IN THE SUPREME COURT OF THE STATE OF DELAWARE

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM, NEW YORK CITY EMPLOYEES' RETIREMENT SYSTEM, NEW YORK CITY POLICE PENSION FUND, POLICE OFFICERS' VARIABLE SUPPLEMENTS FUND, POLICE SUPERVISOR OFFICERS' VARIABLE SUPPLEMENTS FUND, NEW YORK CITY FIRE DEPARTMENT PENSION FUND, FIRE FIGHTERS' VARIABLE SUPPLEMENTS FUND, FIRE OFFICERS' VARIABLE SUPPLEMENTS FUND, BOARD OF EDUCATION RETIREMENT SYSTEM OF THE CITY OF NEW YORK, TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK, NEW YORK CITY TEACHERS' VARIABLE ANNUITY PROGRAM, AND INDIANA ELECTRICAL WORKERS PENSION TRUST FUND IBEW,

Plaintiffs Below,
Appellants,

v.

AIDA M. ALVAREZ, JAMES I. CASH, JR., ROGER C. CORBETT, DOUGLAS N. DAFT, MICHAEL T. DUKE, GREGORY B. PENNER, STEVEN S. REINEMUND, JIM C. WALTON, S. ROBSON WALTON, LINDA S. WOLF, H. LEE SCOTT, JR., CHRISTOPHER J. WILLIAMS, JAMES W. BREYER, M. MICHELE BURNS, DAVID D. GLASS, ROLAND A. HERNANDEZ, JOHN D. OPIE, J. PAUL REASON, ARNE M. SORENSON, JOSE H. VILLARREAL, JOSE LUIS RODRIGUEZMACEDO RIVERA, EDUARDO CASTRO-WRIGHT,

§ §

No. 295, 2016

Court Below:

Court of Chancery
of the State of Delaware

C. A. No. 7455-CB

THOMAS A. HYDE, THOMAS A. MARS, JOHN B. MENZER, EDUARDO F. SOLORZANO MORALES, AND LEE STUCKY,	§ § § §
Defendants Below, Appellees,	§ § §
WAL-MART STORES, INC.,	§ §
Nominal Defendant Below, Appellee.	§

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

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

O R D E R

(1) This is a troubling case. Upon learning of a potential bribery scandal at a Mexican subsidiary of Wal-Mart Stores, Inc. ("Wal-Mart"), the appellants in this case (the "Delaware Plaintiffs") did exactly what this Court has suggested on numerous occasions, namely, use the "tools at hand" to inspect the company's pertinent books and records before filing a derivative complaint. Several sets of plaintiffs chose not to do that, and instead filed complaints in federal court in Arkansas (the "Arkansas Plaintiffs") and in the Delaware Court of Chancery. During an initial conference in Delaware, then-Chancellor Strine, now Chief Justice Strine, explicitly warned plaintiffs' counsel that the extant complaints before him likely would not survive a motion to dismiss.[1] The

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

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

Chancellor urged counsel, as this was not an expedited matter, to undertake a careful examination of the books and records before filing a derivative action. The Delaware Plaintiffs, who arguably had the most skin in the game, heeded the Chancellor's warning and pursued a books and records demand and lawsuit that spanned the course of almost three years.[2]

(2) The problem for the Delaware Plaintiffs was that the Arkansas Plaintiffs chose a different strategy by filing a case in federal court. Their claims largely resembled the claims in Delaware, but added claims under Sections 14(a) and 29(b) of the Securities Exchange Act of 1934.[3] The firms representing the Arkansas Plaintiffs made a tactical decision to forgo a books and records inspection. Instead, they believed that they had obtained sufficient information from a *New York Times* article that had described the alleged scandal in some detail and referenced a number of internal documents, which were made publicly available on the *Times*' web site.[4]

(3) In the Court of Chancery, the defendants filed a "one-forum" motion, seeking to have the litigation proceed solely in Delaware. In Arkansas, they moved for a stay pending the outcome of the Delaware litigation, in part because the ultimate issues to

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

[3] It appears from the record on appeal that the *New York Times* published the bribery allegations on April 21, 2012; the first Delaware complaint was filed on April 25, 2012 (A44); and the first Arkansas complaint was filed on April 25, 2012 (B14).

