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March 8, 2010 | Posted By

Tenth Circuit Holds Corporate Shareholders Do Not Have Standing Under Rico To Sue Derivatively For Alleged Injuries To Corporation

In *Bixler v. Foster*, No. 09-2138, 2010 WL 597477 (10th Cir. Feb. 22, 2010), the United States Court of Appeals for the Tenth Circuit affirmed the dismissal of a class action lawsuit brought by minority shareholders of Mineral Energy and Technology Corporation ("METCO") against its directors and lawyers. Plaintiffs alleged that defendants violated the civil Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1961-1968, for authorizing and facilitating the transfer of METCO's assets to an Australian corporation. The Tenth Circuit held that, among other things, (1) plaintiffs lacked standing under RICO to assert shareholder derivative claims and (2) allegations of securities fraud did not establish predicate acts under RICO. This decision confirms that the civil RICO statutes generally are not available to shareholders and investors seeking redress for alleged ordinary corporate misconduct.

The action centered around the directors and majority shareholders of METCO, a New Mexico uranium mining company. The directors negotiated a trade of METCO's uranium mining claims to subsidiaries of defendant Uranium King, Ltd. ("UKL"), an Australian corporation. UKL subsequently merged with another Australian corporation, Monaro Mining NL ("Monaro"). Plaintiffs alleged that the transfer of the mining claims provided for METCO to receive $6.5 million and stock in UKL in exchange for METCO's uranium interests. The UKL stock was then to be distributed among the METCO shareholders on a pro rata basis. According to plaintiffs, after defendants transferred the METCO uranium claim deed to UKL, UKL abandoned the agreement and paid neither the money nor the UKL stock to METCO. Consequently, plaintiffs lost the value of their investment in METCO. Additionally, plaintiffs allege that the directors were "highly compensated" for arranging the transaction.

Based on this conduct, the plaintiffs alleged that defendants defrauded them of their share of the UKL stock and rendered their METCO investment virtually worthless. Plaintiffs also averred that the UKL-Monaro merger was a fraudulent means of transferring the mining claims to a third entity. Furthermore, plaintiffs claimed that the defendants conspired to deprive them of the value of their METCO shares by a series of predicate acts based on the above-described conduct, in violation of RICO. The United States District Court for the District of New Mexico granted the defendants' motions to dismiss holding (among other things) that plaintiffs did not have standing to bring RICO claims on METCO's behalf based on the diminution of the value of their shares and that the Private Securities Litigation Reform Act of 1995 ("Reform Act") precluded RICO claims based on securities fraud. Plaintiffs appealed.

With regard to plaintiffs' standing argument, the Tenth Circuit held that, as a general rule, conduct by corporate management which harms a corporation confers standing to sue on the corporation, not its shareholders. There are two exceptions to this rule, however. First, the shareholder standing rule allows shareholders to bring a claim where the corporation's management has refused to pursue the same action for reasons other than good faith business judgment. Second, a shareholder with a *direct, personal interest* in a cause of action may bring suit even if the corporation's rights are also implicated. Plaintiffs argued that their claim fell within this latter exception. Specifically, the plaintiffs alleged that the defendants' actions caused their proportionate corporate ownership to be diluted, a direct personal injury.

To support their argument, plaintiffs asserted facts that showed that the majority shareholders received *personal compensation* for arranging the mining-claim transaction, while the minority shareholders did not. Thus, plaintiffs reasoned, the minority shareholders suffered a diminution in value of their corporate shares without receiving the same monetary compensation the majority shareholders received. The Tenth Circuit was not persuaded. The Court held that because plaintiffs made no showing that *more shares were issued* or that *the value of the majority shareholders' shares increased more than theirs*, plaintiffs failed to show that their corporate ownership was diluted. Thus, there was no *direct, personal* interest to afford them standing. The Court's conclusion accorded with the uniform holdings of all other Courts of Appeals that have considered the question and held, similarly, that corporate shareholders do not have standing to sue derivatively under the civil RICO statute for alleged injuries to the corporation.

Next, plaintiffs argued that the provision in the Reform Act stating that "no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of [RICO]," Pub. L. No. 104-67, § 107, 109 Stat. 737, 758 (Dec. 22, 1995), amending 18 U.S.C. § 1964(c), did not apply because their claims did not involve the "purchase or sale of securities," as required by the statute. The Court disagreed and held that although the minority shareholders did not "purchase" or "sell" their METCO shares as part of the alleged wrongdoing, their allegations that defendants defrauded them from receiving UKL stock as provided in the transaction, and the subsequent (allegedly fraudulent) merger of UKL and Monaro, adequately described a "purchase" and "sale" of securities to bar their claim under RICO. The Court also held that plaintiffs' assertion that defendants transferred METCO's uranium interests to UKL with the intent not to honor the corresponding agreement to issue UKL stock to METCO or its shareholders, also described a violation of the Securities and Exchange Commission's ("SEC") Rule 10b-5.

Plaintiffs also attempted to argue that the Reform Act exception does not apply because most of the alleged predicate acts did not describe securities fraud. They maintained that their allegations that defendants committed mail and wire fraud, bank fraud, extortion, obstruction of justice and interstate travel in support of racketeering described conduct not covered by the Reform Act. Again, the Court disagreed and held that although such conduct constituted illegal and fraudulent activity, it was also undertaken *in connection with*

the purchase of a security. Thus, these activities could not support a civil RICO claim after the enactment of the Reform Act. The Court observed that "allowing plaintiffs to engage in surgical presentation of the cause of action would undermine the purpose of the RICO amendment." Hence, the Court concluded that the plaintiffs' claims fell within the Reform Act and thus could not form the basis of a civil RICO claim.

This decision further confirms the Circuits' uniformity in holding that corporate shareholders do not have standing to sue under the civil RICO statute for alleged injuries to the corporation. It is also another instance in which the courts have strictly construed the Reform Act exception to RICO claims, barring claimants from seeking relief under the civil RICO statutes for claims that even remotely involve the purchase or sale of securities.

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