

DOES *SALZBERG V. SCIABACUCCHI*'S APPLIED ANALYSIS OF DGCL § 102(B)(1) RENDER IT VIOLATIVE OF THE SUPREMACY CLAUSE?

*Kaleb Byars**

INTRODUCTION

In *Salzberg v. Sciabacucchi*,¹ the Delaware Supreme Court held that federal-forum provisions in Delaware certificates of incorporation are valid under § 102(b)(1) of the General Corporation Law of the State of Delaware.² While these provisions may be valid under the language of § 102(b)(1), *Salzberg* begs the question of whether its construction of § 102(b)(1)—rendering federal-forum provisions valid as a matter of Delaware corporate law—causes § 102(b)(1) to violate the Supremacy Clause of the U.S. Constitution.³ This Comment analyzes this question, and it concludes that after *Salzberg*, § 102(b)(1) indeed violates the Supremacy Clause to the extent that it validates federal-forum provisions.

This Comment first recounts relevant portions of the *Salzberg* opinion in Part I. In Part II, this Comment considers germane Supremacy Clause jurisprudence. Finally, Part III concludes that *Salzberg*'s construction of

* Third-year J.D. Candidate, the University of Tennessee College of Law (Class of 2021) | Editor-in-Chief, the *Tennessee Law Review* | Bachelor of Science in Business Administration: Economics and Finance, the University of Tennessee at Martin. The author expresses sincere thanks to Professor Joan Heminway for her unwavering assistance in developing the idea for this Comment. The author also expresses thanks to all organizers of and participants in the 2020 Business Transactions: Connecting the Threads Symposium for their support and feedback during the presentation of this piece. Finally, the author expresses thanks to the editors and staff of *Transactions: The Tennessee Journal of Business Law* for their editing efforts. The author specifically thanks McKay Devault, Mason Rush, Eric Salama, and Rachel West for their outstanding editing support.

¹ 227 A.3d 102 (Del. 2020).

² DEL. CODE ANN. tit 8, § 102(b)(1) (2020). Federal-forum provisions are forum-selection clauses that provide that plaintiffs seeking to bring claims arising out of the contract at issue must bring such claims in a federal forum. *See, e.g., Salzberg*, 227 A.3d at 109.

³ U.S. CONST. art. VI, cl. 2.

the application of § 102(b)(1) to federal-forum provisions renders the statute violative of the Supremacy Clause, explains this conclusion, and identifies a harm that *Salzberg* threatens.

SALZBERG V. SCLABACUCCHI

Matthew Sciabacucchi purchased shares in three Delaware corporations.⁴ Each of the three corporations had federal-forum provisions in their certificates of incorporation that required claims under the Securities Act of 1933, as amended (the “Act”)⁵ to be filed in federal courts.⁶ Sciabacucchi challenged these “federal-forum provisions” under Delaware law.⁷ The Delaware Court of Chancery held the provisions were invalid, reasoning that “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 under Delaware’s corporate law.”⁸

In *Salzberg*, the Delaware Supreme Court reversed.⁹ The court first recounted relevant sections of the Act. Most importantly, the Act explicitly allows plaintiffs to bring claims under the Act in *either* federal or state court.¹⁰ Moreover, the Act provides that when a plaintiff brings a claim under it in state court, the defendant may not remove the claim to federal court.¹¹

The Delaware Supreme Court then turned to § 102(b)(1). Section 102(b)(1) broadly provides, “[T]he certificate of incorporation [may contain a provision] for the management of the business and for the conduct of the affairs of the corporation, and any provision creating,

⁴ *Salzberg*, 227 A.3d at 109.

⁵ See generally 15 U.S.C. §§ 77a–77aa (2018).

⁶ *Salzberg*, 227 A.3d at 111–12.

⁷ *Id.* at 112.

⁸ *Sciabacucchi v. Salzberg*, No. 2017-0931-JTL, 2018 WL 6719718, at *3 (Del. Ch. Dec. 19, 2018).

⁹ *Salzberg*, 227 A.3d at 138.

