INSIGHTS
THE CORPORATE & SECURITIES LAW ADVISOR
ASPEN PUBLISHERS Volume 26 Number 4, April 2012

CORPORATE GOVERNANCE

Director Liability: From *Van Gorkom to Southern Peru* and Beyond

The Delaware courts have, on a couple of occasions over the past few decades, held corporate directors liable in headline-grabbing fashion. But the case law shows that the courts also continue to permit disinterested directors to make business decisions in the good-faith pursuit of stockholders' interests without fear that a court, in hindsight, will hold them personally liable for decisions that turn out badly.

by Gregory P. Williams, Rudolf Koch, and Christopher H. Lyons

A little more than a quarter century has passed since the Delaware Supreme Court delivered its game-changing opinion in *Smith v. Van Gorkom*[1]—two years prior to the inaugural issue of INSIGHTS. Prior to *Van Gorkom*, personal liability for directors' breaches of their fiduciary duty of care was possible, but largely theoretical. In *Van Gorkom*, the Court found independent directors personally liable for violating their duty of care by failing to deliberate sufficiently before approving a cash-out merger at a 50 percent premium over the market price. At the time, many feared that the case was the beginning of a new era when accepting a directorship would mean signing on to a very real threat of personal liability.

That era never materialized. Although *Van Gorkom* led to more elaborate board processes and a greater reliance on independent advisors, its holding was effectively overturned by the Delaware General Assembly's adoption of Section 102(b)(7) of the General Corporation Law.[2] Subsequent case law, most famously *Disney*,[3] made clear that a disinterested director—protected by an exculpatory charter provision adopted pursuant to Section 102(b)(7)—will not be held personally liable unless she acts disloyally.

The jaws of the corporate bar collectively dropped again in late 2011. In *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*,[4] the Court of Chancery entered an eye-popping $1.347 billion monetary judgment against a controlling stockholder entity and held certain conflicted directors jointly and severally liable. Not only is this the largest monetary judgment ever awarded by the Court of Chancery, but it also is one of the largest judgments ever awarded by *any* court. Consistent with post-*Van Gorkom* case law, the *Southern Peru* Court dismissed the independent directors on summary judgment

---

Gregory P. Williams is a director and Rudolf Koch and Christopher H. Lyons are associates, at Richards, Layton & Finger, P.A., in Wilmington, Delaware. Richards, Layton & Finger was counsel in several of the cases discussed herein, but the opinions expressed in this article are those of the authors and not necessarily those of Richards, Layton & Finger or its clients.

because they were protected by an exculpatory charter provision and did not act in bad faith.[5] The conflicted defendants had no such protection. *Southern Peru* inevitably will lead to changes in corporate governance, as *Van Gorkom* did.

This article looks back at the evolution of director liability over the past 27 years, based on developments during that time, then looks toward the next chapter of director liability.

Smith v. Van Gorkom

In *Smith v. Van Gorkom*, the Delaware Supreme Court found the directors of the Trans Union Corporation personally liable for approving a merger without sufficient information and deliberation.[6] The Court denied the directors the protection of the business judgment rule despite the facts that there was no evidence of self-dealing, the deal price was almost 50 percent higher than the recent market price for the company's stock, and the company's financial advisors had been unsuccessful in their attempts to obtain a higher price.

The Court held that

> a director's duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty. Here, there were no allegations of fraud, bad faith, or self-dealing, . . . [so] it is presumed that the directors reached their business decision in good faith, and considerations of motive are irrelevant to the issue before us.[7]

The Court nevertheless found that the Trans Union board "did not reach an informed business judgment" in approving the merger.[8] The directors, "at a minimum, were grossly negligent in approving the 'sale' of the company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency."[9] Further, the Court found that neither (1) the failure of another bidder to make a better offer in the time available,[10] (2) the board's subsequent meetings to "review" the process and reaffirm its commitment to the merger,[11] nor (3) stockholder approval[12] could cure the board's failure to exercise the requisite care.

The Supreme Court's imposition of personal liability on the Trans Union directors gave rise to strident criticism. Corporate America was not happy with Delaware, and Delaware reacted swiftly.

