

## SHAREHOLDER DERIVATIVE ACTION, CRIMINAL CASES

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This month we discuss a shareholder derivative action in which the Court of Appeals agreed that demand on the board of directors was excused as futile. We also discuss the decisions in two criminal cases. In one, the Court addressed the effect of requesting a charge on a lesser included offense for which the statute of limitations had run. In the other, the Court dealt with two cases in which defendants claimed to neither have been present for sidebars during jury selections nor to have waived their right to be present.

### Shareholder Derivative Litigation

In a shareholder's derivative action where Michael Zinn ("Zinn"), the all-in-one "founder, majority stockholder, board chairman, chief executive officer and president" of a publicly owned company, engaged in conduct rivaling that of our modern-day corporate "buccaneers," the unanimous Court of Appeals, in an opinion by Chief Judge Judith S. Kaye, swept aside arguments that a prior demand under § 626(c) of the Business Corporation Law was required to be made upon the board of directors of the company before the action could proceed, and granted summary judgment to the plaintiff against Zinn. Even those who have negative feelings about the wisdom of shareholder derivative actions, and favor a broad sweep for the business judgment rule, will be hard-pressed to suppress a "cheer" for the result in this case.

The case, *Basbach v. Zinn*, had its beginning in the 1992 and 1994 campaigns of a member of the New York State Assembly for a congressional seat. In 1997, following a federal grand jury investigation, Zinn and Besicorp Group, Inc. ("Besicorp"), the corporation he controlled, were indicted for a scheme to violate provisions of the Federal Election Campaign Act against corporate campaign contributions. The scheme involved Zinn, who was the finance chairman of the candidate's election campaign, and other officers and employees of Besicorp making contributions to the campaign fund that the company would arrange to be reimbursed to them. Besicorp then deducted these reimbursements as business expenses on its federal income tax returns.

After the grand jury investigation began, but before the indictment, a specially convened meeting of the board of Besicorp decided that Zinn and others should be reimbursed for legal fees and expenses that would be incurred in responding to the grand jury, but that

such payments would be reimbursed to Besicorp if indemnification turned out to be inappropriate.

Soon after the indictment, Zinn and Besicorp pled guilty to aiding and abetting the submission of false statements to the Federal Election Commission. Besicorp pled guilty to filing a false tax return and Zinn pled to aiding and abetting the filing of the false return.

In his plea allocution, in open court and under penalty of perjury, Zinn totally acknowledged his guilt. Soon thereafter, the first derivative suit was brought on behalf of Besicorp against Zinn and the other directors for breach of their fiduciary duties, for waste of corporate assets, and for not seeking reimbursement of legal fees and expenses advanced for Zinn.

Defendants moved to dismiss the derivative case for failure to allege the requisite demand on the board and the motion (to the surprise of this column) was granted in the Supreme Court. Thereafter, Besicorp's Legal Defense Management Committee, which included Zinn, by that time out of prison and reinstated as an officer and director, with the help of a "report of independent counsel" retained to provide advice as to whether Besicorp could reimburse Zinn for his legal costs and expenses and deal with its obligations to seek reimbursement, gave Zinn a total "whitewash," agreeing to reimburse him for everything, including the cost of his defending himself against the criminal charges to which he had pled guilty.

Soon after the Committee's action, the Appellate Division, Third Department, in February 1999, reversed the order of the Supreme Court, which had dismissed the first derivative case for lack of demand.

But that is only part of the story. There was a second derivative action brought on behalf of Besicorp (the "Lichtenburg Action"). In that case, the defendants successfully secured the dismissal of the action again based on a failure to make the requisite demand upon the board. Zinn and the other defendants then took the determination in *Lichtenburg* and moved for summary judgment in the first derivative case on the basis of collateral estoppel, predicated on the fact that the court in the Lichtenburg Action had basically held that the directors of Besicorp were not the "cronies" of Zinn so that demand upon them was not futile, and that that issue had been fully litigated in *Lichtenburg* so that the plaintiffs in the first derivative case were collaterally estopped from relitigating it. The Supreme Court denied the defendants' motion and granted the plaintiff summary judgment, but the Third Department reversed, granting summary judgment to the defendants and dismissing the complaint. Plaintiff in the first derivative suit at that point had lost everything and Zinn was on his way to total reimbursement by the corporation for his costs and expenses of his crimes. Enter the Court of Appeals.

The Court, after neatly laying out the rationale for the demand requirement and the law in New York regarding when such demand may be excused as futile, quickly disposed of the applicability of the conclusion in the *Lichtenburg* Action that the doctrine of collateral estoppel barred the relitigation of the futility argument in the first derivative case. It did not, the Court concluded. The *Lichtenburg* Action brought on behalf of Besicorp against Zinn and the board was based on the grant by the board of stock options and warrants for inadequate consideration, among other things, thereby wasting corporate assets. The claims in *Lichtenburg* (stock options and warrants) did not involve the issues concerning the improprieties in the criminal case. In short, because there was no identity of issue, which collateral estoppel requires, the holding in *Lichtenburg* was not binding. That left the issue of futility.

Again the Court quickly concluded that demand was futile. While the board was not acting in its self-interest in dealing with the implications of the criminal case, the history of the board's handling of Zinn's costs associated with that case showed the board to be dominated and controlled by him. Demand was futile.

The result: the Supreme Court's grant of summary judgment for the plaintiff was reinstated. The Court concluded on the face of the record in the criminal case there could be no issue of fact as to whether Zinn acted in good faith (Business Corporation Law § 722[a] and [b]) so as to permit his indemnification by Besicorp. But this case of corporate manipulation may not be over because the Court denied summary judgment against the defendants other than Zinn.

