APPENDIX

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IN THE SUPREME COURT OF THE
STATE OF DELAWARE

No. 295, 2016

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM, ET AL.,
Plaintiffs Below,
Appellants,

v.

AIDA M. ALVAREZ, ET AL.,
Defendants Below,
Appellees,

WAL-MART STORES, INC.,
Nominal Defendant Below,
Appellee.

[Submitted: November 1, 2017
Decided: January 25, 2018]

Before VALIHURA, VAUGHN and TRAYNOR, Justices; WHARTON and CLARK, Judges* constituting the Court en Banc.

VALIHURA, Justice:

The Court of Chancery initially found that Wal-Mart stockholders who were attempting to prosecute derivative claims in Delaware could no longer do so

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* Sitting by designation pursuant to Del. Const. Art. IV §§ 12 and 38 and Supreme Court Rules 2 and 4(a) to fill up the quorum as required.

because another court, a federal court in Arkansas, had reached a final judgment on the issue of demand futility first, and the stockholders were adequately represented in that action. But the derivative plaintiffs in Delaware assert that applying issue preclusion in this context violates their Due Process rights.

This dispute implicates complex questions of law and policy, including: the relationship among competing derivative plaintiffs (and whether they may be said to be in "privity" with one another); whether failure to seek board-level company documents renders a derivative plaintiff's representation inadequate; policies underlying issue preclusion, such as preventing duplicative litigation and promoting judicial economy; and our obligation to respect the judgments of other jurisdictions.

The Chancellor's Original Opinion[1] granting Defendants'[2] motion to dismiss, issued May 13, 2016,

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[1] *In re Wal-Mart Stores, Inc. Del. Deriv. Litig. (Orig. Op.)*, 2016 WL 2908344 (Del. Ch. May 13, 2016).

[2] The individual defendants (appellees) fall into three groups: (1) all fifteen directors of Wal-Mart Stores, Inc. ("Wal-Mart" or the "Company"), an international retail corporation headquartered in Arkansas and incorporated in Delaware, at the time the original derivative complaints were filed in Arkansas federal court and the Delaware Court of Chancery in 2012 (Aida M. Alvarez, James W. Breyer, M. Michele Burns, James I. Cash Jr., Roger C. Corbett, Douglas N. Daft, Michael T. Duke, Gregory B. Penner, Steven S. Reinemund, H. Lee Scott Jr., Arne M. Sorensen, Jim C. Walton, S. Robson Walton, Christopher J. Williams, and Linda S. Wolf); (2) Wal-Mart directors at the time of the alleged misconduct who had stopped serving as directors by the time the complaints were filed (David D. Glass, Roland A. Hernandez, John D. Opie, J. Paul Reason, and Jose H. Villarreal); and (3) former executives of Wal-Mart or WalMex (José Luis Rodriguezmacedo Rivera, Eduardo Castro-Wright, Thomas A. Hyde, Thomas A. Mars, John B. Menzer, Eduardo F. Solorzano

did not expressly focus on the Delaware Plaintiffs'[3] Due Process arguments as a separate issue. We asked the Chancellor to supplement his opinion by focusing on the Due Process concerns. In his Supplemental Opinion,[4] issued July 25, 2017, the Chancellor reiterated that, under the present state of the law, the subsequent plaintiffs' Due Process rights were not violated. Nevertheless, he advocates a different approach. Though acknowledging that no federal court has reached the same conclusion, the Chancellor suggested that we adopt a rule that a judgment in a derivative action cannot bind a corporation or other stockholders until the suit has survived a Rule 23.1 motion to dismiss. The Chancellor believes that such a rule would better protect derivative plaintiffs' Due Process rights, even when they were adequately represented in the first action.

We decline to adopt the Chancellor's recommendation that we refuse to give preclusive effect to other courts' decisions on demand futility and, instead, AFFIRM the Original Opinion granting Defendants' motion to dismiss for the reasons discussed below,

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Morales, and Lee Stucky). Wal-Mart is the nominal defendant. Collectively, they are "Defendants."

[3] The Delaware Plaintiffs, the appellants, are the California State Teachers' Retirement System, New York City Employees' Retirement System, New York City Police Pension Fund, Police Officers' Variable Supplements Fund, Police Supervisor Officers' Variable Supplements Fund, New York City Fire Department Pension Fund, Fire Fighters' Variable Supplements Fund, Fire Officers' Variable Supplements Fund, Board of Education Retirement System of the City of New York, Teachers' Retirement System of the City of New York, New York City Teachers' Variable Annuity Program, and Indiana Electrical Workers Pension Trust Fund IBEW.

[4] *In re Wal-Mart Stores, Inc. Del. Deriv. Litig. (Supp. Op.)*, 167 A.3d 513 (Del. Ch. 2017).

including because, under the governing federal law, there is no Due Process violation.

I.

The facts of this case follow the familiar pattern when news reports expose scandal at a corporation.[5] After the *New York Times* reported in April 2012 on an alleged bribery scheme and cover-up perpetrated by executives at Wal-Mart's Mexican unit,[6] Wal-Mart de Mexico ("WalMex"), derivative suits followed. The Arkansas Plaintiffs[7] filed eight derivative complaints in the United States District Court for the Western District of Arkansas, and seven derivative actions were filed in the Delaware Court of Chancery.[8] The claims in Arkansas and Delaware were similar: they were primarily for breaches of fiduciary duty related to the Wal-Mart board's oversight of WalMex, though the litigation in Arkansas included additional claims under Sections 14(a) and 29(b) of the Securities Exchange Act of 1934, and a claim for contribution

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[5] A more detailed description of the procedural and factual background can be found in our order remanding this case, *Cal. State Teachers' Ret. Sys. v. Alvarez (Remand Or.)*, 2017 WL 6421389 (Del. Jan. 18, 2017) (the "Remand Order"), and in the Court of Chancery's Original Opinion. *See Orig. Op.*, 2016 WL 2908344. This opinion assumes familiarity with those opinions and focuses on the issues raised in our Remand Order.

[6] *See* David Barstow, *Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle*, N.Y. Times (Apr. 21, 2012), http://www.nytimes.com/2012/04/22/business/at-wal-martin-mexico-a-bribe-inquiry-silenced.html.

[7] The nonparty Arkansas Plaintiffs include John Cottrell, William Cottrell, Larry Emory, Kathryn Johnston Lomax, Louisiana Municipal Police Employees' Retirement System, Andrew Richman, and Elizabeth Tuberville. *See Cottrell v. Duke (Cottrell II)*, 829 F.3d 983 (8th Cir. 2016).

[8] *Orig. Op.*, 2016 WL 2908344, at *1, *7.

and indemnity.[9] The Defendants filed motions seeking to have all litigation proceed in one forum[10] and to stay the Arkansas litigation.[11] The Arkansas court initially stayed its proceedings pending the litigation in Delaware.[12]

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[9] *See Orig. Op.*, 2016 WL 2908344, at *9-10; Consolidated Verified Shareholder Derivative Complaint, *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, No. 4:12-cv-4041 (W.D. Ark. May 31, 2013), at B100-03 [hereinafter Arkansas Complaint]. In general, citations to the record have been shortened to a short name of the document, "at," and the appendix page number. Page numbers beginning with "A" refer to the Appendix to the Delaware Plaintiffs' Opening Brief on Appeal; and page numbers beginning with "B" refer to the Appendix to the Defendants' Answering Brief. References to documents filed in the consolidated Arkansas federal district court action, *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, No. 4:12-cv-4041, are noted by "Ark. Litig."; documents filed in the consolidated Delaware Court of Chancery derivative litigation, *In re Wal-Mart Stores, Inc. Del. Deriv. Litig.*, C.A. Nos. 7455-CS & 7455-CB, are noted by "Del. Deriv. Litig."; and documents filed in the Delaware Court of Chancery Section 220 litigation, *Ind. Elec. Workers Pension Tr. Fund IBEW v. Wal-Mart Stores, Inc.*, C.A. No. 7779-CB, are noted by, "Del. § 220 Litig.," and "Del. § 220 Litig. Appeal" for the appeal to this Court.

[10] *See* Defendants' Brief in Support of Their Motion to Proceed in One Jurisdiction, Delaware Deriv. Litig. (June 9, 2012), at B013.

[11] *See* Co-Lead Plaintiffs' Opposition to Defendants' Motion to Stay and for Extension of Time to Respond to the Complaint and Defendants' Notice Filed July 13, 2012, Arkansas Litig. (July 17, 2012), at A609 [hereinafter Stay Opposition]; Reply Memorandum in Support of Wal-Mart's Motion to Stay the Entire Action, Arkansas Litig. (July 26, 2012), at A632; Transcript of Hearing on Motion to Stay, Arkansas Litig. (Sept. 6, 2012), at B163 [hereinafter Stay Hearing Transcript].

[12] *See In re Wal-Mart Stores, Inc. S'holder Deriv. Litig. (Ark. Stay Order)*, 2012 WL 5935340, at *1 (W.D. Ark. Nov. 27, 2012), *superseding*, 2012 WL 5897181 (W.D. Ark. Nov. 20, 2012).

But the situation took a turn from the ordinary when the litigation over a books-and-records demand filed pursuant to 8 *Del. C.* § 220 ("Section 220") became unusually contentious after the plaintiff alleged deficiencies in the Company's first production, received August 1, 2012.[13] This dispute included a trial,[14] an appeal to this Court,[15] and a subsequent motion for contempt against Wal-Mart.[16] In all, the Section 220 litigation lasted nearly three years.

The Delaware Plaintiffs attempted to obtain the Company's books and records because then-Chancellor Strine had commented, "I don't know why the plaintiffs would ever wish to proceed" without first obtaining additional documentary evidence.[17] He added, "[t]here is everything about the context of this case which requires great care and pleading,"[18] and he urged the Delaware Plaintiffs to "take a sincere look at the books and records and file the strongest possible complaint that [they] could."[19]

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[13] *See* Order, Del. Deriv. Litig. (Sept. 5, 2012), *available via File & Serve*. The plaintiff in the Section 220 action, Indiana Electrical Workers Pension Trust Fund IBEW ("Indiana Electrical Workers"), did not file one of the original seven Delaware derivative complaints.

[14] *See Ind. Elec. Workers Pension Tr. Fund IBEW v. Wal-Mart Stores, Inc.*, 2013 WL 5636296 (Del. Ch. Oct. 15, 2013) (Order).

[15] *See Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Tr. Fund IBEW*, 95 A.3d 1264 (Del. 2014).

[16] *See* Transcript of Oral Argument on Plaintiffs' Motion for Order of Civil Contempt and Rulings of the Court, Del. § 220 Litig. (May 7, 2015), at B230.

[17] Transcript of Hearing on Leadership, Del. Deriv. Litig. (July 16, 2012), at A55.

[18] *Id.* at A53.

[19] *Id.* at A56.

The Arkansas Plaintiffs were aware of the Chancellor's warning.[20]

In the meantime, as the litigation over Wal-Mart's document production dragged on, the Eighth Circuit vacated the Arkansas federal district court's stay out of concern for the stalled Section 14(a) claim.[21] The Eighth Circuit concluded that the district court's continued, blanket abstention was not proper under the *Colorado River* doctrine because the "Delaware and Federal Proceedings are not parallel" given that "Delaware courts have no jurisdiction to directly address the merits of the [Arkansas] Plaintiffs' Securities Act claims."[22] But the Eighth Circuit noted that, on remand, the district court "may impose a more finite and less comprehensive stay, if it concludes that such a stay properly balances the rights of the parties and serves the interests of judicial economy."[23]

Back at the Arkansas district court, the Defendants modified their stay request and asked for a stay that would expire upon the Delaware court's ruling

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[20] *See*, *e.g.*, Stay Opposition, *supra* note 4, at A617 (noting that "[t]here is unlikely to be an operative complaint in Delaware for at least several months because the Delaware court has directed the plaintiffs to seek certain corporate documents under Delaware law.").

[21] *Cottrell v. Duke (Cottrell I)*, 737 F.3d 1238, 1242-43, 1245 (8th Cir. 2013).

[22] *Id.* at 1245; *see also id.* at 1240 (explaining that, "[i]n *Colorado River Water Conservation District v. United States*, the United States Supreme Court held that exceptional circumstances may permit a federal court to refrain from hearing a case and instead defer to a concurrent, parallel state-court proceeding." (citing 424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976))).

[23] *Id.* at 1249.

on demand futility. They argued that this more limited stay would thus satisfy the Eighth Circuit's directive.[24] But the Arkansas court denied the Defendants' motion.[25] The Defendants then moved to dismiss the Arkansas Complaint for failure to plead demand futility under Federal Rule of Civil Procedure 23.1.[26]

The Delaware Plaintiffs had expressed concern that, if the Arkansas court ruled first and found demand futility lacking, the Defendants were likely to argue in Delaware that the Arkansas court's ruling on demand futility should have preclusive effect through the doctrine of "collateral estoppel," also known as "issue preclusion" (used here interchangeably).[27] The Delaware Plaintiffs also knew

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[24] *See* Memorandum in Support of Wal-Mart's Renewed Motion for a Limited Stay of this Action, Ark. Litig. (Jan. 10, 2014), at A666; Reply in Support of Wal-Mart's Renewed Motion for a Limited Stay of this Action, Ark. Litig. (Feb. 18, 2014), at A682-83.

[25] *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig. (Ark. Stay Denial Order)*, 2014 WL 12700619, at *2 (W.D. Ark. June 4, 2014).

[26] *See* Memorandum in Support of Defendants' Motion to Dismiss for Failure to Establish Demand Futility, Ark. Litig. (July 3, 2014), at A378.

[27] *See*, *e.g.*, Letter from Stuart Grant to the Chancellor, Del. § 220 Litig. (Sept. 3, 2014), at 2, *available via File & Serve* (urging the Chancellor to expedite proceedings) ("[T]here is a severe risk that, if demand futility is not found in the Arkansas proceedings, the Defendants will likely assert in this Court that the Arkansas decision is entitled to collateral estoppel in the Delaware Derivative Action." (citing *Pyott v. La. Mun. Police Emps.' Ret. Sys. (Pyott II)*, 74 A.3d 612 (Del. 2014))); Indiana Electrical Workers' Motion for Expedited Oral Argument and Decision, Del. § 220 Litig. Appeal (June 6, 2014), at B161 ("If the Arkansas district court concludes that demand is not excused, the

that the Arkansas court had warned in its June 4, 2014, order denying Defendants' stay that "[i]t is likely that the first decision on demand futility will be entitled to collateral estoppel effect."[28] Yet the Delaware Plaintiffs refrained from intervening or otherwise expressing their concerns to the Arkansas court.[29] On March 31, 2015, the Arkansas court

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Plaintiffs in the Delaware Derivative Litigation, including Plaintiff in this appeal, face a severe risk that the Arkansas decision will have collateral estoppel effect in Delaware.").

[28] *Ark. Stay Denial Order*, 2014 WL 12700619, at *2.

[29] Our Remand Order did not suggest that plaintiffs had an *obligation* to intervene in the Arkansas action. *See Remand Or.*, 2017 WL 6421389 at *4 ("[T]here is much force in the suggestion that the Delaware Plaintiffs should have sought to intervene in the Arkansas court to protect their interests . . . ."); *see also Richards v. Jefferson Cty.*, 517 U.S. 793, 800 n.5, 116 S.Ct. 1761, 135 L.Ed.2d 76 (1996) ("The general rule is that '[t]he law does not impose upon a person absolutely entitled to a hearing the burden of voluntary intervention in a suit to which he is a stranger.'" (quoting *Chase Nat. Bank v. Norwalk*, 291 U.S. 431, 441, 54 S.Ct. 475, 78 L.Ed. 894 (1934))). The Delaware Plaintiffs insist that they could not have intervened in Arkansas given that they did not yet have all of the documents that they felt they needed to file a complaint. *See* Oral Argument before the Delaware Supreme Court (Nov. 1, 2017), at 1:44, https://livestream.com/accounts/5969852/events/7894380/videos/165264607 [hereinafter Oral Argument]. However, although formal intervention is not required, there were other potential avenues to ensure that they would not be precluded, or at least have a more compelling argument before this Court that the Arkansas Plaintiffs failed to adequately represent them. Such measures include filing a statement of interest, *see*, *e.g.*, *United States v. Metro. St. Louis Sewer Dist.*, 569 F.3d 829, 834, 841 (8th Cir. 2009) (affirming denial of motion to intervene but referring to Fed. R. Civ. P. 24(c) as providing for the filing of a statement of interest), and participating as amici curiae to inform the Arkansas court of their concerns. Though such other measures are not required either, we simply note that Delaware Plaintiffs' awareness of the potential for collateral estoppel, combined with their failure

granted Defendants' motion to dismiss, with prejudice.[30]

On May 1, 2015, nearly a month after the Arkansas dismissal, the Delaware Plaintiffs amended the operative Delaware Complaint, asserting a single derivative claim for breach of fiduciary duty. As anticipated, Defendants moved to dismiss. And, as also anticipated, Defendants argued that the Arkansas decision collaterally estopped the Delaware Plaintiffs from relitigating the issue of demand futility. They also contended that, if not precluded, Delaware Plaintiffs failed to plead demand futility.

The Court of Chancery granted Defendants' motion to dismiss based on issue preclusion. In determining the preclusive effect of the Arkansas federal court's dismissal, the Court of Chancery looked to federal common law, which the Chancellor determined looks to the law of the rendering state in which the federal court exercised diversity jurisdiction (in this case, Arkansas).[31] Thus, the trial court found that Arkan-

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to coordinate with the Arkansas Plaintiffs and failure to express their concerns to the Arkansas court, suggest that all the equities may not favor the Delaware Plaintiffs here. *See also Dana v. Morgan*, 232 F. 85, 91 (2d Cir. 1916) (rejecting contention that plaintiff had "not had his day in court" in view of his knowledge of the pendency of another suit and noting that he could have intervened to "inform[] the court of anything he deemed important").

[30] *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 2015 WL 1470184, at *10 (W.D. Ark. Mar. 31, 2015) (order), *amended by*, 2015 WL 13375767, at *1, *10 (W.D. Ark. Apr. 3, 2015), *enforced*, 2015 WL 1928779 (W.D. Ark. Apr. 7, 2015) (judgment) (enforcing motion to dismiss, with prejudice), *aff'd*, *Cottrell II*, 829 F.3d 983.

[31] *See Orig. Op.*, 2016 WL 2908344, at *1, *8 ("Under federal common law, a federal court sitting in diversity jurisdiction will

sas state law governed, "[s]ubject to Constitutional standards of due process."[32] The Chancellor held that Defendants satisfied the requisite elements for preclusion under Arkansas law, including privity.[33]

The Chancellor also observed that "[a]pplying the privity requirement to derivative actions involving two different stockholder plaintiffs raises the question [of] whether the required privity is between the two stockholders, or between each stockholder and the corporation."[34] He agreed with the view that the first stockholder plaintiff does not represent the second stockholder plaintiff. Rather, "both plaintiffs sue on behalf of the corporation and are essentially interchangeable."[35] The Chancellor summarized his conclusions on privity as follows:

> [T]he overwhelming majority of decisions in other jurisdictions have found privity between different

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apply the preclusion law of the state in which it sits." (citing *Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 508-09, 121 S.Ct. 1021, 149 L.Ed.2d 32 (2001))). The Arkansas Complaint invoked diversity jurisdiction under 28 U.S.C. § 1332(a)(2), as well as federal question jurisdiction under 28 U.S.C. § 1331 and supplemental jurisdiction under 28 U.S.C. § 1367(a). *See* Arkansas Complaint, *supra* note 9, at B039.

[32] *Orig. Op.*, 2016 WL 2908344, at *1. In our Remand Order, we observed that "[t]he United States Supreme Court has made clear that the preclusive effect of a federal court judgment is determined by federal common law, *subject to due process limitations*." *See Remand Or.*, 2017 WL 6421389, at *6 (citing *Taylor v. Sturgell*, 553 U.S. 880, 891, 128 S.Ct. 2161, 171 L.Ed.2d 155 (2008)).

[33] *Orig. Op.*, 2016 WL 2908344, at *9 (citing *Ark. Dep't of Human Servs. v. Dearman*, 40 Ark. App. 63, 842 S.W.2d 449, 452 (1992) (en banc)).

[34] *Id.* at *12.

[35] *Id.* at *13.

> stockholder plaintiffs in derivative actions on the premise that the corporation is the real party in interest [in] both actions, a premise that the Arkansas Supreme Court has recognized expressly. The Restatement is inconclusive, and public policy arguments exist on both sides of the privity question. Taking all these points into consideration, it is my opinion that Arkansas courts likely would find that the privity requirement is satisfied here because that result accords with the clear weight of authority and resonates with the policy in Arkansas of using preclusion to ensure that issues are litigated only once.[36]

He observed that "most courts addressing the issue have concluded that the corporation is bound by the results of the first judgment in subsequent litigation, even if the result is to preclude a different stockholder's subsequent derivative claim."[37] Regarding federal Due Process concerns, the Court of Chancery suggested that scrutinizing the adequacy of the prior representation serves as a proxy for ensuring that plaintiffs' Due Process rights are protected.[38] Here,

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[36] *Id.* at *17. Because no court in Arkansas had squarely decided whether privity exists among successive derivative plaintiffs, the Chancellor looked in part to the Restatement (Second) of Judgments (Am. L. Inst. 1982) [hereinafter Restatement], as he determined Arkansas courts would for unsettled questions of issue preclusion law. *See id.* at *13-17.

[37] *Id.* at *13.

[38] *Id.* at *17 ("Due process under the United States Constitution requires that a judicial procedure 'fairly insures the protection of the interests of absent parties who are to be bound by it.' One requirement for such procedures is that the absent parties 'are in fact adequately represented by parties who are present.'" (quoting *Hansberry v. Lee*, 311 U.S. 32, 42-43, 61 S.Ct. 115, 85 L.Ed. 22 (1940))). The Chancellor addressed the Due Process

the Chancellor found that the Arkansas Plaintiffs were adequate representatives and, accordingly, implied that there was no Due Process violation.

On appeal, Delaware Plaintiffs argue that the Court of Chancery erred in finding: (a) privity between Arkansas and Delaware Plaintiffs; (b) adequate representation by the Arkansas Plaintiffs; and (c) that the issue of demand futility was "actually litigated" in Arkansas. They also argue that the Court of Chancery violated their Due Process rights, including by finding: (i) privity; and (ii) adequacy of representation.[39] We review the trial court's dismissal based on issue preclusion, and its interpretation of federal Due Process principles, *de novo*.[40]

We first considered this appeal last spring, but we postponed a final ruling because the Delaware Plaintiffs' Due Process arguments gave us pause. In asserting that the Court of Chancery had violated their Due Process rights by finding privity between the Arkansas and Delaware plaintiffs, the Delaware Plaintiffs rely on Vice Chancellor Laster's opinion in *EZCORP*,[41] which the Chancellor had not addressed

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issue solely by examining the adequacy of representation. *See id.* at *17-23.

[39] Delaware Plaintiffs' Opening Br. at 23 ("[T]he Due Process Clause and Restatement both require two separate elements – the authority to act as a representative plaintiff [*i.e.*, through privity] *and* adequacy of representation.").

[40] *See Cohen v. State ex rel. Stewart*, 89 A.3d 65, 86 (Del. 2014) ("This Court reviews claims of violations of constitutional rights *de novo*."); *Betts v. Townsends, Inc.*, 765 A.2d 531, 533 (Del. 2000) (noting that whether a tribunal was "barred by *res judicata* or collateral estoppel" from deciding certain issues "raises a question of law that this Court reviews *de novo*").

[41] *In re EZCORP Inc. Consulting Agreement Deriv. Litig.*, 130 A.3d 934 (Del. Ch. 2016).

in his Original Opinion, likely because the Delaware Plaintiffs had submitted the Court of Chancery's opinion in *EZCORP* to the Chancellor *after* completion of the motion to dismiss briefing.

In *EZCORP*, a plaintiff filed a derivative complaint against the outside directors of EZCORP. Between the briefing and argument on the defendants' motion to dismiss, the plaintiff proposed a voluntary dismissal of the complaint without prejudice. The defendants objected and sought a dismissal with prejudice "as to the world."[42] Applying Court of Chancery Rule 15(aaa),[43] the trial court ruled that the complaint should be dismissed with prejudice, but only as to the named plaintiff.[44] In dicta, the Court of Chancery also observed that, both as a matter of Delaware law[45] and Due Process, a derivative plaintiff may not bind a later derivative plaintiff unless and until the first derivative plaintiff survives a motion to dismiss,

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[42] *Id.* at 940, 942.

[43] Del. Ct. Ch. R. 15(aaa) ("In the event a party fails to timely file an amended complaint or motion to amend under this subsection (aaa) and the Court thereafter concludes that the complaint should be dismissed under Rule 12(b)(6) or 23.1, such dismissal shall be with prejudice (and in the case of complaints brought pursuant to Rules 23 or 23.1 with prejudice to the named plaintiffs only) unless the Court, for good cause shown, shall find that dismissal with prejudice would not be just under all the circumstances.").

[44] *EZCORP*, 130 A.3d at 942-43.

[45] *Id.* at 943-46. However, in his Supplemental Opinion, the Chancellor viewed Delaware law as "unsettled on this issue." *Supp. Op.*, 167 A.3d at 524 n.60 (noting that "the Court of Chancery is divided on the privity issue as a matter of Delaware law" (quoting *Pyott v. La. Mun. Police Emps.' Ret. Sys. (Pyott II)*, 74 A.3d 612, 618 (Del. 2013))).

or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit.[46]

The *EZCORP* decision relies on the dual, or two-fold, nature of derivative litigation, noting that the key distinction between the first and second phases of a derivative action is that "the first phase of the derivative action [is one] in which the stockholder sues individually to obtain authority to assert the corporation's claim."[47] The Vice Chancellor reasoned that, "until the derivative action passes the Rule 23.1 stage, the named plaintiff does not have authority to sue on behalf of the corporation or anyone else."[48]

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[46] *EZCORP*, 130 A.3d at 947-48 (citing *Smith v. Bayer Corp.*, 564 U.S. 299, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011)).

[47] *Id.* at 945; *see also Spiegel v. Buntrock*, 571 A.2d 767, 773 (Del. 1990) ("The nature of the derivative action is two-fold. 'First, it is the equivalent of a suit by the shareholders to compel the corporation to sue. Second, it is a suit by the corporation, asserted by the shareholders on its behalf, against those liable to it.' " (quoting *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984))); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 (Del. 1981) (describing " 'two phases' of a derivative suit, the stockholder's suit to compel the corporation to sue and the corporation's suit"); *Ross v. Bernhard*, 396 U.S. 531, 534-35, 90 S.Ct. 733, 24 L.Ed.2d 729 (1970) (describing "the dual nature of the stockholder's action: first, the plaintiff's right to sue on behalf of the corporation and, second, the merits of the corporation claim itself.").

[48] *EZCORP*, 130 A.3d at 945; *see also id.* at 943 ("As a matter of Delaware law, a stockholder whose litigation efforts are opposed by the corporation does not have authority to sue on behalf of the corporation until there has been a finding of demand excusal or wrongful refusal . . . ." (citing *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993))); *id.* at 944 ("The right to bring a derivative action does not come into existence until the plaintiff shareholder has made a demand on the corporation to institute such an action or until the shareholder has demonstrated

Thus, in *EZCORP*, the Vice Chancellor suggested that binding subsequent derivative plaintiffs to a dismissal based on demand futility in a case where they were not parties "deprive[s] them of the due process of law guaranteed by the Fourteenth Amendment."[49] The Vice Chancellor relied on the United States Supreme Court decision in *Smith v. Bayer Corp.*,[50] which suggested that, as a matter of Due Process, "[n]either a proposed class action nor a rejected class action may bind nonparties."[51] The

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that demand would be futile." (quoting *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d 726, 730 (Del. 1988))).

[49] *Id.* at 947 (quoting *Richards*, 517 U.S. at 797, 116 S.Ct. 1761).

[50] 564 U.S. 299, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011).

[51] *Id.* at 315. The *Bayer* decision is based "on the Anti-Injunction Act and the principles of issue preclusion that inform it," and, thus, did not consider the plaintiff's "argument, based on *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 [105 S.Ct. 2965, 86 L.Ed.2d 628] (1985), that the District Court's action violated the Due Process Clause." *Id.* at 308 n.7, 131 S.Ct. 2368. The Anti-Injunction Act provides that a federal court "may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to *protect or effectuate its judgments*." 28 U.S.C. § 2283 (emphasis added). Thus, this last exception, known as the "relitigation exception," is "designed to implement 'well-recognized concepts' of claim and issue preclusion," and thus authorizes injunctions when necessary "to prevent state litigation of a claim or issue 'that previously was presented to and decided by the federal court.' " *Bayer*, 564 U.S. at 306, 131 S.Ct. 2368 (quoting *Chick Kam Choo v. Exxon Corp.*, 486 U.S. 140, 147-48, 108 S.Ct. 1684, 100 L.Ed.2d 127 (1988)). Given that "a court does not usually get to dictate to other courts the preclusion consequences of its own judgment," the Court has tried to keep its application "strict and narrow" and thus allows injunctions "only if preclusion is clear beyond peradventure." *Id.* at 306-07, 131 S.Ct. 2368 (internal quotation marks omitted).

Vice Chancellor believed that the same logic should apply to derivative actions that do not adequately plead demand futility. Thus, he stated that, "just as the Due Process Clause prevents a judgment from binding absent class members before a class has been certified, the Due Process Clause likewise prevents a judgment from binding the corporation or other stockholders in a derivative action until the action has survived a Rule 23.1 motion to dismiss, or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit."[52] The Court of Chancery's Original Opinion did not expressly discuss *Bayer*.

In response, Defendants argue that this Court, in *Pyott II*,[53] had already addressed the Due Process issue, at least implicitly. They observe that this Court recognized in *Pyott II* that numerous jurisdictions have held that, "because the real plaintiff in a derivative suit is the corporation, 'differing groups of shareholders who can potentially stand in the corporation's stead are in privity for the purposes of issue preclusion.' "[54] Defendants observe that we had more recently affirmed a similar finding of privity in *Asbestos Workers Local 42 Pension Fund v. Bammann*.[55]

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[52] *EZCORP*, 130 A.3d at 948.

[53] 74 A.3d 612 (Del. 2013).

[54] *Id.* at 616-17 (quoting *LeBoyer v. Greenspan*, 2007 WL 4287646, at *3 (C.D. Cal. June 13, 2007)).

[55] 132 A.3d 749 (Del. 2016), *aff'g* 2015 WL 2455469 (Del. Ch. May 22, 2015) (applying collateral estoppel under New York law). In *Bammann*, the Court of Chancery cited New York authority for the proposition that, "[a]s to the question of privity, under New York law, '[i]t is well-settled that collateral estoppel may be applied in the shareholder derivative context.' " 2015 WL 2455469, at *16 (quoting *Carroll ex rel. Pfizer, Inc. v.*

Further, they argue that Arkansas federal courts have repeatedly "held or presumed that '[c]ollateral estoppel prevents the issue of pre-suit demand futility from being relitigated.' "[56]

Regarding *EZCORP*, Defendants note that, even if its approach were advisable as a matter of Delaware policy, it does not accurately reflect federal law or the law of Arkansas. They elaborate that *EZCORP* turned only on Delaware law (specifically Court of Chancery Rule 15 (aaa)), which allows the Delaware Court of Chancery to dismiss derivative suits as to the named plaintiff only. They point out that the Federal Rules of Civil Procedure (which governed the proceedings in Arkansas federal court) lack a similar provision, as do the procedural rules of Arkansas.

When first considering this appeal, we believed that there was some "force" to the Delaware Plaintiffs' argument that the Court of Chancery may have "conflated" the privity and Due Process analyses.[57] We appreciate that Arkansas law is unsettled in this derivative context. Moreover, even the United States

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McKinnell, 19 Misc.3d 1106(A), 2008 WL 731834, at *2 (N.Y. Sup. Ct. Mar. 17, 2008)). The Court of Chancery stated that, "[t]his principle recognizes that 'shareholder plaintiffs are treated like equal and effectively interchangeable members of a class action because their claims belong to and are brought on behalf of the corporation' and that, accordingly, 'a judgment rendered in such an action brought on behalf of the corporation by one shareholder will generally be effective to preclude other actions predicated on the same wrong brought by other shareholders.' " *Id.* (quoting New York authorities).

[56] Defendants' Answering Br. at 2 (quoting *Harben v. Dillard*, 2010 WL 3893980, at *6 (E.D. Ark. Sept. 30, 2010)).

[57] *Remand Or.*, 2017 WL 6421389, at *5. We also observed that "[b]oth sides agree that, although they overlap, the privity and Due Process issues are distinct." *Id.*

Supreme Court, in *Taylor v. Sturgell*,[58] cautioned that the term "privity" has been used to cover a range of different relationships and observed, for example, that "privity" has referred to substantive legal relationships justifying preclusion and, alternatively, the term has also been used more broadly "as a way to express the conclusion that nonparty preclusion is appropriate on any ground."[59]

As such, the United States Supreme Court, accordingly, avoided the term "privity"[60] in *Taylor*, an opinion where it identified six recognized situations where nonparty preclusion does not violate the Due Process Clause of the United States Constitution.[61] These six situations are when the party to be precluded: (1) agreed to be precluded by contract;[62] (2) had a pre-existing substantive legal relationship with the prior litigant;[63] (3) was adequately represented

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[58] 553 U.S. 880, 128 S.Ct. 2161, 171 L.Ed.2d 155 (2008).

