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Case Number 295,2016D

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, DAVID D. GLASS, ROLAND A. HERNANDEZ, JOHN D. OPIE, J. PAUL

No. 295, 2016

Court Below: Court of Chancery of the State of Delaware, C.A. No. 7455-CB

PUBLIC/REDACTED VERSION

SEPTEMBER 23, 2016

REASON, ARNE M. SORENSON, JOSE H. VILLARREAL, JOSE LUIS RODRIGUEZMACEDO RIVERA, EDUARDO CASTRO-WRIGHT, THOMAS A. HYDE, THOMAS A. MARS, JOHN B. MENZER, EDUARDO F. SOLORZANO MORALES, AND LEE STUCKY,

Defendants Below,
Appellees

WAL-MART STORES, INC.

Nominal Defendant Below,
Appellee.

APPELLANTS' REPLY BRIEF

Dated: September 8, 2016

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases **Page(s)**

Rules

Other Authorities

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN FINDING PRIVITY BETWEEN THE DELAWARE AND ARKANSAS PLAINTIFFS

A. THIS COURT'S RULING IN *PYOTT II* DOES NOT REQUIRE A FINDING OF PRIVITY

Defendants rely on *Pyott v. Louisiana Municipal Police Employees' Retirement System*, 74 A.3d 612 (Del. 2013) ("*Pyott II*"), as purportedly recognizing a general rule that derivative plaintiffs are in privity because the corporation is the real party in interest. *See* Defendants' Answering Brief ("AB") at 2, 7-8. This is incorrect because this Court in *Pyott II* simply applied a clear California precedent that "compelled" dismissal under "settled" California preclusion law. *Id*. at 616-17 (citing *LeBoyer v. Greenspan*, 2007 WL 4287646, at *3 (C.D. Cal. June 13, 2007)). Conversely, in the case at bar, Defendants cite no settled Arkansas law that would compel dismissal – indeed, the Court of Chancery correctly noted that "Arkansas courts have not yet explicitly addressed this privity question." Op. at 30 (A-1142).[1]

[1] Likewise in *Asbestos Workers Local 42 Pension Fund v. Bammann*, which this Court summarily affirmed, the Court of Chancery applied clear New York precedent holding that "[i]t is well-settled that collateral estoppel may be applied in the shareholder derivative context." 2015 WL 2455469, at *16 (Del. Ch. May 22, 2015) (citation and quotations omitted), *aff'd*, 132 A.3d 749 (Del. 2016) (TABLE). Defendants' reliance on *Laborers' District Council Construction Industry Pension Fund v. Bensoussan*, 2016 WL 3407708 (Del. Ch. June 14, 2016), is similarly misplaced. In that case, the Court of Chancery also applied New York law, but the issue of privity was never litigated. *Id.*, at *7 ("Plaintiffs do not dispute that privity exists here.").

Pyott II, therefore, does not compel a finding of privity here. In fact, this Court in *Pyott II* expressly noted that it was not considering the privity arguments presented here. 74 A.3d at 618 ("[W]e cannot address the merits of that issue in this case.").[2] Instead, *Pyott II* reaffirms the uncontroversial position that "a state court is required to give a federal judgment the same force and effect as it would be given under the preclusion rules of the state in which the federal court is sitting." *Id.* at 616. Thus, *Pyott II* cannot be the end of the inquiry where Arkansas law is unclear. The Court still must determine what Arkansas preclusion rules provide, and for that inquiry, the parties and the Court of Chancery all agree that Arkansas would follow the Restatement. *See* AB at 9, 12, 22; Op. at 31 (A-1143).

B. ARKANSAS FOLLOWS THE RESTATEMENT, WHICH REQUIRES AUTHORIZATION BY COURT OR CONTRACT FOR PARTIES TO BE IN PRIVITY

Defendants acknowledge that Arkansas courts look to the Restatement of Judgments when considering unsettled questions of issue preclusion. AB at 9. Yet Defendants fail to address the Restatement guidance set forth in Delaware Plaintiffs' Opening Brief ("OB") at 18-20. Section 59 of the Restatement states that whether a derivative action is binding on non-party stockholders is determined by Sections 41 and 42. Restatement (Second) of Judgments § 59 (1982) at cmt. c.

