APPENDIX A

2015 WL 13375767
United States District Court,
W.D. Arkansas, Texarkana Division.

IN RE WAL-MART STORES, INC.
SHAREHOLDER DERIVATIVE LITIGATION
This Document Relates to: All Actions

Master Docket No. 4:12-cv-4041

Signed 04/03/2015

AMENDED ORDER

Susan O. Hickey, United States District Judge

On March 31, 2015, the Court issued an Order (ECF No. 137) dismissing this case. The Court's Order is amended to reflect the correction of minor typographical errors. The Amended Order reads as follows:

Before the Court is a Motion to Dismiss Case for Failure to Establish Demand Futility filed by Nominal Defendant Wal-Mart and the Individual Defendants.[1] ECF No. 109. Plaintiffs have filed a response. ECF No. 114. Defendants[2] have filed a reply. ECF No. 115. The Court has reviewed the memoranda and various

[1] The term "Individual Defendants" refers to all persons named as defendants in this action.

[2] The "Defendants" collectively refers to Nominal Defendant Wal-Mart and the Individual Defendants.

supplements submitted by the parties. ECF Nos. 110, 116, 119, 121, 122, 124, 125, 127, 128, 129, 131, 132, 133, 134, 135, and 136. For the reasons set forth below, the Court will grant the motion filed by Defendants.

I. BACKGROUND

The following facts are drawn from allegations contained in Plaintiff's Consolidated Verified Shareholder Derivative Complaint ("Complaint"). ECF No. 16. The Court notes that, in this Order, page number references from ECF documents refer to the page number found in the ECF heading at the top of the filed ECF document.

Wal-Mart, a multinational retail company, is a Delaware corporation headquartered in Bentonville, Arkansas. Wal-Mart de Mexico ("Walmex") is Wal-Mart's largest and most profitable subsidiary. When the fiscal year 2012 ended, Walmex had generated approximately 28% of Wal-Mart's net sales.

At the time the Amended Complaint was filed in May 2012, Wal-Mart's board of directors ("the Board") was made up of the following fifteen members (collectively referred to as "Director Defendants"):

- H. Lee Scott has served as director since 1999. He was Wal-Mart's President and CEO from January 2000 through January 31, 2009. He continued as Executive Officer of Wal-Mart and as Chairman of the Board's Executive Committee until his retirement on January 31, 2011.

- Michael T. Duke has served as a director since November 2008. He is currently President and CEO of Wal-Mart. He has served on the Board's Executive Committee since 2008. He has also served as the Vice Chairman with responsibility for Wal-Mart International and as Executive Vice President and President and CEO of Wal-Mart U.S.
- S. Robson Walton has served as a director since 1978 and as Chairman of the Board since 1992. He has served on the Board's Executive Committee since 2005. Prior to becoming Chairman of the Board in 1992, he held a variety of positions with Wal-Mart, including Senior Vice President, Corporate Secretary, General Counsel, and Vice Chairman. He is the son of Wal-Mart's founder, Sam Walton.
- Jim C. Walton has served as a director since September 28, 2005. He has served on the Board's Strategic Planning and Finance Committee since 2005. He is also the son of Sam Walton.
- James W. Breyer has served as a director since 2001. He has served on the Board's Strategic Planning and Finance Committee since 2005.
- Michelle Burns has served as a director since 2003. She served on the Board's Audit Committee between 2003 and February 20, 2006, and on the Compensation, Nominating and Governance Committee during

2007. She has served on the Strategic Planning and Finance Committee since 2007.

- Christopher J. Williams has served as a director since 2004. He has served on the Board's Audit Committee since March 4, 2005, and has been the Chairman of the Audit Committee since 2008.
- Douglas N. Daft has served as a director since January 2005. He has served on the Board's Compensation, Nominating and Governance Committee since 2005.
- Linda S. Wolf has served as a director of Wal-Mart since June 2005. She has served on the Board's Compensation, Nominating and Governance Committee since 2006.
- Gregory B. Penner has served as a director since 2008. He served on the Board's Strategic Planning and Finance Committee in 2009. From 2002 to 2005, he served as Wal-Mart's Senior Vice President and Chief Financial Officer-Japan. He is the son-in-law of S. Robson Walton.
- Aida M. Alvarez has served as a director since 2006 and a member of the Board's Audit Committee since 2007.
- James I. Cash has served as a director and a member of the Board's Audit Committee since 2006.
- Roger C. Corbett has served as a director since 2006.

- Steven S. Reinemund has served as a director and a member of the Board's Compensation, Nominating and Governance Committee since 2010.
- Arne M. Sorenson has served as a director and a member of the Board's Audit Committee since 2008.

These fifteen individuals constitute the Board for purposes of evaluating demand futility. Eight of these fifteen Director Defendants were on the Board in 2005-2006, which is when most of the alleged wrongful conduct in this case occurred.

Plaintiffs, who are certain shareholders of Wal-Mart, allege that, beginning in 2003, Walmex's top leaders, including its lead executive Eduardo Castro-Wright and general counsel José Luis Rodriguez-macedo, engaged in a systemic campaign of bribery throughout Mexico to ensure quick and easy approval of building permits for Walmex's new stores. This scheme was first revealed to the public on April 12, 2012, by a journalist in the article titled "Wal-Mart Hushed Up a Vast Mexican Bribery Case" published by *The New York Times*. The primary source quoted in the article is a former Walmex inhouse attorney, Sergio Cicero Zapata ("Cicero"), who had worked in Walmex's real estate department for over ten years before he retired in 2004.

On September 21, 2005, Cicero sent an email to Maritza Munich, general counsel of Wal-Mart International, which stated that he had information about irregularities authorized by individuals at Walmex, including its board chairman, general counsel, chief auditor, and top real estate executive. Munich hired

a prominent attorney in Mexico City to debrief Cicero. Cicero detailed how Castro-Wright and Rodriguez-macedo, along with other top Walmex officials, had funneled millions of dollars to middlemen, known as "gestores," to bribe local government officials to approve plans to build Walmex stores. This allowed Walmex to quickly build hundreds of new stores. The payments to gestores were masked by fabricated invoices and recorded as legitimate business expenses.

In October 2005, Munich sent memos detailing Cicero's allegations to Wal-Mart's senior management, including Wal-Mart's general counsel, Thomas Mars. On October 15, 2005, a Wal-Mart attorney sent Duke, who was Vice Chairman of the International Division, an email detailing Cicero's allegations. Wal-Mart hired an outside law firm, Willkie Farr & Gallagher, who had extensive experience in Foreign Corrupt Practices Act cases, to conduct an investigation regarding the bribery allegations. Willkie Farr proposed a four-month investigation plan. The proposed investigation plan called for: (1) tracing all payments to anyone who had helped Walmex obtain permits in the past five years; (2) scrutinizing any and all payments to government officials; and (3) interviewing every person who might know about the payoffs, including implicated members of Walmex's board of directors.

Wal-Mart rejected Willkie Farr's investigation proposal. Instead, Wal-Mart assigned its own Corporate Investigations Unit to conduct a preliminary investigation. Once the preliminary investigation was completed, Wal-Mart would proceed with a full investigation if it determined that there was a likelihood

that laws had been violated. The Corporate Investigations Unit was comprised of less than seventy employees, and only four of these employees specialized in corporate fraud. Ronald Halter, a former FBI agent, led the two-week investigation that commenced on November 12, 2005. Duke traveled to Mexico City to meet with Walmex officials who were unhappy that Halter was investigating the gestores payments. In a document entitled "Investigation and Audit Plan," Halter stated that he would give a progress report on the investigation to Bentonville management and the Chairman of the Audit Committee, Roland A. Hernandez, on November 16, 2005.

In a December 2005 report, Halter stated that "[t]here is reasonable suspicion to believe that Mexican and USA laws have been violated" and that there was "no defendable explanation" for the millions of dollars in gestores payments. The report described hundreds of gestores payments, mystery codes used to conceal those payments, and rewritten audits. According to Plaintiffs, Halter's report was presented to Wal-Mart's top management, including the CEO (Scott), the general counsel (Mars), and the 2005-2006 board of directors.

In February 2006, Plaintiffs allege that Scott, Mars, and these directors instituted a cover-up after hearing the evidence of bribery, which included ending the investigation into Walmex and handed control of the investigation to Rodriguezmacedo, one of the investigation's main suspects. In May 2006, Rodriguezmacedo concluded the investigation by compiling a six-page report exonerating himself and his fellow Walmex employees. Rodriguezmacedo stated in the report that there was no evidence or clear indication

of bribes paid to Mexican government authorities with the purpose of wrongfully securing any licenses or permits. In 2005, Castro-Wright was promoted to senior executive in charge of all Wal-Mart stores in the United States

Plaintiffs allege that the Individual Defendants concealed violations of the Foreign Corrupt Practices Act and mislead investors concerning the bribery at Walmex with false proxy statements filed with the United States Securities and Exchange Commission ("SEC"). In December 2011, after learning of *The New York* Times' investigation, Wal-Mart informed the United States Department of Justice and the SEC that Wal-Mart had begun an internal investigation into possible violations of the Foreign Corrupt Practices Act.

