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,	No. 295, 2016 Appeal from the Memorandum Opinion, dated May 13, 2016, of the Court of Chancery 0f the State of Delaware, C.A. No. 7455-CB

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Defendants Below, Appellees	)
WAL-MART STORES, INC.,	)
Nominal Defendant Below, Appellee	)

[CORRECTED] BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND RETAIL LITIGATION CENTER, INC. AS *AMICI CURIAE* IN SUPPORT OF DEFENDANT-APPELLEE WAL-MART STORES, INC. AND DISMISSAL

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INTEREST OF *AMICI CURIAE*

The Chamber of Commerce of the United States of America ("Chamber"), with 300,000 members, is the world's largest business federation. The Chamber represents the interests of more than three million companies and professional organizations of every size, in every industry, and from every region of the country. One of the Chamber's most important roles is to advocate on behalf of its members in cases that raise issues of significance to the nation's business community.

The Retail Litigation Center, Inc. ("RLC," and, together with the Chamber, "Amici") is a public policy organization that identifies and engages in legal proceedings that affect the retail industry. The RLC's members include many of the country's largest and most innovative retailers. The member entities whose interests the RLC represents employ millions of people throughout the United States, provide goods and services to tens of millions more, and account for tens of billions of dollars in annual sales. The RLC seeks to provide courts with retail-industry perspectives on important legal issues, and to highlight the potential industry-wide consequences of significant pending cases.

The issue in this case—whether stockholders seeking to bring a derivative lawsuit have a due process right to relitigate the issue of demand futility notwithstanding another court's prior dismissal of an action for failure to

sufficiently plead demand futility—is of crucial importance to public companies chartered in Delaware. Corporate activity leads, regularly and inevitably, to derivative litigation in multiple jurisdictions. While derivative actions are an important tool for holding directors responsible for wrongdoing, they also by their nature infringe on a key value of Delaware corporation law: the managerial freedom of directors. The demand requirement balances these two interests. Stockholders can usurp directors' authority to set corporate litigation policy, but only upon a showing that the directors are unsuited to set that policy themselves.

The regime recommended by the Court of Chancery would jeopardize the fundamental precept of director control by undermining the demand requirement. Instead of litigating demand futility once and for all, whatever the outcome—bearing the consequences if they are adjudged interested or moving on if a court decides otherwise—directors would be in a never-win situation. If one court determined that demand was not excused, other stockholder plaintiffs would take their own bite at the apple, and so on. Such a regime would do little more than compound legal fees at the expense of current stockholders. To strike the appropriate balance between testing director independence or interest and allowing directors to exercise their business judgment, Delaware should follow the long-standing rule with respect to demand futility that this Court reaffirmed in *Pyott v. Louisiana Municipal Police Employees' Retirement System*: "Once a court

of competent jurisdiction has issued a final judgment . . . a successive case is governed by the principles of collateral estoppel under the full faith and credit doctrine." 74 A.3d 612, 616 (Del. 2013). Amici's members would suffer under any other rule.

Pursuant to Delaware Supreme Court Rule 28(b), Amici have contemporaneously filed a motion for leave to file this brief. Counsel for Plaintiffs-Appellants oppose Amici's motion; counsel for Defendants-Appellees have consented to Amici's motion.

SUMMARY OF ARGUMENT

The rise in multi-jurisdictional derivative litigation, where groups of stockholder plaintiffs rush to file similar (or even identical) lawsuits in multiple fora, strains judicial resources and burdens corporations and their boards. The Court of Chancery recommended a rule that would make this problem worse by removing a key curb on duplicative litigation—the principle that if demand is not excused for one group of stockholders, it is not excused for all. This Court should reject that recommendation, for at least three reasons.

First, by denying preclusive effect to a finding that demand futility was inadequately pleaded, Delaware courts would give stockholder plaintiffs a nearly unlimited opportunity to litigate the issue of demand futility. This would increase the already high costs corporations bear to defend against duplicative derivative litigations, and would weaken the ability of boards to manage corporate affairs.