[2] Defendants' argument that the plaintiff in *Pyott* made "precisely the same 'due process' argument" as the Delaware Plaintiffs here, and that this argument was "implicitly rejected" (AB at 15), is therefore inaccurate and misleading. *See also* § I(D), *infra.*

In turn, Section 41 identifies five categories of persons who have authority to bind non-parties. *Id.* at § 41. Only one of these categories – a representative plaintiff in a class action – is analogous to a derivative plaintiff.[3] *Id.* at § 41(1)(e). Such a representative, however, must be "designated as such with the approval of the court." *Id.* This designation is necessary "to confer on the representative the requisite authority" and may be either "adjudicative or contractual." *Id.* at § 41 cmt. a. In the case at bar, no court conferred authority on the Arkansas Plaintiffs to bind non-parties.

None of the Arkansas cases that Defendants cite address these provisions of the Restatement, because none squarely raise the issue of privity among derivative plaintiffs. *See Harben v. Dillard*, 2010 WL 3893980, at *4 (E.D. Ark. Sept. 30, 2010) (addressing whether a subsequently filed derivative action could preclude an issue from the first action and whether the initial judgment was valid and the issues fully litigated); *Ark. Dept. of Human Servs. v. Dearman*, 842 S.W. 2d 449 (Ark. Ct. of Appeals 1992) (en banc) (addressing privity in context of alleged sexual abuse by father). Defendants also cite *Brandon v. Brandon Constr. Co.*, 776 S.W. 2d

[3] Defendants dispute that derivative plaintiffs and class action plaintiffs are analogous (AB at 18) but fail to put forth any argument – much less provide legal support – that any other potential exception listed in Section 41 is preferable for establishing privity among derivative plaintiffs. Because Arkansas law would look to the Restatement and Defendants have not argued that any of the Restatement's five recognized categories of privity apply, Defendants have abandoned the analysis which they (and the Court of Chancery below) agree an Arkansas court would have undertaken.

349 (Ark. 1989). This case actually supports Delaware Plaintiffs' interpretation that Arkansas views derivative actions as analogous to class actions. In *Brandon,* the Arkansas Supreme Court recognized that Rule 23.1 determines whether a litigant is "disqualif[ied] from individually maintaining a derivative action" and ruled that a minority stockholder could bring a derivative suit as a "class of one." 776 S.W. 2d at 352, 354.

C. WAL-MART IS NOT THE "SOLE" PARTY IN INTEREST AND THE DELAWARE PLAINTIFFS ARE NOT "NOMINAL" PLAINTIFFS

The Court of Chancery erred in failing to analyze the Delaware Plaintiffs' rights under the Due Process Clause (*see* OB at 15-17) and Defendants' Answering Brief fares no better. Defendants argue that Wal-Mart is the "sole real party in interest" and that since Wal-Mart may not re-litigate the issue of demand futility neither may the Delaware Plaintiffs, whom Defendants contend are merely "nominal." AB at 10-13. Due Process, however, requires more than a presumption that all derivative plaintiffs are interchangeable simply because they seek to represent the corporation in which they invest. *See, e.g., La. Mun. Police Empls. Ret. Sys. v. Pyott*, 46 A.3d 313, 330 (Del. Ch. 2012) ("*Pyott I*") ("[T]he legal truism that the underlying claim in a derivative action belongs to the corporation . . . does not support the proposition that stockholders are in privity. . . ."), *overruled on other grounds*, 74 A.3d 612 (Del. 2013).

