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Client Alert Commentary

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California Court of Appeal Upholds Federal Forum Provision Covering State-Court IPO Securities Class Actions

Latham's victory for Restoration Robotics promises to curb wasteful two-track Securities Act litigation and restore market stability for directors and officers insurance coverage.

Key Points:

- In the first appellate decision issued outside of Delaware, the California Court of Appeal enforced a forum selection clause in a corporate charter requiring that all Securities Act claims be brought in federal court.
- Companies can now avoid the cost and inefficiency of having to litigate post-offering securities class actions simultaneously in both federal and state court.

On April 28, 2022, the California Court of Appeal issued a much-anticipated decision in *Wong v. Restoration Robotics*, Case No. A161489, enforcing a forum selection clause contained in a corporate charter provision that required all claims under the Securities Act of 1933 to be brought in federal court. Such forum selection provisions — known as federal forum provisions or FFPs — were broadly implemented in the wake of the United States Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees' Retirement Fund*, 138 S. Ct. 1061 (2018). In *Cyan*, the Court held that state courts retain concurrent jurisdiction over claims arising under the Securities Act, and unleashed a wave of wasteful parallel litigation in federal and state court. Through bylaw and charter provisions, many companies sought to avoid these harmful consequences by requiring that Securities Act claims be brought exclusively in federal court.

Two years ago, the Delaware Supreme Court held in *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020) that FFPs were facially valid under both Delaware state law and federal law. But the Delaware Supreme Court's decision in *Sciabacucchi* left open whether FFPs are enforceable under the laws of other states. In *Restoration Robotics*, the California Court of Appeal was confronted with a slew of challenges to FFPs under both federal and California law — and rejected them all. According to the Court — FFPs do not violate the Securities Act, they do not violate the federal constitution, and they do not violate California law. The decision marks a significant win for corporations and their shareholders hoping to stem the tide of duplicative litigation arising from public securities offerings — particularly in cases brought in California state court.

Background

In October 2017, Restoration Robotics, Inc. — a Delaware corporation — conducted a modest US$25 million initial public offering.[1] As part of the IPO process, the company amended its certificate of incorporation to include a provision that 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 Article VIII."

This FFP was disclosed to prospective investors almost a month before Restoration Robotics' IPO.

Nevertheless, by the following spring, Restoration Robotics and several company officers and directors (together, Restoration Robotics) faced multiple lawsuits asserting claims under Sections 11, 12(a)(2), and 15 of the Securities Act. Consistent with the FFP, two such lawsuits were filed and subsequently consolidated in federal district court. The federal litigation ultimately settled in May 2021.

Meanwhile, Plaintiff in this case sued Restoration Robotics in California state court, bringing materially identical claims under the Securities Act. Restoration Robotics moved to dismiss based on the FFP. The Superior Court (Weiner, J.) agreed that the FFP barred Plaintiff's lawsuit in state court and dismissed the case. Plaintiff then appealed to the California Court of Appeal.

The Court of Appeal's Decision in *Restoration Robotics*

On April 28, 2022, the California Court of Appeal affirmed the Superior Court's decision enforcing Restoration Robotics' FFP. The Court methodically rejected each of Plaintiff's statutory, constitutional, and California law challenges to the FFP.

First, the Court held that FFPs do not violate the Securities Act — and, more specifically, that FFPs do not run afoul of the statute's so-called "removal bar" or "anti-waiver provision." The removal bar in Section 22(a) of the Securities Act provides that "no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States." 15 U.S.C. § 77v(a). The removal bar, the Court explained, does only what it says — it bars removal. And because "Restoration Robotics does not seek to remove this case to federal court," but instead merely "seeks to enforce the FFP," "the removal bar has no apparent application to the FFP." In so holding, the Court rejected Plaintiff's invitation "to look behind the words of the statute." Citing the US Supreme Court's decision in *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), the Court added that, if Securities Act claims "can be adjudicated outside of any court by the terms of a forum selection provision that requires arbitration," one would be "hard pressed to see why the claims cannot be adjudicated in a federal court by the terms of an FFP."

