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JURISDICTION AND PROCEDURE

Shareholder Derivative Litigation and Parallel Proceedings: Practical and Strategic Implications, Part I



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I. Introduction

Corporations facing civil litigation or regulatory investigations often find themselves simultaneously beset with stockholder derivative actions premised on the same underlying facts. For instance, a corporation, together with certain of its directors and officers, may be sued in a securities fraud or employment discrimination class action case, or be the subject of a Securities and Exchange Commission or Department of Justice investigation, only to then see a stockholder derivative case filed based on the same events.

The very different nature of these types of proceedings introduces a host of thorny practical and strategic concerns. A shareholder derivative action – which is nominally brought by the corporation *against* directors or officers – may result in a corporation being ascribed positions adverse to its defense in parallel proceedings, in which the corporation may have an interest in arguing that its directors or employees did *not* commit wrongdoing. Thus, the simultaneous litigation of a derivative action and parallel proceedings may undermine a corporation's position in both. In addition, as a practical matter, the underlying facts may still be developing. A derivative case could be at best premature, and at worst, may interfere with or complicate resolution of the parallel matters. For instance, where a derivative claim seeks indemnification from directors and/or offi-

cers in connection with amounts paid by the corporation in parallel proceedings, liability may be entirely contingent upon the outcome of those proceedings. In such circumstances, it makes sense that the underlying predicate for liability be established first before proceeding with derivative litigation.

This article – the first in a two-part series – discusses the practical and strategic issues that arise in connection with seeking to stay shareholder derivative litigation because of pending parallel proceedings arising from the same events and the factors to justify a stay.¹ We review various factors concerning whether a stay is warranted or appropriate, and then review the caselaw, both in Delaware and elsewhere, addressing these considerations. We conclude with a discussion of a recent decision of the Delaware Chancery Court, *In re Molycorp, Inc. Shareholder Derivative Litigation*.² Although the *Molycorp* court acknowledged that the derivative action had a “closely related factual underpinning[]” to a pending federal securities action, the court nevertheless held that a stay of the action was unnecessary because the claims and theories of liability in the actions did not overlap.³ However, as discussed below, the *Molycorp* holding should not be given a broad reading because the opinion did not engage with the full array of considerations discussed herein.

II. Practical and Strategic Considerations in Favor of Stay

There are a number of practical and strategic considerations weighing in favor of stays of derivative litigation in the face of parallel proceedings. These considerations are discussed below.

Prejudice. One consideration that has persuaded courts to stay derivative actions in light of parallel proceedings is the determination that any harm suffered by the plaintiff and other stockholders due to a delay in the prosecution of the derivative claims is outweighed by the potential for harm to the corporation if the action were not stayed. For instance, courts have recognized that the fact that a corporation is pursuing claims against its directors and/or officers could by itself be viewed as an admission by the corporation in connection with parallel proceedings in which the corporation is a defendant and claimed to be liable for the actions of its agents.⁴ For this reason, and because of the related

¹ The issue of whether or not a derivative action should be allowed to proceed because the stockholder has adequately alleged that a demand on the board would be futile is often litigated as a threshold issue. A determination that a demand is required may, as a practical matter, avoid the need to confront the issues discussed in this article. However, a demand can raise issues of its own. For this reason, the second article in this series will address key considerations for companies faced with shareholder demands for board action in connection with events that are the subject of ongoing litigation or regulatory investigations.

² 2014 BL 133790 (Del. Ch. Feb. 7, 2014).

³ *Id.* at *6.

⁴ *In re STEC, Inc. Derivative Litig.*, 2012 BL 400353, at *4 (C.D. Cal. Jan. 11, 2012); *In re Groupon Derivative Litig.*, 882 F. Supp. 2d 1043, 1052 (N.D. Ill. 2012); *In re First Solar Derivative Litig.*, 2012 WL 6570914, at *2 (D. Ariz. Dec. 17, 2012); *Cucci v. Edwards*, 2007 BL 295648, at *2 (C.D. Cal. 2007); *Breault v. Folino*, 2002 BL 23287, at *2 (C.D. Cal. Mar. 15,

concern that findings of fact against directors and officers in the derivative proceeding might be used against the corporation in parallel proceedings, it may not be in the best interest of the corporation for derivative claims to go forward at least until the parallel proceedings have fully concluded.⁵

Discovery in derivative proceedings could also prejudice the corporation. This is true even if a protective order is in place. For example, if a court determines that demand on a corporation’s board of directors was excused, under Delaware law, the board of directors would have the option of appointing a special litigation committee with authority to act on behalf of the corporation in connection with the derivative litigation.⁶ If the special litigation committee, upon conducting an investigation, concludes that claims against the corporation’s directors and officers are not in the corporation’s best interest, it would typically file a motion to dismiss the action.⁷ Most courts have held that special litigation committee reports, to the extent they are relied upon in connection with a motion to dismiss, cannot remain under seal, and therefore will be accessible to parties adverse to the corporation in other proceedings.⁸ To the extent that a report contains adverse factual findings regarding directors, officers, or other employees of the corporation, it could be prejudicial to the company in connection with parallel proceedings.

