

Stays of Derivative Actions Pending Resolution of Related Securities Class Actions

April 10, 2025

Editor's note: Authored by Amanda Main, Tijana Brien and Tara Levens, this article was originally published in the [American Bar Association's Class Action & Derivative newsletter](#)

Companies facing securities class actions also often face one or more derivative lawsuits based on the same underlying facts. But simultaneously litigating securities class actions and derivative lawsuits can lead to complications, inefficiencies, prejudice to defendants, and inconsistent rulings. This is why parties typically agree to stay derivative lawsuits pending the resolution of related securities class actions. When the parties do not agree, defendants seek, and usually obtain, such relief from the court. In the rare cases where courts deny a motion to stay, it is often due to the unique procedural posture of a case or because the derivative claims raise issues of state law or are not based on the same core conduct at issue in the related securities class action.

What are follow-on derivative actions?

A derivative action is a lawsuit brought by one or more shareholders on behalf of a company. In many cases, derivative actions “follow on” a related securities class action, meaning they are based on the same conduct as the securities class action. However, unlike the securities class action, which involves claims under federal securities laws, derivative actions typically involve claims of breaches of fiduciary duties, corporate waste and/or unjust enrichment.

Follow-on derivative lawsuits have become increasingly common. Forty-seven percent of securities class action settlements between 2019 and 2023 were accompanied by a follow-on derivative action. Laarni T. Bulan & Matthew Davis, *Parallel Derivative Action Settlements Outcomes: 2023 Review and Analysis*, Cornerstone Research 1, <http://bit.ly/43hzOlp> (last visited Feb. 28, 2025). Unsurprisingly, due to the number of companies incorporated in Delaware, the Delaware Court of Chancery is the most popular forum for derivative actions, followed by the United States District Courts for the District of Delaware, Northern District of California, and Southern District of New York, *id.* at 3.

Why staying follow-on derivative actions pending resolution of securities class actions makes sense.

There are several reasons why it makes sense to stay a follow-on derivative action pending the resolution of the related securities class action. To begin, since the allegations in the two actions arise from the same set of facts, they often involve the same witnesses and evidence. If the cases proceeded simultaneously, this would lead to inefficiencies and potentially conflicting rulings.

Further, the outcome of the securities class action may affect the outcome of the derivative action as follow-on derivative lawsuits typically seek indemnification for amounts paid in the related securities class action, meaning that liability in the derivative lawsuit is contingent on the outcome of the class action. If the securities class action is dismissed, there may be no basis for a derivative lawsuit premised on the same allegations.

Moreover, if both suits proceed contemporaneously, the company (on whose behalf and in whose interests the derivative lawsuit is brought) may be prejudiced. For example, a corporation may be defending its officers and directors in the securities class action while the derivative plaintiff, on behalf of the company, attempts to discredit the same officers and directors in the derivative lawsuit. Similarly, if derivative plaintiffs succeed in their claims before the class action is resolved, the officers' liability could be imputed to the corporation, undermining the company's defenses in the class action.

Given the overlap, staying a derivative lawsuit pending the resolution of a related securities class action preserves both judicial and corporate resources and protects the company's and officers' ability to defend themselves in both cases.

Delaware Chancery Court takes a practical approach to assessing whether a stay is warranted.

Most derivative suits are brought in the Delaware state court, as most public companies are incorporated under Delaware law. The Delaware Court of Chancery assesses a motion to stay under its “inherent power” “to exercise its discretion to control the disposition of actions on its docket in order to promote economies of time and effort for the court, litigants, and counsel,” which must only be exercised “rationally.” *Brenner v. Albrecht*, 2012 WL 252286, at *4 (Del. Ch. Jan. 27, 2012) (internal quotations omitted). In performing this analysis, the Chancery Court considers the “practical considerations that make it unduly complicated, inefficient, and unnecessary for the action before it to proceed ahead or apace of a related litigation” versus the “prejudice Plaintiff will suffer if the motion is granted.” *Id.*

The Chancery Court also sometimes invokes the *McWane* doctrine, which provides that the court’s discretion to grant a stay should be freely exercised where “there is a prior action pending elsewhere, in a court capable of doing prompt and complete justice, involving the same parties and the same issues” *McWane Cast Iron Pipe Corp. v. McDowell Wellman Eng’g Corp.*, 263 A.2d 281, 283 (Del. 1970).

1. Practical considerations warranting a stay

The Chancery Court is often swayed by several key considerations, including: (1) the risk of prejudice to the company if forced to simultaneously defend against the securities class action and prosecute the same individuals in the follow-on derivative litigation; (2) the contingent nature of the relief requested in the follow-on derivative litigation; and (3) judicial economy.

