

FOLLOWING ON THE FOREIGN CORRUPT PRACTICES ACT: THE DYNAMIC SHAREHOLDER DERIVATIVE SUIT

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ABSTRACT

Corporations that have allegedly violated the Foreign Corrupt Practices Act (FCPA) increasingly face a new threat of liability: cases brought by private plaintiffs in follow-on derivative suits. These derivative suits for breaches of fiduciary duty focus on whether directors provided the necessary oversight through compliance systems designed to detect and prevent FCPA violations. The demand requirement, a procedural hurdle of derivative suits, has stymied plaintiffs that are unable to show that directors cannot disinterestedly assess whether to pursue a claim for violations. This Note proposes a framework that systematizes the factual scenarios under which the demand requirement could be excused. Using other instances of regulatory violations as a lens, courts can infer that directors knew of FCPA violations based on patterns of bribes and the importance of bribery to the overall business of the corporation. Only plaintiffs that have utilized procedural devices to inspect corporate books and records, however, can expect courts to reach this inference of director knowledge. Despite being much maligned, the follow-on derivative suit may actually clarify the duties of directors in FCPA compliance and advance the corporate governance reforms of corporations, separately from the deterrent effect of government enforcement.

INTRODUCTION

On April 21, 2012, a *New York Times* article reported a failed investigation into Wal-Mart's business-driven bribery practices worldwide.¹ The incident that prompted the investigation began in

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1. David Barstow, *Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle*, N.Y. TIMES, Apr. 22, 2012, at A1.

2005, when a former executive at Wal-Mart de Mexico (Wal-Mex), Wal-Mart's largest foreign subsidiary, alerted Wal-Mart that Wal-Mex had systematically bribed government officials to facilitate expansion across Mexico.² The article detailed a carefully organized system in which bribes were paid through middlemen and concealed on invoices using secret-code numbers denoting the purpose of each bribe.³ Wal-Mart's investigative unit discovered payments totaling more than \$24 million and recommended a full investigation into possible violations of the Foreign Corrupt Practices Act (FCPA).⁴ The article claimed that instead "Wal-Mart's leaders shut [the investigation] down."⁵ Concerned that the details about the bribes would reach the public, Wal-Mart's board of directors decided on a new course of action: the Wal-Mex general counsel would head the investigation, effectively giving responsibility to uncover wrongdoing to those under suspicion.⁶

Once Wal-Mart's bribery scandal made headlines, the California State Teachers Retirement System (CalSTRS), concerned that Wal-Mart's bribery practices and the corresponding potential for hefty penalties would negatively impact its substantial holdings in Wal-Mart, filed a shareholder derivative suit against Wal-Mart's board in the Delaware Court of Chancery.⁷ CalSTRS used the *New York Times* article to support allegations that three directors had "direct contemporaneous knowledge of the bribery allegations" based on internal communications regarding the preliminary internal investigation.⁸ The plaintiffs also alleged that the rest of the board "would have been informed of the adverse findings," pursuant to Wal-Mart's corporate governance guidelines.⁹ CalSTRS claimed the board breached its fiduciary duties by refusing to conduct a full and independent investigation despite (1) whistleblower evidence that

2. *Id.*

3. *Id.*

4. Foreign Corrupt Practices Act, 15 U.S.C. §§ 78m, 78dd-1 to -3, 78ff (2012); *see* Barstow, *supra* note 1.

5. Barstow, *supra* note 1.

6. *Id.*

7. Verified Shareholder Derivative Complaint, Cal. State Teachers' Ret. Sys. v. Alvarez, No. 7490, at 24 (Del. Ch. May 3, 2012), *available at* <http://graphics8.nytimes.com/news/business/walmart-shareholder-complaint.pdf>.

8. *Id.* at 28-29.

9. *Id.* at 29.

Wal-Mex paid bribes to foreign officials and (2) the investigative report's finding that Wal-Mex violated anti-bribery laws.¹⁰

The suit was derivative in that injury belonged to the corporation, not the shareholders themselves. A derivative plaintiff like CalSTRS must satisfy Delaware's demand requirement. The demand requirement obligates a plaintiff, before filing suit, to ask the board to bring a suit on behalf of the corporation.¹¹ Alternatively, a plaintiff can allege demand futility and ask the court to excuse the demand requirement by showing that demand would be useless because the board would be unable to consider the best interests of the corporation in deciding whether to bring a case.¹² CalSTRS sought to overcome the demand requirement by pleading demand futility because the directors, having already ignored the need for an investigation, were now "incapable of impartially investigating or taking appropriate action against themselves and others."¹³ In fact, multiple shareholder derivative suits against Wal-Mart make similar allegations and are still in pretrial stages at the time of publication: seven in Delaware and five in Arkansas state and federal court.¹⁴

Academics and practitioners now recognize the likelihood that litigation, similar to CalSTRS's derivative suit, will follow allegations

10. *Id.* at 2, 3.

11. In shareholder derivative suits, the derivative plaintiff is asserting injury on behalf of the corporation and is therefore required to demand that the board address this injury. *See* DEL. CH. CT. R. 23.1(a) ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort."); *see also* FED. R. CIV. P. 23.1(b)(3) (requiring particularized pleading like Delaware).

12. *See* Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) ("[W]here officers and directors are under an influence which sterilizes their discretion, they cannot be considered proper persons to conduct litigation on behalf of the corporation."), *overruled in part on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

13. Verified Shareholder Derivative Complaint, *supra* note 7, at 29. Instead, the complaint alleged that the directors allowed those accused of wrongdoing or their subordinates to head investigations and "maintain[ed] a wholly inadequate corporate investigations unit." *Id.* at 32.

14. *See* Mike Koehler, *Foreign Corrupt Practices Act Enforcement as Seen Through Wal-Mart's Potential Exposure*, WHITE COLLAR CRIME REP., Sept. 21, 2012, at 1, 7 ("[A]t least 12 shareholder lawsuits have been filed against Wal-Mart and/or its officers and directors in the wake of the *Times* article."). *See generally In re* Wal-Mart Stores, Inc. S'holder Derivative Litig., No. 4:12-cv-4041, 2012 WL 5935340, at *1 (W.D. Ark. Nov. 27, 2012) (consolidating state and federal suits against Wal-Mart and ordering a stay of proceedings in Arkansas as consolidated suits moved forward in the Delaware Court of Chancery). Although the suits are still in early stages, the extent of alleged wrongdoing at Wal-Mart indicates widespread failings of the corporate compliance system. *See* Stephanie Clifford & David Barstow, *Wal-Mart Takes a Broader Look at Bribery Cases*, N.Y. TIMES, Nov. 16, 2012, at A1 (noting that Wal-Mart's bribery practices extended to other large country markets, including Brazil, China, and India).

of FCPA violations.¹⁵ However, these follow-on derivative suits¹⁶ have been criticized as an ineffective means of enforcing director obligations,¹⁷ because they are subject to heightened pleading requirements.¹⁸ Moreover, commentators attribute little value to follow-on derivative suits, arguing that such suits are only financially motivated by attorneys' fees and carry little legal substance.¹⁹

By contrast, this Note posits that follow-on derivative suits do possess value in that they provide an opportunity to develop a

15. *E.g.*, Koehler, *supra* note 14, at 6–7; *see* George H. Brown, Debra Wong Yang & Matthew S. Kahn, *Strategies for Mitigating Civil Liability Consequences of FCPA Investigations & Enforcement Actions*, SEC. LITIG. REP., Apr. 2012 (reprint at 1), available at [http://www.gibsondunn.com/publications/Documents/BrownYangKahn-StrategiesforMitigatingCivilLiabilityConsequences%20\(2\).pdf](http://www.gibsondunn.com/publications/Documents/BrownYangKahn-StrategiesforMitigatingCivilLiabilityConsequences%20(2).pdf) (“[F]ollow-on litigation [has] become virtually a guaranteed by-product of an internal or government FCPA investigation.”); Jason E. Prince, *A Rose by Any Other Name? Foreign Corrupt Practices Act-Inspired Civil Actions*, THE ADVOCATE, Mar./Apr. 2009, at 20, 22–23 (acknowledging a possible surge in shareholder actions after a class of shareholders received a large securities settlement); *see also* 2012 Mid-Year FCPA Update, GIBSON DUNN 13–16 (July 9, 2012), <http://www.gibsondunn.com/publications/Documents/2012MidYearFCPAUpdate.pdf> (noting that “the continued stream of FCPA-inspired” litigation and the development of “several new fronts in this landscape”).

16. This Note refers to shareholder derivative suits that allege breaches of fiduciary duty arising from alleged violations of the FCPA as follow-on derivative suits.

17. Donald A. Corbett & Daniel K. Roque, *The Next Wave of FCPA Shareholder Derivative Actions*, 42 Sec. Reg. & L. Rep. (BNA) 855, 858 (2010); Gideon Mark, *Private FCPA Enforcement*, 49 AM. BUS. L.J. 419, 446–47, 459–86 (2012) (indicating that collateral litigation will likely increase, but arguing that the different forms of collateral litigation are not viable and thus, a private right of action under the FCPA is necessary); Ann Deen Westbrook, *Double Trouble: Collateral Shareholder Litigation Following Foreign Corrupt Practices Act Investigation*, 73 OHIO ST. L.J. 1217, 1224–26, 1252 (2012) (casting the FCPA-related shareholder derivative suit as a phenomenon arising from the lack of a private cause of action and arguing that federal securities actions serve as better vehicles in private litigation).

18. *See infra* Part II.

19. FCPA investigations and derivative suits have been widely covered by specialized blogs. *See, e.g.*, Mike Koehler, *A Purpose or Parasitic?*, FCPA PROFESSOR (Feb. 15, 2012), <http://www.fcpaprofessor.com/a-purpose-or-parasitic> (noting that, only in the “rare” event directors have encouraged an FCPA violation, a derivative suit would be justified); Mike Koehler, *Nice Pay Day, but What Did You Accomplish?*, FCPA PROFESSOR (Sept. 20, 2012), <http://www.fcpaprofessor.com/nice-pay-day-but-what-did-you-accomplish> (arguing that companies will settle with plaintiffs “for what amounts to nuisance value” and that plaintiffs actually do not accomplish anything, except a pay day); Kevin LaCroix, *Faltering Lawsuits: Dismissal Motions Hit FCPA Follow-On Civil Actions and Say-on-Pay Suits*, D&O DIARY (July 30, 2012), <http://www.dandodiary.com/2012/07/articles/foreign-corrupt-practices-act/faltering-lawsuits-dismissal-motions-hit-fcpa-followon-civil-actions-and-sayonpay-suits> (noting the lawsuits that have failed to make it past pleading stages and that “[i]f nothing else, these cases show that claimants eager to pursue shareholder derivative suits following on FCPA investigations cannot dispense with the procedural prerequisites”); *see also* Brown et al., *supra* note 15 (reprint at 1) (noting that private parties have “devised many creative ways to ride into court on the coattails of an alleged FCPA violation” and that some of these plaintiffs have achieved significant monetary, though not legal, success).

coherent body of law regarding the obligations of directors of corporations that have allegedly violated positive law. Regardless of whether demand is excused or the case settles or is dismissed, the FCPA follow-on derivative suit serves an important purpose in improving corporate compliance with the FCPA's provisions. In some cases, for example, director behavior may be egregious enough to infer knowledge and impose liability for breach of fiduciary duties. Weaker cases involving decentralized management, however, are unlikely to allege demand futility required for a derivative suit to withstand dismissal, but plaintiffs may still influence director behavior by negotiating settlements that include specific corporate governance reforms that reduce the risk of future FCPA violations.

The liability underlying an FCPA follow-on derivative suit is premised on a *Caremark*²⁰ claim. Plaintiffs alleging a *Caremark* claim assert that directors breached their oversight duties to the corporation.²¹ Although *Caremark* claims are difficult to win,²² this Note offers a framework for understanding cases in which plaintiffs have successfully pled demand futility based on violations of positive law. The presented typology carves out a subset of cases and factual scenarios worthy of shareholder scrutiny into whether directors knew about possible violations and fulfilled their oversight duties. In follow-on derivative suits, courts have hesitated to infer directors' knowledge of FCPA violations; however, inferring knowledge may be reasonable when directors participate in direct control of defective compliance programs that led to violations of federal law. Furthermore, this Note acknowledges the practical challenges of shareholder derivative suits and sets FCPA follow-on derivative suits within the context of the Delaware Court of Chancery's recent encouragement to plaintiffs to use procedural devices to support their pleadings.

This Note opens in Part I with background on the FCPA and government enforcement. Part II focuses on the pleading burdens of *Caremark* cases and details how the demand-futility requirement has

20. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

21. 4 THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 535–39 (Stephen A. Radin ed., 6th ed. 2009).

22. *See e.g., Caremark*, 698 A.2d at 967 (“The theory here advanced is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.”); Claire A. Hill & Brett McDonnell, *Stone v. Ritter and the Expanding Duty of Loyalty*, 76 FORDHAM L. REV. 1769, 1777 (2007) (“*Caremark* duties are deliberately structured to make it extremely hard for plaintiffs to win.”).

been applied in FCPA follow-on derivative cases.²³ Part III introduces a series of cases in which corporations violated positive law—namely off-label advertising and Medicare/Medicaid federal regulations—and plaintiffs successfully pled demand futility. These examples urge a new approach to the elusive *Caremark* obligations of directors, specifically as they relate to obligations to oversee FCPA-compliance systems. In addition to explaining how courts have misapplied case law on the failure to monitor and the breach of good-faith and loyalty duties in FCPA cases, the discussion of *Caremark*'s progeny sets the stage for a more flexible approach to inferring director knowledge of violations. Part IV elucidates the value of FCPA derivative follow-on suits in influencing corporate behavior and encouraging compliance systems even when plaintiffs unsuccessfully plead demand futility and negotiate a settlement.

I. UNDERSTANDING THE FCPA

The FCPA is a major source of potential liability for corporations with widespread global operations.²⁴ The Department of Justice (DOJ) and Securities and Exchange Commission (SEC) have criminal and civil enforcement authority, respectively, over violations by public companies; the DOJ also has criminal and civil enforcement authority over FCPA violations by domestic concerns.²⁵ Part of the 1934 Securities Exchange Act (Exchange Act),²⁶ the FCPA applies to

23. This Note focuses on Delaware corporate law because the majority of corporations are incorporated in Delaware, and even if corporations are incorporated elsewhere, many states follow Delaware's demand-futility analysis. See *infra* notes 68–69 and accompanying text.