[59] *Id.* at 894 n.8, 128 S.Ct. 2161; *see also Richards*, 517 U.S. at 798, 116 S.Ct. 1761 ("[T]he term 'privity' is now used to describe various relationships between litigants that would not have come within the traditional definition of that term.").

[60] 553 U.S. at 894 n.8, 128 S.Ct. 2161 (2008) ("To ward off confusion, we avoid using the term 'privity' in this opinion.").

[61] These exceptions generally followed those articulated in the Restatement, including Section 41, in particular. *See id.* at 893 n.6 n.8, 128 S.Ct. 2161.

[62] *Id.* at 893, 128 S.Ct. 2161.

[63] *Id.* at 894 n.8, 128 S.Ct. 2161 (noting that "substantive legal relationships justifying preclusion are sometimes collectively referred to as 'privity.' "). The Supreme Court specified that those "substantive legal relationships" that qualify under this exception "include, but are not limited to, preceding and succeeding owners of property, bailee and bailor, and assignee and assignor." *Id.* at 894, 128 S.Ct. 2161 (citing Restatement §§ 43-44, 52, 55). The Court also observed that such exceptions

by the prior litigant who shared its interests;[64] (4) assumed control over the prior litigation;[65] (5) is attempting to act as a proxy for the prior litigant seeking to relitigate a given issue;[66] or (6) is expressly prohibited by a statutory scheme that complies with Due Process.[67] The United States Supreme Court stated that this is a nonexclusive list and that there may be other exceptions recognized by case law.[68]

In our Remand Order, we suggested that the "most analogous of these exceptions involves putative class actions"[69] (*i.e.*, this third exception)—those "limited circumstances" where a "nonparty may be bound by a judgment because she was 'adequately represented by someone with the same interests who [wa]s a party' to the suit."[70] Such representative suits include, among others, "properly conducted class actions"[71]

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derive "as much from the needs of property law as from the values of preclusion by judgment." *Id.* (quoting 18A Charles Alan Wright, Arthur R. Miller, & Edward H. Cooper, Federal Practice and Procedure § 4448 (2d ed. 2002) [hereinafter Wright & Miller]).

[64] *Id.* at 894-95, 128 S.Ct. 2161 (citing to, among other authorities, Restatement § 41).

[65] *Id.* at 895, 128 S.Ct. 2161.

[66] *Id.*

[67] *Id.*

[68] *Id.* at 893 n.6, 128 S.Ct. 2161 (noting that these categories could be organized differently and the list was not "a definitive taxonomy").

[69] *Remand Or.*, 2017 WL 6421389, at *6.

[70] *Taylor*, 553 U.S. at 894, 128 S.Ct. 2161 (quoting *Richards*, 517 U.S. at 798, 116 S.Ct. 1761).

[71] *Id.* (citing *Martin v. Wilks*, 490 U.S. 755, 762 n.2, 109 S.Ct. 2180, 104 L.Ed.2d 835 (1989)); *see also Cooper v. Federal Reserve Bank of Richmond*, 467 U.S. 867, 874, 104 S.Ct. 2794, 81 L.Ed.2d

and "suits brought by trustees, guardians, and other fiduciaries."[72]

In *Smith v. Bayer*,[73] the United States Supreme Court considered whether putative, uncertified class actions fall within this exception as "properly conducted class action[s]," and it held that they do not.[74] The Court stated that "a 'properly conducted class action,' with binding effect on nonparties [*i.e.*, consistent with Due Process], can come about in federal courts in just one way—through the procedure set out in Rule 23."[75] In other words, "[n]either a proposed class action nor a rejected class action may bind nonparties."[76] Only class actions certified under Rule 23 may bind unnamed members of the certified class actions under this exception to avoid breaching the Due Process rights of subsequent litigants. We questioned whether the same reasoning should be applied to derivative plaintiffs who fail to plead demand futility, given the similarities between a pre-demand futility derivative action and a pre-certified class action.

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718 (1984) ("[U]nder elementary principles of prior adjudication a judgment in a properly entertained class action is binding on class members in any subsequent litigation.").

[72] *Taylor*, 553 U.S. at 894, 128 S.Ct. 2161 (citing *Sea-Land Services, Inc. v. Gaudet*, 414 U.S. 573, 593, 94 S.Ct. 806, 39 L.Ed.2d 9 (1974); Restatement § 41).

[73] 564 U.S. 299, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011).

[74] *Id.* at 314-15, 131 S.Ct. 2368.

[75] *Id.* at 315, 131 S.Ct. 2368.

[76] *Id.*; *see also id.* at 313, 131 S.Ct. 2368 ("The definition of the term 'party' can on no account be stretched so far as to cover a person . . . whom the plaintiff in a lawsuit was denied leave to represent.").

Accordingly, we posed the following question to the Chancellor:

> In a situation where dismissal by the federal court in Arkansas of a stockholder plaintiff's derivative action for failure to plead demand futility is held by the Delaware Court of Chancery to preclude subsequent stockholders from pursuing derivative litigation, have the subsequent stockholders' Due Process rights been violated? *See Smith v. Bayer Corp.*, 564 U.S. 299 [131 S.Ct. 2368, 180 L.Ed.2d 341](2011).[77]

We requested a supplemental opinion on this question. In doing so, we underscored the "troubling" nature of this case.[78] On the one hand, this Court has repeatedly admonished plaintiffs to use the "tools at hand" and to request company books and records under Section 220 to attempt to substantiate their allegations before filing derivative complaints.[79] Delaware Plaintiffs heeded this advice and demanded Company books and records under Section 220. In contrast, the Arkansas Plaintiffs did not seek books and records, and their complaint was dismissed with prejudice.

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[77] *Remand Or.*, 2017 WL 6421389, at *8.

[78] *Id.* at *1.

[79] *Id.*; *see also Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 120 (Del. 2006) (describing "this Court's encouragement of stockholders, who can show a proper purpose, to use the 'tools at hand' to obtain the necessary information before filing a derivative action."); *King v. VeriFone Holdings, Inc.*, 12 A.3d 1140, 1145 (Del. 2011) ("Delaware courts have strongly encouraged stockholder-plaintiffs to utilize Section 220 before filing a derivative action, in order to satisfy the heightened demand futility pleading requirements of Court of Chancery Rule 23.1.").

On the other hand, we have acknowledged the importance of the Full Faith and Credit Clause of the U.S. Constitution,[80] which implicates principles of comity and respect for the judgments of other courts. We have observed that, although Delaware has an "undisputed interest" in "governing the internal affairs of its corporations," that interest "must yield to the stronger national interests that all state and federal courts have in respecting each other's judgments."[81] The importance of these intertwined issues and their policy implications deserved closer examination and the benefits of additional briefing if the Chancellor desired.

After requesting and receiving additional briefing from the parties, the Chancellor provided his thoughts in his Supplemental Opinion. He found that the weight of authority suggests that, no, the Court of Chancery does not violate the Due Process rights of later derivative plaintiffs if it concludes that a federal court's dismissal of a prior plaintiff's derivative action for failure to plead demand futility precludes subsequent stockholders from pursuing derivative litigation relating to the same issues—unless the prior representation was inadequate, *i.e.*, "unless the representative plaintiff's management of the first derivative action was 'so grossly deficient as to be apparent to the opposing party' or failed to satisfy

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[80] *See Remand Or.*, 2017 WL 6421389, at *7 n.47; *see also Pyott II*, 74 A.3d at 616 ("The United States Supreme Court has held that the full faith and credit obligation is 'exacting' and that there is 'no roving 'public policy exception' to the full faith and credit due judgments.' " (quoting *Baker v. Gen. Motors Corp.*, 522 U.S. 222, 232-33, 118 S.Ct. 657, 139 L.Ed.2d 580 (1998))).

[81] *Pyott II*, 74 A.3d at 616.

one of the Restatement's other criteria for determining adequacy of representation."[82]

Nonetheless, the Chancellor recommended that this Court depart from the weight of authority and adopt the rule proposed in *EZCORP*.[83] Although the Chancellor acknowledged that "no court has done so to date, and although the [Delaware] Supreme Court previously declined to embrace such a rule in the context of considering the question of privity in derivative litigation,"[84] the Chancellor suggested that such a rule would "better safeguard the due process rights of stockholder plaintiffs and should go a long way to addressing fast-filer problems currently inherent in multi-forum derivative litigation."[85]

II.

We appreciate the Chancellor's thoughtful deliberations on this difficult matter. But we decline to embrace his suggestion that the *EZCORP* approach become the law governing the preclusive effect of prior determinations of demand futility, especially given that federal law governs our evaluation of Due Process concerns. Three federal circuit courts have already addressed whether granting preclusive effect to prior determinations of demand futility violates Due Process, and they each arrived at the same conclusion: the Due Process rights of subsequent derivative plaintiffs are protected, and dismissal based on issue preclusion is appropriate, when their

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[82] Supp. Op., 167 A.3d at 515 (citing Restatement § 42 cmt. f).

[83] *See id.* at 525 ("I respectfully suggest that the Supreme Court should consider a different approach and adopt the one suggested in *EZCORP*.").

[84] *Id.* at 516 (citing *Pyott II*, 74 A.3d at 616-18).

[85] *Id.*

interests were aligned with and were adequately represented by the prior plaintiffs.[86] Most other cases on this issue have granted preclusive effect to a prior court's decision on demand futility, though many of these opinions do not expressly address Due Process.[87]

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[86] *See Arduini v. Hart*, 774 F.3d 622, 633-34 (9th Cir. 2014) (applying Nevada law); *In re Sonus Networks, Inc. S'holder Deriv. Litig.*, 499 F.3d 47, 64 (1st Cir. 2007) (applying Massachusetts law); *Nathan v. Rowan*, 651 F.2d 1223, 1226-28 (6th Cir. 1981) (applying federal common law).

[87] Defendants suggest that "a solid wall of federal and state decisions from across the country" address the Due Process concerns here. *See* Oral Argument, *supra* note 29, at 20:12; *id.* at 20:44 (referring to cases listed in Defendants' Supp. Mem. at 1, n.1). While these cases support giving preclusive effect to prior determinations of demand futility, close examination reveals that most of the cited cases do not expressly address the Due Process rights of the subsequent derivative plaintiffs. Some allow preclusion after finding adequate representation (which, we acknowledge, is part of the Due Process analysis). *See Hanson v. Odyssey Healthcare, Inc.*, 2007 WL 5186795, at *6 (N.D. Tex. Sept. 21, 2007); *In re Bed Bath & Beyond Inc. Deriv. Litig.*, 2007 WL 4165389, at *7-8 (D. N.J. Nov. 19, 2007); *Henik v. LaBranche*, 433 F.Supp.2d 372, 381-82 (S.D.N.Y. 2006); *Laborers' Dist. Council Constr. Indus. Pension Fund v. Bensoussan*, 2016 WL 3407708, *10-13 (Del. Ch. June 14, 2016), *aff'd*, 155 A.3d 1283 (Del. 2017); *In re Career Educ. Corp. Deriv. Litig.*, 2007 WL 2875203, at *10 (Del. Ch. Sept. 28, 2007); *see also Cramer v. Gen. Tel. & Elecs. Corp.*, 582 F.2d 259, 269 (3d Cir. 1978) ("Nonparty shareholders are usually bound by a judgment in a derivative suit on the theory that the named plaintiff represented their interests in the case. But that rationale is valid only if the representation of the shareholders' interests was adequate."); *In re JPMorgan Chase Derivative Litig.*, 263 F.Supp.3d 920, 938-39 (E.D. Cal. 2017). Others do not address the adequacy of the prior representation, yet apply issue preclusion in this context after finding other elements satisfied. *See In re MGM Mirage Deriv. Litig.*, 2014 WL 2960449, at *7 (D. Nev. June 30, 2014); *Harben v. Dillard*, 2010 WL 3893980, at *6

A. The Governing Law

As we observed above, "[t]he preclusive effect of a federal-court judgment is determined by federal common law."[88] Though, by its terms, the Full Faith and Credit Clause of the United States Constitution does not explicitly apply to judgments of federal courts,[89] the United States Supreme Court "has

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(E.D. Ark. Sept. 30, 2010); *LeBoyer v. Greenspan*, 2007 WL 4287646 (C.D. Cal. June 13, 2007); *Asbestos Workers Local 42 Pension Fund v. Bammann*, 2015 WL 2455469, at *16 n.135 (Del. Ch. May 22, 2015) (noting that the plaintiff "has not argued an absence of an opportunity to fully and fairly litigate this issue" or that the prior derivative plaintiffs were inadequate representatives), *aff'd*, 132 A.3d 749 (Del. 2016); *City of Providence v. Dimon*, 2015 WL 4594150, at *7 (Del. Ch. July 29, 2015) (applying res judicata) ("Under New York law, a later stockholder asserting derivative claims on behalf of a corporation is considered to be the 'same plaintiff' as a different stockholder asserting those claims on behalf of the corporation in a separate action."), *aff'd*, 134 A.3d 758 (Del. 2016); *see also Smith v. Waste Mgmt., Inc.*, 407 F.3d 381, 386 (5th Cir. 2005); *Dana v. Morgan*, 232 F. 85, 90-91 (2d Cir. 1916); *Liken v. Shaffer*, 64 F.Supp. 432, 443-44 (N.D. Iowa 1946). We observe that, in *Pyott II*, we cited in a footnote as dicta Justice Ginsburg's concurring and partially dissenting opinion in *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, as noting the general point that "final judgments can be attacked collaterally on due process grounds for failure to satisfy the adequate representation requirement." 74 A.3d at 618 n.21 (citing 516 U.S. 367, 395-96, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996) (Ginsburg, J., concurring in part and dissenting in part)). However, we did not reach the Due Process implications of preclusion as the plaintiffs-appellees in *Pyott II* had advised this Court that the Due Process question had not been fully briefed before the Court of Chancery and was not being argued on appeal. *See Remand Or.*, 2017 WL 6421389, at *6-7 (citing *Pyott II*, 74 A.3d at 616-18).

[88] *Taylor*, 553 U.S. at 891, 128 S.Ct. 2161.

[89] U.S. Const., art. IV, § 1 ("Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.").

held that a state court is required to give a federal judgment the same force and effect as it would be given under the preclusion rules of the state in which the federal court is sitting."[90]

All parties and the Court of Chancery agreed that, under federal common law, a federal court sitting in diversity jurisdiction will apply the preclusion law of the state in which it sits. The Court of Chancery reasoned that the "issue requiring preclusion analysis here is the Arkansas district court's decision concerning demand futility relating to the Arkansas plaintiffs' fiduciary duty claim, which was brought under the district court's diversity jurisdiction."[91] Though that is true, we observe that the Arkansas Complaint also asserted federal question and supplemental jurisdiction given the presence of the federal securities law claims. Thus, it is arguable that the federal common law of issue preclusion applies.[92]

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[90] *Pyott II*, 74 A.3d at 616 (citing *Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 501, 121 S.Ct. 1021, 149 L.Ed.2d 32 (2001)).

[91] *Orig. Op.*, 2016 WL 2908344, at *8. The Chancellor observed that the fiduciary duty claim at issue here was brought under the district court's diversity jurisdiction, as well as the court's supplemental jurisdiction, but that no party had argued that the analysis would differ. *See id.* at *8 n.33. He followed the approach of *Fresh Del Monte Produce Inc. v. Del Monte Foods, Inc.*, 2016 WL 236249, at *3 n.4 (S.D.N.Y. Jan. 20, 2016), which applied "federal rules of preclusion to judgments on claims premised on federal question jurisdiction, and New York [*i.e.*, state law] rules of preclusion to judgments on claims premised upon diversity or supplemental jurisdiction." *See Orig. Op.*, 2016 WL 2908344, at *8 n.33.

[92] *See*, *e.g.*, *Taylor*, 553 U.S. at 891, 128 S.Ct. 2161 ("For judgments in federal-question cases . . . federal courts participate in developing 'uniform federal rule[s]' of res judicata, which this Court has ultimate authority to determine and declare." (quoting

However, we believe the result would be the same under both federal and Arkansas law. As discussed below, Arkansas law draws on federal law (as well as the Restatement), and the United States Supreme Court recently reiterated that the federal courts also

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Semtek, 531 U.S. at 508, 121 S.Ct. 1021)); Richard H. Fallon, Jr. et al., *Hart and Wechsler's The Federal Courts and the Federal System* 1368 (7th ed. 2015) ("When a federal court decides a federal question, federal preclusion rules govern the preclusive effect of the judgment in subsequent state or federal court proceedings."); *see also*, *e.g.*, *Cooper v. Glasser*, 419 S.W.3d 924, 929 (Tenn. 2013) (observing that "*Semtek* clearly establishes three points: (1) state claim-preclusion law controls the preclusive effect of a federal dismissal in a diversity case unless state law sufficiently undermines federal interests; (2) any resolution of the substance/procedure concerns raised in these cases necessarily implicates *Erie* and the Rules Enabling Act; and (3) state courts must give judgments in federal-question cases the claim-preclusive effect that federal law commands," and that "*Semtek* does not, however, state whether federal or state claim-preclusion law governs supplemental state-law claims filed in federal court."). In *Cooper*, the Tennessee Supreme Court applied state claim-preclusion law in analyzing the preclusive effect of voluntary dismissals of supplemental state law claims filed in federal court. *Id.* at 930; *see also Sprint Commc'n Co. v. Crow Creek Sioux Tribal Ct.*, 121 F.Supp.3d 905, 925, n.19 (D. S.D. 2015) (noting that, "[t]he parties have not addressed whether state or federal doctrine should be followed in cases where both diversity and federal question jurisdiction are invoked," but that "South Dakota's doctrine of issue preclusion draws on federal law and does not differ greatly from the test articulated by the Eighth Circuit."). *But see JPMorgan*, 263 F.Supp.3d at 930-31 (concluding that "federal common law determines Steinberg's preclusive effect because Steinberg addressed a federal question," and stating, "that Steinberg also involved state law claims does not change this Court's conclusion because the Steinberg court considered those claims on the basis of supplemental jurisdiction only").

look to the Restatement (Second) of Judgments for "the ordinary elements of issue preclusion."[93]

All parties also agree that examining privity does not end our inquiry. The United States Supreme Court has stated that "[t]he federal common law of preclusion is, of course, subject to due process limitations."[94] Regarding issues of Due Process, federal law governs our analysis.[95]

As such, for issue preclusion to apply, the party asserting issue preclusion must satisfy the court that, first, all elements of issue preclusion are present and, second, Due Process requirements are satisfied.[96] We address these requirements in turn.

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[93] *See*, *e.g.*, *B & B Hardware, Inc. v. Hargis Indus., Inc.*, —— U.S. ——, 135 S.Ct. 1293, 1303, 191 L.Ed.2d 222 (2015).

[94] *Taylor*, 553 U.S. at 891, 128 S.Ct. 2161 (citing *Richards*, 517 U.S. 793, 797, 116 S.Ct. 1761 (1996)).

[95] *Kremer v. Chem. Constr. Corp.*, 456 U.S. 461, 481, 102 S.Ct. 1883, 72 L.Ed.2d 262 (1982) ("[S]tate proceedings need do no more than satisfy the minimum procedural requirements of the Fourteenth Amendment's Due Process Clause in order to qualify for the full faith and credit guaranteed by federal law."); *id.* at 482, 102 S.Ct. 1883 ("The State must, however, satisfy the applicable requirements of the Due Process Clause. A State may not grant preclusive effect in its own courts to a constitutionally infirm judgment, and other state and federal courts are not required to accord full faith and credit to such a judgment."); *see also Richards*, 517 U.S. at 805, 116 S.Ct. 1761 (reversing Alabama state court's application of res judicata as invalid "as a matter of federal due process").

[96] *See Taylor*, 553 U.S. at 907, 128 S.Ct. 2161 ("[A] party asserting preclusion must carry the burden of establishing all necessary elements." (quoting 18 Wright & Miller, *supra* note 63, § 4405) (alteration in original)).

B. Issue Preclusion

"Collateral estoppel, or issue preclusion, bars relitigation of issues, law, or fact actually litigated in the first suit."[97] The Chancellor noted that collateral estoppel requires the "following four elements": "1) the issue sought to be precluded must be the same as that involved in the prior litigation; 2) that issue must have been actually litigated; 3) the issue must have been determined by a valid and final judgment; and 4) the determination must have been essential to the judgment."[98] Though many Arkansas cases

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[97] *Riverdale Dev. Co. v. Ruffin Bldg. Systems, Inc.*, 356 Ark. 90, 146 S.W.3d 852, 855 (2004). "[I]ssue preclusion encompasses the doctrines once known as 'collateral estoppel' and 'direct estoppel.'" *Taylor*, 553 U.S. at 892 n.5, 128 S.Ct. 2161.

[98] *Riverdale*, 146 S.W.3d at 855. In *B & B Hardware*, the United States Supreme Court noted that, "[t]he Court . . . regularly turns to the Restatement (Second) of Judgments for a statement of the ordinary elements of issue preclusion." 135 S.Ct. at 1303. It also stated that, "[t]he Restatement explains that subject to certain well-known exceptions, the general rule is that '[w]hen an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim.'" *Id.* (quoting Restatement § 27; citing Restatement § 28 as providing exceptions). Arkansas courts also look to the Restatement, including § 27. *See*, *e.g.*, *Estate of Goston v. Ford Motor Co.*, 320 Ark. 699, 898 S.W.2d 471, 473 (1995). The facts that both federal common law and Arkansas law look to the Restatement, and that Arkansas law looks to federal jurisdictions, support our conclusion that the result is the same under both federal common law and Arkansas law. *See also Ginters v. Frazier*, 614 F.3d 822, 826 (8th Cir. 2010) (quoting *Robinette v. Jones*, 476 F.3d 585, 589 (8th Cir. 2007)):

> In the Eighth Circuit, issue preclusion has five elements: (1) the party sought to be precluded in the second suit must have been a party, or in privity with a party, to the original

indicate that there are "four elements" of issue preclusion,[99] the Court of Chancery adopted the view of the parties and suggested that issue preclusion under Arkansas law requires another two elements: (i) privity; and (ii) adequacy of the prior representation. We thus assume that these elements are also required for issue preclusion to be applied.[100]

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lawsuit; (2) the issue sought to be precluded must be the same as the issue involved in the prior action; (3) the issue sought to be precluded must have been actually litigated in the prior action; (4) the issue sought to be precluded must have been determined by a valid and final judgment; and (5) the determination in the prior action must have been essential to the prior judgment.

[99] *See*, *e.g.*, *Riverdale*, 146 S.W.3d at 855 ("four elements"); *Mann v. Pierce*, 2016 Ark. 418, 505 S.W.3d 150, 154 (2016) ("four requirements"); *Fisher v. Jones*, 311 Ark. 450, 844 S.W.2d 954, 957 (1993) ("four elements"); *Abraham v. Beck*, 2015 Ark. 80, 456 S.W.3d 744, 752 (2015) (listing four "elements" of collateral estoppel); *Morgan v. Turner*, 2010 Ark. 245, 368 S.W.3d 888, 895 (2010) (same). *But see Crockett v. C.A.G. Investments, Inc.*, 2011 Ark. 208, 381 S.W.3d 793, 799 (2011) ("Under issue preclusion (collateral estoppel), a decision by a court of competent jurisdiction on matters which were at issue, and which were directly and necessarily adjudicated, bars any further litigation on those issues by the plaintiff or his privies against the defendant or his privies on the same issue."); *Dearman*, 842 S.W.2d at 452 (citing 18 Wright & Miller, *supra* note 63, § 4448, for the view that the "doctrine [of collateral estoppel] applies only to persons who were parties or who are in privity with persons who were parties in the first action").

[100] The one case applying Arkansas law that considers defendants' assertion of issue preclusion against a second derivative plaintiff's attempt to litigate demand futility, *Harben v. Dillard*, 2010 WL 3893980 (E.D. Ark. Sept. 30, 2010), does not include privity as an element for the applicability of issue preclusion. *See id.* at *3. The Chancellor mentioned the case, but did not consider it helpful because "the parties did not raise and the court did not explicitly address the question of privity." *Orig.*

The Arkansas Supreme Court in *Crockett v. C.A.G. Investments, Inc.*[101] said that privity "exists when two parties are so identified with one another that they represent the same legal right."[102] Here, the parties have sparred over whether the requisite showing of privity is satisfied by demonstrating that privity exists among competing sets of derivative plaintiffs, or that privity exists between the corporation and its stockholders acting as derivative plaintiffs. The Arkansas Supreme Court has not yet addressed "privity" in this context. Thus, confronting this unsettled question of issue preclusion law, the parties agreed, as did the Chancellor, that the Arkansas courts would look to the Restatement (Second) of Judgments (the "Restatement") for guidance.[103] Arkansas courts also look to other jurisdictions[104] and consider policy implications.[105]

Op., 2016 WL 2908344, at *12 n.64 (citing *Harben*, 2010 WL 3893980, at *1).

[101] 2011 Ark. 208, 381 S.W.3d 793 (2011).

[102] *Id.* at 799; *see also Dearman*, 842 S.W.2d at 452 ("The Arkansas Supreme Court has said that privity within the meaning of res judicata means a person so identified in interest with another that he represents the same legal right." (citing *Spears v. State Farm Fire & Cas. Ins.*, 291 Ark. 465, 725 S.W.2d 835 (1987))).

[103] *See Orig. Op.*, 2016 WL 2908344, at *13-16; Supp. Op., 167 A.3d at 518-19; Delaware Plaintiffs' Opening Br. at 18; Defendants' Answering Br. at 11; Delaware Plaintiffs' Reply Br. at 2; Defendants' Supp. Mem. at 10.

[104] *See Orig. Op.*, 2016 WL 2908344, at *13 n.66 (citing *Dearman*, 842 S.W.2d at 452 (citing Third Circuit, Colorado, New York, and New Jersey opinions in discussing privity)).

[105] *See id.* (citing *Beaver v. John Q. Hammons Hotels, L.P.*, 355 Ark. 359, 138 S.W.3d 664, 670 (2003)); *see also Crockett*, 381 S.W.3d at 799 ("The true reason for holding an issue to be

The Restatement does not use the term "privity." Yet the parties and the Chancellor focused on Section 41, which explains that a nonparty "who is represented by a party is bound by and entitled to the benefits of a judgment as though he were a party."[106] Section 41 then lists five situations where a nonparty is said to have been represented by a prior party,[107] thereby allowing preclusion of a nonparty provided certain preconditions are met.[108] One such situation is Section 41(1)(e), where the prior party was a "representative of a class of persons similarly situated, *designated as such with the approval of the court*, of which the [nonparty] is a member."[109]

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barred is not necessarily the identity or privity of the parties, but instead to put an end to litigation by preventing a party who has had one fair trial on a matter from relitigating the matter a second time.").

[106] Restatement § 41(1). The Chancellor also referenced Restatement § 59 cmt. c, which states, in relevant part:

> The stockholder's or member's derivative action is usually though not invariably in the form of a suit by some of the stockholders or members as representatives of all of them. Whether the judgment in such a representative suit is binding upon all stockholders or members is determined by the rules stated in §§ 41 and 42. If it is binding under those rules, it precludes a subsequent derivative action by stockholders or members who were not individually parties to the original action.

Restatement § 59 cmt. c, *quoted in Orig. Op.*, 2016 WL 2908344, at *15.

[107] Restatement § 41(1)(a)-(e).

[108] *See* Restatement § 41 ("Exceptions to this general rule are stated in § 42"); Restatement § 42 (outlining situations where "[a] person is *not* bound by a judgment for or against a party who purports to represent him" (emphasis added)).

[109] Restatement § 41(1)(e) (emphasis added).

As to the possibility of privity among successive sets of derivative plaintiffs, the Delaware Plaintiffs argue that a subsequent derivative plaintiff lacks privity with an earlier derivative plaintiff who did not survive a motion to dismiss because that earlier derivative plaintiff was not "designated" as a representative by the court, as under the Restatement Section 41(1)(e) scenario.[110] Delaware Plaintiffs posit that, just as in class actions, where such judicial designation (or "judicial authority") is conferred through the class certification procedures of Federal Rule of Civil Procedure 23, the "right of stockholders to try to sue derivatively cannot be extinguished by a foreign judgment if no representative authority was conferred."[111] Delaware Plaintiffs argue that such representative authority is conferred only *after* the derivative complaint survives a motion to dismiss for failure to plead demand futility: "a stockholder's *right* to seek leave to compel assertion of the corporate claim is an individual one . . . and the plaintiff does not represent any person until obtaining that leave,"[112] *i.e.*, by a court's finding that the plaintiff's complaint has survived a motion to dismiss.

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[110] *See* Delaware Plaintiffs' Opening Br. at 19 (citing Restatement § 41(1)(e)); Delaware Plaintiffs' Reply Br. at 3 (same). Delaware Plaintiffs had argued before the trial court that preclusion could not apply as a matter of federal common law because there is no substantive legal relationship between the Arkansas Plaintiffs and the Delaware Plaintiffs. But the Chancellor rejected that argument in a footnote because he found that "the relevant substantive legal relationship is between Wal-Mart and the Arkansas plaintiffs, not between plaintiffs and the Arkansas plaintiffs." *Orig. Op.*, 2016 WL 2908344, at *23 n.124.

[111] Delaware Plaintiffs' Response to Amici Curiae Briefs at 6.

[112] *Id.* at 5-6.

Regarding the possibility of privity between the Delaware Plaintiffs and Wal-Mart, which *was a party* to the prior litigation, Delaware Plaintiffs argue that they lacked such privity because they "were unrepresented" by Wal-Mart in the prior litigation and "Wal-Mart was named merely as a nominal defendant, with *adverse* interests [to Delaware Plaintiffs]—not the identity of interests that is the hallmark of privity."[113]

Defendants counter by pointing to "the prevailing rule" that "stockholder-plaintiffs are in privity on the issue of demand futility because they 'are acting on behalf of the corporation . . . and the underlying issue of demand futility is the same regardless of which shareholder brings suit.' "[114] And they argue that, given that no Arkansas authorities conflict with this approach, the Chancellor was right when concluding in his Original Opinion that "the Arkansas Supreme Court would follow the majority rule that privity attaches to subsequent derivative stockholders."[115]

We see the privity analysis as follows: Privity under Arkansas law "exists when two parties are so identified with one another that they represent the same legal right."[116] Arkansas' approach appears to be a flexible and practical inquiry that eschews strict reliance on formal categories of representative relationships and focuses on "the reasons for holding a person bound by a judgment," including fairness

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[113] *Id.* at 5.

[114] Defendants' Answering Br. at 7 (quoting *Arduini*, 774 F.3d at 634).

[115] *Id.* at 9 (quoting *Orig. Op.*, 2016 WL 2908344, at *14).

[116] *Crockett*, 381 S.W.3d at 799.

concerns.[117] Similarly, while the United States Supreme Court has abandoned the term "privity,"[118] federal courts applying federal common law, like courts in Arkansas, have focused on whether the person arguably precluded is so identified in interest with the former litigant that she represents the same legal right.[119] Viewing derivative litigation in stages,

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[117] *Dearman*, 842 S.W.2d at 452. In *Dearman*, an en banc Arkansas Court of Appeals (intermediate appellate court), included privity among the prerequisites for collateral estoppel and noted that the latest decisions discussing privity "look directly to the reasons for holding a person bound by a judgment," such as fairness concerns, and recommend that "the label is either discarded entirely or retained as no more than a convenient means of expressing conclusions that are supported by independent analysis." 842 S.W.2d at 452 (quoting 18 Wright & Miller, *supra* note 63, § 4448). The court also explained that "persons in a privity relationship are deemed to have interests so closely intertwined that a decision involving one should control the other." *Id.*

[118] *See supra* notes 58-59 and accompanying text.

