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Eighth Circuit Upholds Application of Maryland's Narrow Futility Exception to Demand Requirement

The United States Court of Appeals for the Eighth Circuit recently affirmed the application of Maryland's demand requirement to a derivative claim arising under the federal Racketeer Influenced and Corrupt Organizations Act ("RICO") as well as to Maryland state law claims. *Gomes v. American Century Companies, Inc.*, 710 F.3d 811 (8th Cir. 2013). Plaintiff, an investor in a Maryland corporation, argued that applying Maryland's demand requirement to his racketeering claim would be inconsistent with RICO's broad remedial purpose, and also contended that even if his RICO claim were subject to the demand requirement, demand was excused as to his Maryland claims.

Upholding a decision of the United States District Court, the Eighth Circuit held that application of Maryland's demand requirement would not frustrate the policies of RICO: "That a federal statute has a remedial purpose does not make all claims arising under it immune from state law demand requirements. [Citation omitted.] Requiring an investor to offer the corporation an opportunity to pursue its own claim does not preclude the investor from suing if the directors refuse the demand." *Id.* at 816.

Plaintiff also alleged, on behalf of the corporation, breach of fiduciary duty, negligence, waste and racketeering. The Court, again affirming the District Court, held that demand was not excused on any of Plaintiff's claims. This decision is not surprising. Plaintiff was not able to allege anything more than that the directors who made the disputed decisions would be the same directors who would be responding to the demand and, therefore, could not be expected to authorize a suit against themselves. The Eighth Circuit correctly applied the decision of the Court of Appeals of Maryland in *Werbowsky v. Collomb*, 766 A.2d 123, 144 (Md. 2001), holding that demand is excused only when, quoting *Werbowsky*:

> The allegations or evidence clearly demonstrate, in a very particular manner, either that (1) a demand, or delay and awaiting a response to a demand, would cause irreparable harm to the corporation, or (2) a majority of the directors are so personally and directly conflicted or committed to the decision in dispute that they cannot reasonably be expected to respond to a demand in good faith and within the ambit of the business judgment rule.

Gomes, 710 F.3d at 816.

More specifically, the Court in *Gomes* held: "After *Werbowsky*, participation by directors in alleged wrongdoing is not sufficient to excuse demand." *Id*. at 818. Implicitly, the

Court held that in order to establish a conflict or commitment sufficient to excuse demand, a derivative plaintiff must establish more than just the participation of the directors in the decision – the clear holding of the *Werbowsky* case. Indeed, as the court in *Werbowsky* noted: "The demand requirement is important. Directors are presumed to act properly and in the best interest of the corporation. They enjoy the benefit and protection of the business judgment rule, and their control of corporate affairs should not be impinged based on non-specific or speculative allegations of wrongdoing." *Werbowsky*, 766 A.2d at 144.

The Eighth Circuit correctly noted that: "No Maryland court has held after *Werbowsky* that demand was excused because the directors participated in the transaction giving rise to the claim and might be personally liable if the claim succeeded." *Gomes*, 710 F.3d at 817. The decision thus reaffirms Maryland's narrow interpretation of the futility exception to the demand requirement in derivative suits.

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As always, my colleagues and I are available at any time to discuss these or other matters of Maryland law.

Jim Hanks