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Will Delaware *Sciabacucchi* decision limit multi-jurisdictional Securities Act litigation?

By James J. Beha II and Steve Rappoport, *Morrison & Foerster*

MAY 5, 2020

INTRODUCTION

In *Salzberg v. Sciabacucchi*,[1] the Delaware Supreme Court recently reversed a lower court decision and upheld the validity of federal forum selection provisions in corporate charters — that is, provisions requiring shareholders to bring claims under the Securities Act of 1933 in federal court.

This means that federal forum provisions may become a powerful new tool for public companies seeking to limit the risk of facing multiple identical shareholder class actions in different jurisdictions.

While it is now clear that FFPs are valid under Delaware law, these provisions will effectively limit duplicative state-court litigation only if other courts — particularly state courts in New York and California, where the majority of state-court Securities Act cases are filed — enforce them.

As discussed below, these provisions should be enforced because neither corporations nor their shareholders benefit from wasteful, duplicative litigation of identical claims in multiple jurisdictions.

BACKGROUND: THE PRINCIPAL FEDERAL LAWS GOVERNING SECURITIES LITIGATION

Enacted in the wake of the Great Depression "to promote honest practices in the securities markets," the Securities Act and the Securities Exchange Act of 1934 provide the legal basis for the vast majority of federal securities claims.[2]

At issue here is the Securities Act, which was enacted to regulate securities offerings such as initial public offerings.

It created private rights of action for misstatements in connection with securities offerings, provided for concurrent federal and state jurisdiction over such claims, and barred removal to federal court of claims filed in state court.[3] "So if a plaintiff chose to bring a 1933 Act suit in state court, the defendant could not change the forum."[4]

In the years after Congress enacted the Securities Act and the Exchange Act, federal securities class action litigation proliferated. In an effort to curb "abuses of the class-action vehicle in litigation involving nationally traded securities," Congress adopted the Private Securities Litigation Reform Act in 1995.[5]

In general, the Reform Act made it more difficult to pursue securities class actions.

It created a safe harbor for forward-looking statements, imposed new restrictions on the selection and compensation of lead plaintiffs in federal securities class actions, imposed heightened pleading standards for federal securities fraud claims, and implemented a stay of discovery pending the resolution of motions to dismiss federal securities claims.

As the *Sciabacucchi* court recognized, however, the Reform Act

"'had an unintended consequence: It prompted at least some members of the plaintiffs' bar to avoid the federal forum altogether.

Rather than face the obstacles set in their path by the [Reform Act], plaintiffs and their representatives began bringing class actions under state law, often in state court.'"[6]

> Parallel federal and state court class actions asserting the same claims "run completely counter to the efficiency rationale of the class action."

In response, Congress passed the Securities Litigation Uniform Standards Act in 1998, which precludes class actions based on state law that allege an "untrue statement or omission of a material fact" in connection with the purchase or sale of a covered security from being brought by a private party in either state or federal court.[7]

SLUSA also provided that "[a]ny covered class action brought in any state court involving a covered security ... shall be removable to the federal district court."[8]

THE GROWTH OF PARALLEL SECURITIES ACT CLASS ACTIONS

In the years after Congress enacted SLUSA, a split of authority developed over the application of the statute's removal provision to Securities Act class actions filed in state courts. Most federal

courts determined that SLUSA's removal provision permitted removal of Securities Act class actions.[9]

But a minority of federal courts, particularly federal district courts in California, held that the Securities Act's bar on removal to federal court survived SLUSA and remanded Section 11 cases to state court.[10]

Relying on this California authority, securities plaintiffs' lawyers increasingly brought Securities Act class actions in California state courts.[11]

The Supreme Court resolved the split in authority about whether Section 11 cases were removable to federal court in its 2018 decision in *Cyan Inc. v. Beaver County Employees Retirement Fund*.

It held that federal and state courts retain concurrent jurisdiction over Securities Act claims and that Securities Act claims filed in state court are not removable to federal court.[12]

The consequences of *Cyan* have been stark — the number of Securities Act class actions filed in state court has skyrocketed, as has the number of cases involving parallel filings in both state and federal courts.