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

be decided on the merits involved questions of Delaware law. The federal judge agreed to stay her hand while the Delaware litigation proceeded.[5] The United States Court of Appeals for the Eighth Circuit reversed the stay on December 18, 2013, emphasizing the district court's federal jurisdiction over the Section 14(a) claim.[6]

(4) The Defendants then moved for a more limited stay, which the federal judge denied, citing delays that had occurred in the Delaware action.[7] In its June 4, 2014 order rejecting Defendant's Renewed Motion for a Limited Stay, the Arkansas federal court stated that "[i]t is likely that the first decision on demand futility will be entitled to collateral estoppel effect."[8] That statement triggered alarm bells for the Delaware Plaintiffs, who still had no complaint on file. According to the record before this Court, the Delaware Plaintiffs responded to that warning by seeking expedition of the defendants' then-pending appeal of the books and records case in this Court—a request that was granted.[9] The Delaware Plaintiffs made no attempt to intervene in the litigation

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

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

[7] Order at B135, *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, No. 4:12-cv-4041 (W.D. Ark. June 4, 2014). It is clear and undisputed that the federal judge was fully aware of the proceedings in Delaware, including the Delaware Plaintiffs' pursuit of Wal-Mart's books and records. *See, e.g.*, Tr. of Hearing on Mot. to Stay at B172-75 (Tr. 10:2-13:20), *In re Wal-Mart Stores, Inc. S'holder Deriv. Litig.*, No. 4:12-cv-4041 (W.D. Ark. Sep. 6, 2012).

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

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

in Arkansas, but claim to have unsuccessfully attempted, in a series of phone calls, to convince the Arkansas Plaintiffs to join the Delaware action.[10] Delaware counsel submitted an affidavit asserting that these discussions broke down because their Arkansas counterparts demanded an unacceptable portion of the fee pie.[11] The Arkansas Plaintiffs, according to the Delaware Plaintiffs, were unwilling to join forces with the Delaware Plaintiffs or wait to see what they might uncover as a result of their books and records inspection.[12] For whatever reason, the two groups—both of whom were seeking permission to act on behalf of the same corporate entity—could not manage to work together. Given the Chancellor's early assessment of the state of the complaints, it should come as no surprise that the federal judge dismissed the Arkansas complaint on March 31, 2015.[13]

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

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

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

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

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

barred.[14]

(6) The parties agree that the Chancellor was correct that, in determining the preclusive effect of the Arkansas federal court's dismissal, the Court of Chancery must look to federal common law, which, in turn, looks to the law of the rendering state (Arkansas) in which the federal court exercises diversity jurisdiction.[15] Under Arkansas law, "[f]or collateral estoppel to apply, the following four elements must be met: 1) the issue sought to be precluded must be the same as that involved in the prior litigation; 2) that issue must have been actually litigated; 3) the issue must have been determined by a valid and final judgment; and 4) the determination must have been essential to the judgment."[16] In addition, the parties to be precluded must have been parties in the prior litigation or been in privity with those parties.[17] Further, the party in the earlier decision must have adequately represented the nonparty.[18]

(7) Delaware Plaintiffs challenge the preclusive effect of the Arkansas dismissal in Delaware by contending that: their Due Process rights were violated as a result of the Delaware dismissal; the privity requirement was not satisfied; the Arkansas Plaintiffs were inadequate representatives; and, the Delaware Plaintiffs' claims under

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

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

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

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

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

Aronson v. Lewis[19] were not "actually litigated."

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

(9) As for the alleged inadequacy of representation, this Court has some sympathy for the Delaware Plaintiffs' position. They heeded the Chancellor's advice,[20] and the plaintiffs who did not heed those warnings suffered dismissal of their complaint with the ultimate effect of barring the action of the Delaware Plaintiffs, who spent nearly three years fighting the books and records battle. Although Section 220 proceedings are supposed to be streamlined and summary,[21] it is not inconceivable that obtaining the

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

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

[21] *See* 8 *Del. C.* § 220(c).

sought-after documents would involve substantial time and effort in a case where the underlying allegations involve an alleged bribery scandal and cover-up. We have formed no conclusion as to whether the Delaware Plaintiffs were the cause of any undue or unexplained delay, or whether the Defendants deliberately "slow-rolled" the litigation ball in Delaware in order to allow the Arkansas litigation to proceed.[22]

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

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

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

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

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

[23] We note that New York law, although of no application here, provides an exception to claim preclusion in derivative actions where a stockholder seeks to intervene in the prior action to protect its interests but is denied leave to participate. *See Parkoff v. Gen. Tel. & Elecs. Corp.*, 425 N.E.2d 820, 824 (N.Y. 1981). We also note that *Parkoff* addressed *res judicata*, as opposed to collateral estoppel. *Id.* at 821. In *Parkoff*, the New York Court of Appeals noted that the general rule of claim preclusion "is qualified by the condition that the judgment being raised as a

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

(14) The parties appear to agree that the Restatement's standards of gross deficiency[24] and divergence of interests[25] apply in determining whether the Arkansas Plaintiffs and their counsel were inadequate representatives.[26] Notwithstanding the former Chancellor's warning about the likely deficiency of the then-pending Delaware

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

[24] Restatement (Second) of Judgments § 42 cmt. f ("Where the representative's management of the litigation is so grossly deficient as to be apparent to the opposing party, it . . . creates no justifiable reliance interest in the adjudication on the part of the opposing party.").