24. See, e.g., Mike Koehler, *The Foreign Corrupt Practices Act in the Ultimate Year of Its Decade of Resurgence*, 43 IND. L. REV. 389, 396 (2010) (“But with the increase of globalization . . . it is no longer just large resource extraction companies doing business in overseas markets that need to be concerned with the FCPA.”); Carl Pacini, *The Foreign Corrupt Practice Act: Taking a Bite out of Bribery in International Business Transactions*, 17 FORDHAM J. CORP. & FIN. L. 545, 560–61 (2012) (explaining how the FCPA reaches foreign subsidiaries and joint ventures); Lawrence J. Trautman & Kara Altenbaumer-Price, *The Foreign Corrupt Practices Act: Minefield for Directors*, 6 VA. L. & BUS. REV. 145, 147–49 (underscoring the need for companies to be aware of FCPA risks even if not currently operating in a major BRIC market because of the “potential for corporate catastrophe”).

25. Mark, *supra* note 17, at 426–27; see CRIMINAL DIV., U.S. DEP'T OF JUSTICE, A RESOURCE GUIDE TO THE FOREIGN CORRUPT PRACTICES ACT 4–5 (2012), available at <http://www.justice.gov/criminal/fraud/fcpa/guide.pdf> (explaining the SEC and DOJ's enforcement authority over issuers (public companies) and the DOJ's authority over domestic concerns (non-issuers) which includes American citizens, nationals, residents, businesses, and foreign persons or businesses that commit an FCPA violation while in the United States).

26. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78pp (2012).

all issuers of securities registered with the SEC and companies subject to the Exchange Act's reporting requirements.²⁷

There are two main grounds for liability under the FCPA. First, anti-bribery provisions make it illegal to offer, promise, authorize, or make a payment of money or anything of value to a foreign official in exchange for obtaining or retaining business.²⁸ Second, provisions on recordkeeping and internal controls²⁹ require Exchange Act issuers to file reports that provide “reasonable detail” of transactions and assets.³⁰ A corporation that offered bribes and then mischaracterized the bribes as proper business expenses runs the risk of both criminal and civil liability.³¹ Issuers must also devise an internal auditing control system “sufficient to provide reasonable assurances” that transactions meet the compliance requirements set by management.³² Violations of the accounting provisions are actionable in civil proceedings but only constitute a criminal offense when a person knowingly violates or fails to implement internal controls.³³

The last several years have marked the busiest years for FCPA enforcement since the law was enacted in 1977.³⁴ In 2010 and 2011, the DOJ and SEC initiated a combined total of 122 proceedings³⁵—more than any previous year.³⁶ In 2012, the number of enforcement proceedings declined,³⁷ but the number of open investigations, both

27. See 15 U.S.C. § 78c(a)(8) (2012) (defining “issuer” for purposes of the FCPA).

28. *Id.* § 78dd-1(a).

29. *Id.* §§ 78m(a)–(b). These accounting provisions constituted a major expansion of SEC powers. See *SEC v. World-Wide Coin. Invest., Ltd.*, 567 F. Supp. 724, 746–47 (N.D. Ga. 1983) (noting that the accounting provisions of the FCPA extend SEC authority over the financial management and accounting of corporations “beyond the traditional ambit of disclosure requirements”).

30. 15 U.S.C. § 78m(b)(2)(A).

31. See CRIMINAL DIV., U.S. DEP'T OF JUSTICE, *supra* note 25, at 39 (“[I]t is never appropriate to mischaracterize transactions in a company's books and records.”).

32. 15 U.S.C. § 78m(b)(2)(B).

33. *Id.* § 78m(b)(4), (5); see Koehler, *supra* note 24, at 396.

34. See, e.g., John Ashcroft & John Ratcliffe, *The Recent and Unusual Evolution of an Expanding FCPA*, 26 NOTRE DAME J.L. ETHICS & PUB. POL'Y 25, 26 (2012) (noting that FCPA prosecutions have “skyrocketed” and huge “penalties or fines [have] been the routine, almost commonplace result”); Corbett & Roque, *supra* note 17, at 855 (arguing that “renewed enforcement” of the FCPA has triggered the emergence of collateral civil litigation related to bribery).

35. 2012 *Mid-Year FCPA Update*, *supra* note 15, at 2.

36. See Mark, *supra* note 17, at 431 (underscoring the stark contrast in enforcement in 2010 and 2011 as compared to 2004, when only five actions were initiated).

37. 2013 *Mid-Year FCPA Update*, GIBSON DUNN 2 (July 8, 2013), <http://www.gibsondunn.com/publications/Documents/2013-Mid-Year-FCPA-Update.pdf>

criminal and civil, remained high at about 150 DOJ and 80 SEC investigations.³⁸

The pace and scale of recent FCPA-enforcement activity is due to efficient enforcement methods.³⁹ The government may resolve investigations without undertaking full prosecutions. Rather, the DOJ utilizes deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) to resolve cases of bribery, accounting misconduct, and money laundering related to FCPA violations.⁴⁰ Under these agreements, the DOJ need not expend resources to satisfy the burden of proof in a criminal prosecution,⁴¹ and a corporation avoids a criminal indictment but remains liable for fines, disgorgement of profits, prejudgment interest, and may be obligated to undertake corporate reforms.⁴² Corporations are motivated to disclose FCPA violations to avoid indictment⁴³ and to receive leniency in the assessment of penalties.⁴⁴

In response to the successful efforts of the DOJ and SEC, robust academic discussion and critique have developed, with many

(explaining that in 2010 and 2011, respectively, there were seventy-four and forty-eight DOJ and SEC actions combined, but that in 2012, there were only twenty-three). By the middle of 2013, sixteen new cases had been initiated, *id.*, indicating a “return to the robust levels of recent years” after the “relative downtick” in 2012, *id.* at 1.

38. Mark, *supra* note 17, at 432.

39. See Mike Koehler, *Big, Bold, and Bizarre: The Foreign Corrupt Practices Act Enters a New Era*, 43 U. TOL. L. REV. 99, 104 (2011) (explaining the stark contrast between the \$1.8 billion in fines in 2010 and the single enforcement action in 2000 for a \$300,000 fine as resulting from “a remarkable transformation . . . [in] FCPA enforcement and theories of prosecution”).

40. WORKING GRP. ON BRIBERY IN INT’L BUS. TRANSACTIONS, ORG. FOR ECON. CO-OPERATION & DEV., PHASE 3 REPORT ON IMPLEMENTING THE OECD ANTI-BRIBERY CONVENTION IN THE UNITED STATES 11, 32 (2010), available at <http://www.oecd.org/daf/anti-bribery/anti-briberyconvention/UnitedStatesphase3reportEN.pdf>.

41. Koehler, *supra* note 39, at 129.

42. See Mark, *supra* note 17, at 431–34 (detailing the use of different enforcement methods by the DOJ and SEC in specific cases).

43. See *id.* at 430–31 (noting that up to 60 percent of government enforcement actions are a result of voluntary corporate disclosures).

44. See Sarah Marberg, Note, *Promises of Leniency: Whether Companies Should Self-Disclose Violations of the FCPA*, 45 VAND. J. TRANSNAT’L L. 557, 574–77 (2012) (suggesting widespread skepticism that the DOJ actually credits companies that voluntarily disclose despite DOJ attempts to incentivize cooperation both officially and unofficially). A corporation that refuses to disclose voluntarily runs the risk of higher penalties, but may also be subject to private liability under securities-fraud regulations. See RAYMOND WONG & PATRICK CONROY, NERA ECON. CONSULTING, FCPA SETTLEMENTS: IT’S A SMALL WORLD AFTER ALL 5 ex.1, 7–9 (2009), available at http://www.nera.com/extImage/Pub_FCPA_Settlements_0109_Final2.pdf (detailing cases brought against corporations for nondisclosure under Securities Rule 10b-5, 17 C.F.R. § 240.10b-5 (2013), and tracking market capitalization losses as a result of publicized FCPA violations).

commentators focusing on the shortcomings of government enforcement.⁴⁵ For example, because almost all enforcement actions are resolved with DPAs, corporations face an uncertain landscape of liability without the benefit of judicial interpretation.⁴⁶ Instead, FCPA liability is “improperly developing through the terms and conditions of DPAs, rather than by jury verdicts and appellate court decisions.”⁴⁷

Recently released government implementation guidelines clarify FCPA requirements for corporations.⁴⁸ The guidelines identify the factors the government considers in evaluating existing compliance efforts.⁴⁹ However, they do not explicitly delineate the responsibilities for a director or an officer of a corporation beyond vague admonitions to remain committed to a “culture of compliance” and to carry out the compliance system in “good faith.”⁵⁰ Judicial interpretation of FCPA liability would facilitate compliance efforts by unpacking these substantive responsibilities of directors that, as the examples above demonstrate, are not self-defining. In follow-on derivative suits, judicial interpretation of director liability after an

45. See generally Ashcroft & Ratcliffe, *supra* note 34; Lauren Giudice, Note, *Regulating Corruption: Analyzing Uncertainty in Current Foreign Corrupt Practice Act Enforcement*, 91 B.U. L. REV. 347 (2011); Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO. J. INT'L L. 907 (2010); Pacini, *supra* note 24; Cortney C. Thomas, Note, *Foreign Corrupt Practices Act: A Decade of Rapid Expansion Explained, Defended, and Justified*, 29 REV. LITIG. 439 (2010). Commentators focusing on reforms to the FCPA have primarily advocated for leniency reforms, such as an amendment that incorporates a good-faith compliance defense. E.g. Mike Koehler, *Revisiting a Foreign Corrupt Practice Act Compliance Defense*, 2012 WIS. L. REV. 609, 617, 654 (2012); Michael B. Mukasey & James C. Dunlop, *Can Someone Please Turn on the Lights? Bringing Transparency to the Foreign Corrupt Practices Act*, ENGAGE, Mar. 2012, at 30, 49; cf. Robert W. Tarun & Peter P. Tomczak, *A Proposal for a United States Department of Justice Foreign Corrupt Practices Act Leniency Policy*, 47 AM. CRIM. L. REV. 153, 213–23 (2010) (arguing for a leniency policy modeled after antitrust policies in light of the large-scale cooperation of corporations under investigation for FCPA violations).

46. See Ashcroft & Ratcliffe, *supra* note 34, at 34 (noting that terms like “foreign official” and “bribe,” after more than thirty-four years, remain “undefined”).

47. *Id.* at 33. Only one corporation has been tried and convicted of FCPA violations. Mark, *supra* note 17, at 443. That conviction was subsequently vacated. *United States v. Aguilar*, 831 F. Supp. 2d 1180, 1210 (C.D. Cal. 2011).

48. See, e.g., CRIMINAL DIV., U.S. DEP'T OF JUSTICE, *supra* note 25, at 24–26 (explaining which types of payments constitute illegal expenditures and when the FCPA exemption for facilitation payments applies).

49. See *id.* at 53 (listing the “pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management” as one of the factors, among many others, informing the decision to investigate possible violations).

50. *Id.* at 57 (quoting Cynthia A. Glassman, Comm'r, Sec. & Exch. Comm'n, SEC Implementation of Sarbanes-Oxley: The New Corporate Governance, Remarks at National Economists Club (April 7, 2003) (transcript available at <http://www.sec.gov/news/speech/spch040703cag.htm>)).

FCPA violation would provide important jurisprudential data points for corporate directors and officers overseeing compliance systems.

Responses to FCPA violations indicate that corporations are well-served by looking beyond the government action to the downstream private collateral litigation that follows.⁵¹ Company securities disclosures or news of a settlement between a corporation and the DOJ or SEC often trigger private actions.⁵² Most commentators expect this trend to continue.⁵³ The absence of a private cause of action under the FCPA itself⁵⁴ means that private actors have resorted to other legal avenues to bring claims arising from an alleged FCPA violation—the shareholder derivative suit among them.

II. HURDLES TO ALLEGING DEMAND FUTILITY

This Part explains the main procedural requirement in shareholder derivative suits: demand on the board, or alternatively, demand futility. First, this Part lays out seminal Delaware case law that guides the analysis of when demand is futile. It then argues that courts outside of Delaware have misapplied demand futility in FCPA follow-on derivative suits. Second, this Part addresses the intersection of demand with pleading the directors' failure to monitor and underscores how the analyses at the procedural stages of demand and pleading require an inquiry into substantive law of director and officer obligations.

51. See Jeffrey S. Johnston & Erika Tristán, *The Next FCPA Battleground: Private Civil Lawsuits Following Foreign Corrupt Practices Act Settlements with U.S. Government Authorities*, LITIG. NEWS (Vinson & Elkins, Houston, Tex.), Winter 2011, at 1–4, available at <http://www.velaw.com/uploadedFiles/VEsite/Resources/VELitigationNewsWinter2011.pdf> (noting that even after corporations settle with the government, private parties employ a variety of legal measures, including civil RICO claims and securities fraud actions, against corporations).

52. *Id.* at 2.

53. See Corbett & Roque, *supra* note 17, at 855 (“[The FCPA enforcement] spike will undoubtedly result in an increase in parallel civil litigation.”); Mark, *supra* note 17, at 447 (“The expected continued expansion of FCPA enforcement is likely to be mirrored in a concomitant increase in additional collateral litigation.”).

54. *Lamb v. Phillip Morris, Inc.*, 915 F.2d 1024, 1029 (6th Cir. 1990) (holding that a private right of action is not available under the FCPA in part because a private right of action “would directly contravene the carefully tailored FCPA scheme presently in place”).

A. *Mechanics of the Demand Requirement*

Requiring plaintiffs to show that demand is futile affords them the opportunity to explain why the directors are not equipped to handle litigation due to self-interest or incapacity to act in the best interests of the corporation.⁵⁵ After first detailing the contours of this requirement, this Section argues that state courts conducting the demand-futility inquiry in FCPA cases have confused the two Delaware tests for demand futility—(1) board action, or malfeasance, and (2) board inaction, or nonfeasance. This confusion has increased the burden on shareholders to argue that demand should be excused and has led to skepticism about the value of shareholder litigation.