[119] *See Cooper v. Harris*, —— U.S. ——, 137 S.Ct. 1455, 1467, 197 L.Ed.2d 837 (2017) ("[W]hen plaintiffs in two cases have a special relationship, a judgment against one can indeed bind both." (citing *Taylor*, 553 U.S. at 893-95, 128 S.Ct. 2161)); *Entek GRB, LLC v. Stull Ranches, LLC*, 763 F.3d 1252, 1258 (10th Cir. 2014) (Gorsuch, J.) ("Of course, privity is but a label. But it is a label that seeks to convey the existence of a relationship sufficient to give courts confidence that the party in the former litigation was an effective representative of the current party's interests." (citing *Taylor*, 553 U.S. at 894 n.8, 128 S.Ct. 2161); *id.* at 1258-59 ("Privity is a legal conclusion designating a person so identified in interest with a party to former litigation that he represents precisely the same right in respect to the subject matter involved." (quoting *Headwaters Inc. v. U.S. Forest Serv.*, 399 F.3d 1047, 1052-53 (9th. Cir. 2005))).

and analyzing what is happening at each stage, helps to explain why privity exists here.[120]

At the first stage of a derivative action (assertion of demand futility), the stockholder-derivative plaintiff is permitted to litigate only the board's capacity to control the corporation's claims. The corporation is always the sole owner of the claims.[121] In other words, the suit is always about the corporation's right to seek redress for alleged harm to the corporation. As the Arkansas Supreme Court has stated, "inherent in the nature of the [derivative] suit itself [is] that it is the corporation whose rights are being redressed rather than those of the individual plaintiff."[122]

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[120] An intermediate appellate court in New York expressed a flexible approach similar to that of Arkansas' en banc intermediate appellate court in *Dearman*. *See supra* note 117. The New York court, in declining to require that a party to be precluded fits in the precise categories of Section 41, stated:

> We think the better rule, however, and that which is actually applied in this State as well as in a number of other jurisdictions, eschews strict reliance on formal representative relationships in favor of a more flexible consideration of whether all of the facts and circumstances of the party's and nonparty's actual relationship, their mutuality of interests and the manner in which the nonparty's interests were represented in the prior litigation establishes a functional representation such that the nonparty may be thought to have had a vicarious day in court.

Slocum ex rel. Nathan A v. Joseph B, 183 A.D.2d 102, 588 N.Y.S.2d 930, 931 (1992).

[121] *E.g.*, *City of Birmingham Ret. & Relief Sys. v. Good*, 177 A.3d 47, 55, 2017 WL 6397490, at *4 (Del. Dec. 15, 2017) (describing a derivative claim as "a claim belonging to the corporation").

[122] *Brandon v. Brandon Constr. Co.*, 300 Ark. 44, 776 S.W.2d 349, 352 (1989).

The demand requirement (contained in Federal Rule of Civil Procedure 23.1)[123] reflects the requirement that a corporation's important business decisions should be made by its board of directors.[124] Such decisions include the decision to sue a corporation's directors on behalf of the corporation.[125] At the start of the derivative suit, the stockholder-derivative plaintiff only has standing, as a matter of equity, to set in motion the judicial machinery on the corporation's behalf.[126] The stockholder-derivative plaintiff may assume control of the corporation's claim only

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[123] Fed. R. Civ. P. 23.1(b) ("The complaint must . . . (3) state with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and (B) the reasons for not obtaining the action or not making the effort."); *see also* Del. Ct. Ch. R. 23.1 ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort.").

[124] *See*, *e.g.*, *Spiegel*, 571 A.2d at 773 ("The decision to bring a law suit or to refrain from litigating a claim on behalf of a corporation is a decision concerning the management of the corporation. Consequently, such decisions are part of the responsibility of the board of directors.") (citation omitted).

[125] 8 *Del. C.* § 141(a) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . .").

[126] *See*, *e.g.*, *Schoon v. Smith*, 953 A.2d 196, 202 (Del. 2008); *accord Dana*, 232 F. at 90. In *Schoon*, we observed that, "[t]he stockholder does not bring such a suit because *his* rights have been *directly* violated, or because the cause of action is *his* . . . ." 953 A.2d at 202 (quoting 4 *Pomeroy's Equity Jurisprudence* § 1095 (5th ed.1941)). Rather, "he is permitted to sue in this manner *simply in order to set in motion the judicial machinery of the court*," and the "corporation alone has a direct interest" in the litigation. *Id.* (quoting same).

if he demonstrates that demand on the board would be futile. But, through the entire process, the corporation alone is the real party in interest because the suit is always on its behalf.

The "dual" nature of the derivative action does not transform a stockholder's standing to sue on behalf of the corporation into an individual claim belonging to the stockholder. The named plaintiff, at this stage, only has standing to seek to bring an action by and in the right *of the corporation* and never has an individual cause of action. This highlights a fundamental distinction from class actions, where the named plaintiff initially asserts an individual claim and only acts in a representative capacity after the court certifies that the requirements for class certification are met.[127]

However, when multiple derivative actions are filed (in one or more jurisdictions), the plaintiffs share an identity of interest in seeking to prosecute claims by and in the right of the same real party in interest—*i.e.*, as representatives of—the corporation. Here, the Delaware and Arkansas Plaintiffs sought to enforce the same legal rights by stepping into Wal-Mart's shoes to assert the corporation's claims related to the same alleged misconduct and investigation. Though not a formal "representative" of other stockholders at this stage because the real party in interest is the corporation, differing groups of stockholders who seek to control the corporation's cause of

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[127] *Cf. Bayer*, 564 U.S. at 314-15, 131 S.Ct. 2368 (rejecting argument that the party who sought class certification's "interests were aligned with the members of the class he proposed and he 'act[ed] in a representative capacity when he sought class certification.' " (quoting Brief for Respondent Bayer)).

action share the same interest and therefore are in privity.

Even before *Crockett*, in *Arkansas Department of Human Services v. Dearman*,[128] the Arkansas Court of Appeals said in a compellingly straightforward fashion that privity "means a person so identified in interest with another that he represents the same legal right," also titled an "identity of interest."[129] There, the court found privity between a mother and the state's Department of Human Services ("DHS") as they shared an "identity of interest": both the mother and DHS sought "to prove allegations of sexual abuse against the father of the children, to remove them from his custody, and to protect the best interests of the children."[130] Further, the subsequent litigant, DHS, had "notice of the earlier action and the opportunity to participate."[131] Thus, the *Dearman* court found privity where a subsequent litigant with notice of the first action sought to relitigate the same issue on behalf of the same real party in interest, the children. The Arkansas Supreme Court applied the *Dearman* test in *Crockett*.[132] Although the Arkansas Supreme Court has not addressed the application of collateral estoppel in the derivative context, we think that application of Arkansas' flexible approach set forth in *Crockett* and *Dearman* suggests that there is privity here as a

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[128] 40 Ark. App. 63, 842 S.W.2d 449 (1992) (en banc).

[129] *Id.* at 452.

[130] *Id.*

[131] *Id.* at 452-53.

[132] *See Crockett*, 381 S.W.3d at 799 (noting that privity "exists when two parties are so identified with one another that they represent the same legal right.").

matter of Arkansas law. This is so given the identity of interest derivative plaintiffs share in having a stockholder control the corporation's claim instead of the directors, and given that the real party in interest, the corporation, was a party to the litigation.[133]

A review of federal common law reinforces this view. The five federal circuit courts that have considered whether privity exists between sets of successive derivative plaintiffs have all found the requisite privity under the applicable law, whether state law or federal common law.[134] In *Sonus*, the First Circuit found privity between two successive

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[133] We agree with the Chancellor that the Restatement "does not meaningfully analyze whether the corporation's status as the real party in interest makes privity a foregone conclusion for subsequent representative stockholders." *Orig. Op.*, 2016 WL 2908344, at *16. But, as this Court observed in *Pyott II*, "[b]ecause the real plaintiff in a derivative suit is the corporation, 'differing groups of shareholders who can potentially stand in a corporation's stead are in privity for the purposes of issue preclusion.' " *Pyott II*, 74 A.3d at 617 (applying California law) (quoting *LeBoyer v. Greenspan*, 2007 WL 4287646, at *3 (C.D. Cal. June 13, 2007)); *see also*, *e.g.*, *Parkoff v. Gen. Tel. & Elecs. Corp.*, 53 N.Y.2d 412, 442 N.Y.S.2d 432, 425 N.E.2d 820, 824 (1981) ("Because the claim asserted in a stockholder's derivative action is a claim belonging to and on behalf of the corporation, a judgment rendered in such an action brought on behalf of the corporation by one shareholder will generally be effective to preclude other actions predicated on the same wrong brought by other shareholders.").

[134] *Arduini*, 774 F.3d at 634 (applying Nevada law); *Sonus*, 499 F.3d at 57 (applying Massachusetts law); *Smith v. Waste Mgmt., Inc.*, 407 F.3d 381, 386 (5th Cir. 2005) (citing Fifth Circuit case applying Texas law); *Nathan*, 651 F.2d at 1226 (applying federal common law); *Dana*, 232 F. at 90 (not specifying the applicable law). Further, the Third Circuit reached the same result, even though it did not use the term privity. *See Cramer*, 582 F.2d at 269.

derivative plaintiffs suing on behalf of the same corporation because "[u]nder Massachusetts law, a derivative suit is prosecuted 'in the right of a corporation,' "[135] and "the plaintiff in a derivative suit represents the corporation, which is the real party in interest."[136] In other words, privity existed because both derivative plaintiffs sought to represent the same legal right—that of the corporation, which was the real party in interest. In *Arduini*, the Ninth Circuit relied on *Sonus* to find the same.[137]

In *Dana v. Morgan*, a century-old Second Circuit case, the second derivative plaintiff argued that "the judgment of the New York court [*i.e.*, the first court] does not affect him, as he was not a party to it, a privy to it, or represented in it."[138] However, the court determined, "[t]he answer is that the corporation whose interest he seeks to represent in this suit was a party to that [prior New York] action and is

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[135] *Sonus*, 499 F.3d at 64 (quoting Mass. Gen. Laws Ann. ch 156D, § 7.40).

[136] *Id.* at 63.

[137] *Arduini*, 774 F.3d at 634 (quoting *Sonus*, 499 F.3d at 64, as explaining that " 'the prevailing rule [is] that the shareholder in a derivative suit represents the corporation,' " and concluding that "[s]uch reasoning applies equally to Nevada derivative suits, where the shareholders are acting on behalf of the corporation and its shareholders and the underlying issue of demand futility is the same regardless of which shareholder brings suit."). *See also Goldman v. Northrop Corp.*, 603 F.2d 106, 109 (9th Cir. 1979) ("The parties [in subsequent derivative suits] are the same, although represented by different shareholders. Neither Springer nor Goldman sought to obtain personal judgments. The corporation was the sole real party in interest in both cases.").

[138] 232 F. at 91.

concluded by it and that that concludes him."[139] After all, "there can be but one adjudication in the rights of the corporation."[140] In *Nathan v. Rowan*, the Sixth Circuit cited *Dana* in holding that, "[i]n shareholder derivative actions arising under Fed. R. Civ. P. 23.1, parties and their privies include the corporation and all nonparty shareholders."[141] And, in *Smith v. Waste Management*, the Fifth Circuit found privity, but did not explain why.[142] Thus, we are satisfied that privity exists here and that the requirements of issue preclusion are met.[143]

We address the last purported element, the adequacy of representation requirement, as part of the federal Due Process overlay. As the Chancellor acknowledged, "[his] consideration of due process in *Wal-Mart I* [the Original Opinion] was embedded in the determination of adequacy of representation."[144]

C. The Federal Due Process Requirement

As mentioned, "[t]he federal common law of preclusion is subject to due process limitations."[145] Such

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[139] *Id.*

[140] *Id.* at 89.

[141] 651 F.2d at 1226.

[142] *See* 407 F.3d at 386.

[143] We are satisfied with the Chancellor's conclusion in his Original Opinion that the four primary elements of issue preclusion under Arkansas law are also satisfied. We believe the result is the same under federal common law.

[144] Supp. Op., 167 A.3d at 515.

[145] *Taylor*, 553 U.S. at 892, 128 S.Ct. 2161; *Kremer*, 456 U.S. at 482, 102 S.Ct. 1883 ("A State may not grant preclusive effect in its own courts to a constitutionally infirm judgment, and other state and federal courts are not required to accord full faith and credit to such a judgment.").

limitations derive from the Due Process Clause of the Fourteenth Amendment, which provides that no state shall "deprive any person of life, liberty, or property without due process of law . . . ."[146] "The opportunity to be heard is an essential requisite of due process of law in judicial proceedings."[147] Non-party issue preclusion, by its nature—*i.e.*, depriving a party of the ability to litigate an issue—conflicts with the "historic tradition," rooted in Due Process, "that everyone should have his own day in court."[148] Therefore, as a general rule, "one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process."[149] But this general "rule against nonparty preclusion" is subject

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[146] U.S. Const. amend. XIV.

[147] *Richards*, 517 U.S. at 797 n.4, 116 S.Ct. 1761. *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 99 S.Ct. 645, 58 L.Ed.2d 552 (1979), suggests that, where a subsequent litigant is in privity with a prior party, he can be said to have had an opportunity to be heard. *See id.* at 327, 99 S.Ct. 645 n.7 ("It is a violation of due process for a judgment to be binding on a litigant who was not a party or a privy and therefore has never had an opportunity to be heard.").

[148] *Richards*, 517 U.S. at 798, 116 S.Ct. 1761 (quoting 18 Wright & Miller, *supra* note 63, § 4449); *see also id.* at 797 n.4, 116 S.Ct. 1761 (noting that the state "cannot, without disregarding the requirement of due process, give a conclusive effect to a prior judgment against one who is neither a party nor in privity with a party therein." (quoting *Postal Tel. Cable Co. v. City of Newport*, 247 U.S. 464, 476, 38 S.Ct. 566, 62 L.Ed. 1215 (1918))).

[149] *Taylor*, 553 U.S. at 893, 128 S.Ct. 2161 (quoting *Hansberry*, 311 U.S. at 40, 61 S.Ct. 115); *see also Wilks*, 490 U.S. at 762, 109 S.Ct. 2180 ("A judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers to those proceedings.").

to several exceptions, such as those outlined in *Taylor*—exceptions where the application of non-party issue preclusion is said to comply with the requirements of Due Process.[150]

One of these exceptions—the so-called "third exception"—covers "certain limited circumstances" where "a nonparty may be bound by a judgment because she was 'adequately represented by someone with the same interests who [wa]s a party' to the suit."[151] Thus, this exception has two prongs: (a) same interests, and (b) adequate representation of those interests.

The privity analysis discussed above underscores the commonality and alignment of interests among successive sets of derivative plaintiffs. As explained above, we are satisfied that there is sufficient alignment of interest under both Arkansas and federal common law. Therefore, with this commonality-of-interest safeguard satisfied, the evaluation of the adequacy of the prior representation becomes the primary protection for the Due Process rights of subsequent derivative plaintiffs.[152]

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[150] *See Taylor*, 553 U.S. at 893-95, 128 S.Ct. 2161; *see also supra* notes 60-68 and accompanying text.

[151] *Taylor*, 553 U.S. at 894, 128 S.Ct. 2161 (quoting *Richards*, 517 U.S. at 798, 116 S.Ct. 1761).

[152] *See Sonus*, 499 F.3d at 65 ("Precluding the suit of a litigant who has not been adequately represented in the earlier suit would raise serious due process concerns.") (focusing Due Process analysis on adequacy of representation after finding privity); *Arduini*, 774 F.3d at 635 (same); *Nathan*, 651 F.2d at 1226 ("Though Nathan was not a party to the Singer action, nonparty shareholders are bound by judgments [in derivative actions] if their interests were adequately represented."); *id.* at 1227 (noting that "[i]t is well settled that the constitutional requirements of due process and full faith and credit mandate

The United States Supreme Court in *Taylor* articulated three "minimum" requirements for showing that "[a] party's representation of a nonparty is 'adequate' for preclusion purposes."[153] First, the interest of the nonparty and her representative must be aligned.[154] Second, "either the party understood herself to be acting in a representative capacity or the original court took care to protect the interests of the nonparty."[155] And third, "sometimes" notice is required.[156]

Here, as mentioned, the privity analysis reinforces and satisfies the alignment-of-interests requirement.

Second, as to whether the derivative plaintiffs here understood that they were acting in a representative capacity although not yet authorized to control the corporate cause of action, the record makes clear that both sets of plaintiffs understood that a judgment in their case could impact the other stockholders.[157] The Arkansas Plaintiffs had been warned by the federal court of the likelihood that the court's decision

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that absent class members are not bound by a judgment in a class action unless the class representative provided adequate and fair representation" and applying this principle in the derivative context). In *Sonus*, the First Circuit noted that "[t]he adequacy of representation has been a subject of great concern in derivative suits because of the possibilities for collusion between the nominal plaintiff and the defendants." 499 F.3d at 64.

[153] 553 U.S. at 899, 128 S.Ct. 2161.

[154] *Id.* at 900, 128 S.Ct. 2161.

[155] *Id.*

[156] *Id.*

[157] *See supra* notes 27-30 and accompanying text; *Cottrell I*, 737 F.3d at 1243 ("[A] judgment rendered in Delaware will likely preclude subsequent litigation in the Federal proceeding.").

would have preclusive effect.[158] And, as noted, the Delaware Plaintiffs acknowledged that likelihood and expressed concern to both the Delaware Court of Chancery and the Delaware Supreme Court about the "severe risk" that an Arkansas judgment on demand futility would precede a Delaware ruling, and the Arkansas judgment would have preclusive effect.[159] Moreover, the Arkansas court took care to protect the interests of the nonparty Delaware Plaintiffs by granting a stay while they pursued their Section 220 litigation in Delaware. The federal court initially stayed the Arkansas proceedings "pending the resolution of the state-court actions in the Delaware Court of Chancery."[160] Thus, that court was willing to stand down and let the Delaware litigation proceed to conclusion.[161]

Third, federal courts have signaled that derivative suits are situations where notice is not required to

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[158] *See Ark. Stay Denial Order*, 2014 WL 12700619, at *2.

[159] *See supra* note 27.

[160] *Ark. Stay Order*, 2012 WL 5935340, at *7.

[161] The Arkansas court acknowledged that it had received a copy of then-Chancellor Strine's order which contemplated the completion of the Section 220 proceedings before the Delaware Complaint would be filed. *See* Stay Hearing Transcript, *supra* note 11, at B175. The Arkansas court's order granting the initial stay notes the presence of seven derivative actions in Delaware and that, "[t]he claims and parties in this action and the Delaware action[s] are almost identical, and the issues involved overlap substantially." *Ark. Stay Order*, 2012 WL 5935340, at *5, *7. It reasoned that, "[b]ecause Delaware law is controlling over Plaintiffs' claims, this factor weighs in favor of abstention." *Id.* at *6. It also stated that "the Court feels that the parties would benefit from the Delaware court's experience in applying its state's law and managing this type of litigation." *Id.*

comply with Due Process.[162] We need not resolve that issue as it is undisputed that Delaware Plaintiffs had notice of the Arkansas action in this instance.

Federal courts have also looked to Sections 42(1)(d) and (e), and Comments e and f, of the Restatement for further guidance on what qualifies as "adequate" representation in order to comply with Due Process.[163] Indeed, the Restatement explains that its

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[162] The United States Supreme Court has stated, "An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Armstrong v. Manzo*, 380 U.S. 545, 550, 85 S.Ct. 1187, 14 L.Ed.2d 62 (1965). However, several courts have suggested that notice is not required to avoid a Due Process violation in precluding subsequent derivative plaintiffs from litigating demand futility. *See*, *e.g.*, *Arduini*, 774 F.3d at 637-38. In *Arduini*, the Ninth Circuit declined to require notice, relying on Fed. R. Civ. P. 23.1(c), which only requires "[n]otice of a proposed settlement, voluntary dismissal, or compromise." *Id.* at 637; *see also* Restatement § 42(1)(a) & cmt. b (mandating notice where "required," such as under "procedural statutes and rules"). The court also looked to Restatement § 41(2), which provides that "[a] person represented by a party to an action is bound by the judgment even though the person himself does not have notice of the action, is not served with process, or is not subject to service of process." *Arduini*, 774 F.3d at 637. The court noted that, likewise, the prior derivative plaintiffs in that case were "in essence representing all [company] shareholders when they filed their derivative suit, thus binding subsequent derivative plaintiffs even if they personally did not have notice of the [earlier suit's] dismissal." *Id.*; *see also*, *e.g.*, *Nathan*, 651 F.2d at 1228 ("[I]n derivative actions nonparty shareholders are not entitled to notice of dismissal following a hearing on the merits.").

[163] *See Nevada v. United States*, 463 U.S. 110, 135 n.15, 103 S.Ct. 2906, 77 L.Ed.2d 509 (1983); *Matsushita*, 516 U.S. at 396,

requirements are "closely related to, if indeed they are not particularized expressions of, the requirements of due process."[164] In addition to providing that there cannot be a "substantial divergence of interests" between the representative and the represented,[165] the Restatement states that the prior representative must not have "failed to prosecute or defend the action with due diligence and reasonable prudence" such that "the opposing party was on notice of facts making that failure apparent."[166] Comment f to Section 42(1)(e) provides additional commentary describing what constitutes inadequate conduct of litigation.[167] First, the comment speaks

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116 S.Ct. 873 (Ginsburg, J., concurring in part and dissenting in part); *Arduini*, 774 F.3d at 635-36; *Sonus*, 499 F.3d at 64-66; *Hanson*, 2007 WL 5186795, at *6; *Henik*, 433 F.Supp.2d at 381. Federal common law governs our analysis of Due Process and, as such, the contours of the required adequacy of the prior representation. In contrast, the Court of Chancery considered the adequacy of representation an issue of Arkansas law. *See Orig. Op.*, 2016 WL 2908344, at *20 ("Arkansas law controls here").

[164] Restatement § 42(1)(d), (e) & Reporter's Note (noting that the alignment of Sections 41 and 42 with the requirements of due process "historically was obscured by the tendency of courts to see some of these questions in the context of necessary parties issues" and that *Hansberry v. Lee* stands "as a reminder that there are constitutional limits on giving binding effect to litigation conducted through representatives").

[165] *See Taylor*, 553 U.S. at 900, 128 S.Ct. 2161; *see also* Restatement § 42(1)(d) (providing that, "[w]ith respect to the representative of a class," representation is inadequate if "there was such a substantial divergence of interest between him and the members of the class, or a group within the class, that he could not fairly represent them with respect to the matters as to which the judgment is subsequently invoked").

[166] Restatement § 42(1)(e).

[167] *Id.* at cmt. f.

to the *quality* of the representation, by specifying that the representation must not have been "grossly deficient," and then explaining what that entails.[168] Second, the comment speaks to *conflicts of interest*, such as whether the prior judgment was the product of collusion between the representative and the opposing party and whether, "to the knowledge of the opposing party, the representative s [ought] to further his own interest at the expense of the represented person."[169] "[W]hether the representation has been inadequate is a question of fact to be decided in light of the issues presented in the case and the factual and legal contentions that might reasonably have been expected to be presented."[170]

Based on our reasoning, we affirm the Chancellor's ultimate conclusion that the Arkansas Plaintiffs were adequate representatives because, in addition to the absence of any conflicts or other misalignment of interests among the competing sets of plaintiffs in seeking to represent Wal-Mart, (i) the quality of their representation was not grossly deficient, and (ii) their economic interests were not antagonistic to other stockholders.

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[168] *Id.*

[169] *Id.*; *see also Arduini*, 774 F.3d at 635 ("[W]e have noted that an 'adequate [shareholder] representative must have the capacity to vigorously and conscientiously prosecute a derivative suit and be free from economic interests that are antagonistic to the interests of the class.' " (quoting *Larson v. Dumke*, 900 F.2d 1363, 1367 (9th Cir. 1990))).

[170] Restatement § 42 cmt. f.

i. The Arkansas Plaintiffs' failure to seek books and records from the Company does not render them grossly deficient representatives.

Delaware Plaintiffs argue that the Arkansas Plaintiffs demonstrated "grossly deficient," inadequate representation by failing to seek additional books and records despite the Chancellor's warning.[171] They contend that this choice amounts to more than mere "[t]actical mistakes or negligence" or failure "to invoke all possible legal theories or to develop all possible sources of proof"—situations that the Restatement views as insufficient grounds to deny preclusive effect to a prior judgment.[172]

Delaware courts have repeatedly urged parties to use Section 220 to seek relevant books and records before filing derivative complaints. The Delaware Plaintiffs contend that, although the *New York Times* article detailed conduct by certain officers and employees and included excerpts to certain key company documents, the documents did not address *board-level* conduct. Thus, they argue that the Arkansas Plaintiffs should have known they would be unable to meet the pleading requirements to establish demand futility, as then-Chancellor Strine had warned.

We might see this as a closer call if the Arkansas Plaintiffs had not obtained *any* documents, particularly since the complaints were focused on the state-

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[171] *See id.* ("Where the representative's management of the litigation is so grossly deficient as to be apparent to the opposing party, it likewise creates no justifiable reliance interest in the adjudication on the part of the opposing party.").

[172] *See id.* ("Tactical mistakes or negligence on the part of the representative are not as such sufficient to render the judgment vulnerable.").

law *Caremark* claims.[173] But that is not the case. At the argument on the initial motion to stay in Arkansas, for example, Arkansas Plaintiffs' counsel acknowledged that she shared then-Chancellor Strine's view that "oftentimes it is very hard to implicate the board without seeing some internal documents showing that the board knew of the wrongdoing," but she argued that this situation was different: she stated that internal memoranda in the public domain (linked from the *New York Times* article) "show beyond any doubt that the board of directors was told about the widespread bribery and they were told about the coverup of the widespread bribery back in 2005."[174] Arkansas Plaintiffs' counsel stated, "we thought about [obtaining documents through Section 220] long and hard," but determined that, "[i]n this case we didn't need it because we had these underlying documents."[175]

The Chancellor concluded that "it does not follow that plaintiffs are necessarily inadequate representatives because their counsel chose not to follow a recommended strategy in a different action, even one suggested by a preeminent corporate jurist, particu-

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[173] *Orig Op.*, 2016 WL 2908344, at *5 (noting that the Arkansas Plaintiffs alleged that certain director defendants breached their duty of loyalty by not acting in good faith to ensure Wal-Mart's compliance with the law, known as a *Caremark* claim (referring to *In re Caremark Int'l Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996))).

[174] Stay Hearing Transcript, supra note 11, at B208-09.

[175] *Id.* at B209. Arkansas counsel also argued, "I don't think we need [Section 220 books and records] because we have the defendants [*sic*] own—we have them in the cross hairs, Your Honor. We have the document showing that they knew what was going on in 2005, and the majority of the directors are still sitting on the board." *Id.* at B210.

larly when they are litigating in a different jurisdiction before a different judiciary."[176] As the Chancellor recognized, the Arkansas Plaintiffs were represented by more than a dozen attorneys from several firms, and no one argued that they were not experienced counsel. In fact, one lead counsel had successfully litigated a key Delaware Section 220 case, and one of the lead Arkansas Plaintiffs had been lead plaintiff in the *Pyott* case.

Here, the Arkansas Plaintiffs considered making a Section 220 demand, but they decided against it because they considered the documents in the *New York Times* article sufficient.[177] It turns out they were wrong. Although it might have been a tactical error, the Arkansas Plaintiffs' decision to forgo a Section 220 demand *in this instance* does not rise to the level of constitutional inadequacy.[178] Reasonable litigants can differ on such tactical decisions.

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[176] *Orig. Op.*, 2016 WL 2908344, at *20.

[177] *See* Stay Hearing Transcript, *supra* note 11, at B208-10.

[178] *See Bensoussan*, 2016 WL 3407708, at *12 ("[A]lthough it is certainly better a practice for stockholder plaintiffs to use 'the tools at hand' to thoroughly investigate derivative claims before filing suit, the N.Y. plaintiffs' failure to do so in this case falls, in my view, into the category of an imperfect legal strategy and does not rise to the level of litigation management that was so grossly deficient as to render them inadequate representatives."), *aff'd*, 155 A.3d 1283 (Del. 2017); *Norfolk Cty. Ret. Sys. v. Jos. A. Bank Clothiers, Inc.*, 2009 WL 353746, at *8 (Del. Ch. Feb. 12, 2009) ("Although the prior plaintiff's failure to make a books and records request before filing a derivative lawsuit does not comport with the approach suggested by Delaware courts, that alone does not indicate that he was an inadequate representative."), *aff'd*, 977 A.2d 899 (Del. 2009).

ii. The Arkansas Plaintiffs did not seek to advance their interests at the expense of the Delaware Plaintiffs.

The Delaware Plaintiffs argue that Arkansas Plaintiffs "acted to further their own economic interest in litigating in Arkansas," against the Chancellor's warning that plaintiffs should seek Company books and records.[179] Delaware Plaintiffs assert that "[t]he moment they did so, an irreconcilable conflict arose between the Arkansas Plaintiffs and other Wal-Mart stockholders."[180] The Restatement provides that a prior judgment may be denied preclusive effect where, "to the knowledge of the opposing party, the representative seeks to further his own interest at the expense of the represented person."[181] The plaintiffs' interests, as distinguished from the counsels' interests, were identical, as discussed above. Moreover, we see no support for any suggestion that the Arkansas Plaintiffs had an interest adverse to Wal-Mart or that they would benefit from harming the Company and, by extension, from harming Delaware Plaintiffs.

In their supplemental briefing following remand, the Delaware Plaintiffs argue that the Court of Chancery erred in "halting" discovery regarding the alleged "conflicts of the Arkansas Plaintiffs' counsel."[182] They further contend that the discovery stay was improper given the Chancellor's "heavy reliance on an affidavit of Arkansas Plaintiffs' counsel," whom

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[179] Delaware Plaintiffs' Opening Br. at 29.

[180] *Id.*

[181] Restatement § 42 cmt. f.

[182] Delaware Plaintiffs' Supp. Mem. at 20.

they had no opportunity to cross-examine.[183] But the Delaware Plaintiffs confined this argument to a footnote in their opening brief on appeal.[184] Thus, the argument is waived,[185] and we do not address the question of whether discovery might have been appropriate (and, if so, to what extent) as to the asserted conflict among Arkansas Plaintiffs' counsel.

III.

In conclusion, as we said in *Pyott II*, our state's interest in governing the internal affairs of Delaware corporations must yield to the "stronger national interests that all state and federal courts have in respecting each other's judgments."[186] This delicate balance would be impaired were we to adopt the Chancellor's suggestion to follow the *EZCORP* dicta as the rule for determining the preclusive effect of other courts' dismissals based on demand futility.

Accordingly, we affirm the Court of Chancery's dismissal of the Delaware Plaintiffs' complaint. Defendants satisfied the requirements for invoking issue preclusion under either Arkansas law or federal common law. The federal law on the Due Process implications of issue preclusion demonstrates that the application of issue preclusion here does not violate the Due Process rights of the Delaware Plaintiffs. We greatly appreciate the thought and time that the Chancellor and the parties devoted to this important matter.

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[183] *Id.* at 20 n.17.

[184] Delaware Plaintiffs' Opening Br. at 28 n.42.

[185] *See* Del. Sup. Ct. R. 14(b)(vi)(A)(3).

[186] 74 A.3d at 616.

IN THE COURT OF CHANCERY OF DELAWARE

Consolidated C.A. No. 7455-CB

IN RE WAL-MART STORES, INC.
DELAWARE DERIVATIVE LITIGATION

[Decided: July 25, 2017]

SUPPLEMENTAL OPINION

BOUCHARD, C.

This supplemental opinion is submitted in response to the Delaware Supreme Court's order of remand (the "Remand Order") asking this Court to address the following question:

> In a situation where dismissal by the federal court in Arkansas of a stockholder plaintiff's derivative action for failure to plead demand futility is held by the Delaware Court of Chancery to preclude subsequent stockholders from pursuing derivative litigation, have the subsequent stockholders' Due Process rights been violated? *See Smith v. Bayer Corp.*, 564 U.S. 299, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011).[1]

The first sentence of the Remand Order states: "This is a troubling case."[2] I agree. The trouble arises from a tension in competing policies. On the one hand, Delaware courts have long encouraged stockholders contemplating derivative actions to use the "tools at

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[1] *Cal. State Teachers' Ret. Sys. v. Alvarez*, 2017 WL 239364, at *8 (Del. Jan. 18, 2017) (ORDER).

[2] *Id.* at *1.

hand"—in particular to obtain corporate books and records under Section 220 of the Delaware General Corporation Law—*before* filing derivative litigation so that the issue of demand futility may be decided on a well-developed factual record.[3] On the other hand, as a matter of comity and in the interest of preserving judicial resources, public policy discourages duplicative litigation. The tension between these policies in representative stockholder litigation involving multiple forums is heightened by the "fast-filer" phenomenon, where counsel handling cases on a contingent basis have a significant financial incentive to race to the courthouse in an effort to beat out their competition and seize control of a case, often at the expense of undertaking adequate due diligence.

Courts that have considered whether a stockholder plaintiff in a second derivative action is barred from re-litigating the issue of demand futility based on the failure of a plaintiff to demonstrate demand futility in a first derivative action—in particular two federal circuit courts—have found that due process is satisfied if the plaintiff in the first action adequately represented other stockholders of the corporation who were not parties to the first action. In doing so, those courts have applied principles from the Restatement (Second) of Judgments (the "Restatement"). This is the approach I followed in concluding in my memorandum opinion dated May 16, 2016 that the earlier Arkansas decision precluded re-litigation of the demand futility issue in Delaware ("*Wal-Mart I*").[4] In other

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[3] *See Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 120 (Del. 2006); *Rales v. Blasband*, 634 A.2d 927, 934-35 n.10 (Del. 1993).

[4] *In re Wal-Mart Stores, Inc. Del. Deriv. Litig.*, 2016 WL 2908344 (Del. Ch. May 13, 2016).

words, my consideration of due process in *Wal-Mart I* was embedded in the determination of adequacy of representation.

