

## NEW YORK COURT OF APPEALS ROUNDUP

### COURT OF APPEALS TACKLES INTERNATIONAL BUSINESS DISPUTE IN 'ECCLES V. SHAMROCK CAPITAL ADVISERS'

WILLIAM T. RUSSELL, JR. AND LINTON MANN III

SIMPSON THACHER & BARTLETT LLP

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The Court of Appeals recently handed down a significant decision in *Eccles, et al. v. Shamrock Capital Advisers, et al.*, which clarified the choice-of-law principles governing alleged breaches of fiduciary duties in international business disputes. The case centered on the merger of FanDuel Ltd. (FanDuel), a company incorporated in Scotland, with the U.S. assets of Paddy Power Betfair PLC (Paddy Power), and it questioned whether Scottish law or New York law should govern the fiduciary duty claims that arose from the merger.

In a unanimous opinion, the court held that, with rare exception, there is a presumption that the substantive law of the place of incorporation applies to disputes involving the internal affairs of a corporation. And New York courts have significant flexibility and discretion when deciding whether to take judicial notice of applicable foreign law to apply to the case at hand without a hearing.

FanDuel was founded in Scotland in 2007 and initially operated under the name Hubdub Ltd. The company transitioned from current events betting to fantasy sports, becoming a prominent entity in the daily fantasy sports industry by 2009. FanDuel established its headquarters in New York in 2011, expanding rapidly and by 2015 was engaging in fierce competition with its rival DraftKings. In 2016, FanDuel and DraftKings proposed a “merger of equals” valued at \$1.2 billion.

The merger, however, fell through as a result of antitrust and other regulatory concerns. Subsequently, FanDuel’s ownership structure was simplified and various share classes were consolidated into preferred shares and common shares.

A critical feature of this restructuring was the waterfall provision which prioritized compensating preferred shareholders before common shareholders in the event of the company’s dissolution. In 2018, as the U.S. Supreme Court considered a case with the potential to legalize sports betting in the United States, FanDuel’s board once again explored merger options. The board negotiated a merger with Paddy Power, resulting in a new company, PandaCo Inc. (PandaCo). The merger terms allocated approximately 40% of PandaCo to FanDuel shareholders and 60% to Paddy Power.

The plaintiffs, a group of more than 100 common shareholders and founders of FanDuel, filed suit against certain preferred shareholders and directors alleging that the merger was deliberately undervalued in order to benefit the preferred shareholders. They claimed that the directors were motivated by self-interest, did not seek an independent valuation of FanDuel’s assets and manipulated the valuation to ensure that the common shareholders received nothing from the merger. The plaintiffs’ claims included breach of fiduciary duties, aiding and abetting breach of fiduciary duties and unjust enrichment.

The defendants moved to dismiss the complaint and argued that, under the internal affairs doctrine, Scottish law applied to the claims because they arose from the relationship between and among the directors and shareholders of an entity incorporated in Scotland.

Moreover, under Scottish law, claims concerning alleged duties owed by directors to shareholders or among shareholders are not cognizable because directors generally only owe duties to the corporation as a whole rather than to individual shareholders, and defendants argued that there were no special circumstances present on the alleged facts to justify disregarding the general rule.

In support of their motion, the defendants submitted the affirmation of a retired judge of the Supreme Courts of Scotland to explain how Scottish law would apply to the asserted claims.

The plaintiffs responded by arguing that the internal affairs doctrine was inapplicable and that, even if it did apply, New York law should govern because New York had a greater interest in the litigation given FanDuel's significant contacts with New York. In the event that Scottish law did apply, the plaintiffs submitted an affirmation of a Scottish corporate attorney asserting that the complaint sufficiently alleged factual circumstances creating fiduciary obligations between the director defendants and the plaintiffs.

The Supreme Court, New York County applied New York law and denied most of the defendants' motions to dismiss. No. 651223/2020, 2022 N.Y. Misc. LEXIS 262, at \*22, \*35 (N.Y. Sup. Ct. Jan. 17, 2022). The Appellate Division, First Department reversed and applied Scottish law based on the internal affairs doctrine, which typically requires applying the law of the place of incorporation to disputes involving corporate governance. 209 A.D.3d 486, 487–88 (1st Dep't 2022).

