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Hastily Filed Derivative Suits Can Have Preclusive Effect

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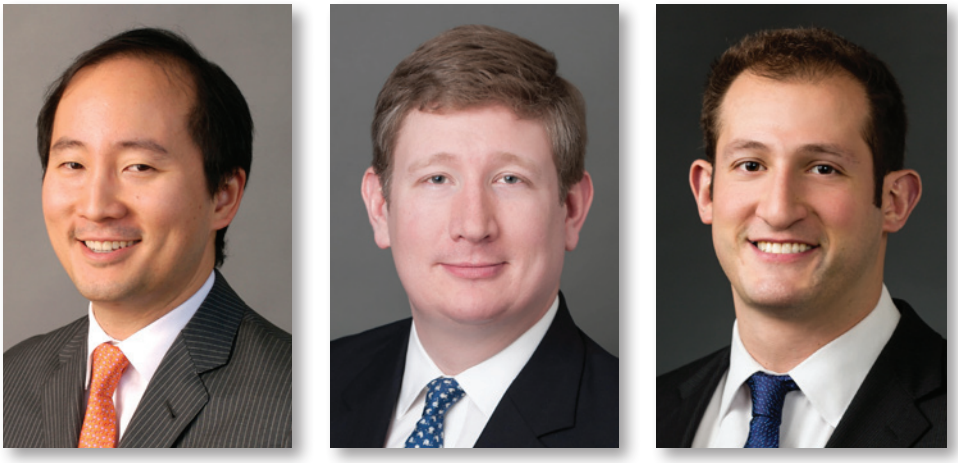

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The recent decision in *Laborers' District Council Construction Industry Pension Fund v. Bensoussan*, No. CV 11293-CB (Del. Ch. June 14, 2016), illustrates that derivative suits allegedly filed without adequate investigation can have preclusive effect against more factually developed, but later-filed, suits. In *Bensoussan*, Delaware Court of Chancery Chancellor Andre G. Bouchard dismissed a derivative suit on preclusion grounds notwithstanding the stockholders' contention that the plaintiffs in a derivative action filed earlier in federal district court in New York failed to make a books and records request or otherwise adequately investigate their claims before filing suit.

Background

On June 5, 2013, Dennis Wilson, the founder of lululemon athletica Inc., allegedly learned that the company's CEO, Christine Day, intended to resign. On June 7, a brokerage firm sold some of Wilson's shares allegedly pursuant to a trading plan for nearly $50 million in proceeds. On June 10, the company announced Day's intention to resign, and lululemon stock dropped more than 17 percent. The timing of Wilson's stock sale prompted widespread media attention, and litigation ensued.

In August 2013, two stockholders filed derivative actions in federal court in New York. The plaintiffs did not request inspection of lululemon's books and records before filing suit and alleged that making a demand on lululemon's board prior to initiating litigation would have been futile. The two actions were consolidated in January 2014.

Meanwhile, in May and October of 2013, two other stockholders requested inspection of lululemon's books and records pursuant to 8 Del. C. Section 220. In March 2014, these two stockholders moved to intervene in the New York suit, requesting a stay pending the outcome of their books and records investigation. On April 9, 2014, however, the federal district court in New York denied the motion to intervene and granted the motion to dismiss pending in the action on the ground that the plaintiffs had failed to adequately plead demand futility.

In July 2015, the two stockholders whose intervention motion had been denied by the federal district court in New York filed a derivative action in the Delaware Court of Chancery. On Aug. 18, 2015, the defendants moved to dismiss.

Issue and Claim Preclusion

Bouchard focused his analysis of the motion to dismiss on issue preclusion (collateral estoppel) and claim preclusion (res judicata), and applied New York law because "a state court is required to give a federal judgment the same force and effect as it would be given under the preclusion law of the state in which the federal court is sitting," quoting *Pyott v. Louisiana Municipal Police Employees' Retirement System*, 74 A.3d 612, 615-16 (Del. 2013).

On issue preclusion, Bouchard explained that "the party seeking the benefit of collateral estoppel must prove that the identical issue was necessarily decided in the prior action and is decisive in the present action"; and "the party to be precluded from relitigating an issue must have had a full and fair opportunity to contest the prior determination." The Delaware plaintiffs argued that collateral estoppel should not apply because the New York plaintiffs' pleading did not contain the factual detail in the Delaware plaintiffs' pleading and instead "merely devot[ed] one page to allegations regarding issues related to Wilson's stock sales." Bouchard rejected the Delaware plaintiffs' argument because both suits "advanced the same theory of demand futility" and "all that is relevant is whether the district court necessarily decided the same demand futility issue presented here." The Delaware plaintiffs also argued that the New York plaintiffs did not represent their interests because New York counsel made poor strategic choices, including by filing suit before making a books and records request. Although critical of the New York plaintiffs' "imperfect legal strategy," Bouchard observed that the Delaware plaintiffs' motion to intervene in the New York action constituted an opportunity to present "their views concerning the desirability of obtaining books and records before pressing derivative claims." Accordingly, Bouchard "barred [the plaintiffs] from relitigating the issue of demand futility in the action under the doctrine of issue preclusion."

Bouchard also held that dismissal was warranted on claim preclusion grounds because "it is well-established under New York law ... that privity exists between different stockholders of a corporation in derivative actions for purposes of preclusion"; the New York action was adjudicated on the merits in that it was dismissed "with prejudice to the ability of the plaintiffs to seek to replead demand futility"; and "the claims at issue [in the Delaware action] arose out of the same transaction that forms the basis of the claims asserted in the New York Action" and "implicated the same issue of demand futility."

Conclusion

In *Pyott*, the Delaware Supreme Court explicitly "reject[ed] the 'fast filer' irrebuttable presumption of inadequacy" for multi-jurisdictional derivative suits. In the wake of *Pyott*, the Court of Chancery has repeatedly dismissed later-filed derivative actions on issue or claim preclusion grounds. Bouchard's decision in *Bensoussan* underscores that even derivative suits allegedly filed without adequate investigation can have preclusive effect. •

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