



# SECURITIES REGULATION & LAW



## REPORT

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### FOREIGN CORRUPT PRACTICES ACT

## The Next Wave of FCPA Shareholder Derivative Actions



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### I. Introduction: Heightened FCPA Enforcement and Shareholder Actions

The renewed enforcement of the Foreign Corrupt Practices Act (“FCPA”) by the Department of Justice (“DOJ”) and the Securities and Exchange Commission (“SEC”) has resulted in a record-setting number of FCPA indictments and corporate fines.<sup>1</sup> This

<sup>1</sup> Lanny A. Breuer, Assistant Attorney Gen., Criminal Div., Prepared Address to the 22nd National Forum on the Foreign Corrupt Practices Act 2 (Nov. 17, 2009), [http://](http://www.justice.gov/criminal/pr/speeches/2009/11/09aagbreuer-remarks-fcpa.pdf)

spike will undoubtedly result in an increase in parallel civil litigation. The last surge in enforcement activity concerning improper payments to foreign officials—during the 1970s and 1980s—was accompanied by a wave of related civil litigation, including shareholder class and derivative actions.

This article focuses on key developments in the law relating to shareholder derivative actions since the initial wave of FCPA-related cases and discusses recent relevant decisions on the issue. While derivative plaintiffs will now be armed with a new theory upon which to hold directors and officers liable for FCPA violations,

[www.justice.gov/criminal/pr/speeches/2009/11/09aagbreuer-remarks-fcpa.pdf](http://www.justice.gov/criminal/pr/speeches/2009/11/09aagbreuer-remarks-fcpa.pdf) 11-17-

the burden on a plaintiff to prevail in such litigation remains high.

## II. The First Wave of FCPA-Related Shareholder Derivative Actions

The 1970s and early 1980s saw significant congressional and regulatory focus on payments to foreign officials, politicians, and political parties. This scrutiny led to the enactment of the FCPA in 1977, regulatory investigations, and criminal prosecutions. Shareholders joined in, filing derivative actions to hold directors and officers personally liable to their companies for the purported damages caused by the foreign payments. The derivative complaints typically alleged that the companies' required SEC disclosures had omitted material information—the foreign bribes and kickbacks.

**A. Inadequate Pleading.** Many of the early decisions rejected derivative claims predicated on questionable payments to foreign officials. These cases were principally dismissed for failing to properly plead demand futility<sup>2</sup> or state a federal claim.<sup>3</sup> A number of them involved conduct that predated the FCPA, and thus courts noted that the foreign payments were not apparently illegal.<sup>4</sup>

Later cases arising after the enactment of the FCPA and based on conduct that was unquestionably illegal suffered the same fate. For instance, in *Shields v. Erickson*,<sup>5</sup> the company pled guilty to FCPA violations and paid more than \$100 million in fines. A derivative action followed, alleging, among other things, that the directors and officers were liable for violating the books and records provision of the FCPA.<sup>6</sup> Yet despite the admitted illegal conduct, the court dismissed the complaint as a result of the plaintiff's failure to plead demand futility. The court reasoned that the complaint simply lacked any particularized facts of director self-dealing,

bias, or knowledge of the wrongdoing.<sup>7</sup> The court also voiced commonly expressed judicial skepticism regarding derivative cases: “[D]erivative actions brought by minority stockholders could, if unconstrained, undermine the basic principle of corporate governance that the decisions of a corporation—including the decision to initiate litigation—should be made by the board of directors.”<sup>8</sup>

However, at least two courts during this time period found that the derivative plaintiffs had sufficiently alleged demand futility. In *Miller v. Loucks*,<sup>9</sup> the court excused the demand because of the egregious nature of the alleged underlying conduct. These acts included violations of the FCPA, affiliation with alleged terrorists, and aid to a terrorist country.<sup>10</sup> And demand was also excused in *Burt v. Danforth*,<sup>11</sup> under Maryland law, because the complaint alleged futility based on the assertion that the directors would not authorize litigation, which would amount to a suit against themselves. The *Burt* court's view is clearly in the minority on this point.<sup>12</sup> These decisions illustrate the fact-specific analysis of demand futility, as well as the different approaches that states take on the issue.<sup>13</sup> While many states look to Delaware for guidance on handling derivative actions and corporate governance issues, many states have imposed their own gloss on such matters.