Delaware's Legislature Reacts

In the wake of *Van Gorkom*, fear that independent directors faced heightened risk of personal liability for acting with gross negligence caused a directors and officers liability insurance crisis.[13] In addition, business people questioned whether the risks of serving on corporate boards outweighed the benefits. The Delaware General Assembly came to the rescue by enacting Section 102(b)(7) of the General Corporation Law.[14] Section 102(b)(7), which became effective July 1, 1986, permits corporations to amend their corporate charters to shelter directors from personal liability to the corporation or its stockholders, so long as their actions do not constitute: (1) a breach of the director's duty of loyalty; (2) acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law; (3) unlawful payment of a dividend or unlawful stock purchase or redemption; or (4) any action for which the director derived an improper personal benefit.[15] The overwhelming majority of publicly traded corporations incorporated in Delaware has adopted an exculpatory charter provision pursuant to Section 102(b)(7).[16]

Although Delaware's legislature essentially overturned the holding in *Van Gorkom*, the case nevertheless broadly changed corporate governance.[17] For instance, *Van Gorkom* triggered increased reliance on third-party advisors to provide expert opinions and the development of

elaborate decision-making procedures to demonstrate adequate deliberation.[18] Lawyers advising boards drilled into their clients the importance of diligence, careful analysis, and obtaining expert advice. Broadly speaking, corporate boards do a better job than they did 27 years ago—boardrooms filled with inattentive, lazy directors are now extremely rare, if they exist at all.

Delaware Courts Set the Parameters of Good Faith

Not surprisingly, enterprising plaintiffs' lawyers tried to avoid the reach of exculpatory charter provisions authorized under Section 102(b)(7). "Bad faith"—unprotected by Section 102(b)(7)—became the new battle cry for the plaintiffs' bar. Instead of characterizing a lack of diligence as gross negligence, plaintiffs argued that such behavior amounted to bad faith. When the Delaware Supreme Court in 1993 stated, in *obiter dictum* in *Cede & Co. v. Technicolor*, that good faith is one of the "triads" of fiduciary duties (along with care and loyalty), such efforts appeared to be paying dividends.[19]

Caremark: Directors Receive Some Comfort

In *Caremark*, decided in 1996, Chancellor Allen recognized that high-quality candidates might eschew service on corporate boards if they feared that a court would look back with the benefit of hindsight and determine that harm to the corporation could have been prevented by non-negligent directors.[20] By examining whether the directors had made a good faith effort to see that the corporation had an effective monitoring system, *Caremark* alleviated independent directors' fear that the Supreme Court's "triad" language in *Technicolor* would require them to prove that harm incurred by the corporation was not the result of their negligence. In this regard, Chancellor Allen artfully explained:

> What should be understood, but may not widely be understood by courts or commentators who are not often required to face such questions, is that compliance with a director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith *or* rationality of the process employed.[21]

The Court recognized that bad things happen to businesses—without any basis for holding directors personally accountable for those bad things.

Disney: Bad Faith Requires Scienter

Whatever comfort *Caremark* provided, however, was soon under attack in the widely publicized litigation challenging the lucrative severance package awarded by the Walt Disney Company to Michael Ovitz after a tumultuous and very short tenure as Disney's President. The *Disney* plaintiffs claimed that "directors violate their duty of good faith if they are making material decisions without adequate information and without adequate deliberation."[22] With *Disney*, the stage was set to determine the parameters of good faith.

After a 37-day trial, the Court of Chancery found no violation of the duty of care or bad faith.[23] Chancellor Chandler rejected the argument that the directors acted in bad faith, by wasting corporate assets, in firing Ovitz under his employment contract's non-fault termination provision, because he credited testimony that Disney was better off without Ovitz and found that Ovitz could not be terminated for cause.[24] Addressing the board's decision to hire Ovitz and to approve the employment contract, the Chancellor observed that "many lessons of what not to do can be learned from defendants' conduct here."[25] After critiquing the performance of the CEO and the compensation committee,[26] the Chancellor observed that "I hope that this case will serve to inform stockholders, directors and officers of how the Company's fiduciaries underperformed. . . . [T]he standards used to measure the conduct of fiduciaries under Delaware law[, however,] are not

the same standards used in determining good corporate governance."[27] Rather, he wrote that "the concept of *intentional dereliction of duty*, a *conscious disregard for one's responsibilities*, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith."[28] Applying this standard, the Court entered judgment for the defendants, holding that they "did not act in bad faith, and were at most ordinarily negligent."[29]

On appeal, the Supreme Court described bad faith as a "third category" of director misconduct, falling somewhere between gross negligence and subjective motivation to harm the company.[30] The Court first noted that "gross negligence (including a failure to inform one's self of available material facts), without more," does not constitute bad faith.[31] Quoting the opinion below, the Court then identified three nonexclusive examples of bad faith: (1) where "the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation;" (2) "where the fiduciary acts with the intent to violate applicable positive law;" or (3) "where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."[32] The Supreme Court affirmed the Court of Chancery's holding that the directors were not liable because, although their actions were hardly a model of good corporate governance, the directors had not acted in bad faith.[33]

Disney made clear that acting in bad faith means more than acting with gross negligence; it requires *scienter*. Whether the obligation to act in good faith is subsumed within the duty of loyalty, however, was an issue that would have to wait.