The First Department rejected the plaintiffs' argument that the internal affairs doctrine applies only to officers and directors at the time of the lawsuit; rather, the doctrine applies so long as the defendants were directors at the time of the events giving rise to the suit. According to the First Department, Scottish law provides that directors owe fiduciary duties to the company as a whole, not to individual shareholders, and therefore the plaintiffs' fiduciary duty claims should be dismissed.

In a unanimous opinion by Associate Judge Madeline Singas, the Court of Appeals agreed with the First Department's determination that Scottish law applies but reversed on the application of Scottish law to the plaintiffs' claims. Appellate Division Justices Molly Reynolds Fitzgerald and Angela G. Iannacci sat by designation as Associate Judges Michael Garcia and Caitlin Halligan took no part in the decision.

With respect to matters arising from the internal affairs of a corporation, including the relationships between directors and shareholders, the court clarified that in New York, the presumptive approach is to apply the law of the state of incorporation. To overcome that presumption and establish the applicability of New York law to the internal affairs of a corporation incorporated elsewhere, a party must demonstrate both that (1) the interests of the place of incorporation are minimal, i.e., the corporation has virtually no contact with the place of incorporation other than the fact of its incorporation, and (2) New York has a dominant interest in applying its own substantive law.

The court emphasized the internal affairs doctrine's role in ensuring consistency and predictability in corporate governance and honoring the expectations of shareholders who chose what jurisdiction's laws will govern the corporation's affairs. This doctrine is vital to avoiding conflicting duties and legal obligations that could arise if different states' laws were applied to the same corporate actions.

In applying these principles to the case at hand, the court noted that FanDuel had substantial contacts with Scotland: it was founded and registered there, its Articles of Association referenced the UK Companies Act of 2006 as the governing law, and it maintained offices in Scotland with several plaintiffs residing in Scotland.

The New York interests, on the other hand, do not dominate even though FanDuel has its principal office in New York, board meetings were held in New York, and the merger was negotiated in New York, but where only 10-15% of FanDuel's total revenue was derived from New York customers. According to the court, these factors reinforced the presumption that Scottish law applies.

Under Scottish law, which is influenced by English common law, directors do not owe fiduciary duties directly to shareholders solely based on their role. However, special circumstances can create fiduciary

obligations to individual shareholders. These circumstances might include, but are not limited to, close familial relationships, instances where directors act as agents for shareholders, or specific vulnerabilities of shareholders due to corporate actions.

In this case, the plaintiffs argued that special circumstances existed because the directors, in negotiating the merger and valuing the merger consideration, had a duty not to undermine the common shareholders' interests.

The Court of Appeals found that the interaction between the waterfall provision and the drag-along rights, which allowed preferred shareholders to compel a merger, placed common shareholders in a particularly vulnerable position. This arrangement could imply that directors had a limited fiduciary duty to protect the common shareholders' interests during the merger negotiations. This interpretation aligns with principles of English common law, where directors might owe duties to individual shareholders in special situations involving close relationships or instances where directors effectively act as agents for shareholders.

The Court of Appeals also addressed the issue of judicial notice of foreign law. Pursuant to CPLR 4511(b), courts have the discretion to take judicial notice of foreign laws if furnished with sufficient information. In this case, the court found that the parties had provided ample materials, including expert affirmations, relevant statutes, and dozens of cases cogently explaining the relevant principles to enable courts to take judicial notice of Scottish law without the need for a hearing.

The Court reversed the First Department's dismissal of the fiduciary duty claims and reinstated the trial court's order denying the motions to dismiss.

This decision resolved questions that frequently confront New York courts in the context of international business disputes. The decision underscores the importance of the internal affairs doctrine and highlights the potential for directors' fiduciary duties to extend to individual shareholders under certain conditions. It also illustrates the flexibility and discretion courts have in taking judicial notice of foreign laws without a hearing, which is crucial in cases involving cross-border governance issues.

**William T. Russell Jr. and Linton Mann III** are partners at Simpson Thacher & Bartlett.

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