1. *Delaware Demand-Futility Analysis: Alleging Director Interest.* The demand requirement reinforces the basic premise of corporate law that the board of directors is tasked with the management of and discretion over the affairs of the corporation. The default rule is that the directors manage the corporation’s “business and affairs.”⁵⁶ Thus, Federal Rule of Civil Procedure 23.1(b)(3)(A) and (B) and Delaware Chancery Rule 23.1(a) impose a demand requirement for shareholder derivative suits.⁵⁷ The demand requirement, as “a natural outgrowth” of the board’s authority, requires that plaintiffs in derivative suits appeal to the board of directors before bringing a suit on the corporation’s behalf.⁵⁸ As compared to shareholder plaintiffs, the board of directors is better positioned to respond to the corporation’s alleged injury.⁵⁹ In addition to preserving the board’s authority over

55. See, e.g., *In re Tyson Foods, Inc. Consol. S’holder Litig.*, 919 A.2d 563, 581–82 (Del. Ch. 2007) (outlining the ways a plaintiff “can show that a director is unable to act objectively with respect to pre-suit demand,” including interest in the litigation outcome, close personal relationships, and structural bias arising from a director beholden to another); Claire A. Hill & Brett H. McDonnell, *Fiduciary Duties: The Emerging Jurisprudence*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 133, 136 (Claire A. Hill & Brett H. McDonnell eds., 2012) (explaining that plaintiffs must “present particularized facts . . . that a majority of the board is interested or lacking in independence or else that the board does not deserve the protection of the business judgment rule”).

56. DEL. CODE ANN. tit. 8, § 141(a) (2011).

57. FED. R. CIV. P. 23.1(b)(3)(A)–(B); DEL. CH. CT. R. 23.1(a).

58. Andrew C.W. Lund, *Rethinking Aronson: Board Authority and Overdelegation*, 11 U. PA. J. BUS. L. 703, 703–04 (2009).

59. See, e.g., *La. Mun. Police Emps. Ret. Sys. v. Pyott*, 46 A.3d 313, 339 (Del. Ch. 2012) (describing the many resources within the board’s reach including full information of the corporation’s business dealings, internal expertise, and the ability to reach a compromise with the alleged wrongdoer), *rev’d on other grounds*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013).

suits, the demand requirement is also intended to filter out groundless litigation quickly and efficiently.⁶⁰

A plaintiff can only circumvent the board by alleging that demand, had it been made, would have been futile, which a plaintiff can do only by calling into question the impartiality of the board.⁶¹ The mechanism for excusing demand makes it possible to enforce director fiduciary duties in cases in which directors engaged in malfeasance.⁶² A plaintiff's challenge to a specific decision or action by the board is subject to the *Aronson v. Lewis*⁶³ test, which requires particularized allegations that “create a reasonable doubt” that the board's decision should receive business-judgment protection⁶⁴ and that the directors were “disinterested and independent” at the time the complaint was filed.⁶⁵ If the plaintiff does not challenge any specific action by the board and instead seeks to establish liability for the board's inaction, courts apply *Rales v. Blasband*.⁶⁶ A court applying the *Rales* test asks whether directors could have responded to the demand with independent and disinterested business judgment.⁶⁷

Courts look to the law of the state of incorporation—in many cases, Delaware law—to identify the standards for demand futility.⁶⁸

60. Jack B. Jacobs, *The Vanishing Substance-Procedure Distinction in Contemporary Corporate Litigation: An Essay*, 41 SUFFOLK U. L. REV. 1, 7 (2007).

61. *Aronson v. Lewis*, 473 A.2d 805, 808 (Del. 1984), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). The discussion of structural bias as grounds for excusing demand is outside the scope of this Note. The interpersonal relationship of directors certainly may play a part in demonstrating that the board, as a whole, is unable to consider demand objectively, but such issues are more about fact-specific allegations regarding the inner dynamic of corporations than about a compliance system that has failed to avert a violation of positive law. *See Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1051–52 (Del. 2004); Hill & McDonnell, *supra* note 55, at 142 (distinguishing the stricter standard of review for structural bias from the weaker standard for *Caremark* oversight claims).

62. Lund, *supra* note 58, at 712.

63. *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

64. *Id.* at 808. The business judgment rule “is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action was taken in the best interests of the company.” *Id.* at 812.

65. *Id.* at 814.

66. *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).

67. *Id.* at 934.

68. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 108–09 (1991); Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 66 (2009). In circumstances in which Delaware law does not apply, plaintiffs may face a universal demand requirement that is likely to completely foreclose an FCPA follow-on

Even if the corporation is incorporated elsewhere, many states follow the *Rales* and *Aronson* tests.⁶⁹ These tests for demand futility provide an extraordinary remedy in cases in which the board's impartiality is questioned, but the analysis is weighted in favor of the board.⁷⁰

Typically, a plaintiff can allege interest under *Aronson* or *Rales* by pointing to self-dealing by a director who appears on both sides of a transaction⁷¹ or by showing that a director is interested due to a threat of personal liability because a suit by the corporation would be detrimental to him.⁷² Alternatively, a plaintiff may question a director's independence by alleging that a director is dominated by a personal relationship or an interested director.⁷³ Claims against a specific director's interest or independence, however, cannot be imputed to the rest of the board.⁷⁴ Pleadings must be particularized to individual directors, and to excuse demand, a court must reasonably doubt the independence or interest of a majority of the board.⁷⁵

2. *Confusion Outside Delaware.* This Section gives an example of how the demand analyses have been particularly complicated in

derivative suit without making demand on the board. *See, e.g.,* Haw. Structural Ironworkers Pension Trust *ex rel.* Alcoa, Inc. v. Belda, No. 08-0614, 2008 WL 2705548, at *7 (W.D. Pa. July 9, 2008) (dismissing the FCPA follow-on derivative suit because the plaintiff failed to satisfy the "very narrow" irreparable-harm demand exception and could not show threat to standing); RALPH C. FERRARA, KEVIN T. ABIKOFF & LAURA LEEDY GANSLER, SHAREHOLDER DERIVATIVE LITIGATION: BESIEGING THE BOARD § 6.03 n.3 (2013) (enumerating the jurisdictions that have adopted a universal demand requirement to avoid the "inconsistent and confusing" demand-required and demand-futility analyses). Other jurisdictions entirely foreclose shareholder derivative suits. For example, a pension fund unsuccessfully brought a derivative suit against the directors of BAE Systems PLC (BAE) for making bribes to Saudi officials. *City of Harper Woods Emps. Ret. Sys. v. Olver*, 589 F.3d 1292, 1294–95 (D.C. Cir. 2009). Because BAE was incorporated in the United Kingdom, the old common-law rule of *Foss v. Harbottle*, 67 Eng. Rep. 189, 202 (Ch. 1843), dictated that if harm was done to a company, the company was the only plaintiff with standing. *Olver*, 589 F.3d at 1294–95.

69. *See, e.g., In re Abbott Labs. Derivative S'holders Litig.*, 325 F.3d 795, 803 (7th Cir. 2003) (holding that Illinois follows Delaware in using *Aronson*).

70. *See In re INFOUSA, Inc. S'holders Litig.*, 953 A.2d 963, 986 (Del. Ch. 2007) ("The spirit that clearly animates each test is a Court's unwillingness to set aside the prerogatives of a board of directors unless the derivative plaintiff has shown some reason to doubt that the board will exercise its discretion impartially and in good faith.").

71. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

72. *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).

73. *Orman v. Cullman*, 794 A.2d 5, 25 n.50 (Del. Ch. 2002); *see also supra* note 55 and accompanying text.

74. *See Desimone v. Barrows*, 924 A.2d 908, 943 (Del. Ch. 2007) (explaining that there is no "universally applicable rule about knowledge imputation").

75. *Id.*

the FCPA context. Because some claims allege both wrongful action and inaction by the board, courts must choose between *Rales* and *Aronson*.⁷⁶ Whereas the dual pleading may be seen as a sleight of hand, the determination of whether *Rales* or *Aronson* should apply is very fact specific: allegations that the board consciously ignored violations fall under *Aronson*, and allegations that the board failed to act, without more, trigger *Rales*.

Conflating the *Rales* and *Aronson* standards proves particularly problematic when courts distort the demand-futility analysis by focusing on the *wrong* board action as the reference point for determining whether a director is interested in the challenged actions. Specifically, courts have defaulted to framing bribery as an action which itself requires director self-dealing. For example, in *Strong ex rel. Tidewater, Inc. v. Taylor*,⁷⁷ the complaint alleged that directors refused to enforce anti-bribery policies,⁷⁸ but the court could not decide whether these allegations constituted inaction under *Rales* or *willful* inaction under *Aronson*.⁷⁹ Foregoing the issue of nonenforcement, the court instead focused on whether the directors were personally interested in the underlying bribery.⁸⁰ Because the court concluded that the directors were not self-dealing and did not receive any personal benefit from the bribes, the directors were found to be disinterested and demand was not excused.⁸¹

Here, the court used the wrong decision by the board as its reference point. The analysis considered only the underlying act of bribery. However, the decision of how to address violations or enforce bribery policies goes to the question of director involvement not in the crime of bribery but in the cover-up. The court should have focused on whether directors decided not to enforce policies or knew about violations but did nothing, rather than requiring proof that the directors themselves offered bribes or received pecuniary benefit. Excusing demand only when a director has made a bribe for his own

76. See Donald A. Corbett & Daniel K. Roque, *FCPA Shareholder Derivative Plaintiffs Rack Up Strikes but Keep Swinging*, N.Y. L.J., Jan. 18, 2013, at 1, 3 (noting attempts by plaintiffs to “frame their claims based on affirmative board conduct, as opposed to a failure to monitor”).

77. *Strong ex rel. Tidewater, Inc. v. Taylor*, 877 F. Supp. 2d 433 (E.D. La. 2012).

78. *Id.* at 439.

79. *Id.* at 444.

80. *Id.* at 445.

81. *Id.*

benefit obviates the fact that plaintiffs are bringing claims for a director's failure to provide oversight, not for self-dealing.⁸²

Confusion over the proper application of *Rales* and *Aronson* arises because the action-or-inaction line is difficult to delineate and subject to manipulation in how plaintiffs plead their cases. The main problem, however, is ensuring that the court is considering the right baseline decision for determining whether a board is interested or not. In FCPA cases, as shown above, this decision will likely turn on how the company responded to potential violations.⁸³ Only in rare cases will it focus on the actual act of bribing a foreign official or approving a bribe.⁸⁴

B. Pleading Failure To Monitor

To successfully plead demand futility in oversight cases, a plaintiff must allege that a director is interested because it is substantially likely that the director violated a duty. As this Section explains, there are two levels of pleading in oversight cases. First, the plaintiff must allege a *Caremark* violation, a very high threshold that requires a showing that the directors violated their oversight duties either through action or inaction.⁸⁵ The substantive law on directors' oversight duties—upon which all FCPA follow-on derivative suits are premised—has evolved from a reconfiguration of the duty of loyalty and good faith.⁸⁶ Second, the plaintiff must show futility arising from the directors' interest and inability to impartially consider a demand because it is substantially likely they are liable. To show (1) bad faith for the *Caremark* violation and (2) substantial likelihood of liability for demand futility, plaintiffs must allege the directors *knew* they were violating a duty. The intersection of knowledge for the *Caremark* and demand-futility analyses is briefly introduced in this Section and fleshed out further in Part III.

82. See *infra* notes 107–11 and accompanying text.

83. See *Strong*, 877 F. Supp. 2d at 444; see also *Freuler v. Parker*, 803 F. Supp. 2d 630, 641 (S.D. Tex. 2011) (alleging the defendant directors “failed to establish and maintain” FCPA controls and “failed to enforce . . . existing policies”), *aff'd*, No. 12-20260, 2013 WL 1153058 (5th Cir. Mar. 11, 2013) (per curiam).

84. E.g., *La. Mun. Police Em. Ret. Sys. v. Wynn*, No. 2:12-CVM-509-JCM, 2013 WL 431339, at *1 (D. Nev. Feb. 1, 2013).

85. See *supra* Part II.A.1 for the distinct standards for action (*Aronson*) or inaction (*Rales*) in demand futility.

86. Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 464, 470–73 (2009); see also *infra* note 99.

1. Caremark *Liability and Demand-Futility Analysis*. A *Caremark* claim stems from a board decision resulting in loss due to negligence (action, an *Aronson* problem) or an “unconsidered failure of the board to act” if action would have prevented loss to the corporation (inaction, a *Rales* problem).⁸⁷ Under *Caremark*, plaintiffs must show (1) a breach of fiduciary duty based on the directors’ actual knowledge of legal violations or (2) that directors should have known of legal violations and breached their duty of good faith in failing “to prevent or remedy [the] situation.”⁸⁸ Only an “utter failure to attempt to assure a reasonable information and reporting system exists” establishes the bad faith necessary to find that a director has failed to exercise oversight.⁸⁹ Given this high standard, implementing a compliance system is likely sufficient to avoid *Caremark* liability; even if the system is inadequate, liability is unlikely, so long as the system is not so grossly inadequate as to implicate a director’s bad faith because he knew it was inadequate *and* failed to monitor it.⁹⁰

The intersection between *Caremark* liability and the demand-futility analysis requires a close examination of the scenarios that would give rise to a claim. *Caremark* opened the door to director liability in the absence of conflicts of interest but still limited liability to extreme circumstances of director misconduct.⁹¹ Oversight failures include scenarios of both action and inaction, for example, (1) a director who knowingly violated the law, (2) a director who knew of possible violations but took no action, or (3) a director who caused the corporation to violate the law to yield greater profits.⁹² A board that has “consciously failed to act” even after receiving evidence of a “red flag” alerting the directors they were breaching their duties⁹³

87. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996).

88. *Id.* at 971. In *Caremark*, shareholders brought a derivative suit against directors alleging that they had breached their duty of care by failing to supervise the company’s contracts with physicians, which led to federal liability for violation of anti-kickback laws. *Id.* at 961–64.

89. *Id.* at 971.

90. See *Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (en banc) (outlining “necessary conditions predicate” to liability as a complete failure to implement a system or when there is a system, failure to monitor, and “disabling [the directors] from being informed of risks or problems requiring their attention”).