Judicial Economy. Courts have held that stays are also warranted where the factual matters underlying the derivative litigation are not fully developed. Most obviously, to the extent that a derivative action is premised upon a claim for indemnification in connection with any losses faced by the corporation in parallel proceedings, it would not make sense for the derivative action to proceed given that the derivative claim may be limited or eliminated completely by the resolution of the parallel proceeding.⁹

2002); *Brenner v. Albrecht*, 2012 BL 24018, at *6-7 (Del. Ch. Jan. 27, 2012); *South v. Baker*, 62 A.3d 1, 25 (Del. Ch. 2012).

⁵ *STEC*, 2012 BL 400353, at *4-6; *Groupon*, 882 F. Supp. 2d at 1052; *First Solar*, 2012 WL 6570914, at *2; *Rosenblum ex rel. Amgen, Inc. v. Sharer*, 2008 BL 355878, at *8 (C.D. Cal. July 28, 2008); *Breault*, 2002 BL 23287, at *2; *Brenner*, 2012 BL 24018, at *5-6; *South*, 62 A.3d at 25.

⁶ *See, e.g., Spiegel v. Buntrock*, 571 A.2d 767, 772 (Del. 1990).

⁷ *See, e.g., Zapata Corp. v. Maldonado*, 430 A.2d 779, 788 (Del. 1981).

⁸ *See, e.g., Matter of Continental Ill. Sec. Litig.*, 732 F.2d 1302, 1314-16 (7th Cir. 1984); *Joy v. North*, 692 F.2d 880, 894 (2d Cir. 1982). *But see In re Perrigo Co.*, 128 F.3d 430, 440-41 (6th Cir. 1997) (holding that when a district court relies upon an SLC report in adjudicating a motion to dismiss, the court should “conduct a hearing regarding whether the report or parts thereof should be disclosed to the public, or whether that information should remain sealed”).

⁹ *Groupon*, 882 F. Supp. 2d at 1048 (“Courts that have considered the interplay between derivative and securities actions have often found that derivative claims cannot be adjudicated in full (or even in large measure) until the [securities class] [a]ction is tried.” (internal quotation marks omitted)); *Rosenblum*, 2008 BL 355878 at *9 (“If Amgen is exonerated in the securities class action, then it is unclear what, if anything, would be left of the derivative action.”); *In re Massey Energy Co.*, 2011 BL 149645, at *30 (Del. Ch. May 31, 2011) (“One cannot even rationally determine what the potential derivative liability is until the direct liability Massey faces is determined.”).

Even if the derivative claims are not premised entirely upon liability in the parallel proceedings, however, and instead assert a separate theory of liability premised upon the same underlying facts as the parallel proceedings, a stay may still be appropriate. That is because relevant factual issues are still likely to be resolved in the course of parallel proceedings.¹⁰ Thus, unless there is a compelling need for the derivative litigation to go forward immediately – and, as discussed below, these situations would seem to be rare – the best use of company and judicial resources may be to litigate the issues once, rather than risk multiple rounds of amended derivative pleadings. Because any relevant facts in the parallel proceedings would already have come to light, any allegations or legal theories that may have arisen as a result of the parallel proceeding could then be fully incorporated at the outset of any litigation on the merits of the derivative claim.¹¹ For similar reasons, courts frequently have held that considerations of comity also weigh in favor of staying derivative proceedings, because the granting of a stay would avoid the risk of inconsistent factual findings in the derivative proceeding and any parallel proceeding.¹²

Indeed, it may not be possible to evaluate which, if any, theories of derivative liability should be litigated until any parallel proceedings have fully concluded. Even if the plaintiff in an existing derivative action represents to a court that the plaintiff is prepared to go forward on their existing complaint, Delaware courts have held that a dismissal with prejudice as to one derivative plaintiff may not necessarily bar a derivative action by other stockholders, if the named plaintiff was not an ad-

¹⁰ *Groupon*, 882 F. Supp. 2d at 1050-51; *First Solar*, 2012 WL 6570914, at *2 (“[I]t is at least reasonably possible that resolution of the class action case will lead to prompt resolution of the derivative action saving litigation costs and court resources in the long term.”); *Rosenblum*, 2008 BL 355878, at *9; *In re Ormat Technologies, Inc.*, 2011 BL 222446, at *5 (D. Nev. Aug. 29, 2011) (“A stay of this action would also preserve judicial resources because the claims and parties in the two lawsuits substantially overlap.”); *Cucci*, 2007 BL 295648, at *2 (staying derivative action pending resolution of a motion to dismiss a related securities class action complaint because “both actions rest upon the same or closely related transactions, happenings or events, and thus will call for the determination of the same or substantially related questions of fact”); *South*, 62 A.3d at 23.

