



Pitfalls To Avoid In Appointing And Acting As A Special Litigation Committee

By Janel Dressen

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The appointment of a special litigation committee (SLC) is a highly effective response by a company when a derivative demand is made by an owner. Minn. Stat. § 302A.241, subd. 1. An SLC enables a company to take control of claims even when a majority of the board is in a conflict of interest position. *In re UnitedHealth Grp. Inc. Derivative Litig.*, 754 N.W.2d 544, 550 (Minn. 2008). There are some important rules, however, that a company must follow to properly appoint an SLC and for an SLC to follow before the process may have its intended effect.

First, an SLC must be independent. Minn. Stat. § 302A.241, subds. 1, 2. Independence is based upon the totality of the circumstances, including whether the members were involved in the alleged wrongdoing or approved the alleged wrongdoing and whether the members had business or social relationships with the alleged wrongdoers, among other factors. *In re. UnitedHealth Grp.*, 754 N.W.2d at 560, n.11.

Second, once formed, an SLC must not be subject to the board's discretion or control. *Id.* at 550. In other words, once an SLC is appointed, it must be empowered to act independently. Unlike other committees, which remain under the control of the board, an SLC must be delegated full authority to control the litigation. *Jansen v. Best & Flanagan*, 662 N.W.2d 876, 882 (Minn. 2003.)

The Minnesota Court of Appeals recently considered this issue in *Toretta v. Lachinski*, No. A12-0779, 2013 WL 491523 (Minn. Ct. App. February 11, 2013), *rev. denied* April 30, 2013. In *Toretta*, the derivative plaintiff challenged the district court's dismissal of his derivative claims arguing that the SLC was not sufficiently independent. *Toretta* argued, based upon the board resolution appointing the SLC, that the SLC was authorized to only make a "recommendation" and that it lacked full authority to issue a "directive" to the board on whether to pursue derivative claims. In noting that the district court need not defer to the decision of an SLC that plays a "mere advisory role," the Court of Appeals found that the board resolution at issue delegated "the complete power and authority" of the board to the SLC. *Id.* at *9. The resolution explicitly stated: "Any action duly taken or decision duly made by the [SLC] within the course and scope of its authority shall be binding on the Companies." And indeed, after the SLC "recommended" that the companies decline to pursue the derivative claims, the board passed a resolution to bring a motion to dismiss "consistent with the recommendations in the SLC report." *Id.* The Court of Appeals affirmed the dismissal of the derivative claims based upon the SLC's report. *Id.* The *Toretta* decision highlights the importance of delegating complete authority to an SLC to consider the legal rights and remedies of the company without interference or control by the board.

Third, a court applying Minnesota law will not permit an SLC to improve its investigation after issuing its decision. In *Janssen*, after the SLC issued its report, the corporation attempted to remedy deficiencies in the delegation of authority. The Minnesota Supreme Court held that an SLC is not entitled to a second opportunity to conduct its investigation if the first investigation was deficient. 662 N.W.2d at 889-90. Consequently, "if the initial SLC investigation and recommendation fail to satisfy [the business-judgment] standard, the derivative suit proceeds on its merits without any opportunity to rectify any deficiencies." *In re UnitedHealth Grp.*, 754 N.W.2d at 559.

Finally, an SLC's procedures in investigating the derivative claims must be "adequate, appropriate, and pursued in good faith." *Blohm v. Kelly*, 765 N.W.2d 147, 155 (Minn. Ct. App. 2009). Whether an SLC's procedures are proper depends on the nature of the particular investigation and (1) the length and scope of the investigation; (2) the committee's use of independent counsel or experts; (3) the corporation's or the defendant's involvement, if any, in the investigation; and (4) the adequacy and reliability of the information supplied to the committee. *Id.* at 1029. "Evidence that the investigation has been so restricted in scope, so shallow in execution, or otherwise so pro forma or halfhearted as to constitute a pretext or sham. . . would raise questions of good faith." *Id.*

The appointment and use of an SLC is a beneficial tool for companies seeking to limit the risk and cost of derivative litigation if it is properly appointed and it acts consistently with the foregoing rules.