Based on the approach used in *Wal-Mart I* and the federal circuit court decisions it follows, the answer to the question posed in the Remand Order would be "no" unless the representative plaintiff's management of the first derivative action was "so grossly deficient as to be apparent to the opposing party"[5] or failed to satisfy one of the Restatement's other criteria for determining adequacy of representation.[6] But that does not mean that a better approach is not worthy of consideration.

In *In re EZCORP, Inc. Consulting Agreement Derivative Litigation*, Vice Chancellor Laster stated in *dictum* that, both as a matter of Delaware law and as a matter of due process, a judgment cannot bind "the corporation or other stockholders in a derivative action until the action has survived a Rule 23.1 motion to dismiss, or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit."[7] *EZCORP* thus endorses a bright-line rule drawing a distinction between the pre- and post-demand futility phases of derivative litigation. In doing so, the Court analogized derivative actions to class actions, relying on the United States Supreme Court's adoption of a similar bright-line rule in *Smith*

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[5] Restatement § 42 cmt. f.

[6] For example, inadequacy of representation also may be found under the Restatement if the interests of the representative and the represented person are not aligned or if there is collusion between the representative plaintiff and the defendant. *See Wal-Mart I*, 2016 WL 2908344, at *18 & n.103.

[7] *In re EZCORP Inc. Consulting Agreement Deriv. Litig.*, 130 A.3d 934, 948 (Del. Ch. 2016).

v. Bayer, which distinguished between pre- and post-certification in the class action context, although *Bayer* explicitly was not decided on due process grounds.[8]

Considering afresh the question presented in the Remand Order, I recommend that the Supreme Court adopt the rule proposed in *EZCORP*. Although no court has done so to date, and although the Supreme Court previously declined to embrace such a rule in the context of considering the question of privity in derivative litigation,[9] it is my opinion for the reasons explained below that this rule will better safeguard the due process rights of stockholder plaintiffs and should go a long way to addressing fast-filer problems currently inherent in multi-forum derivative litigation.

I. BACKGROUND

A detailed description of the factual background giving rise to this action is set forth in *Wal-Mart I*.[10] This supplemental opinion assumes general familiarity with *Wal-Mart I* and sets forth below only certain facts relevant to addressing the issue on remand.

A. The Arkansas Litigation

In April 2012, *The New York Times* published an article detailing an alleged bribery scheme at

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[8] *Id.* at 946-49; *Smith v. Bayer Corp.*, 564 U.S. 299, 308 n.7, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011).

[9] *Pyott v. La. Mun. Police Empls.' Ret. Sys.*, 74 A.3d 612, 616-18 (Del. 2013) ("*Pyott II*") (rejecting "the 'fast-filer' irrebuttable presumption of inadequacy" and holding that the Court of Chancery should have applied California law and found two successive stockholder plaintiffs to be in privity even though the earlier action was dismissed for failure to adequately plead demand futility), *rev'g La. Mun. Police Empls.' Ret. Sys. v. Pyott*, 46 A.3d 313, 330 (Del. Ch. 2012) ("*Pyott I*").

[10] *Wal-Mart I*, 2016 WL 2908344, at *2-7.

Wal-Mart de Mexico, a subsidiary of Wal-Mart Stores, Inc. ("Wal-Mart"), and the related cover-up. Shortly after the article was published, Wal-Mart stockholders filed multiple derivative suits in Delaware and Arkansas.

The United States District Court for the Western District of Arkansas consolidated the federal actions in Arkansas, and the Arkansas plaintiffs filed a consolidated complaint on May 31, 2012. The Arkansas complaint asserted claims against certain of Wal-Mart's current and former directors and officers for breach of fiduciary duty and for violations of Sections 14(a) and 29(b) of the Securities Exchange Act.[11] On March 31, 2015, the district court granted defendants' motion to dismiss the Arkansas complaint under Federal Rule of Civil Procedure 23.1 for failing to adequately allege demand futility (the "Arkansas Decision").[12] On July 22, 2016, the Eighth Circuit affirmed the Arkansas Decision.[13]

B. The Delaware Litigation

Around the same time the Arkansas litigation was beginning, seven derivative actions were filed in this Court. On June 6, 2012, plaintiff Indiana Electrical Workers Pension Trust Fund IBEW sent Wal-Mart a demand for books and records under 8 *Del. C.* § 220. On August 13, 2012, after Wal-Mart produced certain documents, IBEW filed a Section 220 complaint alleging deficiencies in Wal-Mart's document produc-

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[11] *See* Consolidated Verified Shareholder Derivative Complaint, *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, C.A. No. 4:12-CV-4041-SOH (W.D. Ark. May 31, 2012).

[12] *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 2015 WL 1470184, at *1 (W.D. Ark. Mar. 31, 2015) (ORDER).

[13] *Cottrell v. Duke*, 829 F.3d 983 (8th Cir. 2016).

tion.[14] On September 5, 2012, the Court of Chancery consolidated the seven derivative actions, appointed co-lead plaintiffs and co-lead counsel, and ordered plaintiffs to file a consolidated amended complaint after completion of the Section 220 action.[15]

After a trial on the papers, an appeal to the Delaware Supreme Court,[16] and a subsequent motion for contempt,[17] the Section 220 action eventually reached a final resolution on May 7, 2015.[18] In the meantime, on May 1, 2015, about one month after the district court's dismissal of the Arkansas complaint, the Delaware plaintiffs filed the Verified Consolidated Amended Stockholder Derivative Complaint in this action, asserting a single claim against certain of Wal-Mart's current and former directors and officers for breach of fiduciary duty.

On June 1, 2015, defendants in the Delaware action moved to dismiss, arguing that the Arkansas Decision collaterally estopped plaintiffs from alleging demand futility, and that even if they were not collaterally estopped, plaintiffs had failed to adequately plead demand futility under Court of Chancery Rule 23.1.

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[14] Verified Complaint, *Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, C.A. No. 7779-CS, 2012 WL 3525645 (Del. Ch. Aug. 13, 2012).

[15] *In re Wal-Mart Stores, Inc. Del. Deriv. Litig.*, C.A. No. 7455-CS (Del. Ch. Sept. 5, 2012) (ORDER).

[16] *See Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW*, 95 A.3d 1264 (Del. 2014).

[17] *See Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, C.A. No. 7779-CB, 2015 WL 2150668 (Del. Ch. May 7, 2015) (TRANSCRIPT).

[18] *Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, 2015 WL 2150668 (Del. Ch. May 7, 2015) (ORDER).

I granted defendants' motion to dismiss on May 13, 2016, finding that the Arkansas Decision precluded the Delaware plaintiffs from re-litigating the issue of demand futility.[19] Specifically, I held that "[s]ubject to Constitutional standards of due process, Arkansas law governs the question of issue preclusion in this case."[20] Under Arkansas law, issue preclusion applies when the following requirements are satisfied:

> (1) the issue sought to be precluded must be the same as the issue in the prior litigation; (2) the issue must have been actually litigated; (3) the issue must have been determined by a valid and final judgment; and (4) the determination must have been essential to the judgment. In addition, the parties to be precluded must have been parties in the prior litigation or been in privity with those parties. Finally, the precluded party must have been adequately represented in the previous litigation.[21]

Although Arkansas courts have not addressed issue preclusion in the context of stockholder derivative suits, which involves unique issues of "privity" and "adequate representation," I concluded, based on the clear weight of authority from other jurisdictions and

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[19] *Wal-Mart I*, 2016 WL 2908344, at *1.

[20] *Id.* *See Alvarez*, 2017 WL 239364, at *2 ("The parties agree that the Chancellor was correct that, in determining the preclusive effect of the Arkansas federal court's dismissal, the Court of Chancery must look to federal common law, which, in turn, looks to the law of the rendering state (Arkansas) in which the federal court exercises diversity jurisdiction.").

[21] *Wal-Mart I*, 2016 WL 2908344, at *9 (citing *Riverdale Dev. Co., LLC v. Ruffin Bldg. Sys., Inc.*, 356 Ark. 90, 146 S.W.3d 852, 855 (2004); *Morgan v. Turner*, 2010 Ark. 245, 368 S.W.3d 888, 895 (2010); *Ark. Dep't of Human Servs. v. Dearman*, 40 Ark.App. 63, 842 S.W.2d 449, 452 (1992) (en banc)).

guidance from the Restatement, that an Arkansas court likely would find the test for issue preclusion satisfied in this case.

In reaching my conclusion on the "privity" issue, I looked to "decisions from courts in other jurisdictions, the Restatement, and principles of public policy."[22] I noted that "[a]pplying the privity requirement to derivative actions involving two different stockholder plaintiffs raises the question whether the required privity is between the two stockholders, or between each stockholder and the corporation."[23] After reviewing an extensive body of case law from other jurisdictions, I found that:

> The vast majority of other jurisdictions that have decided the issue have concluded that privity exists between different stockholder plaintiffs who file separate derivative actions. The common theme in the opinions where privity has been found is that the corporation is the real party in interest in both the first derivative action and the subsequent suit. Viewed in this fashion, the first stockholder plaintiff does not represent the second stockholder plaintiff. Instead, both plaintiffs sue on behalf of the corporation and are essentially interchangeable.[24]

I also found that "the Restatement is ambiguous on the privity question in the derivative context,"[25] and that "public policy arguments exist on both sides of the privity question," but concerns about fast-filers "may be balanced by requiring that a derivative

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[22] *Wal-Mart I*, 2016 WL 2908344, at *13.

[23] *Id.* at *12.

[24] *Id.* at *13.

[25] *Id.* at *15.

plaintiff be an adequate representative in order for a judgment to have a preclusive effect on subsequent actions."[26] As a result, I determined that Arkansas courts likely would find the privity requirement satisfied.

In the last part of my issue preclusion analysis, I considered whether the Arkansas plaintiffs were adequate representatives, and in doing so, addressed the issue of due process that is embedded in the adequate representation requirement.[27] More specifically, as explained in the opinion, I looked, as other courts have done, to the Restatement for an analytical framework to determine compliance with due process "because Constitutional principles of due process are embedded in the pertinent provisions of the Restatement."[28] Applying Section 42 of the Restatement, I concluded that the Arkansas plaintiffs were adequate representatives because their interests were not misaligned, and because their representation was not "grossly deficient," which is a key standard for determining inadequacy under the Restatement:

> The failure of a representative to invoke all possible legal theories or to develop all possible resources of proof does not make his representation legally ineffective, any more than such circumstances overcome the binding effect of a judgment on a party himself. . . . Where the representative's management of the litigation is ***so grossly deficient as to be apparent to the opposing party***, it likewise creates no justifiable

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[26] *Id.* at *17.

[27] *See id.* at *18 & n.101.

[28] *See id.* at *18 n.99 (collecting authorities).

> reliance interest in the adjudication on the part of the opposing party. Tactical mistakes or negligence on the part of the representative are not as such sufficient to render the judgment vulnerable.[29]

In assessing whether the Arkansas plaintiffs' representation was grossly deficient, I relied on guidance from the Delaware Supreme Court in *Pyott v. Louisiana Municipal Police Employees' Retirement System* ("*Pyott II*"), which rejected a presumption of inadequacy for stockholders who fail to pursue books and records before filing derivative actions.[30] In this case, as in *Pyott II*, there was no basis on which to conclude that the Arkansas plaintiffs were inadequate representatives absent such a presumption.[31] For these reasons, I determined that a court in Arkansas would accord preclusive effect to the Arkansas Decision and, impliedly, that the Delaware plaintiffs' constitutional right to due process had not been violated.

C. The Remand Order

Plaintiffs appealed from *Wal-Mart I*. On January 18, 2017, the Delaware Supreme Court issued the Remand Order, asking this Court to address the following question:

> In a situation where dismissal by the federal court in Arkansas of a stockholder plaintiff's derivative action for failure to plead demand

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[29] Restatement § 42 cmt. f (emphasis added); *see Wal-Mart I*, 2016 WL 2908344, at *19-21.

[30] *See Pyott II*, 74 A.3d at 618 ("We reject the 'fast-filer' irrebuttable presumption of inadequacy . . . . Absent the presumption, there was no basis on which to conclude that the California plaintiffs were inadequate").

[31] *See Wal-Mart I*, 2016 WL 2908344, at *19-21.

> futility is held by the Delaware Court of Chancery to preclude subsequent stockholders from pursuing derivative litigation, have the subsequent stockholders' Due Process rights been violated? *See Smith v. Bayer Corp.*, 564 U.S. 299, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011).[32]

Following remand, the Court received supplemental briefing from the parties.

II. ANALYSIS

A. Nonparty Preclusion in General

In *Richards v. Jefferson County, Alabama*, the United States Supreme Court stated that:

> State courts are generally free to develop their own rules for protecting against the relitigation of common issues or the piecemeal resolution of disputes. We have long held, however, that extreme applications of the doctrine of res judicata may be inconsistent with a federal right that is "fundamental in character."[33]

As I read the Remand Order, the Delaware Supreme Court appears to agree with the issue preclusion analysis set forth in *Wal-Mart I* as a matter of Arkansas state law,[34] which follows the approach

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[32] *Alvarez*, 2017 WL 239364, at *8.

[33] *Richards v. Jefferson Cty., Ala.*, 517 U.S. 793, 797, 116 S.Ct. 1761, 135 L.Ed.2d 76 (1996) (internal citations omitted).

[34] *See Alvarez*, 2017 WL 239364, at *3 ("Although we reserve judgment until our final ruling after remand, we presently have no disagreement with the Court of Chancery's analysis of Arkansas law (which largely looks to the Restatement (Second) of Judgments)—particularly as it relates to the questions of whether the issue to be precluded was actually litigated and the adequacy of representation."); *id.* at *5 ("As a matter of Arkansas state law on the privity issue, we are presently satisfied with the state of the record and do not perceive any error.").

most jurisdictions have taken. Thus, frankly stated, the issue presented on remand is whether the predominant approach on issue preclusion in the derivative action context constitutes such an "extreme application[] of the doctrine of res judicata" as to affront due process.

In 2008, in *Taylor v. Sturgell*, the United States Supreme Court struck down, on due process grounds, a "virtual representation" theory that was purportedly based on some Supreme Court decisions "recognizing that a nonparty may be bound by a judgment if she was adequately represented by a party to the earlier suit."[35] The Court began its analysis by citing the general rule stated in *Hansberry v. Lee* that "one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process."[36] The Court then delineated six categories of recognized exceptions to the general rule against nonparty preclusion:[37]

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[35] *Taylor v. Sturgell*, 553 U.S. 880, 898, 128 S.Ct. 2161, 171 L.Ed.2d 155 (2008).

[36] *Id.* at 893, 128 S.Ct. 2161 (quoting *Hansberry v. Lee*, 311 U.S. 32, 40, 61 S.Ct. 115, 85 L.Ed. 22 (1940)).

[37] The Supreme Court avoided using the term "privity" in *Sturgell* to prevent confusion because "privity," which originally referred to the "substantive legal relationships justifying preclusion" (the second exception identified in *Sturgell*), "has also come to be used more broadly, as a way to express the conclusion that nonparty preclusion is appropriate on any ground." *Id.* at 894, 128 S.Ct. 2161 n.8. Case law also suggests that it might be difficult to draw a clear line between "privity" and "adequate representation." *See, e.g.*, *In re Sonus Networks, Inc., S'holder Deriv. Litig.*, 499 F.3d 47, 64 (1st Cir. 2007) (referring to the "adequate representation" requirement as a "caveat" for the privity finding).

> First, a person who agrees to be bound by the determination of issues in an action between others is bound in accordance with the terms of his agreement.
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> Second, nonparty preclusion may be justified based on a variety of pre-existing substantive legal relationships between the person to be bound and a party to the judgment.
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> * * * * *
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> Third, . . . in certain limited circumstances, a nonparty may be bound by a judgment ***because she was adequately represented by someone with the same interests who was a party to the suit***. Representative suits with preclusive effect on nonparties include properly conducted class actions, and suits brought by trustees, guardians, and other fiduciaries.
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> Fourth, a nonparty is bound by a judgment if she assumed control over the litigation in which that judgment was rendered.
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> Fifth, a party bound by a judgment may not avoid its preclusive force by relitigating through a proxy.
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> Sixth, in certain circumstances a special statutory scheme may expressly foreclose successive litigation by nonlitigants . . . if the scheme is otherwise consistent with due process.[38]

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[38] *Sturgell*, 553 U.S. at 893-95, 128 S.Ct. 2161 (internal citations and quotations omitted) (emphasis added).

In the lower court opinion in *Sturgell*, the D.C. Circuit purported to ground its virtual representation doctrine in the third exception that, "in some circumstances, a person may be bound by a judgment if she was adequately represented by a party to the proceeding yielding that judgment."[39] The Supreme Court, however, found that the D.C. Circuit had misapprehended the constitutional standard of "adequate representation," which required, at a minimum, "either special procedures to protect the nonparties' interests or an understanding by the concerned parties that the first suit was brought in a representative capacity."[40]

The *Sturgell* Court's focus on the adequacy of representation in its due process analysis of the application of the third exception suggests that the "adequate representation" requirement provides the core constitutional check on when a nonparty may be bound by a judgment against someone with the same interests who was a party in a prior suit. In addition, although not many cases have addressed the issue of due process in the context of precluding relitigation of demand futility in stockholder derivative actions, those that have done so—in particular two federal circuit courts—also focused their due process inquiries on the adequacy of representation.

B. Nonparty Preclusion in Derivative Actions: *Arduini* and *Sonus*

In 2014, in *Arduini v. Hart*, the Ninth Circuit affirmed a district court's dismissal of a derivative action filed by plaintiff Lawrence Arduini.[41] Arduini

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[39] *Id.* at 896, 128 S.Ct. 2161.

[40] *Id.* at 897, 900, 128 S.Ct. 2161.

[41] *Arduini v. Hart*, 774 F.3d 622, 625 (9th Cir. 2014).

had filed his action in federal court in Nevada against International Gaming Technology and its board of directors, alleging that certain officers of the company made intentionally misleading statements about the company's financial prospects.[42] Before Arduini filed his lawsuit, however, the same court had dismissed another derivative action (the *Fosbre* action) asserting substantially similar claims for failure to make a demand on the company's board or to sufficiently allege demand futility.[43] Applying the doctrine of issue preclusion, the district court held that Arduini was barred from relitigating demand futility based on the dismissal of the *Fosbre* action. In an opinion post-dating *Sturgell*, the Ninth Circuit affirmed.[44]

Arduini contended on appeal that issue preclusion should not apply because, among other things, "he is not in privity with the *Fosbre* plaintiffs for the purposes of issue preclusion," and "the equities and due process weigh against applying issue preclusion here."[45] On the privity issue, Arduini advanced the same argument as the plaintiffs in *Wal-Mart I*, namely, that "there is no privity because shareholders who fail to establish their representative capacity can only act on their own behalf and are not in privity with other shareholders."[46] Significantly, the Ninth Circuit followed the majority rule from other jurisdictions to find privity, despite its stated concern about due process rights:

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[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *Id.* at 629.

[46] *Id.* at 633 (citing *Pyott I*, 46 A.3d at 330).

> The fact that Arduini was not a party to the *Fosbre* case does potentially raise concerns. The Nevada Supreme Court has stated that issue preclusion can only be used against a party whose due process rights have been met by virtue of that party having been a party or in privity with a party in the prior litigation.[47]

Thus, in holding the way it did, the Ninth Circuit implicitly rejected the notion that finding privity between Arduini and his fellow stockholders violated due process even though the earlier stockholder plaintiffs failed to establish demand futility.

The Ninth Circuit also expressly considered due process in connection with its discussion of adequate representation.[48] It noted that "precluding the suit of a litigant who has not been adequately represented in the earlier suit would raise serious due process concerns."[49] Although the Court left "for another day the precise contours of what conduct constitutes inadequate representation," the authorities it cited were consistent with the "grossly deficient" standard in the Restatement. In particular, the Court cited

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[47] *Arduini*, 774 F.3d at 633.

[48] *See id.* at 634-38. It appears that "adequate representation" is not an element of issue preclusion under Nevada state law. *See id.* at 629 ("In order for an issue decided in another case to have preclusive effect, (1) the issue decided in the prior litigation must be identical to the issue presented in the current action; (2) the initial ruling must have been on the merits and have become final; . . . (3) the party against whom the judgment is asserted must have been a party or in privity with a party to the prior litigation; and (4) the issue was actually and necessarily litigated."). Thus, as I read the decision, the *Arduini* Court's discussion of adequate representation was driven by constitutional concerns.

[49] *Id.* at 635 (internal citations omitted).

In re Sonus Networks, Inc., Shareholder Derivative Litigation, a First Circuit decision (discussed below) that adopted the "grossly deficient" standard,[50] and it looked to Section 42(1) of the Restatement, which, as noted above, utilizes a "grossly deficient" standard for determining adequacy of representation.[51] Relying on these authorities, the Ninth Circuit concluded that the earlier stockholder plaintiffs were adequate representatives.

Relying on *Sturgell*, furthermore, Arduini raised a due process argument that he should have been given notice of the dismissal of the earlier case. The Ninth Circuit rejected the argument, reasoning that "*Taylor v. Sturgell* is inapposite" because, unlike in *Sturgell*, "[h]ere, both Arduini and the *Fosbre* plaintiffs were acting in a representative capacity as shareholders on behalf of [International Gaming Technology]. ***Because the Fosbre plaintiffs adequately represented the shareholders*** and issue preclusion applies, there is no need for Arduini to receive personal notice of the *Fosbre* court's decisions."[52]

In sum, the *Arduini* Court was aware of the Supreme Court's decision in *Sturgell*, explicitly considered due process in its rulings on adequacy of representation and the failure to provide notice of the *Fosbre* dismissal, and implicitly considered due process in its ruling on privity. In the end, however, the Court did not find any constitutional obstacle in barring Arduini from relitigating demand futility.

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[50] *Id.*; *see Sonus*, 499 F.3d at 66, 71.

[51] *Arduini*, 774 F.3d at 635.

[52] *Id.* at 638 (emphasis added).

In 2007, the First Circuit reached a similar conclusion in *Sonus*, where it affirmed a district court's dismissal of a stockholder derivative action on the basis that dismissal of an earlier derivative action in Massachusetts state court precluded plaintiffs in the federal court from relitigating demand futility.[53] In rejecting plaintiffs' argument that privity did not exist because "the state court judgment did not adjudicate the corporation's rights, but only the question of whether the state court plaintiffs should be permitted to bring suit on behalf of the corporation," the First Circuit stated that: "plaintiffs' argument could have some force if the question in the state court had concerned some issue peculiar to the state court plaintiffs ***or the adequacy of their representation***, but it did not."[54] The Court further commented that "[p]recluding the suit of a litigant who has not been adequately represented in the earlier suit would raise serious due process concerns" and went on to adopt the "grossly deficient" standard under the Restatement to determine adequacy of representation.[55]

Thus, similar to *Arduini*, the *Sonus* Court focused its due process inquiry on the adequacy of represen-

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[53] *Sonus*, 499 F.3d at 53.

[54] *Id.* at 64 (emphasis added). Although *Sonus* pre-dated *Sturgell*, the First Circuit noted that the "structural fact about derivative litigation" (*i.e.*, that "the corporation is bound by the results of the suit in subsequent litigation, even if different shareholders prosecute the suits") "makes irrelevant questions of 'virtual representation,' that is, the representation by a party of a nonparty outside the context of a class action." *Id.* at 64 & n.10.

[55] *See id.* at 65, 66, 71.

tation in the first derivative action.[56] This is the logic underlying *Wal-Mart I* as well. In other words, ensuring compliance with due process was embedded in my analysis of whether the Arkansas plaintiffs were adequate representatives, which turned on my application of principles from the Restatement, primarily the "grossly deficient" standard that the *Arduini* and *Sonus* Courts also employed.[57]

C. A Different Approach to Non-Party Preclusion in Derivative Actions: *EZCORP*

Last year, Vice Chancellor Laster advocated for a different approach for addressing non-party preclusion in derivative actions than the *Arduini* and *Sonus* Courts. In *EZCORP*, a plaintiff filed a derivative complaint against three outside directors of EZCORP, Inc. After the defendants' motion to dismiss was fully briefed but before it was argued, the Delaware Supreme Court issued an intervening decision that led the plaintiff to re-evaluate the strength of his allegations and to propose a voluntary dismissal without prejudice. The defendants, however, sought a dismissal with prejudice "as to the world."[58] Applying Court of Chancery Rule 15(aaa),

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[56] In *Pyott II*, although "adequate representation" was not one of the five factors identified for issue preclusion under California law, *see Pyott II*, 74 A.3d at 617, the Delaware Supreme Court nevertheless addressed the issue, citing Justice Ginsburg's partial concurrence and dissent in *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 395-96, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996), for the proposition that "final judgments can be attacked collaterally on due process grounds for failure to satisfy the adequate representation requirement." *Id.* at 618 & n.21.

[57] *Wal-Mart I*, 2016 WL 2908344, at *17-21.

[58] *EZCORP*, 130 A.3d at 940.

the Court ruled that the complaint should be dismissed with prejudice but only as to the named plaintiff.[59]

The *EZCORP* Court then went on to hold, in *dicta*, that both as a matter of Delaware law[60] and as a matter of due process, a judgment cannot bind "the corporation or other stockholders in a derivative action until the action has survived a Rule 23.1 motion to dismiss, or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit."[61] In other words, the *EZCORP* Court proposed a bright-line rule drawing a distinction between the pre- and post-demand futility phases of derivative litigation. In so concluding, the Court analogized stockholder derivative actions to class actions, relying on the United State Supreme Court's 2011 decision in the class action context in *Smith v. Bayer*.[62]

In *Bayer*, a federal district court enjoined a state court from considering a plaintiff's motion for class certification because the district court previously had denied a similar certification motion in a related case that was brought by a different plaintiff against the same defendant (Bayer) alleging similar claims.[63] After the Eighth Circuit affirmed the decision, the precluded plaintiff appealed to the United States

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[59] *Id.* at 938.

[60] *Id.* at 943-46. I note that Delaware law is unsettled on this issue. *See Pyott II*, 74 A.3d at 618 ("Although the Court of Chancery is divided on the privity issue as a matter of Delaware law, we cannot address the merits of that issue in this case.").

[61] *EZCORP*, 130 A.3d at 948.

[62] *Id.* at 946-49.

[63] *Bayer*, 564 U.S. at 302, 131 S.Ct. 2368.

Supreme Court. On appeal, Bayer argued that preclusion was proper because the plaintiff qualified as a party to the prior litigation, and in the alternative, because the plaintiff fell under the class action exception to the rule against nonparty preclusion.[64]

The Supreme Court swiftly rejected the first argument, holding that the "definition of the term 'party' can on no account be stretched so far as to cover a person like Smith, whom the plaintiff in a lawsuit was denied leave to represent."[65] It also rejected the alternative argument based on the class action exception, reasoning that: "If we know one thing about the McCollins suit, we know that it was *not* a class action. Indeed, the very ruling that Bayer argues ought to be given preclusive effect is the District Court's decision that a class could not properly be certified."[66]

The Supreme Court further noted that Bayer's position was essentially a reincarnation of the "virtual representation" theory rejected in *Sturgell*, which was based on "identity of interests and some kind of relationship between parties and nonparties."[67] As the *Sturgell* Court held, such a theory would "recognize, in effect, a common-law kind of class action . . . . shorn of the procedural protections prescribed in *Hansberry*, *Richards*, and Rule 23."[68]

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[64] *See id.* at 313, 131 S.Ct. 2368.

[65] *Id.*

[66] *Id.* at 314, 131 S.Ct. 2368 (emphasis in original).

[67] *Id.* at 315, 131 S.Ct. 2368 (citing *Sturgell*, 553 U.S. at 901, 128 S.Ct. 2161).

[68] *Sturgell*, 553 U.S. at 901, 128 S.Ct. 2161.

The *EZCORP* Court reasoned that before a stockholder acquires authority to litigate on behalf of a corporation, either by obtaining approval from the corporation, or by surviving a Rule 23.1 motion to dismiss, she is in a similar position as a purported class representative for an uncertified class. Thus, the Court concluded that, "[u]nder the logic of *Bayer*, the Due Process Clause forecloses a judgment in a derivative action that is entered before the stockholder plaintiff acquires authority to litigate on behalf of the corporation from binding anyone other than the named stockholder plaintiff."[69]

D. Nonparty Preclusion in Derivative Actions: Re-examining the Law

Although *Arduini*, *Sonus*, and most other cases from various jurisdictions have come to similar conclusions on issue preclusion in the demand futility context, albeit typically in the context of considering the issue of privity,[70] I respectfully suggest that the Supreme Court should consider a different approach and adopt the one suggested in *EZCORP*. I base this recommendation on (1) the similarities between class actions and derivative actions, (2) some of the realities of derivative litigation, and (3) public policy considerations.

1. Similarities between Class Actions and Derivative Actions

Defendants advance two major arguments to distinguish *Bayer* and *EZCORP*. First, defendants argue that *Bayer* did not establish any constitutional principles because the *Bayer* Court expressly based its

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[69] *EZCORP*, 130 A.3d at 949.

[70] *See Wal-Mart I*, 2016 WL 2908344, at *13 n.69 (collecting authorities).

decision "on the Anti–Injunction Act and the principles of issue preclusion," and did not consider petitioner's argument on due process.[71] Although the *Bayer* Court did not specifically address due process, its discussion of nonparty preclusion, which heavily relied upon *Sturgell*, has obvious constitutional overtones. As discussed below, moreover, the importance of *Bayer* is not so much in its holding, but in its logic, which, if applied to the derivative action context, would have due process implications under the framework set forth in *Sturgell*.

Second, defendants argue that "*EZCORP* rested on a false equivalence between class and derivative actions" and that "[c]lass and derivative actions are not the same—they arise from different substantive laws and are implemented through different procedural rules."[72] To my mind, however, there are significant similarities between class and derivative actions.

In *Parfi Holding AB v. Mirror Image Internet*, then-Vice Chancellor Strine stated that: "Although it is too often overlooked, derivative suits are a form of representative action. Indeed, they should be seen for what they are, a form of class action."[73] Not only do class actions and derivative actions have apparent similarities, the rules that govern their respective operations in federal courts—Federal Rules of Civil Procedure 23 and 23.1—share a common ancestry:

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[71] *Bayer*, 564 U.S. at 308 n.7, 131 S.Ct. 2368. *See* Appearing Defs.' Suppl. Br. on Remand 16-17.

[72] *See* Appearing Defs.' Suppl. Br. on Remand 19-26.

[73] *Parfi Hldg. AB v. Mirror Image Internet*, 954 A.2d 911, 940 (Del. Ch. 2008) (Strine, V.C.).

derivative actions in federal courts were governed by Rule 23 until 1966, when Rule 23.1 was adopted.[74]

Federal Rules 23 and 23.1 also share similar texts and structures. For example, Rule 23(a) lays out the prerequisites for bringing a class action, which include numerosity, commonality, typicality, and adequacy.[75] By comparison, Federal Rule 23.1(a) states that a derivative action may only be maintained if the plaintiff "fairly and adequately represent[s] the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association."[76] It is understandable that Rule 23.1(a) only requires "adequacy" and not the other three elements set out in Rule 23(a). By definition, a derivative action satisfies the "commonality" and "typicality" requirements, and given the identity of issues presented regardless of which stockholder brings the action, the "numerosity" requirement is irrelevant in the derivative context.

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[74] *See* 7A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Fed. Practice and Procedure* § 1753, at 42-43 (3d ed. 2005) ("The provisions for representative actions were completely rewritten and augmented in 1966. Drastically altered provisions for the conduct of ordinary class actions are to be found in Rule 23, a new Rule 23.1 was adopted, replacing original Rule 23(b), to deal with derivative actions by stockholders."); *see also Snyder v. Harris*, 394 U.S. 332, 351 n.13, 89 S.Ct. 1053, 22 L.Ed.2d 319 (1969) ("A 'true' class action could also be maintained to enforce a right 'secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it.' Stockholders' derivative actions were the most significant type of suit within this group. They are now separately dealt with under Rule 23.1 in addition.").

[75] Fed. R. Civ. P. 23(a)(1)-(4). In addition to satisfying the prerequisites in Rule 23(a), a class action must fall under one of the sub-categories in Rule 23(b). Fed. R. Civ. P. 23(b).

[76] Fed. R. Civ. P. 23.1(a).

Other similarities between class actions and derivative actions under the federal rules can be found in the procedural protections afforded to the unnamed class members or stockholders. Rule 23(e) and Rule 23.1(c) both require court approval and appropriate notice in cases of settlement, voluntary dismissal, or compromise.[77] Rule 23(d) gives a trial court extensive power to ensure "the fair and efficient conduct" of a class action, including the power to issue orders that "determine the course of proceedings" and require "appropriate notice to some or all class members."[78] Similarly, the Advisory Committee Notes accompanying Rule 23.1 state that "[t]he court has inherent power to provide for the conduct of the proceedings in a derivative action, including the power to determine the course of the proceedings and require that any appropriate notice be given to shareholders or members."[79]

There also is significant appeal in the analogy advanced in *EZCORP*, which focused on the similarities between a stockholder who is denied authority to sue on the corporation's behalf and a purported class

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[77] Fed. R. Civ. P. 23(e) ("The claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval. The following procedures apply to a proposed settlement, voluntary dismissal, or compromise: (1) The court must direct notice in a reasonable manner to all class members who would be bound by the proposal."); Fed. R. Civ. P. 23.1(c) ("A derivative action may be settled, voluntarily dismissed, or compromised only with the court's approval. Notice of a proposed settlement, voluntary dismissal, or compromise must be given to shareholders or members in the manner that the court orders.").

