COURT OF CHANCERY
OF THE
STATE OF DELAWARE

JOHN W. NOBLE
VICE CHANCELLOR

417 S. STATE STREET
DOVER, DELAWARE 19901
TELEPHONE: (302) 739-4397
FACSIMILE: (302) 739-6179

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Norman M. Monhait, Esquire
Rosenthal, Monhait, Gross
& Goddess, P.A.
Mellon Bank Center, Suite 1401
P.O. Box 1070
Wilmington, DE 19899-1070

Julie T. Saunders, Esquire
Skadden, Arps, Slate, Meagher
& Flom LLP
One Rodney Square
P.O. Box 636
Wilmington, DE 19899-0636

John L. Reed, Esquire
Duane Morris LLP
1100 N. Market Street, #1200
Wilmington, DE 19801

Judith M. Kinney, Esquire
Reed Smith LLP
1201 Market Street, Suite 1500
Wilmington, DE 19801

Re: In re National Auto Credit, Inc. - Shareholders Litigation
C.A. No. 19028-NC; Consolidated
Date Submitted: April 20, 2004

Dear Counsel:

The Defendants have moved to dismiss this derivative action (the "Delaware Action") because of a settlement reached in a proceeding in New York brought by a different plaintiff but asserting substantially the same claims against the same

defendants.[1] That sounds like a fairly routine application, one requiring the Court to give effect to the settlement in New York through the full faith and credit clause of the United States Constitution.[2] The difference, in this instance, is that the settlement in New York will not go into effect until the dismissal of the Delaware Action. The question, thus, is whether the order approving the settlement in New York constitutes a final order for purposes of application of the principles of claim preclusion through the full faith and credit clause.[3]

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[1] Although the Defendants have labeled their application as a motion to dismiss, it will be treated as one for summary judgment because they are relying upon the doctrine of res judicata, which is raised as an affirmative defense, *see* Ct. Ch. R. 8(c), and matters beyond the Complaint (and the documents integral to the Complaint's allegations). The Court, accordingly, is called upon to answer two questions: (i) whether material facts are in dispute, and (ii) whether the Defendants, as the moving parties, are entitled to judgment as a matter of law. The material facts are not in dispute.

[2] U.S. CONST. art. IV, § 1 ("Full Faith and Credit shall be given in each State to the . . . judicial proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such . . . Proceedings shall be proved, and the Effect thereof."); *see* 28 U.S.C. § 1738, known as the Full Faith and Credit Act or the Federal Res Judicata Act (The "judicial proceedings [of any State] . . . shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken.").

[3] The Defendants have not argued that this action should be dismissed as a matter of comity or judicial efficiency. They argue that they are entitled to dismissal as a matter of right as conferred by the full faith and credit clause.

I.

Robert Zadra ("Zadra") brought an action, both derivatively and as a putative class representative, in the Supreme Court of the State of New York (the "New York Action")[4] seeking remedies for the same wrongs alleged in the Delaware Action's governing complaint.[5] The defendants in the New York Action, also Defendants in this action, and Zadra negotiated a settlement (the "Amended Stipulation of Settlement"). By Order and Judgment, filed January 8, 2004 (the "New York Order"), the Amended Stipulation of Settlement was approved.[6] The Lead Plaintiff in the Delaware Action and others objected to the proposed settlement; those objections were rejected.[7]

In order to ascertain the effect of the New York Order on this action, it is first necessary to set forth its pertinent terms. In addition to approving the Amended

[4] *Zadra v. McNamara*, Index No. 01-604859.
[5] The Complaint in this consolidated action alleges that individual defendants breached their fiduciary duties to Nominal Defendant National Auto Credit, Inc., a Delaware corporation ("NAC"). The claims are summarized in *In re National Auto Credit, Inc. S'holders Litig.*, 2003 WL 139768 (Del. Ch. Jan. 10, 2003). This action is the product of the consolidation of three actions. Academy Capital Management, Inc. ("ACM") was designated as Lead Plaintiff.
[6] The Amended Stipulation of Settlement and the New York Order may be found in Defs.' Mot. to Dismiss, Ex. A.
[7] The New York Order has been appealed. Defs.' Reply Br. Ex. B.

