IN THE SUPREME COURT OF THE STATE OF NEVADA

MICHAEL KIRSCH; AND SIU YIP, Appellants, v. PETER G. TRABER; JAMES C. CZIRR; JACK W. CALLICUTT; GILBERT F. AMELIO; KEVIN D. FREEMAN; ARTHUR R. GREENBERG; ROD D. MARTIN; JOHN F. MAULDIN; STEVEN PRELACK; HERMAN PAUL PRESSLER, III; DR. MARC RUBIN; AND GALECTIN THERAPEUTICS, INC., A NEVADA CORPORATION, Respondents.	**Supreme Court No. 70854** Appeal from District Court Case No. A-14-706397-B

APPELLANT'S NOTICE OF SUPPLEMENTAL AUTHORITIES IN SUPPORT OF APPELLANT'S OPENING BRIEF AND REPLY BRIEF

Submitted by:

DAVID S. LEE, ESQ.
Nevada Bar No. 6088
NATASHA A. LANDRUM, ESQ.
Nevada Bar No. 7414
DIRK W. GASPAR, ESQ.
Nevada Bar No. 10046
LEE, HERNANDEZ, LANDRUM & GAROFALO
7575 Vegas Drive, Suite 150
Las Vegas, NV 89128
Phone: (702) 880-9750
Fax: (702) 314-1210

Pursuant to NRAP 31(e), Appellant Kirsch hereby submits this Notice of Supplemental Authorities in support of Appellant's Opening Brief and Reply Brief. Specifically, this Notice and the authorities cited herein supplement pages 19-31 of the Opening Brief and pages 1-9 of the Reply Brief.

Appellant Kirsch respectfully submits the Wal-Mart Delaware Court of Chancery decision which was issued after briefs were fully submitted by all parties in the present appeal, and which is of direct relevance to the present appeal. In re Wal-Mart Stores, Inc. Delaware Derivative Litig., 2017 Del. Ch. LEXIS 131 (2017). APP001585. The Wal-Mart case was decided after the Delaware Supreme Court remanded the case to the Chancery Court with a request 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.

Id. at 1.

In answering this question in the affirmative (holding that preclusion of the second derivative claimant's action violates due process), Chancellor Andre Bouchard stated "I recommend that the Supreme Court adopt the rule proposed in EZCORP." Id. at 2; see also In re EZCORP Consulting Agreement Derivative Litig., 130 A3d 934 (Del. Ch. 2016). Accordingly, Appellant also attaches a copy

CERTIFICATE OF SERVICE

On the 27th day of October, 2017, the undersigned, an employee of Lee, Hernandez, Landrum & Garofalo, A.P.C., hereby served a true copy of APPELLANT'S NOTICE OF SUPPLEMENTAL AUTHORITIES IN SUPPORT OF APPELLANT'S OPENING BRIEF AND REPLY BRIEF, to the parties listed below via the electronic service through the Nevada Supreme Court's website (or, if necessary, by U.S. Mail, first class, postage pre-paid):

Lyssa S. Anderson, Esq.
Ryan W. Daniels, Esq.
KAEMPFER CROWELL
8345 W. Sunset Road, Ste. 250
Las Vegas, NV 89113
Telephone:(702) 792-7000
Fax:(702) 796-7181
landerson@kcnvlaw.com
ATTORNEY FOR DEFENDANT

Michael R. Smith, Esq.
B. Warren Pope, Esq.
Benjamin Lee, Esq.
KING & SPAULDING, LLP
1180 Peachtree Street, NE
Atlanta, GA 30309
ATTORNEY FOR DEFENDANT

John P. Aldrich, Esq.
ALDRICH LAW FIRM, LTD
1601 S. Rainbow Blvd., Ste. 160
Las Vegas, NV 89146
(702) 853-5490
Fax: (702) 227-1975
jaldrich@johnaldricklawfirm.com
ATTORNEY FOR INTERVENORS

Michael I. Fistel, Jr., Esq.
JOHSON & WEAVER, LLP
40 Powder Springs St.
Marietta, GA 30064
(770)200-3104
michaelf@johnsonandweaver.com
ATTORNEY FOR INTERVENORS

of the In re EZCORP (APP001620) decision in which Vice Chancellor Travis Laster analogized the pre-demand futility phase of derivative litigation to the pre-class certification phase of class action litigation.

The EZCORP court held that a denial of class certification cannot bind another non-party claimant seeking class certification for the reasons set forth in Smith v. Bayer Corp., the sole case cited by the Delaware Supreme Court in its request to Chancellor Bouchard. See Smith v. Bayer Corp.564 U.S. 299 (2011) (in which plaintiffs in a consumer class action were not precluded from attempting to certify a class in state court after a federal judge denied class certification in a case brought by a different plaintiff).

DATED this 27th day of October, 2017.

LEE, HERNANDEZ, LANDRUM & GAROFALO

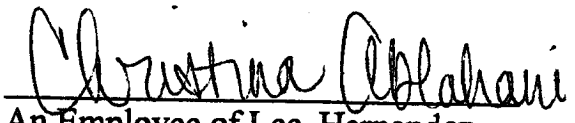
By: _____

DAVID S. LEE, ESQ., NVB 6088
NATASHA A. LANDRUM, ESQ., NVB 7414
DIRK W. GASPAR, ESQ., NVB 10046
7575 Vegas Drive, Suite 150
Las Vegas, NV 89128

EDWARD W. MILLER, ESQ. (*pro hac vice*)
JOSHUA M. LIFSHITZ, ESQ.
IFSHITZ AND MILLER
821 Franklin Avenue, Suite 209
Garden City, New York
Attorneys for Appellant

Robert B. Weiser, Esq.
Brett D. Stecker, Esq.
James Ficaro, Esq.
THE WEISER LAW FIRM, P.C.
22 Cassett Avenue, First Floor
Berwyn, PA 19312
(610) 225-2677
rw@weiserlawfirm.com
bds@weiserlawfirm.com
jmf@weiserlawfirm.com
Attorneys for INTERVENOR – Sui Yip

Kathleen A. Herkenhoff, Esq.
THE WEISER LAW FIRM, P.C.
12707 High Bluff Drive, Suite 200
San Diego, CA 92130
(858) 794-1441
kah@weiserlawfirm.com
Attorneys for INTERVENOR – Sui Yip



An Employee of Lee, Hernandez, Landrum & Garofalo, A.P.C.

Exhibit "B"

Exhibit "B"

IN THE SUPREME COURT OF THE STATE OF NEVADA

MICHAEL KIRSCH; AND SIU YIP, Appellants, v. PETER G. TRABER; JAMES C. CZIRR; JACK W. CALLICUTT; GILBERT F. AMELIO; KEVIN D. FREEMAN; ARTHUR R. GREENBERG; ROD D. MARTIN; JOHN F. MAULDIN; STEVEN PRELACK; HERMAN PAUL PRESSLER, III; DR. MARC RUBIN; AND GALECTIN THERAPEUTICS, INC., A NEVADA CORPORATION, Respondents.	**Supreme Court No. 70854** District Court Case No. A-14-706397-B

APPENDIX TO APPELLANT'S NOTICE OF SUPPLEMENTAL AUTHORITIES IN SUPPORT OF APPELLANT'S OPENING BRIEF AND REPLY BRIEF

Submitted by:

DAVID S. LEE, ESQ.
Nevada Bar No. 6088
NATASHA A. LANDRUM, ESQ.
Nevada Bar No. 7414
DIRK W. GASPAR, ESQ.
Nevada Bar No. 10046
LEE, HERNANDEZ, LANDRUM & GAROFALO
7575 Vegas Drive, Suite 150
Las Vegas, NV 89128
Phone: (702) 880-9750
Fax: (702) 314-1210

LEE, HERNANDEZ, LANDRUM & GAROFALO
7575 VEGAS DRIVE, SUITE 150
LAS VEGAS, NV 89128
(702) 880-9750

APPELLANT'S APPENDIX

DOCUMENT DESCRIPTION	BATES NUMBER	VOLUME NUMBER
In re Wal-Mart Stores, Inc. Delaware Derivative Litig., 2017 Del. Ch. LEXIS 131 (2017)	APP001585 – APP001619	I
In re EZCORP Consulting Agreement Derivative Litig., 130 A3d 934 (Del. Ch. 2016)	APP001620 - APP001633	I

DATED this 27th day of October, 2017.