¹¹ *Brenner v. Albrecht*, 2012 BL 24018, at *7 (Del. Ch. Jan. 27, 2012) (even where “at least some portion of [the] derivative claims [was] ripe for adjudication,” court noted the “wisdom as a practical matter of treating indemnification claims as unripe until the liability for which indemnification is sought is determined”); *Brudno v. Wise*, 2003 BL 1596, at *5 (Del. Ch. Apr. 1, 2003) (“[W]hether or not the derivative claims are, in some measure, ripe enough for current assertion, they cannot be adjudicated *in full*” until parallel proceedings have concluded (emphasis added)).

¹² *In re STEC, Inc. Derivative Litig.*, 2012 BL 400353, at *6 (C.D. Cal. Jan. 11, 2012) (noting that a stay would simplify the issues presented and promote the orderly course of justice because the outcome of the securities action would inform the “advisability” of pursuing the derivative action, and a stay would avoid the possibility of conflicting outcomes in the cases); *Brenner*, 2012 BL 24018, at *7 (“Even if the plaintiffs in the Securities Class Action never learned about such [adverse] admissions or rulings [in the derivative action], there would remain a risk of inconsistent rulings between this Court and the District Court.”).

equate representative of the corporation.¹³ In particular, courts have held that a stockholder may not be an adequate representative if the plaintiff rushes to file suit without first conducting an adequate investigation to determine whether or not there is a connection between the alleged corporate trauma and director conduct.¹⁴ Thus, the most efficient use of the company’s resources may be to litigate an action after all relevant facts and potential theories are known, rather than incur the risk of having to re-litigate a derivative action based on the same underlying facts, but alleging differing theories of liability or scope. A stay under such circumstances would also discourage plaintiffs from filing hastily-developed complaints in an effort to win the proverbial “race to the courthouse” and obtain appointment as lead plaintiff.¹⁵

Additional Benefits From Stay. There are a number of other reasons to justify a stay of derivative proceedings until parallel proceedings have concluded. First, the corporation in a derivative proceeding may be unable fully to assess the amount and likelihood of potential liability if the claims were to be pursued, thus impairing the corporation’s ability to assess whether any potential recovery in a derivative action would warrant the disruption and distraction to the corporation of pursuing the action itself.¹⁶ Corporations may also be better able to determine from the outset whether circumstances warrant separate representation for various directors and/or officers in the derivative proceedings, with all the attendant expense that can require for the corporation (including pursuant to advancement provisions), if those decisions can be made on a more informed basis after parallel proceedings have concluded.

Finally, it is worth noting that in many cases, the considerations identified by courts *against* granting stays can be addressed through other means. For instance, a stay of a derivative litigation could delay the corporation’s recovery in that action. However, to the extent that monetary damages are sought, a court can compensate the corporation for any delay in recovery through the award of prejudgment interest.¹⁷ Moreover, even if equitable relief is sought, the majority of

¹³ *South*, 62 A.3d at 20-26.

¹⁴ *See id.* at 23.

¹⁵ *Id.* at 25 (“[A] deliberate and thorough pre-suit investigation, rather than haste, was required to further the interests of the corporation. *Caremark* claims are difficult to plead and harder to prove.”)

¹⁶ *Brenner*, 2012 BL 24018, at *7 (“Defendants deserve to know, for example, the extent of their prospective exposure when making strategic decisions during the course of litigation such as how vigorously to defend an action and, relatedly, how much to spend on defense. Such practical concerns are especially important where, as *Brenner* alleges here, the Company ‘is largely self insured so that expenses, settlements or damages in excess of \$5 million in these actions will not be recoverable under the primary coverage insurance policies.’”); *see also Inloes v. Williams*, 2014 BL 224990, at *2 (E.D. Va. Feb. 28, 2014).

¹⁷ *Brenner*, 2012 BL 24018, at *7 (“Therefore, prejudgment interest can redress any harm caused by a delay. Regarding the discovery process, the same practical consideration of overlapping allegations that renders simultaneous prosecution of both cases unduly complicated, inefficient, and unnecessary also mitigates the risk of delaying discovery here. Because the two actions are somewhat related, the Securities Class Action plaintiffs ‘have a strong incentive to develop evidence that will

shareholder derivative actions are filed only after the allegedly wrongful conduct already has ceased and been publicly revealed. In such cases, there is no urgent need for an injunction to halt ongoing wrongful conduct.¹⁸ In addition, with the passage of time, relevant evidence may be compromised because evidence may no longer exist or witnesses' memories may fade. But prosecution of the underlying action can serve not only to preserve relevant evidence, but potentially to further develop that evidence so that the derivative action, once it proceeds, can be streamlined.¹⁹

III. Review of Case Law Regarding Stays

Delaware and other state and federal courts have relied upon many of these considerations in determining whether to exercise their inherent discretion by granting a stay of derivative action in light of pending parallel proceedings. This section reviews the caselaw in Delaware and elsewhere on this issue.