91. DEBORAH A. DEMOTT, *SHAREHOLDER DERIVATIVE ACTIONS LAW AND PRACTICE* 17–18 (2012).

92. *Id.*

93. See *La. Mun. Police Emps. Ret. Sys. v. Pyott*, 46 A.3d 313, 341 (Del. Ch. 2012) (discussing “the proverbial ‘red flag’”), *rev’d on other grounds*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013).

may straddle (1) and (2). Lack of action, just like a decision to outright violate a law, would constitute a board decision subject to challenge under *Aronson*.⁹⁴ If the board did not act, and *Rales* applies instead, *Caremark* requires “a sustained or systematic failure . . . to exercise oversight.”⁹⁵

Caremark expanded director oversight duties while also “constrain[ing] courts’ authority to hold directors liable for poor compliance decisions.”⁹⁶ *Caremark*, in tandem with *Stone ex rel. AmSouth Bancorporation v. Ritter*,⁹⁷ requires that directors carry out monitoring duties and ensure that a reasonable compliance system is in place. The liability for breach, however, only arises when the director acted in bad faith by consciously or knowingly failing to fulfill the duty concerning compliance and monitoring.⁹⁸ *Stone* clarified that good-faith violations arising from *Caremark* oversight liability were actually a subset of duty of loyalty claims.⁹⁹

2. *Bribery and the Duties of Directors*. This Section explains (1) how the development of the duty of loyalty in Delaware jurisprudence affects the analysis of director duties insofar as bribery is concerned and (2) the challenges facing a plaintiff who must plead demand futility by relying on allegations of a violation of oversight duties. The most obvious violation of the duty of loyalty occurs when a director has a conflict of interest or engages in self-dealing.¹⁰⁰ But the duty of loyalty currently encompasses more than eliminating conflicts of interest and an obligation to abstain from self-dealing.¹⁰¹

94. *See id.* (“The decision to act [to violate the law] and the conscious decision not to act are thus equally subject to review under traditional fiduciary duty principles and equally able to create the requisite connection to the board.”).

95. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).

96. Jennifer Arlen, *The Story of Allis-Chalmers, Caremark, and Stone: Directors’ Evolving Duty To Monitor*, in *CORPORATE LAW STORIES* 325 (J. Mark Ramseyer ed., 2009).

97. *Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362 (Del. 2006) (en banc).

98. Arlen, *supra* note 96, at 325–26.

99. *Stone*, 911 A.2d at 369–70; Hill & McDonnell, *supra* note 22, at 1778. *Stone* resolved a prior disagreement over whether the duty of good faith was a freestanding duty that existed separately from the duties of care and loyalty. *See* Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 *DEL. J. CORP. L.* 1, 12–14 (2006) (outlining then-Vice Chancellor Strine’s opposition to the “triadic formulation of duties of corporate managers” in favor of an approach in which good faith is part of the duty of loyalty); *id.* at 15–21 (disagreeing with the “dyadic” approach to the duty of good faith based on Delaware precedent and the meaning of “faith” as compared to “good faith”).

100. *See* Hill & McDonnell, *supra* note 22, at 1779.

101. Gold, *supra* note 86, at 488.

Professors Hill and McDonnell outline three scenarios aside from the traditional self-dealing violation that violate the duty of loyalty: (1) when directors defer excessively to each other to the detriment of the corporation, (2) when directors act with “suspect motive[s]” in following a course of action that benefits them, and (3) when directors are themselves involved in violations of positive law or have failed to monitor the conduct of other actors who engaged in illegal action.¹⁰²

The last category, unlike the first two, does not necessarily involve a conflict of interest between directors and shareholders.¹⁰³ For example, a bribe may facilitate and enhance the corporation’s business, and a director who encourages the payment of a bribe may do so with the objective of furthering the corporation’s business.¹⁰⁴ This scenario, in which a director engages in outright illegal behavior, clearly violates the duty of loyalty notwithstanding the absence of a conflict of interest.¹⁰⁵ Less clear is whether a director breaches the duty of loyalty by failing to monitor corporate practices that may lead to bribery.¹⁰⁶

Despite the expansion of the duty of loyalty to non-self-interested conduct, courts outside of Delaware insist on trying to fit the FCPA-related *Caremark* claims into the traditional self-dealing paradigm of loyalty violations. In *Strong*, the district court dismissed the complaint for failure to plead demand futility because the

102. Hill & McDonnell, *supra* note 22, at 1780–81.

103. *Id.* at 1784; *see also* Eisenberg, *supra* note 99, at 38 (arguing, prior to the *Stone* decision, that a knowing violation of the law “will seldom violate the duty of loyalty” because the director has not acted out of self-interest).

104. Hill & McDonnell, *supra* note 22, at 1784.

105. *See id.* at 1784–85 (suggesting reasons to equate illegal behavior with a violation of loyalty because illegal behavior indicates a propensity for other conduct that may “directly diverge[] with the shareholders’ interests or because of a duty owed to the public more generally to ensure the corporation is law-abiding”); *see also* Eisenberg, *supra* note 99, at 31 (explaining the “well established principle” that a director cannot cause a corporation to violate the law even if the violation is profit maximizing because any profit is outweighed by the penalty and reputational damage).

106. *See* Gold, *supra* note 86, at 485 (citing Eisenberg, *supra* note 99, at 38) (“Trying to squeeze such conduct into the duty of loyalty is like trying to squeeze the foot of Cinderella’s stepsister into Cinderella’s glass slipper—an enterprise equally painful and fruitless.”); Hill & McDonnell, *supra* note 22, at 1785 (“[D]irectors are shirking their responsibility to be vigilant when they, on some metric, ‘ought’ to know what their lack of vigilance might permit; hence, the violation of the duty of good faith.”); *id.* at 1780 (arguing that “snoozing,” though superficially less serious than “stealing,” may still be problematic depending on the motivation behind director’s inattention).

directors did not themselves benefit from any bribes.¹⁰⁷ The court's analysis failed to recognize that, under a *Caremark* claim, self-dealing is not *required* for demand futility; instead, demand futility can be pled by showing a substantial likelihood of liability for failing to oversee the violation.¹⁰⁸ A court's focus on the underlying act of bribery would be appropriate when the directors are themselves implicated in approving the bribe. Even in that case, however, self-dealing is not the only road to excusing demand.¹⁰⁹ For example, in a recent FCPA follow-on derivative suit, the district court decided whether directors, who had allegedly approved a bribe to a public institution in Macau, were interested.¹¹⁰ The court did not look for evidence the directors were self-dealing when they approved the bribe, but reasoned that the directors may be interested since they may be liable for violating the FCPA.¹¹¹

FCPA follow-on derivative suits are thus different from other *Caremark* cases because the underlying facts pertaining to corporate bribery are unlikely to hinge on a director's own self-interest or self-dealing in a transaction. In other duty of loyalty cases, such as claims against the board for backdating stock options for directors and officers,¹¹² there are clear grounds on which to allege that directors are interested in the challenged transaction. In the bribery context, however, a plaintiff is likely unable to show individual directors benefitted directly from a bribe to a government official. Whereas in the "first wave" of the 1970s, plaintiffs alleged *direct* participation by directors and officers, plaintiffs during the current "second wave" of derivative suits allege that directors failed to monitor FCPA risks and

107. Strong *ex rel.* Tidewater, Inc. v. Taylor, 877 F. Supp. 2d 433, 445 (E.D. La. 2012).

108. Hill & McDonnell, *supra* note 22, at 1780; *see* La. Mun. Police Emps. Ret. Sys. v. Pyott, 46 A.3d 313, 340 (Del. Ch. 2012) ("Without a substantial threat of director liability, a court has no reason to doubt the board's ability to evaluate a demand."), *rev'd on other grounds*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013).

109. *See* La. Mun. Police Emps. Ret. Sys. v. Wynn, No. 2:12-CVM-509-JCM, 2013 WL 431339, at *5 (D. Nev. Feb. 1, 2013) (employing the substantial likelihood of liability test for director interest).

110. *Id.* at *1, *5.

111. *Id.* at *6. Nevada law requires knowledge that a bribe was illegal to excuse demand. The court held the plaintiffs had insufficiently alleged that the directors knew the payment was illegal and dismissed the complaint. *Id.*

112. *See, e.g.,* Desimone v. Barrows, 924 A.2d 908, 909 (Del. Ch. 2007); *In re* Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563, 583 (Del. Ch. 2007).

compliance.¹¹³ These *Caremark* claims allow plaintiffs to sue directors who were not themselves involved in bribery.¹¹⁴

Demand futility remains a major hurdle, even if the director need not be the one receiving or giving a bribe. To overcome this procedural hurdle, there must be some other reason why the directors cannot disinterestedly respond to the violation and why the plaintiff should be allowed to defend the corporation's interests instead. Courts have rejected different bases for questioning directors' motivation. For example, a plaintiff cannot rely on an allegation that directors are interested based solely on the fact that they receive compensation¹¹⁵ or that compensation motivated them to circumvent or refuse to enforce anti-bribery policies.¹¹⁶ Instead, the shareholder claim under *Caremark* must "contend[] that the directors set in motion or 'allowed a situation to develop and continue which exposed the corporation to enormous legal liability and that in doing so they violated a duty to be active monitors of corporate performance.'"¹¹⁷ It is not, however, necessary to demonstrate a "reasonable probability of success on the merits."¹¹⁸ If plaintiffs can show that directors failed to monitor and that directors *knew* they were violating a fiduciary duty by "conscious[ly] disregard[ing] their responsibilities,"¹¹⁹ they are more likely to demonstrate a failure of oversight and a substantial likelihood of liability under the demand-futility analysis for director interest.

Thus, the procedural and substantive aspects of the suit collapse into one another because the plaintiff must show a connection between the "corporate calamity" and the board that results in a "substantial threat of director liability" sufficient to give the court pause as to whether the board could disinterestedly evaluate a

113. Corbett & Roque, *supra* note 17, at 858.

114. *Id.*

115. See, e.g., *In re Am. Int'l Group, Inc. Derivative Litig.* 700 F. Supp. 2d 419, 432 (S.D.N.Y. 2010) (holding that ordinary compensation is not sufficient to excuse demand and that plaintiffs must allege specific facts calling into question the board's independence based on compensation).

116. Strong *ex rel.* Tidewater, Inc. v. Taylor, 877 F. Supp. 2d 433, 445 (E.D. La. 2012).

117. La. Mun. Police Emps. Ret. Sys. v. Pyott, 46 A.3d 313, 340 (Del. Ch. 2012) (quoting *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996)), *rev'd on other grounds*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013). For a discussion of *Caremark* and directors' duty of loyalty, see *infra* Part III.A.1.

118. Rales v. Blasband, 634 A.2d 927, 934 (Del. 1993).

119. Stone *ex rel.* AmSouth Bancorp. v. Ritter, 911 A.2d 362, 370 (Del. 2006) (en banc).

demand.¹²⁰ Even with the expansion of loyalty and the ability to plead demand futility by alleging a substantial likelihood of liability, serious challenges remain for plaintiffs who allege director knowledge. As the next Part shows, there are cases suggesting that patterns of violations or red flags give rise to an inference of knowledge.

III. DEMAND EXCUSED: *CAREMARK* TYPOLOGIES

The baseline in an FCPA follow-on derivative suit is that *Caremark* pleading poses an extraordinarily difficult burden for plaintiffs.¹²¹ Courts generally give deference to a board when there is a compliance system in place, but this deference is tempered when there are suspicious circumstances that suggest board bias due to director involvement in the wrongdoing.¹²² This Part demonstrates that there *are* certain types of cases in which plaintiffs have successfully pleaded demand futility. Oversight of violations of positive law cases falls in the middle of a spectrum of *Caremark* cases. Self-interest cases present the easiest facts under which to excuse demand because there are direct personal benefits.¹²³ In contrast, cases featuring a failure to assess business risks pose the hardest facts under which to excuse demand because even the worst investments are covered by the business judgment rule.¹²⁴ Oversight of violations cases falls in between these two extremes because violations of positive law neither give rise to personal benefits nor are sanctioned by business judgment.

Because FCPA follow-on derivative suits do not fit the typical duty of loyalty paradigm, *Caremark* claims arising out of regulatory violations provide a better reference point for determining under what circumstances courts are willing to allow a derivative suit to proceed because a board of directors is interested or otherwise lacks

120. *Id.*

121. *See supra* note 22 and accompanying text.

122. *See Hill & McDonnell, supra* note 22, at 1792 (explaining how there is little structural or interest bias in *Caremark* cases because usually subordinates would have engaged in illegal behavior).

123. For discussion of cases in which directors backdated stock options, see *supra* note 112 and accompanying text.

124. *See In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 123–24 (Del. Ch. 2009) (holding that *Caremark* claims based on directors' failure to gauge the risk of subprime mortgages are not so much about oversight liability as about an attempt to "hold the director defendants personally liable for making (or allowing to be made) business decisions that, in hindsight, turned out poorly for the Company").

independence. Many of the *Caremark* cases that have excused demand involve healthcare corporations that have violated Food and Drug Administration (FDA) regulations or Medicare/Medicaid reimbursement regulations.¹²⁵ The healthcare industry, much like corporate overseas activities subject to the FCPA, has experienced an upward trend in government scrutiny and oversight.¹²⁶ Another interesting feature shared by the healthcare and FCPA *Caremark* cases is the fact that many plaintiffs have resorted to courts outside of Delaware. These cases suggest that other state courts outside of Delaware are more willing to allow shareholder derivative suits to proceed.¹²⁷

A. *Using Knowledge To Excuse Demand*

Because the standard for director liability is abstract, the groupings of *Caremark* cases are a useful starting point for the very fact-specific analysis of *Caremark* claims in the FCPA context.¹²⁸ The typologies show the factual scenarios that have allowed—and would allow—a plaintiff to show that the board of directors has knowledge of the violations. The cases excusing demand fall into one or more of the following factual scenarios: (1) an extensive paper trail detailing a regulatory violation, (2) business strategies that institutionalize a regulatory violation and make the business dependent on facilitating violations, and (3) objective indicators, such as audit reports and oversized profits, coupled with directors' experience, that give rise to an inference that the board knew of a violation. Under these scenarios, knowledge serves as the basis for excusing demand because

125. See *infra* Part III.A.1–3.

126. Kimberly D. Baker & Arissa M. Peterson, *Post-Caremark Implications for Health Care Organization Boards of Directors*, 3 SEATTLE J. FOR SOC. JUST. 387, 387 (2004).

127. See Scott J. Davis & Michael T. Torres, *Directors' Monetary Liability for Actions or Omissions Not in Good Faith* 28 (unpublished manuscript) (May 22, 2009), available at <http://blogs.law.harvard.edu/corpgov/files/2009/05/directors-monetary-liability-for-actions-or-omissions-not-in-good-faith.pdf> (explaining how two *Caremark* cases, *McCall v. Scott*, 239 F.3d 808 (6th Cir. 2001) and *Abbott Laboratories*, a Seventh Circuit case, are indicative of other courts' willingness to allow oversight claims, in contrast to Delaware cases on demand).

