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Delaware Court of Chancery Strikes Federal Forum Selection Provisions

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In *Sciabacucchi v. Salzberg*,[1] the Delaware Court of Chancery struck down provisions in the certificate of incorporation of three defendant corporations purporting to require any claim under the Securities Act of 1933 (1933 Act) to be filed in the federal district courts of the United States of America. The opinion is relevant not only for its key holding but also for the Court's observations regarding the scope of provisions that validly may be included in certificates of incorporation and bylaws of Delaware corporations.

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Background

In connection with their initial public offerings, each of the three nominal defendants, Blue Apron Holdings, Inc., Roku, Inc. and Stitch Fix, Inc., adopted provisions in their certificate of incorporation providing, in relevant part, that the federal district courts of the United States of America would be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the 1933 Act (Federal Forum Provisions).[2] The three nominal defendants' Federal Forum Provisions were substantively identical, except that Blue Apron's provision was qualified such that it would apply only to the fullest extent permitted by law.[3]

The plaintiff bought shares of common stock under the registration statement of each of the defendant corporations, either in or shortly after its initial public offering, and therefore was found entitled to sue under Section 11 of the 1933 Act for misstatements or omissions in the registration statement of each defendant.[4] In December 2017, the plaintiff brought suit in the Delaware Court of Chancery against each nominal defendant, seeking a declaration that its Federal Forum Provision was invalid.[5]

Legal Analysis

At the outset, the Court noted that the inclusion of forum selection clauses in certificates of

incorporation and bylaws is a relatively recent phenomenon, one that traces its origins to the Court's own musings, in the context of a settlement hearing, that corporations could adopt "charter provisions" selecting an exclusive forum (presumably the Delaware Court of Chancery) for "intra-entity disputes."[6] Within one year after those musings, nearly 200 corporations had adopted or proposed to adopt forum selection provisions for intra-corporate claims in their charter or bylaws, and the trend continued in ensuing years.[7]

In 2013, the Court in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.* addressed a challenge to the facial validity of Chevron's and FedEx's forum selection bylaws.[8] The *Boilermakers* Court rejected the challenge, holding that Section 109(b) of the DGCL—which provides that the bylaws may "contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees"[9]—provides ample authority for the adoption of intra-corporate forum selection clauses. Such clauses, by their nature, "regulate where stockholders can exercise their right to bring certain internal affairs claims against the corporation and its directors and officers" and

> plainly relate to the conduct of the corporation by channeling internal affairs cases into the courts of the state of incorporation, providing for the opportunity to have internal affairs cases resolved authoritatively by [the Delaware] Supreme Court if any party wishes to take an appeal.[10]

The *Sciabacucchi* Court construed the opinion in *Boilermakers* as making a clear distinction between forum selection bylaws regulating internal affairs matters, which are permissible, and those purporting to regulate external matters, such as tort claims, which are not permissible.[11]

The *Sciabacucchi* Court similarly construed the Delaware Supreme Court's opinion *ATP Tour, Inc. v. Deutscher Tennis Bund*.[12] In *ATP*, the Supreme Court held that a so-called "fee-shifting provision" in a nonstock corporation's bylaws was facially valid.[13] In construing the *ATP* opinion, the *Sciabacucchi* Court focused on the Supreme Court's reasoning that the fee-shifting provision, being designed to allocate risks among parties to the corporate contract in intra-corporate disputes, fell within the scope of matters that may permissibly be included in the bylaws under Section 109(b) of the DGCL.[14]

Forum selection provisions may only validly address "'the rights and powers of the plaintiff-stockholder as a stockholder.'"

Not long after *Boilermakers* and *ATP* were decided, the Delaware General Assembly adopted legislation (1) adding new Section 115 of the DGCL, which specifically validated the adoption of provisions of the charter and bylaws selecting the Delaware courts as the exclusive forum for "internal corporate claims,"[15] and (2) amending Sections 102 and 109 of the DGCL to prohibit stock corporations from adopting fee-shifting charter or bylaw provisions.[16] The *Sciabacucchi* Court construed these developments as providing further support for the notion that forum selection provisions may not extend to so-called "external" matters. While it acknowledged that Section 115 does not provide "explicitly that the charter or bylaws cannot include forum-selection provisions addressing other types of claims"—that is, those in addition to "internal corporate claims"—the Court noted that the statute's omission of a reference to other types of claims "comport[ed] with the precedent leading up to Section 115," which precedent, in the Court's view, "recognized that the charter and bylaws can only address internal-affairs claims."[17] The Court also construed the fact that Sections 102 and 109 only prohibited fee-shifting provisions for internal corporate claims to mean that the legislature assumed that it was unnecessary to make the

provision apply more broadly, as charter or bylaw fee shifting provisions that extended beyond internal corporate claims would be invalid under existing law.[18]

In reviewing the authority forming the basis of its conclusion that forum selection provisions may only validly address "'the rights and powers of the plaintiff-stockholder as a stockholder,'"[19] the Court held that the Federal Forum Provisions related to external matters and, therefore, were invalid.[20] The Court stated that the "distinct nature" of a claim under the 1933 Act—in which a plaintiff must assert either that the registration statement or prospectus contained a material misstatement or omission or that the issuer wrongfully failed to register securities before offering them for sale—served to demonstrate that it was external to the corporation.[21] First, the Court noted that any party signing the registration statement may become a defendant in a 1933 Act claim, and that no such party's status as a director or officer of the corporation (or such party having any other internal role with the corporation) is a prerequisite to such party being named as a defendant.[22] In addition, the Court noted, the 1933 Act deals with violations relating to the sale of "securities," which is defined broadly to include various types of instruments, of which shares of capital stock are only one subset.[23] Moreover, the Court stated, even when a party purchases shares of capital stock, the investor's cause of action stems not from the ownership of the share, but rather from the purchase of the stock.[24] The purchaser need not be a stockholder at the time of purchase to assert the claim, and the purchaser need not continue to hold the stock to assert the claim. Based on the foregoing, the Court found that claims under the 1933 Act more closely resemble tort claims—external to the corporation—rather than internal corporate claims.[25]