As for the anti-waiver provision, Section 14 of the Securities Act provides that "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void." 15 U.S.C. § 77n. The California Court of Appeal held that the FFP does not "amount[] to a waiver of compliance" within the meaning of that provision. Relying again on the Supreme Court's decision in *Rodriguez*, the Court reasoned that the Securities Act's provision of concurrent jurisdiction to state and federal courts "does not impose any duty" requiring compliance and thus "can be overridden by a forum selection agreement without violating the 1933 Act's anti-waiver provision." The Court further rejected Plaintiff's argument that

Rodriguez was distinguishable because it involved the Federal Arbitration Act's "policy favoring arbitration," noting that if arbitration does not inherently undermine any of the substantive rights afforded by the Securities Act, one "cannot discern how resort to a federal court could undermine any of those rights."

Second, the Court rejected Plaintiff's argument that FFPs violate the dormant Commerce Clause and the Supremacy Clause of the federal constitution. With regard to the Commerce Clause, the Court held that Plaintiff's challenge failed for two independent reasons. As a threshold matter, the Court concluded that FFPs did not involve "state action," a necessary element of any dormant Commerce Clause claim. Restoration Robotics, the Court explained, is "a private entity" that "does not perform a traditional, exclusive public function," was not "compelled by Delaware law to include an FFP in its certificate of incorporation," and was not "acting jointly" with any government official in adopting the FFP. "Even apart from the lack of state action," the Court continued, Plaintiff's dormant Commerce Clause challenge failed on the merits. Citing the US Supreme Court's decision in *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987), the Court noted that Delaware "has an interest in promoting stable relationships among parties involved in the corporations it charters." And as the Delaware Supreme Court recognized in *Sciabacucchi*, FFPs "allow for consolidation and coordination of such claims to avoid inefficiencies and unnecessary costs," benefitting corporations and stockholders alike. Accordingly, the Court concluded that "[a]ny burden on interstate commerce here is slight compared to the benefits."

As for the Supremacy Clause, the Court rejected Plaintiff's contention that Delaware unconstitutionally discriminates against federal law by ensuring that (purportedly) analogous claims under Delaware law may be heard in Delaware courts but not affording similar protection to Securities Act claims. For one thing, the Court explained, Plaintiff's argument "appears to rest on a false premise" because Plaintiff could not "identify any state law that is similar to his [federal claim] in size and type." For another, the precedents on which Plaintiff had relied — *Howlett By and Through Howlett v. Rose*, 496 U.S. 356 (1990), and *Haywood v. Drown*, 556 U.S. 729 (2009) — looked nothing like this case. *Howlett* and *Haywood*, the Court reasoned, "stand for the principle that a State cannot simply refuse to entertain a federal claim based on a policy disagreement." But because "Delaware does not purport to shut its doors, or the doors of any other state court to [Securities] Act claims," there is no Supremacy Clause problem.

Third, the Court held that Restoration Robotics' FFP was both valid and enforceable. On validity, the Court held that Delaware law — not California law — controls. Because the Delaware Supreme Court held in *Sciabacucchi* that "FFP's are valid provisions within the certificates of incorporation of Delaware corporations," that resolved the matter of validity. On enforceability, all agreed that the inquiry was governed by California law. Applying California law, the Court held that the FFP was neither "outside the reasonable expectations of shareholders" (because "the FFP was made public . . . several weeks before the IPO") nor "unconscionable" (because it was conspicuously presented in the "corporation's certificate of incorporation" and merely required Plaintiff to bring his federal claim "in a local federal court").

Implications

The decision in *Restoration Robotics* is a major win for corporations and stockholders alike, as it affirms the validity and enforceability of a provision that provides a convenient method to avoid duplicative litigation of Securities Act claims in federal and state court. Plaintiff could conceivably seek further review in the California Supreme Court, and other state appellate courts could also take a different view on the validity and enforceability of FFPs. But if the California Court of Appeal's well-reasoned decision portends a broader consensus to come, it promises to curb wasteful two-track litigation of Securities Act claims — and, by extension, restore stability to the market for directors and officers insurance coverage.

Companies weighing an IPO should strongly consider adopting a federal forum selection provision in their corporate bylaws or charter. Public companies that do not already have such provisions should likewise evaluate whether federal forum selection provisions should be added to corporate bylaws in advance of subsequent stock offerings or other events that may expose them to Securities Act liability. The upside is immense, and the downside is minimal.

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Endnotes

[1] Restoration Robotics was acquired by Venus Concept Ltd. in a 2019 merger.