128. See Stelman, *supra* note 68, at 115 (noting how although the fiduciary duties are “constan[t]” the true challenge lies in the application of these “fiduciary precepts to changing factual scenarios”). Courts have looked to other demand cases to determine which factual scenario most closely approximates shareholder allegations against directors for violations of the FCPA. See, e.g., *Midwestern Teamsters Pension Trust Fund v. Deaton*, No. H-08-1809, 2009 WL 6799492, at *7 (S.D. Tex. May 7, 2009) (“On this record, Plaintiffs’ allegations more closely resemble those in *Guttman*, rather than those in *Abbott*.”), adopted by *Midwestern Teamsters Pension Fund v. Baker Hughes Inc.*, 2010 WL 3359560 (S.D. Tex. May 26, 2010).

courts can find that continued violations are not protected by the business judgment rule (the *Aronson* test) or find that directors are interested because they knew of the violations and thus, face a substantial likelihood of liability due to their inaction (the *Rales* test).

1. *Type One: Extensive Paper Trail and Persistent Violations.* Courts are reluctant to infer knowledge even when corporations repeatedly violate the FCPA, but Type One cases show that reporting systems put directors on notice of prior violations—particularly when there are repeated violations—and provide an inference that they knew of violations that occurred thereafter.

In *In re Abbott Laboratories Derivative Shareholders Litigation*,¹²⁹ the FDA assessed a civil fine against Abbott and ordered it to destroy medical inventory that violated federal regulations.¹³⁰ Before the fine, the FDA sent four warnings to company headquarters after inspections revealed that products were “adulterated.”¹³¹ Abbott received warning letters even after it entered an FDA Compliance Plan; three years after starting the Compliance Plan and four years after the first warnings, the FDA terminated the cooperative arrangement, citing Abbott’s repeated violations.¹³² The plaintiffs alleged that Abbott’s directors were aware that the company failed to comply for six years.¹³³

The district court dismissed the case after concluding that the alleged facts did not indicate the directors were substantially likely to be liable for their inaction under *Rales*.¹³⁴ But the Seventh Circuit, overturning the district court, disagreed that the directors had merely failed to act and decided instead that *Aronson* was the appropriate standard because there was evidence the directors knew about Abbott’s violations through the warning letters and audit-committee

129. *In re Abbott Labs. Derivative S’holders Litig.*, 325 F.3d 795 (7th Cir. 2003).

130. *See id.* at 798 (finding that Abbott had failed to comply with regulations for manufacturing of diagnostic tests kits and regulations protecting human subjects from hazard during testing).

131. *Id.* at 799.

132. *Id.* at 800.

133. *Id.* at 802. The plaintiffs pointed to meetings of the board and alleged that they had received information about Abbott’s continued noncompliance. *Id.*

134. *See In re Abbott Labs. Derivative S’holders Litig.*, 141 F. Supp. 2d 946, 948, 950–51 (N.D. Ill. 2002) (finding that plaintiffs did not show that the directors knew about the violations, and, even if they did know, that their inaction would not show that the directors did not believe Abbott was trying to comply with the FDA); *see also In re Abbott Labs.*, 325 F.3d at 803, 805 (citing *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993)).

meetings.¹³⁵ The decision to ignore FDA warnings was not protected by the business judgment rule.¹³⁶ Despite the difficulty inherent in overcoming the business judgment rule,¹³⁷ the *Abbott* plaintiffs successfully alleged that the board's "conscious inaction" amounted to a violation of good faith, which was not protected by business judgment under *Aronson*, and which violated *Caremark* oversight duties.¹³⁸

To reach the business-judgment issue, the Seventh Circuit first inferred director knowledge from the extensive paper trail.¹³⁹ The court interpreted the board's knowledge and failure to address violations as action subject to *Aronson* rather than inaction subject to *Rales*.¹⁴⁰ Unlike the directors in *Caremark*,¹⁴¹ the *Abbott* board knew about the FDA violations due to multiple warning letters from the FDA, meetings with FDA representatives, and newspaper articles about possible detriment to *Abbott*.¹⁴²

Abbott is not a case in which a reporting system was completely absent or inadequate. Demand futility was based on the fact that defendant directors were aware of violations and had received notice from the FDA.¹⁴³ In fact, *Abbott* indicates that when there is a reporting system in place, the court may assume that the reporting

135. *In re Abbott Labs.*, 325 F.3d at 806.

136. *See id.* at 809 ("[W]e find that the plaintiffs have sufficiently pleaded allegations, if true, of a breach of the duty of good faith to reasonably conclude that the directors' actions fell outside the protection of the business judgment rule.").

137. *See Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled in part on other grounds* by *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (explaining the presumption that "directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company" and that the plaintiff challenging a board decision bears the burden of rebutting the presumption).

138. *In re Abbott Labs.*, 325 F.3d at 809.

139. *See id.* ("Given the extensive paper trail in *Abbott* concerning the violations and the inferred awareness of the problems, the facts support a reasonable assumption that there was a 'sustained [and] systematic failure of the board to exercise oversight . . .'" (quoting *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996), *rev'd on other grounds*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013))).

140. For a discussion on the action versus inaction distinction in *Aronson* and *Rales*, see *supra* notes 62–67.

141. *See supra* note 88 and accompanying text.

142. *In re Abbott Labs.*, 325 F.3d at 808. The court also noted that the "magnitude and duration of the FDA violations in *Abbott* were so great that it occasioned the highest fine ever imposed by the FDA." *Id.* at 809.

143. *Id.* at 806.

system worked as intended, and thus, that the board was aware of violations and consciously decided not to act.¹⁴⁴

In the FCPA context, by contrast, courts have given defendant directors the benefit of the doubt even in the face of persistent violations and even—perhaps especially—when there is a compliance system. In *Midwestern Teamsters Pension Trust Fund v. Deaton*,¹⁴⁵ a clear pattern of FCPA violations was present: Baker Hughes employees made illegal payments in Brazil and India in 1995 and 1998, respectively, and the company discovered these payments in 1999.¹⁴⁶ Even after new violations in Angola, Indonesia, Nigeria, Kazakhstan, Russia, and Uzbekistan emerged in 2007, the Texas district court dismissed a derivative suit alleging that Baker Hughes had failed to provide adequate oversight to avoid payments in violation of the FCPA.¹⁴⁷ The court concluded that illegal payments took place *despite* the advice of the FCPA adviser and emphasized that Baker Hughes had implemented a revised FCPA policy before the 2007 violations.¹⁴⁸ The *Midwestern* court distinguished *Abbott* on the basis that the *Abbott* board failed to take any steps to remedy its violations, whereas Baker Hughes made adjustments and addressed its persistent corruption issues, even though the changes failed to prevent future violations.¹⁴⁹ *Midwestern* diverges from the main thrust of *Abbott*, namely that board knowledge is inferred because corporate reporting systems are assumed to work as they should and that, based on the violations, the directors did nothing to comply with the FDA.¹⁵⁰ Instead, the *Midwestern* court took a different tack: the reporting system insulated the Baker Hughes directors from liability and was not a basis to infer board knowledge of violations, as in *Abbott*. Moreover, violations after improvements to the reporting system happened *despite* the reporting system and could not suggest bad faith or a board failure.¹⁵¹ The *Midwestern* court did not dwell on

144. *See id.* (“Where there is a corporate governance structure in place, we must then assume the corporate governance procedures were followed and that the board *knew* of the problems and *decided* no action was required.” (emphasis added)).

145. *Midwestern Teamsters Pension Trust Fund v. Deaton*, No. H-08-1809, 2009 WL 6799492 (S.D. Tex. May 7, 2009), *adopted by* *Midwestern Teamsters Pension Trust Fund v. Baker Hughes Inc.*, 2010 WL 3359560 (S.D. Tex. May 26, 2010).

146. *Id.* at *2.

147. *Id.* at *3, *11.

148. *Id.* at *2–3.

149. *Id.* at *7.

150. *See In re Abbott Labs. Derivative S’holders Litig.*, 325 F.2d 795, 806 (7th Cir. 2003).

151. *Midwestern*, 2009 WL 6799492, at *8.

the fact that for all its revisions, the compliance system still failed in several countries, and nor did the court attempt to draw inferences against the board or assume that the reporting system would have worked as it was intended so that the board would be kept apprised of the violations.¹⁵² In fact, under *Midwestern*, corporations can have their cake and eat it too. A corporation can point to compliance systems to avoid liability for an utter failure of oversight or grossly inadequate system.¹⁵³ At the same time, directors can disclaim knowledge of violations because the compliance system was inadequate and failed to alert them of subsequent violations.¹⁵⁴

Given the uncertain effect of the reporting system for the purposes of the *Aronson* or *Rales* tests,¹⁵⁵ district courts are likely to reach different conclusions regarding which test to apply. The *Midwestern* approach of assuming violations following revisions of reporting systems are not actionable gives defendant directors too much deference, whereas the *Abbott* approach of imputing knowledge based on an assumption that reporting systems will work effectively may go too far in the other direction. The best approach would likely consider the case-specific allegations by each derivative plaintiff regarding the particular reporting system in place and would evaluate the adequacy of the reporting system to determine whether the board consciously acted to ignore future violations or had implemented rigorous checks that nevertheless failed.

2. *Type Two: Knowledge Based on Overt Business Strategy by the Board that Encouraged or Facilitated Violations.* Employing a business strategy that is dependent on violating positive law or facilitating a violation, if sufficiently overt, is an easier path to

152. The court did, however, note the shortcomings in the pleadings of the *Midwestern* plaintiffs. See *infra* note 194.

153. See *supra* notes 89–90.

154. Even a reasonably designed compliance system can fail at times. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996), *rev'd on other grounds*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013). But in *Midwestern*, the government brought complaints against Baker Hughes for violations in six countries, after the company was put on notice after the first set of violations in 1999 and after the intervening reform of the compliance system between 1999 and 2007. See *supra* notes 146–47.

155. The issue of whether *Rales* or *Aronson* applies remains an open question across different district courts and remains unresolved by Delaware courts. See *In re Intel Corp. Derivative Litig.*, 621 F. Supp. 2d 165, 173 (D. Del. 2009) (outlining the different positions held by the Seventh and Third Circuits in applying Delaware law and whether *Abbott* is a faithful application of Delaware law).

excusing demand because it suggests that the board *itself* encouraged a violation.¹⁵⁶

In *In re SFBC International, Inc., Securities & Derivative Litigation*,¹⁵⁷ the plaintiffs alleged that PharmaNet Development Group (PDG) violated FDA requirements for clinical trials by failing to disclose medical risks to participants and underreporting negative side effects.¹⁵⁸ After PDG's practices became public, shareholders sued the board for "failing to correct the widespread mismanagement of the company and egregious wrongdoing."¹⁵⁹ The plaintiffs alleged PDG's "strategy for growth and expansion" was based on a violation of ethical procedures and falsification of reports.¹⁶⁰ The plaintiffs pointed to substandard testing at PDG's largest facility which comprised 60 percent of clinical-trial facilities and accounted for 30 percent of total profits—a sizeable portion of PDG's operations.¹⁶¹

Applying *Rales*, the district court concluded that the directors had a "disabling personal interest" and could not exercise disinterested and independent judgment because they faced a substantial likelihood of liability for PDG's business practices.¹⁶² Beyond the red flags raised by FDA warnings, the directors knew or "should have known" how the corporation conducted clinical trials, particularly because misconduct was pervasive and not decentralized.¹⁶³ Their failure to monitor PDG's "core business" amounted to egregious mismanagement of clinical trials and satisfied the *Caremark* requirement of conscious disregard for their duties.¹⁶⁴ The court emphasized that the directors knew of and should be liable for the FDA violations because those violations stimulated PDG's business.¹⁶⁵

156. See *supra* note 105 and accompanying text, which explain how explicit violations of positive law always violate the duty of loyalty and give rise to director liability.

157. *In re SFBC Int'l, Inc. Sec. & Derivative Litig.*, 495 F. Supp. 2d 477 (D.N.J. 2007).

158. *Id.* at 479–80.

159. *Id.* at 481.

160. See *id.* at 480–81 (detailing mammoth clinical-testing operations where it became endemic to use uneducated test subjects, to allow human test subjects to participate in overlapping trials, and to conceal these violations by using conflicted review boards to oversee the clinical trials).

161. *Id.* at 481.

162. *Id.* at 483, 485.

163. *Id.* at 485–86.

164. *Id.* at 486.

165. See *id.* at 485 (concluding that PDG's "operating procedure . . . enable[d] the company to secure and perform contracts for large drug trials").

In addition to which aspects of the business the violation affects, the extent of the violations also determines whether a court will conclude that the violations have become institutionalized in the business strategy of a corporation. If the regulatory violation is an isolated event, the board is less likely to be liable for the conduct. But if there is a pattern of repeat violations, a board could be implicated in supporting, or at least willfully ignoring, the violations.¹⁶⁶ In cases concerning off-label drug marketing, for example, courts have concluded that business practices that make illegal marketing a core business priority indicate board participation in violations, particularly if there have been violations in the past.¹⁶⁷ Moreover, if red flags and previous misconduct are pervasive, the need to allege particularized knowledge for *each* defendant may be and has been relaxed.¹⁶⁸

Although strategic planning in off-label marketing has given rise to inferences of director knowledge, the Delaware Court of Chancery has been reluctant to make the same inferences from bribery patterns. Commentators point to *In re Dow Chemical Co. Derivative Litigation*¹⁶⁹ as foreclosing all shareholder derivative suits from FCPA violations.¹⁷⁰ Reading *Dow* this broadly, however, is a mistake. In *Dow*, despite assuming that Dow bribed officials in Kuwait, the court dismissed the plaintiffs' suit because there was no basis to conclude the board knew or should have known about the bribe.¹⁷¹ Neither previous SEC fines nor bribery incidents in other countries convinced

166. See *id.* (finding that the FDA violations at issue were not “merely decentralized activity by employees of a far-flung enterprise of the company”).

167. *In re Pfizer Inc. S'holder Derivative Litig.*, 722 F. Supp. 2d 453, 461–62 (S.D.N.Y. 2010); see *La. Mun. Police Emps. Ret. Sys. v. Pyott*, 46 A.3d 313, 352, 355–56 (Del. Ch. 2012) (inferring knowing approval of violations because the FDA sent warning letters and the company had previously settled claims), *rev'd on other grounds*, No. 380, 2013 WL 1364695, at *4 (Del. Apr. 4, 2013). For a discussion of *Pyott*'s subsequent history, see *infra* Part III.B.