¹⁰ 15 U.S.C. § 77v(a). For background on the history and controversy surrounding the proper venue for claims under the Act, see generally GIBSON DUNN, SUPREME COURT HOLDS STATES MAY HEAR SECURITIES FRAUD CLASS ACTIONS UNDER THE 1933 ACT; LAURI SMILAN & NICKI LOCKER, *Saying So Long to State Court Securities Litigation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 11, 2019), <https://corp.gov.law.harvard.edu/2019/02/11/saying-so-long-to-state-court-securities-litigation/>.

¹¹ 15 U.S.C. § 77v(a).

defining, limiting and regulating the powers of the corporation, the directors, and the stockholders”¹² Relying on § 102(b)(1), the court held that federal-forum provisions are valid.¹³ At its core, the court reasoned that § 102(b)(1)’s broad language permits private ordering of a corporation’s affairs and that federal-forum provisions are part of the management of a corporation’s business and means of exercising control over the powers of the corporation and its constituents.¹⁴

However, the court’s analysis rested entirely on its interpretation of § 102(b)(1) as applied in the context of litigation under the Act. The court did not consider whether the statute’s application to federal-forum provisions comports with the Supremacy Clause.¹⁵

THE SUPREMACY CLAUSE

The Supremacy Clause provides that federal law is the “supreme Law of the Land” and that “every State shall be bound [by federal law], any Thing in the . . . Laws of any State to the Contrary notwithstanding.”¹⁶ Stated more simply, when federal law and state law conflict, federal law “preempts” the state law and governs over it.¹⁷ Preemption can occur in a number of ways,¹⁸ but most pertinently, “field preemption” occurs when Congress intends to displace a state’s ability to regulate in a field or when Congress’s interest in regulating a given field is particularly influential.¹⁹

However, legal issues under the Supremacy Clause extend beyond preemption. Indeed, the Clause prohibits states from acting in contravention of federal action or otherwise interfering with federal

¹² DEL. CODE ANN. tit 8, § 102(b)(1) (2020).

¹³ *Salzberg*, 227 A.3d at 114. The holding related specifically to the provisions at issue in the case, but the holding broadly suggests that federal-forum provisions are generally valid.

¹⁴ *Id.* at 113–14. The court continued for some length, discussing the difference between “internal affairs” claims, intra-corporate claims, and external claims and concluding that the claims at issue were not external claims and thus the federal-forum provisions were valid under § 102(b)(1). *See generally id.* at 120–32. This Comment omits this discussion because it is immaterial to its thesis.

¹⁵ Of course, the plaintiffs did not challenge the constitutionality of § 102(b)(1), so that issue was not before the court.

¹⁶ U.S. CONST. art. VI, cl. 2.

¹⁷ CALVIN MASSEY & BRANNON P. DENNING, *AMERICAN CONSTITUTIONAL LAW: POWERS AND LIBERTIES* 321 (6th ed. 2019).

¹⁸ *See generally id.* at 321–23 (explaining that when Congress intends to preempt state law, “it does so either expressly or by implication”).

¹⁹ *Id.* at 322.

rights.²⁰ Notably, states may not refuse to enforce federal laws or federally granted rights.²¹ Therefore, the Supreme Court has held states may not without “valid excuse” refuse to hear a class of cases simply because those cases are based on a question of federal law.²² Federalism requires this result. As the Court stated in *Howlett ex rel. Howlett v. Rose*:

Federal law is enforceable in state courts not because Congress has determined that federal courts would otherwise be burdened or that state courts might provide a more convenient forum—although both might well be true—but because the Constitution and laws passed pursuant to it are as much laws in the States as laws passed by the [states]. *The Supremacy Clause . . . charges state courts with a coordinate responsibility to enforce [federal] law . . .* The two together form one system of jurisprudence, which constitutes the law of the land for the State[,] and the courts of the two jurisdictions are . . . courts of the same country, having jurisdiction partly different and partly concurrent.²³

Citing *Howlett*, at least one court has explicitly recognized that states may not discriminate against federal causes of action and thus must equally adjudicate federal causes of action before their courts.²⁴ It is worth recognizing there is an exception to the general rule that states must hear and process properly filed federal claims. Specifically, a state may refuse to adjudicate *individual cases* when necessary for efficient administration of the state’s courts.²⁵

SALZBERG RENDERS § 102(B)(1) VIOLATIVE
OF THE SUPREMACY CLAUSE

With this brief background on the *Salzberg* opinion and the Supremacy Clause in the backdrop, an inescapable conclusion emerges: *Salzberg*’s interpretation of § 102(b)(1) renders it violative of the Supremacy Clause and therefore unconstitutional as applied to federal-forum provisions.