[78] Fed. R. Civ. P. 23(d) & Advisory Committee Notes; *see also* 7B Wright, Miller & Kane, *supra* note 74, § 1791.

[79] Fed. R. Civ. P. 23.1 Advisory Committee Notes (1966).

representative who is denied his bid to represent the proposed class.[80] Both federal and Delaware courts have long recognized the dual nature of derivative litigation. For example, in *Ross v. Bernhard*, the United States Supreme Court observed "the dual nature of the stockholder's action: first, the plaintiff's right to sue on behalf of the corporation and, second, the merits of the corporation claim itself."[81] Similarly, in *Aronson v. Lewis*, the Delaware Supreme Court held that: "The nature of the [derivative] action is two-fold. First, it is the equivalent of a suit by the shareholders to compel the corporation to sue. Second, it is a suit by the corporation, asserted by the shareholders on its behalf, against those liable to it."[82]

As noted in *Wal-Mart I*, "[t]he common theme in the opinions" that have concluded that privity exists between different stockholder plaintiffs who file separate derivative actions "is that the corporation is the real party in interest in both the first derivative action and the subsequent suit."[83] That the corporation is the real party in interest, however, does not

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[80] *See EZCORP*, 130 A.3d at 947.

[81] *Ross v. Bernhard*, 396 U.S. 531, 534-35, 90 S.Ct. 733, 24 L.Ed.2d 729 (1970); *see also Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96, 111 S.Ct. 1711, 114 L.Ed.2d 152 (1991) (internal citations and quotations omitted) ("Ordinarily, it is only when demand is excused that the shareholder enjoys the right to initiate suit on behalf of his corporation in disregard of the directors' wishes.").

[82] *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984), *overruled on other grounds*, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). *See also EZCORP*, 130 A.3d at 943-44 (discussing the dual nature of derivative actions as a matter of Delaware law).

[83] *Wal-Mart I*, 2016 WL 2908344, at *13.

answer who has the authority to represent the corporation. When a court denies a stockholder the authority to sue on behalf of the corporation by granting a Rule 23.1 motion to dismiss, the purported derivative action is no more a representative action than the proposed class action in *Bayer* that was denied certification. Thus, a strong case can be made that a derivative action that has not survived a Rule 23.1 motion to dismiss should not fall under the representative action exception in *Sturgell*.[84]

2. "Adequate Representation" in Derivative Litigation Practice

The need for a more rigorous preclusion rule in the derivative action context is heightened by the disparity between class and derivative actions in terms of how adequacy of representation is assessed in practice. Both Federal Rule 23 and Rule 23.1 require the proposed class or stockholder representative to be "adequate," and there are some similarities in the standard of adequacy under the two rules.[85]

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[84] In the Remand Order, the Supreme Court commented that "there is much force in the suggestion that the Delaware Plaintiffs should have sought to intervene in the Arkansas court to protect their interests—notwithstanding the fact that they had not yet obtained the documents they were seeking" in the Section 220 action. *Alvarez*, 2017 WL 239364, at *4. It should be noted, however, that the United States Supreme Court held in *Richards* that "[t]he general rule is that the law does not impose upon any person absolutely entitled to a hearing the burden of voluntary intervention in a suit to which he is a stranger." *Richards*, 517 U.S. at 800 n.5, 116 S.Ct. 1761 (internal citations and quotations omitted).

[85] *See* 7C Wright, Miller & Kane, *supra* note 74, § 1833 at 147 (recognizing that the new Rule 23.1 "does not represent a change in substance" and that "[m]any of the factors that are considered when determining adequacy of representation in a

But in the class action context, the purported class representative has to affirmatively demonstrate his adequacy in order to obtain certification.[86] In a derivative action, by comparison, the burden is on the defendant to show that the plaintiff is an inadequate representative.[87]

Class actions also frequently engender competition at the front-end in the appointment of class counsel where the Court considers, among other things, the quality of the pleadings and the vigorousness of plaintiff's counsel.[88] Such competition is less common, at least in my experience, in derivative litigation, where plaintiff's counsel invariably have the option

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class action under Rule 23 also apply in the context of derivative suits.").

[86] *See Comcast Corp. v. Behrend*, 569 U.S. 27, 133 S.Ct. 1426, 1432, 185 L.Ed.2d 515 (2013) (internal citations and quotations omitted) ("a party seeking to maintain a class action must affirmatively demonstrate his compliance with Rule 23. The Rule does not set forth a mere pleading standard. Rather, a party must . . . be prepared to prove that there are in fact sufficiently numerous parties, common questions of law or fact, typicality of claims or defenses, and adequacy of representation, as required by Rule 23(a).").

[87] *See Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 592 n.15 (holding that under Federal Rule of Civil Procedure 23.1, the "burden is on the defendants to obtain a finding of inadequate representation"). *See also* 7C Wright, Miller & Kane, *supra* note 74, § 1834 at 159.

[88] *See Hirt v. U.S. Timberlands Serv. Co., LLC*, 2002 WL 1558342, at *2 (Del. Ch. July 3, 2002). *See also Moore v. Tangipahoa Parish School Bd.*, 298 F.Supp. 288, 294 (E.D. La. 1969) ("When more than one member of a class seeks to represent the class, the court must determine which applicant's interests are most typical of the interests of the class as a whole and which group will most fairly and adequately protect the interests of the class they represent."); 7A Wright, Miller & Kane, *supra* note 74, § 1765 at 320-21.

to file suit in a second forum and begin a race to the courthouse rather than to compete for leadership. Once multi-forum derivative litigation is underway, or even just anticipated, defendants often have an incentive not to challenge adequacy in an initial derivative action (*e.g.*, if the plaintiff's demand futility allegations appear weak) in the hope of obtaining a favorable determination on demand futility to bar re-litigation of the issue in a later proceeding against a more formidable adversary, *i.e.*, one who has undertaken additional due diligence and filed a more factually-developed pleading.[89]

In the Arkansas Decision, the district court judge did not discuss the Arkansas plaintiffs' adequacy.[90] The same was true in *Sonus*, where "the adequacy of the plaintiffs' representation was not litigated . . . in either [the state or the federal] action."[91] As a practical matter, the first time a court may evaluate the adequacy of a named plaintiff's representation in a derivative action is when it applies the issue preclusion test in a subsequent case. What is lost in this back-end form of adequacy review is the ability for courts to compare the qualities of competing representatives and to choose the best representative for the corporation and stockholders up-front, on a clean slate.

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[89] This is not to say that a stockholder plaintiff's adequacy is never challenged in a derivative litigation. *See*, *e.g.*, *Parfi*, 954 A.2d at 942 (finding the plaintiffs to be inadequate representatives because they knowingly misled the court about a material issue); *Youngman v. Tahmoush*, 457 A.2d 376 (Del. Ch. 1983); *Katz v. Plant Indus., Inc.*, 1981 WL 15148 (Del. Ch. Oct. 27, 1981).

[90] *See generally* Arkansas Decision, 2015 WL 1470184.

[91] *Sonus*, 499 F.3d at 65.

In short, under the current state of the law, the moment a stockholder files a derivative action, he is deemed in most jurisdictions to be in privity with all the other stockholders of the corporation that he purports to represent. This "automatic privity" rule, together with an adequacy review undertaken at the back end under a "grossly deficient" standard that sets a relatively high bar for challenging the adequacy of one's representation, strikes a balance between preventing duplicative litigation and protecting due process rights that is far less favorable to stockholder plaintiffs in derivative litigation than it is to unnamed members in class actions.

3. Public Policy

Competing public policies exist on both sides of the debate concerning current issue preclusion law in the demand futility context. On one hand, the current legal regime better serves judicial efficiency and conserves public resources by preventing duplicative litigation concerning demand futility.[92] On the other hand, the approach suggested in *EZCORP* should go a long way to addressing the "fast-filer" problem and ensuring better protection of due process rights for stockholder plaintiffs.

In balancing similar competing policies, the United States Supreme Court's observations in *Sturgell* and *Bayer* are instructive. In *Sturgell*, the Federal Aviation Administration argued that in public law

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[92] Defendants argue that "the defendants in a derivative suit—the company and its directors and officers—also have due process rights, including a right to avoid serial and duplicative litigation." Appearing Defs.' Suppl. Br. on Remand 26. But I could discern no support for such a "due process right" in either of the two cases the defendants cited for this proposition, without providing any textual explanation.

cases, "the number of plaintiffs with standing is potentially limitless," thus the virtual representation theory is necessary to combat the threat of repetitive lawsuits.[93] The Supreme Court was unconvinced. It reasoned that:

> First, *stare decisis* will allow courts swiftly to dispose of repetitive suits brought in the same circuit. Second, even when *stare decisis* is not dispositive, "the human tendency not to waste money will deter the bringing of suits based on claims or issues that have already been adversely determined against others." This intuition seems to be borne out by experience: The FAA has not called our attention to any instances of abusive FOIA suits in the Circuits that reject the virtual representation theory respondents advocate here.[94]

Similarly, in *Bayer*, Bayer Corp. argued that the Supreme Court's decision not to bind unnamed class members in an uncertified class would allow repetitive litigation to try to certify the same class simply by changing named plaintiffs. The Court responded: "But principles of *stare decisis* and comity among courts generally suffice to mitigate the sometimes substantial costs of similar litigation brought by different plaintiffs. The right approach does not lie in binding nonparties to a judgment."[95]

The same reasoning applies with equal force to derivative actions. Although different stockholders theoretically would be able to file *seriatim* lawsuits litigating demand futility under the *EZCORP* rule,

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[93] *Sturgell*, 553 U.S. at 903, 128 S.Ct. 2161.

[94] *Id.* at 903-04, 128 S.Ct. 2161.

[95] *Bayer*, 564 U.S. at 317, 131 S.Ct. 2368.

principles of *stare decisis* and comity are likely sufficient to allow courts to swiftly dispose of truly repetitive actions. The experience of this Court suggests that when one stockholder fails to establish demand futility, rarely does another stockholder file a substantially similar complaint simply to try again. What can and does happen is that a second stockholder plaintiff will file a more refined complaint with more particularized allegations or more tailored legal theories after doing additional homework, such as obtaining corporate books and records through a Section 220 proceeding.[96] In these cases, the second court presumably would be understandably cautious about following earlier rulings in cases brought by less prepared stockholders.

In the pre-demand futility stage of a derivative action, furthermore, the plaintiff is essentially litigating against his own company over the right to sue. Thus, unlike the plaintiffs in *Sturgell* or *Bayer*, who ostensibly had little economic incentive to conserve the resources of the defendants, plaintiffs in derivative actions have more incentive to bring truly meritorious cases on behalf of the company, especially if a similar prior attempt already has failed.

III. CONCLUSION

For the foregoing reasons, having carefully considered the question in the Remand Order from a fresh perspective and with an open mind, I recommend that the Supreme Court adopt the rule proposed in *EZCORP*. If the Court agrees with this recommendation, the case will need to be remanded again for me to decide the issue of demand futility based on the allegations in plaintiffs' complaint. If the Court

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[96] *E.g.*, *Pyott I*, 46 A.3d 313; *Wal-Mart I*, 2016 WL 2908344.

disagrees, I respectfully submit that *Wal-Mart I* correctly dismissed plaintiffs' complaint consistent with prevailing authority and should be affirmed.[97]

[97] In their supplemental brief on remand, plaintiffs argue that issue preclusion also should not apply because the Arkansas Decision was not based on factual findings on the merits. Co-lead Pls.' Resp. to Certified Question on Remand 21-25. Plaintiffs never raised this argument previously in this litigation, and thus waived it. *See* Del. S. Ct. R. 14(b)(vi)(A)(3) ("The merits of any argument that is not raised in the body of the opening brief shall be deemed waived and will not be considered by the Court on appeal.").

IN THE SUPREME COURT OF THE
STATE OF DELAWARE

No. 295, 2016

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM, ET AL.,
Plaintiffs Below,
Appellants,

v.

AIDA M. ALVAREZ, ET AL.,
Defendants Below,
Appellees,

WAL-MART STORES, INC.,
Nominal Defendant Below,
Appellee.

[Submitted: December 14, 2016
Decided: January 18, 2017]

Before HOLLAND, VALIHURA, and VAUGHN, Justices; WHARTON and CLARK, Judges* constituting the Court en Banc.

ORDER

Karen L. Valihura, Justice

(1) This is a troubling case. Upon learning of a potential bribery scandal at a Mexican subsidiary of

* Sitting by designation pursuant to Del. Const. Art. IV § 12 and Supreme Court Rules 2 and 4(a) to fill up the quorum as required.

Wal-Mart Stores, Inc. ("Wal-Mart"), the appellants in this case (the "Delaware Plaintiffs") did exactly what this Court has suggested on numerous occasions, namely, use the "tools at hand" to inspect the company's pertinent books and records before filing a derivative complaint. Several sets of plaintiffs chose not to do that, and instead filed complaints in federal court in Arkansas (the "Arkansas Plaintiffs") and in the Delaware Court of Chancery. During an initial conference in Delaware, then-Chancellor Strine, now Chief Justice Strine, explicitly warned plaintiffs' counsel that the extant complaints before him likely would not survive a motion to dismiss.[1] The Chancellor urged counsel, as this was not an expedited matter, to undertake a careful examination of the books and records before filing a derivative action. The Delaware Plaintiffs, who arguably had the most skin in the game, heeded the Chancellor's warning and pursued a books and records demand and lawsuit that spanned the course of almost three years.[2]

(2) The problem for the Delaware Plaintiffs was that the Arkansas Plaintiffs chose a different strategy by filing a case in federal court. Their claims largely resembled the claims in Delaware, but added claims under Sections 14(a) and 29(b) of the Securities Exchange Act of 1934.[3] The firms representing the

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[1] *See* Tr. of Oral Argument at A45-83, *Klein v. Walton*, No. 7455-CS (Del. Ch. July 16, 2012).

[2] According to their counsel's representations at oral argument before this Court, the Delaware Plaintiffs own over 11 million shares of Wal-Mart stock, representing an investment of about $750 million. *See* Oral Argument at 50:30, *CalSTRS v. Alvarez*, No. 295-2016 (Del. Dec. 14, 2016), https://livestream.com/accounts/5969852/events/6740380/videos/144431752/player.

[3] It appears from the record on appeal that the *New York Times* published the bribery allegations on April 21, 2012; the

Arkansas Plaintiffs made a tactical decision to forgo a books and records inspection. Instead, they believed that they had obtained sufficient information from a *New York Times* article that had described the alleged scandal in some detail and referenced a number of internal documents, which were made publicly available on the *Times*' web site.[4]

(3) In the Court of Chancery, the defendants filed a "one-forum" motion, seeking to have the litigation proceed solely in Delaware. In Arkansas, they moved for a stay pending the outcome of the Delaware litigation, in part because the ultimate issues to be decided on the merits involved questions of Delaware law. The federal judge agreed to stay her hand while the Delaware litigation proceeded.[5] The United States Court of Appeals for the Eighth Circuit reversed the stay on December 18, 2013, emphasizing the district court's federal jurisdiction over the Section 14(a) claim.[6]

(4) The Defendants then moved for a more limited stay, which the federal judge denied, citing delays that had occurred in the Delaware action.[7] In its

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first Delaware complaint was filed on April 25, 2012 (A44); and the first Arkansas complaint was filed on April 25, 2012 (B14).

[4] *See* David Barstow, *Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle*, N.Y. Times (Apr. 21, 2012), http://www.nytimes.com/2012/04/22/business/at-walmart-in-mexico-a-bribe-inquiry-silenced.html.

[5] *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 2012 WL 5935340 (W.D. Ark. Nov. 27, 2012), *vacated and remanded sub nom. Cottrell v. Duke*, 737 F.3d 1238 (8th Cir. 2013).

[6] *Cottrell*, 737 F.3d at 1240.

[7] Order at B135, *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, No. 4:12-cv-4041 (W.D. Ark. June 4, 2014). It is clear and undisputed that the federal judge was fully aware of the

June 4, 2014 order rejecting Defendant's Renewed Motion for a Limited Stay, the Arkansas federal court stated that "[i]t is likely that the first decision on demand futility will be entitled to collateral estoppel effect."[8] That statement triggered alarm bells for the Delaware Plaintiffs, who still had no complaint on file. According to the record before this Court, the Delaware Plaintiffs responded to that warning by seeking expedition of the defendants' then-pending appeal of the books and records case in this Court—a request that was granted.[9] The Delaware Plaintiffs made no attempt to intervene in the litigation in Arkansas, but claim to have unsuccessfully attempted, in a series of phone calls, to convince the Arkansas Plaintiffs to join the Delaware action.[10] Delaware counsel submitted an affidavit asserting that these discussions broke down because their Arkansas counterparts demanded an unacceptable

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proceedings in Delaware, including the Delaware Plaintiffs' pursuit of Wal-Mart's books and records. *See*, *e.g.*, Tr. of Hearing on Mot. to Stay at B172-75 (Tr. 10:2-13:20), *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, No. 4:12-cv-4041 (W.D. Ark. Sep. 6, 2012).

[8] Order, *supra* note 7, at B135 (citing *Harben v. Dillard*, 2010 WL 3893980, at *6 (E.D. Ark. Sep. 30, 2010)). The Arkansas federal court's citation to *Harben* should have caused concern for the Delaware Plaintiffs. *See Harben*, 2010 WL 3893980, at *6 ("Collateral estoppel prevents the issue of pre-suit demand futility from being relitigated."). We note, as did the Chancellor, that the parties in *Harben* did not raise, and the court did not explicitly address the issue of privity.

[9] *See* Mot. for Expedited Oral Arg. & Decision at B159-62, *Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW*, No. 614-2013 (Del. June 6, 2014).

[10] Aff. of Stuart M. Grant at A592-93 ¶¶ 9-13, *In re Wal-Mart Stores, Inc. Del. Deriv. Litig.*, No. 7455-CB (Del. Ch. July 1, 2015).

portion of the fee pie.[11] The Arkansas Plaintiffs, according to the Delaware Plaintiffs, were unwilling to join forces with the Delaware Plaintiffs or wait to see what they might uncover as a result of their books and records inspection.[12] For whatever reason, the two groups—both of whom were seeking permission to act on behalf of the same corporate entity—could not manage to work together. Given the Chancellor's early assessment of the state of the complaints, it should come as no surprise that the federal judge dismissed the Arkansas complaint on March 31, 2015.[13]

(5) With the dismissal from the federal court in hand, the Defendants argued to the Court of Chancery that the Delaware Plaintiffs were now collaterally estopped from raising demand futility in Delaware. Unfortunately for the Delaware Plaintiffs, the Chancellor (now Chancellor Bouchard) agreed that the matter in Delaware was indeed barred.[14]

(6) The parties agree that the Chancellor was correct that, in determining the preclusive effect of the Arkansas federal court's dismissal, the Court of Chancery must look to federal common law, which, in turn, looks to the law of the rendering state (Arkansas) in which the federal court exercises diversity

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[11] *Id.* at A593 ¶ 13. The Court of Chancery noted that counsel for the Arkansas Plaintiffs submitted an affidavit vigorously denying these assertions. *In re Wal-Mart Stores, Inc. Del. Deriv. Litig.* (*Wal-Mart Del.*), 2016 WL 2908344, at *19 n.107 (Del. Ch. May 13, 2016).

[12] *See* Oral Argument, *supra* note 2, at 8:18 & 14:45.

[13] *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 2015 WL 1470184, at *1 (W.D. Ark. Mar. 31, 2015), *aff'd sub nom. Cottrell v. Duke*, 829 F.3d 983 (8th Cir. 2016).

[14] *Wal-Mart Del.*, 2016 WL 2908344, at *1

jurisdiction.[15] Under Arkansas law, "[f]or collateral estoppel to apply, the following four elements must be met: 1) the issue sought to be precluded must be the same as that involved in the prior litigation; 2) that issue must have been actually litigated; 3) the issue must have been determined by a valid and final judgment; and 4) the determination must have been essential to the judgment."[16] In addition, the parties to be precluded must have been parties in the prior litigation or been in privity with those parties.[17] Further, the party in the earlier decision must have adequately represented the nonparty.[18]

(7) Delaware Plaintiffs challenge the preclusive effect of the Arkansas dismissal in Delaware by contending that: their Due Process rights were violated as a result of the Delaware dismissal; the privity requirement was not satisfied; the Arkansas Plaintiffs were inadequate representatives; and, the Delaware Plaintiffs' claims under *Aronson v. Lewis*[19] were not "actually litigated."

(8) Although we reserve judgment until our final ruling after remand, we presently have no disagreement with the Court of Chancery's analysis of Arkansas law (which largely looks to the Restatement (Second) of Judgments)—particularly as it relates to the questions of whether the issue to be

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[15] *See* Opening Br. 17 n.32; Answering Br. 8.

[16] *Riverdale Dev. Co. v. Ruffin Bldg. Sys., Inc.*, 146 S.W.3d 852, 855 (Ark. 2004) (citation omitted).

[17] *Ark. Dep't of Human Servs. v. Dearman*, 842 S.W.2d 449, 452 (Ark. Ct. App. 1992).

[18] *See Hansberry v. Lee*, 311 U.S. 32, 42-43 (1940).

[19] 473 A.2d 805 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

precluded was actually litigated and the adequacy of representation.

(9) As for the alleged inadequacy of representation, this Court has some sympathy for the Delaware Plaintiffs' position. They heeded the Chancellor's advice,[20] and the plaintiffs who did not heed those warnings suffered dismissal of their complaint with the ultimate effect of barring the action of the Delaware Plaintiffs, who spent nearly three years fighting the books and records battle. Although Section 220 proceedings are supposed to be streamlined and summary,[21] it is not inconceivable that obtaining the sought-after documents would involve substantial time and effort in a case where the underlying allegations involve an alleged bribery scandal and cover-

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[20] *See* Tr. of Oral Argument, *supra* note 1, at A55 (Tr. 11:15-19) ("I don't know why the plaintiffs would ever wish to proceed—either one of the contending groups would wish to proceed to defend either of the extant complaints."); *id.* at A56 (Tr. 12:1-9) ("This is exactly the kind of nonexpedited case where actual stockholders, people who actually cared about the outcome, would wish to investigate by way of a books and records examination, take a sincere look at the books and records and file the strongest possible complaint that you could. Got no idea why anyone would rush off having read the *New York Times* and decide that that's a good way to state a *Caremark* claim."); *id.* at A80 (Tr. 36:18-22) ("It would seem to me, you know, you all ought to work together, get the books and records, put the strongest possible complaint on the table, have some additional conversations and perhaps the disagreements will go away."); *cf. Asbestos Workers Local 42 Pension Fund v. Bammann*, 2015 WL 2455469, at *18 n.147 (Del. Ch. May 21, 2015), *as revised* (May 22, 2015), *aff'd*, 132 A.3d 749 (Del. 2016) ("A specter of unfairness appears, however, in the derivative context, where a derivative plaintiff with a viable claim may be estopped from proceeding based on the inadequate efforts of a fellow stockholder in privity, a feckless fast filer.")

[21] *See* 8 *Del. C.* § 220(c).

up. We have formed no conclusion as to whether the Delaware Plaintiffs were the cause of any undue or unexplained delay, or whether the Defendants deliberately "slow-rolled" the litigation ball in Delaware in order to allow the Arkansas litigation to proceed.[22]

(10) Although the Delaware Plaintiffs have accused Arkansas counsel of having a conflict as a result of the alleged demand for fees as a condition to joining the litigation in Delaware, we think that there is some room for criticism of both plaintiffs' camps. Especially once it became apparent that the stay of the Arkansas litigation would be lifted and the judge warned that her decision would likely have preclusive effect, the Delaware Plaintiffs should have coordinated, intervened, or participated in some fashion in the Arkansas proceedings. They claim that such involvement was impossible because they still did not have the documents they sought (which they say they needed in order to file a complaint in intervention) and did not want to be bound by the Arkansas dismissal if they joined that case by filing a complaint that did not yet reflect the fruits of their extensive Section 220 efforts. From our vantage point, one thing seems obvious—namely, that the absence of any meaningful coordination between the Delaware and Arkansas Plaintiffs aided neither's cause. Once the litigation train began going down the Arkansas tracks, it would seem to have been incumbent upon

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[22] Nor do we intend to retreat in any way from this Court's repeated suggestions that plaintiffs should use the "tools at hand" in derivative proceedings. *See King v. VeriFone Holdings, Inc.*, 12 A.3d 1140, 1145 (Del. 2011) ("Delaware courts have strongly encouraged stockholder-plaintiffs to utilize Section 220 before filing a derivative action, in order to satisfy the heightened demand futility pleading requirements of Court of Chancery Rule 23.1." (citations omitted)).

the Delaware Plaintiffs to take steps there to attempt to prevent foreclosure of their action in Delaware. Instead, they took no action in the Arkansas court —leaving them to address the litigation fallout in Delaware.

(11) Defendants maintain that there were many ways the Delaware Plaintiffs could have participated in the Arkansas proceedings. They claim that the Delaware Plaintiffs' choice not to participate in the Arkansas proceedings weighs against any finding that the Chancellor violated the Delaware Plaintiffs' Due Process Rights.

(12) The Delaware Plaintiffs were warned that the Arkansas court might rule first. If the Delaware Plaintiffs feared that the Arkansas Plaintiffs were not adequately protecting their interests, we think that there is much force in the suggestion that the Delaware Plaintiffs should have sought to intervene in the Arkansas court to protect their interests—notwithstanding the fact that they had not yet obtained the documents they were seeking—a fact that was already known to the Arkansas court. Such an attempt to intervene, even if unsuccessful, would ensure that the rendering court would take into account the litigation pending elsewhere and make a determination as to whether any dismissal should be with or without prejudice, and as to the named plaintiff only, and what provision, if any, should be made to protect the interests of the other shareholders litigating in other fora.[23]

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[23] We note that New York law, although of no application here, provides an exception to claim preclusion in derivative actions where a stockholder seeks to intervene in the prior action to protect its interests but is denied leave to participate. *See Parkoff v. Gen. Tel. & Elecs. Corp.*, 425 N.E.2d 820, 824

(13) Having invested time and effort in an intense Section 220 proceeding, it is understandable that the Delaware Plaintiffs were reluctant to join in the Arkansas litigation or felt unprepared to file a complaint in intervention without the sought-after books and records. But having a foot in the litigation door in Arkansas was likely preferable to having it slammed shut. We express no final view of the preclusion issue at this juncture, given the remainder of this ruling, but wanted to set forth our concerns about the Delaware Plaintiffs' failure to intervene or to attempt to limit the effect and breadth of any potential ruling by the Arkansas court once it became evident that the Arkansas court likely would rule first.

(14) The parties appear to agree that the Restatement's standards of gross deficiency[24] and divergence

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(N.Y. 1981). We also note that *Parkoff* addressed *res judicata*, as opposed to collateral estoppel. *Id.* at 821. In *Parkoff*, the New York Court of Appeals noted that the general rule of claim preclusion "is qualified by the condition that the judgment being raised as a bar not be the product of collusion or other fraud on the nonparty shareholders and by the further condition that the shareholder sought to be bound by the outcome in the prior action not have been frustrated in an attempt to join or to intervene in the action that went to judgment." *Id.* at 824 (citations omitted). As our sister court explained, this qualification is intended to protect against the risk that the first-filing stockholders fail to proceed with adequate diligence. *Id.* As the United States Court of Appeals for the Second Circuit had earlier stated, "[t]he judgment in the state court is conclusive not only upon the stockholders who brought the suit but upon the corporation also and upon those who had the right to intervene but did not avail themselves of it." *Dana v. Morgan*, 232 F. 85, 89 (2d Cir. 1916).

[24] Restatement (Second) of Judgments § 42 cmt. f ("Where the representative's management of the litigation is so grossly deficient as to be apparent to the opposing party, it . . . creates

of interests[25] apply in determining whether the Arkansas Plaintiffs and their counsel were inadequate representatives.[26] Notwithstanding the former Chancellor's warning about the likely deficiency of the then-pending Delaware complaints, we cannot say that the Arkansas Plaintiffs, who made a tactical decision to base their complaint on the documents referenced in the *New York Times* article,[27] coupled with their desire for a jury trial (which is unavailable in the Court of Chancery), and perhaps other strategic considerations, were "grossly deficient" in their representation. As to the contention that the Arkansas Plaintiffs' interests were not sufficiently aligned with those of the Delaware Plaintiffs, although we are troubled by the assertion that a dispute over fee allocation would preclude the kind of coordination that was needed here, we note that this assertion was contested below, and we are not presently inclined to disturb the Chancellor's ruling that the Arkansas Plaintiffs were not inadequate representatives of Wal-Mart.

(15) As to the privity analysis, because no court in Arkansas had squarely decided the issue, the Chancellor looked in part to the Restatement (Second) of

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no justifiable reliance interest in the adjudication on the part of the opposing party.").

[25] *Id.* ("[A] judgment is not binding on the represented person . . . where, to the knowledge of the opposing party, the representative seeks to further his own interest at the expense of the represented person.").

[26] *See* Opening Br. 26; Answering Br. 22.

[27] *See* Barstow, *supra* note 4.

Judgments.[28] The Chancellor noted that the Arkansas Supreme Court has stated that, in derivative cases, the corporation is the real party in interest.[29] The Chancellor was persuaded that an Arkansas court would likely rule as several federal courts have—that the privity element is satisfied here. As a matter of Arkansas state law on the privity issue, we are presently satisfied with the state of the record and do not perceive any error.

(16) But there is force to the Delaware Plaintiffs' argument that the privity and Due Process analyses were conflated by the Court of Chancery. Both sides agree that, although they overlap, the privity and Due Process issues are distinct.[30] The Delaware Plaintiffs contend that the Chancellor did not address the Due Process issue or the Due Process aspect of the privity requirement.[31] At the outset of his opinion,

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[28] *Wal-Mart Del.*, 2016 WL 2908344, at *13-17 (considering also decisions from courts in other jurisdictions and public policy).

[29] *Id.* at *14 (citing *Brandon v. Brandon Constr. Co.*, 776 S.W.2d 349, 352 (Ark. 1989)).

[30] *See* Oral Argument, *supra* note 2, at 2:25 (counsel for Delaware Plaintiffs describing "two privity issues," one of which is analyzed under "federal due process law"); *id.* at 22:50 (counsel for Defendants describing the privity and due process issues as "closely related"). The term "privity" itself can be confusing, as the United States Supreme Court observed in its discussion of nonparty claim preclusion in *Taylor v. Sturgell*, 553 U.S. 880 (2008). There, the Court noted that the term "privity" is often used to refer to "[t]he substantive legal relationships justifying preclusion[,]" but that the term "has also come to be used more broadly, as a way to express the conclusion that nonparty preclusion is appropriate on any ground." *Taylor*, 553 U.S. at 894 n.8. Consequently, "[t]o ward off confusion," the Court avoided using the term "privity" in its opinion. *Id.*

[31] *See*, *e.g.*, Opening Br. 15-16, 21-22.

the Chancellor acknowledged that the privity issue is a matter of Arkansas state law, so long as federal constitutional Due Process is not offended.[32] However, after acknowledging the Delaware Plaintiffs' argument that both Arkansas and federal "standards must be met," the Chancellor disposed of the federal Due Process analysis, stating that "the federal common law rule in diversity cases is to apply the preclusion law of the state in which the court sits, as explained above."[33] Appellants assert that the Chancellor focused almost exclusively on privity as a question of Arkansas state law and never addressed the federal Due Process analysis required by the United States Constitution as it relates to nonparty preclusion.

(17) The United States Supreme Court has made clear that the preclusive effect of a federal court judgment is determined by federal common law, *subject to due process limitations*.[34] It has held that the general rule is that "one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process."[35] This rule against nonparty preclusion is subject to exceptions, six of which

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[32] *Wal-Mart Del.*, 2016 WL 2908344, at *1 ("Subject to Constitutional standards of due process, Arkansas law governs the question of issue preclusion in this case.").

[33] *Id.* at *8 n.34 (citing *Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 508-09 (2001)). The Court of Chancery did consider Due Process in its discussion of adequacy of representation.

[34] *Taylor*, 553 U.S. at 891.

