Delaware Supreme Court Upholds Federal-Forum Provisions for Securities Act Claims

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In a landmark ruling, the Delaware Supreme Court has unanimously held that a Delaware corporation may validly adopt a charter provision that requires claims brought by its stockholders under the Securities Act of 1933 to be filed in federal court. *Salzberg v. Blue Apron Holdings, Inc.*, 2020 WL 1280785 (Del. Mar. 18, 2020). The Court concluded that the Delaware statute governing charter provisions gives a corporation broad flexibility to adopt provisions that relate to the management of its business and affairs and its relationship with its stockholders.

In the wake of the U.S. Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), which held that state courts have jurisdiction to hear actions asserting Securities Act claims and that such actions brought in state court may not be removed, *Salzberg* may provide corporations with a means to ensure that these federal claims are litigated exclusively in federal court and avoid simultaneous state and federal litigation of duplicative Securities Act claims.

State Court Jurisdiction over Securities Act Claims. Sections 11 and 12(a)(2) of the Securities Act impose liability on companies in connection with false or misleading statements in registration statements and prospectuses. As originally enacted, the Securities Act provided for concurrent federal and state court jurisdiction and barred the removal of actions filed in state court.

In 1995, Congress enacted the Private Securities Litigation Reform Act ("PSLRA") to curb perceived abuses of the class action vehicle in litigation involving nationally traded securities. The PSLRA includes a number of important procedural protections, including the lead plaintiff process, an automatic stay of discovery, and limitations on any award of damages to the named plaintiff and on the payment of attorneys' fees and expenses. The PSLRA had an unintended consequence, however, as it prompted some plaintiffs to avoid federal court and instead bring Securities Act claims in state court.

Three years later, Congress passed the Securities Litigation Uniform Standards Act ("SLUSA") with the express purpose of closing that loophole and requiring that securities class actions be subject to the PSLRA. A deep divide subsequently formed

among federal district courts regarding whether SLUSA deprives state courts of concurrent jurisdiction over class actions asserting Securities Act claims only, without accompanying securities fraud claims under the Securities Exchange Act of 1934.

In 2018, approximately 20 years after SLUSA was enacted, the U.S. Supreme Court resolved the issue with its unanimous decision in *Cyan*, which found the language of SLUSA's amendments ambiguous and held that state courts retain jurisdiction to hear Securities Act class actions. The *Cyan* decision has resulted in a spike in class actions under the Securities Act being filed in state courts—frequently in multiple state and federal courts simultaneously—and companies have sought alternative means of ensuring that class actions under the federal securities laws are litigated in federal courts.

The *Salzberg* Decision. A solution pursued by some corporations was to amend their charters to include forum-selection provisions requiring that actions brought under the Securities Act be filed exclusively in federal court. The *Salzberg* case involved a fairly typical federal-forum provision ("FFP"):

> Unless the Company consents in writing to the selection of an alternative forum, the federal district courts of the United States of America shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933. Any person or entity purchasing or otherwise acquiring any interest in any security of [the Company] shall be deemed to have notice of and consented to [this provision].

Salzberg, 2020 WL 1280785, at *1.

The Delaware Court of Chancery held in December 2018 that such FFPs were invalid because a charter provision "cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware's corporate law." *Sciabacucchi v.* Salzberg, No. 2017-0931-JTL, 2018 WL 6719718, at *3 (Del. Ch. Dec. 19, 2018).

On appeal, the Delaware Supreme Court unanimously reversed the Court of Chancery's decision and concluded that FFPs fall within the proper subject matter of a charter provision under Delaware law and are therefore facially valid. The Court analyzed the text of Delaware General Corporation Law Section 102(b)(1), which governs certificates of incorporation and includes broad language allowing "*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, or any class of the stockholders, … if such provisions are not contrary to the laws of this State." *Salzberg*, 2020 WL 1280785 at *4 (quoting 8

Del. C. § 102(b)(1)) (emphasis in original). An FFP, the Court held, "could easily fall within either of these broad categories." *Id.*

Interestingly, in explaining how FFPs can provide corporations with efficiencies in managing their affairs, the Court recited detailed statistics regarding the sharp rise in Securities Act filings in state court following the *Cyan* decision and the large percentage of such filings that had a parallel action in federal court. *Id.* at *5. The Court noted that "no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court." *Id.* "The costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts are obvious." *Id.* FFPs "classically fit" within the scope of Section 102(b)(1) by "directing 1933 Act claims to federal courts when coordination and consolidation are possible." *Id.*

Significance for Securities Litigation. The Delaware Supreme Court's landmark decision in *Salzberg* provides Delaware corporations with a powerful tool to avoid the costs and inefficiencies of litigating Securities Act class actions in state court. Keeping Securities Act class actions in federal court ensures that defendants receive the benefit of the PSLRA's procedural protections, can assert defenses before courts with experience interpreting and applying the federal statutes, and avoid the costs and burdens of defending duplicative litigation in multiple forums.

Some uncertainty remains. Although *Salzberg* held that FFPs are *facially* valid, it is possible that individual FFPs will be challenged on an as *applied* basis. Other states may not follow Delaware's lead, which will depend in part on individual state law issues. Furthermore, given the decades-long struggles over this issue, the principles underlying the *Salzberg* decision may be subject to further challenge, perhaps in federal court.

Despite these uncertainties, *Salzberg* is an important decision, especially for companies contemplating an initial or secondary public offering, and every corporation should give serious consideration to adopting an FFP or amending its constituent documents to include an FFP.

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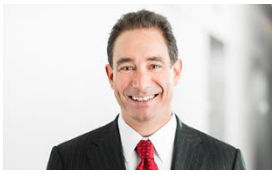
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