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

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

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

(15) As to the privity analysis, because no court in Arkansas had squarely decided the issue, the Chancellor looked in part to the Restatement (Second) of Judgments.[28] The Chancellor noted that the Arkansas Supreme Court has stated that, in derivative cases, the corporation is the real party in interest.[29] The Chancellor was persuaded that an Arkansas court would likely rule as several federal courts have—that the privity element is satisfied here. As a matter of Arkansas state law on the privity issue, we are presently satisfied with the state of the record and do not perceive any error.

(16) But there is force to the Delaware Plaintiffs' argument that the privity and

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

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

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

Due Process analyses were conflated by the Court of Chancery. Both sides agree that, although they overlap, the privity and Due Process issues are distinct.[30] The Delaware Plaintiffs contend that the Chancellor did not address the Due Process issue or the Due Process aspect of the privity requirement.[31] At the outset of his opinion, the Chancellor acknowledged that the privity issue is a matter of Arkansas state law, so long as federal constitutional Due Process is not offended.[32] However, after acknowledging the Delaware Plaintiffs' argument that both Arkansas and federal "standards must be met," the Chancellor disposed of the federal Due Process analysis, stating that "the federal common law rule in diversity cases is to apply the preclusion law of the state in which the court sits, as explained above."[33] Appellants assert that the Chancellor focused almost exclusively on privity as a question of Arkansas state law and never addressed the federal Due Process analysis required by the United States Constitution as it relates to nonparty preclusion.

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

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

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

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

(17) The United States Supreme Court has made clear that the preclusive effect of a federal court judgment is determined by federal common law, *subject to due process limitations*.[34] It has held that the general rule is that "one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process."[35] This rule against nonparty preclusion is subject to exceptions, six of which were identified by the United States Supreme Court in *Taylor v. Sturgell*.[36]

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

> Bayer's first claim ill-comports with any proper understanding of what a "party" is. In general, "[a] 'party' to litigation is '[o]ne by or against whom a lawsuit is brought,' or one who 'become[s] a party by intervention, substitution, or third-party practice.' And we have further held that an unnamed member of a *certified* class may be 'considered a party for the [particular] purpos[e] of appealing' an adverse judgment. But as the dissent in *Devlin* noted, no one in that case was 'willing to advance the novel and surely erroneous argument that a nonnamed class member is a party to the

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

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

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

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

[38] *Id.* at 315.

> class-action litigation *before the class is certified.* Still less does that argument make sense *once certification is denied*. The definition of the term 'party' can on no account be stretched so far as to cover a person . . . whom the plaintiff in a lawsuit was denied leave to represent.[39]

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

(20) The Defendants suggest on appeal that the Due Process issue was addressed by this Court in *Pyott II*.[42] We disagree. In *Pyott II*, this Court did not address Due Process because no party disputed that the California federal court in *LeBoyer v.*

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

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

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

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

Greenspan[43] had held that a Rule 23.1 dismissal is afforded preclusive effect in a subsequent or parallel suit brought by different stockholders making the same claims. The trial court in *Pyott I*[44] acknowledged that a California court would conclude that the California decision precluded the appellees in that case from pursuing the Delaware litigation. But the trial court (erroneously) determined that the privity question was a matter of Delaware law because one's status as a derivative plaintiff arose from a legal relationship with the corporation that fell within the internal affairs doctrine. The Court of Chancery then focused on the dual nature of the derivative action and held that there was no privity because, until a stockholder survives an action to dismiss based on a failure to make a demand, the stockholder is not acting for the corporation.

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

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

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

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

23.1 dismissal. Accordingly, this Court in *Pyott II* did not find it necessary to address the Due Process issue, as clear precedent decided by a California federal court "compelled" dismissal of the Delaware action.[46] In addition, the plaintiffs-appellees in *Pyott II* had advised this Court that the Due Process question had not been fully briefed before the Court of Chancery and was not being argued on appeal.[47]

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

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

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

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

[49] *Id.* at 945.

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

(23) Thus, in *EZCORP*, Vice Chancellor Laster held that binding other litigants to an adjudication in a case where they were not parties "deprive[s] them of the due process of law guaranteed by the Fourteenth Amendment."[52] The Vice Chancellor relied upon the United States Supreme Court decision in *Bayer*,[53] stating that, "just as the Due Process Clause prevents a judgment binding absent class members before a class has been certified, the Due Process Clause likewise prevents a judgment from binding the corporation or other stockholders in a derivative action until the action has survived a Rule 23.1 motion to dismiss, or the board of directors has given the plaintiff authority to proceed by declining to oppose the suit."[54]

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

[51] *Id.* at 948.

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

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

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

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

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

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

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

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

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

BY THE COURT:

/s/ Karen L. Valihura
Justice