

Delaware Supreme Court Validates Federal Forum Provisions in Delaware Corporations' Charters

It's no secret that securities class action (SCA) lawsuits have been on the rise. Among other reasons, this is due to the U.S. Supreme Court's ruling in *Cyan Inc. v. Beaver County Employees Retirement Fund*, in which the Court held that state courts have concurrent jurisdiction over actions filed under the Securities Act of 1933. Since then, state SCA lawsuits have increased, sometimes filed alongside a federal SCA lawsuit, and thus unnecessarily increasing defense expenditures typically covered by D&O insurance policies.

On March 18, 2020, however, the Delaware Supreme Court did its part to help minimize SCAs and reduce attendant D&O-related costs. In *Sciabacucchi v. Salzberg*, ---A.3d---, 2020 WL 1280785 (Del. 2020), the court validated a forum provision in a Delaware corporation's charter requiring actions arising under the federal Securities Act of 1933 (1933 Act) to be filed in federal court. In doing so, it overturned the Delaware Chancery Court's ruling that the forum bylaw was invalid because 1933 Act claims did not involve rights or relationships established by or under Delaware's corporate law.

According to the court, Section 102(b)(1) under Delaware corporate law authorizes two broad types of provisions: (1) any provision for the management of the business and for the conduct of the affairs of the corporation; and (2) 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 Delaware law.

The court held that the forum bylaws at issue are facially valid because they fall under either authorizing provision. The court reasoned that the forum bylaws "involve a type of securities claim related to the management of litigation arising out of the Board's disclosures to current and prospective stockholders in connection with an IPO or secondary offering." In addition, "a corporation's management of its business and affairs and of its relationship with its stockholders is the drafting, reviewing, and filing of registration statements by a corporation and its directors." The court characterized the overlap of federal and state law in the disclosure area as "historic," "compatible," and "complimentary." It thus concluded that a bylaw seeking "to regulate the forum in which such 'intra-corporate' litigation can occur is a provision that addresses the 'management of the business' and the 'conduct of the affairs of the corporation,' and is, thus, facially valid under Section 102(b)(1)." In doing so, the court also ruled that forum bylaws did not violate Delaware laws or policies, reasoning that Section 102(b)(1)'s scope is broadly enabling and that it is not limited to a Delaware corporation's internal affairs.

Notably, in holding that forum bylaws are facially valid, the court took note of *Cyan*, observing that "when parallel state and federal actions are filed, no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court." The result, according to the court, is increased costs and inefficiencies, as well as possible inconsistent judgments and rulings. The court reasoned that by directing 1933 Act claims to federal courts when coordination and consolidation are possible, forum bylaws "classically fit the definition of a provision 'for the management of the business and for the conduct of the affairs of the corporation.'" Since forum bylaws also prescribe where current and former stockholders can bring Section 11 claims against the corporation and its directors and officers, the court reasoned that they also are a provision "defining, limiting and regulating the powers of the corporation, the directors and the stockholders."

Conclusion

The influx of SCA filings has undermined D&O underwriting profitability and yearly results. This,



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among other things, has led to increased premiums and self-insured retentions, as well as a reduction in capacity. The *Sciabacucchi* Court's holding validating a federal forum provision in a Delaware corporation's charter is certainly a win for D&O insurers. Such provisions have already been added to more than a hundred Delaware public companies' bylaws or charters. For these companies, state SCA lawsuits alleging 1933 Act claims should all but disappear. Moreover, it's expected other Delaware corporations will follow suit and add forum bylaws. The *Sciabacucchi* Court's ruling will thus help minimize the rise of state SCAs and limit attendant D&O-related costs.

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