A. The Delaware Approach. *Brudno v. Wise*,²⁰ a decision by then-Vice Chancellor Strine, remains one of the most cited Delaware opinions setting forth the circumstances in which a court may exercise its inherent discretion in granting a stay of a derivative suit in light of a parallel action. *Brudno* involved a shareholder derivative action that proceeded simultaneously with a federal securities suit and an inquiry by the Federal Energy Regulatory Commission ("FERC"). The basis for the derivative litigation was the contention that "certain inside directors actively participated in the misconduct" at issue in the securities action and FERC inquiry, and that the outside directors were "culpable for their failure to prevent the misconduct."²¹ Therefore, the "primary thrust" of the complaint was to ensure "that the . . . directors, rather than [the corporation], bear ultimate responsibility for any costs arising out of the Federal Securities Actions or the FERC proceeding."²²

The defendants moved for a stay of the action under *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Engineering Corp.*²³ and its progeny, pursuant to which Delaware courts may exercise their judicial discretion in favor of a stay where a prior action, involving the

be useful to the plaintiffs in [both actions].'" (quoting *Brudno*, 2003 BL 1596, at *5 n.11)).

¹⁸ See, e.g., *South*, 62 A.3d at 25 ("Critically, there was no reason to rush [in pursuing derivative claims] that would further the interests of the corporation. . . . [T]he underlying harms – the accidents at the Lucky Friday mine – [did not] call for haste. During 2011, as those unfortunate incidents were occurring, no stockholder plaintiff filed suit. It was only the public announcement of the lowered projection for silver production and the filing of the federal securities complaints that spurred the Souths and other derivative plaintiffs into action.").

¹⁹ *In re Ormat Technologies, Inc.*, 2011 BL 222446, at *5 (D. Nev. Aug. 29, 2011) ("Plaintiffs may be able to benefit from the proceedings in the Securities Class Action, and any potential harm from delayed litigation is more than outweighed by the harm of denying the stay and forcing Ormat to expend resources on this derivative suit, and the harm to Ormat of having its witnesses for the Securities Class Action undermined in this action.").

²⁰ 2003 BL 1596 (Del. Ch. Apr. 1, 2003).

²¹ *Id.* at *3.

²² *Id.*

²³ 263 A.2d 281 (Del. 1970).

same parties and issues, is pending in a foreign court. In *Brudno*, previously-filed securities actions and a companion derivative action were pending in another jurisdiction.²⁴ The court held that it was unnecessary to apply *McWane*, because even if it applied a standard *forum non conveniens* analysis, a stay was appropriate, and the same result would obtain under an exercise of the court's inherent discretion to control its own docket.²⁵ The Court reasoned that the derivative suit was merely a "placeholder indemnity action" in which, "to a great extent, the plaintiffs [] expressly hinge[d] [the corporation's] right to relief on the outcome in the Federal Securities Action. As a result, it makes little sense for this Action to proceed until the bases for the plaintiffs' indemnity claims are settled, or at the very least, closer to that point."²⁶ The court also noted that the federal derivative action had been stayed in light of the same federal securities action.²⁷ Therefore, the court held that the "interests of litigative efficiency, judicial economy, and comity weigh[ed] heavily in favor of the entry of a stay for the time being," although the court noted it would remain open to reconsidering the issue at a later point.²⁸

In a later decision, then-Vice Chancellor Strine outlined an additional rationale for granting a stay of derivative litigation in *dicta* in *In re Massey Energy Company*.²⁹ In April 2010, an explosion at a Massey mine in West Virginia killed 29 miners. Several families of the miners sued the corporation and regulatory proceedings ensued. In response, Massey stockholders filed derivative suits, seeking to hold corporate directors and officers responsible for their alleged failure to comply with applicable mine safety regulations.³⁰ In the wake of all this, Massey's stock price fell significantly and Massey entered into a merger agreement with Alpha Natural Resources, Inc. ("Alpha"). The stockholders sought a preliminary injunction to block the proposed merger on the basis that it allowed Alpha to acquire Massey without paying for the economic value of the derivative claims.³¹

The court denied the motion for preliminary injunction, holding that the plaintiffs failed to establish that they had a reasonable likelihood of success on the merits or that they faced an irreparable injury. Moreover, the court held that the balance of equities weighed against an injunction because the stockholders could decide for themselves whether to approve the merger.³² In so holding, the court echoed *Brudno* in rejecting the

²⁴ 2003 BL 1596, at *3.

²⁵ *Id.* at *1.

²⁶ *Id.*

²⁷ *Id.* at *5 (commenting on the motivations of the federal judge's decision and noting "it is difficult to fault the idea that the primary liability case should go forward before the case seeking indemnity, when the indemnity case's outcome necessarily depends on the outcome of the primary case. That judgment about how the cases should precede made by a judicial colleague should not be lightly disregarded." (internal citation omitted)).

²⁸ *Id.* (emphasis in original).

²⁹ 2011 BL 149645 (Del. Ch. May 31, 2011).

³⁰ *Id.* at *2.

³¹ *Id.* at *2. The *Massey* court devoted significant space to examining whether the derivative claims survive a merger under Delaware law. However, this issue is outside the scope of this article and will not be discussed here.

