
May 19, 2015

Delaware Supreme Court Clarifies That Plaintiffs Must Plead a Non-Exculpated Claim of Breach of Fiduciary Duty to Survive Motion to Dismiss, Even Where Entire Fairness Applies

Last week, the Delaware Supreme Court cleared up a confused area of the law and held that in a stockholder suit challenging an acquisition by a controlling stockholder, a plaintiff seeking monetary damages from independent directors who negotiated and approved the merger must allege with specificity that each director protected by an exculpatory charter provision breached their duty of loyalty or good faith, even where Delaware's stringent entire fairness standard of review applies to the court's evaluation of the transaction.

In re Cornerstone Therapeutics Inc. and *In re Zhongpin Inc. S'holders Litig.* both involved squeeze-out mergers led by significant, if not controlling, stockholders, the terms of which had been negotiated by independent special committees of the respective boards and ultimately approved by a majority of the minority stockholders. Plaintiffs sued not only the controlling stockholder and its affiliated directors, but also the independent directors who had negotiated and approved the mergers. Neither transaction qualified for the deferential business judgment standard of review available under *Kahn v. M&F Worldwide Corporation* and the Court of Chancery therefore held that the stringent "entire fairness" standard—requiring the controlling shareholder who is the proponent of the transaction to carry the burden of proving that the deal is fair to the minority stockholders—was applicable. Although both companies had adopted a charter provision pursuant to Section 102(b)(7) of the Delaware General Corporation Law that exculpated directors from claims for damages to the fullest extent permitted by Delaware law, the Court of Chancery held that claims for breach of fiduciary duty against independent directors survive a motion to dismiss whenever the entire fairness standard applied to the transaction, even if the claims against the independent directors were covered by the exculpation provision in the target's charter. On appeal, the Supreme Court disagreed and held that:

- *A plaintiff must plead non-exculpated claims against each particular director for a complaint to survive dismissal with respect to that director, regardless of the standard of review applicable to the transaction* – The Supreme Court held that even if plaintiffs can plead facts supporting the application of the entire fairness standard to the transaction, and thus the allegedly-interested fiduciaries were automatically subject to a duty of loyalty claim, it does not follow that all of the independent directors are also subject to such a claim. As to the independent directors who enjoy the benefit of an exculpatory provision, plaintiffs must plead facts indicating that the director breached the duty of loyalty (i.e., he or she was interested in the transaction or otherwise acted in bad faith) in order for the claim against such director to survive dismissal.
- *Independent directors are entitled to the protection of the business judgment rule in controlling stockholder transactions unless the plaintiff pleads facts that the presumption should not apply* – The Supreme Court stated that holding otherwise would "create more harm than benefit for minority stockholders" because independent directors would then be incentivized to avoid serving on special committees or to reject transactions "solely because their role in negotiating on behalf of the

stockholders would cause them to remain as defendants until the end of any litigation challenging the transaction.”

This opinion emphasizes that independent directors who fulfill their fiduciary duty of care should be free to approve a transaction that is in the best interests of the stockholders, even when such transaction involves a controlling stockholder.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Matthew W. Abbott
212-373-3402
mabbott@paulweiss.com

Edward T. Ackerman
212-373-3310
eackerman@paulweiss.com

Angelo Bonvino
212-373-3570
abonvino@paulweiss.com

Ariel J. Deckelbaum
212-373-3546
ajdeckelbaum@paulweiss.com

Justin G. Hamill
212-373-3189
jhamill@paulweiss.com

Daniel J. Kramer
212-373-3020
dkramer@paulweiss.com

Stephen P. Lamb
302-655-4411
slamb@paulweiss.com

Jeffrey D. Marell
212-373-3105
jmarell@paulweiss.com

Toby S. Myerson
212-373-3033
tmyerson@paulweiss.com

Carl L. Reisner
212-373-3017
creisner@paulweiss.com

Richard A. Rosen
212-373-3305
rrosen@paulweiss.com

Taurie M. Zeitzer
212-373-3353
tzeitzer@paulweiss.com

Frances F. Mi
212-373-3185
fmi@paulweiss.com

Justin Shuler contributed to this memorandum.