

September 4, 2020

## *West v. ACRE*—California Superior Court Refuses Enforcement of Forum Selection Provision Designating Delaware Court of Chancery as Violating Plaintiff’s Right to Trial by Jury

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### **The Los Angeles County Superior Court’s Decision Calls into Question Continued Enforceability by California Courts in Actions at Law of Provisions That Designate Forums Without Trials by Jury**

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#### **SUMMARY**

On July 29, 2020, Judge David Cowan of the Los Angeles County Superior Court (“Los Angeles Superior Court”) lifted a stay that it had previously entered enforcing a forum selection provision designating jurisdiction in the Delaware Court of Chancery or the U.S. District Court for the District of Delaware.<sup>1</sup> After the stay order was entered in 2017, Plaintiff William West (“West”) filed an action in Delaware state court, which was then transferred to the Court of Chancery. In agreeing to lift the stay, Judge Cowan found that continued enforcement of the forum selection provision would diminish California resident West’s California Constitutional right to a jury trial, because the Court of Chancery does not conduct non-advisory jury trials. Typically, California courts give effect to mandatory forum selection provisions, and a party opposing enforcement bears the burden of showing that enforcement would be “unreasonable or unfair.” Where a plaintiff’s claims are based on “unwaivable rights created by California statutes,” however, the burden shifts to the party seeking to enforce the clause to show that litigating in the designated non-California forum does not diminish plaintiff’s “unwaivable rights.”

Applying two California cases that held (1) pre-dispute jury waivers are unenforceable under California law and (2) a plaintiff’s demand for a jury trial implicates fundamental and inviolate rights, Judge Cowan held

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that enforcing the Delaware forum selection clause prevented Plaintiff West from a jury trial and thus was an impermissible pre-dispute waiver of jury trial. Accordingly, Judge Cowan lifted the stay, and West's claims were allowed to proceed in California notwithstanding the forum selection clause.

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### BACKGROUND

In 2012, plaintiff William West, a California resident, co-founded Defendant Access Control Related Enterprises, LLC ("ACRE"). In 2015, ACRE terminated West for cause. In 2016, West filed a complaint in the Los Angeles Superior Court asserting state law claims, including wrongful termination, against ACRE and others. On May 2, 2017, the Los Angeles Superior Court granted defendants' motion to stay, then finding that the forum selection provision in the parties' Securityholders' Agreement—designating federal court in Delaware or the Court of Chancery—controlled. West then filed a complaint in federal court in Delaware but soon after voluntarily dismissed the action for lack of subject matter jurisdiction. He then filed a complaint in the New Castle County Superior Court ("New Castle Superior Court")—a court that does conduct jury trials—which defendants moved to dismiss, or alternately transfer to the Court of Chancery. The New Castle Superior Court transferred the action to the Court of Chancery in January 2020. Following that transfer, West moved in California to lift the May 2017 stay, and moved in the Court of Chancery to stay those proceedings. West argued that in light of his demand for a jury trial in California, allowing the action to proceed in the Court of Chancery constituted an impermissible "pre-dispute" jury waiver under California law.

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### THE LOS ANGELES SUPERIOR COURT'S DECISION

In an unpublished order determining whether to lift the May 2017 stay, Judge Cowan revisited enforceability of the forum selection clause at issue. Under California law, mandatory forum selection clauses are given effect, unless the party opposing enforcement carries the "substantial" burden of proving that enforcement of the provision would be unreasonable or unfair.<sup>2</sup> California courts will not defer to the chosen forum if enforcement "would substantially diminish the rights of California residents in a way that violates [California] public policy."<sup>3</sup> Accordingly, California courts have held that, "when the claims at issue are based on unwaivable rights created by California statutes," the burden is switched: the party seeking enforcement of the forum selection clause must show that "litigating the claims in the contractually-designated forum will not diminish in any way [plaintiff's] substantive rights afforded . . . under California law."<sup>4</sup>

In applying these principles, Judge Cowan relied upon two California decisions.<sup>5</sup> First, in *Grafton Partners v. Superior Court*, 36 Cal. 4th 944 (2005), the California Supreme Court held that a "pre-dispute" waiver of one's "inviolable right" to a trial by jury is not enforceable in California.<sup>6</sup> Under Article I, Section 16 of the California Constitution, parties may only waive their right to a jury trial "by statute," *i.e.*, as set forth in California Code of Civil Procedure Section 631(f).<sup>7</sup> *Grafton Partners* held that because Section 631(f) does not authorize pre-dispute waivers, they are unenforceable.<sup>8</sup>