Stone: Good Faith Is Part of the Duty of Loyalty

The wait, it turned out, would not be long. Five months after deciding *Disney*, in *Stone v. Ritter*, the Delaware Supreme Court linked the third example of bad faith set forth in *Disney* to the standard expressed by Chancellor Allen in *Caremark* for when directors might be held liable for lack of sufficient oversight.[34] Specifically, the Court stated:

> The third of these examples describes, and is fully consistent with, the lack of good faith conduct that the *Caremark* court held was a "necessary condition" for director oversight liability, i.e., "a sustained or systematic failure of the board to exercise oversight-such as an utter failure to attempt to assure a reasonable information and reporting system exists . . . ."[35]

Chancellor Chandler famously applied this standard in *In re Citigroup Inc. Shareholder Derivative Litigation*,[36] to dismiss claims in the wake of the financial crisis that amounted "essentially to a claim that Citigroup suffered large losses and that there were certain warning signs that could or should have put defendants on notice of the business risks related to Citigroup's investments in subprime assets."[37] The Chancellor observed that, rather than stating a claim under *Stone* and *Caremark*, plaintiffs were "inviting the Court to engage in the exact kind of judicial second guessing that is proscribed by the business judgment rule."[38]

Significantly, the *Stone* Court also made clear that "[t]he failure to act in good faith may result in liability because the requirement to act in good faith is a subsidiary element, *i.e.*, a condition of the fundamental duty of loyalty."[39] Thus, "the fiduciary duty of loyalty . . . encompasses cases where the fiduciary fails to act in good faith."[40]

Lyondell: *Disney* Applies in the Transactional Context

In 2009, in *Lyondell Chemical Co. v. Ryan,* the Delaware Supreme Court reaffirmed the definition of bad faith set forth in *Disney* and clarified that this standard applies in the transactional context.[41] In some ways, the directors' consideration of the challenged merger in *Lyondell* resembled the directors' actions in *Van*

Gorkom.[42] In *Lyondell*, however, the Supreme Court determined that the Court of Chancery should have granted summary judgment in favor of two independent directors because they were protected by the company's exculpatory charter provision and had not acted in bad faith. The Court noted that "[i]n the transactional context, [an] extreme set of facts [is] required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties."[43] Plaintiffs must show that defendants completely and "utterly failed" even to "attempt" to meet their duties.[44] The Delaware Supreme Court (with assistance of the legislature) had come full circle.

Whither *Van Gorkom*?

While the enactment and embrace of Section 102(b)(7) and subsequent case law have rendered the ruling in *Van Gorkom* dead, its effect on director behavior lives on. An exculpatory charter provision will protect directors from monetary liability for gross negligence, *i.e.*, care violations. Moreover, attempting to fulfill their duties will suffice to allow disinterested directors to defeat allegations of bad faith and the liability that attaches to bad faith. Independent directors, acting loyally, have little to fear in terms of personal liability.[45] The cost for acting disloyally, on the other hand, can be massive.

Southern Peru Highlights Risks

Unlike in the situations described above, in circumstances where the corporate action under review involves self-dealing conduct approved by a conflicted board, the entire fairness standard of review, not the business judgment rule, applies. For self-dealing directors, subjective bad faith is not required to impose personal liability. Rather, such directors' liability rises or falls with whether the transaction was fair to the corporation.[46] By contrast, even if the challenged transaction was unfair, the Court will examine disinterested directors' states of mind on a director-by-director basis to determine liability.[47]

In re Southern Peru

In *Southern Peru*, the Court of Chancery awarded $1.347 billion as damages in a derivative action challenging the acquisition by Southern Peru Copper Corporation (Southern Peru) of another corporation controlled by Southern Peru's controlling stockholder, Grupo Mexico, S.A.B. de C.V. (Grupo Mexico), based on the Court's post-trial determination that the transaction was unfair and the controlling stockholder defendants breached their duty of loyalty.[48]