Second, following the Court of Chancery's recommendation would not diminish the incentive for stockholders to rush to the courthouse with poorly investigated, shoddily pleaded complaints. To the contrary, by lessening the consequences of a determination that demand was not futile, this approach could encourage plaintiffs to file more hurried derivative suits. Delaware courts and

corporations have other tools that can deter the rush to the courthouse. A change in well-settled preclusion rules is thus unwarranted.

Third, the reasoning in *In re EZCORP, Inc. Consulting Agreement Derivative Litigation*, 130 A.3d 934, 948-49 (Del. Ch. 2016), the basis for the Court of Chancery's recommendation, does not apply to this case or any other typical demand futility judgment. *EZCORP* involved the preclusive effect of a voluntary—not a litigated—dismissal. Whatever rules apply in that scenario, preclusion must apply where dismissal on demand futility grounds is actually litigated. In that circumstance, all shareholders interested in suing the corporation stand in privity with regard to the key issue of demand futility.

ARGUMENT

I. A RIGHT TO RELITIGATE DEMAND FUTILITY WOULD INCREASE THE HIGH COSTS OF DERIVATIVE LITIGATION AND INFRINGE ON BOARDS' MANAGEMENT RIGHTS.

A. Corporations Already Shoulder a Heavy Burden of Duplicative and Successive Stockholder Derivative Litigation.

When corporations appear in the news, stockholder plaintiffs rush to file derivative lawsuits, claiming that demand is excused as futile and forcing corporations to expend legal fees litigating that issue in multiple courts at the same time. One recent article observed a "marked increase in shareholder litigation generally over the last decade," commenting that the increase in stockholder suits "has reached crisis proportions." Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 Del. J. Corp. L. 851, 852 (2016). Another scholar, in studying multi-forum stockholder derivative litigation specifically, found that "[n]early two-thirds of the public company derivative suits involved more than one federal derivative suit, and more than one-quarter involved four or more federal derivative suits." Jessica M. Erickson, *Overlitigating Corporate Fraud: An Empirical Examination*, 97 Iowa L. Rev. 49, 65 (2011). Moreover, "[m]ore than half of the federal derivative suits in the study were accompanied by a parallel derivative suit filed in state court." *Id.*

The Chancellor's recommendation would make this "crisis" situation even worse. Under current law, if a court concludes that a demand would not have

been futile, that ruling will settle the issue of demand futility and result in the dismissal of all other derivative suits. *See Pyott*, 74 A.3d at 616-17. The Chancellor's recommended preclusion regime, by contrast, would lead to nearly unlimited relitigation of the same demand futility question. Regardless of how many courts conclude that demand was not excused, other stockholders would remain free to continue their duplicative suits, and still other stockholders could file additional suits with similar (or identical) demand futility allegations, just to try their luck with another court—thus permitting the very multiplicity of lawsuits that Delaware long has sought to prevent. Indeed, this Court has previously recognized that it would be "wasteful of the court's and the litigants' resources" to allow redundant litigation regarding the same fundamental issue of demand futility. *See King v. VeriFone Hldgs., Inc.*, 12 A.3d 1140, 1150 (Del. 2011).

The Chancellor's approach would also discourage efficient cooperation among plaintiffs' lawyers. Plaintiffs' lawyers currently have an incentive to cooperate to avoid potential preclusion by, for example, intervening in a more advanced case (*see, e.g.*, *Laborers' District Council v. Bensoussan*, 2016 WL 3407708, at *5 (Del. Ch. June 14, 2016)) or seeking to stay litigation that might result in preclusion (*see, e.g.*, *Biondi v. Scrushy*, 820 A.2d 1148, 1158-59 (Del. Ch. 2003)). That incentive will be lessened if this Court adopts the Chancellor's recommendation. Stockholder plaintiffs will have every motivation

to pursue parallel proceedings independently, knowing that they can each attempt to convince their chosen court to find demand futility without the threat of preclusion. The result would be an increase in expensive, duplicative litigation for Delaware corporations.

