Client Alert.

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FCPA Derivative Suit Dismissed:
Complaint Devoid of Specific Allegations Falls Woefully Short

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In November 2010, Tidewater Inc. paid more than $15 million to US regulators to settle charges that it had violated the Foreign Corrupt Practices Act ("FCPA"). Consistent with a growing trend, Tidewater soon faced the threat of even more liability in the form of tag-along private shareholder litigation. Just in time for the Fourth of July holiday last week, however, a federal judge in Louisiana gave Tidewater and a number of its officers and directors reason to celebrate. Judge Jane Triche Milazzo dismissed in its entirety a derivative shareholder complaint against the company (as a nominal defendant) and certain officers and directors because "Plaintiff did not adequately plead demand futility."[1]

TIDEWATER'S FCPA SETTLEMENTS

Tidewater is a Delaware corporation that owns and operates offshore service and supply vessels to the global offshore energy industry. Tidewater's wholly owned subsidiary, Tidewater Marine International Inc. ("TMII"), a Panamanian company, provided managerial and administrative oversight for most of Tidewater's international operations.

In 2010, Tidewater and TMII were swept up into the widespread FCPA regulatory action against global freight forwarding company Panalpina World Transport and five oil and gas service companies. US regulators alleged that TMII paid, through its employees and agents, approximately $160,000 in bribes to Azerbaijani tax inspectors to improperly secure favorable tax assessments, and approximately $1.6 million in bribes through Panalpina to Nigerian customs officials to induce the officials to disregard Nigerian regulations regarding the importation of Tidewater's vessels.[2]

Through outside counsel, Tidewater conducted an internal investigation and reported its findings to US regulators. On November 4, 2010, TMII entered into a deferred prosecution agreement with the Department of Justice under which TMII agreed to pay a penalty of $7.35 million. On the same day, Tidewater also settled with the Securities and Exchange Commission and agreed to pay disgorgement of over $8,000,000.

THE DERIVATIVE COMPLAINT

Three months later, on February 16, 2011, Plaintiff Jonathan Strong filed a shareholder derivative lawsuit based on Tidewater's alleged violations of the FCPA and the Securities Exchange Act of 1934. Strong, a Tidewater shareholder, brought the action against certain officers and members Tidewater's Board of Directors alleging that they breached their fiduciary duties in that they:

(1) Knew or recklessly disregarded the fact that employees, representatives, agents and/or contractors were paying, had paid and/or had offered to pay bribes to Azerbaijani and Nigerian government officials to obtain favorable treatment for Tidewater;
(2) Caused Tidewater to pay bribes and disguise the bribe payments as legitimate expenses in Tidewater's books and financial disclosures; and
(3) Failed to maintain adequate internal controls to ensure compliance with the FCPA and the Exchange Act.[3]

[1] *Strong v. Taylor et al.*, Order and Reason, Civil Action No. 11-392, at 6 (E.D. La. July 2, 2012) ("Order").

[2] *U.S. v. Tidewater Marine Int'l Inc.,* No. 4-10-cr-770 (S.D. Texas 2010); *S.E.C. v. Tidewater, Inc.*, No. 2:10-cv-4180 (E.D. La. 2010).

[3] Order at 4.

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Strong alleged that as a result of these actions, Tidewater had to pay multi-million dollar penalties to US regulators, suffered damages to its reputation, and incurred significant expenses in connection with investigating the illegal activities. The complaint sought injunctive relief related to Tidewater's internal controls and asserted a claim for damages on Tidewater's behalf against the officer and director defendants for "breaches of fiduciary duties, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment."[4] Defendants moved to dismiss, among other grounds, on the basis that Strong failed to make a formal demand on Tidewater's Board prior to filing his lawsuit. In a pointed opinion, Judge Milazzo unequivocally agreed with defendants.

