Securities Regulation Daily Wrap Up, FIDUCIARY DUTIES—Del. Ch.: Qualcomm's antitrust troubles don't implicate directors in derivative suit, (Aug. 2, 2016)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

A Qualcomm shareholder suing the board for its alleged failure to respond to antitrust "red flags" was thwarted by its failure to first demand that the corporation bring the claim. The pension-fund plaintiff had an uphill battle in pursuing its *Caremark* claim that the board breached its duty of loyalty by consciously disregarding corporate misconduct. Even assuming that antitrust settlements and foreign judgments constituted red flags, the complaint did not adequately plead that the board's response constituted bad faith (*Melbourne Municipal Firefighters' Pension Trust Fund v. Jacobs*, August 1, 2016, Montgomery-Reeves, T.).

Antitrust liability. According to the complaint, Qualcomm's ownership of technologies and patents essential to wireless telecommunications has allowed it to become "a toll collector for almost every smartphone manufactured." Qualcomm had acknowledged that it must offer to license its products on fair, reasonable, and non-discriminatory (FRAND) terms, but nevertheless allegedly leveraged its market power unfairly by charging unreasonably high licensing fees, bundling and tying patent licenses, demanding royalty-free licenses from licensees in return, and imposing unreasonable conditions on licensees and chip purchasers.

These allegations led to an $891 million settlement with Broadcom in 2009 and extra-U.S. proceedings in which Qualcomm was found to have violated South Korean and Japanese laws. Then, in 2013, the National Development and Reform Commission of the People's Republic of China (NDRC) notified Qualcomm that it was investigating violations of the country's anti-monopoly law. This investigation resulted in a 2015 settlement, where Qualcomm agreed to pay a $975 million fine.

Derivative allegations. The plaintiff demanded books and records from Qualcomm, received and reviewed them, and filed a derivative complaint without making a presuit demand on the board. The complaint asserts two claims for breach of fiduciary duty, against the director and officer defendants, respectively. According to the plaintiff, demand was excused as futile because a majority of the board faced a substantial likelihood of liability for breaching their duty of loyalty by failing to oversee the company's compliance with antitrust laws.

The complaint pointed to the Broadcom settlement and South Korean and Japanese decisions as red flags. These legal outcomes were disclosed in SEC filings signed by a majority of the board. According to the complaint, an absence of any indication that the board took steps to address the continuing and repeated antitrust violations in foreign markets evidenced its conscious disregard for the duty to remedy and prevent that misconduct. This bad-faith, conscious inaction resulted in Qualcomm's incurring a nearly $1 billion fine to the NDRC.

***Caremark* analysis.** Stacking *Rales* (the applicable standard for assessing demand futility) and *Caremark* (the basis for the theory that the defendants were liable for failure to monitor compliance with the law), the court observed that demand would only be excused if the Qualcomm board acted in bad faith. In practice, plaintiffs tend to approach *Caremark* by pleading that the board consciously disregarded certain red flags indicating corporate misconduct.

The complaint, however, did not plead facts from which the court could reasonably infer that the board acted in bad faith. The court did not need to consider whether the settlement and decisions actually constituted red flags or whether the board's response to those alleged red flags proximately caused the damage from the NDRC

decision. For purposes of evaluating whether the board acted in bad faith, the court assumed that the settlement and decisions were red flags.

Although the court assumed the existence of red flags, it assessed the severity of those red flags by way of distinguishing *In re Massey Energy Co.* (Del.Ch. 2011). There, bad-faith inaction was sufficient to plead a *Caremark* claim. But the court observed that the red flags in *Massey* "were far more egregious and indisputable than those alleged here."

Furthermore, the complaint conceded that the board continuously monitored each of the three alleged red flags and the NDRC decision. The board also consistently maintained that Qualcomm's business practices did not violate international antitrust law and focused on educating industry participants and government officials as to the legality of those practices. The complaint, therefore, was not that the board completely failed to respond to the red flags, but that the response was insufficient. "Red flags that rise to the severity of those in *Massey* may implicate an immediate duty to alter a company's culture and business practices," the court wrote. "This case, however, is not one in which the company pled guilty to criminal charges—as in *Massey*—or was advised by its general counsel that its business plan included potentially illegal conduct—as in [*La. Mun. Police Empls' Ret. Sys. v.*] *Pyott*" (Del.Ch. 2012).

Finding no inference of bad faith, the court dismissed the fiduciary duty claims against the director defendants. With only two of 15 officers also sitting on the board, the court also dismissed the claims against the officer defendants, as there was no possibility that a majority of the board could face liability for those claims.

The case is No. 10872-VCMR.

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Companies: Melbourne Municipal Firefighters' Pension Trust Fund; Qualcomm, Inc.; Broadcom Corporation

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