On April 27, 2012, four days after *The New York Times* article was published, the first shareholder derivative action[3] was filed in the United States District Court for the Western District of Arkansas against current and former directors and officers of Wal-Mart. Seven additional shareholder actions were filed in Arkansas, and these actions have been consolidated into the present action.

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[3] "The derivative form of action permits an individual shareholder to bring suit to enforce a corporate cause of action against officers, directors, and third parties." *Kamen v. Kemper Fin. Servs. Inc.*, 500 U.S. 90, 95, 111 S. Ct. 1711 (1991) (citations omitted) (internal quotations omitted). The purpose of the derivative action is "to place in the hands of the individual shareholder a means to protect the interests of the corporation from the misfeasance and malfeasance of faithless directors and managers." *Id*. (citations omitted) (internal quotations omitted).

Plaintiffs allege that the Individual Defendants breached their fiduciary duties of loyalty and good faith by: (1) permitting violations of foreign and federal laws and Wal-Mart's code of ethics; (2) permitting the obstruction of an adequate investigation of known potential (and/or actual) violations of foreign and federal laws; and (3) covering up (or attempting to cover up) known potential (and/or actual) violations of foreign and federal laws. ECF No. 16, ¶ 284. Plaintiffs also allege that Individual Defendants violated Sections 14(a) and 29(b) of the Exchange Act by causing Wal-Mart to make false or misleading statements in its April 2010 and April 2011 proxy materials relating to annual director elections. ECF No. 16, ¶¶ 286-296.

Defendants move to dismiss the Complaint (ECF No. 16) pursuant to Rule 23.1 of the Federal Rules of Civil Procedure. Defendants assert that Plaintiffs have failed to adequately allege demand futility as required by applicable Delaware law.

II. STANDARD OF REVIEW

A. Rule 23.1

Federal Rule of Civil Procedure 23.1 requires a shareholder seeking to represent the interests of a corporation through a derivative suit to either demand that the corporation's directors take action or plead with particularity the futility of making such a demand. *Gomes v. Am. Century Co., Inc.*, 710 F.3d 811, 815 (8th Cir. 2013). The law encourages corporations to address problems internally, and the purpose of Rule 23.1 is to "affor[d] the directors an opportunity to exercise their reasonable business judgment and waive a legal right vested in the corporation in the be-

lief that its best interests will be promoted by not insisting on such right." *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96, 111 S. Ct. 1711 (1991). Rule 23.1 does not establish guidelines for determining whether demand would be futile; thus a court must look to the substantive law of the state of incorporation. *Id*. at 108-09.

B. Delaware Law

In the present case, because Wal-Mart is a Delaware corporation, Delaware law governs the substantive aspects of the demand requirement. *See id*. Plaintiffs did not demand Board action before filing this lawsuit, and they assert that the demand requirement should be excused by futility. Demand is required if, in view of all the particularized allegations in the Complaint and drawing all reasonable inferences in favor of Plaintiffs, there is no reasonable doubt of the ability of a majority, here eight of the fifteen Director Defendants, to respond to demand appropriately. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 833 A.2d 961, 977 (Del. Ch. 2003). Delaware has developed two approaches to claims of demand futility. The parties dispute which of the two should be applied to this case.

When a case alleges that the directors made a conscious business decision in breach of their fiduciary duties, courts must apply the *Aronson* test to determine whether demand was futile. *Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008). This test requires a plaintiff to allege particularized facts creating a reason for the Court to doubt that "(1) the directors are disinterested and independent [or that] (2) the challenged

transaction was otherwise the product of a valid exercise of business judgment." *Id*. (citing *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984) (overruled on other grounds)). If either prong of the *Aronson* test is met, demand is excused. *In re J.P. Morgan Chase & Co. S'holder Litig.,* 906 A.2d 808, 820 (Del. Ch. 2005).

On the other hand, "where the subject of a derivative suit is not a business decision of the [b]oard but rather a violation of the [b]oard's oversight duties," courts must apply the *Rales* test to determine whether demand was futile. *Wood,* 953 A.2d at 140. This test requires a plaintiff to allege "particularized facts establishing a reason to doubt that 'the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.'" *Id*. (citing *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993)).[4]

Here, Defendants contend that the *Aronson* test does not apply because Plaintiffs do not challenge a specific board action. Defendants also contend that, under either the *Aronson* or *Rales* test, Plaintiffs have failed to plead particularized facts establishing demand futility. Plaintiffs respond that their Complaint satisfies both tests; however, they assert that the Court should apply the *Aronson* test to this case because the Board made a conscious decision not to act, which is a conscious action.

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[4] The *Rales* test is essentially the first prong of *Aronson*. *See Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003). Both *Aronson* and *Rales* call upon courts to ascertain whether directors were disinterested and independent. *In re SAIC Inc. Derivative Litig*., 948 F. Supp. 2d 366, 377 (S.D.N.Y. 2013) (applying Delaware law).

In their Complaint, Plaintiffs attempt to invoke the *Aronson* test by referencing alleged decisions made collectively by the Board and stating that these decisions "were not valid exercises of business judgment." ECF No. 16, ¶¶ 256-260. Plaintiffs conclusively allege that the Director Defendants collectively made a "decision to violate the FCPA and Mexican law," "to close the investigative case into bribery in Mexico," "to seek reelection while concealing the wrongdoing," "to reward wrongdoers through promotions and compensation," and "to conceal the wrongdoing." ECF No. 16, ¶¶ 256-260. Plaintiffs also allege that the Board made a conscious decision not to take action in response to clear evidence of criminal conduct and that this is a decision reviewable under *Aronson*. ECF No. 114, p. 21.

The Complaint alleges Defendants breached their fiduciary duties to Wal-Mart and are personally liable to it for alleged losses. ECF No. 16, ¶¶ 282-285. The Complaint further alleges that the Director Defendants caused Wal-Mart to disseminate false and misleading proxy statements. ECF No. 16, ¶¶ 286-292. According to Plaintiffs, Defendant Scott was obligated to report any material violation of laws by Wal-Mart directly to the Audit Committee of the Board. ECF No. 16, ¶ 57. The Complaint identifies Defendants Burns and Williams as members of the Audit Committee and alleges that they had a duty to report to the Board any instances of Wal-Mart's non-compliance with the FCPA. ECF No. 16, ¶¶ 28-29. The Complaint consistently implies that Defendants should have or must have known about the alleged misconduct by virtue of their positions and the supposed reporting structure at Wal-Mart. ECF No. 16, ¶¶ 135,

219, 261, 265. According to Plaintiffs, "senior executives ... knew about" the alleged misconduct, those "executives [were] required to regularly report to the Audit Committee of Wal-Mart's Board," and the Audit Committee, in turn, "was obligated to report on [this] to Wal-Mart's full Board." ECF No. 114, p. 30. Plaintiffs allege that, given the "inference" that information concerning bribery was reported to Wal-Mart's Board, Wal-Mart made a conscious decision not to act on this information.

Plaintiffs reference vague "decisions" made by Defendants but do not plead with particularity who made these decisions, how these decisions were made, or when the decisions were made.[5] *See La. Mun. Police Employees' Retirement Sys. v. Hesse*, 962 F. Supp. 2d 576, 584 (S.D.N.Y. 2013) (relying on Delaware law and stating that *Aronson* does not apply when a plaintiff offers no facts to show that a defendant made a conscious decision to act, such as when the decision was made and the contours of the decision). Plaintiffs generally allege that the Board made a decision not to act in response to evidence of criminal conduct. ECF No. 114, p. 27. Missing from the Complaint are any particularized facts that link a majority of the Director Defendants to any actual decision. Plaintiffs point to no alleged meeting, discussion, or

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[5] Plaintiffs conclusively refer to "decisions" by the Board to "conceal the wrongdoing" (ECF No. 16, ¶ 260), "to let Walmex 'self-investigate'" (ECF No. 114, p. 19), "to violate the FCPA and Mexican law" (ECF No. 16, ¶ 256), and "to allow then-CEO Scott to quash the investigation ... and to cover up the criminal enterprise" (ECF No. 114, p. 26).

vote where the Board allegedly made one of these decisions. This lack of such particularized facts regarding a conscious decision about how or whether to respond to the alleged misconduct indicates that an analysis under *Aronson* is inappropriate.[6] *See South v. Baker*, 62 A.3d 1, 14 (Del. Ch. 2012) (stating that absent an allegation "that any particular director in office at the time of the filing of the complaint made a specific decision challenged in the complaint, so the more specialized two-part *Aronson* test does not apply"); *Seminaris v. Landa*, 662 A.2d 1350, 1354 (Del. Ch. 1995) ("Plaintiff does not challenge any specific board action that approved or ratified these alleged wrongdoings. Plaintiff must satisfy the one step test announced in *Rales* to demonstrate that he was excused from making a demand.").