B. The Chancellor's Approach Would Interfere with Boards' Ability to Manage Corporate Affairs.

It is a "basic principle of corporate governance that the decisions of a corporation—including the decision to initiate litigation—should be made by the board of directors or the majority of the shareholders." *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 530 (1984). The demand requirement serves the important function of allowing the board to exercise its managerial privilege to decide whether to expend limited corporate resources in particular litigation. *See Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). Stockholders can co-opt managers' authority to make those decisions, but only if they can establish that demand would be futile.

Denying preclusive effect to final demand futility determinations would upend this well-established balance by enhancing individual stockholders' power to set corporate priorities. Stockholders could force directors to expend corporate resources fighting seriatim demand excusal battles without any managerial desire to make the issue a corporate priority. Moreover, even after dismissal of one stockholder suit for failure to plead demand futility, boards could

nonetheless be incentivized to settle weak claims, contrary to their managerial preferences, to avoid repeated and expensive litigation on the issue of demand futility, as well as costly battles over books and records demands. *See* Dennis J. Block, Stephen A. Radin & James P. Rosenweig, *The Role of the Business Judgment Rule in Shareholder Litigation at the Turn of the Decade*, 45 Bus. Law. 469, 470-73 (1990) (demand requirement protects directors "from the harassment of litigious dissident shareholders who might otherwise contest decisions on matters clearly within the directors' discretion"); Andrew C.W. Lund, *Rethinking Aronson: Board Authority and Overdelegation*, 11 U. Pa. J. Bus. L 703, 706-12 (2009) (discussing benefits of preserving board authority through demand requirement).

Under the Court of Chancery's recommendation, this interference with board authority could continue until the limitations period expired and all pending litigations were disposed of, depriving boards of the ability to exercise their business judgment on behalf of all stockholders.

II. THE COURT OF CHANCERY'S RECOMMENDED APPROACH WOULD NOT SOLVE THE "FAST-FILER" PROBLEM, AND IS NOT NECESSARY TO ADDRESS THAT LEGITIMATE CONCERN.

A. Changing Preclusion Rules Would Not Discourage "Fast-Filers."

The Court of Chancery reasoned that denying preclusive effect to a judicial determination that demand futility was inadequately pleaded "should go a long way to addressing the 'fast-filer' problem." *In re Wal-Mart Stores, Inc. Del. Deriv. Litig.*, 2017 WL 3138201, at *13 (Del. Ch. July 25, 2017). The Chancellor was referring, of course, to the "unseemly race to the courthouse" by stockholder plaintiffs that results in "a plethora of superficial complaints that could not be sustained." *Rales v. Blasband*, 634 A.2d 927, 934 n. 10 (Del. 1993); *Pyott*, 74 A.3d at 618 (expressing "concerns about fast filers"). Although the policy goal of deterring such stockholder derivative suits is laudable, the Chancellor's recommendation would not diminish the "fast-filer" phenomenon.

There have always been significant incentives to file quickly. Preclusion rules did not create these incentives. Nor would a change in preclusion rules eliminate them. As this Court has explained, the "fast-filer" problem is "chiefly generated by the 'first to file' custom seemingly permitting the winner of the race to be named lead counsel." *Rales*, 634 A.2d at 934 n. 10. Early filing also is a basis on which plaintiffs' lawyers argue that their suit made a "substantive contribution to the case," which is one consideration courts rely on to determine

whether counsel will share in any future award of attorney's fees. *In re Activision Blizzard, Inc.*, 124 A.3d 1025, 1075-76 (Del. Ch. 2015).