Stipulation of Settlement as "fair and reasonable and in the best interests of NAC, its shareholders and the members of the Class," the New York Order provides in part:

> 2. In light of the pending consolidated derivative action filed in the Court of Chancery for the State of Delaware, entitled "*In re National Auto Credit, Inc. Shareholders Litigation*," C.A. No. 19028 NC ("the Consolidated Derivative Action"), and the requirement of the Amended Stipulation of Settlement that such Consolidated Derivative Action be dismissed with prejudice before the entry of the Final Order and Judgment in this Action, the parties hereto are hereby directed to take all reasonable steps necessary to procure the immediate dismissal with prejudice of the Consolidated Derivative Action.
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> 3. Pending receipt by the Court of notification that there has been entered a final, nonappealable order dismissing with prejudice the Consolidated Derivative Action, all discovery and other pretrial proceedings in the Action are stayed . . .
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> 4. Upon notification to the Court that there has been entered a final, non-appealable order and judgment by the Delaware Chancery Court and any applicable court of appellate jurisdiction in Delaware dismissing with prejudice the Consolidated Derivative Action, this Court will issue its Final Order and Judgement, which will order the parties to forthwith perform the provisions of the Amended Stipulation Settlement as follows:
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> > a. Ordering Defendants . . . , to make the payments from the Settlement Fund . . . and to otherwise effectuate the remaining terms of the Settlement . . .
> >
> > b. Ordering the Amended Derivative and Class Action Complaint in this Action be dismissed with prejudice. . . .
> >
> > c. Ordering that the named plaintiff in this Action, NAC, all members of the Class previously certified by this Court and all other shareholders of NAC [which would include the Delaware Plaintiffs]

> are barred and permanently enjoined from prosecuting against the Settling Defendants . . . any class, representative, derivative, or individual claim, known or unknown, which has been or could have been asserted in the Action, the Consolidated Derivative Action, or in any other court or forum in connection with, arising out of or in any way related to any acts, facts, transactions, occurrences, representations or omissions set forth, alleged, embraced or otherwise referred to in the Amended Derivative and Class Action Complaint in this Action, the Consolidated Derivative Action, and the Amended Stipulation of Settlement. . . .
>
> . . . .
>
> 6. This Court shall retain exclusive jurisdiction over the action and the parties to the Amended Stipulation of Settlement to enter any further orders as may be necessary to enforce the Amended Stipulation of Settlement, the settlement provided for therein and the provisions of this Conditional Final Order and Judgment.

II.

In accordance with 28 U.S.C. § 1738, "all courts [must] treat a state court judgment with the same respect that it would receive in the courts of the rendering state."[8] Thus, the New York law of res judicata governs whether the New York Order must be given claim preclusion effect in this action.[9] In New York, it is an "established rule that a dismissal on the merits of one derivative action is generally a bar to suits by

[8] *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 373 (1996).
[9] *Horsehead Indus., Inc. v. Paramount Communications, Inc.*, 258 F.3d 132, 141-42 (3d Cir. 2001).

other stockholders of the same corporation on the same cause of action."[10] In order for a judgment to be accorded res judicata effect under the law of New York, it must be "final."[11] Unfortunately, the concept of finality varies with the context, and no one simple formulation can capture its full essence.

> Whether a judgment, not "final" in the sense of 28 U.S.C. § 1291, ought nevertheless be considered "final" in the sense of precluding further litigation of the same issue, turns upon such factors as the nature of the decision (i.e., that it was not avowedly tentative), the adequacy of the hearing, and the opportunity for review. "Finality" in the context here relevant may mean little more than that the litigation of a particular issue has reached such a stage that a court sees no really good reason for permitting it to be litigated again.[12]

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[10] *Auerbach v. Bennett*, 393 N.E.2d 994, 998-99 (N.Y. App. Div. 1979).

[11] *Reilly v. Reid*, 379 N.E.2d 172, 174 (N.Y. 1978). "Judicial actions must achieve a basic minimum quality to become eligible for res judicata effects. The traditional words used to describe this quality require that there be a judgment that is valid, final, and on the merits." 18A WRIGHT, MILLER & COOPER, FEDERAL PROTECTION AND PROCEDURE: JURISDICTION 2d § 4427, at 4 (2002).