III. DISCUSSION

Plaintiffs set forth their reasons for failing to make a demand on the Board in paragraph 255 of the Complaint. These reasons include: "(1) the Board's actions which damaged [Wal-Mart] were the product of

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[6] The Court notes, however, that the difference between *Rales* and *Aronson* may blur in cases like this one, since 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 judgment protections. *See Guttman v. Huang*, 823 A.2d 492, 501 (Del Ch. 2003) (recognizing this overlap and stating that when "there are allegations that a majority of the board that must consider a demand acted wrongfully, the *Rales* test sensibly addresses concerns similar to the second prong of *Aronson*").

a valid exercise of business judgment; and/or (2) a majority of the Board is incapable of making an independent and disinterested decision about whether to institute and vigorously prosecute this action." Because the Court has determined that the *Rales* test applies to this case, the Court will not consider whether the Board's actions, or conscious inaction, were a valid exercise of business judgment.[7]

Under *Rales*, these allegations must establish a reason to doubt that the Board could have properly exercised its independent and disinterested business judgment in responding to a demand. *Rales*, 634 A.2d at 934. A reasonable doubt of disinterestedness can be shown if Plaintiffs' particularized allegations, construed as true, demonstrate a "substantial likelihood" of Defendants' personal liability. *Id*. at 936 (finding a reasonable doubt of disinterestedness where the potential for liability is not a mere threat but instead may rise to a substantial likelihood).

Wal-Mart's charter immunizes its directors from liability for breaches of fiduciary duty to the fullest extent allowed by § 102(b)(7) of the Delaware General Corporation Law. ECF No. 111-1, p. 13. Thus, Wal-Mart's charter exculpates its directors from personal

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[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 judgment protections. *See Guttman*, 823 A.2d at 501 (recognizing the overlap and stating that when "there are allegations that a majority of the board that must consider a demand acted wrongfully, the *Rales* test sensibly addresses concerns similar to the second prong of *Aronson*").

liability for monetary damages except "breaches of the duty of loyalty or actions or omissions not in good faith or that involve intentional misconduct or a knowing violation of law." *In re SAIC, Inc. Deriv. Litig.*, 948 F. Supp. 2d 366, 378 (S.D.N.Y. 2013) (applying Delaware law). Where directors are contractually or otherwise exculpated from liability except for claims based on fraudulent, illegal, or bad faith conduct, a plaintiff must plead particularized facts that demonstrate the directors acted with scienter, meaning that they had actual or constructive knowledge that their conduct was legally improper. *Wood*, 953 A.2d at 141.

A. Substantial Likelihood of Liability for Participation in the 2005-2006 Events

Plaintiffs allege that Defendants breached their fiduciary duties to Wal-Mart by permitting its directors and officers to violate foreign and federal laws, by permitting the obstruction of an adequate investigation of these violations, and by covering up these violations. Plaintiffs further allege that a majority of the Director Defendants have a strong interest in refusing to bring the claims asserted by Plaintiffs because a majority of the Director Defendants[8] face a substantial likelihood of personal liability stemming from a majority of the Director Defendants' active participation in the 2005-2006 events. According to Plaintiffs, nine Director Defendants knew about the wrongful conduct in 2005-2006 (the alleged bribery in Mexico and the internal investigation that allegedly con-

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[8] Plaintiffs identify these nine Director Defendants as Scott, Duke, S. Robson Walton, Jim Walton, Breyer, Burns, Daft, Williams, and Wolf.

cealed the wrongdoing) and either actively participated in it or acquiesced in it. Defendants argue that Plaintiffs have failed to sufficiently plead that a majority of the Board knew about or consciously ignored the alleged wrongful conduct in 2005-2006 and therefore cannot show that a majority of the Director Defendants face a substantial likelihood of personal liability. The Court agrees.

Nothing in the Complaint suggests any particularized basis to infer that a majority of the Board had actual or constructive knowledge of the alleged misconduct, let alone that they acted improperly with scienter. *See Guttman*, 823 A.2d at 504. Plaintiffs' 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. Thus, as discussed below, Plaintiffs have failed to plead with particularity that at least eight Director Defendants face a substantial likelihood of personal liability so that their ability to consider a demand impartially would be compromised.

1. Director Defendants Breyer, Burns, Daft, Williams, and Wolf

Breyer, Burns, Daft, Williams, and Wolf were on the Board during the alleged 2005-2006 misconduct. Plaintiffs allege in a conclusory fashion that these five Director Defendants must have had knowledge because they were "either directly informed of the wrongdoing or were informed through the proper operation of the Board's governance and [Wal-Mart's] reporting systems." ECF No. 16, ¶ 278. According to Plaintiffs, these five Director Defendants must have

known about the alleged Walmex events merely because "Scott had an obligation to report" them to the Audit Committee and, in turn, "the Audit Committee was required ... to report" them "to the full Board of Directors." ECF No. 114, p. 17.

Notably, Plaintiffs do not allege that Scott actually reported the Walmex events to the Audit Committee. Plaintiffs have alleged no facts to support the allegation that this group of five Director Defendants were "directly informed" of any wrongdoing. Instead, Plaintiffs rely on group-wide conclusory allegations about what the Board must have known based on an imputation of knowledge theory. This theory, however, is flawed.

First, Plaintiffs' allegations that these five Director Defendants should have been informed of the wrongdoing "through the proper operation of the Board's governance and [Wal-Mart's] reporting systems" are not sufficiently particular to show that these Director Defendants had constructive knowledge of wrongdoing. Courts may not impute knowledge of wrongdoing to directors simply because they serve on the board or because the corporate governance structure requires that notice of the wrongdoing reach the board. *Gulbrandsen v. Stumpf*, 2013 WL 6406922, at *6 (N.D. Cal. Dec. 6, 2013) (applying Delaware law); *In re Citigroup Inc. v. S'holder Derivative Litig.*, 964 A.2d 106, 135 (Del. Ch. 2009) ("[D]irector liability is not measured by the aspirational standards established by the internal documents detailing a company's oversight system."); *Wood*, 953 A.2d at 142; *Desimone v. Barrows*, 924 A.2d 908, 943, n.121 (Del. Ch. 2007) (Directors cannot be charged with knowledge of information simply because they served

on a board with a director who may have known such information).

Second, Plaintiffs allege that, because these five Director Defendants served on various committees during 2005-2006, they should be presumed to have been aware of the allegedly illegal conduct in Mexico and the alleged cover-up.[9] Delaware law, however, does not allow plaintiffs to presume a director's knowledge based on his or her committee membership. *See South*, 62 A.3d A 17 & n.6 ("As numerous Delaware decisions make clear, an allegation that the underlying cause of a corporate trauma falls within the delegated authority of a board committee does not support an inference that the directors on that committee knew of and consciously disregarded the problem for purposes of Rule 23.1."); *Wood*, 953 A.2d at 16 ("[T]he assert[ion] that membership on the Audit Committee is a sufficient basis to infer the requisite scienter is contrary to well-settled Delaware law.").

The Complaint is devoid of particularized facts on a director-by-director basis that would support that these five Director Defendants had knowledge of the alleged misconduct. Thus, Plaintiffs' allegation that the Board made a conscious "decision to condone and cover up criminal activity at the company" (ECF No. 114, p. 8) must fail because a conscious decision requires knowledge. Without showing knowledge,

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[9] Plaintiffs allege that Breyer served on the Committee on Strategic Planning, and therefore that he "would have inquired whether Wal-Mart's exponential growth in Mexico was being accomplished in compliance with the law." ECF No. 16, ¶ 224. Plaintiffs allege that Burns and Williams served on the Audit Committee, and therefore they must have received reports regarding the investigation. ECF No. 16, ¶ 28-29 and 135.

Plaintiffs cannot show that these five Director Defendants face a substantial likelihood of personal liability stemming from the 2005-2006 events.

2. Directors Alvarez, Cash, Corbett, Reinemund, and Sorenson

Alvarez, Cash, Corbett, Reinemund, and Sorenson joined the Board in recent years and were not on the Board during the alleged misconduct in 2005-2006. They are each mentioned by name in the lengthy Complaint only three times. ECF No. 16, ¶¶ 33-37, 254, and 269. Plaintiffs offer no reason why these five Director Defendants would face a substantial likelihood of personal liability stemming from the 2005-2006 conduct. Accordingly, Plaintiffs have not given the Court a reason to doubt that the ten Director Defendants discussed above—a majority of the Board—are capable of exercising a disinterested and independent business judgment.