**B. Special Committee Cases.** A number of companies faced with derivative actions based on allegations of improper foreign payments appointed a special committee of the board of directors (commonly referred to as a special litigation committee (“SLC”)) to investigate the merits of the claims asserted in the derivative complaint.<sup>14</sup> The SLC process, a relatively new corporate

<sup>7</sup> *Id.* at 692.

<sup>8</sup> *Id.* at 691 (quoting *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523 (1984)).

<sup>9</sup> No. 91 C 6539, 1992 WL 329313 (N.D. Ill. Nov. 5, 1992).

<sup>10</sup> *Id.* at \*5, \*8.

<sup>11</sup> 742 F. Supp. 1043 (E.D. Mo. 1990).

<sup>12</sup> See, e.g., *Aronson v. Lewis*, 473 A.2d 805, 818 (Del. 1984) (“Plaintiff's final argument is the incantation that demand is excused because the directors otherwise would have to sue themselves, thereby placing the conduct of the litigation in hostile hands and preventing its effective prosecution. This bootstrap argument has been made to and dismissed by other courts.”).

<sup>13</sup> *Shields* and *Miller* both relied, at least in part, on Delaware law. *Burt* was decided under Maryland law. In contrast to Delaware law, the *Burt* court ruled that merely naming a director as a defendant would be enough to establish demand futility. Compare *Shields*, 710 F. Supp. at 692 (“The only self-interest plead [sic] is that the directors would not want to bring this suit because it would subject them to liability. This is insufficient to excuse demand.”), with *Burt*, 742 F. Supp. at 1048 (“Thus, plaintiff suggests a situation where the Board would have to sue itself for engaging in illegal activity. As such, according to Maryland law, plaintiff has provided sufficient reasons excusing a prior demand on the Board.”). Since *Burt*, Maryland appears to have narrowed the circumstances under which demand may be deemed futile. See generally *Werbowsky v. Collomb*, 766 A.2d 123 (Md. 2001).

<sup>14</sup> See, e.g., *Rosengarten v. Int'l Tel. & Tel. Corp.*, 466 F. Supp. 817 (S.D.N.Y. 1979) (upholding board committee's decision to terminate derivative action); *Gall v. Exxon Corp.*, 418 F. Supp. 508, 509-10 (S.D.N.Y. 1976) (SLC formed in response to shareholder derivative complaint alleging \$59 million were improperly paid to foreign entities); *Auerbach v. Bennett*, 47 N.Y.2d 619 (1979); *Falkenberg v. Baldwin*, 1980

<sup>2</sup> Before commencing a derivative action, a plaintiff must generally issue a demand on the board of directors to pursue the purported cause of action or set out why making a demand would be futile. See *infra* Section III.B. Rule 23.1 of the Federal Rules of Civil Procedure and many similar state rules require that demand futility allegations be pled with particularity. See, e.g., Del. Ch. Ct. R. 23.1(a); N.Y. Bus. Corp. Law § 626(c). In federal cases, while the federal rule governs pleading, state law provides the substantive standard. *Halebian v. Berv*, 590 F.3d 195, 211 (2d Cir. 2009).

<sup>3</sup> *Lewis v. Valley*, 476 F. Supp. 62 (S.D.N.Y. 1979) (dismissing the complaint on grounds of failure to plead demand futility and a federal securities law claim related to alleged proxy violations); *In re Tenneco Sec. Litig.*, 449 F. Supp. 528, 530-32 (S.D. Tex. 1978) (dismissing federal securities claim based on foreign and domestic bribes and political contributions); *Lewis v. Elam*, No. 76 Civ. 1769, 1977 WL 1008 (S.D.N.Y. Apr. 5, 1977) (dismissing proxy violation for questionable foreign payments for failing to show causation); *Levy v. Johnson*, No. 76 Civ. 1178, 1977 WL 931 (S.D.N.Y. Feb. 15, 1977) (dismissing proxy violation claim because the alleged improper payments were not the subject of the proxy solicitation). After dismissing the federal claims, many of the courts dismissed the pendant state law claims for lack of jurisdiction without further discussion. See, e.g., *Valley*, 476 F. Supp. at 67; *Johnson*, 1977 WL 931, at \*2.