[12] *Lummus Co. v. Commonwealth Oil Ref. Co.*, 297 F.2d 80, 89 (2d Cir. 1962). Although ACM expresses displeasure with certain procedural aspects of the New York Action, it does not present, for this Court's purposes, a viable challenge to the adequacy of the hearing(s) in which it participated. In addition, its appeal of the New York Order confirms the existence of an opportunity for review. That ACM and other objectors appealed the New York Order raises two questions. First, the pendency of the appeal does not deprive the New York Order of any res judicata effect. *See Horsehead Indus., Inc.*, 258 F.3d at 141-42 (citing *In re Amica Mut. Ins. Co.*, 445 N.Y.S.2d 820, 822 (App. Div. 1981)). Second, there is something of an argument that if the New York Order can be appealed, as it was, then that order should be considered final for preclusion purposes. That an appeal has been taken, however, does not demonstrate that a claim has been determined finally because orders that fall far short of being "final" may be appealed for varying reasons under state procedural rules. An appeal taken (with the appellate

III.

The starting point for any analysis of a court's order, of course, is with the language of the order.[13] The Defendants properly counsel the Court not to isolate its consideration of the New York Order to certain words but to view the order comprehensively and in the context in which it was issued – after a contested settlement proceeding. Paragraph 2 of the New York Order recites that the Delaware Action must "be dismissed with prejudice before entry of the Final Order and Judgment in [the New York Action]." Similarly, by Paragraph 4 of the New York Order, after the Delaware Action has been dismissed without the possibility of any appeal, the "Final Order and Judgment" will be entered in the New York Action, and, then, and only then, will the benefit of the settlement be distributed. Finally, in Paragraph 6, the New York Order is referred to as the "Conditional Final Order and Judgment." The use of the word

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jurisdiction not at issue) under rules that define a final judgment for appeal purposes as one "which determines the merits of the controversy or the rights of the parties and leaves nothing for future determination of consideration," *Showell Poultry, Inc. v. Delmarva Poultry Corp.*, 146 A.2d 794, 796 (Del. 1958), would be a significant factor in determining finality for res judicata purposes. That degree of finality is not present here. *See* Tr. of Oral Arg. 6-8. On the other hand, that "degree of finality" is not required because "[f]inality for the purposes of res judicata is not as strict as the requirements of finality for the purposes of bringing an appeal." *Yaba v. Roosevelt*, 961 F. Supp. 611, 622 n.3 (S.D.N.Y. 1997).

[13] *See, e.g.*, *Dudick v. Gulyas*, 770 N.Y.S.2d 924, 925 (App. Div. 2004).

"conditional" and the recognition that another order will be necessary suggests a degree of tentativeness. Conversely, a "final" order for res judicata purposes need not be the "last" order to be entered in the case.

As a substantive matter, the New York Order's disposition of the claims is expressly conditioned upon this Court's first dismissing the Delaware Action. The dismissal, however, of the Delaware Action is not a mere ministerial act.[14] The decision to give res judicata (or collateral estoppel) effect to the judgment of another court may require inquiry into many issues: for example, whether the judgment was final and valid; whether there was a full and fair opportunity to be heard; whether the issues were the same.[15] The New York Order can, by its terms, be of no dispositive effect until another court (and the appellate jurisdiction reviewing it as well) has terminated the other litigation. Thus, the dispositive nature of the New York Order has no viability until the Delaware judicial system has acted. Accordingly, by its terms – the mechanism which gives substance to the New York Order – the New York Order is conditional; it is

[14] The New York Order directs that "parties [to the New York Action] to take all reasonable steps necessary to procure the immediate dismissal with prejudice of [the Delaware Action.]" The grounds for obtaining dismissal are not set forth. It perhaps should be noted that not all of the Plaintiffs in the Delaware Action appeared to object to the settlement in New York; therefore, not all of the Plaintiffs in the Delaware Action can be considered parties in the New York Action.

[15] *See, e.g., Horsehead Indus., Inc.*, 258 F.3d at 141-47.

conditioned on an inquiry by another court that is far more than an administrative or ministerial act. As such, the New York Order is "avowedly tentative" as to dismissal of the derivative claims.