B. Substantial Likelihood of Liability for Plaintiffs' *Caremark Claim*

Plaintiffs allege that certain Director Defendants breached their fiduciary duty of loyalty by not acting in good faith to ensure Wal-Mart's compliance with the law.[10] This special type of breach of loyalty claim is known as a *Caremark claim*,[11] and it is "possibly

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[10] Plaintiffs state that they "have pled this theory of liability as an alternative to their theory that Defendants deliberately violated the law." ECF No. 114, p. 39.

[11] *In re Caremark Int'l Inc. Derivative Litig*. held that a "sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of

the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 372 (Del. 2006). "The essence of a *Caremark* claim is a breach of the duty of loyalty arising from a director's bad-faith failure to exercise oversight over the company." *Rich ex rel. Fuqi Int'l, Inc. v. Yu Kwai Chong*, 66 A.3d 963, 980-82 (Del Ch. 2013). Bad faith "in the corporate fiduciary of loyalty context" includes "a failure to act in the face of a known duty to act, which demonstrates a conscious disregard of one's duties." *Gatz Properties, LLC v. Auriga Capital Corp.*, 59 A.3d 1206, 1216-17 (Del. 2012). "Under Caremark and its progeny, liability for such a failure to oversee requires a showing that the directors knew they were not discharging their fiduciary obligations or that they demonstrated a conscious disregard for their duties." *In re Intel Corp. Derivative Litig.,* 621 F. Supp. 2d 165, 174 (D. Del. 2008). Here, Plaintiffs have not alleged particularized facts sufficient to show a substantial likelihood of liability under this high standard. *See Rales,* 634 A.2d at 936.

According to Plaintiffs, demand is excused under *Rales,* because at least nine Director Defendants face a substantial likelihood of liability arising out of their conscious disregard of evidence of illegality.[12] Plaintiffs allege that certain Director Defendants received

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good faith that is a necessary condition to liability." 698 A.2d 959, 971 (Del. Ch. 1996).

[12] Plaintiffs allege that certain Director Defendants "learned that Wal-Mart internal investigators had confirmed the existence of widespread criminal bribery, but they allowed the investigation to be turned over to a culpable participant, Rodriguez-macedo, and buried it for six years." ECF No. 114, p. 40-41.

evidence of the alleged Walmex bribery scheme, and faced with this "red flag," consciously chose to ignore it. ECF No. 16, ¶ 228. Although the Complaint alleges that the Director Defendants knew of and ignored evidence of wrongdoing, the Complaint nowhere alleges with particularity what exactly the Director Defendants were told about the alleged misconduct or when they were told. Again, Plaintiffs charge most of the Director Defendants with constructive notice of the alleged red flag. The Court, however, has already rejected this theory and determined that Plaintiffs have not pled with particularity that a majority of the Board were put on notice of the alleged 2005-2006 misconduct. If a Director Defendant has no knowledge of the alleged misconduct (or "red flag"), he or she could not have consciously ignored it and disregarded any duty to act on it. Plaintiffs' allegations, therefore, are not sufficient to establish a substantial likelihood of liability giving rise to demand futility.

C. Substantial Likelihood of Liability for Filing False Proxy Statements

Plaintiffs allege that the Director Defendants "allow[ed] Wal-Mart to file false proxy statements in April 2010 and April 2011 in violation of Section 14 of the Exchange Act." ECF No. 114, p. 33. According to Plaintiffs, demand is excused under *Rales*,[13] because a majority of the Board face a substantial likelihood of liability arising out of their alleged filing of false proxy

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[13] The Court finds that the *Rales* standard is applicable here, because the conclusory references to the Board's failure to disclose are insufficiently particularized to allege a specific board decision to omit the information from the proxy statement. *See In re Morgan Stanley Der. Litig.*, 542 F. Supp. 2d 317, 322 (S.D.N.Y. 2008) (applying Delaware law).

statements. *See Rales*, 634 A.2d at 936. Plaintiffs allege that the Director Defendants materially represented the effectiveness of the Board's oversight of compliance issues at Wal-Mart. ECF No. 16, ¶ 288. This claim, however, fails because it rests on the same impermissible and unsupported inferences as Plaintiffs' other theories: the inference that the Board allowed the filing of the proxy statements *despite knowing they were false*. *See SEC v. Shanahan*, 646 F.3d 536, 546 (8th Cir. 2011) (holding that knowledge is the requisite state of mind for Section 14(a) claims, at least as to outside directors). Plaintiffs again rely on the same imputation of knowledge theory that the Court has discussed above, and the Court again rejects this imputation theory as it relates to the Section 14(a) claims.

Further, the Complaint does not contain specific factual allegations that reasonably suggest that a majority of the Director Defendants were involved in the preparation or approval of the proxy statements. *See In re Bank of N.Y. Mellon Corp. Forex Transactions Litig.*, 991 F. Supp. 2d 457, 463 (S.D.N.Y. 2013) (applying Delaware law). There are no allegations explaining any process by which the Board actively or purposefully made a decision to omit the allegedly missing information. Other than pointing to language appearing on the notices of the annual shareholders' meetings declaring that the notices were issued "By the Order of the Board of Directors," Plaintiffs do not allege what specific actions any Defendant Director took to approve or ratify the alleged wrongdoings. Instead, Plaintiffs conclusively state that the Board "caused Wal-Mart to disseminate" the proxy state-

ments. ECF No. 16, ¶ 269. The Court, therefore, cannot conclude that demand is excused based on the theory that a majority of the Board face a substantial likelihood of liability arising out of their filing false proxy statements.

IV. CONCLUSION

For the reasons discussed above, the Court finds that Plaintiffs' conclusory allegations fail to satisfy the requirements for pleading demand futility. Accordingly, Defendants' Motion to Dismiss Case for Failure to Establish Demand Futility (ECF No. 109) is **GRANTED**, and this case is **DISMISSED**.[14]

IT IS SO ORDERED, this 3rd day of April, 2015.

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[14] In their response (ECF No. 114, p. 41), Plaintiffs request leave to address any pleading deficiencies in an amended complaint, in the event the Court finds the Complaint deficient. Plaintiffs, however, fail to advise the Court of how an amendment would cure the defects in the Complaint. Thus, the Court has no idea of what Plaintiffs' amendment might look like or what additional facts may entitle them to relief. Accordingly, the Court concludes that granting leave to amend is inappropriate and Plaintiffs' request for leave to amend is denied.

APPENDIX B

829 F.3d 983

United States Court of Appeals,

Eighth Circuit.

John COTTRELL, Derivatively and ON BEHALF OF WAL-MART STORES, INC.; Louisiana Municipal Police Employees' Retirement System; Elizabeth Tuberville; Kathryn Johnston Lomax; William Cottrell; Andrew Richman; Larry Emory, Derivatively and on behalf of Wal-Mart Stores, Inc.; Nathan F. Austin, Plaintiffs-Appellants,

v.

Michael T. DUKE; Aida M. Alvarez; James W. Breyer; M. Michelle Burns; James I. Cash, Jr.; Roger C. Corbett; Douglas N. Daft; Gregory B. Penner; Steven S. Reinemund; H. Lee Scott, Jr.; Arne M. Sorenson; Jim C. Walton; S. Robson Walton; Christopher J. Williams; Linda S. Wolf; Wal-Mart Stores, Inc., Nominal Defendant; Eduardo Castro-Wright; Thomas A. Mars; Thomas D. Hyde, Defendants-Appellees, Craig Herkert; Eduardo F. Solorzano Morales; Jose Luis Rodriguezmacedo Rivera; Lee Stucky, Defendants, Roland Hernandez, Defendant–Appellee

No. 15-1869

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Submitted: April 14, 2016

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Filed: July 22, 2016

RILEY, Chief Judge.

Owners of shares of Wal-Mart Stores, Inc. (Wal-Mart) sued directors and officers of the corporation, accusing them of breaking state and federal law by permitting and then covering up pervasive bribery committed on behalf of Wal-Mart's Mexican subsidiary, Wal-Mart de Mexico (Wal-Mex). Because the shareholders sought to enforce rights belonging to Wal-Mart, Federal Rule of Civil Procedure 23.1 required them to explain why they did not first ask the board of directors to cause the corporation to pursue the suit itself. The shareholders claimed it would have been futile to go to the board with such a demand. We agree with the district court[1] that the shareholders' explanation was not specific or detailed enough, and we affirm the dismissal of their complaint.