LEE, HERNANDEZ, LANDRUM & GAROFALO

By: _____

DAVID S. LEE, ESQ.
Nevada Bar No. 6088
NATASHA A. LANDRUM, ESQ.
Nevada Bar No. 7414
DIRK W. GASPAR, ESQ.
Nevada Bar No. 10046
7575 Vegas Drive, Suite 150
Las Vegas, NV 89128

EDWARD W. MILLER, ESQ.
(admitted *pro hac vice*)
JOSHUA M. LIFSHITZ, ESQ.
LIFSHITZ AND MILLER
821 Franklin Avenue, Suite 209
Garden City, New York
Attorneys for Appellant

LEE, HERNANDEZ, LANDRUM & GAROFALO
7575 VEGAS DRIVE, SUITE 150
LAS VEGAS, NV 89128
(702) 880-9750

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE WAL-MART STORES, INC. DELAWARE DERIVATIVE LITIGATION	CONSOLIDATED C.A. No. 7455-CB

SUPPLEMENTAL OPINION

Date Decided: July 25, 2017

Stuart M. Grant, Michael J. Barry, and Nathan A. Cook, GRANT & EISENHOFER P.A., Wilmington, Delaware; Ned Weinberger, LABATON SUCHAROW LLP, Wilmington, Delaware; Daniel Girard, Dena Sharp, Jordan Elias, and Adam Polk, GIRARD GIBBS LLP, San Francisco, California; Thomas A. Dubbs, Louis Gottlieb, and Jeffrey A. Dubbin, LABATON SUCHAROW LLP, New York, New York; Frederic S. Fox, Hae Sung Nam, Donald R. Hall, and Jeffrey P. Campisi, KAPLAN FOX & KILSHEIMER LLP, New York, New York; David C. Frederick, KELLOGG, HUBER, HANSEN, TODD, EVANS & FIGEL, P.L.L.C., Washington, District of Columbia; Samuel Issacharoff, KELLOGG, HUBER, HANSEN, TODD, EVANS & FIGEL, P.L.L.C., New York, New York; *Co-Lead Counsel for the Co-Lead Plaintiffs.*

Donald J. Wolfe, Jr., Stephen C. Norman, and Tyler J. Leavengood, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; Theodore J. Boutrous, Jr. and Alexander K. Mircheff, GIBSON, DUNN & CRUTCHER LLP, Los Angeles, California; Mark A. Perry, GIBSON, DUNN & CRUTCHER LLP, Washington, District of Columbia; *Attorneys for Appearing Defendants.*

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 (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 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

---

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

[2] *Id.* at *1.

[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).

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 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

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

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 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]

---

[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).

[8] *Id.* at 946-49; *Smith v. Bayer Corp.*, 564 U.S. 299, 308 n.7 (2011).

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 Wal-Mart de Mexico, a subsidiary of Wal-Mart Stores, Inc.

---

[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"), 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

---

[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).

documents, IBEW filed a Section 220 complaint alleging deficiencies in Wal-Mart's document production.[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

---

[14] Verified Complaint, *Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, C.A. No. 7779-CS (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 126 (Del. 2014).

[17] *See Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, C.A. No. 7779-CB (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).

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.

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

---

[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.*, 146 S.W.3d 852, 855 (Ark. 2004); *Morgan v. Turner*, 368 S.W.3d 888, 895 (Ark.

representation," I concluded, based on the clear weight of authority from other jurisdictions and 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

---

2010); *Ark. Dep't of Human Servs. v. Dearman*, 842 S.W.2d 449, 452 (Ark. Ct. App. 1992) (en banc)).

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

[23] *Id.* at *12.

[24] *Id.* at *13.

[25] *Id.* at *15.

privity question," but concerns about fast-filers "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."[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***

---

[26] *Id.* at *17.

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

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

> ***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.[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.

---

[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.

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 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).[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]

---

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

[33] *Richards v. Jefferson Cty., Ala.*, 517 U.S. 793, 797 (1996) (internal citations omitted).

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 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

---

[34] *See Alvarez*, 2017 WL 239364, at *3 ("Although we reserve judgment until our final ruing 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.").

[35] *Taylor v. Sturgell*, 553 U.S. 880, 898 (2008).

process."[36] The Court then delineated six categories of recognized exceptions to the general rule against nonparty preclusion:[37]

> 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.
>
> * * * * *
>
> 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.
>
> * * * * *
>
> 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.
>
> * * * * *
>
> Fourth, a nonparty is bound by a judgment if she assumed control over the litigation in which that judgment was rendered.
>
> * * * * *

---

[36] *Id.* at 893 (quoting *Hansberry v. Lee*, 311 U.S. 32, 40 (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 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).

> Fifth, a party bound by a judgment may not avoid its preclusive force by relitigating through a proxy.
>
> * * * * *
>
> 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]

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

---

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

[39] *Id.* at 896.

[40] *Id.* at 897, 900.

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 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]

---

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

[42] *Id.*

[43] *Id.*

[44] *Id.*

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:

> 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.

---

[45] *Id.* at 629.

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

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

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 *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.

---

[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).

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

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

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.

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

---

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

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

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 representation in the first derivative action.[56] This is the logic underlying *Wal-Mart I* as well. In other words, ensuring compliance with due

---

[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.

[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 (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.

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

---

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

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

[59] *Id.* at 938.

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 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

---

[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.

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]

---

[64] *See id.* at 313.

[65] *Id.*

[66] *Id.* at 314 (emphasis in original).

[67] *Id.* at 315 (citing *Sturgell*, 553 U.S. at 901).

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

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.

---

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

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

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 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

---

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

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

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: 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]

---

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

[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 re-written 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 (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).

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.

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

---

[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.

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 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

---

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

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

[81] *Ross v. Bernhard*, 396 U.S. 531, 534-35 (1970); *see also Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96 (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.").

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 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]

---

[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.

[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 (internal citations and quotations omitted).

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] 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

---

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

[86] *See Comcast Corp. v. Behrend*, 133 S. Ct. 1426, 1432 (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.

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 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]

---

[88] *See Hirt v. U.S. Timberlands Serv. Co., LLC*, 2002 WL 1558342, at *2 (Del. Ch. July 3, 2002). *See also Moore v. Tangipadoa 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.

[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.

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.

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

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

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 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

---

[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.

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

[94] *Id.* at 903-04.

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, 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.

---

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

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

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 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.").

130 A.3d 934
Court of Chancery of Delaware.

In re Ezcorp Inc. Consulting Agreement Derivative Litigation

C.A. No. 9962–VCL
|
Submitted: October 27, 2015
|
Decided: January 15, 2016

Synopsis

Background: Shareholders brought derivative action against outside directors of corporation, who approved transactions, for breach of fiduciary duty and waste of corporate assets. After the Supreme Court decided *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, which held that a plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct, directors moved to dismiss with prejudice.