Between 2010 and 2018, an average of 12 Securities Act class actions were filed annually in state court and, on average, seven of those involved parallel filings in both state and federal court.[13]

By contrast, in 2018, 32 Securities Act class actions were filed in state courts and 16 of those involved parallel state and federal court filings.[14] In 2019, there were 49 state-court Securities Act class action filings, with 22 involving parallel state and federal court filings.[15]

Parallel state and federal Securities Act class actions are substantially more burdensome and expensive than suits filed in only one forum.

While there are established mechanisms for coordinating multiple related federal actions — including venue motions, the federal multi-district litigation provisions, and the Reform Act's lead plaintiff provisions — no similar mechanisms exist to coordinate parallel state and federal court proceedings (or parallel proceedings in multiple states' courts).

Defendants may seek to stay later-filed cases in favor of the first-filed case, but some state courts have declined to stay later-filed cases in favor of earlier-filed federal court cases.[16]

State courts are particularly reluctant to defer to parallel federal cases when the state court cases are more advanced, which frequently occurs because state court cases may proceed while the Reform Act's lead plaintiff provisions play out in federal court.[17]

While duplicative federal and state court litigation imposes substantial burdens on corporate defendants, there is no concomitant benefit to shareholders from parallel class actions. Ultimately, putative class members in a Securities Act class action can obtain only one recovery.

Indeed, parallel federal-court and state-court class actions asserting the same claims "run completely counter to the efficiency rationale of the class action."[18]

THE EMERGENCE OF CORPORATE FORUM SELECTION BYLAW PROVISIONS

The proliferation of burdensome and wasteful multi-jurisdictional Securities Act litigation echoes the proliferation of multi-jurisdictional M&A litigation a decade ago. By 2013, the vast majority of public company M&A transactions led to shareholder lawsuits in multiple jurisdictions.[19]

In response, many Delaware corporations adopted bylaw provisions designating the Delaware Court of Chancery as the exclusive forum for shareholder derivative actions, actions asserting a breach of a fiduciary duty, actions asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, and actions asserting a claim governed by the internal affairs doctrine.[20]

> Federal forum provisions will only be effective if state courts outside Delaware enforce them.

The Delaware Chancery Court upheld the validity of these clauses in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, where then-Chancellor Leo E. Strine Jr. explained that "forum selection bylaws address the 'rights' of the stockholders," consistent with 8 Del. C. § 109(b), "because they regulate where stockholders can exercise their right to bring certain internal affairs claims against the corporation and its directors and officers."

"They also 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 our Supreme Court if any party wishes to take an appeal."[21]

The Delaware Supreme Court subsequently affirmed. In 2015, the Delaware legislature confirmed the holding of *Boilermakers* by adding new Section 115 and amending sections 102 and 109 of the Delaware General Corporate law to permit the adoption of forum-selection provisions for internal corporate claims.[22]

But Delaware's recognition of the validity of these provisions — and their widespread adoption — did not immediately stem the tide of multi-jurisdiction M&A litigation.

Shareholders continued to bring M&A claims outside Delaware to test whether courts in other jurisdictions would enforce Delaware forum selection provisions.

A few months after the *Boilermakers* decision, however, a New York Commercial Division court dismissed shareholder derivative claims based on the defendant corporation's Delaware forum bylaw.[23] Similar decisions soon followed in California and Illinois state courts.[24]

Since these decisions, state and federal courts nationwide have routinely enforced Delaware forum selection bylaws governing corporate governance claims. As a result, multi-jurisdictional M&A litigation has been significantly reduced.[25]

FEDERAL FORUM PROVISIONS AND *SCIABACUCCI*

To limit the risk of parallel federal and state Securities Act class actions, several companies planning to go public adopted forum-selection provisions into their charters designating federal court as the exclusive forum for shareholder litigation under the Securities Act.

Three such companies were Blue Apron, Roku and Stitch Fix. In *Salzberg*, plaintiff Matthew Sciabacucchi sued these companies seeking a declaratory judgment that their federal forum selection provisions were invalid because Securities Act claims are external, not internal, claims.