One of the most often cited cases on this point, *Brudno v. Wise*, involved allegations that directors and officers breached their fiduciary duties by committing or failing to prevent violations of federal securities laws that were asserted in a separate securities class action. 2003 WL 1874750, at *1 (Del. Ch. Apr. 1, 2003). The Chancery Court granted defendants’ motion to stay the derivative action pending resolution of the earlier-filed federal securities class action because the derivative suit “largely turns on the outcome of the Federal Securities Action.” *Id.* at *4. The Chancery Court noted that if the securities class action led to the “exoneration of and the other defendants . . . it is not apparent what, if anything, would be left of this Action.” *Id.* As such, the Chancery Court concluded that the “interests of litigative efficiency, judicial economy, and comity” all “weigh heavily in favor of” a stay. *Id.* at *5.

Likewise, in another often-cited case, *Brenner v. Albrecht*, the plaintiff alleged the company’s directors and officers breached their fiduciary duties, leading to misstatements in, and later restatements of, the company’s financial statements – the same conduct at issue in the related federal securities class action. 2012 WL 252286, at * 2-3. The Chancery Court relied on two “practical considerations” in deciding to stay the derivative action: (1) the risk of prejudicing the company’s defense of the securities class action; and (2) the contingent nature of the relief sought. *Id.* at *4, *6. The court explained that proceeding with both actions would be “unduly complicated, inefficient, and unnecessary,” would “create will prejudice” the company, and would create “a risk of inconsistent rulings.” *Id.* at *6. As to the contingent nature of the relief, the court also noted that, “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 securities class action. *Id.* (internal quotations omitted).

Recent cases in the Delaware Court of Chancery continue to rely heavily on the “practical considerations” discussed in *Brudno* and *Brenner*. For example, in *In re Insys Therapeutics, Inc. Derivative Litigation*, the court granted a stay, because the company would otherwise need to adopt “conflicting strategies,” and damages would be uncertain until the federal securities case was resolved. 2017 WL 5953515, at *3 (Del. Ch. Nov. 30, 2017). Similarly, in *In re Emergent Biosolutions Inc.*, the court emphasized the company’s “conflicting litigation aims” if both actions proceeded, that the suits also “partially overlap on the merits,” and that the claims “rely on the same facts,” even though the action was “not exclusively a tag-along indemnification case.” Transcript of Record at 40-42, C.A. No. 2021-0974-MTZ (Del. Ch. Mar. 29, 2022).

In *Laborers’ District Council & Contractors’ Pension Fund of Ohio v. Musk*, the court stayed the derivative action after considering the overlapping issues in a federal securities class action and related action by the U.S. Securities and Exchange Commission (“SEC”), concluding that the derivative claims seek to “adjudicate claims that are, at least in some measure, front and center in both of the pending federal actions,” such that proceeding simultaneously “would be inefficient and could prejudice” the company. Transcript of Record at 39, C.A. No. 2019-0187 (Del. Ch. Mar. 18, 2019). The court noted that any decisions in the derivative litigation “could compromise the company’s defense of the claims” in the federal actions and could “confound that litigation” by presenting “claim or issue preclusion issues that otherwise would not be present.” *Id.* at 41-42.

2. Potential prejudice to plaintiff

Courts also consider prejudice to the plaintiff if a stay is granted, but usually conclude that any prejudice is outweighed by practical considerations favoring a stay. For example, in *Brenner*, the court concluded that “prejudgment interest can redress any harm caused by a delay,” and the discovery process will not be impeded by a stay because the securities class action plaintiffs have a “strong incentive to develop evidence” that will be useful to derivative action plaintiffs. 2012 WL 252286 at *7; see also *In re Insys Therapeutics, Inc. Derivative Litigation*, 2017 WL 5953515, at *3-4 (same).

3. Unique circumstances warranting denial of motion to stay

In the rare case where motions to stay have been denied, courts have pointed to case-specific factors, like the unique procedural posture of the case. For example, in *Saman F. Khoury v. Richard Williams*, the underlying securities class action had settled and was simply awaiting final approval, so the court determined there was no need to stay the derivative litigation. C.A. No. 2022-0077-PAF (Del. Ch. Jul. 6, 2022) (Dkt. No. 60). As another example, in *In re American Apparel, Inc. S’holder Derivative Litig.*, the court declined to stay the derivative lawsuit because it granted the defendants’ motion to dismiss, and the sole remaining question was whether the plaintiff could amend the complaint to state a claim. 2012 WL 9506072, at *46 (C.D. Cal. July 31, 2012).

