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Delaware Supreme Court Validates Charter Provisions Requiring Federal Securities Claims to be Brought in Federal Court

By Edward B. Whittemore | March 30, 2020

Recently, the Supreme Court of Delaware issued an important decision about the validity of "exclusive venue" provisions in the corporate charters of Delaware corporations that address stockholder claims brought under the federal securities laws.

Section 11 of the Securities Act of 1933 (the "1933 Act"), imposes liability when a registration statement "contain[s] an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." It allows buyers of securities in public offerings to sue the parties responsible for preparing the registration statement (essentially, the issuer, the officers signing the registration statement, the directors of the issuer, underwriters, auditors, and other experts) for losses sustained as a result of material misstatements or omissions in the registration statement. In a Section 11 claim, the plaintiff is not required to prove that: (1) the defendant had a culpable state of mind as a requirement of recovery (that is, the plaintiff does not have to prove that the defendant had knowledge or intent to deceive or mislead); or (2) that the plaintiff actually "relied" on the misstatements or omissions in the registration statement.

In 2018, the U.S. Supreme Court held in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, that federal and state courts have concurrent jurisdiction over class actions based on 1933 Act claims, which means that such claims brought in state court were not removable to federal court. After the *Cyan* case was decided, many companies were subjected to 1933 Act fraud claims brought by plaintiffs in state courts, including Section 11 claims relating to their initial public offerings, and have been forced to litigate duplicative claims in both state and federal courts. In response, many companies going public adopted provisions in their bylaws or charters designating federal courts as the exclusive forum for the resolution of claims against them under the 1933 Act. Often times, these provisions were added by companies considering an initial public offering, so that the public investors purchasing shares in the IPO are not given the opportunity to approve of the charter provisions.

In *Salzberg v. Sciabacucchi*, No. 346, 2019 (Del. Mar. 18, 2020) (a/k/a the "Blue Apron" case), the Delaware Supreme Court, reversing the Delaware Court of Chancery's decision, confirmed the facial validity of provisions in the certificates of incorporation of Blue Apron Holdings, Inc., Stitch Fix, Inc., and Roku, Inc. requiring all claims under the 1933 Act to be brought in federal courts ("Federal Forum Provisions").

The Supreme Court analyzed 8 *Del. C.* § 102, which governs matters contained in a corporation's charter. Section 102(b)(1) authorizes two broad types of charter provisions: "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 [Delaware]." The Supreme Court found that Federal Forum Provisions easily come within the scope of this statutory language. The Court also found that the scope of Section 102(b)(1) is not limited to "internal corporate affairs" (meaning, statutory claims based on the DGCL or fiduciary principles of Delaware law generally).

The Supreme Court also analyzed the plaintiff's challenge to the Federal Forum Provision on Delaware public policy grounds. The Court held that the DGCL "allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance, and governance of their enterprise." The Court also found the Federal Forum Provisions to be consistent with federal public policy, as embodied in the 1933 Act, or principles of "horizontal sovereignty" (i.e., relations between the laws and courts of the several states).

The Supreme Court's decision is a reflection of Delaware's longstanding approach to private ordering. The Court reminded the parties and the public that a corporate charter is a contract between the corporation and its stockholders, and provisions lawfully adopted and included in charters will generally be respected by the courts, provided that "the statutory parameters and judicially imposed principles of fiduciary duty are honored."

Connecticut and Massachusetts have included provisions in their Business Corporation Acts that are substantially similar to Section 201(b)(1) of the DGCL. While there are no controlling decisions in either Connecticut or Massachusetts on the issues addressed in the *Blue Apron* decision, we believe that the reasoning of the Delaware Supreme Court is sound and would be followed by a Connecticut or Massachusetts court that was asked to rule on a shareholder challenge to a similar charter provision of a Connecticut or Massachusetts corporation.

The case is also a welcome affirmation that corporations can, consistent with corporate statutes and the rights of corporate shareholders, include provisions in corporate charters that help corporations manage shareholder litigation, avoid inconsistent judgments on matters such as discovery, and reduce the costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts.

If you need additional information concerning the *Blue Apron* decision, or its application to your company's charter provisions, please contact any of the following members of the Murtha Cullina LLP Business and Finance Department:

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