<sup>4</sup> See, e.g., *Valley*, 476 F. Supp. at 65 (finding that payments were not illegal under U.S. or foreign law).

<sup>5</sup> 710 F. Supp. 686 (N.D. Ill. 1989).

<sup>6</sup> *Id.* at 687-88.

device at the time, is an extension of the business judgment rule to the litigation context. It allows a board to empower a special committee of independent directors to respond to shareholder claims by determining whether pursuit of the requested litigation is in the best interests of the corporation. An SLC may choose to pursue the allegations in the derivative complaint on behalf of the corporation,<sup>15</sup> elect to settle the claims, move to terminate the case, or employ some combination of these options.

The standards of review of an SLC's decision vary from state to state, but the courts generally defer to the committee, assuming it conducted an independent, good faith, and reasonable investigation.<sup>16</sup> In *Auerbach v. Bennett*,<sup>17</sup> the leading SLC case in New York, GTE Corporation's predecessor launched an internal investigation to determine whether company employees had made any improper foreign payments.<sup>18</sup> The audit committee uncovered that \$11 million had been paid in bribes and kickbacks in the United States and abroad.<sup>19</sup> An SLC was created to determine whether GTE should pursue a filed shareholder derivative action. It ultimately decided that litigation was not in the company's best interests and moved to terminate the derivative action.

The court granted the motion to terminate based on the SLC's independent, good faith, and reasonable investigation.<sup>20</sup> The business judgment doctrine precluded the court's review of the SLC's deliberations, conclusions, findings, and considerations, such as the basis for and any harm to the company from the foreign payments.<sup>21</sup> Instead, the court's analysis focused on the individual SLC members' independence as well as the "adequacy and appropriateness of the [SLC]'s investigative procedures and methodologies."<sup>22</sup>

These early decisions involving an SLC's review of allegations predicated on foreign payments made clear that a court may affirm an SLC determination not to pursue demanded litigation even if the underlying conduct is illegal. As one court determined:

The decision not to bring suit with regard to past conduct which may have been illegal is not itself a violation of law and does not result in the continuation of the alleged violation of law. Rather, it is a decision by the directors of the corporation that pursuit of a cause of action based on acts already consummated is not in the best interest of the corporation.<sup>23</sup>

WL 4655 (N.Y. Sup. Ct. Mar. 3, 1980) (SLC formed to review allegations of foreign payments).

<sup>15</sup> *In re Take-Two Interactive Software, Inc. Derivative Litig.*, No. 1:06 Civ. 5279, 2009 WL 1066251 (S.D.N.Y. Apr. 21, 2009); Complaint, *Comverse Tech., Inc. v. Alexander*, No. 08/600142, 2008 WL 5414566 (N.Y. Sup. Ct. Jan. 16, 2008).

<sup>16</sup> Delaware law provides the court discretion to apply its own independent business judgment to the SLC's determination. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1981). Three variations to this general rule are found under Delaware law, New York law, and the Model Business Corporation Act. See *infra* section V.

<sup>17</sup> 47 N.Y.2d 619 (1979).

<sup>18</sup> *Id.* at 624.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 631-32.

<sup>21</sup> *Id.* at 631, 633, 634.

<sup>22</sup> *Id.* at 634.