In 2004, Grupo Mexico proposed that Southern Peru acquire its 99.15 percent interest in Minera Mexico, S.A. de C.V. (Minera) in exchange for newly issued shares of Southern Peru common stock worth approximately $3.05 billion.[49] In response, the Southern Peru board of directors formed a special committee of independent directors to evaluate the transaction.[50] After initially engaging in an "illustrative give/gets analysis" indicating a $1.4 billion disparity between the value of the Southern Peru common stock (based on trading price) that would be issued to Grupo Mexico and the value of Minera, the special committee's financial advisor abandoned Southern Peru's market value as a measure of its true value and instead focused on "relative" value metrics reflecting the projected relative contribution to cash flows of the two entities to the combined corporation and similar analyses.[51] This approach, which the Court found ignored market value of the shares issued by Southern Peru, enabled the financial advisor to opine that the transaction was fair, and the special committee subsequently approved the transaction.[52]

Southern Peru and Grupo Mexico entered into a merger agreement pursuant to which Southern Peru would acquire Grupo Mexico's interest in Minera for a fixed number of shares. After the definitive agreements were signed, the value of Southern Peru shares to be delivered to Grupo Mexico was approximately $3.1 billion.[53] The share price, however, increased substantially

during the post-signing, pre-closing time period, significantly increasing the value of the shares to go to Grupo Mexico.[54]

The Court determined that entire fairness was the appropriate standard of review because a controlling stockholder stood on both sides of the transaction. The Court further found that the defendants had failed to shift the burden of persuasion on entire fairness because (1) the special committee was not "well functioning," and (2) the merger vote was not "conditioned up-front on the approval of a majority of the disinterested stockholders."[55]

In determining that the transaction was not entirely fair to Southern Peru, the Court spent several pages criticizing the financial advisor's "non-real world set of analyses that obscured the actual value of what Southern Peru was getting."[56] The Court determined that, under the circumstances, the special committee should have focused on the actual give-get involved in cash terms, rather than following its advisor's guidance through a "relative valuation" analysis. This was important because the Court found that the latter analysis inappropriately "optimized" Minera's value (the "get") without making similar adjustments to the value of Southern Peru shares (the "give"), thus distorting the committee's views on valuation in an effort to make an unfair transaction look fair.[57]

The Court also expressed concern that the special committee's mandate was simply to "evaluate" the controlling stockholder's proposal and not to consider alternatives, and the directors were not clear on the extent to which they actively could negotiate.[58] The Court suggested that a special committee, to be effective, must understand that its role is not merely to approve or reject the controlling stockholder's proposal, but also to take all actions necessary to determine whether a particular course of action is advisable, including by considering strategic alternatives.[59] Additionally, the Court made clear that the special committee's obligations extend through closing of the transaction. The Court found that the special committee never reevaluated its recommendation in light of the drastically changed economic circumstances or sought a bring-down fairness opinion from its financial advisor, which the Court described as "a regrettable and important lapse."[60]

In determining damages, the Court calculated the difference between the price at which the special committee would have approved the acquisition had the process been entirely fair ($2.409 billion based on a discounted cash-flow value, the market value of the special committee's counteroffer, and a comparable companies analysis) and the price that the special committee actually agreed to pay ($3.756 billion as of the merger date).[61] The remedy amounted to $1.347 billion (plus statutory interest, after which the judgment amounted to $2.032 billion as of the date of the final order),[62] which the Court held Grupo Mexico could satisfy by returning the appropriate number of shares to Southern Peru.[63]

Importantly, the independent directors were dismissed from the case on summary judgment because they were protected by an exculpatory charter provision, and the evidence did not establish that they had acted in bad faith, under the standard set forth in *Disney*.[64] The remaining directors, who were employed by Grupo Mexico, were found jointly and severally liable.[65] The Court noted that, at the summary judgment stage, the exculpatory charter provision was "of no benefit" to those directors "given the factual question regarding their motivations" and that, at trial, the Grupo Mexico affiliated director defendants "made no effort to show that they acted in good faith and were entitled to exculpation despite their lack of independence."[66]

Looking Forward: So Where Are We?

Independent Directors Continue to Face Little Risk of Liability

Notwithstanding its massive monetary judgment, *Southern Peru* faithfully applies post-*Van*

Gorkom case law in dismissing the independent directors pursuant to the company's exculpatory charter provision. Similarly, the Court's reaction to claims arising out of the financial crisis shows that Delaware law allows directors "to maximize shareholder value in the long term by taking risks without the debilitating fear that they will be held personally liable if the company experiences losses," despite investors' understandable desire when companies suffer losses to "find someone to hold responsible for these losses."[67] Independent, disinterested directors who are afforded the protections of an exculpatory charter provision continue to have little to fear, so long as they act in good faith.[68] And let's face it, it does not take much effort to satisfy the good faith standard. In short, directors have to try—not too much to ask.