DEMAND WAS NOT EXCUSED BECAUSE THE DIRECTORS WERE DISINTERESTED AND INDEPENDENT

In a derivative action, a shareholder is permitted to bring a lawsuit on behalf of a corporation only after the corporation—through its board—has refused to pursue the litigation itself after "suitable demand," or where the plaintiff can demonstrate that it would have been futile to make such a request.[5] Here, Strong filed the derivative lawsuit without first making a demand on Tidewater's board. Therefore, the Court's inquiry focused on whether the complaint set forth particularized facts that Tidewater's directors were "incapable of making an impartial decision regarding the pursuit of the litigation."[6]

The Court found that Plaintiff failed to meet his burden of pleading particularized facts establishing reasonable doubt that a majority of the Tidewater directors were interested or lacked independence. The Court held that Plaintiff had not established that any of the directors were interested on two grounds. First, the complaint was "completely devoid of any allegations of an interested director. There [was] no allegation that any director appeared on both sides of a transaction or expected to derive a personal benefit from it. Nowhere in the Complaint [could] it be found that any one of the directors, much the less a majority benefitted from the bribes themselves."[7]

Second, Plaintiff argued that the directors were interested because proceeding with a lawsuit could expose them to substantial personal liability. More specifically, the complaint alleged that the directors and officers made no effort to enforce the anti-corruption compliance policies and turned a "willful and blind eye to the bribes funded and paid for by Tidewater . . . because paying the bribes were worth more than the costs of any fines by the DOJ or SEC if Tidewater was [] caught. Plaintiff also contend[ed] that the individual defendants ignored, consciously disregarded and/or were reckless in not establishing internal controls. . . ."[8] The Court held, however, that these claims were "completely conclusory [and that such] generalized allegations of participation, acquiescence, or approval [were] insufficient to excuse demand."[9]

Finding that the complaint was "completely devoid of any specific allegations as to any director or board member to show how they may be so interested or non-independent,"[10] the Court concluded that Plaintiff failed to plead that demand on the board would have been futile.

DEMAND WAS ALSO NOT EXCUSED BECAUSE THE DIRECTORS DID NOT INTEND TO BREAK THE LAW

When directors are disinterested and independent, demand may still be excused where a plaintiff pleads particularized facts sufficient to create a reasonable doubt that the board's decision was protected by the business judgment rule. The Court

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[4] *Id.*

[5] Order at 7-8.

[6] *Id.*

[7] *Id.* at 15.

[8] *Id.* at 18.

[9] *Id.* at 19.

[10] *Id.* at 29.

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found the board's decision was protected by the business judgment rule because the complaint was devoid of any allegations that the individual defendants acted in bad faith. The Court acknowledged that Strong's allegations were sufficient to establish Tidewater's FCPA violations. It ruled, however, that the complaint fell "woefully short of the pleading requirements" in establishing that the individual defendants acted with the intent to violate the FCPA.[11]

The Court found it "significant" that, in response to allegations of corruption, Tidewater's directors voluntarily initiated a thorough internal investigation and self-reported the findings to US regulators "before the government even suspected any violations."[12] The Court suggested that such action was fundamentally inconsistent with Plaintiff's allegations that the individual defendants intentionally violated the law.

Because Plaintiff had not raised a reasonable doubt that the "board's actions were not taken honestly and in good faith,"[13] the court found demand was not excused.

CONCLUSION

Although there is no private right of action under the FCPA, the *Tidewater* case is one of a growing number of shareholder derivative suits that have been filed against directors and officers in the wake of FCPA enforcement actions and investigations. Increasingly, officers and directors find themselves on the defensive having to explain and justify how they responded to allegations of bribery.

In this context, as the court in *Tidewater* makes clear, establishing a strong anti-corruption compliance program—including recognizing when an independent internal investigation is needed—not only goes a long way in protecting the company itself, but also can help reduce a director or officer's own litigation exposure. Conversely, the failure to implement such a program, or to affirmatively investigate allegations of bribery, may be used by opportunistic derivative plaintiffs to allege that directors and officers breached their fiduciary duties and should be held personally liable.

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[11] *Id.* at 26.

[12] *Id.*

[13] *Id.* at 27.

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