponents of arbitration clauses for securities litigation in corporate charters.

I. Background

This case relates to the validity of corporate charter provisions that require claims under the Securities Act of 1933 (the "Securities Act") be brought in federal court. The Securities Act provides a private right of action for investors against issuers, directors and officers, underwriters, and accountants for misstatements in registration statements and prospectuses for IPOs, SPOs, and other securities offerings.[1] The Securities Act has very few elements, particularly with respect to the issuer of securities. It contains no scienter, reliance, or loss causation elements.[2] Issuers—unlike other defendants—do not even have a "due diligence" affirmative defense for misstatements in registration statements.[3] These characteristics make the statute plaintiff-friendly.

In 1995, in response to "perceived abuses of the class-action vehicle" by plaintiffs lawyers using the Securities Act and the Securities Exchange Act of 1934, Congress passed the Private Securities Litigation Reform Act (the "PSLRA").[4] The PSLRA's provisions "limit recoverable damages and attorney's fees, provide a 'safe harbor' for forward-looking statements, . . . mandate imposition of sanctions for frivolous litigation, and authorize a stay of discovery pending resolution of any motion to dismiss."[5] The PSLRA had an unintended consequence: plaintiffs "began bringing class actions under state law, often in state court."[6]

To stem the shift from federal court to state court, in 1998 Congress passed the Securities Litigation Uniform Standards Act ("SLUSA"). In the years following SLUSA, a split emerged regarding whether SLUSA required that securities class actions solely bringing claims under the Securities Act be brought in federal court.[7] On March 20, 2018, the United States Supreme Court issued its decision in *Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, and held that SLUSA did not prevent Securities Act class actions from being filed and litigated in state courts.[8] That decision paved the way for Securities Act class actions to be filed in state courts around the country. In fact, in 2019 state court Securities Act filings increased by 40 percent over 2018, and 75 percent of all Securities Act class actions were either state-only cases or cases involving

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[1] *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 358 (2d Cir. 2010) ("Sections 11, 12(a)(2), and 15 of the Securities Act impose liability on certain participants in a registered securities offering when the publicly filed documents used during the offering contain material misstatements or omissions. Section 11 applies to registration statements, and section 12(a)(2) applies to prospectuses and oral communications.") (citing 15 U.S.C. §§ 77k(a), 77l (a)(2)).

[2] *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 109 (2d Cir. 2011) ("[C]laims under sections 11 and 12 [of the Securities Act] do not require allegations of scienter, reliance, or loss causation.").

[3] *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 659 (S.D.N.Y. 2004) ("Section 11 provides an affirmative defense of 'due diligence,' which is available to defendants other than the issuer of the security.").

[4] *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006).

[5] *Id.* (citing 15 U.S.C. § 78u–4).

[6] *Id.* at 82.

[7] *Compare, e.g., Luther v. Countrywide Financial Corp.*, 195 Cal.App.4th 789, 797–798, 125 Cal.Rptr.3d 716, 721 (2011) (holding that state courts have jurisdiction over covered class actions alleging only Securities Act claims), *with, e.g., Knox v. Agria Corp.*, 613 F.Supp.2d 419, 425 (S.D.N.Y.2009) (holding that state courts lack jurisdiction over Securities Act class actions).

[8] 138 S. Ct. 1061 (2018).

both a state and parallel federal action.[9] These cases have presented difficulties for defendants as they are often fighting parallel actions in federal courts, and state courts have been inconsistent in enforcing the provisions of the PSLRA, including the automatic stay of discovery.[10]

To combat the potential for state court class actions, certain companies, including Blue Apron Holdings, Inc., Roku, Inc., and Stitch Fix, Inc., included forum selection clauses in their certificates of incorporation prior to their respective IPOs.[11] The forum selection clauses provided that any claims brought by shareholders for alleged violations of the Securities Act must be brought in federal court.[12] Matthew Sciabacucchi, the plaintiff in *Sciabacucchi*, purchased shares of each company and then filed derivative lawsuits against each of them in Delaware chancery court seeking a declaratory judgment that the forum selection clauses violated Delaware law.[13] Vice Chancellor Laster heard the consolidated cases and held that the provisions violated Delaware law.[14]

II. Opinion

The Delaware Supreme Court was asked to determine whether Vice Chancellor Laster correctly held that the forum selection clauses in certificates of incorporation, which required that Securities Act claims be brought in federal court, were invalid under Delaware law. Vice Chancellor Laster had held that the forum selection clause provisions were invalid because Section 102(b)(1) of the Delaware General Corporation Law, which regulates what provisions may be included in a certification of incorporation, was limited to "internal affairs claims," such as state-law breach of fiduciary duty.[15] Vice Chancellor Laster reasoned that Securities Act claims do not fall within the scope of "internal affairs claims" because, among other things, "[t]he cause of action does not arise out of or relate to the ownership of the share, but rather from the purchase of the share."[16] Thus, Vice Chancellor Laster held that the forum selection clauses were invalid.

