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USA – New York: Trends & Developments

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USA – NEW YORK

Trends and Developments

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King & Spalding LLP has more than 35 commercial litigators in its New York office, with the experience, creativity, and insight to handle even the most complex class actions, multi-jurisdiction litigation, business torts, post-closing, and other commercial disputes. The team is skilled in navigating significant commercial disputes and global matters with expertise in co-ordinating complex, multi-party cases, and overlapping government inquiries. The lawyers have a variety of expertise across substantive areas, including appellate law, class action defence, commercial litigation, construction & engineering disputes, corporate and securities litigation, e-discovery, insolvency litigation, insurance coverage and recovery, intellectual property, international arbitration, labour and employment, product liability, professional liability, and toxic and environmental torts.

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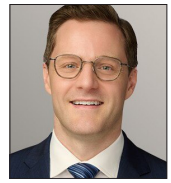

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New York's Ever-Growing Commercial Litigation: Is More Really "More"?

New York State courts have long been leaders in the formation and development of commercial law in the United States. In 1995, New York created a specialised Commercial Division that has seen a fast-growing docket of complex commercial disputes, with tens of thousands of cases decided each year. As the Commercial Division nears its third decade, though, it is becoming clear that *more* litigation in New York courts may no longer be such a good thing.

We discuss below two potentially decisive points that New York now faces. The first concerns a dramatic potential expansion of the scope of New York State courts' general personal jurisdiction over out-of-state corporations registered to do business in New York. The second could allow the Commercial Division to capture more cases from Delaware concerning out-of-state corporations' internal affairs.

All out-of-state corporations doing business in New York will want to heed these important developments. Fundamentally, these developments reflect a basic tension between aiming to bring more commercial litigation to New York and harming the very businesses who are supposed to benefit from specialised commercial courts. More commercial litigation no longer seems to be "more" for out-of-state corporations doing business in New York, and that could have serious long-term effects on both commerce and commercial disputes in New York.

New York Courts Could Soon Hear Far More Cases Against Out-of-State Corporations

Suits against out-of-state corporations are increasingly common in New York State courts, and the floodgates could soon open. In Mallory v Norfolk Southern Railway Co, 600 US 122 (2023), the US Supreme Court ushered in a new era of general personal jurisdiction over out-of-state corporations. Following Mallory, there is now pending before Governor Hochul a bill–NY Senate-Assembly Bill S7476 (2023)–that could potentially make *all* out-of-state corporations registered to do business in New York subject to lawsuits in New York, even when brought by out-of-state plaintiffs on claims wholly unrelated to New York.

Together, Mallory and S7476 could significantly expand the number of cases against out-of-state corporations in New York State courts. This would have potentially dire consequences for not only those corporations, but also other litigants and the New York State court system as a whole.

General personal jurisdiction before Mallory

Before Mallory,the US Supreme Court's jurisprudence on general personal jurisdiction resembled a pendulum swinging back and forth between the two poles of predictability and flexibility. On the one hand, the test for general personal jurisdiction should be predictable, as it is limited by due process: an out-of-state corporation cannot be hauled into a forum if that would offend traditional notions of fair play and justice. On the other hand, the test should be flexible enough that it can adapt to the changing realities of a world where commerce is ever national.

Striking this balance was relatively simple in the 19th and early 20th centuries, when the "territorial" approach to general personal jurisdiction required physical presence in the state. Because most corporations at the time operated in only a single state anyway, they could readily predict where they might be subject to general personal jurisdiction: ie, in their home state.

As corporations increasingly became national in scope, however, the pendulum swung all the way towards flexibility. In the case of International Shoe it was held that an out-of-state corporation may be subject to personal jurisdiction so long as it has sufficient "minimum contacts" with the forum that the suit would not be unfair or unjust. This new approach was malleable enough to accommodate the increasingly interstate operations of corporations. But it did so by sacrificing predictability: the "minimum contacts" test provides minimal insight into where corporations could actually be sued.

Decades after International Shoe, the doctrine on general personal jurisdiction came full circle, swinging back towards a zenith of predictability. The US Supreme Court's recent decisions in Goodyear and Daimler clarified that the "minimum contacts" test was not so flexible after all; it meant only contacts "so 'continuous and systematic' as to render [the corporation] essentially at home" in the forum. After those decisions, out-of-state corporations generally were found at home only where they (1) were incorporated, or (2) had their principal place of business.

The Goodyear/Daimler approach was strong on predictability, allowing out-of-state corporations to know in advance exactly where they might be subject to suit. But it largely eliminated the flexibility that International Shoe had introduced. As a result, some critics thought it was too limiting given the realities of interstate and global commerce.

