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Derivative Suit Dismissal Based on Defective Special Committee Procedure Reversed by Divided Sixth Circuit Panel

A divided panel of the Sixth Circuit held that a special litigation committee lacked independence under Delaware law and reversed the dismissal of a derivative action based upon the committee's recommendation. *The Booth Family Trust v. Jeffries*, No. 09-3443 (6th Cir., April 5, 2011). The majority found that one of the committee member's recusal from considering the claims against one of the defendant directors sufficiently "infected" the judgment of the committee to taint its recommendation.

Shareholders of Abercrombie & Fitch Co. filed a derivative suit against various officers and directors alleging that the defendants caused the corporation to make misleading public statements. Abercrombie invoked the procedural option under Delaware law of forming a special litigation committee to investigate the derivative claims and make a recommendation concerning whether the claims should be pursued. The special litigation committee consisted of two board members, who hired a prominent national law firm to assist in conducting the investigation. After conducting numerous interviews and reviewing documents and records, the special litigation committee issued a 144-page report sixteen months after its formation. The committee concluded that there was no evidence to support the derivative claims and recommended that Abercrombie seek the dismissal of the action. During the course of the investigation, one of the committee members, Allan Tuttle, abstained from considering the claims against Defendant Robert Singer, Abercrombie's Chief Operating Officer, and did not attend Singer's interview.

The District Court found that the corporation satisfied the factors identified under Delaware law supporting the dismissal of a derivative action based upon the recommendation of a special litigation committee. Those factors are that the committee was independent, conducted its investigation in good faith, had reasonable bases for its conclusion, and the decision to dismiss the lawsuit is not inconsistent with business judgment. As to Tuttle's independence, in its opinion, the District Court found the fact that Tuttle previously worked with Singer and considered Singer a friend was not sufficient under Delaware law to show a lack of independence. The District Court noted that Abercrombie's board considered Tuttle's friendship with Singer, but concluded that it did not foreclose independence. The district court further noted: "yet Mr. Tuttle took the additional cautionary step of abstaining from investigation or consideration of Plaintiffs' claims directed against Defendant Singer." *In re Abercrombie & Fitch Co. Derivative Litigation*, No. 2:05-cv-00819, at 9 (U.S.D.C., S.D. of Ohio, March 12, 2009)

The Sixth Circuit majority did not find Tuttle's abstention as an "additional cautionary" measure, but as a demonstration that Tuttle, and therefore the special litigation committee, was not independent. Indeed, the majority indicated that: "[h]ad Tuttle not recused himself from considering the claims against Singer, we might agree with the district court's conclusion that he was independent." *The Booth Family Trust v. Jeffries*, at 12. The court found that the recusal effectively constituted an admission of bias, or "[a]t the very least," creates "a perception that Tuttle was not independent." *Id.*, at 12. According to the majority, Tuttle's "bias" tainted the recommendation of the special committee because Singer was the central figure in the wrongdoing. Consequently, the majority concluded that Tuttle could not impartially consider whether the corporation should pursue the claims against any of the defendant directors because it would necessarily implicate Singer. Thus, the majority found a lack of independence.

The Sixth Circuit majority also found that because Abercrombie's board constituted a two-person special committee and Tuttle's recusal left only one committee member to consider the claims, the recommendation of the special litigation committee was ineffective. Ultimately, the court blamed Abercrombie's board for mishandling "one of those rare situations where Abercrombie had every opportunity to create an independent special litigation committee," despite the "latitude" afforded under Delaware law. *Id.* at 17.

In his dissent, Judge Griffin observed that the majority failed to cite any authority for its conclusion regarding the consequence of Tuttle's recusal. He further disagreed that Tuttle's recusal confirmed a lack of independence. Instead, Judge Griffin sided with the district court in finding that Tuttle's recusal "attempted to expel any doubt regarding the independence of" the special litigation committee. *Id.* at 20. Judge Griffin relied upon Delaware decisions finding that friendships or business relationships often are not sufficient to raise a reasonable doubt regarding a director's independence.

Observation

The majority decision reflects the unsettled and fact intensive decisions of Delaware courts concerning director independence. The recusal issue is unique. Because Michigan courts frequently look to Delaware cases when considering actions by Michigan public corporations, the Sixth Circuit independence and recusal determinations are likely to be influential in cases involving both Delaware and Michigan corporations.

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