In *Taylor v. Sturgell*, the U.S. Supreme Court clarified that non-party preclusion is subject to the limits of Due Process, which generally will not bind a party that is not "designated as a party" or "made a party by service of process." *Taylor v. Sturgell*, 553 U.S. 880, 893 (2008) (citations omitted). The Court then noted several categories of "recognized exceptions" that parallel the Restatement of Judgments, and rejected the creation of an additional exception for "virtual representation." *Id.* at 893-96. Defendants, however, seek to impose an additional exception for derivative plaintiffs that was not recognized by the Supreme Court and, as explained herein and in Delaware Plaintiffs' Opening Brief, would be in conflict with the Restatement, and therefore Arkansas law. *See* OB at 18-20.[4]

Defendants cite no case where an Arkansas court departed from the Restatement to follow the preclusion law of a foreign jurisdiction. Instead, Defendants describe a handful of federal court decisions interpreting a miscellany of states' preclusion laws as "an unbroken line of federal authorities." AB at 7. But federal interpretation of state law is not binding; federal courts have no authority to establish a "line" on state laws. *Erie R. Co. v. Tompkins*, 304 U.S. 64, 79 (1938) (federal "supervision" of state law is "in no case permissible except as to

[4] *B&B Hardware, Inc. v. Hargis Industries, Inc.*, 135 S. Ct. 1293 (2015), which Defendants cite (AB at 11), does not alter the Supreme Court's analysis in *Taylor.* Unlike *Taylor, B&B Hardware* did not address non-party preclusion, but instead a situation involving the same litigants where "a single issue is before a court and an administrative agency." 135 S. Ct. at 1303.

matters by the constitution specifically authorized or delegated to the United States" and would be "an invasion of the authority of the state, and, to that extent, a denial of its independence").

Additionally, it is inaccurate to describe the corporate entity as the "sole" party in interest or a derivative plaintiff as "nominal." If the corporation were the "sole" party in interest, then § 59 of the Restatement, which refers derivative plaintiffs to §§ 41 and 42 to determine their rights regarding issues of preclusion, would be meaningless.[5] Likewise, a derivative plaintiff cannot be considered "nominal." A plaintiff who brings a derivative suit is not only bound by all operative rules of court as an individual litigant, but may also be entitled to investor-level recoveries. *See, e.g., In re El Paso Pipeline P'rs L.P. Deriv. Litig.*, 132 A.3d 67, 122-26 (Del. Ch. 2015) (discussing scenarios in which investor-level recoveries have been awarded).

D. THE COURT OF CHANCERY'S ANALYSIS IN *EZCORP* SHOWS WHY DISMISSAL OF THE DELAWARE ACTION VIOLATED THE DELAWARE PLAINTIFFS' DUE PROCESS RIGHTS

Defendants contend that the Delaware Plaintiffs' constitutional Due Process argument was "implicitly rejected" in *Pyott II*. AB at 14-15. Not so. Indeed, the

[5] Defendants' citation for the "sole real party in interest" language (AB at 10-11) is *Goldman v. Northrop Corp.*, 603 F.2d 106, 109 (9th Cir. 1979). This case involved the inapposite situation where a subsequent derivative action was barred due to the settlement of an earlier action. The quoted language refers to the fact that neither derivative plaintiff "sought to obtain personal judgments" against individual officers and directors.

plaintiffs in *Pyott II* specifically acknowledged during oral argument that, unlike here, they were not making a constitutional argument in favor of Due Process trumping Full Faith and Credit:

> Justice Jacobs: Justice Holland's question is couched in terms of two competing federal constitutional doctrines, correct?
> Counsel: Yes.
> Justice Jacobs: Was that, was that tug of war between Due Process and Full Faith and Credit addressed either by the Court of Chancery or in your brief?
> Counsel: I don't, I don't believe it directly was, because I think the opinion below was based on internal affairs doctrine and I…
> Justice Jacobs: Right, as a choice of law…
> Counsel: As a choice of law.
> Justice Jacobs: Not as a constitutional doctrine.
> Counsel: Correct.
> Justice Jacobs: And you're not arguing that it's a constitutional doctrine…
> Counsel: I cannot make that argument. I cannot make that argument.[6]

With no argument on the tension between Due Process and Full Faith and Credit, the decision in *Pyott II* did not resolve the question presented in this appeal—*i.e.*, whether the Delaware Plaintiffs' Due Process rights were violated in dismissing the Delaware Action due to the dismissal of the Arkansas Action.