Mallory's new framework

Mallory charted a new course. There, an out-of-state plaintiff tried to base general jurisdiction over an out-of-state corporation on Pennsylvania's business-registration statute, which required registered companies to consent to personal jurisdiction in Pennsylvania courts on "any cause of action" against them. Under Goodyear/Daimler, there should have been no general personal jurisdiction because the defendant neither was incorporated in Pennsylvania nor had its principal place of business there. But in a 5-4 decision, the US SupremeCourt found general personal jurisdiction based solely on Pennsylvania's business-registration statute.

Rather than draw on International Shoe and its progeny, Mallory purported to follow a 1917 decision called Pennsylvania Fire, which involved an analogous statute requiring out-of-state corporations to register to do business in-state and appoint an in-state agent for service of process. Mallory explained that statutes that deem registration to do business in-state as consent to suit in that state's courts provide "an *additional* road to jurisdiction over out-of-state corporations." Mallory thus limited the International Shoeline of cases to instances where an out-of-state corporation does not consent to suit.

Mallory ostensibly builds on the predictability of Goodyear and Daimler, while once again trying to adapt to the realities of interstate commerce. But rather than seek to provide flexibility, as International Shoe had done, Mallory aims for *universality*: out-of-state corporations can know exactly where they may be sued, but they likely will be amenable to suit everywhere. As Justice Barrett's dissent explained: "All a State must do is compel a corporation to register to conduct business there (as every State does) and enact a law making registration sufficient for suit on any cause (as every State could do). Then, every company doing business in the State is subject to general jurisdiction based on implied 'consent'."

New York's response to Mallory

In the wake of Mallory, a number of states have moved to enact copycat statutes that would deem registration to do business in-state as consent to suit in-state. In June 2023, the New York Legislature passed its own Mallory bill – NY Senate-Assembly Bill S7476 (2023) – which modifies the Business Corporation Law by deeming an out-of-state corporation's application to do business in-state as "consent to the jurisdiction of the courts of [New York] for all actions against such corporation." That bill now awaits Governor Hochul's signature.

If enacted, S7476 most likely would end up significantly changing the law of general personal jurisdiction in New York. Just two years ago, the NY Court of Appeals reaffirmed that "a foreign corporation does not consent to general jurisdiction in this state merely by complying with the Business Corporation Law's registration provisions": Aybar v Aybar, 37 NY3d 274, 290 (2021). The combination of Mallory and S7476 could unravel this precedent at the seams.

Out-of-state corporations should brace themselves for a potentially exponential increase in the number of suits filed against them in New York. This is a dire prospect for several reasons:

- First, these suits would face a cloud of uncertainty. Justice Alito's concurrence in Mallory explained that Pennsylvania's statute likely violated the Dormant Commerce Clause by subjecting an out-of-state defendant to suit by an out-of-state plaintiff on claims wholly unrelated to Pennsylvania. Until this and other potential challenges are definitively resolved, any lawsuits brought pursuant to S7476 could be short-lived.
- Second, to avoid being subject to suit in New York, out-of-state corporations may avoid entering the New York market altogether or decide to withdraw from that market. New York has long been a leading commercial centre; it should not drive away businesses.
- Third, out-of-state corporations doing business in New York may face heightened forum-shopping. In their suits against such corporations, plaintiffs could flock to New York courts to take advantage of any plaintiff-friendly procedural rules in New York.

New York Law Could Apply to More Internal Affairs Cases

A second development could make the Commercial Division a more attractive venue for bringing claims involving an out-of-state corporation's internal affairs. Delaware's Court of Chancery has long been the preeminent forum for such disputes because internal affairs are generally governed by the law of the place of incorporation (which is often Delaware). But in Eccles v Shamrock Capital Advisors LLC (APL-2023-00087), the NY Court of Appeals has agreed to hear a challenge to New York's long-time precedent that, if adopted, could apply New York law to a torrent of out-of-state internal affairs cases. All out-of-state entities doing business in New York will want to watch this important case.

The internal affairs doctrine

Ordinary choice-of-law rules apply in most commercial litigation, such as business torts or contract or property disputes. In those cases, corporations are essentially no different than individuals, so courts apply the same sort of choice-of-law principles that would apply to individuals. Determining which jurisdiction's law should apply in these cases turns on a variety of factors, including the facts of each transaction, where the parties are domiciled, and each jurisdiction's relative interests in applying its own law.

Cases involving a corporation's internal affairs are different, however. Internal affairs such as the validity of a shareholder vote, the payment of dividends, or whether a fiduciary duty is owed to a plaintiff, cannot practicably be determined differently in different states. New York – and every other state – has therefore long recognised that only one jurisdiction's law should govern a corporation's internal affairs. With rare exception, that jurisdiction is the place of incorporation.

This "internal affairs" rule has several benefits. It facilitates planning by allowing shareholders, officers, and directors to know in advance what law will govern their actions. It promotes consistent outcomes, thereby preventing corporations from facing conflicting demands as to what a given situation requires, and it protects shareholders' expectations that their corporate rights and duties will be determined by the law of the place in which they chose to incorporate.