²⁰ See *Howlett ex rel. Howlett v. Rose*, 496 U.S. 356, 367–73 (1990).

²¹ *Id.* at 369.

²² *Id.* (quoting *Douglas v. New York*, 279 U.S. 377, 387–88 (1929)).

²³ *Id.* at 367 (emphasis added).

²⁴ See *R.A. Ponte Architects, Ltd. v. Invs.’ Alert, Inc.*, 857 A.2d 1, 7 (Md. 2004) (citing *Howlett*, 496 U.S. at 366).

²⁵ See *Howlett*, 496 U.S. at 374–75. Thus, for example, states may grant change of venue motions on *forum non-conveniens* grounds in appropriate cases. *Id.* at 375.

As a preliminary matter, there is a reasonable argument that field preemption alone renders § 102(b)(1) unconstitutional as interpreted in *Salzberg*. The Act and related legislation provide a comprehensive, detailed statutory framework that provides for federal remedies (including by expressly offering plaintiffs their choice of a federal or state forum), and Congress has important interests in monitoring securities law enforcement (e.g., protecting investors, assuring the integrity of securities markets, and promoting capital formation).²⁶ These interests alone arguably suffice to effectuate field preemption.²⁷

More importantly, though, the Act explicitly states that plaintiffs who bring claims under the Act may bring their claims *either* in federal or state court.²⁸ Similarly, the Act provides that a defendant may not remove a claim to federal court after a plaintiff files in state court.²⁹ These two provisions demonstrate Congress's intent to ensure plaintiffs have adequate avenues—and the discretion to choose among those avenues—through which they may seek recourse for violations of the Act in *both* federal and state court. Accordingly, specific statutory language concerning private enforcement discretion, too, supports a finding of field preemption.

Irrespective of preemption, however, it is sufficient that under *Howlett*, states may not outsource a class of federal claims to federal courts because doing so contravenes interests in federalism. Consequently, § 102(b)(1) as interpreted in *Salzberg* violates the Supremacy Clause because it constitutes state action, through corporate authorization to effectually outsource numerous classes of federal securities claims to federal courts. It is true that the statute itself does not expressly outsource federal claims. Nevertheless, the statute violates the Supremacy Clause because it permits corporations—which are creatures of state law (unlike private

²⁶ See 15 U.S.C. § 77b(b) (2018).

²⁷ Of course, states can and do legally enact securities laws as well. See, e.g., Patrick J. McGinley, *When Does Florida's Sunshine Law Apply?*, 24 WEST'S FLA. PRAC. SERIES: FLA. MUN. L. & PRAC. § 10.3 (2020). However, these laws may not themselves contravene federal securities laws. See generally *Howlett*, 496 U.S. at 372 (explaining that states have “great latitude” when forming “the structure and jurisdiction of their own courts”).

²⁸ 15 U.S.C. § 77v(a).

²⁹ *Id.*

individuals)—to unilaterally outsource federal claims to federal courts.³⁰ Other sources support this thesis.³¹

A skeptic may counter this Comment with an argument that the “valid excuse” exception should permit Delaware to outsource federal securities claims to federal courts on grounds that it is inconvenient for Delaware courts to hear the claims. But this argument is to no avail. The “valid excuse” exception applies only when it is inconvenient for a state court to adjudicate an *individual case*.³² On the other hand, the exception does not allow a state court to delegate an entire *class* of cases to federal court merely because adjudicating those cases requires extra effort.³³

