



DELAWARE UPDATE: DERIVATIVE CLAIMS DISMISSED ELSEWHERE CANNOT BE RELITIGATED IN DELAWARE

Last June, the Delaware Court of Chancery ruled that a shareholder derivative suit could be litigated in Delaware even after an identical claim had been dismissed with prejudice by a federal court in California. As we reported at the time,¹ that decision suggested that Delaware corporations might not be able to achieve finality in Delaware following an out-of-state dismissal of a derivative case.

On April 4, 2013, the Delaware Supreme Court reversed the Chancery Court's decision.² Citing the "strong[] national interests that all state and federal courts have in respecting each other's judgments," the high court held that once a derivative claim has been dismissed in a sister jurisdiction, the identical claim cannot be relitigated in Delaware if it would be barred under the rules of the other jurisdiction. The Supreme Court's ruling provides added assurance that once a company has achieved a complete win in derivative litigation, its victory cannot be undone by reexamination under separate principles in Delaware.

BACKGROUND

The case involved Allergan, Inc., a Delaware corporation that pled guilty to a misdemeanor misbranding charge in connection with alleged "off-label" marketing of one of its leading drugs. Two days after the plea was announced, a shareholder of the company filed a derivative suit in the Court of Chancery, alleging that the company's directors had breached their fiduciary duties in connection with off-label marketing. Later, several other derivative actions were filed, and subsequently consolidated into a single case, in federal court in California. The Delaware plaintiffs sought and received documents through a books-and-records demand. The defendants moved to dismiss the complaints in both cases, and the federal court in California ruled first, dismissing that derivative complaint with prejudice. The California court found that the plaintiffs had failed to establish that a pre-suit demand on the company's board of directors would have been futile, and that therefore those plaintiffs did not have standing to sue in the name of the company.

Following the California dismissal, the defendants supplemented their motion to dismiss the Delaware case on the basis that the Delaware action was barred by collateral estoppel, a doctrine that normally bars relitigation by the same plaintiff, or a closely related party said to be “in privity” with that plaintiff, of an issue that was litigated and decided in a prior proceeding. The defendants argued that because the plaintiff-shareholders in California and Delaware were both seeking to represent the corporation, they were in privity with each other.

THE CHANCERY COURT DECISION

In a lengthy 82-page opinion, the Chancery Court refused to dismiss the complaint, rejecting the collateral estoppel argument and permitting the Delaware derivative case to proceed after finding that pre-suit demand on the board was excused. The opinion was based on two key points.

First, the court believed that the central question—whether a shareholder could sue a Delaware corporation after an identical derivative claim had been dismissed—is one that must be decided under Delaware law. Because the question involved the “internal affairs” of Delaware corporations, it was not permissible to have courts in different jurisdictions decide the question under different criteria; it “should be governed uniformly by Delaware law.” Second, the court discussed at length the perceived problem of plaintiff law firms filing claims quickly after a corporate event and arriving at hasty settlements that garner a fee for them but may not protect the interests of their clients. The court concluded that “fast filers” who do not at least seek to examine corporate books and records are presumptively inadequate shareholder representatives. Therefore, a judgment of dismissal in a case prosecuted by a “fast filer” was not automatically entitled to preclusive effect.

Once the Chancery Court decided that the Delaware suit was not barred by the dismissal of the California federal court action, it reached a different conclusion on the issue of demand futility. It found that the plaintiff had successfully pled that a demand on Allergan’s board would be futile, and that therefore the suit could proceed.

THE DELAWARE SUPREME COURT’S REVERSAL

In a terse 12-page opinion, the five justices of the Delaware Supreme Court, sitting *en banc*, resoundingly rejected both of the key conclusions of the Chancery Court and ordered the case dismissed with prejudice. First, the justices decided that, as a matter of both federal and Delaware law, Delaware courts are required to give “full faith and credit” to the judgments of courts in other states. Even though Delaware has a strong interest in governing the internal affairs of its corporations, that interest “must yield to the stronger national interests that all state and federal courts have in respecting each other’s judgments.” Second, the Supreme Court rejected the Chancery Court’s irrebuttable presumption that a “fast filer” is an inadequate representative. Although that might sometimes be true, the Court acknowledged, there was no support in the record of the case that the California plaintiffs were inadequate.

WHAT IT ALL MEANS

Several members of the Delaware Chancery Court have recently expressed the view that cases involving the internal affairs of Delaware corporations should be heard predominantly, if not exclusively, in Delaware courts. This view can present problems for Delaware corporations in light of the reality that they are often subjected to multiple identical claims, brought simultaneously in different courts by different groups of stockholders. The Chancery Court’s decision in the *Allergan* case was consistent with an “only in Delaware” approach to corporate litigation, but it would impose significant burdens if, for example, a company defending a derivative case in California could not be assured that a victory in, or a settlement of, that case would bar subsequent Delaware litigation by a different plaintiff group.

The Delaware Supreme Court’s decision restores a measure of certainty to the process of defending multiple suits. Delaware corporations and their counsel now have added assurance that if a case is dismissed with prejudice by a state or federal court in a sister jurisdiction, and the doctrine of collateral estoppel would prevent relitigation of the same issue in the sister jurisdiction, the finality of the judgment will not be disturbed.

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ENDNOTES

- 1 “Delaware Court Resuscitates a Derivative Lawsuit Despite Dismissal with Prejudice in Another Forum” (June 2012), *available at* http://www.jonesday.com/delaware_court_resuscitates/.
- 2 *Pyott v. La. Mun. Police Emps.’ Ret. Sys.*, No. 380, 2012, (Del. Apr. 4, 2013).

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