Holdings: The Court Of Chancery, Laster, Vice Chancellor, held that:

[1] rule requiring approval of derivative actions called for dismissal with prejudice against directors only as to named shareholders, not the whole world;

[2] the only plaintiff to whom dismissal with prejudice of a derivative action applies is the named plaintiff;

[3] Due Process Clause prevents a judgment from binding the corporation or other stockholders in a derivative action until the action has survived a motion to dismiss; and

[4] shareholder failed to show good cause for dismissal without prejudice .

Dismissed.

West Headnotes (21)

[1] **Judgment**
Involuntary dismissal or nonsuit in general

In general, a dismissal with prejudice constitutes a final decree for res judicata purposes; by contrast, the phrase "without prejudice" will mean only that the otherwise final judgment does not operate as a res judicata bar to preclude a subsequent lawsuit on the same cause of action.

Cases that cite this headnote

[2] **Pretrial Procedure**
Dismissal with or without prejudice

Rule which identified circumstances when a court would dismiss a complaint with prejudice, unless the plaintiff could show good cause why dismissal with prejudice would not be just, called for dismissal with prejudice of derivative action against outside directors only as to the named shareholders, rather than to the world; rule contemplated that dismissal would be as to named plaintiffs only, which matched with class action rule, which otherwise would have required notice to all stockholders before the derivative action was dismissed. Del. Ch. Ct. R. 15(aaa), 23.1.

Cases that cite this headnote

[3] **Corporations and Business Organizations**
Authority of directors

When a corporation suffers harm, the board of directors is the institutional actor legally empowered under Delaware law to determine what, if any, remedial action the corporation should take, including pursuing litigation against the individuals involved. 8 Del. Code § 141(a).

Cases that cite this headnote

[4] **Corporations and Business Organizations**

Management of Corporate Affairs in General

Corporations and Business Organizations
Authority of directors

A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation. 8 Del. Code § 141(a).

Cases that cite this headnote

[5] **Corporations and Business Organizations**
Authority of directors

Directors of Delaware corporations derive their managerial decision making power, which encompasses decisions whether to initiate, or refrain from entering, litigation, from statute that requires corporate affairs to be managed by a board of directors. 8 Del. Code § 141(a).

Cases that cite this headnote

[6] **Corporations and Business Organizations**
Authority of directors

Statute that requires corporate affairs to be managed by a board of directors vests authority in the board to determine what action the corporation will take with its litigation assets, just as with other corporate assets. 8 Del. Code § 141(a).

1 Cases that cite this headnote

[7] **Corporations and Business Organizations**
Nature and Form of Remedy

In a derivative suit, a stockholder plaintiff seeks to displace the board of director's authority to manage corporate affairs. 8 Del. Code § 141(a).

Cases that cite this headnote

[8] **Corporations and Business Organizations**
Excuse for Failure to Demand;Futility

Corporations and Business Organizations
Refusal as condition precedent to right to sue or defend

Because a statute vests statutory authority in the board of directors, 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. 8 Del. Code § 141(a).

1 Cases that cite this headnote

[9] **Corporations and Business Organizations**
Interest of director or officer in lawsuit or lack of independence

Corporations and Business Organizations
Refusal as condition precedent to right to sue or defend

Because directors are empowered by statute to manage, or direct the management of, the business and affairs of the corporation, the right of a stockholder to prosecute a derivative suit is limited to situations where the stockholder has demanded that the directors pursue the corporate claim, and they have wrongfully refused to do so, or where demand is excused because the directors are incapable of making an impartial decision regarding such litigation. 8 Del. Code § 141(a).

1 Cases that cite this headnote

[10] **Corporations and Business Organizations**
Necessity of demand

Corporations and Business Organizations
Excuse for Failure to Demand;Futility

The right to bring a derivative action against a corporation 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.

Cases that cite this headnote

[11] **Corporations and Business Organizations**
Nature and Form of Remedy

A derivative action has a two-fold nature: it is the equivalent of a suit by the shareholders to compel the corporation to sue, and a suit by the corporation, asserted by the shareholders on its behalf, against those liable to it. 8 Del. Code § 141(a).

1 Cases that cite this headnote

[12] **Corporations and Business Organizations**
⇐ Parties

Pretrial Procedure
⇐ Dismissal of part of action or as to some of parties

Pretrial Procedure
⇐ Dismissal with or without prejudice

Until the derivative action passes the stage at which the court dismisses or approves the action, the named plaintiff does not have authority to sue on behalf of the corporation or anyone else, is only suing in the plaintiff's own name to compel the corporation to sue, and is the only plaintiff legitimately in the case at that point, and, thus, named plaintiff is the only plaintiff to whom dismissal with prejudice applies. Del. Ch. Ct. R. 23.1.

Cases that cite this headnote

[13] **Judgment**
⇐ Persons Not Parties or Privies

A foundational principle of American law is that a person who is not a party to an action is not bound by the judgment in that action. Restatement (Second) of Judgments § 62 cmt. a.

Cases that cite this headnote

[14] **Indemnity**
⇐ Conclusiveness of Former Adjudication

Judgment
⇐ Successive estates or interests

Judgment
⇐ Bailor and bailee

Where a non-party has a specific type of pre-existing legal relationship with a named party, such as bailor and bailee, predecessor and successor, or indemnitor and indemnitee, there is an exception to the principle that a nonparty to an action is not bound by the judgment. Restatement (Second) of Judgments § 62 cmt. a.

Cases that cite this headnote

[15] **Judgment**
⇐ Corporations and corporate officers and stockholders

A fellow-stockholder relationship is not the type of legal relationship that fits pre-existing legal relationship exception to principle that judgments are not binding on non-parties; an individual stockholder is not, solely because of potentially aligned interests, presumed to act in the place of, and with the power to bind, the other stockholders. Restatement (Second) of Judgments § 62 cmt. a.

Cases that cite this headnote

[16] **Judgment**
⇐ Corporations and corporate officers and stockholders

Exception to principle that judgments are not binding on non-parties for a nonparty that is involved in the action in a way which justly results in denial of the nonparty's opportunity to relitigate the matters previously in issue does not apply to general scenario of overlapping, or seriatim efforts by unaffiliated stockholders to assert or prompt the assertion of corporate claims. Restatement (Second) of Judgments § 62 cmt. a.

Cases that cite this headnote

[17] **Judgment**
⇐ Persons represented by parties

A representative party must be granted authority, either by the represented party itself, in accordance with agency principles, or, in the class action context, by the court, for applicability of properly-commenced and maintained representative action exception

to principle that judgments are not binding on non-parties. Restatement (Second) of Judgments § 62 cmt. a.

Cases that cite this headnote

[18] **Parties**
Hearing and determination

When a stockholder representative pursues claims on a class basis, authority to do so is conferred by a class certification ruling. Del. Ch. Ct. R. 23.1.

Cases that cite this headnote

[19] **Corporations and Business Organizations**
Conditions precedent in general

Corporations and Business Organizations
Sufficiency of allegations of demand and refusal

Corporations and Business Organizations
Allegations of excuse for failure to demand; futility

When a stockholder representative pursues claims in a derivative action, authority can be conferred in two ways: first, the board of directors or a duly empowered committee can approve the litigation expressly or by failing to oppose it; second, and more commonly, a court can determine that the stockholder plaintiff has authority to proceed by denying a motion for approval of derivative action because the complaint adequately pleads either that demand should be excused as futile or that demand was made and wrongfully refused. Del. Ch. Ct. R. 23.1.

Cases that cite this headnote

[20] **Constitutional Law**
Class Actions

Constitutional Law
Corporations and limited liability companies

Just as the Due Process Clause prevents a judgment from binding absent class members before a class has been certified, it likewise prevents a judgment from binding the corporation or other stockholders in a derivative action until the action has survived a motion to dismiss, or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit. U.S. Const. Amend. 14; Del. Ch. Ct. R. 23.1.

