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The Other Del. Business Courts? Litigating Derivative Suits in NY

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Delaware has long held a position of primacy as the preferred U.S. jurisdiction for incorporating publicly traded companies. Statistics reported by the Delaware Division of Corporations in recent years indicate that more than half of the nation's public companies are incorporated in Delaware. Not surprisingly, the Delaware courts have developed a robust and extensive body of case law governing shareholder derivative lawsuits involving Delaware companies.

In a different sense, New York enjoys its own degree of jurisdictional primacy. Many of the largest U.S. public companies, including many that are incorporated in Delaware, are either headquartered or have a substantial presence in New York—and therefore may be subject to personal jurisdiction there. Thus, although the Delaware courts may exercise jurisdiction over any derivative suit involving a company incorporated under Delaware law, New York's state and federal courts have in recent years served as fora for a substantial volume of derivative suits involving Delaware companies. As several recent cases demonstrate, those courts have largely shown deference to Delaware law, and faithfully applied its principles, when called upon to adjudicate shareholder suits involving Delaware companies.

The New York courts' deference to principles of Delaware law in such suits is not entirely surprising. As the New York Appellate Division noted almost thirty years ago in *Hart v. General Motors*, New York has long endorsed the so-called "internal affairs" doctrine, which recognizes that "'only one state should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands.'" *Hart v. General Motors*, 129 A.D.2d 179, 184 (N.Y. App. Div. 1987) (quoting *Edgar v. MITE*, 457 U.S. 624, 645 (1982)). Indeed, the

Appellate Division observed in *Hart* that "it is Delaware, not New York, which has an interest superior to that of all other states in deciding issues concerning directors' conduct of the internal affairs of corporations chartered under Delaware law."

But it was not a foregone conclusion that New York courts would defer to Delaware law in resolving derivative suits involving Delaware companies. By express statutory terms, portions of New York's Business Corporation Law (BCL)—including the provision authorizing derivative suits as a matter of New York law, BCL Section 626—"shall apply to a foreign corporation doing business in [New York]." Such statutory provisions at least arguably could be read to suggest that derivative claims may be maintained under New York law against foreign corporations that do business in New York. Indeed, in *Culligan Soft Water v. Clayton Dubilier & Rice*, 118 A.D.3d 422, 423 (N.Y. App. Div. 2014), a case against a corporation organized under Bermuda law, the New York Appellate Division found that "the issue of the plaintiffs' standing to bring a shareholder derivative action is governed by New York law, not Bermuda law." (It bears noting that *Culligan* involved circumstances implicating the doctrine of international comity regarding the laws of foreign nations, rather than principles of full faith and credit applicable to the laws of sister states, see, e.g., U.S. Constitution, Article IV, Section 1; 28 U.S.C. Section 1738.)

Nonetheless, New York state courts analyzing derivative suits involving Delaware corporations, as well as New York federal courts hearing such cases in the exercise of diversity jurisdiction, have consistently hewed to the principle that deference is owed to Delaware law, as in *Wandel v. Dimon*, 135 A.D.3d 515 (N.Y. App. Div. 2016); *International Painters v. Cantor Fitzgerald, L.P.*, 132 A.D.3d 470 (N.Y. App. Div. 2015); *Stephen Blau MD Money Purchase Pension Plan v. Dimon*, No. 650654/2014 (N.Y. Sup. Ct. May 6, 2015) ("*Stephen Blau*"); *F5 Capital v. Pappas*, No. 14 Civ. 9356, (S.D.N.Y. Feb. 17, 2016); and *In re SAIC Derivative Litigation*, 948 F. Supp. 2d 366, 376 (S.D.N.Y. 2013), *aff'd sub nom.*, *Welch v. Havenstein*, 553 F. App'x 54 (2d Cir. 2014). Indeed, one recent case expressly rejected a claim that BCL Sections 626 and 1319 compelled application of New York law to derivative claims involving a Delaware company, finding that Section 1319 "is not a conflict of laws rule" and "BCL 1319 and 626 do not require the court to disregard the overwhelming precedent ... holding that Delaware law governs in derivative actions brought on behalf of Delaware corporations." *Stephen Blau*, No. 650654/2014, slip op. at 10-11; *accord, e.g.*, *David Shaev Profit Sharing Plan v. Bank of America*, No 652580/2011 (N.Y. Sup. Ct. Dec. 29, 2014). Thus, for example, the state and federal courts in New York have consistently applied settled substantive principles of Delaware law governing derivative suits, such as the standards for assessing allegations of demand-futility derived from the Delaware Supreme Court's decisions in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), and *Rales v. Blasband*, 634 A.2d 927 (Del. 1993), *see Asbestos Workers Philadelphia Pension Fund v. Bell*, 137 A.D.3d 680 (N.Y. App. Div. 2016), and in particular the so-called *Caremark* standard governing claims for failure of directorial oversight, *see, e.g.*, *SAIC*, 948 F. Supp. 2d 366, *aff'd sub nom.*, *Welch*, 553 F. App'x 54; *In re FalconStor Software*, 39 Misc. 3d 916 (N.Y. Sup. Ct. 2013).

