Corporate and Chancery
YEAR IN REVIEW

Top 10 Delaware corporate opinions of 2006

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THE YEAR 2006 WAS A BANNER YEAR for Delaware corporate opinions, including the long-awaited Delaware Supreme Court decisions in *In re Walt Disney Co.* and *Stone v. Ritter.* These Delaware Supreme Court opinions provide corporate directors with new insights concerning their fiduciary duties of good faith and oversight. Below, we summarize what we have determined to be the top 10 most influential corporate opinions coming out of the Delaware courts in 2006.

For more information, or for copies of any of the opinions and articles listed below, contact Cathy L. Reese, a principal in the Delaware office of Fish & Richardson and head of its Corporate and Chancery Litigation practice. She can be reached at 302-778-8467 or reese@fr.com.

Opinion date and Topics	Case and summary
11/6/2006 Derivative Action Demand Futility Duty of Good Faith Duty of Oversight/Oversight Liability	***Stone v. Ritter,* 911 A.2d 362 (Del. Supr. Nov. 6, 2006) Holland, J.** The Supreme Court here clarified its decision in *Disney* and concluded that good faith is not an independent stand-alone duty, although good faith may be described colloquially as part of a "triad" of fiduciary duties that includes the duties of care and loyalty. The obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. The Supreme Court held that "[o]nly the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly." The Supreme Court also weighed in on the director's fiduciary duty of oversight, as fleshed out by Chancellor Allen in his landmark 1996 decision in *In re Caremark.* The Supreme Court held that *Caremark* correctly articulates necessary conditions for director oversight liability. Oversight liability can arise (i) when directors utterly fail to implement any reporting or information systems or controls, or (ii) when directors, having implemented such systems or controls, consciously fail to monitor or oversee the operation of such controls, and thus disable themselves from being informed of risks or problems. But the *Stone v. Ritter* opinion departs from *Caremark* in two significant respects. First, *Stone v. Ritter* emphasizes that oversight liability requires a showing that directors knew, in failing to implement or monitor reporting systems, they were not discharging their fiduciary obligations. Second, the Supreme Court clarified that such failure to act in the face of a known duty is essentially a conscious disregard of fiduciary responsibilities and not a breach of the duty of care, but a breach of the duty of loyalty. The Supreme Court affirmed the Chancery Court's finding that plaintiffs failed to adequately plead that demand would have been futile, and therefore dismissed the action.
8/24/2006 Issuance of Preferred Stock Interested Transaction Business Judgment Rule	***Benihana of Tokyo, Inc. v. Benihana, Inc.,* 906 A.2d 114 (Del. Supr. Aug. 24, 2006) Berger, J.** The Delaware Supreme Court affirmed a Chancery Court decision in a case where the validity of a board action to issue preferred stock with preemptive rights was questioned. The Supreme Court found that the trial court properly concluded that, where a majority of disinterested directors approved of a transaction, the business judgment rule will apply, even where the issuance of stock is to an inside director and could have the effect of entrenchment. The Court noted that entrenchment was not the only reason for approving the transaction and that the directors did not breach their fiduciary duties by allowing the issuance to occur.
6/8/2006 Breach of Fiduciary Duty Duty of Good Faith separate from Loyalty and Care Executive Compensation	***In re Walt Disney Co. Derivative Litig.,* 906 A.2d 27 (Del. Supr. June 8, 2006) Jacobs, J.** The Delaware Supreme Court affirmed the Chancery Court's finding that director defendants did not breach their fiduciary duties or commit waste in approving a $130 million severance package for a former president of the company. The Delaware Supreme Court recognized that "the duty to act in good faith ... to date is not a well-developed area of [Delaware's] corporate fiduciary law." The Court indicated that bad faith is more than gross negligence and generally falls into one of two categories: (i) conduct that is motivated by an actual intent to harm; and (ii) intentional dereliction of duty, a conscious disregard of one's responsibilities. It noted that the good faith duty was independent from the duty of care and loyalty, though when the duty of good faith is breached, care and loyalty are almost certainly breached as well.
3/8/2006 Mergers and Acquisitions Proxy Disclosures Compensatory Damages	***In re J.P. Morgan Chase & Co. Shareholder Litig.,* 906 A.2d 766 (Del. Supr. March 8, 2006) Jacobs, J.** Delaware Supreme Court, in affirming the Chancery Court's granting of a motion to dismiss, held that Plaintiffs had failed to state a viable claim for compensatory damages arising from allegedly deficient proxy disclosures prior to a merger because the complaint failed to allege any compensable harm to the class. This case highlights the need to show actual quantifiable monetary harm prior to bringing a derivative action and that misstatements or lack of disclosure in a proxy statement are only actionable if accompanied by actual, provable monetary harm.