Here, the Full Faith and Credit Clause is not controlling because it "govern[s] the effects to be given only to state-court judgments" and is not implicated by federal court judgments. *Semtek Int'l. Inc. v. Lockheed Martin*

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[6]Video of the full oral argument hearing is available at *http://courts.delaware.gov/Supreme/Oral Args/ 2013-02-05_380,_2012_Pyott_st_al_v_ Louisana_Municipal _Police.wma.mp3*. The colloquy quoted above is located at 29:55 through 30:42.

Corp., 531 U.S. 497, 506–07 (2001); *see also id.* at 508 ("In short, federal common law governs the claim-preclusive effect of a dismissal by a federal court sitting in diversity."); *accord Pyott II*, 74 A.3d at 615 ("The Full Faith and Credit Clause does not explicitly apply when the 'rendering court' is a federal court rather than a state court.").

Defendants also contend that the *EZCORP* decision "turned only on Delaware law—specifically, Court of Chancery Rule 15(aaa)…." AB at 14. Again, not so here. Defendants ignore the *EZCORP* decision's explanation that, "[b]eyond the Delaware substantive law of derivative actions" and its interaction with Rule 15(aaa), dismissal of subsequent derivative actions is not permitted due to the "more fundamental doctrine" of "due process of law." *In re EZCORP, Inc. Consulting Agreement Deriv. Litig.*, 130 A.3d 934, 946 (Del. Ch. 2016). The *EZCORP* decision's analysis of constitutional Due Process rights in the context of derivative actions involving Delaware corporations applies regardless of where the litigation takes place.

As the Delaware Plaintiffs explained in their Opening Brief, a derivative action involving a Delaware corporation, *i.e.* a Delaware cause of action, is individual in nature prior to a ruling that demand is excused. *See* OB at 12-13. Indeed, as the Court of Chancery explained in *EZCORP*, "[u]ntil authority is conferred, the representative plaintiff only represents himself." 130 A.3d at 947.

Defendants essentially ignore the fact that the Court of Chancery in *EZCORP* concluded that this means Due Process prohibits the dismissal of subsequent derivative actions due to prior findings of lack of demand excusal. *Id*. at 947-49.

Defendants identify serial litigation as a harm to be avoided. AB at 16, 20. However, the Court of Chancery in *EZCORP* addressed this issue, as well, in its extended discussion of the U.S. Supreme Court's decision in *Smith v. Bayer Corp.*, 564 U.S. 299 (2011):

> [T]he [U.S. Supreme] Court rejected the defendant's policy-based arguments. Bayer contended that without a broad judgment that would bind all unnamed class members, multiple plaintiffs could file *seriatim* lawsuits, forcing the "serial relitigation of class certification." The Court responded that "[t]his form of argument flies in the face of the rule against nonparty preclusion.... [O]ur legal system generally relies on principles of *stare decisis* and comity among courts to mitigate the sometimes substantial costs of similar litigation brought by different plaintiffs."

EZCORP, 130 A.3d at 948 (quoting *Bayer*, 564 U.S. at 316-17) (internal citations omitted); *see generally Taylor*, 553 U.S. at 898–901 (rejecting on similar grounds the theory of preclusion by "virtual representation").