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Second, in *Handoush v. Lease Finance Group, LLC*, 41 Cal. App. 5th 729 (2019), the California Court of Appeal held that, even where a plaintiff's claims are "not based on a statutory scheme," the demand for a jury trial implicates "fundamental" and "inviolable" rights under California law, which shifts the burden to the party seeking to enforce the forum selection provision.<sup>9</sup> The court in *Handoush* found that the defendant seeking enforcement of the forum selection clause could not carry its burden, because, unlike California, New York does not prohibit pre-dispute jury waivers, and thus litigation in New York had the "potential to contravene" plaintiff's right to a jury trial.<sup>10</sup> The Court of Appeal, therefore, reversed the trial court's order enforcing the New York forum selection clause.<sup>11</sup>

In granting West's motion to lift the stay, Judge Cowan found that this case was analogous to *Handoush*. West, a California resident, requested a jury trial. Refusing to lift the stay on the grounds that the Delaware forum selection clause was enforceable would result in a pre-dispute jury waiver. The forum selection provision in the Securityholders' Agreement designated federal court in Delaware or the Court of Chancery. Because West's federal court complaint was dismissed for want of jurisdiction, and his action in the New Castle Superior Court was transferred to the Court of Chancery, continued enforcement of the forum selection clause would preclude West from having a jury trial.<sup>12</sup>

Judge Cowan held that the "pre-dispute forum selection clause is effectively and impermissibly used as a pre-dispute waiver of jury trial."<sup>13</sup> Like in *Handoush*, plaintiff West's demand for a jury trial was sufficient to shift the burden to defendant ACRE to "show enforcement would not diminish unwaivable California statutory rights."<sup>14</sup> ACRE did not meet that burden, because it was "undisputed that West would not receive a jury trial if his action proceeds in the Court of Chancery," which would "substantially 'diminish' the un-waivable right to a jury trial that West would otherwise receive under California law."

Judge Cowan rejected each of ACRE's rejoinders for why the motion to lift the stay was procedurally improper and why the burden should not shift to ACRE.<sup>15</sup> Among other conclusions, Judge Cowan found that, regardless of the fitness of the Court of Chancery, "the real issue is whether West would be deprived of his right to a jury trial."<sup>16</sup> Judge Cowan also rejected ACRE's argument that given the Securityholders' Agreement's Delaware choice of law provision, the Superior Court should not apply California law to determine enforceability of the forum selection provision.<sup>17</sup> ACRE did not offer any authority to support the proposition that "a choice of law provision requires California courts to enforce agreements violative of California's public policies."<sup>18</sup> Thus, the Superior Court granted West's motion to lift the stay, allowing litigation to proceed in California.

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## IMPLICATIONS

*West* and *Handoush* reflect two recent decisions of California courts in which the right to trial by jury under California law was relied upon in declining to enforce a forum selection provision.<sup>19</sup> While the right to trial by jury is guaranteed by the California Constitution, it is a "matter of right in a civil action at law, but not in

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equity.”<sup>20</sup> Thus, in actions “at law” brought in California courts, the *West* decision may present a challenge to those seeking to enforce forum selection provisions that designate the Delaware Court of Chancery.<sup>21</sup> Many Delaware entities select the Court of Chancery in their governance documents and other stakeholder agreements as the designated forum for corporate disputes. This decision calls into question whether California trial courts will enforce such provisions in actions at law, given that the Court of Chancery does not conduct non-advisory jury trials. Even where one or more alternative venues are included in a forum selection provision, the *West* decision demonstrates that California courts may still find such a provision unenforceable if those alternate forums are not available in any particular action.

Parties seeking to enforce forum selection provisions in California, however, should closely analyze any anticipated claims that may be brought at law or in equity. California courts look to “the rights involved” and remedies sought in determining “the gist of the action.”<sup>22</sup> The issue of whether *West*’s action was at law or in equity was not squarely addressed in the Superior Court’s July 29 decision. *West*’s California complaint alleged claims for wrongful termination, breach of fiduciary duty, conversion, and a declaration that his non-competition agreement was void. He argued in the motion that his improper termination, for which he sought damages, was “central to [his] grievance” against the defendants, and from which his other claims derived. Though in lifting the stay of *West*’s action in California, Judge Cowan only noted that “*West*’s wrongful termination claim may be competently determined by a jury and he has a right to such determination.”<sup>23</sup> Under other circumstances, courts may find actions asserting breach of fiduciary duty claims to be equitable, potentially limiting the application of *Grafton Partners* and *Handoush*. This will depend on the particular facts and claims alleged. For example, the California Court of Appeal recently found that there was no right to a trial by jury in a post-merger “shareholder breach of fiduciary duty action,” despite claims for damages, because such actions “against the corporate directors [are] generally viewed as a determination of rights in equity.” The court was careful to note, however, that the decision did not “foreclose the right to a jury trial in all or other shareholder actions against corporate fiduciaries, which may invoke different factual scenarios or allegations that are cognizable at law.”<sup>24</sup> As to shareholder derivative actions, the Court of Appeal has held that, even where punitive damages are sought, “California entertains no right to jury trial.”

