CHANNELING CLAIMS: THE IMPORTANCE OF CONSIDERING (AND UPDATING) EXCLUSIVE FORUM PROVISIONS NOW

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In recent years, there has been an ever-increasing number of public and private companies adopting exclusive forum provisions in their charter or bylaws. Having exclusive forum provisions in place can be beneficial for a company and its shareholders by decreasing the risk of facing costly litigation across multiple, potentially distant, jurisdictions and by helping to mitigate the consequent risk of varied results in such jurisdictions.

By following a careful board deliberation process and putting exclusive forum provisions in place now (on a “clear day”), a company can ensure a more streamlined litigation strategy, increase predictability and consistency, and reduce transaction and litigation costs for the company and its shareholders.

There are two primary types of exclusive forum provisions and companies are encouraged to consider adopting a form of both in their charter or bylaws. As discussed below, Delaware has confirmed the validity of both types, and many other jurisdictions often follow Delaware's lead on corporate law matters.

INTERNAL CORPORATE CLAIMS

The first type of exclusive forum provisions are those that apply to internal corporate affairs, derivative actions, or similar matters. In 2015, Delaware codified the validity of this type of exclusive-forum provision in Section 115 of the Delaware General Corporation Law (the DGCL): “The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State.”

SECURITIES ACT CLAIMS

The second type is a more recent evolution and relates to claims brought under the Securities Act of 1933 (the Securities Act). In a 2018 case, the Supreme Court of the United States held that state courts have concurrent jurisdiction over Securities Act claims, which vastly increased the potential exposure of a company with regard to such claims. (*Cyan, Inc. v. Beaver Cty. Employees Ret. Fund*, 138 S. Ct. 1061 (2018)).

In order to avoid facing potential state court actions for Securities Act claims, a company should consider making the federal district courts the exclusive forum for Securities Act claims. The Delaware Supreme Court recently ruled that such a provision is facially valid under Delaware law if set forth in the certificate of incorporation. (*Salzberg v. Sciabacucchi*, 227 A.3d 102, 109 (Del. 2020)). The *Salzberg* decision relied on the wording of Section 102(b)(1) of the DGCL, which allows a certificate of incorporation to include “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…" in each case "if such provisions are not contrary to the laws of this State." (DGCL § 102(b)(1)). The Delaware Supreme Court held that a federal-forum provision in a charter would be authorized under each of those branches of permissible provisions.

One open question post-*Salzberg* is whether the logic extends to similar provisions in a company's bylaws. This question was not directly within the purview of the *Salzberg* court, but there is a good argument that a Securities Act exclusive forum bylaw would also be held to be facially valid since, for example, the court referred to the similar language in Section 109(b) of the DGCL that relates to bylaws: "The bylaws may contain any provision … relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." (see *Salzberg* at 115).

Another open question is whether other states will enforce these exclusive forum provisions, which was addressed in dicta by the Salzberg court. While the full landscape is still unfolding, two recent helpful decisions in different California State Superior Courts enforced Securities Act exclusive forum provisions adopted by Delaware corporations (see *Wong v. Restoration Robotics* (No. 18CIV02609 (San Mateo County), Sept. 1, 2020); *In re Uber Technologies, Inc. Securities Litigation* (No. CGC-19-579544 (San Francisco County), Nov. 16, 2020)). We anticipate that the results in *Wong* and *Uber* will be followed by other courts confronted with the same issue.

OTHER CONSIDERATIONS

Recent trends in Securities Act litigation also point to the need for companies to consider adopting a federal forum provision in addition to the general provision described above. In 2019, there were 428 new class action Securities Act lawsuits filed. (Cornerstone Research, "Securities Class Action Filings – 2019 Year in Review," (2020)). This represented a year-over-year increase of 40 percent over 2018, and was nearly double the average of the prior 20 years. (*Id.*) Of these cases, over 75 percent were either state-only filings or were parallel state-federal filings. (*Id.*) Total filing activity was down in the first half of 2020 compared to 2019, but similar to 2019, 45 percent of state Securities Act class action filings in the first half of 2020 had a parallel federal action. (Cornerstone Research, "Securities Class Action Filings – 2020 Midyear Assessment," (2020)). As a result of these parallel claims, companies are increasingly facing Securities Act claims in either state courts alone or multiple forums simultaneously.

While placing either type of exclusive forum provision in the charter tends to establish a stronger foundation, for most companies it is far easier to amend the bylaws (often by board action alone) than it is to amend the charter (usually requiring both board and shareholder action). A company should weigh the relative burdens and benefits when determining whether to amend the charter or bylaws as well as consider whether other charter or bylaw updates or enhancements are appropriate as part of a more comprehensive review. In addition, although the major proxy advisory firms continue to develop their approach to exclusive forum provisions (particularly where unilateral board action is taken), we suggest that companies work closely with their directors and advisors now to consider whether one or both types of exclusive forum provision would be beneficial to the company and its shareholders.

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