Delaware Courts Scrutinize Behavior When Directors Face Conflicts

After *Van Gorkom*, boards began engaging in elaborate decision-making processes to demonstrate adequate deliberation. Although this process-oriented approach generally has improved corporate governance, it also has led some boards to employ a "check the box" approach. In some cases, boards appear to favor form over substance, preferring a process well choreographed to create a judicial record over one that genuinely seeks the best value for stockholders. In other cases directors fall into a "controlled mindset," as the Court found existed in *Southern Peru*.[69] *Southern Peru* serves as a reminder that in the context of conflicted transactions, Delaware courts will look for evidence that directors pushed back against controlling stockholders, and that they and their advisors thought creatively about alternative transactions and alternative structures. In such circumstances, it will not be enough for directors simply to "check the box."

Delaware Courts Place a Premium on Fully Functioning Special Committees

Much as *Van Gorkom* improved governance, *Southern Peru* likely will lead to better-functioning special committees in conflicted transactions. In this regard, *Southern Peru*'s call for a broader special committee mandate that includes the exploration of strategic alternatives is consistent with other recent Delaware case law addressing the role of special committees *vis-à-vis* controlling stockholders.[70]

The special committee appointed by Crown Media Holdings, Inc. to consider a recapitalization proposal by Hallmark Cards, Inc., its majority stockholder and largest creditor, provides a positive example.[71] Crown's committee was composed of independent directors and was empowered to "consider such matters as it deems advisable" regarding the proposal and to "take such further action, at the Company's expense, as the Special Committee deems appropriate in order to carry out the intent and purposes" of the authorizing resolutions.[72] The board was prohibited from authorizing the recapitalization "without a prior favorable recommendation . . . by the Special Committee."[73] Chancellor Chandler approved this mandate.[74] Importantly, he found that the committee had interpreted its mandate broadly to include, for example, considering various alternatives to the proposal, and that the Committee understood that it had the power to reject the proposal and that its role was to represent the interests of Crown's minority stockholders.[75]

Reviewing the Crown committee's process, the Court found that it "functioned independently of Hallmark and reached the best deal possible through intense negotiations that were appropriately adversarial," and it "actively searched for alternatives"—conduct that the Court concluded "bespeaks independence, and confirms the arm's-length nature of the bargaining process."[76] Finding that both the process and the price were fair, the Court entered judgment for the defendants.[77] On appeal, the Supreme Court affirmed with a one-page order.[78]

Also placing a premium on fully functioning special committees is the "unified standard of review"—first discussed in dicta in *In re Cox*

Communications and then applied in *In re CNX Gas*, and also discussed in *Southern Peru*—for going-private transactions.[79] In *CNX*, the Court imposed additional requirements for directors to obtain the benefit of the business judgment standard of review for a going-private tender offer followed by a short-form merger.[80] The Court held that the business judgment rule (and not entire fairness) will apply to such a transaction, but only if the transaction was (1) negotiated and recommended by an active, informed, and fully empowered special committee of independent and disinterested directors, and (2) subject to a "majority-of-the-minority" tender or vote condition.[81] Importantly, *CNX* further suggests that even with respect to negotiated mergers with controlling stockholders, entire fairness can be avoided by satisfying both of these conditions.[82] The *CNX* Court, however, was not presented with a negotiated merger, and such a determination would arguably require overturning Supreme Court precedent.[83] Similarly, while recognizing that "there might be utility to having further guidance from the Supreme Court in this sensitive area of the law," Chancellor Strine in *Southern Peru* noted that he would be comfortable applying business judgment review to an interested transaction if a transaction is contingent up front on both of these conditions.[84] It remains to be seen whether the Delaware Supreme Court will adopt this approach. In any event, whether special committees are properly functioning will likely continue to be a focus in Delaware courts, as it was in *Southern Peru*.