I. BACKGROUND

We recite the material facts taking the allegations in the shareholders' complaint as true. *See, e.g.*, *Gomes v. Am. Century Cos.*, 710 F.3d 811, 815 (8th Cir. 2013). In September 2005, a former Wal-Mex executive, tired of the "'pressure and stress' of participating in years of corruption" and resentful of being snubbed for a promotion, contacted the general counsel for Wal-Mart's international division and said he had information about financial "'irregularities' authorized 'by the highest levels' at Wal-Mex." Since at least 2002, he claimed, Wal-Mex had engaged in an extensive and systematic practice of bribing Mexican

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[1] The Honorable Susan O. Hickey, United States District Judge for the Western District of Arkansas.

officials, with most of the payoffs facilitated by fixers or middlemen called "gestores." The scheme was orchestrated by top executives, including Wal-Mex's then-CEO, Eduardo Castro-Wright—a rising star who later took over Wal-Mart's U.S. division—and general counsel, José Luis Rodríguezmacedo Rivera (Rodríguezmacedo), with the goal of clearing Mexican regulatory and bureaucratic hurdles so Wal-Mex could take over market share by expanding faster than its rivals could react.[2] After hiring a Mexico City lawyer to debrief the former executive and flying south to meet face-to-face, the general counsel of the international division sent memoranda recounting his claims to Wal-Mart's senior management.

Wal-Mart's first response was to retain an outside law firm to investigate. When the firm proposed questioning "implicated members" of Wal-Mex's board, along with anyone else who might have known about the payments, and tracing every peso Wal-Mex had paid for help getting permits over the past five years, including "any and all payments" to Mexican officials, Wal-Mart decided to have its own Corporate Investigations unit look into the allegations instead. This "Preliminary Inquiry" was expected to last about two weeks in mid-November 2005, according to a partial "Investigation and Audit Plan" attached as an exhibit to the shareholders' complaint.

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[2] According to the shareholders, when they filed their complaint in 2012 Wal-Mex had 2,100 stores and 209,000 employees—making it Mexico's largest private employer—and annual sales of 379 billion pesos, or $29 billion. Wal-Mart allegedly had a total of 10,130 stores and 2.2 million employees.

Wal-Mart's investigators quickly found evidence consistent with the executive's claims, including hundreds of recorded payments to gestores, totaling millions of dollars, plus additional millions in direct "contributions" and "donations" to Mexican authorities. Three days into the investigation, on November 14, 2005, the director of corporate investigations emailed his boss, Wal-Mart's vice president for global security, aviation, and travel, to let him know, simply, "It is not looking good." Besides the payments themselves, the investigators also turned up materials suggesting complicity at the highest levels of Wal-Mex. For example, when an internal Wal-Mex audit in 2004 warned of the increasing amounts the company was paying two gestores to make "facilitating payments" for permits to open new stores, Castro-Wright's concern was not the possibility Wal-Mex owed its rapid growth to illegal payoffs but the risk of becoming overly dependent on too few intermediaries. The solution, directed by Rodríguezmacedo, was to "diversify" the pool of gestores Wal-Mex dealt with—and to scrub references to the issue from the reports that would go to Wal-Mart management.

The investigation ruffled feathers at Wal-Mex, and complaints made their way to the head of Wal-Mart's international division, Michael Duke. Duke, who later became Wal-Mart's president and CEO, was in Mexico on other business just as the investigators were wrapping up their review, and Duke took the opportunity to meet with and reassure Wal-Mex executives offended by the investigators' tone and questions.

The investigators prepared a draft report, dated December 1, concluding "[t]here is reasonable suspicion to believe that Mexican and USA [sic] laws have been violated." It is unclear who saw the report. The document itself, or at least the excerpt attached to the shareholders' complaint, does not say to whom it was sent, though an introductory statement that "Wal-Mart Store's [sic] Internal Audit charter requires that the results of Internal Audit reviews be reported to *management*" (emphasis added) might suggest its intended recipients. The investigation and audit plan had called for "a progress report [to] be given to Bentonville"—Arkansas, Wal-Mart's headquarters—"management and the Chairman of the Audit Committee" on November 16 and for "[a]dditional progress reports [to] be given as appropriate." The shareholders allege, without additional detail, the investigators' findings and suspicions were reported to the chair of Wal-Mart's audit committee, Wal-Mart's CEO, and its general counsel and, "through these three individuals, to the entire Wal-Mart Board."

Over the next two months, the investigators urged Wal-Mart to authorize a full in-house investigation based on their preliminary findings. Instead, in February 2006, Wal-Mart's then-CEO, H. Lee Scott, transferred control over the matter from the nominally independent Corporate Investigations unit to Wal-Mex itself, under the direction of Rodríguez-macedo as general counsel. Far from undertaking the sort of in-depth, exhaustive inquiry the original investigators envisioned, Rodríguezmacedo quickly wrapped up the case, clearing himself and his Wal-Mex colleagues largely based on their denials and the absence of direct evidence—the executives never

"mentioned having ordered or given bribes to government authorities." Much of his six-page report was devoted to questioning the credibility of the former executive whose allegations set the investigation in motion, suggesting the former executive had tricked Wal-Mex into paying gestores "unnecessarily, or for services never rendered" and might have pocketed some of the money for himself. Wal-Mart's director of corporate investigations, although no longer running the investigation, reviewed two drafts of the report. Even after revisions, he thought it was "truly lacking." But Wal-Mart's senior executives were satisfied and closed the inquiry.

All was quiet for several years, until Wal-Mart learned the *New York Times* was conducting its own investigation into what happened at Wal-Mex in the early 2000s. Apparently the whistle-blowing former executive, dissatisfied with the company's response, had shared his story with the press as well. Facing imminent exposure, Wal-Mart resurrected its internal investigation, preemptively informed the U.S. Department of Justice and Securities Exchange Commission it was looking into possible violations of the Foreign Corrupt Practices Act, 15 U.S.C. §§ 78dd–1 to -3, and disclosed both responses in its next quarterly report. The *Times* article, titled "Wal-Mart Hushed Up a Vast Mexican Bribery Case," came out on April 21, 2012.

Derivative lawsuits by Wal-Mart shareholders followed within days. This case brings together eight of them.[3]

In their consolidated complaint, the shareholder plaintiffs alleged numerous Wal-Mart directors and executives, past and present, breached their fiduciary duties to the corporation by allowing Wal-Mex's bribery, covering it up, and letting the internal investigation be watered down to nothing. They also asserted the defendants were liable to Wal-Mart for violating Sections 14(a) and 29(b) of the Securities Exchange Act, 15 U.S.C. §§ 78n(a)(1), 78cc(b), *see also* 17 C.F.R. § 240.14a–9(a) (implementing Section 14(a)(1)), reasoning the defendants caused Wal-Mart to issue proxy statements in connection with board elections in 2010 and 2011 that were false or misleading because they said the directors up for reelection had "integrity," the

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[3] Six lawsuits were filed in federal court in the Western District of Arkansas, where the lawsuits remained. The other two lawsuits were originally filed in Arkansas state court, removed to the Eastern District of Arkansas, and then transferred to the Western District. The district court consolidated the cases as they came in. *See* Fed. R. Civ. P. 42(a)(2).

Lawsuits raising some of the same issues were filed in Delaware state court as well. The district court initially stayed this case to wait for the results of the Delaware litigation, but we vacated the stay and remanded for the federal case to go forward. *See Cottrell v. Duke*, 737 F.3d 1238, 1241, 1250 (8th Cir. 2013). After the district court's decision to dismiss in this case, while this appeal was pending, the Delaware Court of Chancery dismissed the Delaware plaintiffs' complaints, holding that under Arkansas's law of collateral estoppel they could not relitigate the same points. *See In re Wal–Mart Stores, Inc. Del. Derivative Litig.*, No. 7455–CB, 2016 WL 2908344, at *23–24 (Del. Ch. May 13, 2016) (unpublished).

incumbent board tried to ensure Wal-Mart followed the law, and the board and CEO followed Wal-Mart's internal ethical codes.[4] Although the causes of action arising from these alleged violations would have accrued to Wal-Mart, the shareholders did not demand that the corporation, led by its current board, pursue the claims itself. Rather, they alleged circumstances that they thought demonstrated the board could not make that decision impartially, so it was pointless to go through the motions of making demands.

The defendants moved to dismiss on the ground that the shareholders' allegations about the futility of demanding action from the board did not satisfy the pleading requirements of Rule 23.1. *See also* Fed. R. Civ. P. 12(b)(6). The district court granted the motion. The shareholders appeal, invoking our appellate jurisdiction under 28 U.S.C. § 1291.