In the Chancery Court, Vice Chancellor J. Travis Laster sided with Sciabacucchi, holding that the "constitutive documents of a Delaware corporation 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."[26]

In March 2020, the Delaware Supreme Court reversed, holding that federal forum provisions are facially valid under Delaware law.

Beyond finding that such provisions are permissible under 8 Del. Code § 102, which governs matters contained in a corporation's charter, the court also opined that such provisions "provide a corporation with certain efficiencies in managing the procedural aspects of securities litigation following" *Cyan*.[27]

The court observed that "[w]hen parallel state and federal actions are filed, no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court," thus leading to "obvious" costs and inefficiencies and "[t]he possibility of inconsistent judgments and rulings on other matters, such as stays of discovery."[28]

The court reasoned that by requiring Securities Act claims to be filed in federal court, federal forum selection provisions "classically fit the definition of a provision 'for the management of the business and for the conduct of the affairs of the corporation.'"[29]

As the Delaware Supreme Court also recognized, the "the most difficult aspect of this dispute is not with the facial validity" of federal forum selection provisions, "but rather, with the 'down the road' question of whether they will be respected and enforced by our sister states."[30]

Just as Delaware forum provisions were only effective once courts in other jurisdictions enforced them, federal forum provisions will only be effective if state courts outside Delaware enforce them.

Given that most Section 11 class actions filed in state court are brought in New York and California, one important question is whether those states' courts will honor federal forum selection provisions.

As a matter of policy and of both states' law, federal forum provisions should be enforced. Courts in both New York and California recognize a presumption that mandatory forum selection clauses will be enforced unless enforcement would be unreasonable or violate public policy.[31]

In addition, as noted above, New York and California courts enforced Delaware forum selection clauses in bylaws or articles of incorporation for corporate governance claims following the Delaware Chancery Court's *Boilermakers* decision.[32]

Based on this precedent, New York and California courts should enforce federal forum provisions as well. If they do, other states will likely follow, just as they did after *Boilermakers*.

While the Delaware Supreme Court's decision in *Sciabacucchi* is unlikely to be the final word on federal forum bylaw provisions, ultimately state courts throughout the country should enforce those provisions and they should become an effective tool to limit wasteful, duplicative multi-jurisdictional Section 11 class action litigation.

Notes

[1] No. 346, 2019, 2020 WL 1280785 (Del. Mar. 18, 2020).

[2] *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S.Ct. 1061, 1066 (2018).

[3] *See* § 22(a), 48 Stat. 86 ("The district courts of the United States ... shall have jurisdiction[,] concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title"); *Id.* at 87 ("No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States").

[4] *Cyan* at 1066.

[5] *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006).

[6] *Salzberg*, 2020 WL 1280785, at *2.

[7] 15 U.S.C. § 77p.

[8] 15 U.S.C. § 77p(c).

[9] *See, e.g., Northumberland County Retirement Syst. v. GMX Resources, Inc.*, 810 F. Supp. 2d 1282 (W.D. Okla. 2011); *In re Fannie Mae 2008 Sec. Litig.*, 2009 WL 4067266 (S.D.N.Y. Nov. 24, 2009); *Knox v. Agria Corp.*, 613 F. Supp. 2d 419 (S.D.N.Y. 2009); *Rovner v. Vonage Holdings Corp.*, 2007 WL 446658 (D.N.J. Feb. 7, 2007).

[10] *See, e.g., Young v. Pacific Biosciences of California, Inc.*, 2012 WL 851509 (N.D. Cal. Mar. 13 2012); *West Palm Beach Police Pension Fund*, 2011 WL 1099815 (S.D. Cal. Mar. 24, 2011); *Unscheld v. Tri–S Security Corp.*, 2007 WL 2729011 (N.D. Ga. Sept. 14, 2007); *Reyes v. Zynga Inc.*, 2013 WL 5529754 (N.D. Cal. Jan. 23, 2013).

