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Forum-Selection for Federal Securities Claims After *Sciabacucchi*

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On December 19, 2018, Vice Chancellor Laster of the Delaware Court of Chancery held that Delaware law does not permit corporations to include provisions in their certificates of incorporation requiring that claims under the Securities Act of 1933 be brought only in federal court.[1] In combination with the growing trend of securities plaintiffs filing in state courts viewed as plaintiff-friendly and the Supreme Court's ruling in *Cyan, Inc. v. Beaver Cty. Empls. Ret. Fund* that state courts continue to have concurrent jurisdiction over '33 Act claims without the possibility of removal,[2] this ruling escalates the risk that issuers will have to face multiple overlapping class actions that cannot be centralized in a single court. This article explains the decision, and proposes a solution to revive forum-selection provisions in the wake of the *Sciabacucchi* decision by including the forum-selection provision in the terms of the *security* as opposed to the company's foundational documents.

The *Sciabacucchi* Decision

Companies frequently include forum-selection provisions in their certificates of incorporation or bylaws that require internal affairs claims, such as derivative and appraisal actions, to be brought in one or more specified courts—most commonly, the Delaware Court of Chancery. Delaware courts have endorsed these forum-selection provisions, and courts across the country have enforced them. In fact, just two days after *Sciabacucchi*, a published decision of the California Court of Appeal upheld the enforceability of a Delaware corporation's forum-selection bylaw in a stockholder fiduciary duty action challenging disclosures in connection with a merger[3]—signaling that state courts will continue to enforce forum-selection provisions for internal affairs claims.

As securities plaintiffs began to file more and more Securities Act lawsuits in state court, and in anticipation of a decision in *Cyan*, IPO advisors increasingly began advising clients to include similar provisions in their certificates of incorporation to blunt plaintiffs' efforts to shop for favorable forums. The plaintiffs' bar responded by challenging the enforceability of these provisions in the Delaware Court of Chancery, seeking a declaratory ruling that the provisions were invalid.

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

2 138 S. Ct. 1061 (2018).

3 *Drulias v. 1st Century Bancshares, Inc.*, __ Cal. App. 5th __, 2018 WL 6735137 (Cal. Ct. App. Dec. 21, 2018)

Vice Chancellor Laster upheld those challenges, reasoning that the provisions of section 102(b)(1) of the Delaware General Corporation Law ("DGCL") limit corporate charter provisions to governing *internal* claims, and ruling that claims under the federal securities laws were *external* to the corporation. The court noted that "securities," under federal law, include many instruments other than shares of stock, and that claims under the '33 Act do not turn on the internal relationships within the corporation. Thus, while securities plaintiffs are frequently stockholders, Vice Chancellor Laster concluded that they were not bringing their claims *in their capacity as stockholders*.

The court, however, expressly declined to reach other arguments advanced by the plaintiff, including claims that forum-selection for securities claims violated state public policy or was preempted by federal law.

Next Steps for Issuers

In the wake of *Sciabacucchi*, issuers should recognize that Delaware courts may not enforce securities forum-selection provisions in their corporate charters or bylaws. But issuers should also recognize the limitations of the decision: it addresses only the validity of securities forum-selection provisions in the constitutive documents of the *corporation*. It does not hold that forum-selection provisions in *other* contracts or instruments governing the securities are invalid.

This distinction is an important one. Investment securities have their own terms, distinct from the corporation's charter and bylaws. Anyone who has dealt with corporate bonds, for example, knows that the vast majority of the terms governing the bond are found in a separate document—the indenture. Similarly, stock certificates may have restrictive legends or other terms printed on them. Indeed, Article 8 of the Uniform Commercial Code recognizes that terms stated on a security certificate or incorporated by reference therein are effective to bind even a purchaser without notice—which is essential to ensure that everyone who holds a security is bound by the same terms.

Incorporating a forum-selection provision into the terms of the security itself thus provides a route forward for issuers. Indeed, some issuers—particularly major depositaries for American Depositary Shares—have already been doing so, including broad forum-selection provisions in their Deposit Agreements. Kirkland & Ellis recently litigated a case in San Mateo County, California, involving such a provision; while the court ultimately stayed the case based on a traditional *forum non conveniens* analysis in favor of a pending suit in the Southern District of New York without reaching the forum-selection provision, the presence of the provision reinforced the court's conclusion.

Forum-selection provisions are also common in securities that are not publicly traded, and have repeatedly been enforced to dismiss or stay federal securities claims. Most notably, multiple appellate cases in the 1990s upheld the enforceability of the forum-selection provision in Lloyds of London's General Undertaking, which required all disputes to be litigated in English courts, as applied to claims under the Securities Act. Other courts have similarly enforced forum-selection provisions for Exchange Act claims, although those claims already are subject to exclusive federal jurisdiction. The

United States Supreme Court has held that forum-selection provisions do not violate the anti-waiver provisions of the Securities Act, noting in *Rodriguez de Quijas v. Shearson/American Express, Inc.*, which upheld arbitration agreements for Securities Act claims, that procedural provisions such as the choice of a state or federal forum can be waived.[4] Indeed, the Court described arbitration provisions as "in effect, a specialized kind of forum-selection clause."[5]

Key Takeaways

- Absent intervention from the Delaware Supreme Court, it is unlikely that forum-selection provisions in companies' certificates of incorporation and bylaws will be enforceable as applied to federal securities claims.
- Issuers seeking to retain the benefits of forum-selection provisions should consider incorporating forum-selection clauses into the terms of the security itself, as several issuers already have done.
- Forum-selection provisions, once incorporated into the terms of the security, do not violate the anti-waiver provisions of the Securities Act.

4 490 U.S. 477, 481-82 (1989)
5 *Id.* at 483.