[35] *Id.* at 893 (quoting *Hansberry*, 311 U.S. at 40) (internal quotation marks omitted).

were identified by the United States Supreme Court in *Taylor v. Sturgell*.[36]

(18) For our purposes, the most analogous of these exceptions involves putative class actions. In *Smith v. Bayer Corp.*,[37] the United States Supreme Court held that "[n]either a proposed class action nor a rejected class action may bind nonparties."[38] That Court distinguished between an unnamed member of a *certified* class and a situation where certification has been denied:

> Bayer's first claim ill-comports with any proper understanding of what a "party" is. In general, "[a] 'party' to litigation is '[o]ne by or against whom a lawsuit is brought,' or one who 'become[s] a party by intervention, substitution, or third-party practice.' And we have further held that an unnamed member of a *certified* class may be 'considered a party for the [particular] purpos[e] of appealing' an adverse judgment. But as the dissent in *Devlin* noted, no one in that case was 'willing to advance the novel and surely erroneous argument that a nonnamed class member is a party to the class-action litigation *before the class is certified*. Still less does that argument make sense *once certification is denied*. The definition of the term 'party' can on no account be stretched so far as to cover a person . . . whom the plaintiff in a lawsuit was denied leave to represent.[39]

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[36] *Id.* at 893-95.

[37] 564 U.S. 299 (2011).

[38] *Id.* at 315.

[39] *Id.* at 313 (alterations and emphasis in original) (citations omitted).

(19) The Supreme Court noted in *Bayer* that the petitioners had assumed that federal common law should incorporate West Virginia's preclusion law. It also noted that neither party had identified "any way in which federal and state principles of preclusion law differ in any relevant respect."[40] It, therefore, did not decide "whether, in general, federal common law ought to incorporate state law in situations such as this."[41] We note that the Chancellor did not explicitly address the *Bayer* case. It could be that, in this case, the Chancellor assumed that the federal common law essentially incorporated Arkansas state law and that the Due Process analysis did not differ. We believe, however, that the importance of the Due Process issue merits closer examination.

(20) The Defendants suggest on appeal that the Due Process issue was addressed by this Court in *Pyott II*.[42] We disagree. In *Pyott II*, this Court did not address Due Process because no party disputed that the California federal court in *LeBoyer v. Greenspan*[43] had held that a Rule 23.1 dismissal is afforded preclusive effect in a subsequent or parallel suit brought by different stockholders making the same

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[40] *Id.* at 307 n.6 (noting that "federal common law governs the preclusive effect of a decision of a federal court sitting in diversity" (citing *Semtek*, 531 U.S. at 508)).

[41] *Id.* The United States Supreme Court further noted that it rested its decision "on the Anti-Injunction Act and the principles of issue preclusion that inform it," and, thus, did not consider "Smith's argument, based on *Phillips Petroleum Co., v. Shutts*, 472 U.S. 797 (1985), that the District Court's action violated the Due Process Clause." *Id.* at 308 n.7.

[42] *Pyott v. La. Mun. Police Empls.' Ret. Sys.* (*Pyott II*), 74 A.3d 612 (Del. 2013).

[43] 2007 WL 4287646 (C.D. Cal. June 13, 2007).

claims. The trial court in *Pyott I*[44] acknowledged that a California court would conclude that the California decision precluded the appellees in that case from pursuing the Delaware litigation. But the trial court (erroneously) determined that the privity question was a matter of Delaware law because one's status as a derivative plaintiff arose from a legal relationship with the corporation that fell within the internal affairs doctrine. The Court of Chancery then focused on the dual nature of the derivative action and held that there was no privity because, until a stockholder survives an action to dismiss based on a failure to make a demand, the stockholder is not acting for the corporation.

(21) In reversing, this Court expressly said that "[w]e will not address this analysis because, as discussed, the Court of Chancery should not have applied Delaware law in deciding whether the California Federal Court Judgment must be given preclusive effect."[45] We noted that numerous other jurisdictions have held that privity exists between derivative stockholders and that the Court of Chancery was divided on the question as a matter of Delaware law, but we did not address the merits of that issue. Given the California federal court's decision in *LeBoyer*, there seemed to be no disagreement as to how a California court would assess the preclusive effect of a Rule 23.1 dismissal. Accordingly, this Court in *Pyott II* did not find it necessary to address the Due Process issue, as clear precedent decided by a California federal court "compelled" dismissal of

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[44] *La. Mun. Police Empls.' Ret. Sys. v. Pyott* (*Pyott I*), 46 A.3d 313 (Del. Ch. 2012), *rev'd*, *Pyott II*, 74 A.3d 612 (Del. 2013).

[45] *Pyott II*, 74 A.3d at 617-18.

the Delaware action.[46] In addition, the plaintiffs-appellees in *Pyott II* had advised this Court that the Due Process question had not been fully briefed before the Court of Chancery and was not being argued on appeal.[47]

(22) Before this Court, the Delaware Plaintiffs make a more refined argument as to Due Process, relying heavily on Vice Chancellor Laster's opinion in *EZCORP*,[48] which the Chancellor did not address in his opinion. The Delaware Plaintiffs submitted the Court of Chancery's opinion in *EZCORP* to the Chancellor for his consideration *after* the briefing on the motion to dismiss had been completed. Similarly to *Pyott I* (also authored by Vice Chancellor Laster), the *EZCORP* decision refers to the two-fold nature of derivative litigation, noting that the key distinction between the first and second phases of a derivative action is that "the first phase of the derivative action [is one] in which the stockholder sues individually to obtain authority to assert the corporation's claim."[49] As in *Pyott I*, the Vice Chancellor in *EZCORP* held

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[46] *Id.* at 616-17 (citing *LeBoyer*, 2007 WL 4287646, at *1).

[47] *See* Oral Argument at 30:09, *Pyott v. La. Municipal Police Emps.' Ret. Sys.*, No. 380-2012 (Del. Feb. 5, 2013), http://courts.delaware.gov/supreme/oralarguments/ (search "Pyott") (The Court: "[W]as that tug of war between Due Process and Full Faith and Credit addressed either by the Court of Chancery or in your brief?" Counsel: "I don't believe it directly was, because I think the opinion below was based on internal affairs doctrine . . ." The Court: "Right, as a choice of law . . . Not as a constitutional doctrine." Counsel: "Correct." The Court: "And you're not arguing that it's a constitutional doctrine, at least on this . . ." Counsel: "I cannot make that argument.").

[48] *In re EZCORP Inc. Consulting Agreement Deriv. Litig.*, 130 A.3d 934 (Del. Ch. 2016).

[49] *Id.* at 945.

that "until the derivative action passes the Rule 23.1 stage, the named plaintiff does not have authority to sue on behalf of the corporation or anyone else."[50] In *EZCORP*, the Court of Chancery expressly held that it is a matter of Due Process that privity does not attach unless and until a derivative plaintiff survives a motion to dismiss.[51]

(23) Thus, in *EZCORP*, Vice Chancellor Laster held that binding other litigants to an adjudication in a case where they were not parties "deprive[s] them of the due process of law guaranteed by the Fourteenth Amendment."[52] The Vice Chancellor relied upon the United States Supreme Court decision in *Bayer*,[53] stating that, "just as the Due Process Clause prevents a judgment binding absent class members before a class has been certified, the Due Process Clause likewise prevents a judgment from binding the corporation or other stockholders in a derivative

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[50] *Id.*; *see also id.* at 943 ("As a matter of Delaware law, a stockholder whose litigation efforts are opposed by the corporation does not have authority to sue on behalf of the corporation until there has been a finding of demand excusal or wrongful refusal[.]" (quotation omitted) (citing *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993)); *id.* at 944 ("The right to bring a derivative action does not come into existence until the plaintiff shareholder has made a demand on the corporation to institute such an action or until the shareholder has demonstrated that demand would be futile." (footnote omitted) (quoting *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d 726, 730 (Del. 1988))).

[51] *Id.* at 948.

[52] *Id.* at 947 (alteration in original) (quoting *Richards v. Jefferson Cnty., Ala.*, 517 U.S. 793, 797-98 (1996) (noting the general rule that "one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process")).

[53] 564 U.S. 299 (2011).

action until the action has survived a Rule 23.1 motion to dismiss, or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit."[54]

(24) Again, we note that Delaware law does not apply here, as the parties agree. But even so, we are focused on the Due Process issue squarely raised in *EZCORP*, namely, whether a shareholder plaintiff, whose derivative complaint fails to survive a motion to dismiss, may, as a matter of Due Process, bar the action of another derivative plaintiff in Delaware.

(25) In sum, this appeal raises a complex question about the nature of derivative plaintiffs' Due Process rights and the extent to which those rights are in tension with the obligation of Delaware courts to honor the judgments of other jurisdictions. We believe there may be benefit to having the parties more squarely present the Due Process issue to the Chancellor in order to allow the Chancellor to express his views, including as to the analysis set forth in the *EZCORP* decision and whether a preclusion of subsequent derivative stockholder actions raises the same Due Process concerns as the class action litigation discussed by the United States Supreme Court in *Bayer*. Accordingly, we hereby remand the matter to the Chancellor so that the Court of Chancery may benefit from further limited, focused briefing on the Due Process issue if it so desires to request such briefing. Specifically, we ask the parties and then the Court of Chancery to focus on the following limited question:

> In a situation where dismissal by the federal court in Arkansas of a stockholder plaintiff's

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[54] *EZCORP*, 130 A.3d at 948 (citation omitted).

> derivative action for failure to plead demand futility is held by the Delaware Court of Chancery to preclude subsequent stockholders from pursuing derivative litigation, have the subsequent stockholders' Due Process rights been violated? *See Smith v. Bayer Corp.*, 564 U.S. 299 (2011).

Following further submissions of counsel, we would then request the Court of Chancery to supplement its written opinion with a short opinion on the Due Process issue.

(26) This matter is remanded to the Court of Chancery for further limited briefing and supplementation of its decision dated May 13, 2016. Jurisdiction is retained to consider that decision. This Court will rule on the remaining issues (as to which no further proceedings are requested by this Court) upon entry of the Court of Chancery's supplemental opinion. We impose no specific time period for the Court of Chancery to act, recognizing that this matter involves important issues, is not expedited, and trusting the Court of Chancery to address the matter with its usual concern for promptness.

NOW, THEREFORE IT IS ORDERED that the case be and hereby is REMANDED, with jurisdiction retained, to the Court of Chancery for the limited purpose of ruling upon the above-stated question. The Court of Chancery may, in addition, make further findings of fact and rulings of law as it deems appropriate and relevant to enable this Court to perform its appellate review function.

IN THE COURT OF CHANCERY OF DELAWARE

Consolidated C.A. No. 7455-CB

IN RE WAL-MART STORES, INC.
DELAWARE DERIVATIVE LITIGATION

[Submitted: February 3, 2016 |
Decided: May 13, 2016]

MEMORANDUM OPINION

BOUCHARD, C.

In April 2012, the *New York Times* published an exposé describing the cover-up of an alleged bribery scheme at Wal-Mart de Mexico ("WalMex"), a subsidiary of Wal-Mart Stores, Inc. ("Wal–Mart"). On the heels of this article, Wal-Mart stockholders filed fifteen lawsuits in Arkansas and Delaware asserting derivative claims on behalf of Wal-Mart.

One of the stockholders in Delaware demanded access to Wal-Mart's books and records under Section 220 of the Delaware General Corporation Law in an effort to bolster its case. The Delaware actions were consolidated, and the Delaware plaintiffs vigorously pursued the books-and-records litigation, which took three years to resolve, including an appeal to the Delaware Supreme Court. In May 2015, the Delaware plaintiffs filed an amended derivative complaint with information obtained from Wal-Mart's records.

The Arkansas plaintiffs neither sought Wal-Mart's records nor waited for the outcome of the Section 220 case in Delaware. They instead proceeded with their case, which defendants moved to dismiss. In March

2015, before plaintiffs in Delaware had completed the Section 220 litigation and filed their amended complaint, the district court in Arkansas granted defendants' motion to dismiss. It concluded that the Arkansas complaint failed to adequately allege demand futility. Defendants now move to dismiss this action, arguing that issue preclusion prevents the plaintiffs here from re-litigating demand futility.

Subject to Constitutional standards of due process, Arkansas law governs the question of issue preclusion in this case. The basic test for issue preclusion under Arkansas law is easily satisfied here. But Arkansas courts have not addressed issue preclusion in the context of stockholder derivative suits. That context requires one to determine whether two different stockholder plaintiffs asserting derivative claims on behalf of the same corporation in separate cases are in privity. Thus, this case presents the challenge of having a Delaware trial court predict how a court in Arkansas likely would resolve an open question of Arkansas law. I conclude, consistent with the clear weight of authority from other jurisdictions, that an Arkansas court likely would find privity in this situation.

Another challenge of this case is determining whether an Arkansas court would deem a stockholder plaintiff who fails to pursue books and records before launching a derivative lawsuit to be an adequate representative of the corporation. On that question, I conclude, consistent with Delaware Supreme Court authority, that an Arkansas court would not presume inadequacy from failing to pursue books and records but would conduct a case-specific inquiry of the issue with principles of due process in mind and, based on the particular circumstances of this case, would find the Arkansas plaintiffs to be adequate representatives.

For these and other reasons explained below, the plaintiffs in this case are barred from re-litigating demand futility and their complaint must be dismissed.

I. BACKGROUND

Unless noted otherwise, the facts recited in this opinion are based on the allegations of the Verified Consolidated Amended Stockholder Derivative Complaint filed on May 1, 2015 (the "Delaware Complaint"). Although most of these facts are not directly relevant to the analysis of issue preclusion, they are included to provide the context.

A. The Parties

Nominal defendant Wal-Mart Stores, Inc. is a Delaware corporation with headquarters in Arkansas that operates retail stores in the United States and internationally. The company is publicly traded on the New York Stock Exchange. The Walton family, which founded Wal-Mart, controls 49.95% of its voting shares through Walton Enterprises LLC. Co-lead plaintiffs are various pension funds that have been Wal-Mart stockholders at all times relevant to this action.

Defendants Aida M. Alvarez, James W. Breyer, M. Michele Burns, James I. Cash, Roger C. Corbett, Douglas N. Daft, Michael T. Duke, Gregory B. Penner, Steven S. Reinemund, H. Lee Scott, Jr., Arne M. Sorenson, Jim C. Walton, S. Robson Walton, Christopher J. Williams, and Linda S. Wolf were the fifteen members of Wal-Mart's board of directors when the original complaints in Arkansas and Delaware were filed in 2012 (the "Demand Board").[1] They

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[1] Plaintiffs assert that the relevant board for assessing demand futility should be the board when the original Delaware complaints were filed. Compl. ¶ 209. Defendants do not argue otherwise.

joined Wal-Mart's board at various times between 1978 and 2010. Plaintiffs allege that twelve of them were on the board during some part of the alleged bribery or cover-up conduct. In addition to being a director, Duke served as Wal-Mart's Chief Executive Officer from 2009 to 2014.

Defendants David D. Glass, Roland A. Hernandez, John D. Opie, J. Paul Reason, and Jose H. Villarreal were directors during the time of some of the alleged misconduct but were not on the Demand Board because they had ceased serving as directors by the time the original complaints in the Arkansas and Delaware actions were filed. Defendants José Luis Rodriguezmacedo Rivera, Eduardo Castro-Wright, Thomas A. Hyde, Thomas A. Mars, John B. Menzer, Eduardo F. Solórzano Morales, and Lee Stucky are former executives of Wal-Mart or WalMex.

B. The Alleged WalMex Bribery Scheme and Investigation

In the late 1990s and early 2000s, Wal-Mart sought to expand internationally to continue growing despite saturation in the United States. Its subsidiary in Mexico, WalMex, was an important part of that growth. By 2004, WalMex operated 49.6% of Wal-Mart's international discount stores, 32.3% of its international Supercenters, and 66% of its international Sam's Clubs. WalMex is Wal-Mart's largest foreign subsidiary.

According to the Delaware Complaint, WalMex achieved its rapid expansion by bribing government officials in Mexico. This bribery escalated dramatically in 2003 when Castro-Wright became Chief Executive Officer of WalMex. Castro-Wright authorized bribes to quickly secure construction permits, zoning approvals, and licenses with the goal of rapidly

expanding WalMex's operations before competitors had time to react.

A highly publicized example of this scheme was the use of more than $200,000 in bribes to secure multiple permits that allowed WalMex to build a store in Teotihuacán adjacent to an ancient temple and Mayan pyramids. During construction, it was discovered that not only was the store adjacent to these historic sites, but it was being built atop other ancient ruins as well. This revelation sparked protests, accusations of bribery and corruption, and international media attention, including a *New York Times* article published on September 28, 2004.

Between 1998 and 2005, Wal-Mart did not undertake a full audit of WalMex, which enabled its officials to use bribery without interference or inquiry from management in the United States. In late 2003 and early 2004, Wal-Mart created a Corporate Responsibility Department and a Compliance Oversight Committee to oversee international compliance issues and to detect and prevent violations of law. The Compliance Oversight Committee, which consisted of officers from various departments, was charged with reporting compliance issues to the audit committee of Wal-Mart's board.

In early 2004, drafts of new anti-corruption policies were circulating within Wal-Mart, eventually reaching WalMex and its management, including Castro-Wright. Shortly thereafter, WalMex began an internal investigation of Sergio Cicero Zapata, an in-house attorney in WalMex's Real Estate Department. WalMex investigated payments made to two law firms Cicero used as a means to make payments to outside agents known as "gestores" for "gestoria" services. Plaintiffs allege that these payments constituted bribes

to government officials to help WalMex circumvent laws and regulations.[2]

WalMex also retained an outside investigation firm (Kroll, Inc.) to determine whether Cicero had personally benefited from his relationship with the gestores and whether he had potentially defrauded WalMex. Kroll concluded that he had not, but it discovered that Cicero's wife worked for one of the law firms providing gestoria services. After these investigations, WalMex terminated Cicero's employment, informing him that his position had been eliminated due to a restructuring. WalMex did not tell him that he had been the subject of an outside investigation or that management had found out about his wife's employment.

By mid-2004, Wal-Mart's board and audit committee had formally adopted anti-corruption policies prohibiting employees from offering anything of value to government officials on behalf of Wal-Mart. In August 2004, Rodriguezmacedo (WalMex's general counsel) and Castro-Wright contacted Maritza Munich, General Counsel for the Wal-Mart International business segment, about Cicero's possible wrongdoing. They informed Munich that Cicero may have used questionable methods for obtaining licenses and permits and provided her with the results of the Kroll investigation and of an internal 2004 audit, which showed that millions of dollars in illegal payments had been made to the two law firms, which were not on WalMex's list of authorized firms.

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[2] Compl. ¶¶ 54, 71. Wal-Mart contends that such payments can be valid and not violate the Foreign Corrupt Practices Act of 1977. Tr. Oral Arg. 121-22; Defs.' Supp. Br. 12; Defs.' Further Supp. Response 3-4 (arguing that "facilitating payments" is a term of art referring to a valid and legal payment practice).

Because Munich was a member of the Compliance Oversight Committee, plaintiffs infer that Munich must have reported this information to the board's audit committee and that the audit committee would have discussed it with the full Wal-Mart board.

In late 2004, WalMex's internal audit department drafted a report showing that WalMex had expenses in the form of contributions to government entities and payments to outside agents to expedite government paperwork. Certain Wal-Mart managers, including Munich, received this report. Plaintiffs infer that management would have raised this issue with the Compliance Oversight Committee and that the board's audit committee and the full board would have discussed these issues at a meeting in March 2005.

In September 2005, Munich heard from Cicero, who had not been employed at WalMex since sometime around March 2004. Cicero informed Munich that he had information regarding payments WalMex made to complete 300 projects, including the store in Teotihuacán. Munich shared this communication with Mars, Wal-Mart's general counsel. Plaintiffs infer that Mars and other members of management discussed Cicero's allegations of bribery at an audit committee meeting, and that the audit committee reported the allegations to the full board.

In October 2005, Munich hired an attorney in Mexico City to interview Cicero. During multiple interviews, Cicero explained WalMex's practice of bribing officials to remove regulatory obstacles and WalMex's use of gestores to carry out the plan. Cicero provided examples of bribes and noted that he had several binders of documents relating to WalMex's bribery of public officials. Munich provided Mars and

Hyde, Wal-Mart's corporate secretary, with copies of the interview summaries. Mars forwarded this information to Duke and Stucky, among others. In mid-October, Munich and Mars retained Willkie Farr & Gallagher LLP to represent Wal-Mart in connection with the matter.

On November 2, 2005, Willkie Farr recommended that Wal-Mart undertake a thorough external investigation of Cicero's bribery allegations. Wal-Mart opted instead for a less extensive in-house investigation led by the Corporate Investigations Department. Plaintiffs allege that this decision reflects the beginning of a corporate cover-up of the WalMex bribery scheme, noting that Wal-Mart's in-house teams were ill-equipped for the task and were vulnerable to interference from management. Wal-Mart carried out its investigation during November 2005, and the investigators expressed concern over their preliminary findings. On November 18, Munich, Mars, Stucky, and others discussed the results of the investigators' preliminary inquiry, including a number of "facilitating" payments to clear regulatory hurdles and expedite construction of stores. Plaintiffs infer that this information was shared with the audit committee and the Wal-Mart board.

On December 2, 2005, after reviewing the preliminary results with others, Stucky and Mars decided that WalMex would handle the next phase of the investigation, a decision that plaintiffs infer was made with the consent of Hernandez and the other members of the audit committee. Soon after, the Corporate Investigations Department and Internal Audit Services issued separate reports summarizing the evidence surrounding Cicero's bribery allegations. The Corporate Investigations report stated that "there

is reasonable suspicion to believe that Mexican and USA laws may have been violated" and recommended further investigation relating to payments for gestoria services to the two unauthorized law firms.

In mid-December 2005, Mars and Stucky carried out their decision to have WalMex handle the investigation by tasking Rodriguezmacedo and other WalMex officials with a follow-up investigation to complete the inquiry. Shortly thereafter, Rodriguezmacedo and WalMex management responded that they had found information supporting the hypothesis that Cicero was attempting to benefit personally from the transactions at issue. Plaintiffs allege that transferring the investigation to WalMex reflects a decision to cover up the bribery scheme. Shortly before quitting her job at Wal-Mart, Munich expressed concerns over the decision to assign the investigation to WalMex, since WalMex and its employees were the subject of the investigation.

On December 20, 2005, Internal Audit Services issued its final report, which concluded that WalMex had provided payments through gestores to government agencies to expedite licenses and permits, and that WalMex senior management was aware of this practice and had used secret accounting codes to obscure it. The report recommended further investigation.

Beginning in February 2006, Rodriguezmacedo took full charge of the WalMex follow-up investigation. In March 2006, he issued a report concluding that no evidence substantiated the existence of unlawful payments to government authorities. To the contrary, according to the report, Cicero had defrauded WalMex by making payments to gestores for services never rendered. Rodriguezmacedo's

conclusions were largely based on WalMex management's denial that any bribery had taken place. Wal-Mart and WalMex management agreed that a successful legal or financial pursuit of Cicero was unlikely.

In May 2006, with Rodriguezmacedo's final report in hand, Wal-Mart management considered the investigation closed. Plaintiffs infer that the audit committee and the board also reviewed the final report in May and allege that the board should have known the report was unreliable because of Rodriguezmacedo's potential involvement in the alleged bribery scheme and the conclusions the report reached, which were at odds with previous investigations.

The *New York Times* undertook its own investigation of Wal-Mart's response to Cicero's allegations of bribery. In late 2011, Wal-Mart found out about the *New York Times* investigation and alerted the United States Department of Justice and the United States Securities and Exchange Commission that Wal-Mart had begun to investigate possible violations of the Foreign Corrupt Practices Act of 1977 ("FCPA"). In response to reporting by the *New York Times*, Wal-Mart denied that any executives knew about alleged corruption in the company. In May 2012, Wal-Mart reported that its internal investigation would extend beyond WalMex and include potential FCPA violations in other jurisdictions, including Brazil, China, and India.

Plaintiffs allege that Wal-Mart incurred over $500 million in expenses in connection with its FCPA investigations and compliance reviews, and may face significant additional costs if it is fined for FCPA violations.

C. The Arkansas Litigation

On April 21, 2012, the *New York Times* published an article detailing the alleged WalMex bribery scheme and cover-up.[3] Shortly after the article went to press, Wal-Mart stockholders filed numerous derivative suits in Delaware and Arkansas.

The United States District Court for the Western District of Arkansas consolidated the federal actions in Arkansas, and the Arkansas plaintiffs filed a consolidated complaint on May 31, 2012 (the "Arkansas Complaint").[4] The Arkansas Complaint asserted claims against Wal-Mart's directors and executives for breach of fiduciary duty primarily based on intentional wrongdoing as well as a secondary *Caremark* theory for allowing Wal-Mart to violate laws, for violations of Sections 14(a) and 29(b) of the Securities Exchange Act of 1934, and for contribution and indemnity.[5] The Arkansas plaintiffs challenge the same misconduct regarding the bribery scheme at WalMex and the efforts to cover it up that the Delaware plaintiffs challenge in this case.[6]

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[3] *See* David Barstow, *Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle*, N.Y. Times (Apr. 21, 2012), http://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html.

[4] Consolidated Verified Shareholder Derivative Complaint, *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, C.A. No. 4:12-CV-4041-SOH (W.D.Ark. May 31, 2012).

[5] Arkansas Complaint ¶¶ 282-300; *see also In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 4:12-CV-4041, at 16 (W.D. Ark. Apr. 3, 2015) (ORDER) (noting plaintiffs' argument that they pled *Caremark* theory in the alternative to theory of intentional wrongdoing).

[6] Arkansas Complaint ¶¶ 77-192.

On July 6, 2012, defendants in the Arkansas action moved to stay the litigation pending resolution of the proceedings in this Court. On November 20, 2012, the district court granted the stay.[7] On December 18, 2013, however, the Eighth Circuit vacated the stay order in light of the Section 14(a) claim that was present in the Arkansas action but not in the Delaware litigation, and remanded the case to the district court, stating that the district court "may impose a more finite and less comprehensive stay."[8]

On January 10, 2014, defendants in the Arkansas action moved for a more limited stay pending this Court's decision on demand futility but not its resolution of the entire action. In June 2014, the district court denied the motion. In doing so, the district court noted that "it is likely that the first decision on demand futility will be entitled to collateral estoppel effect" and that if the district court "decides the issue first, then the issue will not have to be relitigated in Delaware state court."[9]

Defendants moved to dismiss the Arkansas Complaint under Federal Rule of Civil Procedure 23.1 for failing to adequately allege demand futility. On March 31, 2015, the district court granted their motion.[10] The district court applied Delaware law to

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[7] *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 2012 WL 5935340, at *1 (W.D.Ark. Nov. 27, 2012) (ORDER) (revising initial order of Nov. 20, 2012), *vacated and remanded sub nom. Cottrell v. Duke*, 737 F.3d 1238 (8th Cir.2013).

[8] *Cottrell v. Duke*, 737 F.3d at 1247-49.

[9] *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, C.A. No. 4:12-CV-4041, at 3-4 (W.D.Ark. June 4, 2014) (ORDER).

[10] *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 2015 WL 1470184, at *1 (W.D.Ark. Mar. 31, 2015) (ORDER). The order was amended to correct typographical errors on April 3, 2015.

the substantive aspects of the demand requirement and assessed whether to apply the *Aronson*[11] test or the *Rales*[12] test to determine demand futility. The court noted that there is only a blurry distinction between *Aronson* and *Rales*, but determined that *Rales* must apply because the complaint lacked "any particularized facts that link a majority of the Director Defendants to any actual decision,"[13] as would be required for *Aronson* to apply.

Applying *Rales*, the district court determined that the Arkansas Complaint failed to suggest any particularized basis to infer that a majority of Wal-Mart's fifteen-member board (as defined above, the Demand Board) had actual or constructive knowledge of the bribery scheme or the cover-up. The district court opined that "[p]laintiffs' allegations do not provide the particulars for what each Director Defendant knew, how he or she learned of the information, or when he or she learned of the information."[14] Instead, the Arkansas plaintiffs relied on "group-wide conclusory allegations about what the Board must have known based on an imputation of knowledge theory."[15] The court found these allegations insufficient to establish demand futility, noting that courts may not impute knowledge of wrongdoing based on

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See Leavengood Aff. Ex. 6, *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 4:12-CV-4041 (W.D.Ark. Apr. 3, 2015) (the "Arkansas Order"). The remainder of this opinion cites the amended version.

[11] *Aronson v. Lewis*, 473 A.2d 805 (Del.1984).

[12] *Rales v. Blasband*, 634 A.2d 927 (Del.1993).

[13] Arkansas Order at 11 & n.6.

[14] *Id.* at 13-14.

[15] *Id.* at 14.

directors' board service, their membership on board committees, or because the corporate governance structure of the company requires that information about misconduct must be brought to the board.[16]

Finding that the Arkansas Complaint lacked specific allegations of knowledge, the district court rejected the theory that the board consciously chose to cover up the bribery scheme. Consequently, the court concluded that the directors did not face a substantial likelihood of personal liability. The court also found that defendants would not be at risk of liability for the *Caremark* claim or the Section 14(a) claims for similar reasons—namely, that the Arkansas Complaint did not allege with particularity what the defendants were told but instead charged them with constructive notice of red flags. The district court concluded that the Arkansas plaintiffs had failed to adequately allege demand futility.

On April 7, 2015, the district court entered a final judgment dismissing the case with prejudice. Appeal of this decision is pending before the United States Court of Appeals for the Eighth Circuit.

D. The Delaware Litigation and Procedural Posture

Between April 25, 2012 and June 18, 2012, around the time the Arkansas litigation was getting started, seven derivative actions were filed in this Court. On June 6, 2012, plaintiff Indiana Electrical Workers Pension Trust Fund IBEW sent Wal-Mart a demand for books and records under 8 *Del. C.* § 220. On August 13, 2012, after Wal-Mart produced certain documents, IBEW filed a Section 220 complaint alleging deficiencies in Wal-Mart's document produc-

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[16] *Id.* at 14-15.

tion.[17] On September 5, 2012, the Court of Chancery consolidated the seven then-pending derivative cases, appointed co-lead plaintiffs and co-lead counsel, and ordered plaintiffs to file a consolidated amended complaint after completion of the Section 220 action.[18]

The Section 220 action and related disputes over document production are described in detail elsewhere. To summarize, they involved a trial on the papers, an appeal to the Delaware Supreme Court,[19] and a subsequent motion for contempt.[20] The Section 220 action eventually reached a final resolution on May 7, 2015.[21] In the meantime, on May 1, 2015, about one month after dismissal of the Arkansas Complaint, plaintiffs filed the pending Delaware Complaint. It asserts a single claim for breach of fiduciary duty.

On June 1, 2015, defendants moved to dismiss, arguing that the Arkansas decision collaterally estopped plaintiffs from alleging demand futility, and that even if they were not collaterally estopped, plaintiffs failed to adequately plead demand futility under Court of Chancery Rule 23.1. Defendants also

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[17] Verified Complaint, *Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, C.A. No. 7779-CS (Del. Ch. Aug. 13, 2012).

[18] *In re Wal-Mart Stores, Inc. Del. Deriv. Litig.*, C.A. No. 7455-CS (Del. Ch. Sep. 5, 2012) (ORDER).

[19] *See Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW*, 95 A.3d 126 (Del.2014).

[20] *See Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, C.A. No. 7779-CB (Del. Ch. May 7, 2015) (TRANSCRIPT).

[21] *Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, C.A. No. 7779-CB, 2015 WL 2150668 (Del. Ch. May 7, 2015) (ORDER).

filed a motion to stay discovery, which I granted on June 24, 2015.[22] I heard argument on defendants' motion to dismiss on November 12, 2015. The parties later filed supplemental submissions, with the last filing occurring on February 3, 2016.[23]

II. LEGAL ANALYSIS

A. Legal Standard

"In considering a motion to dismiss under Chancery Court Rule 23.1 for failure to make a presuit demand, as is true in the case of a motion to dismiss under Court of Chancery Rule 12(b)(6), the Court confines its attention to the face of the complaint."[24] Strict application of this rule would deprive defendants of the ability to argue for preclusion if, for example, a plaintiff does not plead facts regarding the potentially preclusive litigation or incorporate documents from that litigation into the complaint. For this reason, "it is axiomatic that a court must still consider the prior adjudication in order to determine whether issue preclusion bars that plaintiff's claims."[25] Conse-

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[22] *In re Wal-Mart Stores, Inc. Del. Deriv. Litig.*, C.A. No. 7455-CB (Del. Ch. June 24, 2015) (TRANSCRIPT).

[23] The supplemental submissions were prompted by a "demonstrative" plaintiffs handed out at oral argument. That document included 40 single-spaced pages of text providing significant amounts of detail plaintiffs had not included in their brief concerning 95 documents obtained in the Section 220 litigation. As a consequence of these new materials and arguments, the parties filed over 50 additional pages of briefing and letters. The plaintiffs' "handout" was not an appropriate demonstrative but instead was an improper attempt to submit a sur-reply brief.

[24] *White v. Panic*, 793 A.2d 356, 363 (Del. Ch.2000), *aff'd*, 783 A.2d 543 (Del.2001).

[25] *M & M Stone Co. v. Pennsylvania*, 388 F. App'x 156, 162 (3d Cir.2010).

quently, courts will take judicial notice of the prior adjudication and resulting opinions, but "only to establish the existence of the opinion, and not for the truth of the facts asserted in the opinion."[26] This is the approach I use in deciding the present motion to dismiss.[27]

In assessing a motion to dismiss a derivative action based on issue preclusion, the Court should look exclusively to the elements of issue preclusion and not to the merits of the underlying issue.[28] I therefore need to address defendants' demand futility arguments under Court of Chancery Rule 23.1 only if plaintiffs' claim is not barred by issue preclusion.[29] Because issue preclusion applies and requires dismissal of this case for the reasons explained below, I do not decide the question of demand futility.