³² See generally *id.*

argument that Alpha would never pursue the derivative claims, reasoning, *inter alia*, that the derivative claims were necessarily contingent on the outcome of the parallel actions – both the securities case and the criminal investigation – and until those actions had concluded, it was not clear whether it would make sense for Alpha to pursue the claims. Noting that the Massey stockholders erroneously conflated the value of their derivative claims with the loss in value of the corporation, the court noted that “[o]ne cannot even rationally determine what the potential derivative liability is until the direct liability Massey faces is determined.”³³

The court also downplayed the stockholders’ argument that Alpha would have no incentive to pursue the derivative claims because the very act of pursuing such claims might impact the position of the corporation in the pending parallel proceeding it also faced.³⁴ The court concluded that, like Alpha, “so too would (or should) the plaintiffs, as fiduciaries for other Massey stockholders, be reluctant to prosecute the Derivative Claims they claim are so valuable until the direct claims against Massey are resolved” because “in either a Merger or non-Merger world . . . much or perhaps most of the Derivative Claims’ value is to reduce to some extent the liability Massey faces as a corporation.”³⁵ As a result, the court held that the derivative claims “should follow, rather than precede, the resolution of the key direct suits and regulatory proceedings.”³⁶ Finally, the court also rejected the plaintiffs’ argument that the merger should be enjoined while the court held a trial on the derivative claims, holding that there were a variety of reasons why that course of action would be “neither practicable nor equitable,” including the fact that it would be “extremely disadvantageous to Massey as a stand-alone entity for Derivative Claims that seek to hold fiduciaries liable to indemnify Massey if Massey is held liable to others to go forward ahead of those direct claims.”³⁷

In *Brenner v. Albrecht*, Vice Chancellor Parsons applied the reasoning in *Massey* to a consideration of whether or not to grant a stay.³⁸ *Brenner* involved deliberate accounting errors by certain employees of SunPower Corporation that caused the corporation to restate its financial results. The announcement of an internal investigation prompted a securities class action, which in turn led to a series of shareholder derivative lawsuits. Most of the derivative plaintiffs agreed to voluntarily stay their suits pending the outcome of the securities class action. However, one shareholder — Brenner — pursued a derivative suit after receiving corporate books and records through a Section 220 demand.³⁹

SunPower argued that the derivative action should be stayed because the allegations in the derivative suit overlapped substantially with those in the parallel securities class action and would prejudice the corporation’s defense in that case, and the relief sought in the derivative action was contingent on the outcome of the paral-

lel securities suit.⁴⁰ Brenner responded that his derivative claims alleged a failure to exercise oversight, a claim fundamentally different from the allegation of an intentional scheme to defraud in the parallel securities action. He further argued that the risk of prejudice to SunPower’s defense was overstated because his complaint was filed under seal, and he agreed not to disclose confidential information that he obtained pursuant to his Section 220 demand. Finally, Brenner noted that the corporation had already incurred \$8 million in costs associated with the restatement of financial records and internal investigation, thus indicating that the corporation had already been damaged and that his suit was therefore not entirely contingent on the outcome of the securities action.⁴¹

Vice Chancellor Parsons noted that the power to grant a stay is “incident to the inherent power of a court to exercise its discretion to control the disposition of actions on its docket in order to promote the economies of time and effort for the court, litigants, and counsel.”⁴² The court turned first to the issue of similarity between the derivative litigation and the parallel class action proceeding, noting that the claims in each case were analogous. The court noted that the plaintiffs in both actions accused SunPower’s directors of having knowledge of wrongdoing or engaging in conscious misconduct, but that “Brenner . . . makes these arguments *on behalf of the corporation* while the Securities Class Action plaintiffs make them *against SunPower*.”⁴³ The court observed that SunPower could pursue one of two litigation strategies: the corporation could cross-claim against its directors and officers as the primary wrongdoers and seek indemnification from them – as asserted in the derivative action – or it could cooperate with its directors and officers and deny that any wrongdoing occurred – as asserted in the parallel securities action. However, it would not be practical for the corporation to pursue both strategies at the same time.⁴⁴ As such, prosecution of both claims concurrently would be “unduly complicated, inefficient, and unnecessary” and the potential for conflict created a significant risk of prejudice to SunPower’s defense in the securities class action.⁴⁵

Next, the court addressed whether the derivative litigation was contingent on the outcome of the parallel securities action. While the court noted that some of Brenner’s derivative claims were ripe for adjudication, it found more persuasive “the wisdom as a practical matter of treating indemnification claims as unripe until the liability for which indemnification is sought is determined”⁴⁶ The court focused in particular on the difficulty for companies of making strategic litigation decisions upon a shifting landscape of material facts, stating that companies “deserve to know, for example, the extent of their prospective exposure when making strategic decisions during the course of litigation such as how vigorously to defend an action and, relatedly, how much to spend on defense.”⁴⁷

³³ *Id.* at *30.

³⁴ *Id.* at *29.

³⁵ *Id.* at *31.

³⁶ *Id.*

³⁷ *Id.* at *36.

