

BUSINESS LAW TODAY

Delaware Insider:

The Devil Is In the Details: How the Delaware Court of Chancery Permitted a Derivative Claim to Survive an Earlier Derivative Dismissal

By [Stephen B. Brauerman](#) and [Sara E. Bussiere](#)

Several recent decisions of the Delaware Court of Chancery dismissed derivative claims on collateral estoppel grounds in deference to the earlier decisions of courts in other jurisdictions dismissing such claims for failure to demonstrate demand futility. *See, e.g., Laborers' District Council Constr. Indus. Pension Fund and Hallandale Beach Police Officers and Firefighters' Personnel Ret. Fund v. Bensoussan*, 2016 WL 3407708 (Del. Ch. June 1, 2016) (*hereinafter* "Bensoussan"); *In re Wal-Mart Stores, Inc. Delaware Derivative Litig.*, 2016 WL 2908344 (Del. Ch. May 13, 2016) (*hereinafter* "Wal-Mart"). Delaware courts showed deference to those earlier decisions notwithstanding that the Delaware complaints were "more detailed, specific, and extensive" than the first filed complaints on which the collateral estoppel dismissals were premised. *Wal-Mart*, 2016 WL 2909344, at *10-11. Continuing this trend, the Delaware Court of Chancery again showed deference to the earlier decision of a sister court in its August 31, 2016 *In re Duke Energy Corporation Derivative Litigation* decision. *In re Duke Energy Corporation Derivative Litigation*, 2016 WL 4543788 (Del. Ch. Aug. 31, 2016) (*hereinafter* "Duke Energy"). *Duke Energy* is, however, unique, in that the Court of Chancery's deference was limited. Unlike *Bensoussan* and *Wal-Mart*, which dis-

missed the subsequent derivative claims in their entirety, *Duke Energy* found the rare circumstance where the claims the proposed derivative plaintiff sought to pursue in Delaware were different from the claims dismissed in the earlier North Carolina proceeding, and offered the stockholder plaintiffs a rare second bite at the apple. *Duke Energy* reaffirms Delaware's deference to the demand analysis of its sister courts in first-filed derivative stockholder litigation, but provides important guidance for the unique circumstances where careful pleading can overcome the doctrine of collateral estoppel.

The Duke Energy Facts

On January 10, 2011, Duke Energy Corporation entered into a merger agreement with its smaller rival, Progress Energy, Inc. Through the merger, Progress stockholders would receive Duke stock worth nearly \$13.7 billion, and Progress would become a wholly owned subsidiary of Duke. Post-merger, the Duke board would consist of 11 Duke directors and 6 Progress directors. Progress' chief executive, William D. Johnson would become Duke's Chief Executive Officer; Duke's chief executive, James E. Rogers would become Executive Chairman. The merger was subject to regulatory approval from state and federal authorities, including the North Carolina Utilities

Commission (NCUC). The stockholders of both companies overwhelmingly voted to approve the transaction.

The Delaware complaint alleges that after obtaining stockholder approval, but before obtaining regulatory approval, the 11 legacy Duke directors began to have second thoughts about allowing Johnson to head the combined company. Rather than cancel the merger agreement, which would have required the payment of a sizeable termination fee, or breach the merger agreement, the legacy Duke directors allegedly agreed to replace Johnson as Chief Executive Officer immediately after the merger was consummated. Allegedly to cover up this plan, on June 27, 2012, Duke entered into an employment agreement with Johnson that contained lucrative severance benefits. The merger closed on July 2, 2012. The Duke board met almost immediately thereafter and appointed Johnson as CEO. Before the meeting concluded, the Duke board went into executive session. During this executive session, reading from a prepared script and without any notice to the legacy Progress directors, a Duke legacy director moved to terminate Johnson and replace him with Rogers. The directors discussed the matter and ultimately voted, along party lines, to replace Johnson with Rogers. Following the public announcement of the Board's decision, the NCUC

began an investigation and public rating agencies downgraded Duke's bonds.