168. See *In re Pfizer*, 722 F. Supp. 2d at 462 (determining that it was “entirely reasonable” to conclude that each director had “deliberate[ly] disregard[ed]” his duties).

169. *In re Dow Chem. Co. Derivative Litig.*, No. 4349-CC, 2010 WL 66769 (Del. Ch. Jan. 11, 2010).

170. See Mark, *supra* note 17, at 481 (“*Dow* may operate to bar derivative claims based on FCPA violations and a *Caremark* theory.”); cf. Corbett & Roque, *supra* note 17, at 858–59 (explaining how *Dow* fits the paradigm of difficult-to-win *Caremark* cases).

171. *In re Dow Chem.*, 2010 WL 66769, at *13.

the Court of Chancery of systematic board involvement in, or board knowledge of, the violations.¹⁷²

Nevertheless, *Dow* should not be read as protecting directors from liability when there is pervasive, institutionalized bribery. As compared to an off-label marketing case in which the plaintiffs could point to a slide presentation to the board that listed off-label marketing as a top priority,¹⁷³ the *Dow* plaintiffs were likely unsuccessful in pleading demand futility because they based their allegations on public rumors of violations and never inspected corporate records. It is likely, then, that if plaintiffs use corporate records to show a pattern of bribery, they will fare better than the *Dow* plaintiffs. For example, Siemens's FCPA violations would likely provide some basis for inferring director knowledge from bribery patterns. Siemens, the most heavily fined FCPA violator to date,¹⁷⁴ had a culture in which "bribery was tolerated and even rewarded."¹⁷⁵ Investigations uncovered pervasive violations across the world in addition to the institutionalization of bribery practices.¹⁷⁶

This typology would open up the possibility of inferring knowledge when a corporation operates in countries or industries with high indexes of corruption and when bribes to foreign officials are central to the expansion of operations. An important limiting principle is necessary, however, as it would go too far for bribery or

172. *See id.* (rejecting the plaintiff's argument that a prior fine for bribery was grounds for knowledge because "similar conduct by different members of management, in a different country, in an unrelated transaction . . . is simply too attenuated to support a Caremark claim").

173. *La. Mun. Police Emps. Ret. Sys. v. Pyott*, 46 A.3d 313, 353 (Del. Ch. 2012), *rev'd on other grounds*, 2013 WL 1264695 (Del. Apr. 4, 2013).

174. Richard L. Cassin, *France's Total SA Cracks Our Top Ten List*, FCPA BLOG (May 29, 2013 12:38 PM), <http://www.fcablog.com/blog/2013/5/29/frances-total-sa-cracks-our-top-10-list.html>.

175. Alexandra Wrage & Anne Richardson, *Siemens AG—Violations of the Foreign Corrupt Practices Act*, 48 INT'L LEGAL MATERIALS 232, 233 (2009).

176. *See id.* at 232–33 (noting how Siemens had "created elaborate payment schemes" and recounting payments in Venezuela, China, Israel, China, Bangladesh, Nigeria, Mexico, Iraq, Russia, and Vietnam in various different industries, all facilitated by slush funds and off-the-books records). While the FCPA violations of Siemens lend themselves nicely to the analysis of the different *Caremark* typologies, a derivative suit against Siemens would be unlikely to succeed. Siemens, incorporated in Germany, would not be subject to Delaware corporate law; rather, under the internal affairs doctrine, German law would determine issues of standing and substantive duties of directors in a derivative suit. *See* DEMOTT, *supra* note 91, at 223 (explaining Delaware case law on internal corporate affairs).

conditions conducive to bribery to be grounds for per se knowledge.¹⁷⁷ Accordingly, knowledge can be reasonably inferred when there is a high risk or incidence of corruption *and*, despite these risks, the corporation has few or inadequate controls. Given the high profile of FCPA enforcement and compliance, no corporation could get away with having absolutely no internal controls;¹⁷⁸ the next logical step for ensuring compliance is scrutiny over the adequacy of systems when there are known bribery risks.

3. *Type Three: Inferring Knowledge from Prior Experience of the Directors or Objective Factors.* Though courts often defer to the decisions of experienced boards, directors' previous experience with violations may speak to their ability to address recurring violations.¹⁷⁹ In *McCall v. Scott*,¹⁸⁰ the plaintiffs alleged pervasive violations of Medicare and Medicaid laws in patient treatment and cost reporting.¹⁸¹ The Sixth Circuit analyzed demand futility under *Rales*.¹⁸² The court concluded that demand was futile because the pleadings created doubt that the directors were disinterested.¹⁸³ There were two discernible bases for liability: (1) the directors' prior experience and (2) other objective indicators.

First, the directors had previously served on the corporation's board and as members of the compensation and audit committees; many red flags, coupled with the board's inaction, suggested recklessness or conscious disregard by the board.¹⁸⁴ The court determined that *Caremark* liability did not require intentional or even reckless infliction of harm on the corporation, and therefore, even unintentional inaction could suffice.¹⁸⁵ Though the allegations did not support a finding of "corporate-wide wrongdoing," they did suggest

177. A "bad outcome" cannot be equated with "bad faith" and a violation of a director's duties. *King ex rel. Cephalon Inc. v. Baldino*, 409 Fed. App'x 535, 538 (3d Cir. 2010); *Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362, 373 (Del. 2006) (en banc).

178. *See, e.g., SEC v. World-Wide Coin Invs., Ltd.*, 567 F. Supp. 724, 751-52 (N.D. Ga. 1973) ("No organization, no matter how small, should ignore the provisions of the FCPA completely."); *see also supra* note 89 and accompanying text.

179. *Baker & Peterson, supra* note 126, at 393.

180. *McCall v. Scott*, 239 F.3d 808 (6th Cir. 2001).

181. *Id.* at 814.

182. *See id.* at 816 (finding that the board's failure to respond to systematic fraud was not "tantamount to a conscious decision to refrain from acting").

183. *Id.* at 819.

184. *Id.*

185. *Id.* at 814.

directors were aware of improper acquisition practices by the corporation.¹⁸⁶ Objective indicators, including audit information, a qui tam action, press reporting, and billing increases, also suggested that directors knew of the corporate misconduct.¹⁸⁷ Taken together, these factors were enough for the court to excuse demand based on the substantial likelihood of director liability.¹⁸⁸

4. *Expanding Inferences of Director Knowledge.* The three types of cases presented above are factual scenarios in which plaintiffs have successfully alleged violations of *Caremark* duties. Given that many FCPA cases have been foiled by the need for plaintiffs to allege director knowledge to show a violation in bad faith and to give rise to substantial liability, these typologies could provide a basis for expanding a board's liability. In some circumstances, it will nevertheless be difficult to infer that the board knew that violations occurred, particularly if the violations involve isolated occurrences of third parties paying bribes in foreign countries.

Accordingly, when FCPA violations are persistent rather than isolated events or when they form part of business strategy more generally, courts should be more willing to infer knowledge. Courts outside of Delaware, at least, seem particularly generous in inferring director knowledge based on a violation's severity. But even Delaware courts have inferred director knowledge in shareholder derivative suits.¹⁸⁹ In *American International Group, Inc. v. Greenberg*,¹⁹⁰ the directors were directly in control of the operations in which fraud occurred.¹⁹¹ In FCPA cases, however, directors generally would not have been in direct control of the overseas operations where FCPA violations are more likely to occur.¹⁹² Nevertheless,

186. *Id.* at 819, 821–22.

187. *Id.* at 821.

188. *Id.* at 824.

189. *Am. Int'l Grp., Inc. v. Greenberg*, 965 A.2d 763, 799 (Del. Ch. 2009) (holding, on a 12(b)(6) motion to dismiss, that the plaintiffs stated a breach of loyalty claim against defendant directors for “knowingly tolerating inadequate internal controls and knowingly failing to monitor their subordinate’s compliance with legal duties”). *AIG* is very similar to Type Two. *See supra* Part III.A.2.

190. *Am. Int'l Grp., Inc. v. Greenberg*, 965 A.2d 763, 799 (Del. Ch. 2009).

191. *Id.* at 777 (drawing all inferences in favor of the plaintiffs and determining that “misconduct was not isolated; it permeated AIG’s way of doing business” so that it was reasonable to infer that the defendant directors knew of fraudulent schemes).

192. *See* Matt A. Vega, *The Sarbanes-Oxley Act and the Culture of Bribery: Expanding the Scope of Private Whistleblower Suits to Overseas Employees*, 46 HARV. J. LEG. 425, 478 (2009) (arguing against the focus on directors in anticorruption efforts and explaining how compliance

changing the baseline of the misconduct from actual bribery to the neglect of high-level compliance programs could be one way of bringing the control into directors' hands. In FCPA cases, courts have not been quite as generous in inferring knowledge from objective indicators. Inferring knowledge based on the risk of corruption in a country where a company has operations, without more, would likely go too far.¹⁹³ Inferring knowledge when there is specific information that directors knew about violations and decided not to investigate, however, would come well within the existing bases for *Caremark* liability.

B. Procedural Strategies for Pleading Demand

This Section analyzes the practical problems in shareholder derivative litigation that would afflict FCPA follow-on litigants, even if courts employ relaxed standards for inferring director knowledge.

1. *Mitigating Conclusory Pleading: Books and Records.* This Section shows that the success of any claim, mentioned above, will be contingent on the successful completion of a books and records inspection. It is difficult, if not impossible, for plaintiffs to survive a motion to dismiss and make sufficiently particularized allegations based on public information alone.¹⁹⁴ If plaintiffs continue to neglect the opportunity to organize and inspect books and records, one way

depends on low-level employees who are the first line of defense against bribery). However, the duty of loyalty of directors does not exempt them from overseeing foreign operations. *Cf. In re Puda Coal, Inc. S'holders Litig.*, C.A. No. 6476-CS, at 17–18 (Del. Ch. Feb. 6, 2013), available at <http://www.delawarelitigation.com/files/2013/02/puda-case.pdf> (underscoring the need for U.S. directors' oversight over foreign operations where a foreign director stole corporate assets).

193. *Cf. Strong ex rel. Tidewater, Inc. v. Taylor*, 877 F. Supp. 2d 433, 450 (E.D. La. 2012) (concluding that the high risk of certain overseas locations, like Nigeria and Azerbaijan, does not give rise to an inference the board of directors knew about possible corruption or that they intentionally failed to act).

194. *See Freuler v. Parker*, 803 F. Supp. 2d 630, 651 (S.D. Tex. 2011) (outlining deficiencies in pleadings including failure to identify auditing reports and how each director should have known the company was violating internal controls), *aff'd*, No. 12-20260, 2013 WL 1153058 (5th Cir. Mar. 11, 2013) (per curiam); *Midwestern Teamsters Pension Trust Fund v. Deaton*, No. H-08-1809, 2009 WL 6799492 (S.D. Tex. May 7, 2009), at *8 (S.D. Tex. May 7, 2009) (“Plaintiffs’ conclusory allegations leave one free to imagine either that Baker Hughes had the most comprehensive compliance program in the industry, or the most deficient.”), *adopted by Midwestern Teamsters Pension Trust Fund v. Baker Hughes Inc.*, 2010 WL 3359560 (S.D. Tex. May 26, 2009).

or another, the Delaware Court of Chancery will force them to do so.¹⁹⁵

Pleading demand futility imposes an extraordinarily difficult burden for *Caremark* plaintiffs.¹⁹⁶ As previously discussed, the most difficult aspect of the pleadings is alleging knowledge by directors.¹⁹⁷ Public information is unlikely sufficient to allege knowledge. The existence of a DOJ investigation, for example, is insufficient to allege that the corporation's directors are substantially likely to be liable because they knew of the violation.¹⁹⁸ In the absence of investigative reporting, information about FCPA violations or related board deliberations is generally not publicly available for plaintiffs seeking to formulate complaints.¹⁹⁹

In Delaware, however, a shareholder may make a written demand to inspect the corporation's books and records under Section 220 of the Delaware Code.²⁰⁰ Section 220 requests are closely tied to heightened pleading requirements for derivative suits, specifically for *Caremark* pleading: “[o]nly the extremely rare complaint will be able to establish” a link between a corporation's legal violation and the board without the benefit of “internal corporate documents.”²⁰¹ Despite repeated admonitions, the docket of derivative shareholder actions has been plagued by first (or “fast”) filers, who do not inspect records.²⁰²

195. See Corbett & Roque, *supra* note 76, at 3 (noting the evident effects of Delaware's preference for books and records requests on litigants: plaintiffs in the Avon and Motorola shareholder derivative suits initiated Section 220 actions prior to filing, and defendant Wal-Mart “voluntarily produced board minutes, agendas, and its FCPA policies”).

196. See *supra* note 22 and accompanying text.

197. For a discussion of strategies for inferring knowledge when plaintiffs cannot point to outright director involvement, see *supra* Part III.A.

198. *Saginaw Police & Fire Pension Fund v. Hewlett-Packard Co.*, No.5:10-CV-4720-EJD, 2012 WL 967063, at *7 (N.D. Cal. Mar. 21, 2012).

199. See Michael J. Borden, *The Role of Financial Journalists in Corporate Governance*, 12 FORDHAM J. CORP. & FIN. L. 311, 345–46 (2007) (explaining how in *Caremark* cases plaintiffs often rely on investigative reports to draft complaints in derivative suits and as a starting point for later stages of a case following an unsuccessful motion to dismiss and attributing this reliance to the “lack of access to discovery”).

200. DEL. CODE ANN. tit. 8, § 220(b) (2011).

201. *La. Mun. Police Emps. Ret. Sys. v. Pyott*, 46 A.3d 313, 342 (Del. Ch. 2012), *rev'd on other grounds*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013); see *id.* at 342–43 (explaining the dismissal of “a steady stream of *Caremark* claims” because plaintiffs did not request inspection).