The New York courts have also consistently held derivative plaintiffs to the same discovery standards that would apply in the Delaware courts. For example, in *Lerner v. Prince*, 119 A.D.3d

122, 128 (N.Y. App. Div. 2014), the New York Appellate Division upheld the denial of a motion to compel discovery during the pendency of a motion to dismiss, holding that "plaintiff's right to discovery in [a] demand-refused case is a substantive question, rather than a procedural one, and therefore is governed by Delaware law." Although New York courts typically apply New York law when deciding discovery matters, which usually are deemed "procedural" in nature, the *Lerner* court found that "Delaware law on discovery is an integral part of the legal framework governing derivative proceedings" and, thus, that the decision whether to permit discovery in such a case is "a substantive question, going directly to the basis of the purported derivative suit." Citing Delaware authorities such as *Scattered v. Chicago Stock Exchange*, 701 A.2d 70 (Del. 1997), *Lerner* held that the plaintiff would not be permitted to take discovery during the pendency of defendants' motion to dismiss. (While stopping short of holding that it was bound to follow Delaware law when deciding whether to allow pre-answer discovery in a Delaware derivative suit, an earlier New York federal case, *In re Boston Scientific Shareholders Litigation*, No. 02 Civ. 247 (S.D.N.Y. June 13, 2007), similarly refused to grant such discovery on the ground that doing so "would frustrate the purposes behind Delaware's substantive law regarding demand-refusal.").

More recently, a trial court in New York's Commercial Division (the business-oriented division of New York's primary trial court, to which derivative cases typically are assigned by court rule) rejected another derivative plaintiff's request to take discovery during the pendency of a motion to dismiss, *see Stephen Blau*, No. 650654/2014, slip op. at 12, this time even over the plaintiff's invocation of section 3211(d) of New York's Civil Practice Law and Rules (CPLR), which provides that the court may "permit ... disclosure to be had" before resolving a motion to dismiss if it can be shown that "facts essential to justify opposition to the motion may exist but cannot then be stated." Despite the plaintiff's effort to invoke that well-established New York procedural rule, the court declined to apply New York law to the evaluation of the plaintiff's request for discovery in light of the "overwhelming body of precedent" reflected in cases such as *Lerner*.

It is unclear what has motivated those plaintiffs who, in recent years, have chosen to commence derivative actions involving Delaware companies in the New York courts. Issues such as convenience for New York-based counsel and clients, ready access to nonparty evidence located in New York, or other pragmatic considerations may well be a driving factor in many cases. But insofar as the volume of derivative case filings in New York might be attributable to efforts at forum shopping by plaintiffs' attorneys hoping to find more deferential legal standards for pleading and proving such cases, recent New York authorities in the derivative sphere indicate that the endeavor has largely been unsuccessful. Indeed, the case law suggests that Delaware practitioners and companies need not be too wary of the potential for divergence from settled principles of substantive Delaware law when derivative claims against Delaware companies are litigated in New York.

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