Preclusion tames, to some extent, incentives to rush to the courthouse by threatening to foreclose future litigation if a hastily filed complaint is dismissed for failure to plead demand futility. *See, e.g.*, *Asbestos Workers Local 42 Pension Fund v. Bammann*, 2015 WL 2455469, at *20 (Del. Ch. May 22, 2015), *aff'd*, 132 A.3d 749 (Del. 2016) (affirming dismissal of derivative complaint supported by Section 220 demand as precluded by demand futility decisions in other fora). The Chancellor's proposed rule, by doing away with this important check, could just as easily exacerbate the tendency to file quickly as relieve it. If a law firm can simply try again in a different court, with a restyled pleading and new stockholder plaintiffs, there could be even less incentive to use Section 220 or other means to prepare a more informed complaint in the first instance. *See* John Armour, Bernard Black & Brian Cheffins, *Delaware's Balancing Act*, 87 Ind. L.J. 1345, 1364-1370 (2012) (discussing role of plaintiffs' bar in growth of multi-jurisdictional derivative litigation).

Because the Court of Chancery's recommended rule could make the "fast-filer" problem worse, Amici oppose that rule.

B. Delaware Courts and Corporations Already Possess Tools to Curb the Problem of "Fast-Filers."

To be sure, under current rules, stockholder plaintiffs risk preclusion by waiting to file a derivative suit until first conducting a proper investigation. But the solution to *this* problem should not be one that imposes greater burdens on corporations by encouraging a multiplicity of hastily filed suits. Rather, the solution should target "fast-filers" themselves.

Delaware courts have tools at their disposal to do so. In *King*, this Court gave several examples of ways in which courts can punish "fast-filers" and incentivize the use of Section 220. 12 A.3d at 1151. Courts can, for instance, punish stockholder plaintiffs by denying them lead-plaintiff status, dismissing a derivative complaint with prejudice and without leave to amend as to the named stockholder plaintiff, or granting leave to amend once on the condition that the plaintiff pay defendants' attorney's fees for the initial motion to dismiss. *Id.* at 1151-52. *See also South v. Baker*, 62 A.3d 1, 6 (Del. Ch. 2012) (citing *King* to dismiss "cursory complaint" with prejudice and without leave to amend as to the named plaintiffs).

Corporations too have tools at hand for curbing fast-filings, including through forum selection bylaws that channel all derivative litigation to Delaware, where this State's courts can manage litigation in a manner that promotes laudable incentives. *See* Jonathan G. Rohr, *Corporate Governance, Collective Action and*

Contractual Freedom: Justifying Delaware's New Restrictions on Private Ordering, 41 Del. J. Corp. L. 803, 840-44 (2017) (discussing forum selection provisions). This Court should encourage the use of these tools to curb "fast-filers" rather than overturn settled precedent and invite an even greater wave of impulsively filed stockholder derivative litigation.

III. *EZCORP* IS THE WRONG CASE TO GENERATE A CHANGE IN PRECLUSION LAW.

The Court of Chancery relied on Vice Chancellor Laster's *dictum* in *In re EZCORP, Inc. Consulting Agreement Derivative Litigation*, 130 A.3d at 948, to justify its recommendation in this case. As explained in Wal-Mart's brief, *see* pp. 7-11, this *dictum* is unsupported by any other court and misreads U.S. Supreme Court precedent.

The due process issues in *EZCORP* also differed fundamentally from those present here, and in the ordinary dismissal for failure to allege demand futility. In *EZCORP*, one shareholder plaintiff sought to *voluntarily* dismiss claims against three defendants, and the Court of Chancery noted its concern that making this voluntary dismissal binding on all other shareholder plaintiffs would raise due process concerns. 130 A.3d at 948.

But the situation for an actually litigated judgment of dismissal is different. In that context, all shareholders interested in pursuing a suit against the corporation have exactly the same incentive: to avoid dismissal by obtaining a ruling that demand was excused. Where dismissal is litigated and ultimately ordered, the litigating shareholders represent, and stand in privity with, all other shareholders who seek to bring suit. *Pyott*, 74 A.3d at 617. In such circumstances, ordinary preclusion rules should apply. *See Cramer v. General Telephone & Electronics 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.").

CONCLUSION

Amici respectfully request that this Court reject the Court of Chancery's recommendation that a final determination that demand was not excused be denied preclusive effect in parallel derivative suits.

Dated: September 12, 2017

Respectfully submitted,

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