1 Cases that cite this headnote

[21] **Corporations and Business Organizations**
Pleading

Pretrial Procedure
Dismissal with or without prejudice

Shareholder failed to show good cause for dismissal without prejudice of derivative action against outside directors, although action was brought before the Supreme Court decided *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, which held that a plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct, and shareholder's counsel recognized the paucity of factual allegations against the directors; with-prejudice dismissal could be revisited if a compelling reason to do so subsequently appeared.

Cases that cite this headnote

Attorneys and Law Firms

*937 Seth. D. Rigrodsky, Brian D. Long, Gina M. Serra, Jeremy J. Reilly, RIGRODSKY & LONG, P.A., Wilmington, Delaware; Nicholas I. Porritt, Adam M. Apton, LEVI & KORSINSKY, LLP, Washington, District of Columbia; Counsel for Plaintiff Lawrence Treppel.

Edward P. Welch, Edward B. Micheletti, Cliff C. Gardner, Lauren N. Rosenello, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, Wilmington, Delaware; Counsel for Defendants Phillip Ean Cohen, MS

Pawn Corporation, MS Pawn Limited Partnership, and Madison Park, LLC.

David C. McBride, Elena C. Norman, Nicholas J. Rohrer, Benjamin M. Potts, YOUNG CONAWAY STARGATT & TAYLOR, LLP, Wilmington, Delaware; Counsel for Defendant Thomas C. Roberts.

A. Thompson Bayliss, John M. Seaman, ABRAMS & BAYLISS LLP, Wilmington, Delaware; Randall W. Bodner, Peter L. Welsh, Jesse M. Boodoo, ROPES & GRAY LLP, Boston, Massachusetts; Counsel for Defendants Joseph J. Beal, William C. Love, and John Farrell.

Srinivas Raju, Sarah A. Clark, RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware; Counsel for Nominal Defendant EZCORP, Inc.

OPINION

LASTER, Vice Chancellor.

The complaint in this action named as defendants Joseph J. Beal, William C. Love, and John Farrell. They were three outside directors of nominal defendant EZCORP, Inc. ("EZCORP" or the "Company") who, in varying combinations, approved transactions challenged in this litigation.

*938 Beal, Love, and Farrell moved to dismiss the complaint, and the motion was fully briefed. Before it could be argued, the Delaware Supreme Court issued its decision in *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, 115 A.3d 1173 (Del. 2015).

After *Cornerstone*, plaintiff's counsel re-evaluated the strength of their allegations against Beal, Love, and Farrell. Recognizing that they had not pled a non-exculpated claim against them, they proposed a dismissal without prejudice.

Beal, Love, and Farrell rejected that idea. They sought a dismissal with prejudice that would bind all potential plaintiffs. As their counsel agreed at oral argument, they wanted a dismissal that would be binding "[a]s to the world." Unable to agree on a form of dismissal, the outside directors pressed on with their motion.

Rule 15(aaa) defines what should happen. It provides that when a plaintiff chooses to stand on his complaint and files an answering brief in opposition to a motion to dismiss, then any dismissal in a class or derivative action is with prejudice as to the named plaintiff, but without prejudice to other potential plaintiffs. Under an exception to the general rule, the court can grant a dismissal without prejudice for good cause shown. In this case, good cause does not exist for a without prejudice dismissal. The claims against the outside directors are dismissed with prejudice as to the named plaintiff only.

I. FACTUAL BACKGROUND

The relevant facts are few. They are drawn from the currently operative pleading, which is the Verified Amended Stockholder Derivative Complaint (the "Complaint").

A. The Company And The Services Agreements

EZCORP is a publicly traded Delaware corporation headquartered in Austin, Texas. Its controlling stockholder is Phillip Ean Cohen.

In 2004, EZCORP entered into a services agreement with defendant Madison Park, LLC, an entity affiliated with Cohen. The agreement called for EZCORP to pay Madison Park $100,000 per month for a period of three years. Beginning in September 2007, when the initial agreement expired, EZCORP and Madison Park entered into annual renewals. In 2008, the monthly fee increased to $150,000. In each of the ensuing five years, the monthly fee increased again: in 2009 to $200,000, in 2010 to $300,000, in 2011 to $400,000, in 2012 to $500,000, and in 2013 to $600,000. In 2014 it remained at $600,000. In return for these payments, Madison Park agreed to consult with EZCORP as needed about mergers, acquisitions, divestitures, strategic planning, corporate development, investor relations, and other matters.

A special committee of the board of directors approved the services agreements for 2007, 2008, and 2009. The board's audit committee approved the later agreements. When the audit committee approved the agreement with Madison Park for 2012 and 2013, its members included Love and Farrell. When the audit committee approved the

agreement with Madison Park for 2014, its members were Beal, Love, and Farrell.

B. This Litigation

On July 9, 2014, plaintiff Lawrence Treppel sent EZCORP a demand for books and records pursuant to 8 *Del. C.* § 220. Treppel sought to examine the services agreements between EZCORP and Madison Park and related documents. EZCORP refused to provide any of the *939 requested documentation, claiming that the demand failed to set forth a credible basis to infer any wrongdoing.

On July 28, 2014, Treppel filed this action. On September 23, 2014, he filed the Complaint. It contains four counts:

- Count I asserts a claim for breach of fiduciary duty against Love, Beal, Farrell, and other director defendants.
- Count II asserts a claim for waste of corporate assets against the same defendants as Count I.
- Count III asserts a claim against Cohen and two of his affiliates for aiding and abetting the directors in breaching their fiduciary duties.
- Count IV asserts a claim against Cohen and Madison Park for unjust enrichment.

C. The Motion To Dismiss

On October 13, 2014, the defendants filed *pro forma* motions to dismiss pursuant to Court of Chancery Rules 12(b)(6) and 23.1. On November 12, 2014, they filed their opening briefs. On January 9, 2015, Treppel filed his answering brief, and on February 6, 2015, the defendants filed their reply briefs. Vice Chancellor Parsons, to whom the case was then assigned, scheduled oral argument for July 7, 2015.

On May 14, 2015, the Delaware Supreme Court issued its decision in *Cornerstone,* which addressed what a plaintiff must plead against outside director defendants to overcome a motion to dismiss based on the existence of an exculpatory charter provision in a setting where the transaction under challenge is governed by the entire fairness standard of review.

Before *Cornerstone,* the Delaware Supreme Court had referred to the effect of an exculpatory charter provision as being "in the nature of an affirmative defense." *Emerald P'rs v. Berlin* (*Emerald I*), 726 A.2d 1215, 1223 (Del.1999). The *Emerald I* decision and other opinions from the high court could be read to distinguish between the application of Section 102(b)(7) at the pleading stage in a case governed by the business judgment rule versus in a case governed by the entire fairness standard.[1] In *Cornerstone,* however, the high court squarely held that "[a] plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct—be it *Revlon, Unocal,* the entire fairness standard, *940 or the business judgment rule." *Cornerstone,* 115 A.3d at 1175–76 (footnotes omitted). So applied, the existence of an exculpatory provision operates more in the nature of an immunity, comparable to the extent to which sovereign immunity typically protects government employees from suit, rather than as an affirmative defense.

Treppel's counsel had named Beal, Love, and Farrel as defendants based on a more plaintiff-friendly understanding of the law, which the Delaware Supreme Court recognized in *Cornerstone* was at least an arguable reading of its earlier precedent. *See id.* at 1185. Treppel's Delaware counsel in fact represented the plaintiffs in *Cornerstone,* where they advanced their interpretation.

