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Securities Litigation Alert

Delaware *lululemon* Decision Continues Delaware Trend Deferring to Judgments in First-Decided Action in Multi-Forum Derivative Litigation

By Stephen A. Radin, Stacy Nettleton, Christine Di Guglielmo, and Thomas James

The Delaware Court of Chancery's dismissal last week of a derivative action in *Laborers' District Council Construction Industry Pension Fund v. Bensoussan*, C.A. 11293-CB ("*lululemon*"), reaffirms the Court of Chancery's deference to judgments rendered in other forums under full faith and credit principles discussed recently in *Asbestos Workers Local 42 Pension Fund v. Bammann*, 2015 WL 2455469 (Del. Ch. May 21, 2015), *aff'd*, 132 A.3d 749 (Del. 2016), *City of Providence v. Dimon*, 2015 WL 4594150 (Del. Ch. July 29, 2015), *aff'd*, 134 A.3d 758 (Del. 2016), and *In re Wal-Mart Stores, Inc. Delaware Derivative Litigation*, 2016 WL 2908344 (Del. Ch. May 13, 2016). The first two of those decisions have already been affirmed by the Delaware Supreme Court, and the third is the subject of a not-yet-briefed appeal.

The Court in *lululemon* held that plaintiffs were precluded from pursuing their derivative claims in Delaware after seeking and receiving documents pursuant to Section 220 of the Delaware General Corporation Law – a practice the Delaware courts have recommended plaintiffs pursue before commencing derivative actions – because the same claims had already been dismissed by a federal court in New York in a derivative action due to the New York plaintiffs' failure to make a pre-suit demand or allege demand futility with the particularity required by Delaware law. The Court rejected plaintiffs' argument that because they had sought books and records pursuant to Section 220, while the New York plaintiffs had not, their claims differed from those asserted in New York and should be allowed to proceed. The decision is significant given the rise in multi-forum derivative litigation – particularly in instances where no forum-selection provision requires litigation in a pre-determined forum unless the corporation agrees otherwise – and highlights the constitutional full faith and credit principles that take precedence in our federalist system over state corporate governance law principles.

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The *lululemon* Decision

Shortly after a Wall Street Journal article concerning sales of lululemon stock by Dennis (Chip) Wilson, lululemon's founder and the then-chairman of lululemon's board, derivative complaints were first filed and later consolidated

in the Southern District of New York alleging that: (1) Mr. Wilson breached his fiduciary duties by allegedly trading on material non-public information, (2) lululemon's directors breached their fiduciary duties because they allegedly failed to investigate or take action after learning of Mr. Wilson's alleged breaches of fiduciary duty, and (3) plaintiffs were excused from making demand on lululemon's board before commencing suit because lululemon's directors were not independent from Mr. Wilson and faced a substantial likelihood of liability for not taking action after learning of Mr. Wilson's alleged breaches of fiduciary duty. With respect to the merits, Mr. Wilson contended that his sales were made by Merrill Lynch, not him, and within the parameters of a 10b5-1 trading plan; plaintiffs alleged that the trades – made after Mr. Wilson had learned that lululeomon's chief executive officer was resigning but before that information was announced by lululemon – were too well timed and his profit was too large for that to have been the case.

Around the same time, other lululemon stockholders commenced actions in the Delaware Court of Chancery seeking books and records under Section 220, including documents relating to Mr. Wilson's trading activity over a lengthy period of time and numerous other subjects. The Delaware plaintiffs sought to intervene in the federal action in New York, seeking a limited stay of the New York action pending resolution of the books and records actions in Delaware or, alternatively, to make any dismissal of the breach of fiduciary duty claim against Mr. Wilson for failure to make a demand or allege facts showing that demand was excused in the New York action without prejudice to their own claims. The district court dismissed the New York action on April 3, 2015 "without prejudice, in the event plaintiffs seek to pursue these claims after making a demand on the board" and then denied the motion to intervene as moot. The Second Circuit affirmed.

Following receipt of documents obtained using Section 220, the Delaware plaintiffs filed a derivative complaint in the Delaware Court of Chancery against Mr. Wilson and lululemon's directors, asserting the same derivative claims that had been dismissed in New York and without making a demand. As in the New York action, the Delaware plaintiffs argued that demand was excused. Defendants moved to dismiss, arguing that the decision of the New York court precluded the Delaware plaintiffs from re-litigating the demand issue. The Court of Chancery, applying the New York law of issue preclusion and claim preclusion, held that the New York decision barred the Delaware action because, among other things, under well-settled New York law stockholders are in privity with each other for the purpose of derivative litigation, the demand futility issue was the same in the two actions, and the New York plaintiffs were adequate representatives of the interests of the Delaware plaintiffs even though they had not sought books and records before commencing suit. The Court dismissed the complaint accordingly.

Key Takeaways

As noted above, *lululemon* is the latest in a series of Court of Chancery decisions giving preclusive effect to decisions by courts outside of Delaware construing corporate governance issues governed by Delaware law. These decisions all hold that full faith and credit principles require that the preclusive effect of a decision is construed pursuant to law of the jurisdiction where the case was decided. There is no exception to full faith and credit principles for cases involving stockholder plaintiffs who do not pursue books and records before filing their derivative complaint despite – in the words of the courts in *Wal-Mart* and *lululemon* – the "repeated admonitions of this Court to inspect a corporation's books and records before launching derivative claims."

Delaware corporations should, of course, also consider adopting forum selection provisions requiring that corporate governance litigation be brought in the Delaware Court of Chancery (unless, such provisions provide, the corporation consents to litigation elsewhere, as corporations faced with related federal securities law and derivative claims sometimes do in order to ensure coordination of discovery and the proceedings in the derivative action and the federal securities action – which cannot be heard in the Delaware Court of Chancery).

Federal and sister-state courts can – and do often – consider and act in accordance with Delaware corporate governance principles where those principles make sense in the context of a particular litigation and there is no reason why the court in a faster-moving case outside of Delaware cannot assess the appropriateness in any given case of waiting to rule on a motion to dismiss the faster moving case until Section 220 proceedings are completed in Delaware. In a world in which there is altogether too much multi-forum litigation, it is in everyone's interest that derivative claims be litigated once, only once, and without the need to defend collateral attacks on judgment as occurred in *Asbestos Workers, City of Providence*, *Wal-Mart*, and *lululemon*.

Securities Litigation Alert is published by the Securities Litigation practice of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

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