<sup>23</sup> *Gall v. Exxon Corp.*, 418 F. Supp. 508, 518 (S.D.N.Y. 1976) (footnote omitted); see *Rosengarten v. Int'l Tel. & Tel. Corp.*, 466 F. Supp. 817, 829 (S.D.N.Y. 1979) ("[W]e find that

### III. Key Developments Since the First Wave

**A. A Failure-To-Monitor Claim.** The focus of allegations in the early cases was the purported active participation in or approval of the wrongful conduct by the defendants. Today, derivative plaintiffs will likely attempt to hold directors and officers liable for FCPA violations under the theory—not fully developed in the 1970s and 1980s—that they failed to monitor the corporation's legal risks. Subsequent to the first wave of cases, the Delaware Chancery Court decided *In re Caremark International, Inc. Derivative Litigation*.<sup>24</sup> This landmark case set out what has become the standard for liability based on a director's or officer's failure of oversight responsibility. Caremark International, Inc. ("Caremark"), a health service provider, came under investigation by federal and state agencies for improperly inducing doctors to refer Medicare and Medicaid patients to Caremark. The company was ultimately indicted and pled guilty to mail fraud, in part, as a result of significant payments intended to induce a doctor to distribute a drug marketed by Caremark.

Shortly thereafter, several shareholder derivative complaints were filed alleging that the Caremark directors had breached their fiduciary duties by failing to oversee Caremark employees or institute remedial action, i.e., liability premised on "unconsidered inaction," as opposed to an affirmative board decision.<sup>25</sup> The court explained that the duty to monitor includes the board's ability "[to] assure [itself] that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance."<sup>26</sup> The court then set the standard, premised on bad faith conduct, for determining oversight liability: "[A] sustained or systematic failure of the board to exercise oversight."<sup>27</sup>

The Delaware Supreme Court in *Stone v. Ritter*<sup>28</sup> later approved this standard and affirmed the predicate conditions for Caremark liability: "(a) [T]he directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."<sup>29</sup> In both cases, liability is predicated on a "showing that the directors knew that they were not discharging their fiduciary obligations."<sup>30</sup> *Stone* also explained that the duty of good faith, which underlies a

the Committee's decision not to pursue these lawsuits was made in the exercise of its bona fide business judgment. This finding does not deal with the propriety or impropriety of the practices which are the subject of the lawsuits. It is based solely on the Committee's conclusion that the prosecution of these actions would cause more harm than benefit to [the company] and its stockholders."

<sup>24</sup> 698 A.2d 959, 970 (Del. Ch. 1996).

<sup>25</sup> *Id.* at 968.

<sup>26</sup> *Id.* at 970.

<sup>27</sup> *Id.* at 971.

<sup>28</sup> 911 A.2d 362 (Del. 2006).

<sup>29</sup> *Id.* at 370.

<sup>30</sup> *Id.* This duty applies equally to directors and officers. *Gantler v. Stephens*, 965 A.2d 695, 708-09 (Del. 2009).

Caremark claim, is not on the same footing as the duties of care and loyalty, but rather is a “ ‘subsidiary element’ ” of the duty of loyalty.<sup>31</sup>

**B. Pleading a Failure-To-Monitor Claim.** Generally, a derivative plaintiff must assert in its complaint either (1) wrongful refusal, i.e., that the board of directors wrongfully refused its demand that the corporation bring suit<sup>32</sup> or (2) demand futility, i.e., that the pre-suit demand on the board to take action would have been futile.<sup>33</sup> For *Caremark* claims, the leading Delaware Supreme Court decision, *Rales v. Blasband*,<sup>34</sup> requires a court “[to] determine whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.”<sup>35</sup> A derivative plaintiff may raise a reasonable doubt as to the directors’ ability to exercise disinterested business judgment by demonstrating that their failure to monitor has subjected them to a “substantial threat of personal liability.”<sup>36</sup>

#### IV. The Second Wave of FCPA-Related Shareholder Derivative Actions

During the first wave, plaintiffs, SLCs, and courts focused on the directors’ or officers’ participation, approval, or knowledge of the foreign payments.<sup>37</sup> *Caremark*, however, provides a theory of liability even as to directors or officers who were not directly implicated in the foreign payments made in violation of the FCPA.<sup>38</sup> But an oversight claim “is possibly the most difficult theory in corporation law upon which a plaintiff might

hope to win a judgment.”<sup>39</sup> This was recently illustrated by a shareholder derivative action brought against Baker Hughes for its admitted FCPA violations.<sup>40</sup>