With *Cornerstone* having clarified matters, Treppel's counsel re-examined their pleading. Recognizing the paucity of factual allegations against defendants Beal, Love, and Farrell, they offered to stipulate to a dismissal of those defendants without prejudice pursuant to Court of Chancery Rule 41(a)(1). Treppel's counsel proposed a without-prejudice dismissal because, assuming they had the benefit of *Cornerstone* before filing the Complaint, they would not have named Beal, Love, and Farrell as defendants. In turn, they would not have faced the prospect of a with-prejudice dismissal and would have retained the freedom to name those individuals as defendants later.

Beal, Love, and Farrell rejected that proposal. They insisted that any dismissal should be with prejudice, not only as to Treppel but as to all other potential plaintiffs. As their counsel conceded at oral argument, Beal, Love,

and Farrell wanted a dismissal with prejudice "[a]s to the world." Dkt. 72 at 31.

Unable to agree on a stipulated order, Beal, Love, and Farrell pressed forward with argument on their motion to dismiss. Treppel's counsel agreed that dismissal was warranted, but argued that good cause existed for it to be without prejudice.

Due to Vice Chancellor Parson's retirement, the case was re-assigned to me.

II. LEGAL ANALYSIS

Rule 41(a)(1) generally permits a plaintiff to dismiss a claim against a defendant unilaterally as long as the defendant has not yet answered or moved for summary judgment. It states:

> Subject to payment of costs and the provisions of Rule 23(e) and Rule 23.1 an action may be dismissed by the plaintiff without order of court (i) by filing a notice of dismissal at any time before service by the adverse party of an answer or of a motion for summary judgment, whichever first occurs.... However, no such dismissal pursuant to subpart (i) above shall be effective where the complaint is subject to a motion to dismiss and the plaintiff has chosen to file an answering brief rather than seeking to amend.... Unless otherwise stated in the notice of dismissal ..., the dismissal is without prejudice, except that a notice of dismissal operates as an adjudication upon the merits when filed by a plaintiff who has once dismissed in any court of the United States or of any state an action based on or including the same claim.

Ct. Ch. R. 41(a)(1).

As indicated by the rule's introductory phrase, when the complaint asserts a derivative claim, a Rule 41(a)(1) dismissal is "[s]ubject to ... the provisions of ... Rule 23.1." Rule 23.1(c) generally requires judicial approval and notice to stockholders before any derivative action can be dismissed. At the same time, Rule 23.1(c) contemplates the ability to forego notice when the dismissal does not present any *941 risk of a surreptitious buyoff of the named plaintiff or its counsel and when the order will not foreclose other plaintiffs from litigating the same claims. The pertinent part states:

> [A derivative] action shall not be dismissed or compromised without the approval of the Court, and notice by mail, publication or otherwise of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the Court directs; *except that if the dismissal is to be without prejudice or with prejudice to the plaintiff only, then such dismissal shall be ordered without notice thereof if there is a showing that no compensation in any form has passed directly or indirectly from any of the defendants to the plaintiff or plaintiff's attorney and that no promise to give any such compensation has been made.*

Ct. Ch. R. 23.1(c) (emphasis added).

Yet another rule, Rule 15(aaa), identifies circumstances when a court will dismiss a complaint with prejudice, thereby limiting a plaintiff's ability to file *seriatim* complaints. Under Rule 15(aaa),

> a party that wishes to respond to a motion to dismiss under Rules 12(b)(6) or 23.1 by amending its pleading must file an amended complaint, or a motion to amend in conformity with this Rule, no later than the time such party's answering brief in response to either of the foregoing motions is due to be filed. 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. Rules 41(a), 23(e) and 23.1 shall be construed so as to give effect to this subsection (aaa).

Ct. Ch. R. 15(aaa). The upshot of Rule 15(aaa) is that "[w]hen a court dismisses a complaint after full briefing in the absence of a timely motion to amend, the dismissal shall be with prejudice unless the plaintiff can show 'good cause [why] dismissal with prejudice would not be just under all the circumstances.' " *E. Sussex Assocs., LLC v. W. Sussex Assocs., LLC,* 2013 WL 2389868, at *1 (Del. Ch. June 3, 2013) (alteration in original). The purpose of this rule is "to conserve litigants' and judicial resources by discouraging a party from briefing a dispositive motion before filing an amended complaint." *Id.*

When originally adopted in 2001, Rule 15(aaa) did not apply literally to a sequence in which the plaintiff filed an answering brief in opposition to a motion to dismiss, then sought to dismiss its complaint without prejudice pursuant to Rule 41(a)(1). This court nevertheless held that the principles underlying Rule 15(aaa) governed, such that the Rule 41(a)(1) dismissal would be with prejudice absent good cause shown. *Stern v. LF Capital P'rs, LLC,* 820 A.2d 1143, 1147 (Del. Ch.2003). Effective February 1, 2006, Rule 15(aaa) was amended to provide that "Rule[ ] 41(a) ... shall be construed so as to give effect to this subsection (aaa)," thereby codifying *Stern.* Rule 15(aaa) now literally applies to notices and motions for voluntary dismissal. *See E. Sussex,* 2013 WL 2389868, at *1.

In this case, Beal, Love, and Farrell filed their opening brief in support of their motion to dismiss, Treppel filed a combined answering brief in opposition to their motion and similar motions filed by other defendants, and Beal, Love, and Farrell *942 filed a reply brief. Treppel then proposed to dismiss his claims against Beal, Love, and Farrell.

Given this sequence, Rule 15(aaa) calls for a dismissal with prejudice as to Treppel only. The plain language of Rule 15(aaa) generates this result because the complaint was brought and filed derivatively and is governed by Rule 23.1. The parenthetical describing the effect of a dismissal states that "in the case of complaints brought pursuant to Rules 23 or 23.1" the dismissal shall be "with prejudice to the named plaintiffs only."

A. Rule 15(aaa) Does Not Contemplate A With–Prejudice Dismissal "As To The World."

[1] Beal, Love, and Farrell reject the prospect of a dismissal that only would be with prejudice as to Treppel. They insist that they are "entitled to under Rule 15(aaa)" a dismissal with prejudice "[a]s to the world." Dkt. 72 at 31–32. The difference between a dismissal with prejudice and without prejudice is consequential. "In general, a dismissal with prejudice constitutes a final decree for *res judicata* purposes." *RBC Capital Mkts., LLC v. Educ. Loan Tr. IV,* 87 A.3d 632, 643 (Del.2014). By contrast, "the phrase 'without prejudice' will mean only that the otherwise final judgment does not operate as a *res judicata* bar to preclude a subsequent lawsuit on the same cause of action." *Braddock v. Zimmerman,* 906 A.2d 776, 784 (Del.2006). A with-prejudice dismissal that applies only to Treppel permits other plaintiffs, including EZCORP and other stockholders, to litigate in the future against Beal, Love, and Farrell about the issues raised in the Complaint. Any future plaintiffs still would need to plead facts sufficient to state a claim, but they would not be barred at the gate by *res judicata.* By contrast, a with-prejudice dismissal "as to the world" would bar anyone else, including EZCORP and other stockholders, from litigating against Beal, Love, and Farrell, no matter what the future might reveal about their conduct.

The three directors base their claimed entitlement to a dismissal with prejudice "as to the world" on the absence of any reference in Rule 15(aaa)'s parenthetical to a voluntary dismissal of the type contemplated here. Dkt. 72 at 31–33. To reiterate, the full sentence in Rule 15(aaa) states:

> 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.