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[26] *Id.*; *see also United Access Techs., LLC v. Centurytel Broadband Servs., LLC*, 6 F.Supp.3d 537, 545 (D.Del.2013) (rejecting argument that reliance on prior opinion for issue preclusion converted motion into one for summary judgment, because materials were used "only to show that the identical issue was actually and necessarily litigated, and not for the truth of facts averred in those proceedings"), *rev'd and remanded on other grounds*, 778 F.3d 1327 (Fed.Cir.2015).

[27] *See Yucaipa Am. All. Fund I, LP v. SBDRE LLC*, 2014 WL 5509787, at *8 & n.33 (Del. Ch. Oct. 31, 2014) (taking judicial notice of opinions from related litigation in order to assess application of issue preclusion in context of motion to dismiss); *see also* D.R.E. 201-202 (establishing rules for judicial notice).

[28] *See Pyott v. La. Mun. Police Emps.' Ret. Sys.* (*Pyott II*), 74 A.3d 612, 616 (Del.2013).

[29] *Asbestos Workers Local 42 Pension Fund v. Bammann*, 2015 WL 2455469, at *15 (Del. Ch. May 22, 2015), *aff'd*, 132 A.3d 749 (Del.2016) (TABLE).

B. Plaintiffs' Claim Is Barred by Issue Preclusion

Issue preclusion "prevents a party who litigated an issue in one forum from later re-litigating that issue in another forum."[30] Delaware courts will give a judgment from another jurisdiction the same force and effect that the court rendering the judgment would give, whether the rendering court is a state court or a federal court.[31] Under federal common law, a federal court sitting in diversity jurisdiction will apply the preclusion law of the state in which it sits.[32] The issue requiring preclusion analysis here is the Arkansas district court's decision concerning demand futility relating to the Arkansas plaintiffs' fiduciary duty claim, which was brought under the district court's diversity jurisdiction.[33] A federal court would therefore apply the preclusion law of the state of Arkansas. The parties agree on this choice of law.[34]

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[30] *Yucaipa*, 2014 WL 5509787, at *11.

[31] *Pyott II*, 74 A.3d at 615-16.

[32] *Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 508-09 (2001).

[33] Arkansas Complaint ¶ 16. The Arkansas Complaint also invoked the district court's supplemental jurisdiction, but the parties do not argue that this alters the analysis. *See Fresh Del Monte Produce Inc. v. Del Monte Foods, Inc.*, 2016 WL 236249, at *3 n.4 (S.D.N.Y. Jan. 20, 2016) ("This Court would, therefore, apply federal rules of preclusion to judgments on claims premised on federal question jurisdiction, and New York rules of preclusion to judgments on claims premised upon diversity or supplemental jurisdiction.").

[34] Tr. Oral Arg. 6, 76. Although plaintiffs argue in their opening brief that federal common law also applies and both standards must be met, the federal common law rule in diversity cases is to apply the preclusion law of the state in which the court sits, as explained above. *See Semtek*, 531 U.S. at 508-09.

The judgment of the district court in the Arkansas litigation determined that the Arkansas Plaintiffs had failed to adequately plead demand futility. Defendants argue that this determination collaterally estops plaintiffs from alleging demand futility in this case.

Under Arkansas law, for issue preclusion to apply, (1) the issue sought to be precluded must be the same as the issue in the prior litigation; (2) the issue must have been actually litigated; (3) the issue must have been determined by a valid and final judgment; and (4) the determination must have been essential to the judgment.[35] In addition, the parties to be precluded must have been parties in the prior litigation[36] or been in privity with those parties.[37] Finally, the precluded party must have been adequately represented in the previous litigation.

Plaintiffs do not dispute that the third and fourth elements required to establish issue preclusion under Arkansas law have been satisfied, because the issue of demand futility was determined by a valid and final judgment[38] and the determination of demand

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[35] *Riverdale Dev. Co., LLC v. Ruffin Bldg. Sys., Inc.*, 146 S.W.3d 852, 855 (Ark.2004).

[36] *See Morgan v. Turner*, 368 S.W.3d 888, 895 (Ark.2010) (citing *Craven v. Fulton Sanitation Serv., Inc.*, 206 S.W.3d 842, 844 (Ark.2005)).

[37] *Ark. Dep't of Human Servs. v. Dearman*, 842 S.W.2d 449, 452 (Ark.Ct.App.1992) (en banc).

[38] In Arkansas, a judgment is generally considered final for issue preclusion purposes even if the judgment has been appealed, as is the case here. *See John Cheeseman Trucking, Inc. v. Pinson*, 855 S.W.2d 941, 943 (Ark.1993) ("Arkansas follows the majority rule that a judgment is final for purposes of issue preclusion, despite a pending appeal for a review of

futility was essential to that judgment. Thus, there are four issues I must decide to resolve the present motion: (1) whether the issue is the same as the issue in the Arkansas litigation, (2) whether the issue was actually litigated in the Arkansas litigation, (3) whether privity exists, and (4) whether representation was adequate. These issues are addressed in turn.

1. The Issue to Be Precluded Is the Same

Under Arkansas law, an issue to be precluded must be the same as the previously litigated issue. To make such a determination, a court will examine the complaints to determine whether the issue at stake is the same.[39]

In the Arkansas Complaint, plaintiffs allege that making a demand on the Demand Board would be futile because reasonable doubts exist concerning (1) whether the directors' actions were the product of a valid exercise of business judgment, and (2) whether the directors were capable of making an independent and disinterested decision about initiating and prosecuting the litigation.[40] The Arkansas Complaint identifies certain alleged actions that were not the product of a valid exercise of business judgment, including the board's decisions to close the bribery

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the judgment, unless the appeal actually consists of a trial *de novo*."). *But see id.* at 944-45 (Gibson, J., concurring) (expressing concerns about using lower court judgments on appeal for collateral estoppel purposes, including risk of inconsistent judgments and danger of irreparable harm to litigants).

[39] *See Harben v. Dillard*, 2010 WL 3893980, at *5 (E.D.Ark. Sept. 30, 2010) (comparing assertions made under claims to be precluded and noting that they were "almost identical" to claims in the other suit).

[40] Arkansas Complaint ¶¶ 254-55.

investigation after a deficient in-house process and to conceal the wrongdoing until the *New York Times* published the results of its investigation.[41] Regarding the board's ability to make an independent and disinterested decision to pursue litigation, the Arkansas Complaint asserts (1) that nine directors were exposed to substantial liability to stockholders and federal agencies because they knew about the WalMex bribery scheme and the cover-up,[42] (2) that nine directors faced potential liability for violating Section 14(a) of the Exchange Act,[43] and (3) other facts, such as familial ties, calling into question the independence or disinterestedness of specific directors.[44]

In the Delaware Complaint, plaintiffs allege that making a demand on the same Demand Board would be futile because (1) twelve of its members face a substantial likelihood of personal liability stemming from their alleged roles in the WalMex bribery scheme cover-up,[45] (2) eight of its members face a substantial likelihood of personal liability because they consciously failed to monitor and oversee systems and controls to prevent corruption and violations of law at Wal-Mart,[46] (3) six of the directors lack

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[41] *See id.* ¶¶ 256-60. Other alleged decisions of the board that are challenged in the Arkansas Complaint include the decision to violate the FCPA and Mexican law through the bribery scheme, to seek re-election to the board while concealing wrongdoing, and to reward wrongdoers through promotions and compensation. *Id.*

[42] *Id.* ¶¶ 261-68.

[43] *Id.* ¶ 269.

[44] *Id.* ¶¶ 270-81.

[45] Compl. ¶ 212.

[46] Compl. ¶ 213.

independence from S. Robson Walton, an allegedly interested director,[47] and (4) there is a reasonable doubt as to whether the investigation and cover-up were valid exercises of the board's business judgment.[48] The Delaware Complaint goes on to explore these issues in detail.

Although certain factual details surface in one complaint and not the other,[49] the core demand futility issue in the Arkansas and Delaware Complaints is the same. They both focus on whether the Demand Board is disabled from deciding whether to initiate litigation against defendants for their involvement in the WalMex bribery scheme and cover-up because the Demand Board's actions were not the product of valid business judgment and because its members lack independence and disinterestedness.

Plaintiffs assert that the two complaints are not identical on the theory that that the demand futility allegations in the Delaware Complaint are more detailed, specific, and extensive than those in the Arkansas Complaint. Under Arkansas law, however, differences between allegations in the complaints will not prevent issue preclusion from applying if the underlying issue is the same.[50] In other words, the

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[47] Compl. ¶ 214.

[48] Compl. ¶ 272.

[49] For instance, the Delaware Complaint focuses more on allegations that the directors lack disinterestedness because of potential *Caremark* liability for consciously failing to monitor Wal-Mart, while the Arkansas Complaint focuses more on the directors' affirmative involvement in the alleged bribery scheme and cover-up.

[50] *See Harben*, 2010 WL 3893980, at *5 (issue of demand futility found to be identical under Arkansas law where the plaintiff in the action to be precluded had access to more

inclusion of additional factual details does not affect whether an underlying *issue* is identical.[51] As this

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documents, but the "claims for breach of fiduciary duties" and "assertions made under those claims [were] almost identical in the two suits."). Notably, however, the *Harben* court did not consider the precluded claims to be more detailed, despite plaintiff's access to additional documents. *Cf. Hardy v. Hardy*, 380 S.W.3d 354, 358 (Ark.2011) (addressing claim preclusion rather than issue preclusion) ("Where a case is based on the same events as the subject matter of a previous lawsuit, res judicata will apply even if the subsequent lawsuit raises new legal issues and seeks additional remedies."); *Zinger v. Terrell*, 985 S.W.2d 737, 741 (Ark.1999) (holding that issue preclusion can bar relitigation of criminal murder conviction in related civil case regarding victim's property). In contrast, Arkansas will not apply issue preclusion when the legal issues in the two cases are different. *See*, *e.g.*, *Haile v. Johnston*, 482 S.W.3d 323, 329 (Ark.2016) (Brill, C.J., concurring) (explaining that issue preclusion did not apply because first case addressed whether an open conviction record prevented candidate from holding public office, while second case addressed different issue of whether a conviction record that was sealed under Arkansas statute prevented same candidate from holding office); *Skallerup v. City of Hot Springs*, 309 S.W.3d 196, 200 (Ark.2009) (declining to apply issue preclusion when first case dealt with annexation and second case dealt with sewer usage rates and debt service charges).

[51] Arkansas courts have not extensively addressed this topic in the context of derivative suits, but other jurisdictions provide guidance. *See Arduini v. Hart*, 774 F.3d 622, 630 (9th Cir.2014) ("[Offering] some additional allegations in support of [plaintiff's] contention that demand is futile does not make this a different issue under Nevada law."); *In re Bed Bath & Beyond Inc. Deriv. Litig.*, 2007 WL 4165389, at *6 (D.N.J. Nov. 19, 2007) (finding that additions to complaint did not prevent issue preclusion because "they still derive from the same gravamen of wrong" and did not negate the identicality of the issues); *Bammann*, 2015 WL 2455469, at *17-18 (applying New York law); *Fuchs Family Trust v. Parker Drilling Co.*, 2015 WL 1036106, at *5 (Del. Ch. Mar. 4, 2015) (applying Texas law while focusing primarily on adequacy of representation); *cf. United States v.*

Court explained in a similar case, "whether the Complaint raises additional facts, or a more compelling characterization of those facts, regarding the same conduct previously at issue" is irrelevant for purposes of issue preclusion.[52] "To hold otherwise would mean that issue preclusion would almost never apply—subsequent plaintiffs could simply add more allegations (or more specific allegations) of corporate malfeasance, and then claim there was no identity of issues."[53]

For these reasons, I reject plaintiffs' assertion that the demand futility issue raised in both complaints is not the same based on the theory that the Delaware Complaint contains additional factual details. To the contrary, because Arkansas law requires only that the issue to be decided is the same, rather than that all facts and arguments are identical, this element of preclusion is satisfied.

2. The Issue of Demand Futility Was Actually Litigated

The next element of issue preclusion requires that the issue sought to be precluded was actually litigated in the previous action. The Arkansas Supreme Court has stated that, "[i]n the context of collateral estoppel, 'actually litigated' means that the issue was raised in pleadings, or otherwise, that the defendant had a full and fair opportunity to be heard, and that

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Karlen, 645 F.2d 635, 638 (8th Cir.1981) (noting that introduction of new facts or claims into second case does not make issue preclusion inappropriate, because issue preclusion merely bars re-litigation of the relevant issue).

[52] *Bammann*, 2015 WL 2455469, at *18 (applying New York Law).

[53] *Arduini*, 774 F.3d at 630.

a decision was rendered on the issue."[54] Whether an issue was "actually litigated" for issue preclusion purposes must be examined on a case-by-case basis.[55]

Plaintiffs argue that certain demand futility issues they raise in Delaware were not properly litigated in the Arkansas action. They contend that deficiencies in the Arkansas Complaint led the district court to apply the *Rales* test when *Aronson* should have applied.[56] Consequently, the district court explicitly declined to consider the second prong of *Aronson*, namely "whether the Board's actions, or conscious inaction, were a valid exercise of business judgment."[57] Plaintiffs argue that, because the Delaware Complaint makes particularized allegations of board actions that would call for the application of *Aronson*, a key issue of demand futility was not fully litigated in Arkansas.

This argument fails for two reasons. First, even if plaintiffs are correct that the Arkansas Complaint was missing facts that, if alleged, would have caused the district court to apply *Aronson* rather than *Rales*, the question of which test to apply was fully litigated and decided in the Arkansas action. The Arkansas Complaint raised the issue of demand futility, and the Arkansas plaintiffs had the opportunity to be

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[54] *Powell v. Lane*, 289 S.W.3d 440, 445 (Ark.2008).

[55] *Id.* at 447 (holding that a default judgment was a valid basis for issue preclusion) ("There is no bright-line rule. Each judgment, taken by default, or otherwise, must be examined to determine what was finally decided and whether it meets the requirements of collateral estoppel.").

[56] Pls.' Ans. Br. 22-24.

[57] Arkansas Order at 12.

heard on the issue.[58] In particular, before the district court stated that it would not consider the second prong of *Aronson*, it provided a full analysis of which test applied based on the allegations in the Arkansas Complaint and decided that the complaint supported an application of *Rales* rather than *Aronson*.[59] Neither deficiencies in the Arkansas Complaint, nor the addition of new facts or arguments to the complaint in this subsequent action, alter the fact that the issue already has been litigated.

Second, the district court's decision to apply *Rales* instead of *Aronson* had no effect on whether the issue of demand futility was litigated because, in my view, the *Rales* test encompasses all relevant aspects of the *Aronson* test. "As many members of this Court have recognized, the *Rales* test functionally covers the same ground as the *Aronson* test in determining the impartiality of directors."[60] The district court itself pointed out the overlap between the two tests, suggesting that the choice of test would not have been likely to affect its analysis.[61] Because the *Rales* test

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[58] *See Harben*, 2010 WL 3893980, at *5 (holding that demand futility had actually been litigated because it was raised in pleadings, was argued at a hearing, and court had issued an order deciding whether demand was futile) (citing *Powell*, 289 S.W.3d at 445).

[59] Arkansas Order 9-11.

[60] *Sandys v. Pincus*, 2016 WL 769999, at *12-13 & n.59 (Del. Ch. Feb. 29, 2016) (compiling authorities and noting that *Rales* is the "cleaner, more straightforward" test for demand futility).

[61] Arkansas Order at 12 n.7 ("The Court notes that the difference between *Rales* and *Aronson* may blur in cases like this one, because the particularized allegations essential to creating reasonable doubt as to the substantial likelihood of personal liability for breach of fiduciary duties may also implicate the question whether the Board can avail itself of business

"folds the two-pronged *Aronson* test into one broader examination,"[62] it is of no substantive consequence that the district court used *Rales* instead of *Aronson*.

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For the reasons explained above, the Arkansas Complaint and the Delaware Complaint present the same issue of demand futility, and the issue was actually litigated in Arkansas even though the district court used the *Rales* test. Plaintiffs concede that the demand futility issue was determined by a valid and final judgment, and that this determination was essential to the judgment. Accordingly, the four elements generally necessary for preclusion to apply under Arkansas law have been established.

3. The Privity Requirement Is Satisfied

In addition to the four elements discussed above, Arkansas preclusion law requires that the party to be precluded be the same as, or in privity with, the party in the action having preclusive effect.[63] Applying the privity requirement to derivative actions involving two different stockholder plaintiffs raises the question whether the required privity is between the two stockholders, or between each stockholder and the corporation. Further complicating matters here,

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judgment protections.") (citing *Guttman v. Huang*, 823 A.2d 492, 501 (Del Ch.2003)).

[62] *David B. Shaev Profit Sharing Account v. Armstrong*, 2006 WL 391931, at *4 (Del. Ch. Feb. 13, 2006), *aff'd*, 911 A.2d 802 (Del.2006) (TABLE); *see also Guttman*, 823 A.2d at 501 (noting that although the "*Rales* test looks somewhat different from *Aronson*, in that [it] involves a singular inquiry[,] . . . that singular inquiry makes germane all of the concerns relevant to both the first and second prongs of *Aronson* ") (Strine, V.C.).

[63] *See Dearman*, 842 S.W.2d at 452.

Arkansas courts have not yet explicitly addressed this privity question.[64]

Courts in Delaware may address unsettled questions of law in another state by examining the present status of the law in that state to determine what rule its courts would be likely to follow.[65] I will therefore examine the status of Arkansas preclusion law to determine whether or not Arkansas courts would conclude that privity exists between derivative stockholder plaintiffs for purposes of issue preclusion. In determining unsettled questions of issue preclusion law, Arkansas courts look to decisions from courts in

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[64] A federal court applying Arkansas law has held a subsequent derivative stockholder plaintiff to be collaterally estopped from alleging demand futility based on the preclusive effect of a previous demand futility ruling, but the parties did not raise and the court did not explicitly address the question of privity. *See Harben*, 2010 WL 3893980, at *1. The plaintiff in *Harben* instead attempted to distinguish other derivative cases by arguing that issue preclusion should not apply to the first-filed case if the second-filed case was decided first. *See* Plaintiff's Memorandum of Points and Authorities in Opposition to Defendants' Opening Supplemental Brief in Support of Defendants' Motion to Dismiss the Complaint, *Harben v. Dillard*, 4:09-CV-00395-BSM, 2010 WL 3229629 (E.D.Ark. Apr. 2, 2010). The federal judge in the Arkansas Wal-Mart litigation similarly opined that issue preclusion would be likely to apply to subsequent suits without explicitly addressing privity. *See In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, C.A. No. 4:12-CV-4041, at 3 (W.D. Ark. June 4, 2014) (ORDER) (citing *Harben*, 2010 WL 3893980, at *6). These cases suggest that federal judges applying Arkansas law believe that privity would exist in derivative actions, although it is unclear to what, if any, extent they analyzed the issue.

[65] *See*, *e.g.*, *Monsanto Co. v. C.E. Heath Comp. & Liab. Ins. Co.*, 652 A.2d 30, 35 (Del.1994); *see also Taylor v. LSI Logic Corp.*, 689 A.2d 1196, 1200 (Del.1997) ("It is not unusual for courts to wrestle with open questions of the law of sister states or foreign countries.").

other jurisdictions,[66] the Restatement of Judgments,[67] and principles of public policy regarding issue preclusion.[68] I consider each category below.

a. Other Jurisdictions

The vast majority of other jurisdictions that have decided the issue have concluded that privity exists between different stockholder plaintiffs who file separate derivative actions.[69] The common theme in the

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[66] *See*, *e.g.*, *Dearman*, 842 S.W.2d at 452 (citing Third Circuit, Colorado, New York, and New Jersey opinions in privity analysis).

[67] *See*, *e.g.*, *Estate of Goston v. Ford Motor Co.*, 898 S.W.2d 471, 473 (Ark.1995) (using definition of issue preclusion from Restatement (Second) of Judgments § 27 (1982)); *Smith v. Roane*, 683 S.W.2d 935, 936 (Ark.1985) (following comment to Restatement (Second) of Judgments § 27 regarding issue preclusion); *Dearman*, 842 S.W.2d at 452-55 (referencing Restatement (Second) of Judgments §§ 28, 39, and 62 in analyzing collateral estoppel issues in majority and dissenting opinions); *cf. B & B Hardware, Inc. v. Hargis Indus., Inc.*, 135 S.Ct. 1293, 1303 (2015) (noting that the United States Supreme Court regularly relies on the Restatement for guidance regarding elements of issue preclusion).

[68] *See*, *e.g.*, *Beaver v. John Q. Hammons Hotels, L.P.*, 138 S.W.3d 664, 670 (Ark.2003).

[69] *See Arduini*, 774 F.3d at 633-34 (holding that derivative plaintiffs are in privity under Nevada law, based on assessment of the holdings of "the majority of courts that have addressed this issue" outside of Nevada, where issue had not been addressed); *In re Sonus Networks, Inc., S'holder Deriv. Litig.*, 499 F.3d 47, 64 (1st Cir.2007) (holding the same as a matter of Massachusetts law); *Nathan v. Rowan*, 651 F.2d 1223, 1226 (6th Cir.1981) (finding privity for purposes of res judicata in stockholder derivative actions arising under Federal Rule of Civil Procedure 23.1, prior to *Semtek*); *Goldman v. Northrop Corp.*, 603 F.2d 106, 109 (9th Cir.1979) (finding subsequent action barred under res judicata because real party in both actions was corporation); *Hanson v. Odyssey Healthcare, Inc.*,

2007 WL 5186795, at *5 (N.D.Tex. Sept. 21, 2007) (finding privity under Texas law because "the unique nature of derivative litigation logically leads to a finding of privity between all shareholder plaintiffs"); *LeBoyer v. Greenspan*, 2007 WL 4287646, at *3 (C.D. Cal. June 13, 2007) (finding privity under California law); *In re Bed Bath & Beyond*, 2007 WL 4165389, at *8 (finding privity under New York law when first derivative plaintiff was an adequate representative); *Henik ex rel. LaBranche & Co., Inc. v. LaBranche*, 433 F.Supp.2d 372, 380 (S.D.N.Y.2006) (noting that "privity among shareholder plaintiffs in the derivative litigation context presents an atypical situation" that allows issue preclusion because in both actions the corporation is the real party in interest); *Bammann*, 2015 WL 2455469, at *16 (applying New York law and noting that stockholders are effectively interchangeable members of a class because claims belong to corporation); *Fuchs Family Trust*, 2015 WL 1036106, at *5 (finding privity between derivative plaintiffs under Texas law to dismiss a Section 220 action); *In re Career Educ. Corp. Deriv. Litig.*, 2007 WL 2875203, at *10 & n.56 (Del. Ch. Sept. 28, 2007) (appearing to apply Illinois law) ("Because the corporation is the true party in interest in a derivative suit, courts have precluded different derivative plaintiffs in subsequent suits. This commonality lends itself to the application of collateral estoppel or issue preclusion."). *But see Kaplan v. Bennett*, 465 F.Supp. 555, 561-62 (S.D.N.Y.1979) (holding no issue preclusion regarding demand futility by distinguishing a failure to make demand in first case from a successful argument in second case that demand would be futile, without addressing the fact that plaintiff in first case, *Cramer v. Gen. Tel. & Elecs. Corp.*, 582 F.2d 259, 265 (3d Cir.1978), had also argued demand futility) ("[The preclusive opinion] affirmed the district court's dismissal of the claim because [first plaintiff] had failed to make a demand upon the board of directors as required by Fed. R. Civ. P. 23.1. A decision based upon a failure to satisfy a procedural requirement is not to be given preclusive effect. However, in the instant case, the Kaplans did not make a demand on the board of directors, but asserted the futility of such a gesture.") (citations omitted); *La. Mun. Police Emps.' Ret. Sys. v. Pyott* (*Pyott I*), 46 A.3d 313, 334 (Del. Ch.2012) ("[A]n earlier Rule 23.1 dismissal does not have preclusive effect on a subsequent derivative action brought by a different plaintiff because, as the earlier Rule 23.1 decision

opinions where privity has been found is that the corporation is the real party in interest in both the first derivative action and the subsequent suit.[70] Viewed in this fashion, the first stockholder plaintiff does not represent the second stockholder plaintiff. Instead, both plaintiffs sue on behalf of the corporation and are essentially interchangeable.[71] Based

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itself established, the prior plaintiff lacked authority to sue on behalf of the corporation and therefore was not in privity with the corporation or other stockholders."), *rev'd on other grounds*, 74 A.3d 612 (Del.2013) (reversing Court of Chancery because California preclusion law applied rather than Delaware law, without opining on issue under Delaware law); *Ex parte Capstone Dev. Corp.*, 779 So.2d 1216, 1218-19 (Ala.2000) (declining to apply res judicata based on interpretation of failure to make a demand as a procedural defect).

[70] *See*, *e.g.*, *Ross v. Bernhard*, 396 U.S. 531, 538 (1970) ("The corporation is a necessary party to the action; without it the case cannot proceed. Although named a defendant, it is the real party in interest, the stockholder being at best the nominal plaintiff."); *Goldman v. Northrop Corp.*, 603 F.2d at 109 ("The parties are the same, although represented by different shareholders. . . . The corporation was the sole real party in interest in both cases."); *Dana v. Morgan*, 232 F. 85, 90-91 (2d Cir.1916) ("[The stockholder] sues, not primarily in his own rights, but in the right of the corporation. The wrongs of which he complains are wrongs to the corporation. . . . [T]he corporation whose interest he seeks to represent in this suit was a party to [the previous] action and is concluded by it and . . . that concludes him."); *LeBoyer*, 2007 WL 4287646, at *3 ("[I]n both suits the plaintiff is the corporation itself."); *In re Career Educ. Corp.*, 2007 WL 2875203, at *10.

[71] *See* 7C Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1840 (3d ed. 1998) ("Determining the effect to be given a judgment in an action under Rule 23.1 generally does not pose any unusual problems because the shareholder-plaintiff in a stockholder-derivative action is seeking to enforce the right of the corporation and the corporation is present as a defendant.").

on this logic, most courts addressing the issue have concluded that the corporation is bound by the results of the first judgment in subsequent litigation, even if the result is to preclude a different stockholder's subsequent derivative claim. These rulings include three federal appellate court decisions and two decisions of this Court.[72]

Pyott I, an opinion from this Court, reached a different conclusion under Delaware law. The Court in *Pyott I* reflected upon the dual nature of a derivative suit, noting that it is first a suit by a stockholder plaintiff to compel the corporation to sue, and it is second a suit by the corporation, asserted by stockholders on its behalf, against defendants.[73] The Court reasoned that, at the stage when defendants challenge demand futility, the stockholder does not yet represent the corporation, nor does the suit yet belong to the corporation. Instead, the stockholder is merely asserting a claim for equitable authority to sue on the corporation's behalf.[74] The Court opined that at that stage the corporation is not yet the real party in interest, and consequently privity between subsequent derivative stockholders is not yet established. Defendants point out that *Pyott I* was reversed, but they overlook the fact that the Supreme Court reversed *Pyott I* for applying Delaware law rather than California law, while explicitly stating that it did not reach the privity question under Delaware

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[72] *See supra* note 69.

[73] *Pyott I*, 46 A.3d at 328-29 (citing *Aronson*, 473 A.2d at 811 and *Cantor v. Sachs*, 162 A. 73, 76 (Del. Ch.1932)).

[74] *See id.* at 330.

law.[75] This issue thus remains unresolved in Delaware.

Although *Pyott I* gives thoughtful consideration to important issues regarding privity and the point at which a derivative action should begin to belong to the corporation, I am not persuaded that an Arkansas court would apply *Pyott I*'s reasoning as a matter of Arkansas law given that the clear weight of authority in other jurisdictions falls on the side of finding privity and given that the reasoning of that authority appears to comport with Arkansas law. In particular, though not in the context of privity, the Arkansas Supreme Court has stated that it is "inherent in the nature of the [derivative] suit itself that it is the corporation whose rights are being redressed rather than those of the individual plaintiff. It follows that the corporation is regarded as the real party in interest."[76] My review of Arkansas law also has not revealed any indication that the interest of the corporation in the suit would only be deemed to begin after demand futility is established, as suggested in *Pyott I*. Accordingly, I believe it is likely that the Arkansas Supreme Court would follow the majority rule that privity attaches to subsequent derivative stockholders.

b. The Restatement of Judgments

Plaintiffs argue that Section 41 of the Restatement (Second) of Judgments (the "Restatement") suggests that there is no privity between different derivative

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[75] *Pyott II*, 74 A.3d at 618 ("Although the Court of Chancery is divided on the privity issue as a matter of Delaware law, we cannot address the merits of that issue in this case.").

[76] *Brandon v. Brandon Constr. Co. Inc.*, 776 S.W.2d 349, 352 (Ark.1989) (quoting *Morgan v. Robertson*, 609 S.W.2d 662, 663 (Ark.Ct.App.1980)).

stockholder plaintiffs.[77] That provision lists five categories of persons who can establish privity with a subsequent plaintiff and bind that plaintiff through issue preclusion. According to plaintiffs, only one of those categories is remotely analogous to a derivative plaintiff, namely category (e), which concerns class action representatives. The relevant part of Section 41 states as follows:

> (1) A person who is not a party to an action but who is represented by a party is bound by and entitled to the benefits of a judgment as though he were a party. A person is represented by a party who is:
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> * * * * *
>
> (e) The representative of a class of persons similarly situated, designated as such with the approval of the court, of which the person is a member.
>
> (2) A person represented by a party to an action is bound by the judgment even though the person himself does not have notice of the action, is not served with process, or is not subject to service of process.

Exceptions to this general rule are stated in § 42.[78]

Relying on Section 41's requirement that the class representative must be "designated as such with the approval of the court" or by contract,[79] plaintiffs argue that, by the same logic, a derivative plaintiff should

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[77] Pls.' Ans. Br. 25-28.

[78] Restatement (Second) of Judgments § 41 (1982). The exceptions in Section 42 regarding adequacy of representation are addressed later in this opinion.

[79] *Id.* § 41 cmt. a ("The method of designating the representative may be adjudicative or contractual. . . .").

not be able to gain representative authority as required to establish privity merely by filing a complaint. For additional support, plaintiffs note a comment to Section 59 of the Restatement, which states in relevant part:

> The stockholder's or member's derivative action is usually though not invariably in the form of a suit by some of the stockholders or members as representatives of all of them. Whether the judgment in such a representative suit is binding upon all stockholders or members is determined by the rules stated in §§ 41 and 42. If it is binding under those rules, it precludes a subsequent derivative action by stockholders or members who were not individually parties to the original action.[80]

Plaintiffs argue that because derivative actions only preclude subsequent actions if they meet the requirements of Sections 41 and 42, and because Section 41 requires an adjudicative or contractual designation of a representative, dismissals of derivative actions for lack of demand futility are not preclusive upon future derivative plaintiffs. This argument tracks the reasoning of *Pyott I* that a derivative plaintiff should not be able to speak for the corporation until demand futility has been established.

Although plaintiffs' argument is plausible, the Restatement is ambiguous on the privity question in the derivative context. Another comment in Section 59 casts doubt on the concept of privity as being between the two derivative stockholders. The comment notes that a stockholder derivative action "is one on behalf of the corporation as such,"[81]

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[80] *Id.* § 59 cmt. c.

[81] *Id.* § 59 cmt. e.

although it does not specify whether a derivative plaintiff acts on behalf of the corporation from the outset or only after demand futility is established. Reflective of the Restatement's lack of clarity concerning privity in the derivative context, cases citing Section 41(1)(e) have come out in both directions: some have held that privity exists between derivative stockholders even when demand futility has not been established,[82] but others, including *Pyott I*, reached the opposite conclusion.[83]

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[82] *See*, *e.g.*, *Arduini*, 774 F.3d at 634 n.11 (relying on Section 41's list of representative relationships in establishing privity) ("These examples of representation are analogous to that of shareholder derivative suits, where a shareholder is acting on behalf of the corporation and also other shareholders."); *see also In re MGM Mirage Deriv. Litig.*, 2014 WL 2960449, at *6 (D. Nev. June 30, 2014) (noting that Restatement's list of relationships that establish privity are examples but that the list is non-exhaustive and can include subsequent derivative stockholders); *In re Sonus Networks, Inc. S'holder Deriv. Litig.*, 422 F.Supp.2d 281, 291 (D.Mass.2006) (citing Sections 41 and 42 in privity analysis, although without explicitly stating that they support derivative stockholder privity), *aff'd*, 499 F.3d 47 (1st Cir.2007); *cf. Slocum ex rel. Nathan A v. Joseph B*, 588 N.Y.S.2d 930, 931 (N.Y.App.Div.1992) (declining in family law case to strictly adhere to list of categories in Section 41) ("We think the better rule, however, and that which is actually applied in this State as well as in a number of other jurisdictions, eschews strict reliance on formal representative relationships in favor of a more flexible consideration of whether all of the facts and circumstances of the party's and nonparty's actual relationship, their mutuality of interests and the manner in which the nonparty's interests were represented in the prior litigation establishes a functional representation such that the nonparty may be thought to have had a vicarious day in court.") (internal quotation marks omitted).

