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Rare Rejection of Directors' Defense

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When a group of investors sued the directors of Ronson Corp. in 2003, the board did what corporations do when faced with a shareholders' derivative suit.

It formed a committee, which recommended dismissal.

If the court had agreed, the case would have ended there, under a 2002 New Jersey Supreme Court ruling that allows dismissal based on the findings of a so-called special litigation committee.

But in the first written New Jersey opinion to assess the conclusions of such a committee, an Essex County chancery judge has found that the Ronson committee neither did its job properly nor reached a reasonable result, leaving the case, *Steel Partners II v. Aronson*, C-101-03, to go forward.

Experts on the use of the special litigation committee defense, which is allowed in many, if not most, states, say the March 30 ruling by Judge Harriet Klein is significant. Not only do courts seldom reject a committee's conclusions, but there are few written opinions analyzing the defense and Klein took the unusual approach of conducting a three-day minitrial, bifurcating the defense from the remainder of the case.

In March 2003, Steel Partners II L.P. of New York, an investment fund, sued the company's seven directors for breach of fiduciary duty on account of actions allegedly taken after Steel Partners bought Ronson stock and tried to buy additional shares that would give it control of the Somerset company.

The board adopted a shareholder rights agreement, allegedly intended as a poison pill to protect against a hostile takeover of Ronson, which makes consumer products and runs an executive jet service.

The board also entered into consulting, stock option and proxy agreements with another shareholder, Carl Dinger III. Steel Partners contends that the agreements were "no-show" contracts that paid Dinger hundreds of thousands of dollars and boosted his ownership, while allowing his shares to be voted by Louis Aronson, Ronson's chief executive officer and president since 1953.

According to Steel Partners, the contracts were approved by a board of directors beholden to Aronson in some way, including Robert, his son; Erwin Ganz and Gerard Quinnan, both retired employees with consulting deals; and Justin Walder, whose law firm, Roseland's Walder Hayden & Brogan, does legal work for Ronson.

The other two directors, I. Leo Motiuk and Saul Weisman, were the ones appointed to the special litigation committee.

Federal Tussle

Ronson turned around and sued Steel Partners in federal court, accusing it of violating federal securities laws and filing the derivative suit maliciously and in bad faith. Motiuk and Weisman were named plaintiffs but an amended complaint filed about a month later dropped them from the case.

U.S. District Judge Garrett Brown Jr. dismissed the suit on statute of limitations grounds and the Third U.S. Circuit Court of Appeals affirmed in *Ronson Corp. v. Steel Partners*, 119 Fed. Appx. 392 (2005). But Motiuk's and Weisman's role as plaintiffs in that suit showed a lack of disinterest that justified rejecting the committee's

report, contended Steel Partners' lawyers, Thomas Fleming and Jack Kint Jr.

Motiuk testified at the minitrial before Klein that he was concerned about a conflict and raised the issue with Seth Taube of McCarter & English, who represented the directors in the federal case, and that Taube agreed a conflict existed. But Motiuk said he was assured by Aronson that Taube had changed his mind. Taube, now with Baker Botts in New York, did not return a call for comment, nor did Motiuk, a lawyer with Windels Marx Lane & Mittendorf in New Brunswick.

Nevertheless, Klein found Motiuk and Weisman independent not only because they relied on Taube's advice but also because Herrick Feinstein, the outside firm hired to advise the committee, had not done work for Ronson and was thus independent. She also noted that Motiuk and Weisman were outside directors not involved in the day-to-day operations of Ronson and had not been employed by the company except for a small bit of work by Motiuk when he was with Shanley & Fisher.

But the three-month investigation by Motiuk and Weisman, a now deceased businessman, and the committee's 139-page report did not pass muster with Klein.

She faulted the committee's failure to do more than three interviews after Ronson produced hundreds of critical documents following months of delay. "While one can have sympathy for their resulting nocturnal labor under the pressure of time constraints, that does not justify their failure to give these documents the scrutiny that they merited," Klein wrote.

Similarly, when met with the "first-time revelation" of a crucial meeting between Dinger and Aronson, the committee did not even ask for notes of the meeting, she observed.

The lack of a thorough investigation led to the lack of a reasonable basis for the committee's conclusions, Klein found.

For example, in finding Dinger's consulting deal legitimate, the committee "closed its eyes to numerous red flags," including a letter in which Dinger expressed his belief that the company would get no benefit from hiring him, said Klein. There was also no good explanation why Ronson would purchase Dinger's options at three times the market price, she said.

Klein also questioned the committee's approval of Aronson's compensation, totaling $4.5 million between 1998 and 2003, nearly three times Ronson's $1.59 million net earnings for the same period.

Clarification of Klein Ruling Sought

Laurence Orloff, who represents the board members, says Klein's opinion is unclear about the reasonableness of the committee's findings on the Shareholder Rights Agreement - the poison pill - and he has filed a motion asking her to modify or clarify the decision on that point and dismiss claims predicated on that agreement.

He is relying on language in the opinion where Klein said there is a reasonable basis for the committee's conclusion that the board took defensive measures in a "good faith belief that they needed to protect Ronson against a hostile takeover waged by Steel Partners that would not be in Ronson's best interest."

"We are confident that the business judgment of the Ronson directors will ultimately be vindicated," says Orloff, of Roseland's Orloff, Lowenbach, Stifelman & Siegel.

Steel Partners has also filed a federal securities action against the directors. On April 19, U.S. District Judge Dennis Cavanaugh denied a motion to dismiss or abstain in the case, *Steel Partners II v. Aronson*, 05-CV-1983.

Orloff says he plans to ask that the ruling be certified to the Third Circuit so he can appeal.

Lawrence Fox, a securities lawyer who has written on the issue of special litigation committees, says the Ronson case is the first he is aware of where a court did not deem an investigation sufficient. The committees usually "leave no stone unturned" because they know a court will be looking over their shoulder, he says.

"I was surprised that the judge accepted their independence," says Fox, of Philadelphia's Drinker Biddle & Reath. If he had been advising the board, he would have suggested adding new directors who were not involved with the disputed decisions.

But he praises Klein for digging into the details of the committee's efforts and calls the ruling a boon for proponents of the defense because it refutes critics who claim committees are always upheld.

James Cox, a Duke University Law School professor, says the committee provided "something of a whitewash," overlooking crucial facts and making up its mind before it had them. Judges need to do the same kind of critical analysis as Klein to prevent defendants from jerry-rigging the process, he says.

Lead Herrick Feinstein lawyer Therese Doherty did not return a call seeking comment. Neither did Walder or Dinger's lawyer, Russell Burnside of Newark's Greenberg Dauber Epstein & Tucker.

The special litigation committee defense is an "extraordinary device, the only instance in American jurisprudence where a defendant can potentially free itself" from litigation by "merely appointing a committee to investigate the allegations of the complaint," wrote Klein.

A 1979 U.S. Supreme Court ruling in *Burks v. Lasker*, 441 U.S. 471, upheld the defense, saying courts should look to the law of the state of incorporation in applying it.

The New Jersey Supreme Court recognized the defense in *In re PSE&G Litigation*, 173 N.J. 258 (2002). No committee was appointed in that case, but the Court held that, regardless of whether a special litigation committee is appointed, a court need not defer to a corporate board's response to a shareholder suit.