

## Removing Nevada Derivative Litigation To Federal Court

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In a case noteworthy for companies incorporated in Nevada, a recent decision by the U.S. District Court for the District of Nevada paved the way for defendants in shareholder derivative lawsuits, brought in Nevada state court and asserting state law claims, to remove the litigation to federal court. The Nevada district court in *Gartner* ruled, for the first time in the Ninth Circuit, that a company in a shareholder derivative lawsuit — although considered a nominal defendant — can be aligned with, and effectively deemed, a plaintiff for purposes of, and thus easing, removal to federal court.[1] The advantages of litigating in a federal forum can include, for example, greater amenability to a stay of discovery pending a motion to dismiss or a bench with wider exposure to corporate governance matters. We discuss the *Gartner* decision and its implications in this article.



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Companies incorporated in foreign states — for example, Delaware[2] and, increasingly, Nevada — face steep legal hurdles in removing shareholder derivative lawsuits, which typically only assert state-based claims and are commenced in the state of incorporation, to the appropriate federal forum. Upon defendants' removal on diversity grounds, plaintiffs often move to remand on the basis of the "forum defendant rule." This rule prevents defendants from removing a case to federal court if at least one defendant is a citizen of the forum state. Because companies in derivative lawsuits must be joined as nominal defendants, and because they are incorporated in (and thereby citizens of) that forum state, the forum defendant rule prevents removal. In other words, even if the company is headquartered outside the forum, and its officers and directors — typically the true defendants in shareholder derivative lawsuits — are domiciled in another state, the forum defendant rule would, by necessity, prevent removal by virtue of the company's incorporation in that forum state.



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For example, in the *Gartner* matter, the nominal defendant company was incorporated in Nevada, headquartered in Colorado, and its directors were domiciled in various states. The plaintiff commenced a shareholder derivative action in Nevada state court, asserting state law causes of action. The defendants removed to federal court, the plaintiff then moved to remand, and the Nevada district court, siding with defendants, ruled that the company can be (and, indeed, was) deemed a plaintiff for purposes of the "forum defendant rule," thus keeping the case in federal court.

### Opposing Interpretations Of The Forum Defendant Rule

This question — whether the forum defendant rule categorically prevents removal of a shareholder

derivative lawsuit to federal court where the corporation is merely incorporated in the forum state — has not been decided by the U.S. Supreme Court or by any of the circuit courts.[3]

The language of the forum defendant rule ambiguously provides, “A civil action otherwise removable solely on the basis of the [diversity] jurisdiction under section 1332(a) of this title may not be removed if any of the *parties in interest properly joined and served as defendants* is a citizen of the State in which such action is brought.”[4] This language, which does not distinguish between classic defendants and nominal defendants, has given rise to two interpretations. The first, typically adopted by plaintiffs, is that the rule merely requires that the defendant have a true interest in the litigation — rather than, say, a trust that holds the disputed assets and is added to the litigation as a nominal party — even if that interest is ultimately aligned with the plaintiff. The second interpretation, adopted by defendants, is that the resident defendant’s interests must be truly aligned with the defendants for the rule to apply.

The plaintiff in *Gartner*, adopting the first interpretation, argued that the rule prevents removal so long as a party with a real interest in the outcome of the litigation, who is named as a defendant, even nominally, is a citizen of the forum state.[5] The plain language of the rule, it argued, does not require any additional analysis as to whether a nominal defendant’s interest — such as a company in a shareholder derivative lawsuit — is truly aligned with the plaintiff.

The defendants, however, countered that this technical reading of the forum defendant rule defeats the rule’s purpose. The purpose of removal based on diversity is to avoid potential state court bias against an out-of-state party. The forum defendant rule creates an exception to diversity removal where the risk of bias is not present, i.e., where a defendant is a resident of the state in which the plaintiff has chosen to sue. In that scenario, a defendant has no need for a federal forum because the state court is, if anything, presumably biased in their favor. The rationale for the forum defendant rule exception, however, does not apply where the “resident” of the forum state is only a corporate nominal defendant because the local state courts will have no bias in favor of the out-of-state directors and officers — the real defendants in interest. And, the presence of the company in the litigation as nominal defendant will not eliminate the risk of bias because the company is, at worst, agnostic as to whether the plaintiff or the directors and officers should prevail. Indeed, if the state court favored the company, this would create a pro-plaintiff bias because the plaintiff’s victory would increase the company’s coffers. Consequently, there is no reason to deprive the real defendants, the officers and directors, of the option made available to out-of-state defendants — removal to federal court.

