

Dismissal Based on a Special Litigation Committee Report – The District Court’s Discretion

By Arthur G. Boylan

When a special litigation committee (SLC) is formed in response to allegations of corporate wrongdoing, common wisdom tells us that the SLC’s conclusion as to whether it is in the company’s business interest to pursue the litigation is critical. In fact, many cases have confirmed – where the SLC is independent and where the SLC conducts a good faith investigation – that the SLC’s conclusions may be nearly dispositive. But, assuming an SLC determines that the lawsuit is not in the company’s interest, the answer to a specific question is significantly less clear: How should the conclusions of the SLC be presented to a court? How and what should the district court review? Is this a motion to dismiss under Rule 12 to test the sufficiency of the pleadings or a motion for summary judgment under Rule 56, where the defendants must demonstrate no genuine issues of material fact? Or should it be considered a motion under Rule 23 because it relates to a derivative action? In a recent decision, *Kokocinski v. Collins*, 2017 WL 780862 (8th Cir. March 1, 2017), the Eighth Circuit Court of Appeals addressed what these motions ought to be and affirmed the dismissal of a suit based on an SLC’s report.

In *Kokocinski*, the claims were based on allegations that the company improperly encouraged physicians to engage in the “off-label” use of a surgically implanted medical device that stimulates bone growth. These allegations inevitably gave rise to a number of whistleblower lawsuits, investigations by federal authorities, and media scrutiny. Negative publicity was followed by a decline in Medtronic’s share price. As a result, the plaintiff brought a derivative action against Medtronic’s directors and officers, alleging securities violations and a host of related claims. Medtronic’s board formed an SLC to investigate the claims. The SLC was comprised of experienced lawyers and it was supported by ex-

perts and its own counsel. Following an investigation, a report was issued wherein the SLC concluded that it would not be in Medtronic’s best interests to pursue the lawsuit. Based on the SLC’s conclusions, the district court dismissed the shareholder derivative action.

At the very outset of the decision on appeal, the Eighth Circuit noted that the standard of review depends on the proper way in which to construe an SLC report-supported motion. The district court construed the motion to be akin to a motion seeking voluntary dismissal of a shareholder’s derivative action under Federal Rule 23 and, thus, borrowed from Rule 56 procedures. Plaintiffs argued that the motion should have been converted to a Rule 56 motion for summary judgment – thus warranting *de novo* review by the Eighth Circuit – because the motion relied on the SLC’s report, which

was outside the pleadings. Referring to case law from other circuits, the Eighth Circuit concluded that the motion should be viewed as a “motion to terminate” the litigation.

Having concluded that the motion should

be considered a “motion to terminate,” the Eighth Circuit determined that the proper standard of review was abuse of discretion. The primary driver for the Eighth Circuit was the fact that the district court’s inquiry on a motion to terminate involves determining whether the legal criteria of Minnesota law have been met based on its familiarity with the case, its weighing of the evidence, and its credibility determinations. After all, according to the Eighth Circuit, an abuse of discretion standard is appropriate when the district court must apply a fact-intensive legal standard, particularly where the district court is better positioned than the reviewing court to decide the issues because of its familiarity with the evidence.

So, what does this mean for corporations and plaintiffs’ counsel seeking to pursue derivative litigation? As a practical matter, this decision once again confirms the convention-

al wisdom that the SLC process is critical for both sides. But this decision also underscores the broad discretion that a district court can (and should) exercise when confronted with a motion based on an SLC report. As the Eighth Circuit explained, “the range of circumstances district courts may face—the size of the corporation, the history and various relationships the SLC members may have with respect to the board and the corporation, the array of various methodologies an SLC may employ in its investigation, the nature and quality of its report, the size of the SLC, and the nature of the derivative claims—will result in myriad, case-specific situations, often vague, best able to be resolved with the experience and case familiarity possessed by the district court.” In other words, the district court must take a close look before terminating the litigation based on an SLC report and the district court’s decision ought to be much deeper than a rubber stamp.

As a practical matter, this decision once again confirms the conventional wisdom that the SLC process is critical for both sides.

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