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New York Law Journal

Four Years In: How Federal Forum Selection Clauses Have Fared Following Delaware's Landmark Decision in 'Salzberg'

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March 4, 2024

Four years ago, in March 2020, the Delaware Supreme Court issued a landmark ruling in *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020). In it, the court upheld the validity of provisions included in a Delaware corporation's certificate of incorporation that require shareholders of that corporation to sue in federal court, rather than state court, over alleged violations of the Securities Act of 1933 (the Securities Act); these claims arise most frequently in the initial public offering (IPO) context. These provisions, referred to as federal forum provisions (FFPs) are essentially contractual provisions between a corporation and its shareholders.

The *Salzberg* ruling was widely viewed as giving corporations a valuable tool in managing litigation, allowing them to reduce duplicative litigation and ease some of the administrative burdens of defending against sprawling securities actions by steering these complex cases to federal courts.

But how valuable this tool would prove to be had yet to be determined in the immediate aftermath of the *Salzberg* decision. In a previous article, we explored the potential reach of *Salzberg* and identified open questions, including: Would state courts enforce FFPs? What would happen to underwriters, who fall outside the contractual FFP relationship? Would FFPs be given the same effect if they were enacted in bylaws as opposed to certificates of incorporation? (*See* Michael G. Bongiorno, et al., "Open Questions After the Landmark Decision in 'Salzberg'", New York Law Journal, May 11, 2020).

Delaware Supreme Court Building.

While questions remain, including how key jurisdictions such as Delaware and New York will apply *Salzberg*, where the landscape has evolved, it has favored public corporations and includes promising decisions from securities litigation

strongholds like California and emerging markets such as Utah.

This article explores those developments and highlights the key takeaways for practitioners.

Question: Will FFPs be enforced?

Short Answer: Yes, state courts have enforced FFPs throughout the country.

One limitation to the *Salzberg* decision was that the court had before it a facial challenge—in other words, the court only considered whether there were any possible scenarios in which FFPs could be permissible. This left FFPs subject to challenge in specific cases in addition to more general challenges, including constitutional challenges. Here's how those challenges have arisen, and been resolved, to date:

• No challenges have reached any state supreme court.

• No **New York** or **Massachusetts** state appellate courts have taken on the question of FFPs' enforceability and Delaware has not revisited the vitality of *Salzberg*'s holding. At least one New York trial court has dismissed an action based on an FFP. *Hook v. Casa Systems*, Index No. 654548/2019, NYSCEF Doc. No. 124 at 7 (N.Y. Sup. Ct. Sept. 15, 2021). In Massachusetts, a trial court noted only in dicta that an FFP likely required dismissal under *Salzberg* but "declin[ed] to resolve" the question and dismissed the complaint on other grounds. *Shen v. Casa Systems,* 2020 WL 8839637, at *4 (Mass. Super. Ct. Jan. 11, 2020).

• In **New Jersey, Utah** and **California**, state courts granted motions to dismiss Securities Act claims and each relevant state's appellate court has affirmed the decision.

• **California** courts have seen the most rigorous challenge to FFPs, where *Salzberg* has been challenged on three separate occasions at the appellate level and FFPs have emerged unscathed.

The three key appellate cases in California merit a closer look:

First, in *Wong v. Restoration Robotics,* plaintiffs sued a Delaware robotics company headquartered in California under the Securities Act after its stock dropped following its IPO. 78 Cal. App. 5th 48, 56–57 (Cal. Ct. App. 2022). The company moved to dismiss based on the FFP in its certificate of incorporation, citing *Salzberg* extensively. Plaintiffs opposed, arguing that the FFP was contrary to the Securities Act, violated both the Commerce Clause and Supremacy Clause of the U.S. Constitution, and was invalid and unenforceable under California law. The lower court granted the motion to dismiss, and plaintiffs appealed.

In a lengthy published opinion, the Court of Appeal for the First District affirmed, holding that the FFP reflected "a contractual agreement between the corporation and its shareholders." Per the court, the FFP, which still allowed plaintiffs to file suit in federal court, did not violate the removal bar or anti-waiver provisions of the Securities Act.

The court then rejected plaintiffs' challenge to the constitutionality of Delaware's General Corporate Law, which permits FFPs, and rejected plaintiffs' assertion that "only the corporation benefits from an FFP…shareholders do not." It noted that the company's shareholders had approved of the FFP and, citing *Salzberg,* stated that "the avoidance of inefficiencies and unnecessary costs in litigation is a benefit to companies and shareholders alike."

Finally, the court rejected plaintiffs' arguments that the FFP was unenforceable or unconscionable because plaintiffs "had no bargaining power to negotiate it, and it was hidden in a prolix amendment to the registration statement." The court reasoned that "provisions of a certificate of incorporation are typically not negotiable, and prolixity is a common characteristic of registration statements[.]"

Second, a month after the *Restoration Robotics* decision, the California Court of Appeal issued another decision addressing FFPs in *Simonton v. Dropbox,* 2022 WL 1514619 (Cal. Ct. App. May

13, 2022). There, the court upheld dismissal of a case arising out of the IPO of Dropbox, a Delaware company headquartered in California, following the reasoning of *Restoration Robotics*.

