



Top 10 Delaware Corporate Opinions of 2008

2008 was marred by economic downturns, financial scandals and collapses, but the influence and importance of Delaware corporate law has remained stable. With over 200 written corporate decisions from the Delaware Supreme Court and Court of Chancery in 2008, finding the top 10 most influential corporate opinions is a difficult task. Below we have summarized those decisions we have determined to be the most significant in the past year. For more information or for copies of any of the opinions listed below, contact Cathy L. Reese, a principal in the Delaware office of Fish & Richardson P.C. and head of its Corporate and Chancery Litigation practice.

Opinion Date and Topic	Case and Summary
1/15/08 Proxy contests Director elections Disclosure	<i>Portnoy v. Cryo-Cell Int'l Inc.</i>, 940 A.2d 43 (Del. Ch. 2008) (Strine, V.C.) This case involved a contested corporate election with a process so tainted that the Court of Chancery ordered a new election. The Court found that a mere offer of a position on a management slate should not be considered a vote-buying arrangement subject to entire fairness review. However, the Court found improper an arrangement between the board and a stockholder, reached on the eve of the election and undisclosed to the stockholders, in which the stockholder promised to purchase more shares (and therefore votes) if the incumbent board would use its powers to expand the board and fill the new seat with the stockholder's designee. As a remedy, the Court ordered a prompt special meeting to hold a new election at the expense of the management slate.
2/12/08 Derivative suits Stockholder standing Equitable standing	<i>Schoon v. Smith</i>, 953 A.2d 196 (Del. 2008) In this case, the Delaware Supreme Court addressed the issue of whether a director, who was not a stockholder, could bring a derivative lawsuit on behalf of the corporation. The Court held that equity could rationalize the extension of standing to an independent director, but only if the director could show

<p>Independent directors</p>	<p>that there would be a complete failure of justice on behalf of the corporation if standing were denied. Here, the stockholder who had elected the director had already begun to use the “tools at hand” that could lead to a potential derivative suit, and the Court reasoned that a “stockholder derivative action would fully and adequately redress any injuries to [the corporation] resulting from a breach of fiduciary duty by its board.” The Court did not give examples of the type of situations where the corporation would suffer a complete failure of justice unless the Court granted equitable standing to an independent, non-stockholder director to bring a derivative action.</p>
<p>2/14/08</p> <p>Business judgment rule</p> <p>Derivative v. direct claims</p> <p>Pleading standards</p> <p>Company sale</p> <p>Reclassification of shares</p>	<p><i>Gantler v. Stephens</i>, 2008 WL 401124 (Del. Ch. Feb. 14, 2008) (Parsons, V.C.), rev’d, 2009 WL 188828 (Del. 2009)*</p> <p>In this case, the Court of Chancery held that the decision not to sell the company was subject to the business judgment standard of review, as was a decision to reclassify the company’s shares. The Court found that “there is no allegation of a hostile takeover attempt, or any threatening actions that could cause the Court reasonably to consider Defendants’ action as ‘defensive,’” and therefore the <i>Unocal</i> standard would not apply. In deciding whether the board’s decision to terminate the sales process and reject the merger offer was entitled to the presumption of business judgment, the Court analyzed whether it reached its decision in a “good faith pursuit of legitimate corporate interests” and whether it did so “advisedly.” Even though the claims were brought directly, the Court found that the complaint failed to allege facts sufficient to establish that the board acted disloyally or failed to exercise due care. Regarding the reclassification, the Court also found that while the complaint had averred sufficient facts to infer that a majority of the board may have been interested or not independent, the decision was still entitled to business judgment protection because it was ratified by a majority of the unaffiliated, adequately informed</p>

