Harvard Law School Forum on Corporate Governance

Trends in Forum Selection Provisions, Merger Objection Class Actions and SPACs Continue To Shape Securities Litigation

Posted by Virginia Milstead, William J. O'Brien III, Skadden, Arps, Slate, Meagher & Flom LLP, on Thursday, January 19, 2023

Editor's note: Virginia Milstead is a Partner, and William J. O'Brien III is Counsel at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum.

Key Points

- State courts are enforcing federal forum provisions for cases under the Securities Act, encouraging companies to amend their charters or bylaws to add these clauses.
- The previous boom in SPAC IPOs and subsequent mergers is likely to sustain a flow of class actions involving those transactions.
- Suits challenging mergers have not declined, but most are now brought as individual suits rather than class actions.

In the first nine months of 2022, plaintiffs filed 157 securities class action lawsuits, according to Cornerstone Research — a figure only slightly lower than the 162 filings in the same period in 2021. Looking behind the numbers, class actions relating to SPACs and cryptocurrencies are expected to remain elevated in 2023 (see "Rise in Crypto Securities Filings Could Persist"), while state courts rulings on federal forum provisions and a shift in tactic for plaintiffs challenging mergers will continue to play out and shape securities litigation in the coming year.

State Courts Continue To Uphold Federal Forum Provisions, Further Diminishing the Impact of *Cyan*

Plaintiffs filed 10 suits under the Securities Act in state court in the first nine months of 2022, compared to 15 in the same period in 2021. State filings are now at roughly one quarter of their 2019 levels. Indeed, Cornerstone reports that no plaintiff brought a state Securities Act claim in the third quarter of 2022.

These declines suggest that the Delaware Supreme Court's endorsement of federal forum provisions (FFPs) in the 2020 *Sciabacucchi* decision is having its anticipated effect by persuading more corporations to add these clauses to their corporate charters or bylaws, thereby steering Securities Act cases away from state courts.

In 2021, trial courts in New York (*Hook v. Casa Systems, Inc.*) and Utah (*Volonte v. Domo, Inc*.) joined California and Delaware in enforcing FFPs. And in May 2022, the first appellate court outside of Delaware — the California Court of Appeal — added to this string of victories by enforcing an FFP in *Wong v. Restoration Robotics, Inc.*

These rulings may weaken the effect of *Cyan, Inc. v. Beaver County Employees Retirement Fund*, the 2018 U.S. Supreme Court decision that affirmed the ability of state courts to hear Securities Act class actions and foreclosed defendants from removing such cases to federal court.

The Bottom Line

Because New York and California state courts are popular jurisdictions for Securities Act claims, corporations could be well positioned to avoid them by including FFPs in their charters, provided that doing so is otherwise viable and appropriate. That said, because courts have not universally adopted FFPs, we expect state court Securities Act litigation to continue, though with less frequency than in previous years.

SPAC-Related Filings Remain Elevated as Courts Begin To Rule on Motions To Dismiss

Filings related to SPACs this year are on track to surpass the number in 2021. While the market for SPAC IPOs has cooled, litigation is likely to persist due to the record numbers of SPAC IPOs and de-SPAC transactions conducted in 2021 and early 2022.

Nearly 500 SPACs are still searching for acquisition partners. These searches, if successful, will likely attract scrutiny as they move toward closing and beyond. In addition, Cornerstone recently observed that the median lag time between a de-SPAC transaction and the commencement of litigation is relatively long — 240 days, or just under eight months. Given the large number of deals completed in 2021, this figure suggests the potential pipeline of cases will not dry up anytime soon.

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In 2022, courts also started deciding SPAC-related motions to dismiss. So far, the results have been mixed. While it is too early to detect trend lines or draw definitive conclusions, several recent decisions have sustained plaintiffs' allegations, either in whole or in part. These results will likely encourage plaintiffs to continue filing SPAC-related suits.

The Bottom Line

We expect to gain more insight into how courts are treating SPAC-related allegations in the coming year as more motions to dismiss are decided.

Merger Objection Class Actions Decline as Plaintiffs Pivot Toward Individual Actions

Merger objection cases continued to decline in 2022, with only five class actions filed in federal court during the first nine months of the year. This trend aligns with a decrease that we first observed in 2020. According to Cornerstone, federal M&A class action filings are now just a fraction of the 198 filings we saw in 2017, the peak year for such suits.

Merger objection litigation, however, has not vanished — or even receded in a meaningful way. Instead, several plaintiffs' firms are filing disclosure challenges in federal court as individual rather than class action lawsuits. This shift is likely motivated in part by a desire to evade the Private Securities Litigation Reform Act, which bars an individual from serving as lead plaintiff in more than five securities class actions in a three-year period. The data appear to bear this out. They show, for instance, that one plaintiff, represented by the same law firm, has filed over two dozen individual merger objection actions in federal court thus far in 2022.

Many of these complaints are voluntarily dismissed quickly. According to Bloomberg, individual actions filed in 2022 were open, on average, for only 40 days — a sign that plaintiffs are routinely procuring a so-called mootness fee in exchange for the company making supplemental disclosures in its proxy statement.

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Because the suits are styled as individual actions, plaintiffs' firms typically can strike these deals while avoiding judicial scrutiny. A proposed class action settlement, by contrast, requires the court's approval.

Some defendants, however, have pushed back and refused to pay this "deal tax." Earlier this year, in a case involving Microsoft's $19.7 billion acquisition of Nuance Communications, the defendant, Nuance, mooted the plaintiff's allegations by filing supplemental disclosures and then rejected counsel's $250,000 fee demand, forcing the plaintiff to seek judicial relief. In February 2022, Judge J. Paul Oetken of the U.S. District Court for the Southern District of New York denied the application, holding that the disclosures were immaterial and had not conferred a "substantial benefit" on Nuance's shareholders. Similarly, in 2021, Judge Ronnie Abrams of the same court denied a firm's request for $400,000 in fees in a case brought against SemGroup Corp., citing similar reasons.

The Bottom Line

Litigation costs may discourage many companies from fighting requests for mootness fees in courts. For that reason, we consider it unlikely that merger objection suits will recede in any substantial way without legislative reform. At the same time, the Nuance and SemGroup Corp. decisions may provide corporate defendants with leverage to negotiate for a lower fee — or, if so inclined, to lodge an objection with the court.