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Delaware Court of Chancery Holds that Board's Decision to Disregard Speculative Projections Did Not Support Claim of Bad Faith

In *In re Chelsea Therapeutics International Ltd. Stockholder Litigation*, the Court of Chancery dismissed claims that the board of a target company acted in bad faith and breached its duty of loyalty by instructing its financial advisor to disregard certain speculative projections in connection with the advisor's valuation analysis, noting that successful fiduciary duty claims based on allegations of bad faith are rare.

Background

The case related to a post-closing damages action challenging the 2014 sale of Chelsea Therapeutics International Ltd. (the "Company") to Lundbeck A/S. The Company's sale to Lundbeck came on the heels of the U.S. Food and Drug Administration's approval of additional applications for Northera, a drug developed by the Company. Prior to announcement of such approval, efforts to shop the Company proved unsuccessful, but following the announcement, several buyers, including Lundbeck, expressed interest.

Lundbeck initially submitted a bid for $6.44 per share in cash, which the Company's Board of Directors determined to be insufficient after considering an analysis prepared by its financial advisor that was based on the Company's standalone value. The Board ultimately agreed to sell the Company to Lundbeck at the $6.44 per share cash price plus up to $1.50 per share of additional consideration contingent on the Company meeting future sales targets. Importantly, the plaintiff stockholders alleged that the Board instructed its financial advisor to disregard two sets of favorable projections (the "Favorable Projections") in connection with the advisor's valuation of the Company. One set of these Favorable Projections had been prepared regularly by the Company since at least 2011 and assumed that the FDA would remove a drug that was Northera's main competitor from the market, resulting in an estimated 16% increase in Northera's market share. The second set of Favorable Projections were based on a 2014 study prepared by an independent consulting firm at the Company's request and projected significant future revenues for the Company if Northera was approved for additional uses.

Analysis

After losing its bid to preliminarily enjoin the transaction with Lundbeck in 2014, plaintiffs amended their complaint, arguing that the defendant directors' instruction to the financial advisor to disregard the Favorable Projections, as well as the defendants' failure to consider the Favorable Projections when recommending the transaction to stockholders, amounted to bad faith. Additionally, plaintiffs alleged disclosure deficiencies due to the defendants' failure to disclose the substance of the Favorable Projections. In granting the defendants' motion to dismiss, the Court of Chancery held as follows:

- *The Board's direction to its financial advisor to disregard the Favorable Projections and its decision to disregard the Favorable Projections in recommending the transaction to stockholders did not amount to bad faith conduct, as the Favorable Projections were highly speculative and based on unlikely scenarios.* Plaintiffs did not allege that the defendants were interested in the transaction, and in fact conceded that they held equity positions which aligned their interests (i.e., maximum value) with stockholders. Plaintiffs argued that certain change-in-control payments that would be payable to defendants upon the Company's sale made the directors interested, but failed to assert that these payments would exceed the alleged loss from selling the Company at a lower value. Plaintiffs thus relied solely on allegations of bad faith conduct.

  To plead a successful claim of bad faith (which the Court described as a "*rara avis*"), plaintiffs had the difficult burden of showing that the Board's decision to exclude the Favorable Projections was "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith". The Court concluded that plaintiffs failed to meet this burden, as the Board's actions were not outside the bounds of reason and it was "readily explicable" that the Board would decline to use the Favorable Projections to value the Company, as the evidence showed that the Favorable Projections were highly speculative.

- *The Board did not have a duty to disclose the substance of the Favorable Projections due to their speculative nature and inherent unreliability.* On a prior occasion in connection with the plaintiffs' motion for a preliminary injunction, the Court denied similar disclosure claims by plaintiffs, pointing again to the speculative nature and general unreliability of the Favorable Projections. Citing this prior ruling, the Court granted the defendants' motion to dismiss as to the disclosure claims, noting that nothing new with respect to the disclosure claims had come to light or been pled since the preliminary injunction hearing.

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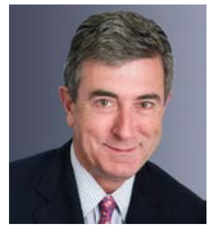


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