The Defendants' sponsorship of the New York Order suffers from yet another fundamental misunderstanding of the nature of res judicata. The Defendants – openly and candidly – are seeking to have the claim preclusive effect of the New York Order determined in advance of entry of a judgment that would obligate them to make any settlement distribution.[16] The Defendants, however, are not entitled to have the claim preclusive effect of the New York Order resolved in the New York Action. "It is well settled that the court adjudicating a dispute cannot predetermine the res judicata effect of its own judgment."[17] The Defendants now seek for the process to be reversed.[18] That the determination of the res judicata effect is sought before they become obligated under the

[16] The record provides some insight into the process that resulted in the conditioning of the New York Order on the dismissal of the Delaware Action. The insurance carrier, as part of the bargaining effort resulting in the Settlement Agreement, insisted upon a policy release from the Defendants, and the Defendants were unwilling to deliver a release to the carrier until the Delaware Action was dismissed. Tr. of Oral Arg. 12-15.

[17] 7B WRIGHT, MILLER & KANE FEDERAL PRACTICE AND PROCEDURE: CIVIL 2d § 1789, at 245 (1986).

[18] The Defendants have not pointed to any authority which concludes that a judgment, expressly conditioned upon the prior granting of relief by a court of another state, has been given preclusive effect to bar the claims asserted by others. Of course, that it has not been done before does necessarily mean that it cannot be done now.

terms of the New York Order is just further evidence that the New York Order is neither final nor entitled to res judicata effect.

The Defendants properly emphasize that finality is neither a precise nor a rigid concept. Yet, they focus on the concept of finality as it has developed in the context of issue preclusion.[19] In that context, for example, a specific factual issue has been resolved or the question of liability has been answered.[20] The proposed settlement of the derivative claims at issue in the New York Action was found to be fair and reasonable. If that were the issue before this Court, then, as a matter of issue preclusion, this Court might well be bound by that determination because it was unconditional. That, however, is not the judicial determination that this Court is being told it must accept. Instead, this Court is being asked to apply principles of claim preclusion to dismiss the Delaware Action with prejudice before the New York Action has been dismissed. This is not an action which, at least in this Court's judgment, the other courts of New York would take

[19] "It is widely recognized that the finality requirement is less stringent for issue preclusion than for claim preclusion." *Christo v. Padgett*, 223 F.3d 1324, 1339 (11th Cir. 2000). *See also Pure Distrib., Inc. v. Baker*, 285 F.3d 150, 156-57 n.5 (1st Cir. 2002). *But see* 18A WRIGHT, MILLER & COOPER, FEDERAL PRACTICE & PROCEDURE: JURISDICTION 2d § 4434, at 128-31 (2002) (suggesting that "finality" for claim preclusion purposes may be relaxed as has occurred with respect to issue preclusion).

[20] *See, e.g.*, *Horsehead Indus., Inc.*, 258 F.3d at 141-47; *Hennessy v. Cement & Concrete Worker's Union*, 963 F. Supp. 334, 338-39 (S.D.N.Y. 1997).

and, thus, this Court is neither required nor permitted to take it pursuant to 28 U.S.C. § 1738.[21]

IV.

The Defendants are not willing to resolve the representative claims in New York unless the Delaware Plaintiffs are first told by a Delaware court, with finality and after the expiration of any potential period for an appeal, that their claims may not be pressed. The Delaware courts, however, have neither reason nor power to inform the Delaware Plaintiffs that their claims are barred by the New York Order unless that judgment is final. However, by its terms, the New York Order is not final. Indeed, it is expressly conditioned upon a happening in this Court.

The conclusion that this action cannot now be dismissed is not the product of any lack of respect for the courts of New York and their judgments. This is not a question of comity or judicial efficiency. It is not a question committed to this Court's discretion. It is simply that this Court cannot deny the Delaware Plaintiffs their opportunity to pursue their claims unless it is required to do so by the full faith and credit clause. Because the

[21] ACM has also moved to vacate this Court's stay of discovery in this forum. That action would not only not accord due deference to the New York Order but also would likely lead to an unwise allocation of resources because of the potential for settlement in New York. Accordingly, ACM's motion is denied, without prejudice.

judgment is "avowedly" conditioned upon an act of this Court, the New York Order is not final for these purposes.

Accordingly, the Defendants' motion to dismiss this action is denied.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Brian P. Glancy, Esquire
Register in Chancery-NC