Next, the Court addressed Blue Apron's claim that the challenge to its Federal Forum Provision was unripe. While noting that the ripeness doctrine permits a court to postpone its review of a claim until the matter arises in final form, the Court determined that it was unnecessary to forestall review in the present case.[26] The Federal Forum Provision, according to the Court, would have a substantial deterrent effect in that it would cause potential plaintiffs to avoid filing 1933 Act claims in state court to avoid incurring the costs and delay associated with a motion to dismiss on jurisdictional grounds.[27]

Finally, the Court addressed Blue Apron's argument that its Federal Forum Provision—which applied only to the fullest extent permitted by law—could not be facially invalid on the basis that there was no manner in which it could operate contrary to Delaware law. The Court rejected that argument, holding that because there was no context in which the Federal Forum Provision could operate validly, there was nothing for the savings clause to negate.[28]

Conclusion

In *Sciabacucchi*, the Court held that certificate of incorporation and bylaw provisions purporting to require disputes under the 1933 Act to be litigated in the federal courts of the United States of America are facially invalid. In so doing, the Court observed that certificates of incorporation and bylaws of Delaware corporations may be used to govern internal affairs matters, but may not be used to bind stockholders with respect to "external matters," such as contract or tort claims that are unrelated to the internal operations or governance of the corporation.

Notes

1. 2018 WL 6719718 (Del. Ch. Dec. 19, 2018).
2. *Id.* at *6.
3. *Id.*
4. *Id.* at *7. The Court found that the plaintiff could also sue under Section 12(a)(1) of the 1933 Act to enforce the registration requirements and could potentially sue under Section 12(a)(2) of the 1933 Act over a material misstatement in the prospectus. *Id.*
5. *Id.* The plaintiff also named as defendants twenty directors of the nominal defendants who had signed the registration statement and served as directors since the public offering.
6. Forum selection provisions arose during an era in which plaintiffs would routinely challenge M&A transactions on

price, process and disclosure grounds in multiple jurisdictions and then settle the claims for non-monetary relief (*e.g.*, enhanced disclosures), following which they would seek an award of attorneys' fees for their efforts. In *In re Revlon, Inc. Stockholders Litigation*, 990 A.2d 940 (Del. Ch. 2010), the Court replaced class counsel that had agreed to such a settlement. In issuing that order, the *Revlon* Court indicated that the threat of replacement could cause counsel to assess more critically which cases warranted time and investment—and could thereby help to stem the flow of nuisance suits. The *Revlon* Court recognized, however, that its efforts in curbing abuse could simply drive plaintiffs to file nuisance suits in jurisdictions outside of Delaware. The *Revlon* Court offered, as a potential response, that corporations adopt "charter provisions selecting an exclusive forum"—presumably the Court of Chancery of the State of Delaware—"for intra-entity disputes." *Id.* at 960.

7. *Sciabacucchi*, 2018 WL 6719718 at *9.
8. 73 A.3d 934 (Del. Ch. 2013). The bylaws at issue in *Boilermakers* provided, in relevant part, that the Delaware Court of Chancery would be the exclusive forum for (1) derivative actions, (2) claims for breach of fiduciary duty, (3) claims arising under the DGCL, and (4) claims under the internal affairs doctrine. *Id.* at 943.
9. 8 *Del. C.* § 109(b).
10. *Boilermakers*, 73 A.3d 950-51.
11. *Sciabacucchi*, 2018 WL 6719718, at *11.
12. 91 A.3d 554, 557 (Del. 2014).
13. *Id.*
14. *Sciabacucchi*, 2018 WL 6719718, at *13.
15. Section 115 defines "internal corporate claims" to mean "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." 8 Del. C. § 115.
16. Del. S.B. 75, 148th Gen. Assem. (2015).
17. *Sciabacucchi*, 2018 WL 6719718, at *14.
18. *Id.* at *15. Although the Federal Forum Provisions were included in the charter rather than the bylaws, the Court found that the reasoning in *Boilermakers* applied with equal force, as the relevant provisions of Section 102 of the DGCL, which deals with provisions that may be included in the charter, covered the same substantive items as those of Section 109 of the DGCL. *Id.* at *22.
19. *Id.* at *11.
20. *Id.* at *16–23.
21. *Id.* at *16.
22. *Id.* at *17.
23. *Id.*
24. *Id.* at *17–18.
25. *Id.* The Court noted the plaintiff's additional argument that the Federal Forum Provision are invalid on the basis that they transgress public policy or the common law implicit in the DGCL, but specifically stated that its "decision has not reached [such] additional arguments." *Id.* at *23.
26. *Id.* at *24.
27. *Id.* The Court separately noted that its decision not to review the matter could encourage other corporations to adopt Federal Forum Provisions and that its resolving the basic legal question would benefit not only the parties before it but other corporations. *Id.* at *25.
28. *Id.*