Third, and most recently, in an unpublished decision, *Pham v. Arlo Technologies,* another appellate district affirmed the dismissal of a Securities Act case arising out of the IPO of Arlo Technologies Inc., another Delaware corporation headquartered in California. 2023 WL 3265558 (Cal. Ct. App. May 5, 2023). The *Pham* court followed the reasoning of *Restoration Robotics* and *Dropbox*.

Since these decisions, the current state of play in California is as follows:

• In all **three California cases**, plaintiffs filed writs of certiorari to the California Supreme Court, which have been denied.

Challenges in New Jersey and Utah met a similar fate, though notably neither decision involved Constitutional challenges such as those raised in California. The key takeaways from those decisions are as follows:

• In **New Jersey**, the Appellate Division affirmed the dismissal of Securities Act claims filed in state court against electroCore, a Delaware corporation based in New Jersey. *Kuehl v. electroCore,* 2023 WL 3444383, at *1, *6 (N.J. Super. Ct. App. Div. May 15, 2023). ElectroCore had an FFP in its certificate of incorporation at the time it went public. Like California, the New Jersey court rejected plaintiffs' arguments that the FFP was unreasonable, contrary to New Jersey public policy, and contravened the Securities Act. The court emphasized that New Jersey courts "look to Delaware courts for guidance on matters of corporate law" and viewed *Salzberg* to be "dispositive."

• In **Utah**, a state appellate court similarly ruled in favor of defendant Domo Inc., a Delaware corporation, when it dismissed Securities Act claims arising out of the company's IPO. *Volonte v. Domo*, 528 P.3d 327, 333 (Utah Ct. App. Mar. 9, 2023). The *Volonte* court found persuasive California's decisions in *Restoration Robotics* and *Dropbox*.

Question: What about underwriters, who are often named in Securities Act litigation but are not parties to the "contract" between a company and its shareholders?

Short Answer: The news is good for underwriters in decisions where courts have reached the issue.

The most informative opinion on this question is the Utah appellate court decision in *Volonte*.

First, the court acknowledged a potential divide between Utah and Delaware law, applied the "most significant relationship" test, and concluded that Delaware, not Utah, had the most significant relationship to the question of whether the underwriters could rely on the FFP. *Volonte*, 528 P.3d at 346-48.

To reach this conclusion, the court considered that the dispute was primarily national in nature, rather than local, and observed that corporations "frequently elect to incorporate out-of-state, and their choices are concentrated in the state of Delaware, in part so as to achieve a great degree of uniformity in the law that govern the business sector" (internal quotation marks omitted).

Next, the court considered *Salzberg's* recognition of the "need for uniformity and predictability relating to judicial decisions regarding FFPs," and that the adoption of FFPs was a response to the duplicative litigation corporations experienced when federal and state courts had concurrent jurisdiction. The fact that Domo and the underwriter defendants had entered into an indemnification agreement for losses arising from securities litigation suggested to the court that both parties saw "their interests as being linked with respect to this kind of Securities Act claim."

Finally, the court went on to determine that Delaware law permitted non-signatory defendants to enforce FFPs against a signatory plaintiff in certain circumstances. Where a party to the contract, like the shareholder plaintiff, effectively sought an "end-run around an otherwise

enforceable forum selection provision in his suit against third-party beneficiaries," like the underwriters, enforcing the FFP was appropriate, and the underwriters were entitled to dismissal.

In addition to the *Volonte* opinion, New York's trial court likewise resolved this question favorably for underwriters in *Hook v. Casa Systems.* Index No. 654548/2019, NYSCEF Doc. No. 124. In *Hook*, the court reasoned that under both Delaware and New York law, non-signatories could be bound by or enforce a forum selection clause, and additionally the language of the FFP applied to "any complaint asserting a cause of action arising under the Securities Act," which the court reasoned would include non-signatories.

Though the case law is thin on this question, the key takeaway for underwriters is:

• FFPs have benefited underwriters when the language of the FFP is broad and covers any complaint asserting a cause of action arising under the Securities Act and when contractual indemnity rights expressly cover losses arising from securities litigation.

Question: Will FFPs in bylaws, which are generally easier to amend than certificates of incorporation, be given equal effect?

Short Answer: Yes, as it currently stands, it appears that FFPs in bylaws will be given equal effect.

To date, both Utah and California have upheld FFPs in bylaws. Here's the breakdown:

• In **Utah**, the court in *Volonte* explained that both Utah and Delaware law made clear that "the bylaws constitute a binding part of the contract between a Delaware corporation and its stockholders." *Volonte*, 528 P.3d at 340. Thus, the court found no meaningful difference between the enforceability of an FFP in bylaws versus a certificate of incorporation.

• Similarly, in the **California** decision *Dropbox,* the court noted in a footnote that the case was not distinguishable on the basis that the FFP appeared in the company's bylaws as it "is well established that a party purchasing stock in a Delaware company agrees to be bound by the company's bylaws." *Dropbox*, 2022 WL 1514619, at *4, n.4.

A Final Reflection: After four years, where does this leave corporations?

Our Concluding Thoughts:

• The *Salzberg* decision remains a significant victory for corporations by giving them the flexibility to manage potential Securities Act litigation arising from their IPOs.

• While there is still some uncertainty around the margins, the initial report, at the decision's four-year anniversary, is uniformly positive across key jurisdictions, including California, Utah and New Jersey.

• Given the precedent discussed here, we anticipate that more and more courts will reiterate and embrace the reasoning of the *Salzberg* decision and that FFPs will become standard in both certificates of incorporation and corporate bylaws.

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