[83] *See Pyott I*, 46 A.3d at 333; *see also Weinfeld v. Minor*, 2016 WL 951352, at *4 (D.Nev. Mar. 9, 2016) (finding no privity

In short, the Restatement is inconclusive as a predictor of how an Arkansas court would decide the privity question. One plausible reading suggests that privity would not exist between derivative plaintiffs unless the plaintiff in the first judgment had been authorized in some fashion by a court or the corporation. On the other hand, the Restatement's lack of differentiation between pre-futility and post-futility plaintiffs instead could indicate that all derivative actions are in a category similar to post-certification class actions. The Restatement does not meaningfully analyze whether the corporation's status as the real party in interest makes privity a foregone conclusion for subsequent representative stockholders. Such a reading, however, would comport with the weight of authority discussed above, which finds privity between derivative plaintiffs, regardless of the stage of the proceeding, because the real party in interest is the corporation.

c. Public Policy

In Arkansas, the doctrine of issue preclusion is "based upon the policy of limiting litigation to one fair trial on an issue. . . ."[84] Issue preclusion should apply "only when the party against whom the earlier decision is being asserted had a full and fair oppor-

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between derivative stockholders for res judicata purposes because none of the categories in Section 41 applied).

[84] *Dearman*, 842 S.W.2d at 451; *accord Beaver*, 138 S.W.3d at 670; *see also Crockett v. C.A.G. Invs., Inc.*, 381 S.W.3d 793, 799 (Ark.2011) (noting that collateral estoppel applies to a plaintiff or his privies when attempting to re-litigate an issue against a defendant or his privies) ("The true reason for holding an issue to be barred is not necessarily the identity or privity of the parties, but instead to put an end to litigation by preventing a party who has had one fair trial on a matter from relitigating the matter a second time.").

tunity to litigate the issue in question."[85] To the extent a certain application of issue preclusion is anathema to public policy, courts will not apply the rule rigidly.[86] Regarding privity, Arkansas appears to take a practical approach. "The underlying purpose of the modern [privity] rule is fundamental fairness and common sense."[87] Arkansas courts have opined that the practical goal of preventing re-litigation by substantially identical parties trumps the need for precise identicality.[88]

It is useful to compare these policy rationales with the rationales other states have given for applying issue preclusion against derivative plaintiffs. Some jurisdictions have concluded that establishing privity over subsequent derivative stockholders is sound public policy because it prevents the perpetual

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[85] *Dearman*, 842 S.W.2d at 451; *see also E. Tex. Motor Freight Lines, Inc. v. Freeman*, 713 S.W.2d 456, 459 (Ark.1986) ("But we have never extended the concept of collateral estoppel to the point that claimants who have had no trial at all, nor any opportunity to present their claims, are precluded by the outcome of litigation to which they were not privy. We believe justice preserves to everyone the right to his 'day in court.' ").

[86] *See United States v. Stauffer Chem. Co.*, 464 U.S. 165, 176 (1984) (White, J., concurring) ("[T]here is no justification for applying collateral estoppel, which is a flexible, judge-made doctrine, in situations where the policy concerns underlying it are absent. . . . Preclusion must be evaluated in light of the policy concerns underlying the doctrine.").

[87] *Dearman*, 842 S.W.2d 449, 452 (quoting *Moore v. Hafeeza*, 515 A.2d 271, 274 (N.J.Super.Ct. Ch. Div.1986)).

[88] *See Wells v. Ark. Pub. Serv. Comm'n*, 616 S.W.2d 718, 719 (Ark.1981) (applying res judicata) ("The exact same parties are not required as it is sufficient if there is substantial identity of the parties."); *Rose v. Jacobs*, 329 S.W.2d 170, 172 (Ark.1959).

re-litigation of the demand futility question.[89] On the other hand, courts in other jurisdictions have expressed concern that finding privity may allow fast-filing derivative plaintiffs who do not make an adequate effort to allege demand futility to preclude more diligent plaintiffs who bring subsequent litigation that could have been more successful even though neither the court nor the corporation ever authorized the fast-filing plaintiffs to represent the corporation.[90]

In my view, the policy rationales for finding subsequent derivative plaintiffs to be in privity would resonate with courts in Arkansas in light of the state's policy of using preclusion to ensure issues are litigated only once and its recognition that the corporation is the real party in interest in a derivative action.[91] At the same time, concerns about fast filers precluding future plaintiffs align with the state's policy of ensuring that parties to be precluded

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[89] *In re Sonus Networks*, 499 F.3d at 64 ("The defendants have already been put to the trouble of litigating the very question at issue, and the policy of repose strongly militates in favor of preclusion."); *Henik*, 433 F.Supp.2d at 380 ("In addition, as Defendants point out, if [derivative stockholder privity] were not the rule, shareholder plaintiffs could indefinitely relitigate the demand futility question in an unlimited number of state and federal courts, a result the preclusion doctrine specifically is aimed at avoiding."). *But see Pyott I*, 46 A.3d at 335 (noting that original judgment could still serve as persuasive authority to second court and could bind original plaintiff through *stare decisis*).

[90] *Bammann*, 2015 WL 2455469, at *18 n.147 ("A specter of unfairness appears, however, in the derivative context, where a derivative plaintiff with a viable claim may be estopped from proceeding based on the inadequate efforts of a fellow stockholder in privity, a feckless fast filer.").

[91] *See Dearman*, 842 S.W.2d at 451; *Brandon*, 776 S.W.2d at 352.

have received a full and fair opportunity to be heard. These competing policy interests may be balanced by requiring that a derivative plaintiff be an adequate representative in order for a judgment to have a preclusive effect on subsequent actions.[92] That issue is addressed in the next section.

* * * * *

To summarize, the overwhelming majority of decisions in other jurisdictions have found privity between different stockholder plaintiffs in derivative actions on the premise that the corporation is the real party in interest both [sic] actions, a premise that the Arkansas Supreme Court has recognized expressly. The Restatement is inconclusive, and public policy arguments exist on both sides of the privity question. Taking all these points into consideration, it is my opinion that Arkansas courts likely would find that the privity requirement is satisfied here because that result accords with the clear weight of authority and resonates with the policy in Arkansas of using preclusion to ensure that issues are litigated only once.

4. The Arkansas Plaintiffs Were Adequate Representatives

The final disputed issue is whether the Arkansas plaintiffs were inadequate representatives such that issue preclusion cannot apply. Due process under the United States Constitution requires that a judicial procedure "fairly insures the protection of the inter-

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[92] Wright & Miller, *supra* note 71, § 1840 ("The justification for binding nonparty stockholders to a judgment in a Rule 23.1 action is that their interests were adequately represented in the litigation. . . . Of course, as is discussed more fully elsewhere, there must be a sufficient showing of procedural fairness and adequate representation to satisfy due process.").

ests of absent parties who are to be bound by it."[93] One requirement for such procedures is that the absent parties "are in fact adequately represented by parties who are present."[94] The Federal Rules of Civil Procedure embrace the principle of due process. Federal Rule 23.1 states that a "derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders . . . who are similarly situated in enforcing the right of the corporation. . . ."[95]

Citing a single pre-*Semtek* district court opinion, plaintiffs argue that federal law applies to the issue because the Arkansas action is governed by Federal Rule 23.1.[96] Plaintiffs acknowledge, however, that "even if Arkansas law applied, the analysis would not differ."[97] This is because Arkansas Rule of Civil

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[93] *Hansberry v. Lee*, 311 U.S. 32, 42 (1940).

[94] *Id.* at 42-43.

[95] Fed.R.Civ.P. 23.1. It bears noting that assessing adequacy of representation under Rule 23.1 (which typically occurs in the context of a motion to dismiss) arises in a different posture than assessing adequacy of representation for purposes of issue preclusion, which arises in a second case after a judgment has been entered in the first. Although plaintiffs' authorities tend to fall in the former category, this case falls into the latter. That being said, the requirements for adequate representation may be similar in these postures, if not the same. *Cf.* William B. Rubenstein, *Finality in Class Action Litigation: Lessons from Habeas*, 82 N.Y.U. L.Rev. 790, 810 (2007) (noting in class action context that the requirements of Rule 23 must be at least as stringent as the requirements of the Constitution, but could be even stricter).

[96] Pls.' Ans. Br. 8 (citing *Recchion ex rel. Westinghouse Elec. Corp. v. Kirby*, 637 F.Supp. 284, 289 (W.D.Pa.1985)).

[97] *Id.* n.21 (citing Ark. R. Civ. P. 23.1).

Procedure 23.1 is substantively identical to Federal Rule 23.1.[98]

In addressing adequacy of representation, defendants focus on Arkansas law and, because there is little authority in Arkansas regarding the adequacy of representation requirement for issue preclusion, they point to the Restatement to provide an analytical framework. Numerous courts similarly have relied on the Restatement to consider the issue of adequacy of representation for purposes of issue preclusion.[99]

Because Arkansas and numerous other courts look to the Restatement to determine unsettled questions of issue preclusion law,[100] and because Constitutional principles of due process are embedded in the perti-

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[98] Ark. R. Civ. P. 23.1 ("The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders . . . similarly situated in enforcing the right of the corporation. . . .").

[99] *See*, *e.g.*, *Arduini*, 774 F.3d at 635-36 (using Restatement to decide issue under Nevada law) ("[I]ssue preclusion does not apply where the first shareholder did not adequately represent the corporation, minimizing the risk of unfairness to shareholders."); *In re Sonus Networks*, 499 F.3d at 64-66 (using Restatement to decide issue under Massachusetts law) ("[T]o bind the corporation, the shareholder plaintiff must have adequately represented the interests of the corporation."); *Hanson*, 2007 WL 5186795, at *6; *Henik*, 433 F.Supp.2d at 381 (noting that issue preclusion in derivative case could be challenged in cases where inadequate representation is alleged); *Pyott II*, 74 A.3d at 618 & nn.21 & 25 (noting use of Restatement to determine adequacy and citing Sonus' quotation of Restatement in determining adequacy); *South v. Baker*, 62 A.3d 1, 12-13 (Del. Ch. 2012) ("Decisions that give preclusive effect to a Rule 23.1 dismissal universally recognize that another stockholder still can sue if the first plaintiff provided inadequate representation.").

[100] *See supra* note 67.

nent provisions of the Restatement,[101] I will look to the analytical framework provided in the Restatement to evaluate the issue of adequacy of representation.

Section 42 of the Restatement outlines certain scenarios in which a person will not be bound to a prior judgment.[102] Relevant here are two questions bearing on adequacy of representation: whether the interests of the representative and the represented person are aligned, and whether the representation was grossly deficient.[103] Keeping in mind that Wal-Mart is the real party in interest and thus the party that must be adequately represented, I address these questions in turn.

a. The Arkansas Plaintiffs' Interests Were Not Misaligned

Adequate representation for preclusion purposes requires that the interests of the party to be precluded and the representative be aligned.[104] The Restatement does not explicitly address conflicts of interest in derivative suits, but it notes that a judgment against one class member will not bind another if a substantial divergence in their interests prevented the first class member from representing the other

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[101] Restatement § 42 & Reporter's Note (listing representation requirements to bind a represented party and noting that "[t]he provisions of this section are thus closely related to, if indeed they are not particularized expressions of, the requirements of due process").

[102] *Id.*

[103] *Id.* § 42(d)-(e). Plaintiffs do not argue that one of the Restatement's other major grounds for inadequacy, collusion between the representative plaintiff and the defendant, exists here. *See id. cmt.* f.

[104] *See Taylor v. Sturgell*, 553 U.S. 880, 900-01 (2008).

adequately.[105] Similarly, derivative cases in other jurisdictions have noted that an adequate representative stockholder must "be free from economic interests that are antagonistic to the interests of the class."[106]

Plaintiffs argue that, by seeking to control the case in order to earn attorneys' fees, Arkansas counsel put their personal economic interests ahead of the interests of Wal-Mart and its stockholders, who instead would have benefited from litigating demand futility with the strongest complaint possible. To support this argument, plaintiffs' lead counsel submitted an affidavit in which he contends that Arkansas counsel recognized that Section 220 documents would help establish demand futility but refused to discontinue the Arkansas litigation in favor of the Delaware litigation unless they were offered a substantial share of any Delaware fee award.[107] Plaintiffs allege no other

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[105] Restatement § 42(1)(d) ("With respect to the representative of a class, there was such a substantial divergence of interest between him and the members of the class, or a group within the class, that he could not fairly represent them with respect to the matters as to which the judgment is subsequently invoked[.]"). A comment goes on to state that "a judgment is not binding on the represented person . . . where, to the knowledge of the opposing party, the representative seeks to further his own interest at the expense of the represented person." *Id.* cmt. f.

[106] *See Arduini*, 774 F.3d at 635.

[107] Affidavit of Stuart M. Grant, ¶ 13, June 30, 2015. Counsel for the Arkansas plaintiffs submitted an affidavit vigorously denying these assertions and providing a very different account of the strategy pursued in the Arkansas action. *See* Affidavit of Judith S. Scolnick ("Scolnick Aff."), ¶¶ 22, 25-26, July 16, 2015. Whether I may consider the contents of these affidavits in deciding the pending motion to dismiss is unclear but ultimately of no moment since they are not necessary to my analysis.

conflict of interest between the Arkansas plaintiffs and Wal-Mart.

In my view, plaintiffs misapprehend the types of conflict that will make a derivative plaintiff an inadequate representative. Representatives have been found inadequate when their interests are directly opposed to the interests of the person being represented, which in this case is Wal-Mart.[108] In contrast, plaintiffs here contend only that counsel for the Arkansas plaintiffs had a personal financial interest in maintaining the litigation in a particular forum—a reality that counsel for any set of plaintiffs involved in multi-jurisdictional litigation would face. They do not allege that the Arkansas plaintiffs had an interest adverse to Wal-Mart or that they would benefit from bringing harm upon the company. To the contrary, it appears that the Arkansas plaintiffs, as stockholders of Wal-Mart, would benefit from any recovery Wal-Mart received through a judgment or settlement in their derivative action. In my view, their counsel's preference to litigate in a certain jurisdiction and to maintain control of the case does not create a misalignment of interests between the Arkansas plaintiffs and Wal-Mart sufficient to

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[108] *See*, *e.g.*, *Hansberry*, 311 U.S. at 44-46 (holding that plaintiffs in first action did not adequately represent defendants in second action where first plaintiffs appeared to seek enforcement of a racially restrictive covenant and defendants in second action sought to resist it); *Hoxworth v. Blinder*, 74 F.3d 205, 208 (10th Cir.1996) (holding no privity for res judicata purposes because "the class was an adversary to the trustee," rendering trustee an inadequate representative) ("As a judgment creditor of Meyer Blinder, the Hoxworth Class was in direct opposition with the trustee. Every dollar of Meyer Blinder's assets the Hoxworth Class reached by imposition of its secured lien would leave one dollar less in the Blinder Robinson estate for the trustee to satisfy creditors.").

impugn their adequacy as Wal-Mart's representatives, especially when their interests otherwise appear to be closely aligned.

b. The Arkansas Plaintiffs Were Not Grossly Deficient Representatives

The second aspect of inadequacy relevant here involves deficient or incompetent representation. Under the Restatement, issue preclusion will not apply if "[t]he representative failed to prosecute or defend the action with due diligence and reasonable prudence, and the opposing party was on notice of facts making that failure apparent."[109] A comment goes on to distinguish between imperfect legal strategies, which would not warrant a finding of inadequacy, and "grossly deficient" management of the litigation that would be apparent to the opposing party so as to undermine that party's reliance on the prior adjudication:

> ***The failure of a representative to invoke all possible legal theories or to develop all possible resources of proof does not make his representation legally ineffective***, any more than such circumstances overcome the binding effect of a judgment on a party himself. . . . Where the representative's management of the litigation is so ***grossly deficient as to be apparent to the opposing party***, it likewise creates no justifiable reliance interest in the adjudication on the part of the opposing party. ***Tactical mistakes or negligence on the part of the representative are not as such sufficient*** to render the judgment vulnerable.[110]

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[109] Restatement § 42(1)(e).

[110] Restatement § 42 cmt. f (emphasis added). Courts have applied the Restatement and its commentary when determining

Plaintiffs argue, in essence, that the Arkansas plaintiffs were grossly deficient because they failed to pursue books and records from Wal-Mart before pursuing their case.[111] They point out that their counsel failed to heed the warnings of then-Chancellor Strine, who admonished plaintiffs' counsel in Delaware not to proceed on a complaint allegedly similar to the Arkansas Complaint without first pursuing books and records to bolster their allega-

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whether representation was deficient in derivative actions. *See*, *e.g.*, *Arduini*, 774 F.3d at 635-36 (applying issue preclusion because plaintiffs "adequately litigated their case" even though they did not succeed in alleging demand futility or amend their complaint); *In re Sonus Networks*, 499 F.3d at 65-66 (applying issue preclusion because differences in the two derivative complaints did not support a finding of grossly deficient representation); *cf. In re Bed Bath & Beyond*, 2007 WL 4165389, at *8 n.7 (focusing test on adequacy of representative's counsel rather than representative and concluding that differences between the complaints did not demonstrate counsel was "grossly deficient" or an inadequate representative).

[111] Plaintiffs also argue that "there is no evidence that the **actual** Arkansas plaintiffs had any input in, or knowledge of," the decision to press on with the litigation rather than pursue books and records, and they submit affidavits from three stockholders who testify that they were not actively informed about the litigation. Pls.' Ans. Br. 9-10. The authorities that plaintiffs rely on, however, involve determining adequacy to serve as a class or derivative representative under Rule 23 or 23.1, and not for purposes of issue preclusion after the fact. *See Bodner v. Oreck Direct, LLC*, 2007 WL 1223777, at *1-2 (N.D.Cal. Apr. 25, 2007); *Rothenberg v. Sec. Mgmt. Co., Inc.*, 667 F.2d 958, 962 (11th Cir.1982). The gravamen of plaintiffs' inadequacy argument for issue preclusion purposes ultimately boils down to the decision of Arkansas counsel not to seek books and records from Wal-Mart as part of their litigation strategy. As discussed below, I conclude that this decision does not demonstrate that the Arkansas plaintiffs were grossly deficient.

tions.[112] They further note that even the defendants criticized the Arkansas plaintiffs' strategy when seeking to stay the Arkansas action.

Taken to its logical extreme, plaintiffs' argument would mean that any stockholder representative in a derivative action who did not first pursue books and records would be inadequate, or at least presumptively inadequate. In *Pyott II*, however, the Delaware Supreme Court rejected a "fast filer" rule that deems plaintiffs presumptively inadequate if they fail to pursue books and records before litigating derivative claims.[113] Arkansas law controls here, but I have no reason to think that Arkansas would reach a different conclusion than *Pyott II* on this issue.[114] Of course, even absent a presumption of "fast filer" inadequacy, the failure to pursue a Section 220 action could serve as meaningful evidence of inadequate representation

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[112] Oral Argument, *Klein v. Walton*, C.A. No. 7455-CS, at 9-12, 19-21 (Del. Ch. July 16, 2012) (TRANSCRIPT). Then-Chancellor Strine gave this warning before the Delaware Supreme Court decided in *Pyott II* that there was no presumption of inadequacy for fast-filing plaintiffs. *See infra* note 113.

[113] *See Pyott II*, 74 A.3d at 618 (rejecting irrebutable presumption of inadequacy for derivative stockholders who file before undertaking a Section 220 action, and also noting that without such a presumption, "there was no basis on which to conclude that the [first] plaintiffs were inadequate").

[114] In dismissing the Arkansas Complaint, the district court did not find that the Arkansas plaintiffs were inadequate representatives under Rule 23.1, or even raise the issue of adequate representation in its order, notwithstanding the Arkansas plaintiffs' decision not to pursue a books and records action. *See generally* Arkansas Order. The requirement of adequate representation under Rule 23.1 may share similarities with the requirement of adequate representation for issue preclusion. *See supra* note 95.

in some cases.[115] But it does not follow that plaintiffs are necessarily inadequate representatives because their counsel chose not to follow a recommended strategy in a different action, even one suggested by a preeminent corporate jurist, particularly when they are litigating in a different jurisdiction before a different judiciary.

Here, the Arkansas plaintiffs have been represented by more than a dozen attorneys from several different law firms.[116] No contention is made that they are not experienced counsel, and the record reflects they have litigated the Arkansas action with apparent vigor, including by seeking an appeal of the district court's dismissal of the case, which is pending before the Eighth Circuit.

Turning to the substance of the Arkansas plaintiffs' strategic decision, perhaps it would have been advantageous for the Arkansas plaintiffs to seek additional factual support through a books-and-records action. But, as their counsel attests, crucial excerpts from a number of key documents underlying the *New York Times* article were available on the article's webpage. In her view, these underlying documents "provided sufficient particularized allegations to surmount the demand futility hurdle."[117] Several of the documents

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[115] *Cf. Bammann*, 2015 WL 2455469, at *18 n.147 ("*Pyott* [*II*] makes clear that a presumption of inadequacy does not arise upon a showing that the prior plaintiff failed to use a section 220 request to develop its case; how a demonstration of inadequacy may be made in the Rule 23.1 context, and the complex issues of comity, efficiency and fairness which would arise therewith, must be addressed through litigation where the issue is fairly presented.").

[116] *See* Arkansas Complaint at 73-75.

[117] Scolnick Aff. ¶ 8. Plaintiffs have sought to strike this affidavit from the record, but I use it only to provide context. It

from the article's webpage were featured in both complaints, including one of the most crucial excerpts from Wal-Mart's internal reports—the statement that "there is reasonable suspicion to believe that Mexican and USA laws may have been violated." Plaintiffs found that statement important enough to quote it nine times in the Delaware Complaint and to feature it in their supplemental briefing as well.[118] This key phrase was included in the excerpts on the *New York Times* website and was relied upon extensively in the Arkansas Complaint.[119]

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can be independently verified from the internet and the Arkansas Complaint that the excerpts the Arkansas plaintiffs used in their complaint were available from the *New York Times* website. *See* Arkansas Complaint Exs. A-I (internal Wal-Mart document excerpts attached to Arkansas Complaint); Barstow, *supra* note 3 (providing links to excerpts of documents). A web archive search indicates that the relevant document excerpts available now were also available when the article was first published. *See* Internet Archive Wayback Machine, https://web.archive.org/web/20120422013641/; http://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html?_r=1 (preserving webpage as of April 22, 2012). Counsel for Arkansas plaintiffs also stated the same views on the *New York Times* documents at the hearing on the motion to stay the Arkansas action. *See* Leavengood Aff. Ex. 29, Transcript of Hearing on Motion to Stay at 47, 64, *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, 4:12-CV-4041-SOH (W.D.Ark. Sept. 6, 2012).

[118] Compl. ¶¶ 6, 136, 158, 277, 279, 295, 332, 336, 339; Pls.' Resp. to Defs.' Supplemental Br. 7. Other important passages supporting the complaints also were available on the *New York Times* website and used by Arkansas plaintiffs. *See*, *e.g.*, Compl. ¶¶ 7, 172, 278, 334, 344; Arkansas Complaint ¶ 191 (quote from internal e-mail opining that WalMex's investigation was "truly lacking"); Compl. ¶¶ 7, 148, 358; Arkansas Complaint ¶ 170 (statement by Munich questioning the wisdom of entrusting investigation to WalMex).

[119] Arkansas Complaint ¶¶ 2, 9, 152, 275.

It is certainly better practice for stockholder plaintiffs to use "the tools at hand" to investigate their claims thoroughly before launching derivative suits,[120] and I share the concerns Delaware courts have expressed regarding the risk of diligent derivative plaintiffs being collaterally estopped by fast filers. Indeed, it may turn out (depending on the outcome of the appeal to the Eighth Circuit) that the Arkansas plaintiffs' assessment of their ability to establish demand futility without pursuing books and records from Wal-Mart was ill-advised. But, in my opinion, that decision falls into the category of an imperfect legal strategy and does not rise to the level of litigation management that was so grossly deficient as to render them inadequate representatives.

The only remaining question involves the contents of the books and records that plaintiffs here eventually secured through their Section 220 litigation. At oral argument and in supplemental submissions, the parties vigorously disputed the extent to which certain documents the Delaware plaintiffs obtained

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[120] *See Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 120 (Del.2006) ("The rise in books and records litigation is directly attributable to this Court's encouragement of stockholders, who can show a proper purpose, to use the 'tools at hand' to obtain the necessary information before filing a derivative action. Section 220 is now recognized as 'an important part of the corporate governance landscape.' "); *White v. Panic*, 783 A.2d 543, 557 (Del.2001) ("[T]his case demonstrates the salutary effects of a rule encouraging plaintiffs to conduct a thorough investigation, using the 'tools at hand' including the use of actions under 8 *Del. C.* § 220 for books and records, before filing a complaint."); *Stone v. Ritter*, 2006 WL 302558, at *1 (Del. Ch. Jan. 26, 2006) ("On numerous previous occasions, this Court and the Delaware Supreme Court have urged would-be derivative plaintiffs to use the so-called 'tools at hand' before filing complaints."), *aff'd*, 911 A.2d 362 (Del.2006).

in the Section 220 action might help to establish demand futility. That dispute is relevant to the issue of demand futility itself, but what is its relevance to the issue of inadequate representation? In other cases, after finding that the outcome of a first-filed derivative action should be given preclusive effect, courts have gone on to compare the allegations in the two derivative complaints, seemingly to provide reassurance that no harm was done in precluding the second action because it would not have passed muster under Rule 23.1 even with the benefit of the corporate records.[121]

I have reservations about this approach because it encourages hindsight review of conduct that should be judged based on the circumstances as they exist in real time.[122] In my view, whether a representative

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[121] *See In re Sonus Networks*, 499 F.3d at 71 ("In sum, we cannot conclude that the allegations in the Second Amended Complaint add material allegations that would pass the test for pleading demand futility under Delaware law. It follows that the state plaintiffs were not grossly deficient in failing to include such allegations in the state complaint."); *In re Career Educ. Corp.*, 2007 WL 2875203, at *10 n.58 (noting that issue preclusion would not reduce the efficacy of Section 220 in that case because "even though the [first plaintiffs] did not pursue a Section 220 demand, the [first] Complaint contained all of the key factual allegations that Plaintiffs rely on in this action").

[122] My review of relevant case law suggests that this concern—whether the substance of documents obtained in a Section 220 action that are used in a second derivative action should be considered in determining adequacy of representation in a first derivative action for purposes of issue preclusion—has not been discussed in depth. For literature that may shed light on somewhat related concerns, see Kevin R. Bernier, Note, *The Inadequacy of the Broad Collateral Attack:* Stephenson v. Dow Chemical Company *and Its Effect on Class Action Settlements*, 84 B.U. L.Rev. 1023, 1041 (2004) (criticizing an opinion that found inadequate representation based on certain class

litigated with sufficient diligence necessarily depends on her knowledge and expectations at the time, rather than on what happened later. Taking a real-time approach to evaluating adequacy could mean, hypothetically, that a grossly deficient or conflicted decision not to pursue books and records would render a representative inadequate even when a subsequent Section 220 action unearthed no meaningful new information. Alternatively, it could mean that a good faith decision not to pursue books and records would not demonstrate inadequacy even if a later Section 220 action found a "smoking gun." But if I were to evaluate adequacy of representation using materials uncovered later, I would be at risk of second-guessing the Arkansas plaintiffs' decision-making based on information that was unavailable to them at the time, and of addressing the merits of demand futility even though principles of comity logically would restrict me to assessing issue preclusion only.

For these reasons, I decline to specifically address the documents that plaintiffs obtained in their

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members' *ex post* dissatisfaction with outcome of a settlement); *see also* Rubenstein, *supra* note 95, at 813 (noting that the second court "might be tempted to ask . . . knowing what we know now [as opposed to at the moment of settlement], was the class adequately represented? . . . [The second court] is not truly revisiting the wisdom of [the first court's] adequacy determination. It is remaking that decision in light of subsequent developments and/or changed circumstances."). *But see* David A. Dana, *Adequacy of Representation After* Stephenson*: A Rawlsian/Behavioral Economics Approach to Class Action Settlements*, 55 Emory L.J. 279, 281 (2006) (suggesting that the adequacy of representation analysis in class action cases should have some relation to *ex post* substantive outcomes because "[a]dequacy or inadequacy of representation, as a practical matter, sometimes unfolds only over time").

Section 220 action in assessing whether they were adequately represented by the Arkansas plaintiffs. I will say only this much: defendants have made legitimate arguments that the Section 220 materials, including some of the best documents (as identified by plaintiffs) supporting the allegations of demand futility, would not have affected the outcome of the demand futility analysis.[123] In particular, defendants have proffered plausible interpretations of these documents suggesting that members of management or directors who may have read them would not necessarily have been put on notice of the bribery scheme. I will not address these arguments further for the reasons explained above.

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In sum, for the reasons explained above, all four elements required under Arkansas law for issue preclusion have been established, and an Arkansas court likely would conclude, consistent with the clear weight of authority from other jurisdictions, that issue preclusion would apply to different stockholder plaintiffs in the context of a derivative suit. The Arkansas plaintiffs were not inadequate representatives of Wal-Mart, whether due to a conflict of interest, gross deficiencies in their representation, or otherwise. Accordingly, the Arkansas district

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[123] *See* Tr. Oral Arg. 102, 109-11, 135-36 (plaintiffs identifying Fung memo, Rodriguezmacedo report, and Halter report as being among their best documents, while cautioning that the Section 220 documents should be viewed in their totality because no single document represents a "smoking gun"); Defs.' Supplemental Br. 4-7 (Dec. 4, 2015) (noting that two of these reports were used in *New York Times* article and among the excerpted materials upon which Arkansas Complaint relied; and that the third memo is exculpatory and renders the two complaints substantively indistinguishable).

court's holding that demand was not futile precludes re-litigation of the issue in this case.[124]

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[124] Plaintiffs make two other arguments against issue preclusion that do not warrant in-depth discussion. First, they argue that issue preclusion cannot apply as a matter of federal common law because there is no "pre-existing substantive legal relationship" between the Arkansas plaintiffs and plaintiffs here. Pls.' Ans. Br. 14-15 (quoting *Taylor v. Sturgell*, 553 U.S. at 894). This argument is unavailing because the relevant substantive legal relationship is between Wal-Mart and the Arkansas plaintiffs, not between plaintiffs and the Arkansas plaintiffs, and because I have concluded that Wal-Mart was adequately represented by the Arkansas plaintiffs.

Second, plaintiffs argue that this case falls into one of two special exceptions to issue preclusion outlined in Section 28 of the Restatement. Pls.' Ans. Br. 28-30. The first exception is that re-litigation can be warranted "by differences in the quality or extensiveness of the procedures followed in the two courts." Restatement § 28(3). This exception generally addresses differences in the courts' competencies, such as using a finding from a summary proceeding in a small claims court to preclude an issue in a larger case. *Id.* cmt. d. Plaintiffs argue that the use of Section 220 differentiates the proceedings in this case. The use of Section 220 is not a difference in the quality of the two courts' procedures, but a difference in the parties' litigation decisions. Thus, the first exception is inapplicable.

The second exception arises from a "clear and convincing need for a new determination" based on a risk to the public interest, adversarial conduct, or other special reasons. *Id.* § 28(5). Plaintiffs argue that, as a policy matter, issue preclusion should not apply in cases such as this in order to ensure the usefulness of Section 220. A desire for Section 220 to be effective, however, is not the sort of urgent public need that justifies an exception to issue preclusion. Plaintiffs also argue that issue preclusion should not apply because defendants' litigation conduct in the Section 220 case delayed plaintiffs' prosecution of the Delaware action. This argument fails because Wal-Mart is the real party in interest being precluded, not the individual plaintiffs, and a full and fair opportunity to litigate Wal-Mart's interests was provided in Arkansas.

III. CONCLUSION

For the foregoing reasons, defendants' motion to dismiss is GRANTED.

IT IS SO ORDERED.

Supreme Court of the United States
Office of the Clerk
Washington, DC 20543-0001

SCOTT S. HARRIS
Clerk of the Court
(202) 479-3011

April 15, 2018

Mr. David C. Frederick
Kellogg, Hansen, Todd,
Figel & Frederick, P.L.L.C.
1615 M Street, NW
Suite 400
Washington, DC 20036-3209

Re: California State Teachers' Retirement System, et al. v. Aida M. Alvarez, et al.
Application No. 17A1104

Dear Mr. Frederick:

The application for an extension of time within which to file a petition for a writ of certiorari in the above-entitled case has been presented to Justice Alito, who on April 15, 2018, extended the time to and including June 22, 2018.

This letter has been sent to those designated on the attached notification list.

Sincerely,

Scott S. Harris, Clerk
by /s/ MELISSA BLALOCK
Melissa Blalock
Case Analyst

[attached notification list omitted]