Several stockholder lawsuits followed, including as relevant to this article, an action brought in state court in North Carolina by Joel Krieger (the "*Krieger Action*") alleging, derivatively on behalf of Duke, that the board breached its fiduciary duties and committed waste by entering into the employment agreement, pursuant to which Duke paid Johnson \$44 million in severance for what amounted to one day's work. As with the plaintiffs in the Delaware action, Krieger did not make a demand on the Duke board before filing his suit. The North Carolina court dismissed the *Krieger Action* for failure to make a pre-suit demand. Applying Delaware law, the *Krieger* court reasoned that the Duke directors did not face a substantial likelihood of personal liability that would impair their independence from the amount and timing of the severance payment to Johnson. Because the consideration the company received from Johnson was not so inadequate as to justify waste, the North Carolina court found that demand was not futile or excused.

The Delaware Court Gives Some, but Not Complete Deference to the *Krieger Action*

Relying heavily on the dismissal in the *Krieger Action*, the Delaware defendants moved to dismiss the Delaware complaint for failure to plead demand futility. The Delaware court, applying North Carolina law, found that the decision in *Krieger* was preclusive to the extent the Delaware complaint "seeks to recover for waste or breach of duty arising from the decisions by the Director Defendants to enter a contract with Johnson, under which discharge would obligate Duke to the payment of millions of dollars in severance—and, shortly thereafter, to fire him . . ."

Notwithstanding that finding, the court observed that "substantial allegations of the instant complaint do not involve that issue." Rather, the Delaware complaint focused on the Duke directors' violation of positive law—their failure to cure misleading representations to the NCUC about who would

head the combined entity. Specifically, as alleged in the Delaware complaint, the director defendants decided to terminate Johnson prior to obtaining regulatory approval of the merger, but did not inform the NCUC of that decision *and* represented, falsely, that no facts had changed when they sought to expedite approval from NCUC following federal approval of the transaction. As to this claim, the Court of Chancery held, collateral estoppel does not apply because the North Carolina court did not address in the *Krieger Action* the issue of demand excusal arising from a violation of positive law.

In reaching this decision, the Court of Chancery distinguished *Bensoussan* and *Wal-Mart*, explaining that these:

decisions [held] that where an issue was presented, and rejected, by a first court, the issue is precluded before a second tribunal, regardless of the fact that the second complaint may plead facts that make the proposition advanced more likely or persuasive . . . Here, by contrast, although the causes of action arise, in the instant case and in the *Krieger Action*, from facts related to the Duke-Progress merger and the discharge of Johnson, the cause of injury alleged here is discrete from that in the *Krieger Action*, and argument that demand is excused proceeds on unique grounds.

Highlighting the difference between the Delaware and *Krieger* Actions, the court noted that "the allegations in the instant case involve whether the Director Defendants made a conscious decision to mislead regulators in violation of positive law, and are able to evaluate whether to authorize their corporation to pursue damages therefrom. The *Krieger Action*, however, involved whether the defendants could independently consider a waste claim."

Although the court found that the Delaware Action and the *Krieger Action* involved different claims, the court recognized the effect its decision could have on subsequent efforts to avoid preclusive

dismissals from earlier-filed actions. As the court observed, "I note that this decision should not open the door to artful crafting by plaintiffs of new causes of action based on a single factual scenario in an attempt to avoid collateral estoppel. The interests of efficiency and finality (and, with respect to litigation in different jurisdictions, comity) require a practical view of the issues presented, to preclude such gamesmanship. This unusual case pushes the limits of such analysis."

Conclusion

The Court of Chancery's decision in *Duke Energy* exemplifies the pragmatic approach Delaware Courts will take when considering motions to dismiss for failure to plead demand futility. While the Court of Chancery will show great deference to preclusive decisions of sister courts addressing the same issues, Delaware courts will not elevate form over substance by allowing a narrow dismissal to subsume later-filed claims that were not properly before the other court. Governing the court's analysis will be the practical implications of the claims and the scope of the earlier suit. For defendants, this means that dismissals should be as broad as possible to encompass all variations of claims depending from common facts. For stockholders, this requires a creative eye for new causes of action not fairly presented the first time. *Duke Energy* confirms Delaware's commitment to pragmatic and practical jurisprudence, balancing the demands of comity, efficiency, and fairness.

Stephen B. Brauerman is a Director and Sara E. Bussiere is an associate at Bayard P.A. in Wilmington, Delaware, where they specialize in corporate and intellectual property litigation. The views expressed herein are the authors' own, and do not necessarily represent the views of Bayard P.A. or its clients. Mr. Brauerman can be reached at (302) 655-5000 or sbrauerman@bayardlaw.com. Ms. Bussiere can be reached at (302) 655-5000 or sbussiere@bayardlaw.com.