Finally, where the claims in the derivative action involve self-interested conduct of fiduciaries, distinct from the disclosure issues in the securities class action, courts have denied motions to stay the derivative action to allow the non-disclosure related claims to proceed. For example, in *In re Cytrx Corp. Stockholder Derivative Litigation*, the court refused to stay claims regarding alleged self-dealing by directors and officers who purportedly engaged in a stock option “spring-loading” scheme, which presented “a substantive Delaware law wrong . . . not one of disclosure.” Transcript of Record at 32, C.A. No. 9864-JTL (Del. Ch. Jan. 8, 2015). The court noted that the claim “only rises or falls based on . . . a matter of Delaware law.” *Id.* at 33. The court did, however, still stay claims related to those at issue in the securities class action. *Id.* at 42-43.

Motions to stay in federal courts

Based on data from 2015-2023, the three most popular federal courts for follow-on derivative lawsuits are the District of Delaware, Southern District of New York, and Northern District of California. Bulan & Davis, *Parallel Derivative Action Settlements Outcomes: 2023 Review and Analysis*, Cornerstone Research, at 3.

Like the Delaware Court of Chancery, these courts typically stay follow-on derivative lawsuits.

The District of Delaware uses a three-factor test that evaluates: “1) whether the granting of a stay would cause the non-moving party to suffer undue prejudice from any delay or allow the moving party to gain a clear tactical advantage over the non-moving party; 2) whether a stay will simplify the issues for trial; and 3) whether discovery is complete and a trial date set.” *In re Twitter, Inc. S’holder Derivative Litig.*, 2018 WL 3536085, at *2 (D. Del. July 23, 2018) (granting motion to stay); see also *Janklow v. Alutto*, 2018 WL 6499869, at *2 (D. Del. Dec. 11, 2018) (same); *In re DaVita Inc. S’holder Derivative Litig.*, 2018 WL 3105061, at *3 (D. Del. June 25, 2018) (same).

The Northern District of California uses a similar three-factor test: “(A) the possible damage which may result from the granting of a stay; (B) the hardship or inequity which a party may suffer as a result of denial of a stay; and (C) the orderly course of justice measured in terms of the simplifying or complicating of issues, proof, and questions of law which could be expected to result from a stay.” *In re RH S’holder Derivative Litig.*, 2019 WL 580668, at *2 (N.D. Cal. Jan. 23, 2019) (granting motion to stay).

In the Southern District of New York, since parties typically stipulate to stays, there is less case law. Defendants moving for stays often cite precedent from California and Delaware, and courts granting those motions have focused on efficiency for both the court and litigants. See, e.g., Transcript of Record at 13-15, *In re Citigroup, Inc. S’holder Derivative Litig.*, No. 1:20cv9438 (AJN), (S.D.N.Y. Feb. 16, 2021) (ECF No. 52) (granting motion to stay).

Duration of stays

Courts addressing motions to stay derivative actions also consider the appropriate length of the stay. Most follow-on derivative lawsuits are stayed until final resolution of the related securities class action. This makes sense because, if the derivative lawsuit is, at its core, a claim for indemnification for the conduct at issue in the securities class action, such a claim cannot be assessed until the class action is resolved. Some courts, primarily the District of Delaware, may grant a stay of the derivative action pending the resolution of a motion to dismiss in the securities class action. If the motion to dismiss in the securities class action is denied, then the court can assess whether a further stay is warranted.

In the limited situations where plaintiffs have successfully lifted a stay, the success of the derivative action was not contingent on liability in the securities class action. For example, in *In re MolyCorp, Inc. Shareholder Derivative Litigation*, the plaintiffs moved to lift the stay in a derivative action after the SEC decided not to recommend formal action against the company, and after plaintiffs proposed an amended complaint eliminating many of the claims overlapping with the securities class action. 2014 WL 1891384, at *4 (Del. Ch. May 12, 2014). Given these developments, the court concluded that the allegations “at the heart” of the derivative matter “implicate an evolving and important question of Delaware corporate law” not raised in the federal securities action, and thus lifted the stay. *Id.* at *6.

Conclusion

Courts are no stranger to parallel derivative and securities class actions and recognize the negative consequences, risks, and inefficiencies if both cases proceed simultaneously. To the extent parties do not agree to stay the derivative action, courts usually will grant such relief pending resolution of the securities class action, or at least through the resolution of the motion to dismiss in the first instance, unless there are unique circumstances or different underlying facts at issue.

Contributors



Amanda Main

[Bio](#)



Tijana Brien

[Bio](#)



Tara Levens

[Bio](#)

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