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Stockholders' Derivative Suit May be Brought Against Multinational Corporation for its Failure to Sue to Recover Illicit Payments to Foreign Officials, Where it is Shown that such Decision was Based on Collusion, Self-interest, Dishonesty or Lack of Good Faith: Gall v. Exxon Corp.

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II. INTERNATIONAL INVESTMENT LAW

B. Multinational Enterprises and Problems of Doing Business Abroad

STOCKHOLDERS' DERIVATIVE SUIT MAY BE BROUGHT AGAINST MULTINATIONAL CORPORATION FOR ITS FAILURE TO SUE TO RECOVER ILLICIT PAYMENTS TO FOREIGN OFFICIALS, WHERE IT IS SHOWN THAT SUCH DECISION WAS BASED ON COLLUSION, SELF-INTEREST, DISHONESTY OR LACK OF GOOD FAITH.

Gall v. Exxon Corporation, 418 F. Supp. 508 (S.D.N.Y. 1976)

In a stockholder's derivative action brought in the United States District Court for the Southern District of New York under Rule 23.1 of the Federal Rules of Civil Procedure, the plaintiff sued Exxon Corporation and a number of its present and former directors and officers. The suit charged the defendants with violations of Sections 13(a) of the Securities Act of 1933,[1] Section 14(a) of the Securities Exchange Act of 1934,[2] and breaches of their fiduciary responsibilities to Exxon. These

1. Securities Act of 1933, § 13(a), 15 U.S.C. § 77e (1970).
2. Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78m (1970).

charges were made in connection with the payment of approximately \$59 million by Exxon officials during the years 1963 through 1972.

Vincenzo Cazzaniga, the President and Managing Director of Esso Italiana, a wholly-owned subsidiary of Exxon Corporation was involved in the contested payments. Cazzaniga made unauthorized payments to an Italian gas pipeline company and to various Italian political parties from secret bank accounts maintained separately from Esso Italiana's funds. The contributions to the political parties during the period in question amounted to \$27.9 million. Apparently, both Exxon's general counsel and Italian counsel informed the corporation's directors that the payments were legal. In 1972 Cazzaniga requested funds to aid in the settlement of a current pending lawsuit against Esso Italiana. Despite the apparent impropriety of such a request, Exxon directors released the funds in order to honor what was believed to have been a commitment made by the president of the Italian subsidiary. This was, allegedly, the last such payment issued through Cazzaniga.

The court found that the decision whether to assert any cause of action held by the corporation was clearly vested within the sound business judgment[3] of Exxon's Board of Directors. The Board, in response to the allegations made by Gall, had established the Special Committee on Litigation (Committee) to determine what action the corporation should take.[4]

After extensive investigation the Committee determined that the contested payments in fact had been made, and that some of Exxon's directors were aware of these payments. However, the Committee decided that it was against the corporation's best interests to sue directors and officers involved. They directed the appropriate officers to seek dismissal of all shareholder derivative actions. The defendants moved for a summary judgment dis-

3. The business judgment rule was articulated by J. Brandeis in United Cooper Sec. Co. v. Amalgamated Cooper Co., 244 U.S. 261, 263–64 (1917):

> Whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management, and is left to the discretion of the directors in the absence of instruction by vote of the stockholders. Courts interfere seldom to control such direction *intra vires* the corporation except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment . . .

4. The Committee was vested with the power to act as the Board of Directors in this matter, pursuant to the by-laws of the corporation.

missing Gall's complaint, stating the court should respect the Committee's determination under the "business judgment" rule.

Plaintiff challenged defendants' summary judgment motion on several grounds. The first ground was that since the payments involved were illegal, any decision by the Committee regarding these payments would not fall within the business judgment rule. In support of this position, Gall primarily relied on *Ashwander v. Tennessee Valley Authority*.[5] The court, however, rejected this argument and distinguished *Ashwander* from the present case. It found that no evidence had been placed on the record indicating that the payments made were illegal either in Italy or the United States. Although the court deliberately avoided deciding whether or not such payments were proper, it determined that, even assuming the payments were illegal, the business judgment rule would still be applicable. The court concluded that the decision would be removed from the ambit of the business judgment rule only if the Committee's decision not to sue was either in violation of the law or constituted ratification and continuation of the illegal acts. Neither of these situations was found present in the case at bar, and the court held that absent allegations of fraud, collusion, self-interest, dishonesty, or other misconduct in the nature of a breach of trust, it would not interfere with the judgment of the corporate directors.

Gall also challenged the Committee's decision on the ground that as the members of the Committee may have been involved in the payments, they were not sufficiently disinterested from the action to render an independent and bona fide business judgment. The court found that no evidence was submitted by Gall to support this allegation. However, the court also determined that the defendants did not present sufficient evidence to rebut this contention. They failed to demonstrate that no genuine issue of material fact had been raised by the complaint. Therefore, the court ruled that summary judgment was not appropriate at this time, and gave the plaintiff sixty days in which to conduct relevant discovery to support her contention. At the end of the sixty day period the defendants would be allowed to reintroduce their motion for summary judgment.

It is important to note, however, that a stockholder's derivative suit may be an appropriate way to challenge a corporation's determination not to sue if evidence is presented which demon-

5. 297 U.S. 288 (1936).

strates fraud, collusion, self-interest, dishonesty, or at a minimum, absence of good faith on the part of the directors of the corporation.

In summary, the thrust of this case is that when a corporation decides not to sue its own officers and directors on charges of overseas political payments or bribes, because of a determination made by an independent intramural committee representing the Board of Directors and exercising good faith and sound business judgment, the corporation will not be subject to a derivative suit by a shareholder.

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