That action stemmed from alleged and admitted FCPA violations between 1999 and 2007. Baker Hughes had discovered, investigated, and self-reported these violations to the DOJ and the SEC, including claims of foreign payments to settle a tax dispute and obtain certain permits and government approval of a merger.<sup>41</sup> Baker Hughes consented to the entry of a cease and desist order with the SEC and adopted enhanced FCPA policies and procedures. The enhancements included a revision of the company’s standard of conduct and FCPA policy, the creation of a panel to assist the company in establishing best FCPA practices, and the establishment of a disclosure control and internal control committee. Finally, in April 2007 Baker Hughes agreed to pay \$44 million to settle claims with the DOJ and the SEC based on payments made to foreign agents in several countries.<sup>42</sup>

The plaintiffs filed their derivative complaint alleging that the directors and officers had breached their duty of loyalty by failing to monitor Baker Hughes’s legal risks, i.e., compliance with the FCPA.<sup>43</sup> Plaintiffs also alleged demand futility under Delaware law (where Baker Hughes is incorporated). Under Rule 23.1 of the Federal Rules of Civil Procedure and *Rales*, the plaintiffs were required to plead, with particularity, facts demonstrating that the board could not have “properly exercised its independent and disinterested business judgment in responding to demand.”<sup>44</sup> Thus the plaintiff had to plead facts showing “that the directors ‘knew that they were not discharging their fiduciary obligations’ and that they failed to act ‘in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities.’ ”<sup>45</sup>

The court found the plaintiffs’ allegations inadequate. It reasoned that the substantial amount of evidence demonstrating compliance with the duty to supervise failed to support a finding that the board had con-

<sup>31</sup> *Stone*, 911 A.2d at 369-70 (quoting *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)).

<sup>32</sup> Under Delaware law a derivative complaint establishes wrongful refusal if it pleads facts that create a reasonable doubt that the board’s decision is protected by the business judgment rule. *Levine v. Smith*, 591 A.2d 194, 211-12 (Del. 1991). The good faith and reasonableness of the board’s review of the shareholder’s demand are at issue. *Id.* at 212. A similar standard applies in New York. New York Jurisprudence § 1229.

<sup>33</sup> The Model Business Corporation Act, though, lists at least twenty states as having adopted a universal demand statute. This law requires a demand in all but the most extreme circumstances, such as where the corporation will be irreparably injured if action is not immediately taken. Model Bus. Corp. Act § 7.42 & cmt. at 7-320 to -321 (2008); *Hawaii Structural Ironworkers Pension Trust Fund v. Belda*, No. 08-0614, 2008 WL 2705548 (W.D. Pa. July 9, 2008) (dismissing FCPA shareholder derivative complaint under Pennsylvania’s universal demand statute).

<sup>34</sup> 634 A.2d 927 (Del. 1993).

<sup>35</sup> *Id.* at 934. If the shareholder challenges a board action or transaction, the *Aronson* test is applied. *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). The leading case in New York is *Marx v. Akers*, 88 N.Y.2d 189 (1996).

<sup>36</sup> *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106, 121 (Del. Ch. 2009).

<sup>37</sup> See, e.g., *Auerbach v. Bennett*, 47 N.Y.2d 619, 631 (1979); *Genzer v. Cunningham*, 98 F. Supp. 682, 696 (E.D. Mich. 1980).

<sup>38</sup> *Midwestern Teamsters Pension Trust Fund v. Deaton*, No. H-08-1809, 2009 U.S. Dist. LEXIS 50521, at \*22 n.5 (S.D. Tex. May 7, 2009), adopted, Dkt. No. 49 (May 26, 2009).