In addition, Defendants claim that "the *corporation*'s rights" have somehow "been determined" upon a decision that the allegations in a particular stockholder's complaint do not adequately support demand excusal. AB at 16. Defendants miss the point. A decision with respect to the adequacy of one stockholder's complaint

merely determines whether, under the circumstances pled, that stockholder may assert the right of the corporation.[7]

Defendants contend that the Delaware Plaintiffs conflate derivative and class actions. AB at 18. However, as the Court of Chancery explained in *EZCORP*, a plaintiff in a derivative action, prior to a finding of demand excusal or a Board decision to confer authority to sue, must be deemed just as much an individual plaintiff as is a plaintiff in a class action before certification of the class for Due Process purposes. *See,* OB at 10-17; *EZCORP*, 130 A.3d at 948 (citing *Parfi Hldg. AB v. Mirror Image Internet*, 954 A.2d 911, 940 (Del. Ch. 2008) (Strine, V.C.) ("Although it is too often overlooked, derivative suits are a form of representative action. Indeed, they should be seen for what they are, a form of class action.").

Also, Defendants claim that the Delaware Plaintiffs should have somehow intervened in the Arkansas Action in order to prevent dismissal of the complaint in that proceeding. AB at 19-20. This is nonsense. Defendants never explain what the Delaware Plaintiffs could have done before they received and had a chance to

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[7] Defendants cite the First Circuit Court of Appeals decision in *Sonus* in support. AB at 16. (citing *In re Sonus Networks, Inc. S'holder Deriv. Litig.*, 499 F.3d 47, 64 (1st Cir. 2007)). The language on which Defendants rely, however, essentially treats the decision of whether demand would be futile as a *finding of fact* by the court, instead of a dismissal-stage finding regarding the adequacy of what a particular plaintiff has pled. *See* AB at 16. The *Sonus* decision then suggests that subsequent dismissals are necessary so that the defendants are not "put to the trouble" of "litigating" demand futility again. *Sonus*, 499 F.3d at 64. This conflicts both with the understanding that there has been no finding of fact as to demand futility and the rejection of the purported threat of serial litigation, already discussed above.

review the complete Section 220 production. By that time, the Arkansas Action had been dismissed. Indeed, prior to dismissal, the Arkansas Action had already been stayed once, and that stay was reversed by the Eighth Circuit Court of Appeals and subsequently lifted by the Arkansas court. B-135 ("[T]he Court is no longer convinced that a stay in this case promotes the interests of judicial economy."). After the appeal, it was *Defendants* who unsuccessfully moved for a partial stay. Without the Section 220 production, and with repeated denials of stays, it is entirely unclear what Defendants claim the Delaware Plaintiffs should, or even could, have done.[8]

[8] The Delaware Plaintiffs would have been required to include a proposed complaint with any intervention request, despite an incomplete Section 220 production. F.R.C.P. 24(c). Defendants also notably attack the Delaware Plaintiffs for having "focused on a drawn-out Section 220 proceeding…." AB at 5. This is a strange line of attack, given that the Delaware Plaintiffs were following then-Chancellor Strine's instruction to pursue books and records, and it was Wal-Mart's conduct that extended the Section 220 proceedings.

II. THE ARKANSAS PLAINTIFFS WERE INADEQUATE REPRESENTATIVES

A. THE ARKANSAS PLAINTIFFS' DECISION TO MOVE FORWARD WAS NOT THE RESULT OF LEGAL STRATEGY

The Arkansas Plaintiffs' decision to seek a ruling on demand futility in Arkansas despite Chancellor Strine's admonition constituted grossly deficient representation. In attributing this decision to "litigation strategy" rather than self-interest, Defendants ignore the timing of the Arkansas Plaintiffs' decision. AB at 25-26. A decision at the outset of litigation to forego books and records may be a matter of legal strategy, but given the Chancellor's warning, Defendants offer no way in which the Arkansas Plaintiffs' decision could have served any legal strategy, even an imperfect one. The only plausible explanation is the one offered by Defendants themselves when they sought a stay of the Arkansas Action—that the Arkansas Plaintiffs were motivated by a desire to place "their own interests ahead of the company they seek to represent . . . [by] get[ting] a jump on those in other jurisdictions, rather than proceed[ing] in a manner that is in the best interest of the company they seek to represent." A-645.[9] In other words, the Arkansas Plaintiffs and their counsel pressed forward to obtain control of the litigation.

