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Delaware Court Limits Non-Delaware Dismissal

Posted by Theodore Mirvis, Wachtell, Lipton, Rosen & Katz, on Monday April 8, 2013

Editor's Note: Theodore N. Mirvis is a partner in the Litigation Department at Wachtell, Lipton, Rosen & Katz. The following post is based on a Wachtell Lipton memorandum by Mr. Mirvis, William Savitt, and Ryan A. McLeod. This post is part of the Delaware law series, which is cosponsored by the Forum and Corporation Service Company; links to other posts in the series are available here. Further reading about the Delaware Supreme Court decision discussed below is available here.

The Delaware Supreme Court held that the Court of Chancery erred by failing to give preclusive effect to an earlier with-prejudice dismissal of a parallel derivative suit in another state, and by creating a presumption that all plaintiffs who file derivative suits without first conducting books-and-records inspections are inadequate representatives. *Pyott v. La. Mun. Police Emps.' Ret. Sys.*, No. 380, 2012 (Del. Apr. 4, 2013). The decision stresses the importance of interstate comity and the need to give full faith and credit to the decisions of other courts.

Allergan is a drug company that incurred losses in resolving civil and criminal investigations of off-label drug marketing. Derivative suits were filed in both federal court in California and the Court of Chancery alleging that Allergan's directors were liable for the losses because they failed to properly monitor the company's marketing practices. The Delaware shareholder plaintiff obtained documents through a books-and-records inspection under 8 *Del. C.* § 220 before filing suit. The California plaintiffs did not, but later amended their complaints when the Delaware plaintiff shared the documents. Defendants moved to dismiss in both jurisdictions. The California federal court ruled first, dismissing with prejudice for failure to establish demand futility. The Court of Chancery refused to give preclusive effect to that ruling, applying Delaware law to the preclusion question. Turning to the merits, Chancery disagreed with the federal court, holding that demand was futile and that the case should proceed.

In a crisp *en banc* decision authored by Justice Berger, the Supreme Court reversed. The Court held that once another court has issued a final judgment, the effect of that judgment on any parallel case "is governed by the principles of collateral estoppel, under the full faith and credit doctrine, and not by demand futility, under the internal affairs doctrine." The Court held that the

Vice Chancellor erred by treating the issue as one of Delaware law, thus failing to recognize that concerns of "federalism, comity, and finality" required the "interest that Delaware has in governing the internal affairs of its corporations" to "yield to the stronger national interests that all state and federal courts have in respecting each other's judgments." With respect to the adequacy of the California plaintiffs, the Court held that the Vice Chancellor erred in creating "an irrebuttable presumption that derivative plaintiffs who file their complaints without seeking books and records . . . are inadequate." Although the Supreme Court noted that it "understands the trial court's concerns about fast filers," there was "no record support" for such a rule, and the Court suggested that "remedies for the problems" fast filers create "should be directed at the lawyers, not the stockholder plaintiffs."

As the plague of duplicative, multijurisdictional corporate litigation continues to proliferate, *Pyott* makes clear that Delaware is sensitive to the unfairness that multiple parallel lawsuits can work on corporations and their directors and is prepared to enforce scrupulously rules of interstate comity that limit this mischief.