Finally, it is important to recognize the harm *Salzberg* and the corresponding Supremacy Clause violation causes. When corporations enact federal-forum provisions, they require potential plaintiffs to seek relief in federal courts. This requirement is problematic for plaintiffs because some states have less exacting pleading standards (e.g., notice pleading) than the federal jurisdiction (i.e., plausible pleading), and this heightened standard renders it more costly for plaintiffs to mount claims under the Act.³⁴ As a result, federal-forum provisions license corporations

³⁰ Cf. Patrick R. Baker, Paula H. Moore, & Kaleb P. Byars, *Unclaimed Property: Uncertainty with Tennessee’s Adoption of the Revised Uniform Unclaimed Property Act and Related Income Tax Liability*, 45 J. BUS. & ECON. PERSPS. 90, 95–96, 98 (2018) (discussing the derivative rights doctrine and the notion that a state may not delegate to private individuals a right that the state itself does not possess). It will be interesting to analyze whether the number of federal-forum provisions in corporate charters increases substantially after *Salzberg*. That type of trend would support that *Salzberg* allows precisely what *Howlett* prohibited: state courts’ refusal to decide a class of cases based on a federal issue. *Howlett*, 496 U.S. at 369 (quoting *Douglas v. New York*, 279 U.S. 377, 387–88 (1929)).

³¹ See, e.g., Plaintiffs’ Opposition to Defendants’ Motion to Dismiss for *Forum Non Conveniens* at 14–16, *In re Dropbox, Inc. Sec. Litig.*, No. 19-CIV-05089 (Cal. App. Dep’t Super. Ct. June 10, 2020); Alison Frankel, *Are Delaware Federal Forum Selection Clauses Unconstitutional?*, REUTERS (Sept. 8, 2020, 5:35 PM), <https://www.reuters.com/article/legal-us-otc-forum/are-delaware-federal-forum-selection-clauses-unconstitutional-idUSKBN25Z375>.

³² See *Howlett*, 496 U.S. at 374–75.

³³ See *id.* (quoting *Douglas*, 279 U.S. at 387–88).

³⁴ Compare *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)) (plausible pleading standard), with *Webb v. Nashville Area Habitat for Humanity, Inc.*, 346 S.W.3d 422, 426 (Tenn. 2011) (notice pleading standard), and *Champagne v. Thurston Cnty.*, 178 P.3d 936, 945 (Wash. 2008) (notice pleading standard). See generally James E. von der Heydt, *Ripple Effects: The Unintended*

and their management constituents (likely with disproportionate bargaining power and wealth) to direct plaintiffs that sue them to a venue where the standard to survive a motion to dismiss is more likely to be dispositive of their cases. Of course, this harm itself causes a collateral harm. Namely, if less securities claims reach at least the summary judgment stage (where courts may decide the claims on the merits), securities law will necessarily remain under-litigated, and the federal system of securities regulation will consequently be less transparent.³⁵ Resultingly, investor protection and market integrity will be less secure, and fewer investors may be willing to participate in national securities markets. Thus, *Salzberg's* holding undermines the paramount goals of the Act.³⁶

CONCLUSION

The Delaware Supreme Court's decision in *Salzberg* causes § 102(b)(1) to violate the Supremacy Clause. This is so because the Securities Act of 1933 clearly expresses intent for securities claims to be adjudicated in both state and federal courts and because § 102(b)(1) after *Salzberg* improperly allows corporations, which are creatures of state law, to outsource all securities claims to federal court. The *Salzberg* decision will cause concrete harm to plaintiffs by subjecting them to a heightened pleading standard, and it will result in less secure investor protection and market integrity. Future plaintiffs should challenge § 102(b)(1) under the Supremacy Clause to avoid these harms.

Change to Jurisdictional Pleading Standards After Iqbal, 60 CLEV. ST. L. REV. 799 (2012) (discussing, *inter alia*, different pleading standards).

³⁵ This Comment recognizes the potential counterargument that its thesis may cause inefficiency via a greater number of concurrent suits in state and federal courts. However, abstention doctrines will mitigate these costs. Moreover, the fact that a constitutional commandment imposes costs does not render the constitutional commandment ineffective.

³⁶ See 15 U.S.C. § 77b(b) (2018).