II. DISCUSSION

Rule 23.1(b)(3) says that shareholders seeking to enforce a corporation's rights through a derivative action must "state with particularity" "any effort" they took "to obtain the desired action from the [corporation's] directors" and "the reasons for not obtaining the action or not making the effort." On its face, that language does not make seeking action from the board a prerequisite to bringing a derivative suit, though it does "clearly *contemplate[ ]*" that such a requirement might apply. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96, 111 S.Ct. 1711, 114 L.Ed.2d 152 (1991). We have therefore recognized Rule 23.1 as "'a

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[4] The shareholders also cursorily pled contribution and indemnity claims, which they do not pursue on appeal.

rule of pleading' that 'requires that the complaint ... allege the facts that will enable a federal court to decide whether'" derivative plaintiffs complied with such a demand requirement imposed by another source. *Gomes*, 710 F.3d at 815 (quoting *Halebian v. Berv*, 590 F.3d 195, 211 (2d Cir. 2009), *abrogated on other grounds by Espinoza ex rel. JPMorgan Chase & Co. v. Dimon*, 797 F.3d 229 (2d Cir. 2015)).

Here, the law of Delaware—where Wal-Mart is incorporated—provides the substantive demand requirement against which to test the shareholders' allegations.[5] *See id.* According to Delaware law, in cases like this, shareholders who did not make a demand on the board cannot bring a derivative suit unless their "particularized factual allegations ... create a reasonable doubt that, as of the time the complaint [was] filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[6] *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993). One reason a

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[5] This is true even though some of the shareholders' claims are based on federal law, because "where a gap in the federal securities laws must be bridged by a rule that bears on the allocation of governing powers within the corporation, federal courts should incorporate state law into federal common law unless the particular state law in question is inconsistent with the policies underlying the federal statute," *Kamen*, 500 U.S. at 108, 111 S. Ct. 1711, and there is no indication of inconsistency with the Exchange Act here.

[6] We agree with the district court that the practical distinction between this standard and the alternative two-pronged analysis articulated in *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984), is "blur[red]" and hard to discern in this case. *Accord Guttman v. Huang*, 823 A.2d 492, 500–01 (Del. Ch. 2003). On appeal the

board might be unable to make a disinterested decision is if a majority of the directors would face "'a substantial likelihood'" of personal liability from a lawsuit brought by the corporation. *Id.* at 936 (quoting *Aronson*, 473 A.2d at 815) ("In such circumstances, a director cannot be expected to exercise his or her independent business judgment without being influenced by the adverse personal consequences resulting from the decision.").

Wal-Mart had fifteen directors when the shareholders filed their complaint in 2012. Two of them, Duke and Scott, allegedly dealt directly with aspects of the Wal- Mex investigation in their roles as executives, and the defendants do not argue those two were disinterested. The focus of this appeal is the seven other 2012 directors who were on the board at the time of the investigation in 2005 and 2006.[7] For those seven directors to face personal liability, the parties agree, they must have at least been aware of the claimed misconduct at Wal-Mex when they allegedly

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shareholders no longer argue that the *Aronson* test should apply instead.

[7] The shareholders briefly suggest one of the six directors who joined the board later, Gregory Penner, was not independent because his father-in-law, S. Robson Walton, was on the old board. *Cf., e.g., Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996) (contemplating that a director's independence might be compromised by "a material ... familial interest"). We are not convinced the shareholders developed this point sufficiently in their opening brief to preserve it, *see, e.g., Koehler v. Brody*, 483 F.3d 590, 599 (8th Cir. 2007), and Penner's independence would not tip the balance either way, so we decline to address the issue. The shareholders cite no reason to doubt the independence or disinterestedness of the other five directors.

acquiesced in the hijacking of the internal investigation and the ongoing coverup and caused Wal- Mart to issue misleading proxy statements.[8]

The upshot, then, is that the shareholders needed to plead "particularized facts"—as distinct from "conclusory allegations"—supporting "reasonable factual inferences," *see Brehm v. Eisner*, 746 A.2d 244, 255 (Del. 2000), that the seven continuing board members learned of the suspected bribery before word of the *New York Times* investigation got out and Wal-Mart began scrambling to do what it allegedly should have been doing from the beginning. The shareholders advance three accounts of how that knowledge reached the board. Reviewing their allegations de novo, *see, e.g.*, *Gomes*, 710 F.3d at 815, we find none of the theories persuasive.

A. Assumption Audit Committee Chair Alerted the Board

The shareholders' first theory is that during the initial in-house investigation in late 2005, Wal-Mart's investigators reported their preliminary findings to the then-chair of the board's audit committee, Roland Hernandez, who alerted the rest of the board. We begin by observing that it takes at least two inferential steps to get to that conclusion from the shareholders' specific allegations. To start, there are no specific

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[8] Because we decide the case based on this common threshold requirement, we need not address the details of the shareholders' theories of liability or the precise degree of culpability necessary for them to succeed on each claim.

facts alleged[9] that directly show Hernandez receiving a report about the possible bribery at Wal-Mex. Rather, the shareholders rely on the asserted facts that the investigation and audit plan said Hernandez, among others, would be sent one or more progress reports and that a report finding a "reasonable suspicion to believe that laws have been violated" actually was drafted.

We take the defendants' point in response, that the plan "evidenced only an *intention*" to report to Hernandez about the progress of the investigation, and intention is not action. We also recognize the plan only specifically said Hernandez was to receive the first progress report, scheduled for November 16, while "[a]dditional progress reports" were to be "given as appropriate" to unspecified recipients. And it is unclear from the complaint whether the December 1 draft—the only report specifically alleged—was an "[a]dditional progress report" supplementing an initial report sent sometime earlier or, instead, the planned first report was simply delayed two weeks. Such uncertainty makes it harder to assume Hernandez was sent a copy—the language in the investigation and audit plan could be read as reflecting an expectation that while the first report would definitely go to the audit committee, it might be "appropriate" for later updates to just be sent to management—and raises questions about what an earlier report might have said. Still, we are satisfied that the combination of the stated intention to report to Hernandez on the

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[9] That the defendants might have admitted facts touching on this point in one of the related Delaware cases, as the shareholders claim in their reply brief, is immaterial to the sufficiency of the complaint the shareholders filed in this case.

progress of the investigation and the preparation of such a report, as alleged by the shareholders, is enough to make it reasonable to infer that Hernandez received the report. While contrary inferences might also plausibly be drawn from the alleged facts, that does not make the shareholders' inference unreasonable.

Hernandez learning about the suspected bribery is not enough for the shareholders. Their suit depends on the information also being passed to the rest of the board.

The shareholders, to a degree, have changed their story of how that happened. According to their complaint—which, of course, is what really matters—Hernandez first told the rest of the audit committee and then the audit committee "was obligated to 'report[ ]'" to the rest of the board. Elsewhere, especially in their briefs on appeal, the shareholders generally skip over the middle step and suggest Hernandez just told the whole board himself. Either way, whether there are three links in their logical chain or just two, the shareholders' inferences are based on a single fact, namely that the audit committee had a duty, formalized in its charter, to "make regular reports to the Board" about, among other things, "the compliance by the Company with legal and regulatory requirements."

To justify drawing conclusions from the audit committee's duty to report, the shareholders rely on a decision in one of the related Delaware cases, where another Wal-Mart shareholder sought access to corporate records that could help establish whether demand on the board would be futile. *See Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Tr. Fund*

IBEW (IBEW), 95 A.3d 1264, 1268–69 (Del. 2014). In explaining why it agreed with the Court of Chancery (and the plaintiff) that Wal-Mart needed to produce "officer-level documents from which director awareness of the WalMex Investigation may be inferred," the Delaware Supreme Court stated the plaintiff "may establish director knowledge of the WalMex Investigation by establishing that certain Wal-Mart officers were in a 'reporting relationship' to Wal-Mart directors, that those officers did in fact report to specific directors, and that those officers received key information regarding the WalMex Investigation." *Id.* at 1273. The shareholders insist their allegations in this case "fall squarely within the four corners of th[at] scenario." They are wrong.

In fact, comparing the shareholders' complaint to the circumstantial evidence contemplated by the Delaware Supreme Court neatly demonstrates where the shareholders fall short. In the Delaware court's words, the shareholders have alleged Hernandez and the audit committee "were in a 'reporting relationship' to Wal-Mart directors" and Hernandez "received key information regarding the WalMex investigation." *Id.* Conspicuously absent here, however, are specific factual allegations establishing Hernandez *"did in fact report* to specific directors." *Id.* (emphasis added).