³⁸ 2012 BL 24018 (Del. Ch. Jan. 27, 2012).

³⁹ *Id.* at *3-4.

⁴⁰ *Id.* at *4.

⁴¹ *Id.* at *4.

⁴² *Id.* (internal quotation marks and citation omitted).

⁴³ *Id.* at *6 (emphasis in original).

⁴⁴ *Id.*

⁴⁵ *Id.* at *6.

⁴⁶ *Id.* at *7.

⁴⁷ *Id.*

Finally, the court evaluated whether a stay would prejudice the plaintiff, noting that Brenner could be harmed insofar as a stay delayed recovery on his claims and impaired the discovery process by the passage of time.⁴⁸ However, the court went on to assert that the recovery sought was primarily monetary and that any delay could be remedied with prejudgment interest. Further, the plaintiffs in the parallel securities class action proceeding would have a strong incentive to develop evidence useful to Brenner in his subsequent derivative action.⁴⁹ Importantly, after conducting its analysis, the court adopted then Vice-Chancellor Strine's reasoning in *Brudno* by underscoring that "the court should remain flexible and open to revisiting the situation as events develop."⁵⁰

The last significant decision in this area is from Vice Chancellor Laster, who applied the reasoning of *Brenner* a few months later in *South v. Baker*.⁵¹ In *South*, stockholders of the Hecla Mining Company brought a derivative action seeking to recover damages the corporation would suffer in connection with securities actions filed after the corporation's involvement in multiple mining accidents, as well as damages related to a mine closure. The court granted the defendants' motion to dismiss, holding that demand was required because the plaintiff failed to plead with particularity that a majority of the Hecla directors faced a substantial likelihood of personal liability.⁵²

The court next addressed the question of whether dismissal with prejudice as to the named plaintiff would have a preclusive effect on the ability of other stockholders to bring derivative suits.⁵³ In conducting this inquiry, the court held that "there was no reason to rush [to file a derivative lawsuit] that would further the interests of the corporation."⁵⁴ First, the court noted that the federal securities complaints were subject to the automatic stay imposed by the PSLRA pending resolution of a motion to dismiss, but no briefing schedule had yet even been established in those actions.⁵⁵ Second, the court held that the underlying harms – the mining accidents – did not call for haste because the derivative plaintiffs only filed suit after the incidents already had occurred, the corporation had publicly lowered its projections, and the federal securities complaints had been filed. Finally, the court held that "a deliberate and thorough pre-suit investigation, rather than haste, was required to further the interests of the corporation" in filing a *Caremark* claim.⁵⁶ As the court noted, "[w]hen a corporation first announces a trauma, the underlying

harms often still will be developing. Related regulatory proceedings and regulatory actions rarely will be resolved. This Court routinely stays *Caremark* claims that seek to shift losses from the corporation to the defendant fiduciaries."⁵⁷ Moreover, the court noted that the pursuit of a *Caremark* claim with undue haste might affirmatively harm the corporation's interests in many cases, because "pursuing a *Caremark* claim during the pendency of the underlying litigation or governmental investigation may well compromise the corporation's position on the merits, thereby causing or exacerbating precisely the harm that the *Caremark* plaintiff ostensibly seeks to remedy."⁵⁸

B. Case Law in Other Jurisdictions. The practical and strategic considerations outlined in *Brudno*, *Massey*, *Brenner*, and *South* have also been identified by courts in a variety of jurisdictions. For example, in *Breault v. Folino*, the U.S. District Court for the Central District of California stayed a derivative action in light of a parallel pending class action, noting that prosecution of the derivative suit would conflict with the corporation's defense in the pending class action.⁵⁹ *Breault* observed that pursuit of the derivative suit would undermine the corporation's position in the class action, as well as divert financial and managerial resources away from existing litigation.⁶⁰ In *Rosenblum v. Sharer*, the same court stayed a derivative action in light of a parallel securities action, finding that pursuit of the derivative action would prejudice the ability of the corporation to defend the securities action, a stay would preserve judicial resources, and the stockholders' claims were necessarily contingent on the outcome of the securities suit.⁶¹ Most recently, in 2012 a court summarized the case law within the Central District of California and noted that courts often grant a stay of derivative litigation in light of a parallel matter "when the cases arise from the same factual allegations and the evidence in the former could jeopardize the corporation's defense in the latter."⁶²

The Northern District of Illinois applied the same reasoning in *In re Groupon Derivative Litigation*, where the court noted that the "[c]ourts that have considered the interplay between derivative and securities actions have often found that derivative claims 'cannot be adjudicated in full (or even in large measure) until the [securities class] [a]ction is tried.'" ⁶³ *Groupon* noted that, though resolution of the securities class action could significantly simplify the parallel derivative litigation, the derivative action did present issues indepen-

⁴⁸ *Id.* at *8.

⁴⁹ *Id.* It is worth noting that the similarity of the underlying claims in parallel proceedings both militates toward the granting of a stay and simultaneously reduces the potential detriment that delayed discovery might cause the stayed plaintiff.