	<p>shareholders.</p> <p><i>*As this compilation was going to press, the Delaware Supreme Court reversed the Gantler decision and remanded for further proceedings, finding that the complaint sufficiently alleged that the board was conflicted and the business judgment rule did not apply and that the ratification doctrine did not apply. The Court agreed that a Unocal analysis was inapplicable.</i></p>
<p>3/13/08 and 4/14/08</p> <p>Advance notice bylaws</p> <p>Corporate bylaws</p> <p>Shareholder rights</p> <p>Securities</p> <p>SEC Rule 14a-8</p>	<p><i>Jana Master Fund, Ltd. v. CNET Networks, Inc., 954 A.2d 335 (Del. Ch.), aff'd, 947 A.2d 1120 (Del. 2008) (Table) (Chandler, C.) and Levitt Corp. v. Office Depot, Inc., 2008 WL 1724244 (Del. Ch. Apr. 14, 2008) (Noble, V.C.)</i></p> <p>These cases involved the interplay between activist stockholder proposals regarding director nominations and the corporations' advance notice bylaws. In <i>CNET</i>, the Court found that the company's notice bylaw applied only to proposals that stockholders sought to have included in the company's proxy materials pursuant to Rule 14a-8 and not to independently financed stockholder proposals and nominations. The Court in <i>Office Depot</i> found that the "business" as it appeared in the bylaw included nominating and electing directors, and that absent any limitations on the nominating process, the notice given by the company satisfied the notice requirement for the surprise slate of competing board candidates offered by the shareholders. Both cases emphasize the importance of shareholder nomination rights and the need for any restriction of those rights in an advanced notice bylaw to be clear and unambiguous to avoid a narrow interpretation in favor of the shareholder franchise.</p>
<p>3/28/08</p> <p>Amending advancement bylaws</p> <p>Advancement</p> <p>Indemnification</p>	<p><i>Schoon v. Troy Corp., 948 A.2d 1157 (Del. Ch. 2008) (Lamb, V.C.)</i></p> <p>In this case, the Court of Chancery approved, over the objections of a former director and a current director, amendments to a corporation's bylaws that removed the right of former directors to advancement and limited the right</p>

<p>Fees on fees</p>	<p>to current directors. The former director challenged the amendment, arguing that the corporation should not be permitted to amend the bylaws to eliminate his advancement right after he had served the corporation in reliance on that right. The Court held that where rights under pre-amendment advancement bylaws had not yet been triggered (such as by the filing of a lawsuit where a director is a defendant or where the company was contemplating such claims against a defendant director), a corporation's amendment to such bylaws to eliminate that right was binding. Thus, the former director was prevented from seeking advancement for claims brought against him after the amendments limiting advancement to current directors were effectuated. Regarding the current director, the amendments did not impair his right to advancement for certain claims, but the Court noted that he, too, was subject to the amended bylaws. The Court also reiterated the importance of proper accounting for matters subject to advancement in legal invoices and the extent to which fees on fees for advancement actions are awarded (i.e., fees on fees are awarded only in proportion to the level of success).</p>
<p>5/7/08</p> <p>LLC</p> <p>LLC agreements</p> <p>Fiduciary duties</p>	<p><i>Fisk Ventures, LLC v. Segal, 2008 WL 1961156 (Del. Ch. May 7, 2008) (Chandler, C.)</i></p> <p>In this case, the Court of Chancery held that an LLC, as a creature of contract, may contractually delineate the fiduciary duties or code of conduct for its members. To exist, these “duties or obligations ... must be found in the LLC Agreement or some other contract.” The Court examined the LLC Agreement and found that it had “eliminate[d] fiduciary duties to the maximum extent permitted by law by flatly stating that members have no duties other than those expressly articulated in the Agreement” and “the Agreement [did] not expressly articulate fiduciary obligations...” Without any of code conduct in the contract having been breached, the Court dismissed the</p>

	allegations of breach of contract, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, and tortious interference with contract for failure to state a claim.
7/1/08 Rule 23.1 Demand futility Derivative suit Exculpatory provisions LLC Act LLC agreements	Wood v. Baum, 953 A.2d 136 (Del. 2008) The Delaware Supreme Court held that an LLC may contractually limit the fiduciary duties of its directors through its operating agreement. In this case, which arose in the context of a dismissal of a derivative complaint for failure to adequately plead demand futility, the Court reemphasized the alternate tests for determining demand futility. The Court analyzed whether the complaint satisfied the <i>Rales v. Blasband</i> test in light of the LLC's operating agreement, which exempted directors from any liability "except in the case of fraudulent or illegal conduct of such person." In light of this provision, the Court explained that to survive a motion to dismiss based on a claim of demand futility, the complaint would have had to allege particular facts that, if proven, would show that a majority of the defendants knowingly engaged in fraudulent or illegal conduct or, under the LLC Act, breached "in bad faith" the covenant of good faith and fair dealing. The Court noted that the latter covenant "functions to protect stockholders' expectations that the company and its board will properly perform the contractual obligations they have under the operative organizational agreements." Affirming the Court of Chancery's dismissal of the complaint for failure to establish demand futility, the Court also noted that plaintiffs failed to use the "tools at hand," such as a books and records demand, to obtain and plead the requisite particularized facts.
7/17/08 (revised 8/15/08) Stockholder proposals Bylaw amendments Fiduciary outs	CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227 (Del. 2008) In this seminal case, the SEC certified a question of law to the Delaware Supreme Court. The SEC sought an opinion on the legality of a stockholder-proposed bylaw that would require a board of directors to reimburse