Courts Scrutinize Financial Advisor Incentives and Analyses in Conflicted Transactions

With increased reliance on financial advisors after *Van Gorkom* came increased scrutiny of advisor conflicts. This focus was perhaps best captured by the Court of Chancery's decision to enjoin temporarily the acquisition of the Del Monte Foods Company due to the board's perceived failure to control its financial advisors' conflicting incentives.[85] Similarly, in *In re El Paso Corp. Shareholder Litigation*, the Court found that plaintiffs had shown a reasonable probability of success on their claim that the defendants breached their fiduciary duties in approving a merger, where the target's financial advisor owned a significant stake in the buyer and the Court found that this conflict was incompletely addressed. The Court also found that the CEO had a motive to engage in "velvet glove negotiating" to improve his chances of effecting a post-merger buyout of certain assets from the buyer.[86] Both of these courts noted, however, that post-closing damages against the independent directors were unlikely.[87]

Southern Peru illustrates that Delaware courts are willing to probe deeply into the substance of financial advisor analyses, even when the financial advisor is not conflicted. Although the *Southern Peru* Court recognized that the special committee's financial advisor did not suffer from conflicts of interest, the Court nevertheless determined that the advisor "appears to have helped its client rationalize the one strategic option available within the controlled mindset that pervaded the Special Committee's process."[88] In reaching this conclusion, which was a key part of the Court's determination that the transaction was not entirely fair, the Court spent several pages of its opinion critiquing the substance of the financial advisor's analyses, displaying an in-depth understanding of the underlying economics.

The Delaware courts' focus on advisors' incentives and willingness to examine the substance of their advice and analyses in conflicted transactions create strong incentives for both directors and their advisors to make sure that analyses are not performed simply to confirm fairness. The era of financial advisors trying to confirm ex-post that a transaction dictated by a controlling stockholder is fair has come to an end.

Conclusion

The landmark decisions discussed herein yield valuable clues as to the future of Delaware corporate jurisprudence. The willingness to

scrutinize the actions of directors and their advisors in transactions involving conflicts of interest, seen most recently in *Southern Peru*, undoubtedly will continue. Self-dealing transactions often are in the interests of all stockholders, but they do merit close attention. Those who promote such transactions need to be aware of the litigation risks. As in the *Crown* case, those risks can be overcome, but they are very real.

Just as inevitable as close scrutiny for self-dealing transactions is judicial respect for decisions made by disinterested, informed directors. Directors who decide to engage in fundamental transactions with third parties, and who make those decisions after careful consideration and with the advice of competent and independent advisors, will find the Delaware courts to be most hospitable. In the future, as in the past, the Delaware courts will be cognizant of the fact that directors of Delaware corporations need to be able to make decisions that entail risk and they need to do so without fear of personal liability.

Notes

1. 488 A.2d 858 (Del. 1985).
2. 8 *Del. C.* § 102(b)(7).
3. *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006).
4. *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 30 A.3d 60 (Del. Ch. 2011), *revised and superseded by* ___ A.3d ___, 2011 WL 6440761 (Del. Ch. Dec. 20, 2011), *appeal docketed*, No. 29, 2012C (Del. Jan. 20, 2012).
5. *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, C.A. 961-VCS (Del. Ch. Dec. 21, 2010) (Transcript).
6. 488 A.2d 858.
7. 488 A.2d at 872-73.
8. *Id*. at 874.
9. *Id.* at 874.
10. *Id.* at 885.
11. *Id.* at 888.
12. *Id.* at 893.
13. *See* Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 Emory L.J. 1155, 1160 (1990) (*Van Gorkom* "exemplifies the legal uncertainty that contributed to the insurance crisis; most practitioners, like the lower court, would have predicted that the facts in *Van Gorkom* would not constitute gross negligence under Delaware's duty of care standard").
14. 8 *Del. C.* § 102(b)(7); *see* 65 Del. Laws ch. 289, § 2 (1986).
15. *Id.*
16. *See* Lawrence A. Hamermesh, *Why I Do Not Teach Van Gorkom*, 34 Ga. L. Rev. 477, 490 (Symp. Bus. Law Educ., Winter 2000). The Delaware legislature further increased the availability of director and officer liability insurance by loosening the nonexclusivity of the indemnification provisions in the General Corporation Law. 65 Del. Laws ch. 289, § 5 (1986) (amending 8 *Del. C.* § 145); *see* E. Norman Veasey, Jesse A. Finkelstein, & C. Stephen Bigler, *Delaware Supports Directors With a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 Bus. Law. 399, 413-17 (1987). Section 145 of the General Corporation Law permits a corporation to indemnify its current and former directors for attorneys' fees and other expenses incurred in their capacity as directors and for judgments rendered against directors or amounts paid in settlement of civil cases in third-party actions involving directors, so long as the directors acted reasonably and in good faith. 8 *Del. C.* § 145.
17. One of the reasons for this impact is that Section 102(b)(7) permits corporate charters to exculpate directors only from *personal* liability. It does not eliminate the duty of care and has no effect on other forms of relief, such as injunctive relief. *See Arnold v. Soc'y for Sav. Bancorp., Inc.*, 678 A.2d 533, 542 (Del. 1996) ("While section 102(b)(7) and charter provisions adopted thereunder will leave stockholders without a monetary remedy in some instances, they remain protected by the availability of injunctive relief.").
18. *See* Charles M. Elson & Robert B. Thompson, *Van Gorkom's Legacy: The Limits of Judicially Enforced Constraints and the Promise of Proprietary Incentives*, 96 Nw. U. L. Rev. 579, 584-85 (2002). In addition, Section 141(e) of the General Corporation Law provides that a member of a board of directors, or a duly designated board committee, may "be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation." 8 *Del. C.* § 141(e).
19. *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993). For an in-depth analysis of good faith under Delaware law, *see* Leo E. Strine, Jr., R. Franklin Balotti, Lawrence A. Hamermesh, & Jeffrey M. Gorris, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L. J. 629 (2010).
20. *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 967-68 (Del. Ch. 1996).
21. *Id.* at 967 (footnote omitted).