### **Lesser Included Offenses**

In *People v. Arthur Mills*, the Court adopted a new rule and held that, "where an indictment is based on legally sufficient evidence defendant's statute of limitations defense is forfeited or waived by his request to charge [a] lesser included offense." Thus, although the statute of limitations for the charge of which defendant was convicted was 5 years and the crime had been committed 21 years earlier, the conviction could stand.

In *Mills*, it was alleged that defendant pushed a boy, causing him to strike his head on a concrete pier and fall into a body of water and then drown. It was further alleged that the defendant did not help the boy and actively discouraged others from doing so by making them think the boy was swimming after he fell, which he was not. Defendant was charged with depraved indifference murder, a crime for which there is no statute of limitations. Defendant requested a charge on the lesser included offense of criminally negligent homicide, a crime with a 5-year statute of limitations. The trial court stated that requesting such a charge would constitute a waiver of any statute of limitations defense. Defense counsel persisted in asking for the lesser charge, stating that defendant was reserving his right to appeal on the statute of limitations ground if convicted of the lesser charge. Defendant was acquitted of murder but found guilty of criminally negligent homicide.

The defense argument on appeal was that the depraved indifference murder indictment had not been supported by legally sufficient evidence, and the prosecution had overcharged the defendant with that crime in order to circumvent the statute of limitations applicable to lesser degrees of homicide. The Court of Appeals majority found, and the dissent agreed, that there had been legally sufficient evidence before the grand jury to support the depraved indifference indictment. The Court, however, divided over whether defendant's request of the lesser charge constituted a waiver or forfeiture of the statute of limitations defense.

The 5-1 majority opinion, by Judge Victoria A. Graffeo, noted that the statute of limitations defense is not jurisdictional and can be waived or forfeited. It further noted the general rule that an affirmative request for a lesser charge constitutes a waiver of the right to challenge on appeal the submission of such charge. The Court then held that general rule applies equally to waiver of a statute of limitations defense. The Court reasoned that the danger of a prosecutor overcharging to avoid the statute of limitations is addressed by requiring the indictment on the greater charge to have been based on legally sufficient evidence.

Judge George Bundy Smith dissented, arguing that defendant had explicitly refused to waive his statute of limitations defense and that "there was no forfeiture, that is, a loss of a statutory right to assert the bar of the statute of limitations, merely by a request to charge a lesser included offense." (Footnote omitted.)

The majority and dissent agreed on an evidentiary issue raised on appeal. Defendant objected to the admission of testimony by his wife, without his consent, as to a statement he had made during their marriage to the effect that he would kill her "just like he did with that kid." The marital privilege is designed to " 'protect and strengthen the marital bond . . . [and] encompasses only those statements . . . that are induced by the marital relation and prompted by the affection, confidence and loyalty engendered by such relationship.'" (Citation omitted.) Threats made during the course of physical abuse, such as the statement made by defendant while choking his wife, are "not entitled to be cloaked in the privilege." Thus, the husband's statement to his wife was admissible through her.

### **Waiver of Right to Be Present**

In *People v. Segundo Jose Velasquez* and *People v. Ronald Foster*, defendants both claimed that they had not been present for conferences during the voir dire of potential jurors and that they had not knowingly waived their "*Antommarchi*" right to be present.<sup>1</sup> The Court of Appeals affirmed the convictions, declining to remand the matters for reconstruction hearings. The results illustrate the importance of making clear and complete records of trial proceedings.

In *Foster*, defendant maintained that he had not been present during robing room conferences with prospective jurors. The transcript of those proceedings did not indicate defendant's presence. The Court suggested "greater attentiveness to indicating defendants'

presence, or absence, in the trial record” in order to avoid such disputes, but ruled that the “presumption of regularity” attaching to judicial proceedings created a presumption that defendant had, in fact, been present. The court reporter’s failure to note defendant’s presence did not rise to the level of “substantial evidence” necessary to overcome that presumption. The Court rejected defendant’s suggestion that the matter be remanded for an evidentiary hearing as to whether he had been present, stating, “[r]econstruction hearings should not be routinely ordered where, as here, the record is simply insufficient to establish facts necessary to meet the defendant’s burden of showing that he was absent from a material stage of the trial.”

In *Velasquez*, there was no dispute that defendant was not present for sidebar conferences during jury selection. The issue instead was whether he had waived his *Antommarchi* right. The record reflected that at the close of a bench conference defense counsel announced in open court, “waived,” at which point the court stated on the record, “Antommarchi waived.” Here, too, the Court of Appeals suggested a “better practice” for trial courts, specifically, “to state [on the record] the substance of the right being waived.” It declined to order a reconstruction hearing on whether the defendant had knowingly waived his right, however. Again relying upon the presumption of regularity, the Court found that “nothing in the record calls into question the effectiveness of defendant’s waiver as announced by counsel, as the waiver occurred in open court in the presence of defendant.”

Judge George Bundy Smith dissented in these cases, as well. The dissent argued that the records in both cases did not indicate that the defendant either was present or had voluntarily, knowingly and intelligently waived his right to be, and thus Justice Smith would have remanded both cases for reconstruction hearings. Noting that the presumption of regularity in the past has been used in relatively limited circumstances, the dissent stated, “[t]he presumption of regularity should not be used as a substitute for the reconstruction of a record.”

<sup>1</sup> See *People v. Antommarchi*, 80 N.Y.2d 247 (1992).