	<p>the reasonable proxy solicitation expenses incurred by stockholders conducting a successful director election contest. The Court framed the two-question issue first as one that required analysis of whether the bylaw “establishes or regulates a process for substantive director decision-making, or one that mandates the decision itself.” Regarding the bylaw at issue, the Court held that the subject of the bylaw (proxy reimbursement) was proper for inclusion and “would facilitate the exercise of [the stockholders’] right to participate in selecting the contestants.” In answering the second question, however, the Court found that the bylaw as written was invalid because it lacked a fiduciary out clause. This decision will undoubtedly have implications for the 2009 proxy season.</p>
<p>7/29/08, 8/29/08, 9/2/08</p> <p>Demand futility</p> <p><i>Revlon</i></p> <p><i>Aronson</i></p> <p>Good faith</p> <p>Duty of loyalty</p> <p>Duty of care</p> <p>Gross negligence</p> <p>102(b)(7)</p>	<p><i>Ryan v. Lyondell</i>, 2008 WL 2923427 (Del. Ch. July 29, 2008) (Noble, V.C.), <i>McPadden v. Sidhu</i>, 2008 WL 4017052 (Del. Ch. Aug. 29, 2008) (Chandler, C.), and <i>In re Lear Corp. S’holder Litig.</i>, 2008 WL 4053221 (Del. Ch. Sept. 2, 2008) (Strine, V.C.)</p> <p>The Court of Chancery released three cases within a few weeks of each other, each dealing with the review of a board’s fiduciary duties of loyalty when confronted with a potential sale of the company. The first, <i>Lyondell</i>, involved a transaction where the board approved the sale of the company following an unsolicited bid of a 45 percent premium over the then-current share price. In denying the motion for summary judgment, the Court found that there was a material question of fact as to whether the board’s failure to engage in a more proactive sales process was a breach of the duty of loyalty (good faith), given the timing of the transaction. The other two cases arose in a different procedural posture, with the Court finding that the board’s actions as pled did not breach the duty of loyalty. In <i>McPadden</i>, the Court analyzed whether under <i>Aronson</i> the complaint had adequately plead demand futility and found that it did, because the allegations of the board’s lack of consideration</p>

	<p>sufficiently demonstrated gross negligence. The Court explained that “gross negligence” is conduct that constitutes reckless indifference or actions that are outside the bounds of reason, which can be exculpated for directors under 102(b)(7). By contrast, the “intentional dereliction of duty or the conscious disregard for one’s responsibilities” (i.e., bad faith conduct) results in a breach of the duty of loyalty, and cannot be exculpated. Thereafter, the claims against the directors in <i>McPadden</i> were dismissed, but those against the officer were not. In <i>Lear</i>, the Court also analyzed whether the complaint satisfied demand futility under the second prong of <i>Aronson</i> and the contours of bad faith. Here, the board was faced with the aftermath of a failed merger attempt that resulted in the payment of a partial termination fee. The Court found that there were no averments “that support a fair inference that the directors consciously acted in a manner contrary to the interests of Lear and its shareholders,” and emphasized the difficulty in bringing such a claim. The complaint in <i>Lear</i> was dismissed in its entirety.</p>
<p>9/29/08</p> <p>Mergers and acquisitions</p> <p>Material adverse change (MAC) clause</p> <p>Material adverse effect (MAE) clause</p> <p>Breach of contract</p> <p>Liquidated damages</p>	<p><i>Hexion Specialty Chems., Inc. v. Huntsman Corp.</i>, 2008 WL 4457544 (Del. Ch. Sept. 29, 2008) (Lamb, V.C.)</p> <p>In this case, the Delaware Court of Chancery found that there was no material adverse effect (MAE) in the seller’s health that would allow a buyer to back out of a merger agreement, and that the buyer’s knowing and intentional tactics in doing so constituted breach of covenants under the agreement that subjected the buyer to uncapped liability to the seller. The Court noted that an “important consideration” in the calculus of an MAE involves determining whether the “adverse change in the target’s business ... is consequential to the company’s long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months.” Finding that the buyer had not suffered an MAE, the Court also explained the importance of this particular bargaining chit: “absent clear</p>

	<p>language to the contrary, the burden of proof with respect to a material adverse effect rests on the party seeking to excuse its performance under the contract.” Hexion (the buyer seeking to escape the deal) could not meet this “heavy burden.” The Court also analyzed the meaning of “knowing and intentional breach” under the merger agreement and found that the buyer met this standard and was therefore liable for full, rather than capped, contract damages. Huntsman (the seller) was granted judgment ordering Hexion to specifically perform its other covenants and obligations under the agreement, which, among other things, would put Hexion and its shareholders “in the position to make an informed judgment about whether to close the transaction...”</p>
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