22. *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 62 (Del. 2006) [hereinafter *Disney* Supreme] (quoting Appellants' Opening Brief).

23. *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 759, 763 (Del. Ch. 2005) [hereinafter *Disney* Chancery], *aff'd*, *Disney* Supreme, 906 A.2d at 67, 75. The Supreme Court declined to state "whether the fiduciary duty to act in good faith is a duty that, like the duty of care and loyalty, can serve as an independent basis for imposing liability upon corporate officers and directors." *Disney* Supreme, 906 A.2d at 67 n.112.

24. *Disney* Chancery, 907 A.2d at 704, 759; *see also id.* at 748-49 (defining waste as "an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration").

25. *Id.* at 760.

26. *Id.* at 762-63 (finding that Disney CEO Michael Eisner's "lapses were many" in hiring Ovitz, and that his actions fell "far short of what shareholders expect and demand from those entrusted with a fiduciary position," but finding that his actions "were taken with the subjective belief that those actions were in the best interests of the Company" and they did "not represent a knowing violation of law or evidence a conscious and intentional disregard of duty").

27. *Id.* at 772.

28. *Id.* at 755.

29. *Id.* at 772.

30. *Id.* at 66.

31. *Id.* at 64-65.

32. 906 A.2d at 67 (quoting *Disney* Chancery, 607 A.2d at 755).

33. *Id.* at 67-68 (affirming finding that directors acted in good faith); *id.* at 55-60 (contrasting directors' conduct with "best practices").

34. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

35. *Id.* at 369.

36. 964 A.2d 106, 125-32 (Del. Ch. 2009).

37. *Id.* at 126-27.

38. *Id.* at 131.

39. *Id.* at 369-70 (internal quotation marks omitted).

40. *Id.* at 370.

41. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 240-44 (Del. 2009).

42. *See id.* at 237-39 (board considered offer for less than a week; meetings at which decision was made to pursue merger rather than remain independent were less than an hour long).

43. *Id.* at 233.

44. *Id.* at 244.

45. *Reis v. Hazelett Strip-Casting Corp.* is a rare case where liability may have turned on the lack of an exculpatory charter provision. 28 A.3d 442, 466 (Del. Ch. 2011). The Court found all of the directors—including, in addition to the controlling stockholder, his son and his subordinate company employees—personally liable, noting that the company's full charter had not been presented and the directors had not argued that it contained an exculpatory provision. *Id.* at 479 (noting also that "[o]rdinarily, the existence of a Section 102(b)(7) provision would compel a director-by-director analysis to determine which defendants are personally liable" (citing *Venhill Ltd. P'ship v. Hillman*, 2008 WL 2270488, at *22 (Del. Ch. June 3, 2008))). Moreover, the defendants did not argue that the other directors' liability differed from the controller's liability in any respect. *See* Defendants' Opening Post-Trial Brief at 14-26, *Reis*, 28 A.3d 442 (C.A. 3552-VCL), 2010 WL 3462170 (filed Sept. 1, 2010) (arguing only that "the defendants acted with entire fairness"). Although the Court held that the transaction was a self-dealing transaction and the "'functional equivalent' of a cash-out merger," thus implicating the controller's duty of loyalty and the entire fairness standard of review, *id.* at 460, and found that the other directors were "beholden" to the controller, *id.* at 460-61, the Court did not address whether the non-controlling directors had breached their duty of loyalty or care.