Ct. Ch. R. 15(aaa). As Beal, Love, and Farrell read it, the parenthetical identifies bases for dismissal, not the type of action filed. Thus, if the action were dismissed "pursuant to Rules 23 or 23.1," then they would agree that the dismissal would be "with prejudice to the named plaintiffs only." *Id.; see* Dkt. 72 at 35. But because Treppel is dismissing the action voluntarily, Beal, Love, and Farrell think the parenthetical does not apply.

[2] Beal, Love, and Farrell misread Rule 15(aaa). The parenthetical does not refer to the basis for dismissal. It refers to the type of action filed. The parenthetical singles out complaints styled as class actions (Rule 23) or as derivative actions (Rule 23.1). It does so because they are representative actions where the plaintiff sues not only for itself but also for others. *943 Rule 15(aaa) contemplates that a dismissal in those types of actions will be as to the named plaintiff only. Rule 15(aaa) also states that Rule 41(a) "shall be construed so as to give effect to this subsection (aaa)." Under the plain language of Rule 15(aaa), Treppel's dismissal is "with prejudice to the named plaintiffs only," subject to the court's ability to grant a dismissal without prejudice for good cause shown. This outcome matches up with Rule 23.1(c), which otherwise would require notice to stockholders before Treppel's complaint could be dismissed. *See* Ct. Ch. R. 23.1(c) (requiring notice "except ... if the dismissal is to be without prejudice or with prejudice as to the plaintiff only" and if no compensation has passed to the plaintiff or his counsel).

B. The Substantive Law Of Derivative Actions Precludes A With–Prejudice Dismissal "As To The World."

[3] [4] [5] [6] Assuming for the sake of argument that Rule 15(aaa) did not provide for this outcome, the same result would follow as a matter of substantive Delaware law. Treppel sued derivatively to remedy harm suffered by EZCORP. But when a corporation suffers harm, the board of directors is the institutional actor legally empowered under Delaware law to determine what, if any, remedial action the corporation should take, including pursuing litigation against the individuals involved. *See* 8 *Del. C.* § 141(a). "A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation."[2] "Directors of Delaware corporations derive their managerial decision making power, which encompasses decisions whether to initiate, or refrain from entering, litigation, from 8 *Del. C.* § 141(a)." *Zapata Corp. v. Maldonado,* 430 A.2d 779, 782 (Del. 1981) (footnote omitted). Section 141(a) vests statutory authority in the board of directors to determine what action the corporation will take with its litigation assets, just as with other corporate assets. *See id.*

[7] [8] [9] [10] In a derivative suit, a stockholder plaintiff like Treppel seeks to displace the board's authority. *Aronson,* 473 A.2d at 811. 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:

> Because directors are empowered to manage, or direct the management of, the business and affairs of the corporation, the right of a stockholder to *944 prosecute a derivative suit is limited to situations where the stockholder has demanded that the directors pursue the corporate claim *and* they have wrongfully refused to do so *or* where demand is excused because the directors are incapable of making an impartial decision regarding such litigation.

Rales v. Blasband, 634 A.2d 927, 932 (Del. 1993) (emphases added; citation omitted). "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." *Kaplan v. Peat, Marwick, Mitchell & Co.,* 540 A.2d 726, 730 (Del. 1988).[3]

[11] The derivative plaintiff's lack of authority to sue on behalf of the corporation until the denial of a Rule 23.1 motion likewise flows from the two-fold nature of the derivative suit. As the Delaware Supreme Court explained in *Aronson*, "[t]he 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." 473 A.2d at 811. Later Delaware Supreme Court decisions reaffirmed the two-fold nature of the derivative suit.[4] Nor was this a new concept. One of Delaware's greatest jurists, Chancellor Josiah Wolcott, wrote half a century before *Aronson* that

> [t]he complainants' case, being asserted by them in their derivative right as stockholders, has a double aspect. Its nature is dual. It asserts as the principal cause of action a claim belonging to the corporation to have an accounting from the defendants and a decree against them for payment to the corporation of the sum found due on such accounting. In this aspect, the cause of action is the corporation's. It does not belong to the complainants. Inasmuch however as the corporation will not sue because of the domination over it by the alleged wrongdoers who are its directors, *945 the complainants as stockholders have a right in equity to compel the assertion of the corporation's rights to redress. This is their individual right. A bill filed by stockholders in their derivative right therefore has two phases—one is the equivalent of a suit to compel the corporation to sue, and the other is the suit by the corporation, asserted by the stockholders in its behalf, against those liable to it. The former belongs to the complaining stockholders; the latter to the corporation.[5]

A Rule 23.1 motion addresses the first phase of the derivative action in which the stockholder sues individually to obtain authority to assert the corporation's claim.

[12] Under these controlling Delaware precedents, 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. The stockholder plaintiff is only suing in the plaintiff's own name to "compel the corporation to sue." *Aronson*, 473 A.2d at 811. The only plaintiff legitimately in the case at that point is the stockholder plaintiff.

Because of the substantive law that governs a derivative action, the named plaintiff is the only party who could be bound by a dismissal with prejudice entered before the denial of a Rule 23.1 motion or before the board or a duly empowered committee permits the stockholder to sue. Here, the only plaintiff validly in the case, and the only plaintiff to whom the with-prejudice dismissal would apply, is Treppel.

The stage of the case differentiates a with-prejudice dismissal under Rule 15(aaa) from later, post-Rule 23.1 judgments in derivative actions that do bind the corporation and all of its stockholders.[6] A judgment in a stockholder derivative action certainly binds the corporation and its stockholders when the plaintiff has authority to assert the corporation's claims. Examples include when (i) the *946 corporation has brought the case or taken it over through the special litigation committee process, (ii) the derivative plaintiff has survived a Rule 23.1 motion, thereby gained authority to sue, and obtained a decision on summary judgment or at trial, or (iii) a court has approved a derivative action settlement and made the determinations required by Rule 23.1. But the general rule does not apply before the stockholder plaintiff has gained authority to sue on behalf of the corporation.

C. Due Process Precludes A With–Prejudice Dismissal "As To The World."

[13] [14] [15] Beyond the Delaware substantive law of derivative actions, there is even a more fundamental doctrine that prevents Beal, Love, and Farrell from obtaining a with-prejudice dismissal "as to the world": due process of law. A foundational principle of American law is that "[a] person who is not a party to an action is not bound by the judgment in that action." Restatement

(Second) of Judgments § 62 cmt. a (1982) [hereinafter Judgments]. This "basic principle of law" is subject to three exceptions. *Id.* One applies "where a non-party has a *specific type of pre-existing legal relationship* with a named party, such as bailor and bailee, predecessor and successor or indemnitor and indemnitee." *Kohls v. Kenetech Corp.*, 791 A.2d 763, 769 (Del. Ch. 2000), *aff'd*, 794 A.2d 1160 (Del.2002). "Being fellow stockholders is plainly not the type of legal relationship that fits [this] exception.... An individual stockholder is not, solely because of potentially aligned interests, presumed to act in the place of (and with the power to bind) the other stockholders." *Id.*

[16] A second exception applies when "a person who is not a party to an action ... is involved with it in a way that falls short of becoming a party but which justly should result in his being denied opportunity to relitigate the matters previously in issue." Judgments § 62 cmt. a. "Several kinds of conduct by a non-party are recognized as having this effect. These include allowing the use of one's name as a party when the effect is to mislead an opposing litigant; assuming control of litigation being maintained by another; and agreeing to be bound by an adjudication between others." *Id.* (citations omitted). Concrete, case-specific actions by a stockholder plaintiff or its counsel might well trigger this exception, such as, for example, if the same counsel represented both stockholders or the plaintiffs otherwise collaborated. *Cf. Beiser v. PMC–Sierra, Inc.*, 2009 WL 483321, at *3 (Del. Ch. Feb. 26, 2009); *Cohen v. El Paso Corp.*, 2004 WL 2340046, at *2 (Del. Ch. Oct. 18, 2004). But the general scenario of parallel, overlapping, or *seriatim* efforts by unaffiliated stockholders to assert or prompt the assertion of corporate claims does not implicate this exception.