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11/29/2006 Preemption of Delaware Shareholder Rights by Federal Securities Law State Law Conflicts with Federal Bankruptcy Law Shareholder Vote Requirement for Asset Sale	***Esopus Creek Value LP v. Hauf,*** **913 A.2d 593 (Del. Ch. Nov. 29, 2006) Lamb, V.C.** The board of directors of a struggling company adopted a plan to file a bankruptcy petition once the asset sale agreement was signed, and thereafter sought approval of the sale from the bankruptcy court, without a meeting and without a vote by the common stockholders. Vice Chancellor Lamb noted that it was unlikely federal securities regulations would be interpreted by a federal court or administered by the SEC in a way that would prevent a Delaware Court from requiring that the proposal to sell substantially all the assets of the corporation be put to a stockholder vote in accordance with Delaware law. The Court ruled that the corporation was prohibited from making any agreement to sell all or substantially all of the assets without approval by the corporation's common stockholders. The order included provisions that require the corporation to fully comply with Delaware law in the giving of notice and distribution of basic information required for an informed vote.
8/18/2006 Squeeze-out Merger Business Judgment Rule Entire Fairness Majority of Minority Voting Provision	***In re PNB Holding C. Shareholders Litig.,*** **2006 WL 2403999, C.A. No. 28-N (Del. Ch. Aug. 18, 2006), Strine, V.C.** Post-trial opinion in a combined appraisal and equitable suit challenging the fairness of a squeeze-out merger. Court noted that directors who remained shareholders in the surviving company were conflicted and must prove the entire fairness to the departing shareholders, unless they could point to a "cleansing devise" such as a special committee or a majority-of-the-minority vote, in order to justify review under the business judgment rule. The Court noted that a proper calculation of the "majority of the minority" vote takes into account in the denominator of the fraction all of the minority shares outstanding, and not merely those actually voting, thus, making the "majority of the minority" potentially more difficult to achieve. The Court applied the entire fairness standard, as there was no cleansing devise and a majority of the minority vote was not achieved. After determining the fair value of the minority shares, the Court concluded that merger was financially unfair to the minority.
8/10/2006 Section 102(b)(7) Fiduciary Duties to Creditors Deepening Insolvency	***Trenwick America Litig. Trust v. Ernst & Young, LLP,*** **906 A.2d 168 (Del. Ch. Aug. 10, 2006), Strine, V.C.** Trustee of litigation trust created in bankruptcy sued the directors and advisors of public company, alleging that various acquisitions by the public company were ill-advised and contributed to the "deepening insolvency" of the subsidiary. The Chancery Court dismissed the case prior to discovery, finding, among other things, that a claim for "deepening insolvency" did not state an independent claim under Delaware state law. Because no facts were alleged that the subsidiary was insolvent at the time of the challenged acquisitions, the parent owed no fiduciary duty to its subsidiary or to the creditors of that entity.
6/27/2006 Stockholder Inspection Rights Director Inspection Rights Confidentiality Agreement	***Schoon v. Troy Corp.,*** **C.A. No. 1677-N, 2006 WL 1851481 (Del. Ch. June 27, 2006) Lamb, V.C.** Plaintiffs (a shareholder and a director of Defendant) sought to compel the inspection of books and records of Defendant under §220. Defendant argued that it believed that the shareholder Plaintiff was using the director plaintiff to provide it with corporate information so that shareholder Plaintiff could value its shares and sell its stock to third parties, including competitors of Defendant. At trial, the Court found that Defendant established that director plaintiff's request for inspection of the company's books and records was not for a proper purpose reasonably related to his position as a director. Defendant offered to provide the shareholder Plaintiff with all of the categories of information it requested, if the shareholder Plaintiff executed a confidentiality agreement restricting its ability to share information with third parties. The Court approved access to records contingent on execution of a confidentiality agreement by shareholder Plaintiff, and denied inspection to director plaintiff. Fish & Richardson represented the defendant, Troy Corporation.
6/5/2006 Bylaw Amendment Certificate of Incorporation Amendment Classified Boards	***Lions Gate Entertainment Corp. v. Image Entertainment, Inc.,*** **C.A. No. 2011-N, 2006 WL 1668051 (Del. Ch. June 5, 2006) Chandler, C.** Plaintiffs sought a declaration that the board of directors of Defendant could not become classified until the 2006 annual stockholders meeting and that all board seats were up for election at that meeting; a declaration that the board did not have the authority to amend the bylaws; and a declaration that the board did not have the authority to amend the certificate of incorporation without a vote of the shareholders. The Chancery Court described this matter as involving "novel issues regarding the construction of corporate instruments providing for a classified board of directors and the reformation of bylaws of a publicly traded company." The Chancery Court entered an order in favor of Plaintiff granting summary judgment on all claims and holding that director election is a fundamental shareholder right and that changing the way directors are elected is a fundamental governance change that requires prior shareholder approval.
4/26/2006 Squeeze-out Merger Appraisal Entire Fairness Director Liability	***Delaware Open MRI Radiology Assocs., P.A. v. Kessler,*** **898 A.2d 290 (Del. Ch. April 26, 2006) Strine, V.C.** The key question here was whether the minority stockholders of Delaware Open MRI Radiology received fair value in a squeeze-out merger. The Court found that the merger was unfair and the Kessler group prevailed on its fiduciary claim. In a novel result, however, the Court held the interested directors who approved the unfair merger jointly and severally liable individually for the full amount of the fair value of the minority shareholders' stock. The Court found that the minority shares had a fair value that was twice the value offered in the merger. The appraisal value was double the merger value largely because the controlling shareholders failed properly to tax affect the value of this "S" corporation, attributed no value to the company's development plans, and overcharged the corporation for reading fees and management fees they paid to themselves. Fish & Richardson represented the minority shareholders in this litigation.