The defendants therefore argued that only a corporate defendant whose interests are truly aligned as a defendant triggers the forum defendant rule and prevents removal. The analytical framework for determining a corporate defendant’s true interest is borrowed from the analysis courts perform in realigning parties’ interests in the related context of diversity jurisdiction.[6] That analysis begins with the assumption that because a derivative lawsuit is brought on behalf of the corporation, “the corporation is the real party in interest and *usually properly aligned as a plaintiff*.”[7] The only exception to this assumption is when company management is “antagonistic” to the litigation, which is defined as where management “defends a course of conduct which [the shareholder] attacks,” or where “management — for good reasons or for bad — is definitely and distinctly opposed to the institution of [the derivative] litigation.”[8]

Thus, under this view, the critical question in determining removal of a shareholder derivative lawsuit is whether company management is antagonistic, or opposed, to the lawsuit. Factors indicating a lack of antagonism include where the corporation is not controlled by the director and officer defendants,[9] where the plaintiff controls the corporation (either through majority stock ownership or other

means),[10] where the corporation is deadlocked and structurally incapable of acting to bring suit against its officers and directors,[11] where the corporation reserved the right to take control of the action,[12] or the absence of a demand letter.[13] Upon a finding of no antagonism, the starting premise remains — because the derivative lawsuit is brought on behalf of the company, it is properly aligned as a plaintiff and the forum defendant rule does not prevent removal.

### **The Gartner Decision and Its Implications**

The Nevada district court's decision in *Gartner* adopted the defendants' approach and ruled that the forum defendant rule does not automatically preclude removal. The court held that "[a]lthough the Ninth Circuit has not yet applied the realignment analysis for determining citizenship when applying the forum-defendant rule," the court's view was "that [the Ninth Circuit] would do so." [14] The court found that the company was not antagonistic to the lawsuit because, inter alia, the majority of the current board of directors were not implicated in the alleged wrongdoing.[15] As the company's interests were properly aligned with the plaintiff, the court deemed the company a plaintiff for purposes of the forum defendant rule and denied the remand motion.

The implications of the *Gartner* decision for companies incorporated in Nevada (and their offices and directors) include the following. First, defendants facing shareholder derivative lawsuits in Nevada state court will not automatically have their removal efforts thwarted by the forum defendant rule. Instead, upon removal, the burden will shift to plaintiffs to demonstrate that the complaint sufficiently alleges that company management is antagonistic to the lawsuit. In the absence of plaintiffs' ability to meet that standard, the lawsuit should remain in federal court. The advantages of litigating in a federal forum can include greater procedural amenability to a stay of discovery pending motions to dismiss as well as judges who may have greater exposure to corporate governance matters. As a result, defendants may stand a greater chance of prevailing on a motion to dismiss, thus avoiding the often prohibitive discovery costs.

Additionally, the parties' briefings and the court's decision on antagonism will likely foreshadow the parties' arguments and the court's position on demand futility, typically raised later on motion to dismiss. In moving to remand to state court, plaintiffs will need to articulate with some detail that company management is distinctly opposed to the litigation, the antagonism standard.[16] Plaintiffs will presumably make a similar argument to survive a motion to dismiss on demand futility grounds, which defendants often bring in shareholder derivative lawsuits. While the demand futility standard — reasonable doubt that the board can impartially consider a demand[17] — appears to be more lenient than, or at least different from, the antagonism standard, the parties' arguments and the court's decision on antagonism can certainly provide valuable insight into the parties' and, especially, the court's views on demand futility.[18]

Of course, in an effort to keep derivative actions in state court, plaintiffs suing Nevada corporations may opt to bring the derivative action in the state of the company's headquarters, rather than in Nevada. Presumably, at least one individual defendant will reside in the state of headquarters, thus triggering the forum defendant rule. This approach, however, would not foreclose individual defendants from raising a personal jurisdiction defense, to the extent that they do not have the requisite minimum contacts with the company's state of headquarters.