The Eccles litigation

In Eccles, the Court of Appeals will decide whether to eliminate the distinctive approach taken in internal affairs cases. The case concerns a claimed fiduciary breach regarding the valuation of a Scottish company (FanDuel Inc) in connection with its 2018 acquisition by a UK company. The Appellate Division held that Scots law governed those claims, as FanDuel was incorporated in Scotland and no exception to the internal affairs rule applied. Because plaintiffs failed to state a claim under Scots law, the Appellate Division dismissed all claims.

Plaintiffs then persuaded the Court of Appeals to hear the case and decide what choice-of-law rule should apply to internal affairs cases. Defendants contend that the Court of Appeals should reaffirm the long-standing internal affairs rule, which recognises that internal affairs cases are – and should be – different from other types of tort cases.

Plaintiffs argue, in contrast, that the Court of Appeals should apply the same balancing test that applies in ordinary tort cases. Under the plaintiffs' proposed test, New York law could govern the internal affairs of an out-of-state corporation depending on such factors as (1) where its business is transacted; (2) where its principal office is located; (3) where its board meets; (4) what percentage of its business activity is in New York; (5) what proportion of shareholders reside in New York; and (6) other facts suggesting the corporation's "presence" in New York.

Potential consequences of Eccles

The Eccles case will be one to keep a close eye on next year. Oral argument has not yet been scheduled but is expected sometime in 2024, with a decision to issue sometime after that.

While the business community hopes the Court of Appeals granted review in Eccles merely to reaffirm the long-standing internal affairs rule, it is possible the court could consider charting a dramatically new course that would have significant consequences for out-of-state businesses.

One salient concern about this case is that the New York contacts at issue are not extensive. Scotland is where FanDuel was founded and incorporated, where most of its offices are, and where a plurality of the Eccles plaintiffs reside. While FanDuel is now headquartered in New York, and the challenged acquisition happened to be negotiated there, counsel for both sides were located outside New York, and the vast majority of FanDuel's revenue at the time came from outside New York. If *these* facts were to warrant application of New York law, then New York law could govern the internal affairs of

out-of-state corporations in innumerable other cases.

Adopting a new balancing test could harm out-of-state corporations doing business in New York in several ways:

- First, shareholders, directors, and officers would no longer be able to predict which law would govern their actions. Out-of-state corporations thus may have difficulty retaining quality leaders who are most conscientious about ensuring the legality of their conduct.
- Second, out-of-state corporations could be subject to conflicting demands imposed by New York and their place of incorporation, which would create a significantly higher risk of forum-shopping in cases where New York internal affairs law favours plaintiffs.
- Third, shareholders would no longer be able to expect that the laws under which they have chosen to do business would be applied to determine their own corporate rights. To preserve these expectations, some companies may avoid or leave the New York market.
- Finally, adopting a new balancing test that allows for New York law to apply in more internal affairs cases could shift more such cases to New York courts–swamping the already overburdened Commercial Division and creating untold delay for litigants who are properly in New York courts.

More Is Not "More"

S7476 and Eccles illustrate a basic tension in the ever-expanding docket of New York courts. In theory, allowing more cases to be brought in New York could benefit corporations doing business here. But in practice, expanding the scope of general personal jurisdiction (as S7476 tries to do) or expanding the applicability of New York law (as Eccles could do) would likely have detrimental consequences for all. In particular, these developments illustrate how the continued growth of commercial litigation in New York State courts now comes with key trade-offs.

In the near future, the trade-off suggests tremendous uncertainty. We noted above that any lawsuits brought pursuant to S7476 could effectively be caught in limbo for years while courts conclusively resolve the constitutional validity of Mallory statutes. Similarly, if Eccles were to adopt a new balancing test in internal affairs cases, it likely would take years for lower courts to work out the circumstances under which New York law would govern the internal affairs of out-of-state corporations. Out-of-state corporations would have little meaningful guidance in the meantime.

In the long-term, the trade-offs are potentially worse still. New York courts are already overburdened, with close to 500,000 cases pending in the system (as of 2022). Clogging New York courts with additional litigation against out-of-state corporations, or additional internal affairs cases, will further slow the judicial process. That would harm everyone, including other litigants and New York's court system as a whole.

In addition, creating the opportunity for more commercial litigation in New York incentivises forum-shopping, as we saw above with both S7476 and Eccles. When New York is yet another potential forum for a lawsuit, plaintiffs will tend to file here only when it suits their interests to do so. The result may be more commercial litigation, but in ways that systematically disadvantage out-of-state corporations. The long-term trends of promoting such forum-shopping do not bode well for New York commerce.

New York should aspire to remain a leader in both commerce and commercial law. These two goals should not be antithetical; but only time will tell whether the state's path pursues both goals in harmony.

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