[17] The third and most pertinent exception is a properly commenced and maintained representative action. *Kohls*, 791 A.2d at 769. Stockholder class and derivative actions qualify, but even here, the authority to represent others is not conferred automatically by filing a complaint. "A representative party must be granted ... authority, either by the represented party itself (in accordance with agency principles) or, in the class action context, by the court." *Id.* It is "self-evident that if a litigant never seeks to and is never compelled to act in a representative capacity, the class of people that *theoretically could have been* represented by that litigant is in no way precluded from asserting their own claims in a subsequent *947 proceeding."[7]

[18] [19] When a stockholder representative pursues claims on a class basis, authority is conferred by a class certification ruling.[8] When a stockholder representative pursues claims in a derivative action, authority can be conferred in two ways. First, the board of directors or a duly empowered committee can approve the litigation expressly or by failing to oppose it. *See Peat, Marwick*, 540 A.2d at 730. Second, and more commonly, a court can determine that the stockholder plaintiff has authority to proceed by denying a Rule 23.1 motion because the complaint adequately pleads either that demand should be excused as futile or that demand was made and wrongfully refused. Until authority is conferred, the representative plaintiff only represents himself.

The limitations that due process places on the scope of a judgment find support in more august authority than common law doctrine. They are embodied in the Due Process Clause of the United States Constitution. The United States Supreme Court has held that to bind 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." *Richards v. Jefferson Cty., Ala.*, 517 U.S. 793, 797, 116 S.Ct. 1761, 135 L.Ed.2d 76 (1996); *accord S. Cent. Bell Tel. Co. v. Ala.*, 526 U.S. 160, 168, 119 S.Ct. 1180, 143 L.Ed.2d 258 (1999).

For present purposes, the most analogous decision is *Smith v. Bayer Corp.*, 564 U.S. 299, 131 S.Ct. 2368, 180 L.Ed.2d 341 (2011), where the United States Supreme Court applied this principle to a putative class action. The *Bayer* litigation began in 2001, when a different plaintiff —George McCollins—sued Bayer Corporation in West Virginia state court. His complaint asserted various state-law claims relating to Baycol, a drug sold by Bayer. McCollins sought to represent a class comprising all West Virginia residents who purchased Baycol. A month later, another West Virginia resident, Keith Smith, filed a similar action in a different county court. Neither knew about the other's suit. Bayer removed McCollins' case to federal court based on diversity jurisdiction, but Smith's case remained in state court for lack of complete diversity. Six years later, with both cases moving at roughly the same pace, the federal court denied class certification in McCollins' action. Bayer than moved to have the federal court enjoin the state court from certifying a class in Smith's action, arguing that "the proposed *948 class in Smith's case was identical to the one the federal court

had just rejected." *Id.* at 2374. The federal court issued the injunction, and the Court of Appeals for the Eighth Circuit affirmed.

The Supreme Court reversed, holding that "[n]either a proposed class action nor a rejected class action may bind nonparties." *Id.* at 2380. In reaching this conclusion, the Court rejected Bayer's argument that "Smith—an unnamed member of a proposed but uncertified class —qualifies as a party to the McCollins litigation." *Id.* at 2379. The Court explained that this argument "ill-comports with any proper understanding of what a 'party' is," and that while an unnamed member of a *certified* class can be considered a party for limited purposes, no one would "advance the novel and surely erroneous argument that a nonnamed class member is a party to the class-action litigation *before that class is certified.*" *Id.* (internal quotation omitted).

The Court found the non-binding nature of the district court's determination all the more clear because class certification was denied. *Id.* at 2379 ("Still less does [Bayer's] argument make sense *once certification is denied.*"). The Court held that "[t]he 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." *Id.*

> 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. So Bayer wants to bind Smith as a member of a class action (because it is only as such that a nonparty in Smith's situation can be bound) to a determination that there could not be a class action.

Id. at 2380. The Court held that a decision properly authorizing the plaintiff to represent a class was a precondition for binding unnamed class members. *Id.*

In reaching this conclusion, the Court rejected the defendant's policy-based arguments. Bayer contended that without a broad judgment that would bind all unnamed class members, multiple plaintiffs could file *seriatim* lawsuits, forcing the "serial relitigation of class certification." *Id.* at 2381. The Court responded that "[t]his form of argument flies in the face of the rule against nonparty preclusion.... [O]ur legal system generally relies on principles of *stare decisis* and comity among courts to mitigate the sometimes substantial costs of similar litigation brought by different plaintiffs." *Id. See generally Taylor v. Sturgell,* 553 U.S. 880, 898–901, 128 S.Ct. 2161, 171 L.Ed.2d 155 (2008) (rejecting on similar grounds the theory of preclusion by "virtual representation").

[20] In my view, 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. *Cf. Parfi Hldg. AB v. Mirror Image Internet,* 954 A.2d 911, 940 (Del. Ch. 2008) (Strine, V.C.) ("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."). In this case, a dismissal order that would be binding "as to the world" would parallel the anti-suit injunction that the district court issued in *Bayer.* Like the order in *Bayer,* it would purport to bind persons who are not parties to the suit and whose interests Treppel *949 has never been given authority to represent. Under 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, just as Rule 15(aaa) provides.

D. Treppel's Request For A Without–Prejudice Dismissal

For the reasons described in the previous sections, Beal, Love, and Farrell cannot obtain a with-prejudice dismissal "as to the world." Treppel takes the polar opposite view, arguing that any dismissal should be without prejudice. To reiterate, Treppel posits that if his counsel had the benefit of *Cornerstone,* he would not have sued Beal, Love, and Farrell. He then would not be in the position of facing a dismissal with prejudice as to himself under Rule 15(aaa) that would limit his ability to name Beal, Love, and Farrell if discovery uncovers a basis for suit.

[21] In my view, Treppel has not established good cause for a without-prejudice dismissal. A similar situation arose

in *Quadrant Structured Products Co., Ltd. v. Vertin*, 2014 WL 5465535 (Del. Ch. Oct. 28, 2014). That decision granted a motion to dismiss in part, dismissing derivative claims for breach of fiduciary duty against certain directors due to the absence of allegations that would have called into question the defendants' loyalty or good faith. Under Rule 15(aaa), the dismissal was with prejudice as to the named plaintiff. The plaintiff moved for reargument, positing that as discovery went forward on other claims, it might yield evidence that would permit the plaintiff to plead a viable claim against the directors. The plaintiff claimed that this possibility supported a without-prejudice dismissal, because only then could the plaintiff name the directors later. I disagreed, noting that the dismissal was an interlocutory ruling. *Id.* at *5. Consequently, subject to the law of the case doctrine, the dismissal could be "revisited should future developments, including evidence generated by the discovery process, provide a compelling reason for doing so." *Id.; accord Siegman v. Columbia Pictures Entm't, Inc.*, 1993 WL 10969, at *3 (Del. Ch. Jan. 15, 1993). This meant there was no prejudice from a with-prejudice dismissal, and good cause for a without-prejudice dismissal did not exist.

The same reasoning applies here. As in *Quadrant*, the with-prejudice dismissal of Beal, Love, and Farrell can be revisited if a "compelling reason to do so appears." *Zirn v. VLI Corp.*, 1994 WL 548938, at *2 (Del. Ch. Sept. 23, 1994) (Allen, C.). That possibility alleviates any need to grant a without-prejudice dismissal now, and good cause does not exist for departing from the default rule established by Rule 15(aaa).

