Securities Regulation Daily Wrap Up, CORPORATE GOVERNANCE—Del. Ch.: Federal forum selection provisions in company charters held invalid regarding 1933 Act claims, (Dec. 19, 2018)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Mark S. Nelson, J.D.

The Delaware Chancery Court held that federal forum selection clauses included in the pre-initial public offering (IPO) corporate charters of three companies are invalid because the provisions impinge upon Securities Act claims held by purchasers of the companies' shares and, thus, relate to the companies' external affairs rather than to internal affairs that could otherwise be the subject of a bylaw or charter forum selection provision under Delaware law. The much-anticipated decision purports to treat shareholder claims based on the Securities Act in a manner consistent with the Securities Act's concurrent federal-state jurisdictional framework and with the Supreme Court's *Cyan* opinion, which reiterated that state courts can hear cases alleging only Securities Act claims. The decision is significant because it suggests a limit on the use of forum selection clauses in charters and bylaws and it implies that future litigation may focus on whether a particular type of claim is external in nature (*Sciabacucchi v. Salzberg*, December 19, 2018, Laster, J.).

Slightly different forum selection provisions. Blue Apron Holdings, Inc., Stitch Fix, Inc., and Roku, Inc., each incorporated in Delaware, filed registration statements during June through October of 2017 to conduct IPOs of their shares. Each company included in its pre-registration corporate charter a provision that purported to require Securities Act claims to be filed only in federal court. Although Stitch Fix and Roku had nearly identical charter provisions, Blue Apron's charter provision included language to the effect that Securities Act claims must be brought in federal court "*to the fullest extent permitted by law*" (emphasis in original).

Plaintiff Matthew Sciabacucchi acquired shares of each company and then sued them in Delaware for the purpose of obtaining a declaratory judgment that the federal forum selection provisions in the companies' charters were invalid. Sciabacucchi and the companies' officers and directors who were named as defendants (the companies themselves were nominal defendants) filed cross motions for summary judgment. The vice chancellor concluded that a facial challenge to the provisions was a good candidate for summary judgment and decided for Sciabacucchi and against the companies regarding the validity of the charter provisions.

1933 Act claim is part of external affairs. According to Vice Chancellor Laster, "first principles" lead to the result that a Delaware company cannot adopt a charter provision (or for that matter a bylaw provision) that purports to affect external claims as opposed to claims related to the internal affairs of the company. In essence: Delaware is omnipresent as the grantor of a corporate charter, so it can impose regulations on a company's internal affairs; even though Delaware is the "creator," it cannot regulate beyond internal affairs; the "predicate act" in the case of a Securities Act claim is the "purchase" of shares, something that occurs before the purchaser becomes a shareholder and, thus, would have a relationship to the corporate contract or to the corporation's internal affairs.

The vice chancellor also reached the same result via reference to the chain of events prompted by then-Chancellor Strine's *Boilermakers* decision holding that forum selection bylaws adopted by Chevron Corporation and FedEx Corporation were statutorily valid under Delaware law and, thus, enforceable. Two large sections of Vice Chancellor Laster's opinion regarding Blue Apron, Stitch Fix, and Roku can be briefly summarized:

- *Boilermakers* applied only to a corporation's internal affairs and does not apply to its external affairs. External affairs under *Boilermakers* would include tort claims and commercial contract claims because they do not involve shareholders as shareholders. *Boilermakers* also would not preclude federal claims.

- The Delaware Supreme Court's decision in *ATP Tour* held that a non-stock corporation's bylaw fee-shifting provision was valid and enforceable. The court, however, suggested that its decision did not extend beyond "intra-corporate litigation."
- Revisions in to Delaware law in 2015 did two things: (1) they codified *Boilermakers*; and (2) they limited *ATP Tour* to its facts and otherwise barred charter and bylaw fee-shifting provisions.
- *Boilermakers* applied to bylaws, but its reasoning applies equally to charters. D.G.C.L. Section 102(b)(1) (charters) and Section 109(b) (bylaws) contain nearly identical language. As a result, the *Boilermakers* distinction between a corporation's internal and external claims applies to charters.
- The Securities Act's language supports the conclusion that Securities Act claims are part of a corporation's external affairs. This conclusion is gleaned from multiple aspects of the Securities Act: (1) the Act focuses on registration statements; (2) the list of potential defendants is broad and is not limited to corporate officers, directors, or other "internal role[s];" (3) "security" is broadly defined and there is nothing special about Delaware in this context; and (4) the "predicate act" is the "purchase" of a "security" (suits are allowed even if the purchaser has disposed of the security).