<sup>39</sup> *In re Caremark Int’l Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996). Courts have recently articulated a significant distinction between *Caremark* claims brought for an alleged failure to monitor legal risks and an alleged failure to monitor business risks. E.g., *In re Citigroup*, 964 A.2d 106; *In re Citigroup Inc. S’holder Derivative Litig.*, No. 07 Civ. 9841, 2009 WL 2610746 (S.D.N.Y. Aug. 25, 2009). In the *Citigroup* Delaware action, the Delaware Chancery Court rejected the plaintiff’s attempt to hold directors liable for their failure to monitor business risks associated with the bank’s exposure to the subprime mortgage market: “To impose oversight liability on directors for failure to monitor ‘excessive’ risk would involve courts in conducting hindsight evaluations of decisions at the heart of the business judgment of directors. Oversight duties under Delaware law are not designed to subject directors . . . to personal liability for failure to predict the future and to properly evaluate business risk.” *In re Citigroup*, 964 A.2d at 131.

<sup>40</sup> *Midwestern Teamsters*, 2009 U.S. Dist. LEXIS 50521; see also *Hawaii Structural Ironworkers Pension Trust Fund v. Belda*, No. 08-0614, 2008 WL 2705548 (W.D. Pa. July 9, 2008) (dismissing FCPA shareholder derivative complaint).

<sup>41</sup> *Midwestern Teamsters*, 2009 U.S. Dist. LEXIS 50521, at \*4.

<sup>42</sup> *Id.* at \*13-14.

<sup>43</sup> *Id.* at \*14.

<sup>44</sup> *Id.* at \*18.

<sup>45</sup> *Id.* at \*23 (quoting *Stone*, 911 A.2d at 370).

sciously disregarded its duties or acted in bad faith. Specifically, the court cited, among other board actions, the company's revised FCPA policy and worldwide investigation, its self-reporting to the government, and its continuing cooperation with regulators. The court further noted that the complaint lacked any allegations regarding deficiencies in the company's oversight procedures. Indeed, the SEC had apparently supported the company's position that certain foreign payments had been made despite express company policies to the contrary.<sup>46</sup> The court also reiterated that under Delaware law FCPA violations were not per se evidence of bad faith.<sup>47</sup>

Plaintiffs also asserted that the board lacked independence because the directors were subject to liability for ignoring several red flags of inadequate FCPA oversight.<sup>48</sup> But the court disagreed. These purported red flags included the SEC's cease and desist order (entered into as a result of Baker Hughes's self-reporting), employee claims of further FCPA violations at or about the time of the cease and desist order, published accounts of alleged FCPA violations, and the government investigations of the company.<sup>49</sup> According to the court, the red flags by themselves could not establish inadequate oversight or bad faith because the board had acted to improve its compliance capabilities. This conduct was inconsistent with an alleged conscious disregard of oversight duties.<sup>50</sup>

*In re Dow Chemical Co. Derivative Litigation*<sup>51</sup> illustrates a similar point. There, public reports suggested that foreign agents may have been bribed in connection with the company's potential joint venture with Kuwait.<sup>52</sup> As a result, a shareholder derivative complaint was filed, alleging a *Caremark* claim for the board's failure to detect the bribery. The court stated that these bribery allegations were sufficiently particularized to create a reasonable inference that officials may in fact have been bribed.<sup>53</sup> Nevertheless, the court granted the defendants' motion to dismiss the *Caremark* count on demand futility grounds, because the plaintiff had failed to demonstrate bad faith. Importantly, the court explained that bad faith could not be properly pled because the derivative plaintiff had acknowledged that relevant corporate governance procedures were in place "without alleging that the board deliberately failed to monitor [these] procedures."<sup>54</sup>

## V. Special Litigation Committee Jurisprudence

Unlike early FCPA-related derivative cases, today's courts are guided by well-established principles for

evaluating SLC determinations. Under the Delaware standard a court will review the SLC's independence, good faith, and reasonableness.<sup>55</sup> Delaware courts also reserve the right to apply their own independent "business judgment" to the SLC's determination.<sup>56</sup> The New York standard limits the court's discretion, providing for a dismissal upon a showing of an independent and good faith investigation; the committee's substantive decision may not be reviewed by the court.<sup>57</sup>

As of the writing of this article, there were no published decisions concerning an SLC's determination on FCPA-related allegations arising out of the current enforcement activity. This is not surprising, given that SLC investigations themselves often take many months. Nevertheless, courts continue to develop and refine SLC jurisprudence, including in scenarios involving allegations of underlying criminal conduct.