III. CONCLUSION

Beal, Love, and Farrell's motion to dismiss is granted. The dismissal is with prejudice only as to Treppel.

All Citations

130 A.3d 934

Footnotes

1 *Compare Emerald I*, 726 A.2d at 1223 (holding that in a challenge to a transaction involving a controlling stockholder to which entire fairness applied, court could not apply Section 102(b)(7) on motion for summary judgment because factual conflicts required a trial to determine nature of the duty breached), *with Malpiede v. Townson*, 780 A.2d 1075, 1094–98 (Del.2001) (holding that in a challenge to third-party, arms' length merger that was approved by a fully informed stockholder vote and to which the business judgment rule applied, the court could apply Section 102(b)(7) at the pleadings stage unless plaintiff pled facts sufficient to show that a majority of the board was not disinterested or independent), *with Emerald P'rs v. Berlin (Emerald II)*, 787 A.2d 85, 90, 92–94 (Del.2001) (holding that in a challenge to a transaction with a majority stockholder to which entire fairness applied, court could not apply Section 102(b)(7) without first analyzing transaction under entire fairness standard to determine nature of the fiduciary breach and distinguishing *Malpiede* as a case involving the business judgment standard of review). *Cf. Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304, 308 (Del.2015) (holding explicitly, as *Malpiede* indicated implicitly, that a fully informed stockholder vote lowers the standard of review from enhanced scrutiny to business judgment review). *See generally* 1 David A. Drexler et al., III, *Delaware Corporation Law and Practice*, § 8.02[7] at 6–17 (2015).

2 *Aronson v. Lewis*, 473 A.2d 805, 811 (Del.1984). In *Brehm v. Eisner*, 746 A.2d 244, 253–54 (Del.2000), the Delaware Supreme Court overruled seven precedents, including *Aronson*, to the extent those precedents reviewed a Rule 23.1 decision by the Court of Chancery under an abuse of discretion standard or otherwise suggested deferential appellate review. *See id.* at 253 & n. 13 (overruling in part on this issue *Scattered Corp. v. Chi. Stock Exch.*, 701 A.2d 70, 72–73 (Del.1997); *Grimes v. Donald*, 673 A.2d 1207, 1217 n. 15 (Del.1996); *Heineman v. Datapoint Corp.*, 611 A.2d 950, 952 (Del.1992); *Levine v. Smith*, 591 A.2d 194, 207 (Del.1991); *Grobow v. Perot*, 539 A.2d 180, 186 (Del.1988); *Pogostin v. Rice*, 480 A.2d 619, 624–25 (Del.1984); and *Aronson*, 473 A.2d at 814). The *Brehm* Court held that going forward, appellate review of a Rule 23.1 determination would be *de novo* and plenary. *Brehm*, 746 A.2d at 253–54. The seven partially overruled precedents otherwise remain good law. In this decision, I do not rely on any of them for the standard of appellate review. Although the technical rules of legal citation would require noting that each was reversed on other grounds by *Brehm*, I have chosen to omit the cumbersome subsequent history, which creates the misimpression that *Brehm* rejected core elements of the Delaware derivative action canon.

3 Delaware Court of Chancery decisions have long said the same thing. *See, e.g., Ainscow v. Sanitary Co. of Am.*, 180 A. 614, 615 (Del. Ch.1935) (Wolcott, C.) ("[A] stockholder has no right to file a bill in the corporation's behalf unless he

has first made demand on the corporation that it bring the suit and the demand has been answered by a refusal, or unless the circumstances are such that because of the relation of the responsible officers of the corporation to the alleged wrongs, a demand would be obviously futile ...."); *accord Maldonado v. Flynn*, 413 A.2d 1251, 1262 (Del. Ch.1980) ("The stockholder's individual right to bring the action does not ripen, however, until he has made a demand on the corporation which has been met with a refusal by the corporation to assert its cause of action or unless he can show a demand to be futile."), *rev'd on other grounds sub nom, Zapata*, 430 A.2d at 784 ("[W]here demand is properly excused, the stockholder does possess the ability to initiate the action on his corporation's behalf.").

4 *See Schoon v. Smith*, 953 A.2d 196, 201–02 (Del.2008) (tracing history of derivative action and explaining its dual nature); *Spiegel v. Buntrock*, 571 A.2d 767, 773 (Del.1990) (quoting *Aronson* for the "two-fold" nature of the derivative action); *Stemberg v. O'Neil*, 550 A.2d 1105, 1124 n. 41 (Del.1988) ("The normal derivative suit was 'two suits in one: (1) The plaintiff brought a suit in equity against the corporation seeking an order against it; (2) to bring a suit for damages or other legal injury for damages or other relief against some third person who had caused legal injury to the corporation.' " (quoting Robert C. Clark, *Corporate Law* 639–40 (1986))); *Peat, Marwick*, 540 A.2d at 730 (quoting *Aronson* in describing the "two-fold" nature of the derivative action); *Zapata*, 430 A.2d at 784 (citing "the 'two phases' of a derivative suit, the stockholder's suit to compel the corporation to sue and the corporation's suit").

5 *Cantor v. Sachs*, 162 A. 73, 76 (Del. Ch. 1932) (citations omitted); *accord Hariff v. Kerkorian*, 324 A.2d 215, 218 (Del. Ch.1974) ("The nature of the derivative suit is two-fold: first, it is the equivalent of a suit by the stockholders to compel the corporation to sue; and second, it is a suit by the corporation, asserted by the stockholders in its behalf, against those liable to it."), *aff'd in part, rev'd in part on other grounds*, 347 A.2d 133 (Del.1975).

6 For cases explaining the general rule, see, for example, *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."); *Dana v. Morgan*, 232 F. 85, 89 (2d Cir. 1916) (explaining that a stockholder derivative "action is really the action of all the stockholders, as it is necessarily commenced in their behalf and for their benefit. And as in such suits the wrong to be redressed is the wrong done to the corporation and as the corporation is a necessary part to the suit, it inevitably follows that there can be but one adjudication on the rights of the corporation. And it is undoubted law that the judgment in the state court is an estoppel and a finality not only as to all matters actually litigated in the suit but also as to all matters which were not but might have been presented to the court and passed upon therein."); *Ratner v. Paramount Pictures, Inc.*, 6 F.R.D. 618, 619 (S.D.N.Y.1942) ("A judgment in the stockholders' derivative action is res judicata both as to the corporation and as to all of its stockholders, including stockholders who were not parties to the original action in subsequent actions based upon the same subject matter."); *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.").

7 *Id.* at 769–70; *see* Judgments § 41 (identifying categories of persons who can bind non-parties as including "[t]he representative of a class of persons similarly situated, *designated as such with the approval of the court*, of which the person is a member" (emphasis added)); *id.* § 59 cmt. c ("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.").

8 *See* Ct. Ch. R. 23; *Standard Fire Ins. Co. v. Knowles*, —U.S. —, 133 S.Ct. 1345, 1349, 185 L.Ed.2d 439 (2013) ("[A] plaintiff who files a proposed class action cannot legally bind members of the proposed class before the class is certified."); *Schwarzschild v. Tse*, 69 F.3d 293, 297 (9th Cir. 1995) ("[W]hen defendants obtain summary judgment before the class has been properly certified or before notice has been sent, ... [the summary judgment] decision binds only the named plaintiffs."); 3 Alba Conte & Herbert B. Newberg, *Newberg on Class Actions* § 7.12, at 63–64 (5th ed. 2013) ("[I]f a court rules on a dispositive motion prior to certification and the defendant prevails[,] ... the resulting order would not bind putative absent class members since no class was certified, and they remained complete nonparties.").

End of Document