

September 17, 2020

## California State Court Enforces Federal Forum Provision and Dismisses Securities Act Claims

This month a California state court became the first court in the country to dismiss claims brought under the Securities Act of 1933 (the “Securities Act”) because the issuer’s corporate charter contained a federal forum provision (an “FFP”) requiring Securities Act claims to be brought in federal court. Earlier this year, the Delaware Supreme Court determined that FFPs are facially valid under Delaware law in *Salzberg v. Sciabacucchi*.<sup>1</sup> In *Wong v. Restoration Robotics, Inc.*, a California state court dismissed Securities Act claims on forum non conveniens grounds against an issuer (a Delaware corporation) and its officers and directors, finding that the issuer’s FFP was legal and enforceable under California law.<sup>2</sup> Although the decision leaves some questions unanswered, it is a welcome development for corporations that have adopted FFPs in the wake of *Sciabacucchi* in efforts to eliminate costly and often duplicative Securities Act litigation in state courts.

### The Burden of State Court Securities Act Cases and the Adoption of FFPs

The Securities Act provides for concurrent jurisdiction in state and federal courts. In 2018, the United States Supreme Court unanimously held in *Cyan, Inc. v. Beaver County Employees Retirement Fund*<sup>3</sup> that state courts have jurisdiction over securities class action lawsuits brought under the Securities Act and that such claims are not removable from state to federal court. After *Cyan*, the securities plaintiffs’ bar dramatically increased the number of Securities Act class actions filed in state courts, which are generally perceived as more favorable forums for plaintiffs than federal courts due to more lenient pleading standards and, according to some courts, the lack of certain statutory protections for defendants. Additionally, Securities Act defendants have increasingly faced parallel, simultaneous lawsuits in both state and federal courts that cannot be consolidated or even coordinated. In the first half of 2020, 45 percent of all Securities Act filings in state court had a parallel action in federal court.<sup>4</sup> The potential for inconsistent state holdings on federal securities laws issues and the increased cost of multi-jurisdictional litigation have led to increased burdens on public companies, including substantially higher D&O insurance premiums. In 2019, insurance

<sup>1</sup> 2020 WL 1280785 (Del. Mar. 18, 2020).

<sup>2</sup> No. 18CIV02609, Order on Motion to Dismiss (Cal. Super. Ct. Sept. 1, 2020).

<sup>3</sup> 138 S. Ct. 1061 (2018).

<sup>4</sup> Stanford Law Sch. Secs. Class Action Clearinghouse & Cornerstone Research, *Securities Class Action Filings 2020 Midyear Assessment* 3 (2020).

premiums for companies going public (an event that often precipitates Securities Act lawsuits) more than doubled compared to 2018 when *Cyan* was decided.<sup>5</sup>

In an effort to counter the increase in state and multi-jurisdictional Securities Act claims, corporations began adopting FFPs in their charters. FFPs provide that federal district courts are the exclusive forum for any lawsuit brought against the corporation asserting claims under the Securities Act.<sup>6</sup> On March 18, 2020, the Delaware Supreme Court reversed a December 2018 decision of the Delaware Court of Chancery and held that FFPs included in corporate charters are facially valid under Section 102(b)(1) of the Delaware General Corporation Law.<sup>7</sup> The court further explained that FFPs do not run afoul of *Cyan* or violate federal or interstate policy because forum selection provisions are uniformly favored under federal and state law.<sup>8</sup>

### **The California Superior Court Enforces an FFP under California Law**

On September 1, 2020, a California state judge granted motions to dismiss long-running Securities Act claims against Restoration Robotics and its directors and officers based on an FFP in the company's charter.<sup>9</sup> Although the court relied on *Sciabacucchi* to determine that Delaware law generally permits FFPs, the court then analyzed the enforceability of the defendant company's FFP under California law.<sup>10</sup> The court found that the FFP at issue was prima facie valid because mandatory forum selection clauses are generally enforceable under California law and because the FFP at issue was subject to shareholder vote and approval, was not applied retroactively, and did not restrict Securities Act claims to a specific federal venue.<sup>11</sup> The court then found that plaintiffs failed to satisfy their burden to show that the FFP was "unenforceable, unconscionable, unjust or unreasonable" under California law because there was "no disruption to the substantive rights of the shareholders to all protections provided by the Securities Act" and no "procedural

