CLIFFORD
CHANCE

Client briefing May 2015

Delaware Supreme Court Rules Independent Directors May Rely on Section 102(b)(7) to Dismiss Claims Against Them in Controlling Stockholder Squeeze-out Mergers

Yesterday, the Delaware Supreme Court, in an opinion authored by Chief Justice Strine, considered interlocutory appeals in two related cases, *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, C.A. No. 8922-VCG and *Leal v. Meeks*, C.A. No. 7393–VCN, to decide a single legal question: Where a plaintiff challenges an interested transaction that is presumptively subject to entire fairness review (such as a squeeze-out merger by a controlling stockholder), must plaintiff plead a non-exculpated claim against disinterested, independent directors in order to survive a motion to dismiss?

Resolving conflicting prior rulings in the Chancery Court, the Supreme Court ruled in the affirmative, holding that "[a] plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct – be it *Revlon*, *Unocal*, the entire fairness standard, or the business judgment rule." A copy of the decision may be found here.

In the Chancery Court, plaintiffs had successfully argued that the independent directors' motions to dismiss should be denied regardless of whether plaintiffs had sufficiently pled non-exculpated claims. Citing prior decisions of the Supreme Court in the *Emerald Partners* litigation, plaintiffs argued that the independent directors' motions to dismiss should be denied solely because plaintiffs had demonstrated that the underlying transaction was subject to entire fairness review.

In reversing the decisions below, the Delaware Supreme Court:

- Rejected plaintiffs' argument that there should be an automatic inference that a director facilitating an interested transaction is disloyal, and therefore not exculpated, because the possibility of conflicted loyalties is heightened in controller transactions and may be unknowable at the pleading stage.
- Found that the position taken by the plaintiffs was inconsistent with the purpose of Section 102(b)(7) of the Delaware General Corporation Law, which was to relieve directors of Delaware corporations from potential liability for mistakes and errors of judgment and from the burden of defending against claims of that type.

Accordingly, facially independent directors should be dismissed from any case (including a controlling stockholder take-private case) in which plaintiffs have not plausibly alleged disloyal conduct or bad faith on the part of those directors.

The cases were remanded to the Chancery Court to determine if plaintiffs have sufficiently pled facts suggesting that the independent directors committed a non-exculpated breach of their fiduciary duty.

The Supreme Court noted at oral argument and in its opinion that its holding will not prevent future plaintiffs from holding faithless directors to account. Plaintiffs challenging a controlling stockholder take-private transaction can sue the controlling stockholder and its affiliated directors, conduct discovery and, if discovery uncovers evidence of non-exculpated directorial misconduct, amend to add the implicated directors. We believe that approach has much to commend it. If followed, it should reduce litigation costs and help avoid inappropriate reputational harm to independent directors. It remains to be seen whether the plaintiffs' bar will follow the Court's guidance.

Clifford Chance represented the Appellant members of the Special Committee of Cornerstone who prevailed in *In re Cornerstone Therapeutics Inc. Stockholder Litigation*.

Authors

Anthony Candido
Partner
T: +1 212 878 3140
E: anthony.candido
@cliffordchance.com

John Healy
Partner
T: +1 212 878 8281
E: john.healy
@cliffordchance.com

Robert Myers
Senior Counsel
T: +1 212 878 3425
E: robert.myers
@cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

www.cliffordchance.com

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.