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Untangling Warrant Agreements: What Companies and Investors Need to Know

By Daniel Stone
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Too often, the drafting process for securities warrants gives little thought to the miscellaneous provisions buried at the end of the contract. This section, perhaps copied and pasted from a prior contract, includes the critically important 'choice of law and forum' provision which can dictate the speed, cost, and outcome of any eventual litigation. Parties must give due consideration to their choice of forum, or they risk entirely undermining their ability to enforce the contracts.

The significance of forum selection has been recently underscored by a challenging affirmative defense frequently raised by issuers seeking to avoid their contractual obligations. When sued to enforce these warrant agreements, these issuers assert that the plaintiffs operate as 'unregistered dealers' and that the warrants are therefore subject to rescission pursuant to Section 29(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78cc(b).

This defense strategy attempts to fundamentally alter the nature of the litigation. To establish that the plaintiffs are unregistered dealers, defendants demand extensive discovery,

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encompassing the plaintiff's customer solicitations, profit generation methods from securities transactions, sales volume, and diligence practices. *See Auctus Fund, LLC v. OriginClear, Inc.,* No. CV 19-10273-FDS, 2023 WL 2140478, at *7-8 (D. Mass. Feb. 21, 2023). Such inquiries, amounting to a comprehensive examination of the plaintiff's entire business, can transform a straightforward contract dispute into a full forensic accounting of the plaintiff, rendering the cost of litigating a breach of warrant case prohibitively high.

Conversely, a properly drafted forum selection clause within the warrant agreement can enable diligent litigators to preempt the 'dealer defense' before it unduly complicates proceedings. Should an issuer-defendant assert this defense in its

answer and affirmative defenses, a prudent litigator should promptly move to strike, preventing the initiation of invasive and costly discovery into every facet of the plaintiff's business.

The success of such a motion to dismiss, however, directly depends on the forum selection provisions often overlooked in contract drafting. This is due to a recent circuit split between the U.S. Court of Appeals for the Second Circuit on the one hand, and the U.S. Court of Appeals for the First and Fifth Circuits on the other. In *Xeriant Inc. v. Auctus Fund, LLC*, the Second Circuit followed longstanding New York and Southern District caselaw in ruling that a contract cannot be rescinded under Section 29(b) unless that contract specifically requires a party to act as an unregistered securities dealer. 141 F.4th 405, 415 (2d Cir. 2025).

The *Xeriant* court clarified that "only unlawful contracts may be rescinded, not unlawful transactions made pursuant to lawful contracts." *Id.* at 414. Consequently, a warrant that merely provides for the purchase of shares, as opposed to the sale of securities into the market, will not be rescindable in courts within the Second Circuit. *Id.* at 415.

The First and Fifth Circuits, by contrast, generally allow issuers to rescind contracts, even if the contract itself does not require alleged unregistered dealer to act as a dealer. For example, in *EdgePoint Cap. Holdings, LLC v. Apothecare Pharmacy, LLC*, the First Circuit determined that a securities contract may be rescinded, even if facially legal, if its performance in fact involved a violation of the Exchange Act's registration requirements. *See* 6 F.4th 50, 59 (1st Cir. 2021); *see also Reg'l Props., Inc. v. Fin. & Real Est. Consulting Co.*, 678 F.2d 552, 560 (5th Cir. 1982).

As a result, litigants seeking to enforce their warrant agreements in the First and Fifth Circuits may find themselves subject to extensive and intrusive discovery into their business practices—discovery that could exceed the value of the warrants themselves.

This circuit split creates an unacknowledged yet significant risk within the forum selection clauses of warrant agreements and other securities contracts. An unsuspecting investor might enter into or acquire a warrant that mandates enforcement actions be brought in the First or Fifth Circuit.

If the issuer breaches the warrant, the warrant holder may be effectively precluded from enforcing the contract due to the prohibitive cost of litigating the dealer defense. This risk can be mitigated by ensuring that warrants and similar securities contracts designate New York courts as their forum, thereby allowing the dealer defense to be addressed swiftly and cheaply as soon as it is asserted.

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