⁵⁰ *Id.* (citing *Brudno v. Wise*, 2003 BL 1596, at *5 (Del. Ch. Apr. 1, 2003)).

⁵¹ 62 A.3d 1 (Del. Ch. 2012).

⁵² *Id.* at 14-19.

⁵³ The court concluded that a dismissal with prejudice does not have a preclusive effect if the initial plaintiff failed to provide adequate representation for the corporation. *Id.* at 26.

⁵⁴ *Id.* at 23.

⁵⁵ See *id.* at 25 (citing 15 U.S.C. § 78u-4(b)(3)(B)).

⁵⁶ *In re Caremark International Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996). A so-called "Caremark claim" alleges a failure of company directors to exercise meaningful oversight over internal operations of a company by failing to

establish adequate monitoring systems to identify legal violations.

⁵⁷ *South*, 62 A.3d at 23-24.

⁵⁸ *Id.* at 25. Further, the court stated that "[a] well-motivated derivative plaintiff, genuinely concerned about the corporation's best interests, will consider these factors and act carefully, not precipitously." *Id.*

⁵⁹ 2002 BL 23287, at *2 (C.D. Cal. Mar. 15, 2002).

⁶⁰ *Id.*; see also *Cucci v. Edwards*, 2007 BL 295648, at *2 (C.D. Cal. Oct. 31, 2007).

⁶¹ See *Rosenblum ex rel. Amgen, Inc. v. Sharer*, 2008 BL 355878, at *8-*9 (C.D. Cal. July 28, 2008).

⁶² *In re STEC, Inc. Derivative Litig.*, 2012 BL 400353, at *4 (C.D. Cal. Jan. 11, 2012).

⁶³ *In re Groupon Derivative Litig.*, 882 F. Supp. 2d 1043, 1048 (N.D. Ill. 2012) (quoting *Brudno v. Wise*, 2003 BL 1596, at *5 (Del. Ch. Apr. 1, 2003)).

dent of those addressed in the securities litigation. Regardless of the presentation of independent claims, however, the Court granted a stay on the grounds that it would favor judicial economy given the substantially overlapping nature of the parallel claims, and because a stay would not prejudice the plaintiff since the court could later revisit whether a stay remained appropriate. Indeed, the court went on to note that allowing the derivative action to go forward might instead prejudice Groupon's ability to defend the parallel securities action.⁶⁴ Similar decisions have also been reached by courts in a variety of jurisdictions across the country.⁶⁵

Finally, some courts have recognized that parallel actions involving securities violations present additional unique considerations when determining whether a stay of a derivative suit is appropriate, since a stay of discovery is required under the PSLRA until resolution of a motion to dismiss. In cases involving a derivative suit and a securities action, courts have considered whether the PSLRA automatic stay of discovery influences the decision to grant a stay of the derivative action. For example, as discussed, the Delaware Chancery Court in *South* indicated that the existence of the PSLRA stay of discovery in a parallel securities action militated against the plaintiff shareholder's decision to file a derivative claim without undertaking the proper investigation.⁶⁶ However, other courts have questioned whether the PSLRA stay necessarily requires a corresponding stay of discovery in derivative actions. For example, in *In re First Bancorp Derivative Litigation*, the U.S. District Court for the Southern District of New York noted that Congress limited the automatic stay to federal securities actions.⁶⁷ But the Court also noted that courts retain discretionary authority under the PSLRA to "stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery . . ."⁶⁸ Therefore, while some courts have considered the effect of a PSLRA stay of discovery when determining whether to stay a parallel derivative action, this factor has not always been held to be determinative.

⁶⁴ *Id.* at 1052.

⁶⁵ See, e.g., *Inloes v. Williams*, 2014 BL 224990, *2 (E.D. Va. Feb. 28, 2014) (staying derivative litigation in light of pending parallel securities class action); *In re First Solar Derivative Litig.*, 2012 WL 6570914 (D. Ariz. Dec. 17, 2012) (same); *In re Ormat Technologies, Inc. Derivative Litig.*, 2011 BL 222446 (D. Nev. Aug. 29, 2011) (same).

⁶⁶ *South v. Baker*, 62 A.3d 1, 25 (Del. Ch. 2012). In *South*, the court ultimately dismissed the derivative action before it; however, the court referred to the same reasoning used by prior courts to grant a stay of derivative actions in prior decisions.

⁶⁷ *In re First Bancorp Derivative Litig.*, 407 F. Supp. 2d 585, 586 (S.D.N.Y. 2006). The court further noted that when Congress amended the PSLRA to prevent "end-runs" around the statute, it did not broaden the automatic stay of discovery to include derivative actions. See also *In re FirstEnergy Shareholder Derivative Litig.*, 219 F.R.D. 584, 586-87 (N.D. Ohio 2004).

⁶⁸ 15 U.S.C. § 78u4(b)(3)(D); see also *First Bancorp*, 407 F. Supp. 2d at 586.