[9] Defendants' counsel, having made the statement above to the Arkansas court, now tries to credit in this Court as litigation strategy the statement of counsel for the Arkansas Plaintiffs that they "thought" about seeking books and records "long and hard" and decided that they "didn't need it" in light of the information that was publicly available. AB at 25 (citing B-209). Even setting aside the difficulties in squaring the positions taken before this Court and the Arkansas

Defendants' authority does not support their argument that the Arkansas Plaintiffs' decision to forego Wal-Mart's books and records should be excused as one of legal strategy. None of the cases Defendants cite are analogous to the adequacy issue here—the decision to ignore an unequivocal warning on the record by the Chancellor in a parallel Delaware case that a functionally-identical, pre-books-and-records complaint would not survive a demand futility motion.[10] Indeed, citing *King*, Defendants claim that the Arkansas Plaintiffs "reasonably relied" on this Court's statement that "Section 220 is not mandatory" and were "well aware that Delaware Plaintiffs were seeking books and records." AB at 24. The mere fact that Section 220 may not be "mandatory" as a general matter of law does not make the Arkansas Plaintiffs' behavior in any way "reasonabl[e]" as Defendants claim. Defendants cannot explain why, under the circumstances, a reasonably informed stockholder plaintiff would want to proceed in Arkansas

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court, the statement by counsel for the Arkansas Plaintiffs simply raises the question of how counsel could know they did not need the Section 220 documents without having seen those documents.

[10] The decisions in *Laborers' District Council Construction Industry Pension Fund v. Bensoussan,* 2016 WL 3407708, at *12 (AB at 23), and *Fuchs Family Trust v. Parker Drilling Co.*, 2015 WL 1036106, at *6 (Del. Ch. Mar. 4, 2015) (AB at 23), merely reiterate the ruling in *Pyott II* that failure to pursue a Section 220 action does not establish inadequate representation in every case. *King v. VeriFone Holdings, Inc.*, 12 A.3d 1140, 1152 (Del. 2011) (AB at 24) addressed the unrelated question whether a stockholder can pursue a Section 220 action after a Rule 23.1 dismissal without prejudice. *Id.*

when a books and records action relating to the same alleged wrongdoing was underway in Delaware.[11]

B. DEFENDANTS' MERITS-BASED ARGUMENTS DO NOT ESTABLISH THAT THE ARKANSAS PLAINTIFFS WERE ADEQUATE

Defendants also argue that because the Section 220 action did not produce a "smoking gun," the Arkansas Plaintiffs' conduct "cannot be criticized with the benefit of hindsight." AB at 26-27. Such merits-based arguments are improper at this stage. As the Court below found, "whether a representative litigated with sufficient diligence necessarily depends on her knowledge and expectations at the time, rather than on what happened later." Op. at 55-56 (A-1167-68).

Defendants' argument also fails on the merits. The Delaware Plaintiffs obtained 14,000 pages of documents[12] in the Section 220 proceeding, of which 150 are cited in the Delaware Plaintiffs' amended complaint. In opposing Defendants' motion to dismiss, the Delaware Plaintiffs argued that some of those documents "show Board knowledge of, and acquiescence in, the decisions to quash the [initial investigation of wrongdoing] and to shift Wal-Mart's internal investigation to

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[11] Plaintiffs' argument is not—as Defendants assert—that this Court should "impose a mandatory Section 220 requirement on every derivative lawsuit involving a Delaware corporation, no matter where it is filed." AB at 32. Plaintiffs argue instead that this case proves the need for a flexible fact-based standard for determining adequacy. *See Pyott II* 74 A.3d at 618 ("Undoubtedly there will be cases where a fast filing stockholder also is an inadequate representative.").

[12] Delaware Plaintiffs dispute Wal-Mart's belated assertion of privilege concerning the document bearing Bates Number WM-220R-01394. AB at 28 n. 5. Delaware Plaintiffs read the quoted language in open court on November 12, 2015. Defendants did not seek to protect the information at the time or after publication of the transcript from that hearing.