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<sup>5</sup> Nicki Locker & Laurie Smilan, *Carving Out IPO Protections*, Harvard Law School Forum on Corporate Governance (Feb. 25, 2020); Judy Greenwald, *Ruling Drives Up D&O Costs*, Business Insurance (Dec. 3, 2018).

<sup>6</sup> For example, the FFP at issue in *Restoration Robotics* stated: "Unless the Corporation consents in writing to the selection of an alternate forum, the federal district courts of the United States of America shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933, as amended. Any person or entity purchasing or otherwise acquiring any interest in any security of the Corporation shall be deemed to have notice of and consented to this [provision]." No. 18CIV02609, Restoration Robotics Defendants' Notice of Motion and Renewed Motion to Dismiss 8 (Cal. Super. Ct. Mar. 30, 2020).

<sup>7</sup> 2020 WL 1280785, at \*4.

<sup>8</sup> *Id.* at \*23.

<sup>9</sup> No. 18CIV02609, Order on Motion to Dismiss 44 (Cal. Super. Ct. Sept. 1, 2020).

<sup>10</sup> *Id.* at 31.

<sup>11</sup> *Id.* at 43.

loss of Due Process” to shareholders.<sup>12</sup> If anything, “[t]here is even greater authority in federal court to obtain personal jurisdiction over defendants, and to subpoena witnesses to trial.”<sup>13</sup>

The court declined to adjudicate plaintiffs’ arguments that the FFP was unconstitutional under the Commerce Clause and the Supremacy Clause, explaining that such an argument would be more properly addressed to a federal court in a different procedural posture.<sup>14</sup> Notably, the court did not dismiss Securities Act claims against the underwriters of Restoration Robotics’ IPO and certain venture capital defendants that hold a large stake in Restoration Robotics, explaining that those defendants failed to file substantive motions to dismiss and were neither parties nor signatories to the corporate charter containing the FFP.<sup>15</sup>

### **Impact of the *Restoration Robotics* Decision**

The decisions in *Sciabacucchi* and *Restoration Robotics* suggest that Delaware corporations should be able to rely on FFPs to avoid the risk and financial burden of litigating Securities Act claims in state courts or multiple jurisdictions. Corporations that have already adopted FFPs in their charters should strongly consider enforcing them if they are sued under the Securities Act in state court, either by moving to dismiss or transfer venue under the doctrine of forum non conveniens, or by moving to dismiss for lack of jurisdiction or improper venue. Corporations that anticipate going public should strongly consider adopting FFPs in their corporate charters. Companies that adopt FFPs should bear in mind the factors cited favorably in *Restoration Robotics*, including that the FFP at issue was not retroactive, was approved by shareholders, and did not restrict Securities Act claims to a particular federal venue—although the ruling did not affirmatively suggest that failure to satisfy any one of these factors would necessarily change the outcome.

It remains to be seen whether other courts—particularly those outside of California—will adopt the reasoning in *Restoration Robotics* and enforce FFPs. The decision also leaves certain other questions unanswered, such as whether and in what circumstances courts will enforce FFPs to dismiss claims against underwriters and other defendants that are not parties to a corporate charter, and whether courts will enforce FFPs that are adopted without shareholder vote in a company’s bylaws instead of a certificate of incorporation. Nonetheless, the *Restoration Robotics* decision is a key step in the path to restoring Securities Act lawsuits to federal courts and bringing litigation costs and insurance premiums back in line.

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<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 38.

<sup>15</sup> *Id.* at 2–3.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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