IV. In re Molycorp, Inc. Shareholder Derivative Litigation – A Departure from Delaware Precedent?

Given the numerous considerations weighing in favor of staying derivative lawsuits in the face of parallel proceedings, a recent decision by the Delaware Chancery Court – *In re Molycorp, Inc. Shareholder Derivative Litigation*⁶⁹ – is worthy of comment. *Molycorp* involved reconsideration of a stay of a derivative action granted in light of a parallel federal securities class action. In granting an initial stay, the court had held that, although the allegations in the original derivative complaint did not overlap entirely with those in the securities action, "both actions implicated a substantially similar scheme of securities fraud, and [] the derivative indemnification claims . . . depended on a predicate finding of liability against Molycorp in the Federal Securities Action."⁷⁰

Both the securities action and the original derivative complaint implicated whether certain defendants had issued material misstatements and engaged in improper trading in connection with certain expedited offerings of stock by the corporation's private investors, from which the corporation had been precluded from participating. The amended derivative complaint, on the other hand, took issue with the same underlying transactions, but instead alleged that the Molycorp directors had breached their fiduciary duties by permitting the private stock offerings to go forward and not exercising a contractual right pursuant to which the corporation could have made its own stock offering.⁷¹

The court concluded that the stay should be lifted because the stockholders' amended complaint eliminated claims regarding material misstatements, indemnification, and other claims closely related to the pending securities action. The court noted that it "frequently stays [] derivative claims in favor of the actions in which the corporation's primary liability will be adjudicated. . . . [b]ut, a derivative action that seeks distinct damages for alleged breaches of fiduciary duty, rather than indemnification for possible securities laws violations, does not implicate the same practical considerations in the Court's calculus of whether to grant a stay."⁷² Although the court acknowledged that the allegations in the amended derivative complaint "partially overlap[ped] with those of the Federal Securities Action," the court noted that defending against these two actions was not unfairly prejudicial to the corporation, but rather "an inherent risk of being a director of a publicly traded Delaware corporation."⁷³ Moreover, although the court also recognized that "[t]he need for expeditious treatment of the Proposed Amended Complaint is not as persuasive as it may be in a summary proceeding . . . or in other contexts," the court held that the Delaware court had an interest in "promptly, uniformly, and authoritatively" deciding a question of Delaware law.⁷⁴

⁶⁹ 2014 BL 133790 (Del. Ch. May 12, 2014).

⁷⁰ *Id.* at *1.

⁷¹ *Id.* at *2-3.

⁷² *Id.* at *5.

⁷³ *Id.* at *5, *6.

⁷⁴ *Id.* at *6.

In holding that the derivative claims should go forward, *Molycorp* rejected the argument that a stay would favor the interests of comity and judicial economy. However, the court did not substantially engage with the consideration set forth in *Massey*, *Brenner*, and *South*, of whether the prosecution of the derivative claims at the same time as the securities claims may conflict with the corporation's defense in the securities action – for instance, by potentially leading to adverse findings of fact regarding the defendants' knowledge and state of mind regarding the disputed transactions.⁷⁵ Thus, while *Molycorp* may suggest possible arguments against a stay, the case should not be read broadly, since in many instances, a stay will remain appropriate because derivative actions and parallel proceedings, despite alleging differing legal theories, will still present practical and strategic difficulties for corporations facing simultaneous parallel litigation.

Other courts have recognized the potential for similarity between securities actions and derivative cases that allege differing legal theories but which arise out of the same underlying conduct. For example, *Groupon* involved the simultaneous prosecution of a federal securities action and a derivative claim alleging breach of fiduciary duty. The *Groupon* court noted that, while the

⁷⁵ *Id.* at n.3 (noting that competing derivative actions filed in Colorado state court had been stayed, and actions filed in Colorado federal court had been dismissed without prejudice in favor of the Delaware action, though the dismissal was reversed and remanded for further consideration of an issue that had been briefed but upon which the federal court had not yet ruled).

legal claims of the two actions were distinct, the underlying issues were similar. In fact, the court noted that “these alternate theories are merely two sides of the same coin, and courts have regularly stayed one action in favor of the other despite the different nature of the claims.”⁷⁶

V. Conclusion

Corporations named as nominal defendants in shareholder derivative actions are often simultaneously subject to parallel proceedings based on the same underlying facts. The concurrent filing of a shareholder derivative suit alongside a pending legal proceeding can present important practical and strategic considerations for a corporation. Courts have generally recognized these difficulties and have often stayed derivative suits until the parallel proceeding has concluded. The practice of staying derivative suits in this context preserves the resources of courts as well as all parties and prevents companies from being forced to take a position adverse to themselves in litigation. Although the recent *Molycorp* decision may appear to cast uncertainty on this framework, the prior precedent of the Delaware Chancery Court and other courts has recognized that certain of the aforementioned considerations will still weigh in favor of a stay even where a derivative action is premised on a different theory of liability than the parallel litigation.

⁷⁶ *In re Groupon Derivative Litig.*, 882 F. Supp. 2d 1043, 1051 (N.D. Ill. 2012) (listing several cases falling under this description).