202. Stevelman, *supra* note 68, at 111. Delaware increasingly favors the “better” complaint. *Id.*

The Delaware Court of Chancery attempted to create a fast-filer presumption against plaintiffs who did not make Section 220 demands prior to filing complaints.²⁰³ Vice Chancellor Laster criticized “fast-filing” plaintiffs and lawyers who treat the derivative suit as a lottery by filing suits without any previous inspection of records or investigation “in the hope that one will hit.”²⁰⁴ In *Louisiana Municipal Police Employees’ Retirement System v. Pyott*,²⁰⁵ unsuccessful plaintiffs in California district court²⁰⁶ “who fail[ed] to conduct a meaningful investigation” prior to filing and failed to plead demand futility were held to be inadequate plaintiffs for collateral estoppel purposes.²⁰⁷ Therefore, plaintiffs who later sued in Delaware were not precluded from bringing a second suit.²⁰⁸ The Delaware Supreme Court, on interlocutory appeal, reversed the application of this presumption in determining the adequacy of the plaintiffs.²⁰⁹ This reversal has also been read as preventing the Court of Chancery from using the Section 220 demand as a prerequisite in the demand-futility analysis.²¹⁰ However, the notion that complaints without Section 220 demands are insufficient for demand-futility pleadings in *Caremark* cases existed before *Pyott*.²¹¹ The Court of Chancery’s presumption just attempted to formalize it: rather than dismissing cases based on conclusory pleadings, the court attempted to apply the presumption against the first plaintiffs in line who did not inspect records.

203. *Pyott*, 46 A.3d at 335–36. For other cases applying the presumption, see *South v. Baker*, No. 7294-VCL, 2012 WL 4372538, at *16–18 (Del. Ch. Sept. 25, 2012) (applying the presumption to dismiss a complaint); *Baca v. Insight Enterprises*, No. 5105-VCL, 2010 WL 2219715, at *5 (Del. Ch. June 3, 2010) (same); *King v. VeriFone Holdings, Inc.*, 994 A.2d 354, 364 (Del. Ch. 2010) (same), *rev’d on other grounds*, 12 A.3d 1140 (Del. 2011).

204. *Pyott*, 46 A.3d at 344.

205. *La. Mun. Police Emps. Ret. Sys. v. Pyott*, 46 A.3d 313 (Del. Ch. 2012), *rev’d*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013).

206. *See In re Allergan, Inc. S’holder Derivative Litig.*, No. SACV 10–1352 DOC, 2012 WL 137457, at *4 (C.D. Cal. Jan. 17, 2012).

207. *Pyott*, 46 A.3d at 350.

208. *Id.* at 351.

209. *Pyott v. La. Mun. Police Emps. Ret. Sys.*, No. 380, 2013 WL 1364695, at *4 (Del. Feb. 5, 2013); *see also infra* Part III.B.2.

210. *See Francis Pileggi, Supreme Court Reverses Chancery on Collateral Estoppel/Demand Futility and Section 220 Issue*, DEL. CORP. & LITIG. BLOG (Apr. 8, 2013), <http://www.delawarelitigation.com/2013/04/articles/delaware-supreme-court-updates/supreme-court-reverses-chancery-on-collateral-estoppeldemand-futility-issue> (noting that *Pyott* likely “diminishes the impact” of other decisions questioning the adequacy of plaintiffs who had not filed Section 220 demand before alleging demand futility).

211. *See Pyott*, 46 A.3d at 343, nn.22–23 (enumerating the many times plaintiff’s cases were dismissed for failing to use Section 220 proceedings).

Effectively, the presumption would have added another step to the shareholder derivative suit.²¹²

Even without the presumption, plaintiffs—who already face a difficult pleading burden under *Caremark*—do themselves a disservice by skipping the Section 220 demand, particularly in FCPA follow-on derivative suits. In fact, criticism for failing to make a Section 220 demand underlies the dismissal of FCPA follow-on derivative suits. In *Dow*, the Court of Chancery’s only FCPA case thus far, the plaintiff’s failure to inspect books and records was detrimental to claims questioning the directors’ independence.²¹³ Thus, plaintiffs alleging deficiency in FCPA compliance programs would similarly benefit from making a Section 220 demand.²¹⁴

2. *The Problem of Multijurisdictional Litigation.* This Section explains the phenomenon of multijurisdictional litigation (MJL) arising from the fast-filing problem discussed above. Because most jurisdictions allow the first filed complaint to move forward, litigants across the country rush to the courthouse to bring the same claims against a corporation. In addition to facing the possibility of dismissal for failing to request books, litigants also face the possibility of being beaten by a faster plaintiff who will then control the litigation.²¹⁵ The main loci in MJL are typically the state of incorporation and the principal place of business.²¹⁶ MJL disadvantages defendants who are forced to litigate in multiple jurisdictions²¹⁷ and who then respond

212. See Jacobs, *supra* note 60, at 5–6 (2007) (detailing the “unforeseen consequence” of Aronson’s pleading requirements was the outgrowth of different motions, including demand excused motions, class certification to circumvent the demand requirement, and Section 220 proceedings to inspect books and records for particularized futility pleading).

213. See *In re Dow Chem. Co. Derivative Litig.*, No. 4349-CC, 2010 WL 66769, at *9 n.50 (Del. Ch. Jan. 11, 2010) (reprimanding plaintiffs for failing to use Section 220 to “flesh out their unparticularized allegations of a ‘clubby’ inner circle on the Dow board” and saying that “[h]ad they done so . . . their allegations might have met the requirements of Rule 23.1”).

214. *Midwestern Teamsters Pension Trust Fund v. Deaton*, No. H-08-1809, 2009 WL 6799492, at *8 (S.D. Tex. May 7, 2009) (finding that the plaintiffs did not offer more than speculation about the implementation of policies and procedures and “leave one free to imagine either that Baker Hughes has the most comprehensive compliance program in the industry, or the most deficient”), *adopted by* *Midwestern Teamsters Pension Trust Fund v. Baker Hughes Inc.*, 2010 WL 3359560 (S.D. Tex. May 26, 2010).

215. Edward B. Micheletti & Jenness E. Parker, *Multi-Jurisdictional Litigation: Who Caused This Problem and Can It Be Fixed?*, 37 DEL. J. CORP. L. 1, 13 (2012). In contrast to the federal panel on multidistrict litigation, there is no “unified system for handling [MJL] on a national scale.” *Id.* at 4 n.12.

216. *Id.* at 5.

217. *Id.* at 7.

with a motion to stay the proceedings in order to litigate in only one forum. To resolve this problem, a court may issue a stay in favor of another jurisdiction when there are concurrent claims. There is no guarantee, however, that courts will always be so deferential.²¹⁸ The issue of how to handle simultaneous, parallel derivative suits remains unresolved, particularly because there is no presumption to disqualify whichever plaintiff failed to file a request to inspect books and records.²¹⁹

The problem of MJL is simplified, however, when a jurisdiction has already decided one of the suits, given that collateral estoppel would preclude subsequent shareholders from alleging the same injury and grounds for demand futility. The resolution of a collateral-estoppel issue in an FCPA follow-on derivative suit is relatively straightforward. In *Holt v. Golden*,²²⁰ plaintiffs filed suit against Smith & Wesson's directors and officers under *Caremark* for "failing to have effective FCPA controls and oversight."²²¹ The suit in *Holt* was filed in federal district court in Massachusetts, and the defendants moved to dismiss for failure to make demand and because a state court had previously dismissed a derivative suit on the grounds that demand was not futile.²²² The district court held that the state court's prior dismissal barred a second derivative suit.²²³ The state court's judgment was preclusive because (1) the core issue was the same—the board's ability to resolve demand—and (2) the board's interest was the same in 2008 and in 2011 because the board composition was the same.²²⁴

The district court's analysis indicated that so long as the second complaint pleads demand futility with reference to the same or nearly the same composition of the board, then a prior court's demand-futility analysis precludes reconsideration.²²⁵ It does not matter that later plaintiffs allege different facts that could excuse demand if those

218. See Stevelman, *supra* note 68, at 108–11 (detailing how Delaware is increasingly reluctant to cede jurisdiction when there is another complaint pending in a different state court).

219. *Pyott v. La. Mun. Police Emps. Ret. Sys.*, No. 380, 2013 WL 1364695, at *3–4 (Del. Apr. 4, 2013).

220. *Holt v. Golden*, 880 F. Supp. 2d 199 (D. Mass. 2012).

221. *Id.* at 201.

222. *Id.*

223. See *id.* at 202 (finding that the state court concluded there was no reasonable doubt a majority of the board was disinterested and independent).

224. *Id.* at 203.

225. *Id.*

facts were previously available.²²⁶ This approach is consistent with the outcome in the Delaware Supreme Court's decision in *Pyott*. Reasoning that full faith and credit required the Court of Chancery to accept the California district court's dismissal of the derivative suit against Allergan for violations of off-label marketing laws,²²⁷ the Supreme Court precluded the later Delaware plaintiffs from bringing suit after California had dismissed a similar suit.²²⁸ Although the Court of Chancery's analysis of demand futility is a useful data point for determining what sets of facts excuse demand,²²⁹ dismissal of the first suit in California rendered moot any future plaintiff actions. Under current law, collateral estoppel remains the operative doctrine when one jurisdiction has already rendered a final judgment.

Pyott eroded the latest attempt by the Court of Chancery to employ "strong-arm tactics to force forum" or to claim "unique competence to interpret and apply Delaware's corporate law."²³⁰ The Delaware Supreme Court still recognized the challenge of fast filing and MJL.²³¹ Moreover, the Court of Chancery is increasingly acting as a preemptive gatekeeper of derivative suits by dismissing cases that fail to conform to the "idealized" shareholder action.²³² Even with formal case management presumptions removed from its toolbox, the Court of Chancery is taking a more proactive role in shepherding plaintiffs through the necessary steps. For example, in the Wal-Mart cases, the Court of Chancery refused to appoint a lead plaintiff out of the seven plaintiffs with pending suits in Delaware. Instead, the court

226. See, e.g., *In re* Sonus Networks, Inc., S'holder Derivative Litig., 499 F.3d 47, 63 (1st Cir. 2007) (giving preclusive effect under Massachusetts law to the first derivative suit and denying later derivative plaintiffs the opportunity to rely on facts alleged in a second complaint because those facts were available at the time of the first suit).

227. *Pyott v. La. Mun. Police Emps. Ret. Sys.*, No. 380, 2013 WL 1364695, at *2 (Del. Apr. 4, 2013).

228. *Id.* at *4.

229. See *supra* Part III.A.2.

230. Stevelman, *supra* note 68, at 64.

231. *Pyott*, 2013 WL 1364695, at *4.

232. See *La. Mun. Police Emps. Ret. Sys. v. Pyott*, 46 A.3d 313, 344–46 (Del. Ch. 2012) (describing the "idealized" shareholder action as one where "dispersed stockholders could act collectively following a corporate trauma . . . They would not file suit hastily . . . [and the] stockholder collective would recognize there is no need to rush. . . Rather than filing hastily, the hypothetical stockholder collective would proceed deliberately. . . [I]t would conduct an investigation and seek books and records . . . [I]f the books and records showed director misconduct, then stockholders could decide to pursue a claim . . . [and] the costly process of briefing and arguing motions to dismiss would take place at once"), *rev'd on other grounds*, 2013 WL 1364695 (Del. Apr. 4, 2013).

appointed three co-lead plaintiffs and ordered a consolidated complaint, but only *after* a Section 220 action.²³³

IV. THE VALUE OF FOLLOW-ON DERIVATIVE LITIGATION TO COMPLIANCE EFFORTS

Given the criticisms levied against shareholder derivative suits in the aftermath of FCPA violations and scandals,²³⁴ this Part attempts to provide a more nuanced view of what value plaintiffs add to the compliance efforts of a corporation, even when their claims are unlikely to succeed. First, there is the effect of articulating standards which carry only a minuscule chance of liability but can still affect how corporations internally structure compliance systems and how directors regard their oversight duties. After all, *Caremark* duties, propounded by the Court of Chancery in dicta, “became the leading standard of review for claims alleging breach of a board’s oversight obligations.”²³⁵ Second, even outside of the typology of cases that could proceed beyond demand-futility stages, there is intrinsic value to cases that have been settled by plaintiffs concerned with encouraging robust compliance measures. This Part ends with a description of which plaintiffs and cases lead to the best litigation and settlement outcomes.

A. *Value of Demand Futility Litigation*

Whether derivative suits based on *Caremark* claims actually deter violations by the corporation remains an open question in corporate law.²³⁶ There may be some deterrent effect because procedurally, shareholder derivative suits can be very burdensome for a corporation that faces suits by multiple plaintiffs across different jurisdictions. Moreover, if plaintiffs begin to heed the Court of Chancery’s frequent admonitions, directors are likely to face more Section 220 motions from plaintiffs who genuinely want to hold boards accountable for violations.

233. Order Regarding Case Management at *6–7, *In re Wal-Mart Stores Inc. Derivative Litig.*, Nos. 7455-CS, 7470-CS, 7477-CS, 7489-CS, 7490-CS, 7612-CS, 7630-CS (Del. Ch. Sept. 5, 2012).

234. See *supra* note 19 and accompanying text and *infra* note 240 and accompanying text.

235. Stephen Bainbridge, *Caremark and Enterprise Risk Management*, 34 J. CORP. L. 967, 974 (2009).

236. See Kenneth B. Davis Jr., *The Forgotten Derivative Suit*, 61 VAND. L. REV. 387, 433 (2008) (indicating that the threat of derivative suits plays a role in deterring major violations and, if such suits are brought, defendant directors seek to settle them quickly).

Defining the contours of unacceptable board responses to FCPA violations, though unlikely to lead to outright liability, may still encourage new perceptions of acceptable behavior by directors.²³⁷ In considering demand-futility cases, courts have an opportunity to give greater teeth to the compliance and oversight duties of directors, particularly as they relate to violations of positive federal law.²³⁸ Moreover, opinions on the sufficiency of pleadings and the boundaries of substantial likelihood of liability to excuse demand are some of the only precedents that mark the boundaries of director oversight duties. Although *Caremark* liability is a remote possibility, follow-on derivative suits enable courts to prescribe how directors interact with compliance systems and what role, if any, they should exercise beyond merely establishing these systems.

B. Value of Shareholder Complaints

Despite the heavy burdens of demand-futility pleading, plaintiffs have not been deterred in the FCPA context or perhaps in *Caremark* cases generally. In FCPA follow-on derivative suits against corporations with a history of violations similar to Wal-Mart or Siemens, plaintiffs could marshal sufficient facts to make a strong showing of at least one of the *Caremark* typologies. This would require alleging a pattern of violations that were internally regulated and formed part of a business strategy across countries. A better case is one in which directors tacitly or explicitly sanctioned bribes to facilitate business. The unsuccessful cases are those in which bribes were isolated events or were carried out by third parties without the knowledge of corporate management.²³⁹

237. See Gold, *supra* note 86, at 515–16, 520–21 (suggesting that although the expansion of the duty of loyalty does not lead to liability, directors' perceptions of loyalty may nevertheless change and alter their behavior by facilitating opposition on the basis of loyalty to actions that are in a grey area of loyalty); Hill & McDonnell, *supra* note 22, at 1794, 1796 (explaining the normative function of *Caremark* in encouraging desirable behavior in directors and the “rush to abide” by *Caremark* and in encouraging courts to use good faith as a “bully pulpit”).

