

[Securities Regulation Daily Wrap Up, FIDUCIARY DUTIES—Del. Ch.: Earlier ruling thwarts suit over Lululemon insider's trades, \(Jun. 15, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Anne Sherry, J.D.](#)

A 2014 federal ruling in a Lululemon derivative suit precluded a similar suit brought in Delaware. The Court of Chancery was facing the same demand futility argument rejected by the Southern District of New York. The plaintiffs' suit concerned the sale of shares by the company's founder, Dennis Wilson, a few days before Lululemon's CEO resigned ([Laborers' District Council Construction Industry Pension Fund v. Bensoussan](#), June 14, 2016, Bouchard, A.).

Issue preclusion (collateral estoppel). The Southern District rejected the plaintiffs' demand futility argument for failure to plead particularized details. Specifically, there were insufficient allegations that the board knew of Wilson's trading in the relevant time frame. Furthermore, Wilson had entered into a Rule 10b5-1 trading plan and the plaintiffs did not adequately allege that the stock sales fell outside of that plan. Neither were there particularized allegations that any directors were likely to be held personally liable for related claims.

The parties agreed that New York law governed the preclusive effect of the district court's dismissal. Under New York law, issue preclusion applies if two requirements are satisfied, with the burden of proof falling on opposite sides. First, the party seeking preclusion must prove that the identical issue was necessarily decided in the prior action and is decisive in the present action. Second, the party to be precluded must prove that it did not have a full opportunity to contest the prior determination.

The district court in New York considered and decided the same issue that the Delaware plaintiffs advanced: that the members of the board were not independent because they faced a substantial likelihood of liability. The plaintiffs unconvincingly argued that the allegations were not identical because the complaint in the New York action devoted 50 pages to alleged false statements and only one page to the stock sales. It was irrelevant that the complaint may have contained allegations concerning other claims—otherwise, plaintiffs could get around issue preclusion simply by including additional facts or allegations. The only thing that mattered was that the district court necessarily decided the same demand futility issue.

The Delaware plaintiffs also failed to meet their burden of proving that they were not afforded an opportunity to litigate in the New York action. The plaintiffs had moved to intervene in that action and made arguments to the district court on a motion to dismiss. Moreover, the chancery court noted, New York law establishes privity between different stockholders of a corporation in derivative actions for purposes of preclusion.

Finally, the plaintiffs argued that the litigants in the New York action were inadequate representatives such that the decision should not be preclusive. The three contentions to this point—that the New York plaintiffs failed to seek a books and records inspection, opposed the Delaware plaintiffs' intervention efforts, and copied allegations from another securities class action—were, the court wrote, "reflective of undesirable practices that pervade representative litigation as lawyers for stockholders jockey for control of a case in an effort to secure a payday for themselves." But it did not follow that the alleged plagiarism substantively impacted the litigation of demand futility. And an imperfect legal strategy does not rise to the level of grossly deficient litigation management.

Claim preclusion (res judicata). Claim preclusion also barred the plaintiffs' claims because the previous action involved an adjudication on the merits; the plaintiffs were in privity with the New York plaintiffs and the claims were or could have been raised in the prior action. A dismissal for failure to plead demand futility is a final judgment on the merits for res judicata purposes. A dismissal without prejudice is not a final determination, but the New York court left room to replead only after making demand on the board. The necessary implication was

that the dismissal was with prejudice to the ability to replead demand futility. Finally, both actions took specific aim at the same transaction and, although the Delaware suit added an additional claim on the theory that the board failed to investigate the trading, there was no reason that claim could not have been asserted in the district court action.

The case is [No. 11293-CB](#).

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Companies: Laborers District Council Construction Industry Pension Fund; Hallandale Beach Police Officers and Firefighters Personnel Retirement Fund; Lululemon Athletica, Inc.

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