WalMex's General Counsel, who was a chief target of the investigation." A-549; *see also* A-562-76, 580-82.

Tellingly, in their August 30, 2016 letter (*see* Reply Brief Appendix at AR5-6) submitting Defendants' Corrected Answering Brief ("CAB"), defense counsel tacitly admits that the Fung Memorandum—the very document they argue "undermines Delaware Plaintiffs' theory of malfeasance entirely"—[redacted] *Compare* AB at 29 *with* CAB at 29 (deleting the statement that the Fung Memorandum was [redacted]. Indeed, as of February 27, 2006—the date on which Hernandez received the Fung Memorandum (A-170) —WalMex [redacted] *See* AR1 (WM-220R-008692) (internal Wal-Mart email correspondence discussing [redacted]; AR3 (WM-220R-008690) (March 1, 2006 email from the Wal-Mart investigation unit asking to [redacted] and stating that [redacted]. [redacted] confirms Delaware Plaintiffs' theory of the case—Wal-Mart's board acquiesced in a cover-up of the illegal bribery scheme by accepting a pretextual conclusion from a flawed and incomplete investigation.

C. THE ARKANSAS PLAINTIFFS' INTERESTS WERE NOT ALIGNED WITH THE INTERESTS OF WAL-MART'S STOCKHOLDERS

Defendants are incorrect in asserting that there was no conflict of interest because both the Arkansas and Delaware Plaintiffs are Wal-Mart stockholders. When the Arkansas Plaintiffs learned of the developments in Delaware, and chose to proceed in Arkansas on their original defective pleadings, instead of availing themselves of the documents obtained in the Section 220 action, a disabling conflict arose. *See* Restatement (Second) of Judgments § 42 cmt. e (1982) (A disabling conflict exists when a divergence of interests is "real rather than conjectural . . . ."); *see also Taylor*, 553 U.S. at 900-01. As Defendants asserted in support of their motion to stay the Arkansas proceedings, the Arkansas Plaintiffs chose to take part in a "horse race" in order to "control the litigation" instead of a single coordinated proceeding "at the expense of the very corporation on whose behalf they purport to bring this action . . . ." A-639, 690. This decision requires a finding of constitutional inadequacy. *See Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 388 (1996) (Ginsburg, J. concurring) (due process applies to both representative plaintiffs and their counsel, including any conflicts of interest by counsel).[13]

[13] The Delaware Plaintiffs were not "equally conflicted by continuing their efforts to litigate in Delaware." AB at 31. Delaware Plaintiffs followed the Chancellor's instruction to protect the interests of Wal-Mart and its stockholders.

III. THE *ARONSON* TEST IS A DISTINCT LEGAL ISSUE AND STANDARD THAT WAS NEVER ACTUALLY LITIGATED IN ARKANSAS

"Two tests are available to determine whether demand is futile" under Delaware law. *Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008). Whereas the *Aronson* test concerns one or more discrete business decisions the board made (under the second *Aronson* prong), the *Rales* test focuses on the board's impartiality director by director. *Id.* ("The *Aronson* test applies . . . where it is alleged that the directors made a conscious business decision in breach of their fiduciary duties," but a "second (*Rales*) test applies where the subject of a derivative suit is not a business decision of the Board but rather a violation of the Board's oversight duties."); *see also* Deborah A. DeMott & David F. Cavers, Shareholder Derivative Actions: Law and Practice § 5:13, at 731-34 (2015). This Court declined to make the *Rales* test "a universal demand requirement," *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993), and has subsequently emphasized that it is "a different test." *Lambrecht v. O'Neal*, 3 A.3d 277, 285 (Del. 2010).