The Delaware Supreme Court disagreed and reversed. First, the Delaware Supreme Court determined that Section 102(b)(1) was not limited to "internal affairs" claims.[17] Rather, Section 102(b)(1) extended to any "intra-corporate" dispute reasoning that "[t]here are matters that are not 'internal affairs,' but are, nevertheless, 'internal' or 'intracorporate' and still within the scope of Section 102(b)(1)."[18]

The Delaware Supreme Court further ruled that Securities Act claims fall within the scope of "internal" or "intracorporate" claims because "they arise from internal corporate conduct on the part of the Board."[19] Thus, the court reasoned, Securities Act claims are distinct from truly "external claims" that do not involve any conduct by the board.[20]

Finally, the Delaware Supreme Court held that forum selection clauses requiring that Securities Act claims be filed in federal court do not violate Delaware or federal public policy because they only affect the procedural aspect of the case and not the merits.[21] The Delaware Supreme Court noted that the United

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[9] Stanford Law Sch. Secs. Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings 2019 Year in Review* at 4, 25 (2020).

[10] *Compare, e.g. Matter of PPDAI Group Securities Litigation*, 2019 WL 2751278, at *7 (N.Y. Sup. Ct. July 1, 2019) (holding PSLRA automatic stay of discovery inapplicable in state court actions); *with, e.g., In re Everquote, Inc. Sec. Litig.*, 2019 WL 3686065, at *8 (N.Y. Sup. Ct. Aug. 7, 2019) (holding that PSLRA stay of discovery applies in all actions regardless of forum).

[11] *Sciabacucchi v. Salzberg*, 2020 WL 1280785, at *1 (Del. Mar. 18, 2020).

[12] *Id.*

[13] *Id.*

[14] *Sciabacucchi v. Salzberg*, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018).

[15] *Id.* at *21.

[16] *Id.* at * 17.

[17] *Sciabacucchi v. Salzberg*, 2020 WL 1280785, at * 13.

[18] *Id.* at *18.

[19] *Id.* at *11.

[20] *Id.* at *12,

[21] *Id.* at *18, *22.

States Supreme Court has already upheld an arbitration provision in a customer brokerage agreement, which the Delaware Supreme Court found was "forceful support for the notion that [forum selection clauses] do not violate federal policy by narrowing the forum alternatives available under the Securities Act."[22] In fact, in upholding the forum selection clauses, the Delaware Supreme Court found that the clauses "advance" the public policies underlying Delaware's corporate law, including "certainty and predictability, uniformity, and prompt judicial resolution to corporate disputes."[23]

III. Significance

This case has significant implications for securities actions going forward. First, the decision may effectively overturn the flexibility afforded plaintiffs under the *Cyan* decision. The explosion of Securities Act class actions in state court will likely cease as more Delaware corporations adopt forum selection clause provisions. This will provide issuers with more predictability regarding the forum in which they will be litigating securities class actions and the rules that will be applied.

Second, the decision may have implications for proponents of arbitration clauses for securities claims in corporate charters. Although the Delaware Supreme Court explicitly stated that arbitration clauses for "internal affairs" claims, like breach of fiduciary duty, would be invalid, it did not address whether arbitration clauses for securities or other "intracorporate" claims would be invalid.[24] Thus, the decision may result in litigants arguing that arbitration clauses in certificates of incorporation would be just as valid as forum selection clauses. In fact, one case addressing the legality of such an arbitration provision under New Jersey law was stayed pending the outcome of *Sciabacucchi*.[25] And while the Securities Exchange Commission has not addressed whether the arbitration provision would be enforceable, Jay Clayton, Chairman of the Securities and Exchange Commission, has stated that the issue is worthy of "careful consideration."[26]

If arbitration clauses are ultimately adopted and enforced, issuers, D&O insurers, and other stakeholders may be wise to consider the unintended consequences of arbitration clauses, including costly arbitration fees, fewer procedural protections, and the potential that large institutional investors and fiduciaries who safeguard investor assets will be forced to file individual actions more frequently.

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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 reach out to:

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[22] *Id.* at *18.
[23] *Id.* at *23.
[24] *Id.* at *23 n.169.
[25] Memorandum Order, *The Doris Behr 2012 Irrevocable Trust v. Johnson & Johnson*, No. 19-cv-8828, ECF No. 50 (D.N.J. Feb. 24, 2020).
[26] Jay Clayton, *Statement on Shareholder Proposals Seeking to Require Mandatory Arbitration Bylaw Provisions*, U.S. Securities & Exchange Commission (Feb. 11, 2019), *available at* https://www.sec.gov/news/public-statement/clayton-statement-mandatory-arbitration-bylaw-provisions.