[11] 56 of 75 (approximately 75%) Securities Act class actions brought in state court between 2000 and 2017 were filed in California.

[12] 138 S.Ct. 1061 (2018).

[13] Cornerstone Research, Securities Class Action Filings, 2019 Year in Review at 9, available at https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review.pdf ("Cornerstone Report").

[14] *Id.*

[15] *Id.*

[16] *See, e.g., Greensky, Inc. Sec. Litig.*, 2019 WL 6310525, at *2 (N.Y. Sup. Ct. Nov. 25, 2019).

[17] *See Matter of Dentsply Sirona, Inc.*, 2019 WL 3526142, at *6-7 (N.Y. Sup. Ct. Aug. 2, 2019); *Matter of PPDAI Grp. Sec. Litig.*, 2019 WL 2751278, at *6-7 (N.Y. Sup. Ct. 2019).

[18] *Swierkowki v. Consol. Rail Corp.*, 168 F. Supp. 2d 389, 395 (E.D. Pa. 2001); *see also Crown, Cork & Seal Co., Inc. v. Parker*, 462 U.S. 345, 349 (1983) (purpose of class action procedure is "promotion of efficiency and economy of litigation").

[19] Cornerstone Research, Shareholder Litigation Involving Acquisitions of Public Companies, Review of 2018 M&A Litigation at 5, available at https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-of-Public-Companies-Review-of-2018-M-and-A-Litigation-pdf.

[20] *See Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A. 3d 934, 942 (Del. Ch. 2013).

[21] *Id.* at 950-51.

[22] In particular, Section 115 defines "internal corporate claims" to include "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.

[23] *Hemg Inc. v. Aspen University*, 2013 WL 5958388 (N.Y. Sup. Ct. Nov. 4, 2013).

[24] *Groen v Safeway Inc.*, 2014 WL 3405752 (Cal. Super. Ct. May 14, 2014); *Miller v Beam Inc.*, 2014 WL 2727089 (Ill. Cir. Ct. Mar. 5, 2014).

[25] Cornerstone Research, Shareholder Litigation Involving Acquisitions of Public Companies, Review of 2018 M&A Litigation at 5, available at https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-of-Public-Companies-Review-of-2018-M-and-A-Litigation-pdf.

[26] *Sciabacucchi v. Salzberg*, 2018 WL 6719718, at *3 (Del. Ch. Dec. 19, 2018).

[27] *Salzberg*, 2020 WL 1280785, at *5.

[28] *Id.*

[29] *Id.*

[30] *Id.* at *20.

[31] *See, e.g., Intershop Commc'ns v. Superior Court*, 104 Cal. App. 4th 191, 196 (2002) ("A mandatory clause will ordinarily be given effect without any analysis of convenience; the only question is whether enforcement of the clause would be unreasonable."); *Arya's Collection, Inc. v. Brink's Glob. Servs., USA, Inc.*, 67 A.D.3d 525 (1st Dep't 2009) (holding mandatory forum selection clause was enforceable unless "enforcement would be unreasonable, unjust or invalid").

[32] *Hemg Inc. v. Aspen University*, 2013 WL 5958388 (N.Y. Sup. Ct. Nov. 4, 2013) (requiring derivative claims alleging breach of fiduciary duty to be brought in Delaware pursuant to forum selection clause in corporate bylaws); *Drulias v. 1st Century Bancshares, Inc.*, 30 Cal. App. 5th 696 (2018) (enforcing Delaware forum selection clause in merger litigation where breach of fiduciary duty was alleged).

This article first appeared on the Westlaw Practitioner Insights Commentaries web page on May 5, 2020.

ABOUT THE AUTHORS

James J. Beha II (L) is a partner in the Litigation Department of **Morrison & Foerster's** New York office. He focuses on securities litigation and mergers-and-acquisitions litigation. He can be reached at jbeha@mofo.com. **Steve Rappoport** (R) is of counsel in the Litigation Department in Morrison & Foerster's New York office. He focuses on securities litigation, financial services litigation and other general commercial litigation. He can be reached at srappoport@mofo.com