The Arkansas court determined "that the *Rales* test applies to this case," and therefore that it "***will not consider*** whether the Board's actions, or conscious inaction, were a valid exercise of business judgment" under *Aronson*. B-151 (emphasis added). It never decided, or even considered, whether the Wal-Mart Board's actions and inaction were valid under *Aronson*'s second prong. But

Arkansas is clear that it only gives preclusive effect to issues that were "actually litigated" where "a decision was rendered." *Powell v. Lane*, 289 S.W.3d 440, 445 (Ark. 2008). In fact, under Arkansas law, "[t]he question of whether an issue was previously litigated is interpreted ***very narrowly*** for purposes of collateral estoppel." *Estate of Goston v. Ford Motor Co.*, 898 S.W. 2d 471, 473 (Ark. 1995) (emphasis added). Because the Arkansas court never actually litigated whether Wal-Mart's directors made conscious business decisions in breach of their fiduciary duties by (a) firing independent investigator Wilkie Farr (A-144) and subsequently (b) putting the investigation into the hands of the chief suspect, Rodriguezmacedo (A-95-96), Delaware Plaintiffs are not precluded from litigating their claim that demand would have been futile under *Aronson*'s second prong.

Defendants counter that the "relevant issue is not the applicability of the *Aronson* (or *Rales*) framework, but rather" whether "the core demand futility issue was the same." AB at 34-35 (citation and internal quotations omitted). Defendants have it backward—this Court can only determine whether the issue litigated in Arkansas was the same as Plaintiffs' *Aronson* claim by comparing *Aronson*'s legal standard to *Rales*. In fact, "issues are not identical" for collateral estoppel "if the second action involves application of ***a different legal standard***, even though the factual setting of both suits may be the same." 18 C. Wright, A. Miller, & E. Cooper, Federal Practice & Procedure § 4417, p. 449 (2d ed. 2002) (emphasis

added). Because *Rales* and *Aronson* are "different" legal standards, *Lambrecht*, 3 A.3d at 285, litigating one in Arkansas cannot preclude litigating the other in Delaware.

Defendants urge the Court to ignore the proper analysis based on an incorrect reading of *B&B Hardware*. *B&B Hardware* arose from an aspect of trademark law where a federal agency and a federal court must each assess a trademark's "likelihood of confusion." The U.S. Supreme Court stated that "[t]he real question" for preclusion "is whether likelihood of confusion for purposes of registration ***is the same standard*** as likelihood of confusion for purposes of infringement," and held it was "a single standard." *B&B Hardware*, 135 S. Ct. at 1303-07. The *Rales* and *Aronson* tests, however, are not a single standard. *See Lambrecht*, 3A.3d at 285. The case therefore does not help Defendants, and actually supports a finding that the *Aronson* standard was never actually litigated in Arkansas.[14]

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[14] The other cases Defendants cite are similarly inapposite because none involved different legal standards applied in earlier proceedings. *See, e.g. Fuchs Family Trust*, 2015 WL 1036106, at *5 (plaintiff argued that "facts and legal theories underlying its case" differed from those raised in the earlier action); *In re MGM Mirage Deriv. Litig.*, 2014 WL 2960449, at *5 (D. Nev. June 30, 2014) ("Plaintiff argues that the *facts* supporting the demand futility issue brought in the Nevada state court are not identical to the *facts* supporting the demand futility issue before this Court. . . ."); *Bammann*, 2015 WL 2455469, at *18 ("Plaintiff alleges that the facts . . . are more developed here. . . ."); *In re Career Educ. Corp. Deriv. Litig.*, 2007 WL 2875203, at *12 (Del. Ch. Sept. 28, 2007) (no challenge to *Rales* standard where allegations of insider trading were "not a specific action taken by the entire board"); *Holt v. Golden*, 880 F. Supp. 2d 199, 203 (D. Mass. 2012)

CONCLUSION

For all the aforementioned reasons, as well as those stated in Plaintiffs' Opening Brief, Plaintiffs respectfully submit that the Opinion should be reversed.

Dated: September 8, 2016

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(plaintiffs in subsequent action argued only that "there has been a change in the availability of information to plead demand futility").

CERTIFICATE OF SERVICE

I hereby certify that on September 23, 2016, a copy of the *Public/Redacted Version of Appellants' Reply Brief* was electronically served via *File and ServeXpress* on the following:

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