

Client Alert

Delaware Supreme Court Upholds Federal Forum Provisions in Corporate Charters

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Recently, the Delaware Supreme Court issued a decision upholding corporate charter provisions that establish federal courts as the exclusive forum for class action cases under the Securities Act of 1933 ("Securities Act"), reversing a 2018 decision by the Delaware Court of Chancery that invalidated such provisions as a matter of law. The Delaware Supreme Court's decision provides Delaware corporations with a significant tool to address the explosion of Securities Act cases filed in state courts following the Supreme Court's decision in *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018), which held that certain Securities Act class actions filed in state courts were not removable to federal courts. If they have not done so already, Delaware corporations should strongly consider amending their charters to include forum selection clauses that make federal court the exclusive forum for litigating claims under the Securities Act.

By way of background, in March 2018, the Supreme Court held in *Cyan* that certain class actions commenced in state court which asserted claims under the Securities Act were not removable to federal court. Since that decision, there has been a significant increase in Securities Act class actions filed in state courts. According to data gathered by Cornerstone Research in mid-2019, of the 61 post-*Cyan* Securities Act filings, almost half were filed solely in state court. Moreover, many companies are faced with multiple Securities Act cases pending in different jurisdictions arising from the same securities offering.

To respond to the increase in state court filings, some companies inserted a provision into their corporate charter that designated federal court as the exclusive forum for Securities Act claims. In December 2018, the Delaware Court of Chancery held that such provisions were categorically impermissible, as corporations should not be able to use corporate charter provisions to regulate a corporation's external relationships, nor the behavior of other parties in other capacities, particularly when

the laws of other states may govern those relationships. In the Chancery Court's view, Securities Act claims were "a clear example of an external claim."¹

On March 18, 2020, the Delaware Supreme Court decided *Salzberg v. Sciabacucchi*, No. 346, 2019, 2020 WL 1280785 (Del. Mar. 18, 2020), reversing the Chancery Court's decision and holding that forum provisions in corporate charters that mandated a federal forum for Securities Act claims were permissible because Delaware General Corporate Law ("DGCL") gives corporations "flexibility and wide discretion" for managing internal affairs, which includes the disclosure issues underlying Section 11 claims. The Court reasoned that because these claims are primarily based on internal corporate conduct, particularly conduct of the Board of Directors, they fall within the purview of DGCL Section 102(b)(1), the statute that provides for the types of provisions that may be included in corporate charters. Additionally, following the Delaware Supreme Court's 2014 holding in *ATP Tour, Inc. v. Deutscher Tennis Bund*,² the Court recognized that intra-corporate litigation relates to the business of the corporation and provisions that govern internal affairs are permissible under Section 102(b)(1).

The Court further recognized that under Delaware law, federal forum provisions are presumptively valid and enforceable. The DGCL was "intended to provide directors and stockholders with flexibility and wide discretion for private ordering and adapting to new situations." Federal forum provisions advance the goals of the law, in allowing courts to achieve judicial economy and avoid duplicative efforts. The Court noted that federal forum provisions can provide a corporation with efficiencies in managing the procedural aspects of securities litigation. Still, while the Court held the provisions are presumptively valid, there are limited circumstances in which federal forum provisions might be invalidated, particularly if enforcement would be unreasonable or contravened a strong public policy of the forum in which the suit is brought.

In light of the Supreme Court's holding, all companies incorporated in Delaware should strongly consider amending their corporate charters to include a federal forum provision, and consider drafting broadly enough to include any claim against third parties that are typically named in Securities Act class actions, such as underwriters and auditors. Not only will this provision provide certainty for corporations that want to avoid litigating duplicative claims in multiple forums, but corporations can avoid Securities Act litigation in state court, where some courts have held that certain protections under the Private Securities Litigation Reform Act of 1995 do not apply, including the automatic stay of discovery.

¹ *Sciabacucchi v. Salzberg*, No. 2017-0931-JTL, 2018 WL 6719718 at *2 (Del. Ch. Dec. 19, 2018).

² 91 A.3d 554 (Del. 2014).

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