### **Conclusion**

Nevada companies (and their officers and directors) should welcome this decision as, under its holding,

shareholder derivative lawsuits will not categorically be restricted to Nevada state court under the forum defendant rule. Rather, defendants will have the opportunity to assert that because the company is not antagonistic to the lawsuit, it is properly aligned with the plaintiff, thus avoiding triggering the forum defendant rule.

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***DISCLOSURE: The authors were the principal drafters of the Gartner briefs, which were filed through local counsel.***

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[1] Gartner v. Pyatt, No. 2:16-cv-00553-JAD-CWH, 2016 U.S. Dist. LEXIS 164281 (D. Nev. Nov. 29, 2016).

[2] See Khoury v. Oppenheimer, 540 F. Supp. 737, 738-39 (D. Del. 1982) (rejecting petitioner's request to realign corporate nominal defendant in derivative suit for purposes of the forum defendant rule because under the facts alleged "it is difficult to conceive of a clearer allegation of management antagonism ....").

[3] See Knop v. Mackall, 645 F.3d 381, 383 (D.C. Cir. 2011) ("The Supreme Court and this Court have not yet decided whether a corporation in a shareholder derivative suit is only a nominal party for purposes of 28 U.S.C. § 1441(b).").

[4] 28 U.S.C. § 1441(b) (emphasis added).

[5] See, e.g., Police Ret. Sys. of St. Louis v. Ersek, Civil Action No. 14-cv-3404-WJM-CBS, 2015 U.S. Dist. LEXIS 53385 (D. Colo. Apr. 23, 2015); Gartner v. Pyatt, No. 2:16-cv-00553-JAD-CWH, 2016 U.S. Dist. LEXIS 164281 (D. Nev. Nov. 29, 2016).

[6] See In re Digimarc Corp. Derivative Litig., 549 F.3d 1223, 1234 (9th Cir. 2008) ("Although the plaintiff is generally the master of his complaint, diversity jurisdiction cannot be conferred upon the federal courts by the parties' own determination of who are plaintiffs and who defendants. Instead, a court must realign the parties in order to protect our judgments against artful pleading and ensure an actual collision of interest.") (citations omitted).

[7] Id. at 1235 (emphasis added).

[8] Id.

[9] See, e.g., Lewis v. Odell, 503 F.2d 445, 446-47 (2d Cir. 1974); Taylor v. Swirnow, 80 F.R.D. 79, 84 (D. Md. 1978); In re Penn Central Sec. Litig., 335 F. Supp. 1026, 1041-42 (E.D. Pa. 1971); Tessari v. Herald, 207 F. Supp. 432, 435-37 (N.D. Ind. 1962).

[10] See, e.g., Liddy v. Urbanek, 707 F.2d 1222, 1225 (11th Cir. 1983); Nejmanowski v. Nejmanowski, 841 F. Supp. 864, 868 (C.D. Ill. 1994); Gibson v. BoPar Dock Co., 780 F. Supp. 371, 374 (W.D. Va. 1991); Taylor, 80 F.R.D. at 84.

[11] See, e.g., *Duffey v. Wheeler*, 820 F.2d 1161, 1162-63 (11th Cir. 1987); *Kartub v. Optical Fashions*, 158 F. Supp. 757, 758-59 (S.D.N.Y. 1958).

[12] See *Digimarc*, 549 F.3d at 1237.

[13] See, e.g., *Lewis*, 503 F.2d at 447; *Nejamanowski*, 841 F. Supp. at 867; *Tessari*, 207 F. Supp. at 435-37.

[14] *Gartner*, No. 2:16-cv-00553-JAD-CWH, 2016 U.S. Dist. LEXIS 164281, \* 6.

[15] *Id.*, at \* 9.

[16] See *Digimarc*, 549 F.3d at 1235 (quoting *Swanson v. Traer*, 354 U.S. 114, 116 (1957)). It bears noting that while being named a defendant, on its own, would — as in the demand futility context — not be sufficient for a finding of that director’s antagonism, *Digimarc* noted that “[n]o court has failed to find antagonism [where a majority of the board were named as defendants].” *Id.*

[17] See, e.g., *Arduini v. Hart*, 774 F.3d 622, 628 (9th Cir. 2014).

[18] See, e.g., *Gartner*, No. 2:16-cv-00553-JAD-CWH, 2016 U.S. Dist. LEXIS 164281, \* 9