Securities Regulation Daily Wrap Up, TOP STORY—Del. Ch.: Chancellor mulls open Arkansas law questions in dismissal of Wal-Mart derivative suit, (May 13, 2016)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

The Chancery Court dismissed a Delaware shareholder derivative suit against Wal-Mart Stores, Inc. that made the same foreign bribery allegations lodged against the company in an Arkansas federal derivative suit, despite the Delaware plaintiffs' effort to amend their suit based on data obtained via lengthy Section 220 litigation, because the Arkansas federal court's earlier dismissal of that case operated to bar re-litigation of the demand futility issue in Delaware. Chancellor Andre Bouchard's opinion noted how the Delaware court was pressed to decide potentially open questions under Arkansas law regarding privity between the Arkansas and Delaware plaintiffs and Wal-Mart and the adequacy of the Arkansas plaintiffs to represent Wal-Mart (*In re Wal-Mart Stores, Inc. Delaware Derivative Litigation*, May 13, 2016, Bouchard, A.).

Pivotal privity. The Chancellor's application of Arkansas's four-pronged test for issue preclusion and that state's two additional preclusion factors cinched the decision to dismiss the Delaware derivative suit. Of these elements, privity and adequacy were of paramount concern as they occupied the two largest parts the court's analysis.

Specifically, the Chancellor had to decide if privity is between the plaintiffs in the separate derivative suits or between each shareholder and the company. Arkansas's courts had not "explicitly" answered this question. But Chancellor Bouchard noted that Delaware courts can opine on how another state's courts would likely decide open legal questions by reviewing the sources of law available to those courts.

For one, other jurisdictions where privity existed between the plaintiffs in multiple derivative suits found the company to be the real party in interest (despite its being named as a nominal defendant). Implicit in this approach is the notion that the separate derivative plaintiffs are fungible because they both sued on the company's behalf. Ultimately, the Chancellor found that Arkansas courts would likely follow this tack instead of a contrary view suggested by a Delaware chancery case positing that a shareholder does not yet represent a company at the demand futility stage of litigation. The chancery case was later reversed for having applied the wrong state's law but left open the privity question.

The Delaware plaintiffs urged a second approach gleaned from the Restatement (Second) of Judgments, which suggests that filing suit is insufficient to implicate privity because privity requires the formal court appointment of a class representative. But the Chancellor said the Restatement's treatment of the topic was too ambiguous to infer how an Arkansas court might apply the relevant text in the context of derivative suits, even if the Delaware plaintiffs made at least a "plausible" argument.

A third factor, Arkansas public policy, weighed in favor of precluding the Delaware plaintiffs. The Chancellor observed that Arkansas has a "practical approach" to privity policy that emphasizes litigating issues once, even if that preference does not require "precise identicality." The Chancellor also said worries about fast-filing plaintiffs who might commandeer litigation from later, more conscientious plaintiffs can be addressed by the adequacy requirement.

Moreover, the Chancellor quickly rejected the Delaware plaintiffs' argument that the Delaware and Arkansas suits were different because the Delaware complaint contained more detailed demand futility allegations than the Arkansas complaint. This tack failed because both suits took aim at the same "core" question of demand futility.

Likewise, the Chancellor rebuffed the Delaware plaintiffs' argument that the demand futility issue was not actually litigated because the Arkansas federal court applied Delaware's *Rales* test when it should have invoked

Aronson (the federal court applied Delaware law to this issue because Wal-Mart is a Delaware company). The Chancellor reiterated his own view—and that of many other Delaware judges, he said—that *Rales* offers a singular expression of *Aronson*'s two prongs, meaning that no substantive difference arose from the Arkansas federal court's use of *Rales*.

Two other issues regarding whether the Arkansas federal court issued a valid and final judgment and whether its determination was essential to that judgment were not disputed. But the Chancellor did have to mull the adequacy of the Arkansas plaintiffs.

Arkansas plaintiffs adequate. As for the adequacy inquiry, the Chancellor opted to once again apply the Restatement (Second) of Judgments, as urged by the Delaware defendants (Arkansas law is quite thin on the topic), instead of federal law, as hoped for by the Delaware plaintiffs (the plaintiffs conceded that federal law and Arkansas law are virtually the same). The Chancellor reiterated that the Restatement analysis puts the focus on Wal-Mart's interests because it is the real party in interest.

For one, there was no misalignment between the plaintiffs doing the representation and the represented party (Wal-Mart) merely because the Arkansas plaintiffs chose to pursue their suit in order to control the litigation and without seeking Wal-Mart's records. The Delaware plaintiffs alleged only that the Arkansas plaintiffs' misalignment arose from their desire to earn attorney fees, as allegedly encapsulated by an affidavit from the Delaware plaintiffs' lead counsel claiming his Arkansas counterpart admitted the Rule 220 records data could help the case but refusing to defer to the Delaware plaintiffs without getting part of the attorney fees in that case.

The Chancellor concluded that the Arkansas plaintiffs were not grossly deficient in representing Wal-Mart. The Delaware plaintiffs again emphasized that the Arkansas plaintiffs did not seek Wal-Mart's records, which the Chancellor noted the defendants could legitimately claim would not have helped them much anyway regarding demand futility, but this line of inquiry also would have led the court to either make a judgment about the Arkansas plaintiffs' real-time knowledge of the case or adopt a "hindsight review" approach for which the Chancellor expressed "reservations." Ultimately, the Chancellor decided not to directly deal with the records issue and found the Arkansas plaintiffs were not inadequate representatives.

The case is No. 7455-CB.

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Companies: Wal-Mart Stores, Inc.; Wal-Mart de Mexico; California State Teachers' Retirement System; New York City Employees' Retirement System

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