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ENDNOTES

- 1        *West v. Access Control Related Enterprises LLC*, No. BC642062 (Jul. 29, 2020).
- 2        *Id.* at 3 (quoting *Verdugo v. Alliantgroup, L.P.*, 237 Cal. App. 4th 141, 147 (2015)).
- 3        *Id.* at 3 (quoting *America Online, Inc. v. Superior Court*, 90 Cal. App. 4th 1, 11 (2001)).
- 4        *Id.* at 3 (quoting *Verdugo*, 237 Cal. App. 4th at 147).
- 5        *Id.* at 3-5.
- 6        *Grafton Partners*, 36 Cal. 4th at 951.
- 7        *Id.* at 956. *Grafton Partners* made clear, however, that arbitration agreements have a statutory foundation (Cal. Code. Civ. P. § 1280) and thus satisfy the “provided by statute” requirement of the California Constitution. 36 Cal. 4th at 955.
- 8        *Id.*
- 9        *Handoush*, 41 Cal. App. 5th at 736, 739.
- 10       *Id.* at 739.
- 11       *Id.* at 735.
- 12       *West*, No. BC642062 (Jul. 29, 2020), at 5. In the New Castle Superior Court proceedings, defendants moved to strike West’s jury trial demand, because the Securityholders’ Agreement contained a jury trial waiver provision. The New Castle Superior Court held that the motion was moot in light of its order transferring the case to the Court of Chancery. Judge Cowan noted that, in ruling that the motion to strike was moot, the New Castle Superior Court agreed that West would not be able to have a jury trial in the Court of Chancery. *Id.*
- 13       *Id.*
- 14       *Id.* at 6 (citing *Verdugo*, 237 Cal. App. 4th at 144).
- 15       *Id.* at 6-10. Notably, ACRE did not argue that “a bench trial in the Court of Chancery would be consistent with West’s right to a jury trial.” *Id.* at 6.
- 16       *Id.* at 8.
- 17       *Id.* at 9-10.
- 18       *Id.* Judge Cowan distinguished *Drulias v. 1st Century Bancshares, Inc.*, 30 Cal. App. 5th 696 (2018), a putative stockholder class action in which Defendant 1st Century Bancshares and its board were represented by Sullivan & Cromwell. In *Drulias*, the Court of Appeal held that Delaware-law corporate claims brought against a Delaware corporation were “not based on unwaivable rights” under California law and declined to shift the burden of proof on enforceability of the Delaware forum selection clause, affirming the trial court’s stay order. According to the *Drulias* court, although Corporations Code Section 2116 allows California residents to bring foreign-law corporate claims against a foreign corporation in California courts, it “does not deprive a court of the discretion to decline to exercise its jurisdiction over an action involving the internal affairs of a foreign corporation where that action would be more appropriately and justly tried elsewhere.” Because *Drulias* concerned alleged statutory rights under Section 2116 and did not implicate the right to a jury trial, Judge Cowan found that the decision was “not instructive here.”
- 19       Although West was an individual plaintiff, under Article I, Section 16 of the California Constitution the right to a jury trial is a right that “shall be secured to all,” including entity plaintiffs. See, e.g., *Grafton Partners*, 36 Cal. 4th at 950-51 (upholding partnership’s right to jury trial by finding pre-dispute jury-trial waiver unenforceable).

ENDNOTES (CONTINUED)

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- <sup>20</sup> *C & K Eng'g Contractors v. Amber Steel Co.*, 23 Cal. 3d 1, 8 (1978) (quoting *Southern Pac. Transportation Co. v. Superior Court*, 58 Cal. App. 3d 433, 436 (1976)).
- <sup>21</sup> A decision of the Superior Court is not binding on California courts, or the courts of other states, although those other courts may find the line of reasoning used by the Superior Court persuasive.
- <sup>22</sup> *C & K Eng'g Contractors*, 23 Cal. 3d at 9.
- <sup>23</sup> *West*, No. BC642062 (Jul. 29, 2020), at 8.
- <sup>24</sup> *See, e.g., Cent. Laborers' Pension Fund v. McAfee, Inc.*, 17 Cal. App. 5th 292, 350 & n.24 (2017) (finding shareholders' claims stemming from merger of two technology companies for breach of fiduciary duty and aiding and abetting a breach, brought under Delaware law, constituted an action in equity under California law, despite a demand for monetary damages, because "a shareholder breach of fiduciary duty action against the corporate directors is generally viewed as a determination of rights in equity" and, thus there was no right to jury trial on those claims).

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