In recent SLC cases the principal issues rightly remain whether the SLC members are disinterested, and whether the SLC conducted a good faith and reasonable investigation. For example, in *In re Take-Two Interactive Software, Inc. Derivative Litigation*,<sup>58</sup> the plaintiffs brought a derivative action against the company's directors and officers, asserting *Caremark* claims based on alleged stock option backdating. The company's chief executive officer, chief accounting officer, and general counsel pled guilty to falsifying business records in connection with the backdating. And the company admitted it "engaged in certain illegal behaviors."<sup>59</sup> An SLC was empowered to investigate the shareholder allegations and recommend action to the board. After its investigation, the SLC moved to terminate the action against certain individuals and assign claims against others to the company.

The derivative plaintiffs urged the court to deny the motion, in part, because it maintained that the SLC was biased and had acted unreasonably and in bad faith. More specifically, the plaintiffs alleged the following flaws in the SLC investigation: (1) the SLC members had failed to conduct the witness interviews or the document review; (2) critical witnesses, who were also defendants, were not interviewed; (3) counsel, not the SLC members, had presented its findings to the board; and (4) the SLC had had only an advisory role rather than the full authority to act on behalf of the company.<sup>60</sup> As to the lawyers' involvement, the court approved of their work as consistent with the functions performed by outside counsel. Additionally, those defendants not interviewed had refused to cooperate;

<sup>55</sup> *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1981); *In re Take-Two Interactive Software, Inc. Derivative Litig.*, No. 1:06 Civ. 5279, 2009 WL 1066251, at \*9-11 (S.D.N.Y. Apr. 21, 2009).

<sup>56</sup> *Zapata*, 430 A.2d at 788-89.

<sup>57</sup> *Auerbach v. Bennett*, 47 N.Y.2d 619, 633-34 (1979); *Ungerleider v. One Fifth Ave. Apartment*, 164 Misc. 2d 118 (N.Y. Sup. Ct. 1995). The Model Business Corporation Act has adopted a standard much like New York's. Model Bus. Corp. Act § 7.44 & cmt. at 7-333 to -334 (2008); *Frank v. LoVetere*, 363 F. Supp. 2d 327 (D. Conn. 2005).

<sup>58</sup> 2009 WL 1066251.

<sup>59</sup> Bloomberg News, *Video Game Maker To Pay \$3 Million To Settle Stock Options Case*, N.Y. Times, Apr. 2, 2009; *Take-Two's Former Chief Sentenced to Probation in Option Backdating Case*, N.Y. Times, Aug. 7, 2007; Matt Richtel, *A Guilty Plea for Options Backdating*, N.Y. Times, Feb. 15, 2007.

<sup>60</sup> 2009 WL 1066251 at \*6, \*8.

<sup>46</sup> *Id.* at \*30.

<sup>47</sup> *Id.* at \*23-24.

<sup>48</sup> Plaintiffs also alleged that the directors and officers lacked independence for several other reasons: (1) they would have had to take action against other directors; (2) their conduct was egregious; and (3) they had material relationships with other directors. *Id.* at \*20. Plaintiffs further claimed that the chief executive officer was interested because named defendants had control over his compensation. *Id.* at \*20, \*39.

<sup>49</sup> *Id.* at \*21-22.

<sup>50</sup> *Id.*

<sup>51</sup> No. 4349-CC, 2010 Del. Ch. LEXIS 2 (Del. Ch. Jan. 11, 2010).

<sup>52</sup> *Id.* at \*12, \*46.

<sup>53</sup> *Id.* at \*47.

