

# Protections for Independent Directors Strengthened by Delaware Supreme Court

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The Delaware Supreme Court held last week that a plaintiff seeking monetary damages from an independent, disinterested director protected by an exculpatory charter provision must specifically plead a non-exculpated claim against the director to survive a motion to dismiss.<sup>1</sup> This rule applies regardless of the standard of review applied to the board's conduct in respect of a challenge to a corporate transaction and includes directors of any special committee negotiating a transaction with a controlling stockholder. As a result, for any corporation whose charter includes a director exculpation clause that mirrors Section 102(b)(7) of the Delaware General Corporation Law, an independent director can obtain dismissal of any claim seeking only monetary damages that does not specifically allege a breach of the fiduciary duties of loyalty and good faith or the prohibition against self-dealing.

## **The *Cornerstone Therapeutics* Decision: An Overview**

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*Background.* In two consolidated actions, stockholder plaintiffs challenged mergers of public companies in which the controlling stockholder,<sup>2</sup> who had representatives on the board of directors, acquired the remaining shares it did not own. Both transactions were negotiated by a special committee of independent, disinterested directors, ultimately approved by a majority of the minority stockholders and priced at a significant premium to the pre-announcement stock price. The plaintiffs brought suit alleging that the directors had breached their fiduciary duties by approving transactions that were unfair to minority stockholders. The independent directors serving on the special committees moved to dismiss by arguing that the plaintiffs had not pled any specific claims that were not exculpated by the companies' charters. Relying on the entire fairness standard of review, the Chancery Court denied the motions, and the Delaware Supreme Court granted interlocutory appeals.

*Opinion.* The Delaware Supreme Court reversed the denial of the independent directors' motions to dismiss and remanded to the Chancery Court to determine whether the plaintiffs had alleged sufficient facts to substantiate a non-exculpated claim. The Court found that, irrespective of the standard of review applied to a transaction (including *Revlon*, *Unocal*, the business judgment rule and entire fairness review), an independent director can obtain dismissal of any claim exculpated by a provision in the corporation's charter. As such, to present a colorable claim against an independent director, a plaintiff must adduce facts that support a "rational inference that the director harbored self-interest adverse to the stockholders' interests, acted to advance the self-interest of an interested party from

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<sup>1</sup> *In re Cornerstone Therapeutics Inc., S'holder Litig.*, No. 564, 2014 (Del. May 14, 2015) & *Leal v. Meeks*, No. 706, 2014 (Del. May 14, 2015) (Strine, C.J.).

<sup>2</sup> In *Cornerstone* and *Leal*, the controlling stockholder owned 65.4% and 17.3%, respectively, of the company's common stock. Nonetheless, the Chancery Court found in *Leal* that the stockholder "held a controlling interest because of his level of control over the management and operations of the company." *Cornerstone*, No. 564, 2014, slip op. at 2 n.6. The Delaware Supreme Court accepted this premise without opining on it substantively. *Id.*

whom they could not be presumed to act independently, or acted in bad faith.”<sup>3</sup> The Court noted that this conclusion comported with precedent requiring individualized consideration of the conduct of independent directors, who are “presumed to be motivated to do their duty with fidelity.”<sup>4</sup>

## Implications for Boards, Independent Directors and Practitioners

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- **Delaware courts are mindful of the critical role of independent directors in evaluating and negotiating potential transactions.** The Court explained that the purpose of Section 102(b)(7) was to “free up directors to take business risks without worrying about negligence lawsuits” and that it had declined “to adopt an approach that would create incentives for independent directors to avoid serving as special committee members, or to reject transactions” solely because of litigation risk.<sup>5</sup> This statement highlights the Court’s concern with ensuring that special committees negotiating transactions can focus on making value-maximizing business decisions.
- **Plaintiffs have other avenues to pursue claims against independent directors.** The Court emphasized that even if plaintiffs do not have sufficient evidence to bring non-exculpated claims against independent directors at the pleading stage, they may bring such claims later. Noting that most transactions are challenged immediately after (and, in many cases, before) they are announced, the Court explained that “plaintiffs will usually have ample time to bring well-pled claims [against independent directors] within the three-year statute of limitations period.”<sup>6</sup>
- **Independent directors will continue to play a central role in fiduciary duty litigation.** Though *Cornerstone* protects independent directors from monetary claims, a court applying the entire fairness test must still assess the actions of those same directors to determine the party upon which the burden of persuasion rests and whether the board’s actions satisfied the test. As such, independent directors should still expect to be deposed in fiduciary duty litigation.<sup>7</sup>
- **The status of pre-closing claims remains unaddressed.** *Cornerstone* specifically addressed only claims for monetary damages. As a result, the opinion is unlikely to affect pre-closing litigation where the plaintiff is seeking injunctive or other equitable relief.

## Conclusion

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Corporate boards, independent directors and practitioners should pay close attention to *Cornerstone*, which may signal increased interest by Delaware courts in cabining the personal liability of directors. If you have any questions concerning the material discussed in this client alert, please contact the following co-authors or any other members of our Mergers & Acquisitions practice group:

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<sup>3</sup> *Id.*, No. 564, 2014, slip op. at 8.

<sup>4</sup> *In re MFW S’holders Litig.*, 67 A.3d 496, 528-29 (Del. Ch. 2013) (Strine, C.).

<sup>5</sup> *Cornerstone*, No. 564, 2014, slip op. at 15-16 (quoting *Malpiede v. Townson*, 780 A.2d 1075, 1095 (Del. 2001)).

<sup>6</sup> *Id.*, No. 564, 2014, slip op. at 13 n.40 (citing DEL. CODE ANN. tit. 10, § 8106).

<sup>7</sup> See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 653 (Del. 2013) (citing *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994)); *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 44-45 (Del. Ch. 2013).