238. Davis, *supra* note 236, at 437 (explaining that demand requirement cases remain important precedents that define the liability of directors, even when demand is not actually excused).

239. Under the FCPA, the doctrine of respondeat superior extends liability to corporations even for the actions of rogue employees because they are considered agents of the corporation. COMM. ON INT'L BUS. TRANSACTIONS, N.Y.C. BAR ASS'N, THE FCPA AND ITS IMPACT ON INTERNATIONAL BUSINESS TRANSACTIONS 4 (2011), available at <http://www2.nycbar.org/pdf/report/uploads>.

1. *Corporate Governance Initiatives.* The *Caremark* typologies analysis for excusing demand based on director knowledge does not address cases in which corruption mechanisms are decentralized. Follow-on derivative litigation may seem “parasitic,” motivated only by attorneys’ fees, or unnecessary in light of government enforcement.²⁴⁰ As FCPA shareholder settlements show, however, even when plaintiffs file claims that will fail to excuse demand, they are still motivated to influence corporate governance and behavior. Corporate governance reform, rather than pure financial recovery, is a major feature of FCPA follow-on derivative-suit settlements.²⁴¹ In fact, settlements in FCPA follow-on derivative suits have not yielded high monetary sums—certainly no sum that approximates DOJ or SEC settlements.²⁴² Although one could speculate that the lack of outright financial recovery is a sign the suits were meritless, FCPA follow-on derivative plaintiffs have negotiated considerable reforms, exceeding typical corporate reforms in other types of derivative suits.²⁴³ Moreover, these corporate reforms may represent a different type of financial value, namely the long-term reduction in corporate costs associated with FCPA violations.

/FCPAImpactonInternationalBusinessTransactions.pdf. Although FCPA civil and criminal liability is perhaps exceedingly broad, this Note acknowledges that civil liability for directors arising from the actions of rogue agents would likely add little to overall compliance efforts.

240. For a perspective on the parasitic nature of follow-on derivative suits, see *supra* note 19 and accompanying text; see also *Can We Sue Our Way to Prosperity?: Litigation’s Effect on America’s Global Competitiveness: Hearing Before the Subcomm. on the Constitution of the H. Comm. on the Judiciary*, 112th Cong. 40 (2011) (statement of John H. Beisner, U.S. Chamber Inst. for Legal Reform) (criticizing FCPA derivative suits for “piggyback[ing]” onto government investigations and being motivated only by the “deep pockets” of company insurers).

241. See Lucinda Low, Sean Griffin & Shannon MacMichael, *What Sets SciClone’s FCPA Derivative Suit Apart*, STEPTOE (Nov. 28, 2011), http://www.stepto.com/publications-pdf.html/pdf/?item_id=7897 (noting that unlike most FCPA collateral litigation in which the main objective is the collection of fees—fees that are sometimes much greater than government penalties—the SciClone settlement was focused on compliance initiatives).

242. Compare Brown et al., *supra* note 15 (reprint at 1) (noting high settlements in follow-on litigation generally, but specifically referencing securities shareholder class actions in which settlements “exceeded by large margins any fines the accused company paid to the government” including \$15.5 million when the government settlement was \$500,000), with *FCPA Autumn Review 2012*, MILLER CHEVALIER (Oct. 16, 2012), <http://www.millerchevalier.com/Publications/MillerChevalierPublications?find=89901> (noting that no settlement has resulted in a major financial award, with attorneys’ fees ranging between \$2.5 million and \$10 million).

243. See, e.g., *In re Johnson & Johnson Derivative Litig.*, 900 F. Supp. 2d 467, 488 (D.N.J. 2012) (determining that corporate reforms were “more substantial and tailored” than typical corporate reforms that are no more than “window dressing cloaking what amounts to nothing more than a strike suit designed to line the pockets of greed-stricken counsel”).

In a settlement between Johnson & Johnson and plaintiffs who filed suit after FDA and FCPA violations came to light, the plaintiffs alleged a breach of fiduciary duties. The corporation moved to dismiss but the parties entered into settlement negotiations before the court ruled on the motion.²⁴⁴ The federal district court in New Jersey that approved the settlement noted that the creation of an oversight committee of independent directors rectified the corporation's shortcomings by creating "company-wide control and assurance systems that are designed to effectively supplement J&J's decentralized management approach."²⁴⁵ Whereas this "decentraliz[ation]"²⁴⁶ would likely have spelled doom for plaintiffs trying to show specific director involvement in business strategy that included bribes, the settlement negotiations provided plaintiffs a means of influencing corporate governance without the burdens of demand pleading. Moreover, the court found that the corporate reforms "confer[red] a substantial benefit" on the defendant corporation.²⁴⁷

For SciClone and Halliburton, corporate reforms were designed to address future FCPA risks.²⁴⁸ The SciClone settlement stipulated very specific corporate reforms—such as the creation of a "compliance coordinator" who is fluent in Mandarin and English—indicating that the parties likely tailored the agreement to the specific risks SciClone faced in FCPA compliance.²⁴⁹ Moreover, the agreement also stipulated the chain of reporting from the compliance

244. Stipulation and Agreement of Settlement at 6, *In re Johnson & Johnson*, 900 F. Supp. 2d 467 (No. 11-2511), available at <http://www.sec.gov/Archives/edgar/data/200406/000020040612000115/a201207168-kexhibit992stip.htm>.

245. *In re Johnson & Johnson*, 900 F. Supp. 2d at 473.

246. *Id.*

247. *Id.* at 487.

248. See e.g., Stipulation of Settlement at 15–16, *In re SciClone Pharm., Inc. S'holder Derivative Litig.*, No. CIV 499030 (Cal. Super. Ct. Sept. 22, 2010) [hereinafter "SciClone Stipulation of Settlement"] (requiring the corporation to undertake due diligence prior to hiring third-party agents abroad as well as to conduct periodic due-diligence inquiries and to competitively compensate agents with fixed salaries to avoid corruption and commissions), available at http://files.shareholder.com/downloads/SCLN/1444862867x0x508025/6f6c3478-e777-4893-9044-b3e3f7f51616/Stipulation_of_Settlement.pdf; Stipulation of Settlement at 20–21, *Policemen & Firemen Ret. Sys. of Detroit v. Cornelison*, No. 2009-29987 (Tex. Dist. Ct. July 9, 2012) [hereinafter "Halliburton Stipulation of Settlement"] (modifying the code of business conduct to require due diligence prior to hiring consultants abroad and requiring enhanced FCPA training for employees in "high-risk countries"), available at http://www.halliburton.com/public/news/pubsdata/press_release/2012/policemen_firemen_cause_no2009_29987.pdf.

249. SciClone Stipulation of Settlement, *supra* note 248, at 9.

coordinator to the audit committee, as well as the frequency of meetings and the board review of anticorruption policies.²⁵⁰ The specificity of this provision scrutinizes the adequacy of the compliance program; a court likely would not engage in such scrutiny in its demand-futility analysis due to the force of the business judgment rule.²⁵¹ Still, a requirement that the board of directors promptly consider voluntary disclosure to the SEC or DOJ in the event of future violations suggests that the plaintiff shareholders acknowledge the primary role of government enforcement in FCPA compliance.²⁵² At the same time, shareholders may also be able to pressure corporations by reprimanding individual directors and officers.²⁵³

2. *Predicting Success.* Features of follow-on derivative suits may be predictive of the corporate governance-oriented goals of derivative plaintiffs and the added value of shareholder derivative suits to general compliance. For example, institutional investors as plaintiffs and the consolidation of cases may predict a settlement that includes corporate governance reforms.²⁵⁴ These predictive factors should not be surprising. Multiple complaints may be expected when violations are particularly egregious. Moreover, institutional investors are generally considered more activist than other investors and more

250. *Id.*

251. *See In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996) (“Obviously the level of detail that is appropriate for such an information system is a question of business judgment.”), *rev'd on other grounds*, No. 380, 2013 WL 1364695 (Del. Apr. 4, 2013).

252. *SciClone Stipulation of Settlement*, *supra* note 248, at 12–13; *see also Halliburton Stipulation of Settlement*, *supra* note 248, at 2 (shielding directors from liability if they disclosed violations to the government and cooperated with the investigation).

253. *See SciClone Stipulation of Settlement*, *supra* note 248, at 17 (requiring the board to consider implementing a policy that would clawback *all* the compensation earned by an officer during the period of misstating bribes as corporate expenses); *Halliburton Stipulation of Settlement*, *supra* note 248, at 1–2 (stipulating that the bonuses and compensation of directors will be revoked if the director participated or directly supervised an individual responsible for the bribery, as determined by disinterested directors of a separate committee). It is interesting that the clawback positions represent different levels of liability risk for directors, with accounting misstatements leaving directors more vulnerable to liability than direct supervision.

254. In the three settlements agreed to by Johnson & Johnson, Halliburton, and SciClone, respectively, multiple cases were consolidated and at least one case had been brought by an institutional investor. *Stipulation and Agreement of Settlement*, *supra* note 244, at 3–4; *SciClone Stipulation of Settlement*, *supra* note 248, at 1; *Halliburton Stipulation of Settlement*, *supra* note 248, at 1–2.

interested in corporate-governance issues.²⁵⁵ Activist institutional investors should to some extent be motivated by the substantial size of their investment.²⁵⁶ Institutional investors should therefore be interested in ensuring compliance for the sake of preserving the value of their investment and avoiding the hefty fines and drops in stock prices that come with FCPA government enforcement. Quite ingeniously, FCPA compliance provides an opportunity for institutional investors to play a greater role in the management of corporations. A growing focus on compliance and oversight duties may lead to greater institutional investor involvement in what typically would have been board-exclusive matters.

Substantively, complaints with facts that do not raise business risk allegations are more likely to result in successful settlement negotiations.²⁵⁷ FCPA cases came of age in the era of mortgage-backed securities (MBS) litigation. The convergence in time of FCPA and MBS litigation is partly to blame for the myopic view of *Caremark* duties for directors in the FCPA context. Because MBS cases raise paradigmatic concerns about the business judgment of directors, *Caremark* cases are generally viewed with skepticism, even when in the case of FCPA follow-on derivative suits there may be egregious failures in oversight duties. MBS and business risk do not lend themselves to easy compliance systems and thus are problematic in a *Caremark* analysis for oversight failures.²⁵⁸

But the outcomes of MBS cases like *In re Citigroup Inc. Shareholder Derivative Litigation*²⁵⁹ should not be generalized to *Caremark* cases based on violations of positive law. With the FCPA,

255. See Randall S. Thomas, *The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation*, 61 VAND. L. REV. 299, 300–01 (2008) (noting the prominent role institutional investors play in corporate governance, including bringing shareholder proposals, serving as lead plaintiffs, and influencing shareholder votes).

256. See James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions To Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 416–17 (2005) (noting that securities reform efforts have attempted to “harness[] the economic self-interest” of institutional investors with large holdings). Despite reform efforts, empirical evidence shows institutional investors have a “dismal record” in bringing suits in the securities class action context. *Id.* at 425.

257. See Bainbridge, *supra* note 235, at 988 (arguing that complaints regarding “red flags involving illegal behavior” are more likely to succeed as compared to risk-management failures).

258. *Id.* at 982.

259. *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009). For a description of the case’s holding, see *supra* note 124.

there are compliance requirements, and the obligations of directors are more easily defined within the parameters of what the law requires. For example, a plaintiff may succeed in challenging the compliance system because it fails to account for vulnerabilities in countries where corruption is particularly prevalent. The same plaintiff, however, would be unsuccessful in alleging a breach of fiduciary duty based on the board's decision to do business in a corruption-ridden country. A plaintiff may challenge the compliance system and the director's response to violations of the FCPA, but collateral attacks against the legitimate business choice *underlying* the violation would likely destroy *Caremark* pleading or, alternatively, prospects of a favorable settlement.

Thus, the foregoing discussion outlines the characteristics in derivative suits that would be determinative in how a court gauges a plaintiff's pleadings and would accordingly lend leverage to plaintiffs in settlement negotiations.²⁶⁰ With the Court of Chancery closely managing the Wal-Mart case proceedings—proceedings that closely approximate the “idealized”²⁶¹ suit—perhaps the unsuccessful trend of follow-on derivative suits in the FCPA context will finally end. Excusing demand would be a significant, though not impossible, departure from Delaware courts' stance on shareholder derivative suits. More likely, a settlement between the plaintiffs and Wal-Mart will include compliance reforms and greater input from institutional plaintiffs.²⁶²

CONCLUSION

As levels and targets of government enforcement of the FCPA evolve, private plaintiffs will continue attempts to establish bases for director liability to account for the losses to corporations from settlements and disgorgements. The lack of successful follow-on derivative suits can be attributed to plaintiffs' failure to account for

260. The predictive features of success add gloss to the “idealized” shareholder suit described by the Delaware Court of Chancery. *See* Part IV.B.2; *see also* *La. Mun. Police Emps. Ret. Sys. v. Pyott*, 46 A.3d 313, 338, 344 (Del. Ch. 2012) (explaining the “idealized” shareholder derivative suit which includes collective shareholder action and resourceful plaintiffs), *rev'd on other grounds*, 2013 WL 1364695 (Del. Apr. 4, 2013).

261. *Pyott*, 46 A.3d at 338.

262. *See* Low et al., *supra* note 241 (noting how recent settlements including corporate-compliance reforms “create[] significant rigidity in what has been a dynamic area [of compliance obligations], and put[] shareholders at the table in establishing controls that heretofore have been the province of management and the board of directors”).

the procedural burdens of the derivative suit. Delaware precedent and the decisions of other courts, however, indicate that demand could be excused based on director knowledge of FCPA violations in at least a subset of cases. Because demand-futility cases provide an avenue for understanding the substantive duties of directors, these cases are particularly important for deepening a corporation's understanding of FCPA violations and liability. Moreover, even if few cases will actually excuse demand, the complaints by shareholders who are well-organized and interested in corporate governance add to the general framework of FCPA compliance. Settlements by FCPA derivative plaintiffs are notable because they target the specific company deficiencies in compliance and give shareholders greater input. Indeed, the FCPA follow-on derivative suit is both changing our conceptions of director liability for FCPA violations and revealing new insights into the role and value of derivative suits in the process.