<sup>54</sup> *Id.* at \*49 n.85.

there was no assertion that the SLC could or should have compelled their interviews. Finally, the court found no basis under Delaware law that the SLC's lack of complete authority rendered it interested as a matter of law.<sup>61</sup>

## VI. Other FCPA-Related Actions

In the current environment of aggressive FCPA enforcement, an increase in other types of civil FCPA-related actions is likely. For example, if companies take action against employees after their FCPA internal investigations, they should expect employee lawsuits in response. These actions may claim wrongful termination based on the employee's violation of corporate anti-bribery policies. Former employees may also allege that they were terminated for raising concerns about potential FCPA violations.<sup>62</sup> Later, as FCPA criminal and regulatory actions are publicly disclosed, share-

<sup>61</sup> *Id.* at \*8. Another recent case from the Southern District of New York provides a unique analysis of SLC independence issues. In *In re ITT Corp. Derivative Litigation*, 653 F. Supp. 2d 453 (S.D.N.Y. 2009), shareholder derivative actions were filed as a result of the company's guilty plea to federal offenses. Two cases were consolidated. One plaintiff had issued a demand; the other had not. Ultimately, the defendants moved to dismiss as to one plaintiff on the ground that it had failed to adequately plead demand futility. Additionally, the SLC formed to investigate the claims moved to terminate based on a finding that pursuit of the litigation was not in the company's best interests. As to the plaintiff alleging demand futility, the court dismissed its claims for failing to adequately plead that the directors were interested. Anomalously, the court also concluded that the other plaintiff, who had made the demand, established that the SLC members were not disinterested under the relevant provision of the governing Indiana statute. On reconsideration, the court stayed the ruling and certified a question to the Indiana Supreme Court. Order, *In re ITT Corp.*, No. 07-CV-2878(CS) (S.D.N.Y. Oct. 27, 2009); Order Accepting Certified Question, *In re ITT Corp.*, No. 07-CV-2878(CS) (S.D.N.Y. Dec. 4, 2009).

<sup>62</sup> First Amended Complaint for Wrongful Discharge, Unpaid Wages, Benefits and Money Damages at 5-6, *Singh v.*

holders will certainly file securities class action complaints.<sup>63</sup>

Other related private actions are almost certain. Corporations doing business overseas often include clauses in their contracts that provide a warranty against or a basis to terminate the contract for FCPA violations. So disputes involving these clauses and contracts may arise.<sup>64</sup> What's more, all these actions will only increase if the Investor Protection Act of 2009 is passed by Congress. This bill would extend rewards to whistleblowers if an SEC action brought under the securities laws—including the FCPA—results in over \$1 million in sanctions.<sup>65</sup>

## VII. Conclusion

More than twenty years ago, the congressional, prosecutorial, and regulatory focus on questionable foreign payments sparked a series of shareholder derivative actions. Based on the U.S. government's renewed interest in this area, another wave of civil litigation is expected. Derivative plaintiffs are today armed with a new theory of liability—a *Caremark* failure-to-monitor claim. Furthermore, unlike many of the earlier cases, the foreign payments are now unquestionably illegal. But shareholders will face new and difficult hurdles: pleading and establishing *Caremark* claims and piercing the work of a proper-functioning SLC.

*Rockwell Automation, Inc.*, No. 09-00597(TSZ), 2009 WL 3225869 (W.D. Wash. July 14, 2009); Plaintiff's First Amended Complaint, *Kirk v. Shaw Env'tl., Inc.*, No.: 1:09-CV-01405, 2009 WL 4994436 (N.D. Ohio Oct. 14, 2009).

<sup>63</sup> Complaint, *Johnson v. Siemens AG*, No. 1:09-CV-05310(JG)(RER) (E.D.N.Y. Dec. 4, 2009).

<sup>64</sup> Complaint for: (1) Breach of Contract (2) Declaratory Judgment, *Upsilon Int'l Corp. v. Argo-Tech Corp.*, No. 2:08-CV-02030(RGK)(SH), 2008 WL 2127719 (C.D. Cal. Mar. 26, 2008).

<sup>65</sup> H.R. 4173, 111th Cong. § 7203 (2010). It is unclear whether the Foreign Business Bribery Prohibition Act of 2009 will gain enough support for enactment; it is currently pending with one sponsor. But it would provide for a private right of action under the FCPA and undoubtedly cause a further increase in FCPA-related litigation. H.R. 2152, 111th Cong. (2009).