The Delaware case, as we understand it, was about drawing inferences regarding *what* officers told directors when they reported to them, not *whether* they reported to the directors in the first place. *See id.* As the court recognized, when people within a corporation share information with members of the board, they do not always record or document the interaction, much less prepare detailed memoranda or

presentations, even (perhaps especially) when dealing with an important or potentially sensitive topic. So rather than limit the plaintiff to such elusive "officer-level *communications* with directors," the court reasoned that if the plaintiff could show an officer meeting with a director, the circumstances of the meeting might indirectly establish what they talked about—for example, if officers met with a director they were supposed to keep informed about an issue shortly after getting briefed on an important development. *See id.*

Likewise, in the bench ruling the Delaware Supreme Court affirmed, then-Chancellor Strine (now the Chief Justice of the Delaware Supreme Court) had explained that although "[i]t would be nifty"—at least for litigation purposes—"if everyone in the world documented everything" and the plaintiff could just look for "a script for briefing the audit committee ... or a memo to the audit committee," even without direct evidence,

> [plaintiffs] [a]re allowed to say, "Mr. Blank is the principal reporting officer to the audit committee. On August 12th, he received a five-page report about wrongdoing at WalMex. There are notes of a conversation he doesn't remember from three days later, with the head of the audit committee. We believe it's inferable that what he knew, given his role with the audit committee, that he, in fact, discharged his duty and communicated that to the head of the audit committee."

Key to that reasoning, like the decision on appeal, are the posited "notes of a conversation" indicating

that a specific interaction happened at which the information could and should have been reported.

Here, by contrast, the shareholders have not identified any particular meetings or reporting between Hernandez, the audit committee, and the rest of the board, either individually or as a whole.[10] Instead, they ask this court first to assume that Hernandez made such reports, because he was supposed to under the audit committee charter, and then to rely on the same reporting obligation to draw further inferences about what his hypothesized reports said. That is more than the Delaware decisions can support.

To bridge the gap, the shareholders turn to another statement seemingly validating their position, this one from the Seventh Circuit: "Where there is a corporate governance structure in place, we must then assume the corporate governance procedures were followed and that the board knew of the problems and decided no action was required." *In re Abbott Labs.*

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[10] We decline the defendants' invitation to fault the shareholders for not "plead[ing] facts director-by-director." While it is true individualized allegations are often necessary in derivative complaints to let courts evaluate the independence and disinterestedness of each director at the necessary level of particularity, *see, e.g.*, *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 134 (Del. Ch. 2009), here the shareholders' theory of the case was that the relevant directors all learned about the investigators' suspicions of bribery in the same way and faced liability for the same reasons, so the same facts demonstrated why each could not consider a demand impartially. If the shareholders had pled sufficient facts to support their theory, we see nothing that would have been gained by demanding that they repeat the same allegations "director-by-director" in their complaint. *Cf. Rosenbloom v. Pyott*, 765 F.3d 1137, 1151 n.13 (9th Cir. 2014).

Derivative S'holders Litig., 325 F.3d 795, 806 (7th Cir. 2003).[11] The shareholders take that line out of context and, as a result, focus on the wrong part and read too much into it. The quoted language comes from the court's discussion of which standard to use to evaluate the plaintiffs' argument about the futility of making a demand on the board before filing their derivative suit. In particular, it directly follows a lengthy explanation of the court's understanding that the standard from *Rales v. Blasband*, 634 A.2d 927—the standard governing this case—would only apply if the plaintiffs' position were that the directors faced personal liability based on "'unconsidered' inaction." *See In re Abbott Labs.*, 325 F.3d at 804–06 (quoting *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996)). In light of that focus on conscious decision-making by the board, we think it is clear that what ultimately mattered to the court in the quoted sentence was not "that the board knew of the problems"—the portion the shareholders rely on—but rather "that the board *decided* no action was required." *Id.* at 806 (emphasis added).

To be sure, the reference to the board's knowledge was not just surplusage. The court's conclusion that

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[11] Technically, *Abbott* was decided under Illinois law, but the Seventh Circuit based its analysis largely on Delaware decisions, explaining "Illinois case law follows Delaware law in establishing demand futility requirements." *In re Abbott Labs.*, 325 F.3d at 803. The court later confirmed *Abbott* reflects its understanding of Delaware, as well as Illinois, law by relying on it in a derivative case involving a Delaware corporation. *See Westmoreland Cty. Emp. Ret. Sys. v. Parkinson*, 727 F.3d 719, 725–29 (7th Cir. 2013).

the board must have consciously decided not to act (assuming the plaintiffs' allegations were true) was based in large part on its determination that the board knew of the problems underlying the complaint. *Id.* But the court did not simply infer that knowledge based on the "assum[ption]" that "corporate governance procedures were followed," as the shareholders' quotation might suggest in isolation. *Id.* To the contrary, the court repeatedly listed other specific factual allegations establishing the directors' awareness, including that the corporation's regulatory violations had given rise to years of warning letters, ongoing government inspections, and meetings with regulators, the directors had signed off on disclosure forms acknowledging the compliance issues, and a *Wall Street Journal* article had made the corporation's problems public knowledge years earlier. *Id.* at 799–800, 806. When the Seventh Circuit addressed the directors' knowledge again in the course of applying the standard it chose and deciding whether demand actually was excused—the portion of the decision directly analogous to this case—it relied on the same catalog of alleged facts, an "extensive paper trail," not just the existence of procedures that would have required information to be reported to the board. *Id.* at 808–09.

The shareholders' references to *Saito v. McCall*, an unpublished decision of the Delaware Court of Chancery, are similarly unavailing. *Saito v. McCall*, No. Civ. A. 17132–NC, 2004 WL 3029876 (Del. Ch. Dec. 20, 2004) (unpublished), *overruled on other grounds by Lambrecht v. O'Neal*, 3 A.3d 277, 293 (Del. 2010). In *Saito*, the court rejected a "head in the sand" defense and decided it could reasonably infer that di-

rectors who knew of their company's accounting problems shared that information with their colleagues on the board. *Id.* at *7 nn.68, 71. Despite some broad language in the decision, other Delaware courts have not adopted the broad reading of *Saito* the shareholders urge on us. *See Desimone v. Barrows*, 924 A.2d 908, 943 (Del. Ch. 2007) ("*Saito* did not lay down any universally applicable rule about knowledge imputation."). Rather, later Delaware cases have treated the decision as "merely involv[ing] the drawing of reasonable inferences from well-pled facts," emphasizing the plaintiffs' allegations "establish[ing] that the accounting problems ... were openly discussed by the directors." *Id.* We find *Desimone's* fact-bound interpretation compelling, particularly because it brings the *Saito* case in line with our understanding of the other Delaware cases discussed above, insofar as it suggests that the inference the shareholders seek here might well be justified if their complaint included "well-pled facts" showing Hernandez talking about Wal-Mex with members of the audit committee or other directors. *Cf. IBEW*, 95 A.3d at 1273.

Having found little support for the shareholders' position in the key decisions they cite, we return to the basic question: Was the audit committee's obligation to report to the board enough, under Delaware law, to make it reasonable to infer the board learned what Hernandez allegedly read in the in-house investigators' draft progress report? The answer, in our view, is no.

Numerous cases from Delaware courts, as well as other courts applying Delaware law, have time and again held that "an allegation that the underlying cause of a corporate trauma falls within the delegated

authority of a board committee does not support an inference that the directors on that committee knew of and consciously disregarded the problem for purposes of Rule 23.1." *South v. Baker*, 62 A.3d 1, 17 (Del. Ch. 2012); *see also, e.g., Wood v. Baum*, 953 A.2d 136, 142 (Del. 2008) (holding the assertion "that membership on the Audit Committee is a sufficient basis to infer the requisite scienter ... is contrary to well-settled Delaware law"). The shareholders do not disagree with that general proposition. Rather, they argue it does not govern their case, which, they say, is unlike the others because it does not rely on "'cookie cutter' allegations that the Board 'must have' or 'should have' learned about a problem merely because a company had some internal report systems and some corporate trauma occurred 'under the watch' of the Board." As distinguishing features, the shareholders identify Hernandez's receipt of the draft report and his duty to report regularly to the board.

We grant that the shareholders' position here is not quite as weak as the plaintiffs' in some other cases, because their allegations at least put the relevant information in the hands of someone, Hernandez, only a degree or two removed from the directors whose knowledge is at issue. *Cf., e.g.*, *South*, 62 A.3d at 17. But that still leaves the crucial question of why we should think the rest of the board knew what Hernandez knew. Notwithstanding the shareholders' vague references to a "plethora" of unspecified "corroborating facts," we discern no particularized allegations supporting that conclusion other than the audit committee charter requiring "regular reports to the

Board."[12] The shareholders' position thus boils down to the same logic Delaware courts have consistently rejected, namely the inference that directors must have known about a problem because someone was supposed to tell them about it. In the context of a derivative suit involving a Delaware corporation, we refuse to assume so much.