The proliferation of bylaw and charter provisions. The court also addressed several additional arguments and the motivations for the rise of bylaw and charter provisions. For one, the court rejected Blue Apron's solo effort to argue the case was unripe for decision. Delaware only requires a "common sense assessment" of ripeness, which the case met. Here, the court cited three reasons for deciding the matter even before Blue Apron (or the other defendants) had moved to dismiss a Securities Act claim based on their charter provisions: (1) the question involved is a "pure question of law," the facts are set and litigation is likely; (2) the "deterrent effect" of the federal forum selection charter provision may push other plaintiffs to go directly to federal court as a cost savings move so a state court might never hear such a case; and (3) the lack of state court review of the question could "encourage" other companies to adopt federal forum selection provisions.

On this third point, Vice Chancellor Laster had hinted at his own role in the proliferation of bylaw/charter provisions that seek to limit plaintiffs' rights when, at the beginning of his opinion, he suggested the possible sources of such provisions. One source he said is the existence of numerous, multi-jurisdictional cases that are settled for attorney fees and without significant benefit to the plaintiffs (a footnote cites Delaware's *Trulia* decision, which clamped down on disclosure-only cases; some studies suggest these cases have shifted to federal courts—*See, e.g.*, NERA Economic Consulting, Recent Trends in Securities Class Action Litigation: 2017 Full-Year Review (January 2018) and Cornerstone Research, Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2017 M&A Litigation (July 2018), with some federal courts applying *Trulia*—*See, e.g.*, *In Re: Walgreen Co. Stockholder Litigation*). Another possible factor was the prior split among federal courts over application of the Securities Litigation Uniform Standards Act at issue in *Cyan*.

The vice chancellor also noted that his "dictum" in *Revlon* that one "possible response" would be for companies to adopt forum selection provisions in their charters was yet another source. He explained that *Revlon* was not a forum selection case and that his dictum was aimed only at "intra-entity disputes." The vice chancellor also cited multiple studies showing the rise of forum selection provisions in public company charters or bylaws: 16 pre-*Revlon*; 195 a year after *Revlon*; 746 in August 2014.

The court also declined to reach Sciabacucchi's argument that federal forum selection provisions in corporate charters violate public policy. The court, however, noted the potential that such provisions violate Delaware public policy and that they might be preempted by the Securities Act. Lastly, the court rejected Blue Apron's argument that the savings provision in its charter provision ("to the fullest extent permitted by law)" could actually save that provision.

The case is No. 2017-0931-JTL.

Attorneys: Kurt M. Heyman (Heyman Enerio Gattuso & Hirzel LLP) for Matthew Sciabacucchi. William B. Chandler III (Wilson Sonsini Goodrich & Rosati, P.C.) for Katrina Lake, Steven Anderson, J. William Gurley, Marka Hansen, Sharon McCollam, Anthony Wood, Ravi Ahuja, Shawn Carolan, Jeffrey Hastings, Alan Hendricks, Neil Hunt, Daniel Leff, Ray Rothrock, Stitch Fix, Inc., and Roku, Inc. Catherine G. Dearlove (Richards,

Layton & Finger, P.A.) for Matthew B. Salzberg, Julie M.B. Bradley, Tracy Britt Cool, Kenneth A. Fox, Robert P. Goodman, Gary R. Hirshberg, Brian P. Kelley, and Blue Apron Holdings, Inc.

Companies: Blue Apron Holdings, Inc.; Stitch Fix, Inc.; Roku, Inc.

LitigationEnforcement: CorporateFinance CorporateGovernance CorpGovNews GCNNews DirectorsOfficers FederalPreemption IPOs DelawareNews