B. Assumption Anyone Else Told the Board

The shareholders' other accounts of how the Wal-Mart board members learned of the allegations of misconduct at Wal-Mex merit less discussion. The shareholders' second theory is that other senior officers at Wal-Mart, besides Hernandez, told the board. We do not doubt that the shareholders' particularized allegations established a handful of officers—though not the "small army" the shareholders claim—including Duke and Scott, as well as Wal-Mart's general counsel, received reports about the alleged bribery scheme at Wal-Mex, were involved to different degrees in making decisions about the investigation, and had duties to report wrongdoing within the corporation. Other

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12 The shareholders assert their inference is "further strengthen[ed]" by allegations that in the fall of 2005, during the initial Wal-Mex investigation, institutional investors raised concerns about reports of unrelated legal and regulatory violations at Wal-Mart. Hernandez rejected the investors' demand that Wal-Mart create a special independent committee to strengthen its internal safeguards, insisting the audit committee provided enough independent oversight. The shareholders' conjecture that because Hernandez was thus "particularly sensitized" to compliance issues relating to internal investigations he was more likely to report what he learned about Wal-Mex is simply too attenuated and unspecific to provide meaningful support for the allegations here.

than those reporting obligations, the shareholders did not plead any facts supporting the inference that the officers actually shared their knowledge. There are no specific allegations showing any of the identified officers met with the board, talked to board members, or otherwise made reports about Wal-Mex. *Cf. IBEW*, 95 A.3d at 1273; *Desimone*, 924 A.2d at 943; *Saito*, 2004 WL 3029876, at *7. This argument thus fails for the same reasons as the shareholders' theory about Hernandez and the audit committee.[13]

C. Assumption the Board Must Have Known

The shareholders' third argument is that the bribery at Wal-Mex was so enormous and egregious, and the threat it posed to Wal-Mart so massive, that the board must have known about it. Without minimizing the alleged wrongdoing here (or drawing factual conclusions about what really happened), we reject the shareholders' legal premise. The cases they cite—notably, none from a Delaware court—do not establish that the severity of the misconduct committed at a corporation, by itself, can be enough to infer board knowledge. To the contrary, these cases generally stand for the weaker, unremarkable proposition that

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[13] We also observe that, as alleged, the duties identified by the shareholders obliged the officers to report to the audit committee, not the board as a whole. So even if the officers did what they were supposed to do, the shareholders' case still depends on an inference the audit committee in turn relayed the information to the rest of the board. That is precisely the inference we already rejected in the context of Hernandez's alleged duty to report.

"the magnitude and duration of the alleged wrongdoing" can be "relevant" and, when combined with other specific factual allegations, can help support or confirm an inference of board awareness. *McCall v. Scott*, 239 F.3d 808, 823 (6th Cir.), *amended on denial* of *rehearing on other grounds*, 250 F.3d 997 (6th Cir. 2001); *see also Rosenbloom*, 765 F.3d at 1154; *In re Abbott Labs.*, 325 F.3d at 809 (citing *McCall* for this point); *In re Pfizer Inc. S'holder Derivative Litig.*, 722 F.Supp.2d 453, 460 (S.D.N.Y. 2010) (citing *Abbott*).[14] As explained in a case the shareholders declined to cite, "[t]o be sure, magnitude and duration may be *probative* of whether the Board knew or should have known about a violation of the law, though these factors will rarely suffice in their own right to satisfy Rule 23.1's requirement in this context that plaintiffs allege with particularity actual or constructive board knowledge." *In re SAIC Inc. Derivative Litig.*, 948 F.Supp.2d 366, 387 (S.D.N.Y. 2013) (citation omitted); *cf. In re Citigroup Inc. S'holders Litig.*, No. 19827,

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[14] We recognize that one federal district court, in an unreported decision, has said "[w]hen a derivative plaintiff alleges a particularized scheme of substantial magnitude and duration that allegedly occurred when a majority of a board served as directors, courts infer that the board had notice of the scheme for purposes of assessing demand futility." *In re Abbott Depakote S'holder Derivative Litig.*, No. 11 C 8114, 2013 WL 2451152, at *9 (N.D. Ill. June 5, 2013). The court did not actually rely on that inference to establish board knowledge, instead adding an alternative justification for its conclusion, namely that the U.S. Department of Justice had subpoenaed documents from the board itself, after informing the company it was under investigation. *See id.* at *10. We do not find the decision persuasive, because the only support for the court's statement was a citation to the same line of cases the shareholders cite here, *see id.* at *9, which we do not believe can bear the weight of the proposed assumption.

2003 WL 21384599, at *3 (Del. Ch. June 5, 2003) (unpublished) ("The fact of ... losses"—even "substantial losses" caused by "involvement in ... scandals"—"is not alone enough for a court to conclude that a majority of [a] corporation's board of directors is disqualified from considering a demand that [the corporation] bring suit against those responsible.").

D. Any Other Basis for Inferring Board Knowledge

That brings us to the shareholders' fallback position, that their various allegations are complementary and it is a mistake to consider each theory of board knowledge in isolation. According to the shareholders, the fact Hernandez and other high-ranking people at Wal-Mart knew about and were involved in the investigation of possible bribery at Wal-Mex shows how egregious and significant the issue was, just as the severity of the misconduct makes it more likely at least one of them did what they were supposed to do and told the board. We agree it would be a mistake to consider the shareholders' alleged facts piecemeal. *See Harris v. Carter*, 582 A.2d 222, 229 (Del. Ch. 1990). And undoubtedly the allegations "buttress each other" in the sense that they all support the shareholders' general conviction that "[i]t simply makes sense that the Board would know about a blatant and serious wrong that persists for many years." The reason the shareholders' theories fail is not that we think they are unbelievable or do not make sense, but because the shareholders have not pled the sort of concrete facts Delaware law requires to substantiate enough of the details. *See Brehm*, 746 A.2d at 254. And because their accounts of what happened all lack particularized allegations about the same key point, namely how

concerns that bribery was endemic at Wal-Mex reached Wal-Mart's board, viewing the complaint as a whole cannot fill in the missing pieces.

A few more ancillary points remain, but they give us little pause. We are wholly unpersuaded by the shareholders' suggestion that their reliance on the audit committee charter is justified by rules of evidence recognizing that "[e]vidence of ... an organization's routine practice" can be used "to prove that on a particular occasion the ... organization acted in accordance with the ... routine practice." Fed. R. Evid. 406; *accord* Del. R. Evid. 406. Even assuming a clause in a corporate governance document (as opposed to testimony about a history of doing what such a clause requires) constitutes relevant evidence of a "routine practice"—a proposition we find doubtful and for which the shareholders cite no support—evidence relevance is a low bar. Although the existence of the committee charter might tend to increase, by some degree, the likelihood that information was reported to the board, *see* Fed. R. Evid. 401(a); Del. R. Evid. 401, such a charter provision alone does not provide a reasonable basis to infer the information actually was conveyed to the board.

Similarly inapposite is Delaware's presumption that corporate directors perform their duties in good faith. *See, e.g.*, *Aronson*, 473 A.2d at 812. That presumption generally comes into play when discerning questions of *why* directors did something, not *what* they did. *See, e.g.*, *In re Synthes, Inc. S'holder Litig.*, 50 A.3d 1022, 1033 (Del. Ch. 2012). We decline to endorse the shareholders' attempt to repurpose the doctrine as a basis for assuming directors took certain af-

firmative actions their duties supposedly required, especially when the shareholders cite no Delaware cases adopting such an approach.

Last, the shareholders' related argument that in dismissing their complaint the district court relied on an unspoken, defendant-friendly inference that Hernandez and the others chose to violate their duties and keep the board in the dark—both factually implausible, according to the shareholders, and legally improper on a motion to dismiss, *see, e.g.*, *Creason v. City of Washington*, 435 F.3d 820, 823 (8th Cir. 2006)—rests on a misunderstanding of the district court's decision. Holding that the shareholders' allegations were not enough to support an inference the board *was* told—the district court's (and our) answer to the question actually presented—is not the same as inferring the board *was not* told. *Cf. Guttman*, 823 A.2d at 507 ("I am, of course, not opining that NVIDIA's directors actually implemented an adequate system of financial controls. What I am opining is that there are not well-pled factual allegations—as opposed to wholly conclusory statements—that the NVIDIA independent directors committed any culpable failure of oversight."). Simply put, the district court never got to the point of deciding, yes or no, whether someone reported to the board about what was going on at Wal-Mex, because the shareholders did not plead particularized facts that justified letting them take the case that far.

III. CONCLUSION

The specific facts alleged in the shareholders' complaint do not give rise to a reasonable inference that Wal-Mart's board of directors learned of the suspected

bribery by Wal-Mex while the alleged bribery was being covered up and the internal investigation quashed. So the allegations do not establish "with particularity" that the threat of personal liability rendered a majority of Wal-Mart's 2012 board incapable of fairly considering whether to pursue the corporate causes of action the shareholders seek to enforce in this case, as required by Rule 23.1 and Delaware's heightened pleading threshold for derivative lawsuits. We therefore affirm the district court's judgment dismissing the case.[15]

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15 The district court denied the shareholders permission to amend their complaint. The shareholders do not challenge that ruling on appeal.