46. *See, e.g.*, *Venhill Ltd. P'ship v. Hillman*, 2008 WL 2270488, at *22 (Del. Ch. June 3, 2008) (discussing hypothetical claim against board composed of self-dealing major stockholder and director, the CEO, two relatives of the self-dealing director, and one independent director: "As I understand it, only the self-dealing director would be subject to damages liability for the gap between a fair price and the deal price without an inquiry into his subjective state of mind. Why? Because under the traditional operation of the entire fairness standard, the self-dealing director would have breached his duty of loyalty if the transaction was unfair, regardless of whether he acted in subjective good faith. After all, that is the central insight of the entire fairness test, which is that when a fiduciary self-deals he might unfairly advantage himself even if he is subjectively attempting to avoid doing so." (footnote omitted)).

47. *See Venhill*, 2008 WL 2270488, at *23; *see also, e.g.*, *In re Loral Space & Commc'ns Inc. Consol. Litig.*, 2008 WL 4293781, at *33; *In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 WL 1305745, at *38 (Del. Ch. May 3, 2004).

48. *S. Peru*, 2011 WL 6440761.

49. *Id.* at *3.

50. *Id.*

51. *Id.* at *7-10.

52. *Id.* at *16.

53. *Id.* at *32.

54. *Id.* at *36.

55. *Id.* at *20-24.

56. *Id.* at *29-35.

57. *Id.*

58. *Id.* at *26 & n.134.

59. *Id.* at *5, *26.

60. *Id.* at *36.

61. *Id.* at *40, *43.

62. *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 2011 WL 6382006, at *1 (Del. Ch. Dec. 20, 2011) (Final Order and Judgment).

63. *S. Peru*, 2011 WL 6440761, at *43.

64. *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, C.A. 961-VCS, at 123-28 (Del. Ch. Dec. 21, 2010) (Transcript).

65. *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 2011 WL 6382006, at *1 (Del. Ch. Dec. 20, 2011) (Final Order and Judgment).

66. *S. Peru*, 2011 WL 6440761, at *19.

67. *Citigroup*, 964 A.2d at 139.

68. *See S. Peru*, 2011 WL 6440761, at *19 (discussing summary judgment ruling). It should be noted, however, that the independent directors' behavior was nevertheless heavily scrutinized in determining that the transaction was not entirely fair; this shows that reputational risk for directors does not necessarily end with dismissal.

69. *Id.* at *26.

70. *See, e.g.*, *Emerald P'rs v. Berlin*, 726 A.2d 1215, 1222-23 (Del. 1999) (describing that the special committee must exert "real bargaining power" in order for defendants to obtain a burden shift).

71. *S. Muoio & Co. v. Hallmark Entm't Invs. Co.*, 2011 WL 863007 (Del. Ch. Mar. 9, 2011), *aff'd*, 35 A.3d 419 (Del. 2011) (TABLE).

72. *Id.* at *5.

73. *Id.*

74. *Id.* at *13.

75. *Id.*

76. *Id.*

77. *Id.* at **17-21.

78. *S. Muoio & Co. v. Hallmark Entm't Invs Co.*, 35 A.3d 419, 2011 WL 6396487 (Del. Dec. 20, 2011).

79. *See S. Peru*, 2011 WL 6440761, at *20 n.70, *23 n.104; *CNX*, 4 A.3d at 406-14; *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 617 (Del. Ch. 2005);

80. 4 A.3d at 414-16 (adding requirement that special committee be given "the power to respond effectively" to the controlling stockholder, "including by deploying a rights plan").

81. *Id.* at 406-14.

82. *Id.* at 413-14.

83. In *Kahn v. Lynch*, the Delaware Supreme Court held that negotiated mergers with controlling stockholders are subject to entire fairness review. *See Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994). As the Court of Chancery later observed, however, "no defendant in *Lynch*, and no defendant since, has argued that the use of an independent special committee *and* a Minority Approval Condition sufficiently alleviates any implicit coercion as to justify invocation of the business judgment rule." *Cox*, 879 A.2d at 617. Moreover, there was no majority-of-the-minority condition in *Lynch* and the controller had threatened a hostile bid if the committee did not agree to its final proposal, which would have precluded application of the business judgment rule under *CNX*. *See Lynch*, 638 A.2d at 1117. In contrast to the *Lynch* standard of review for cash-out mergers, in *Pure Resources* and *Siliconix* (both decided prior to *CNX*), the Chancery Court found that entire fairness may not apply to non-coercive two-step transactions that contain certain procedural protections, including a non-waivable majority-of-the-minority tender condition, a commitment to consummate a prompt short-form merger at the same price, and the absence of retributive threats. *See In re Pure Res., Inc. S'holders Litig.*, 808 A.2d 421, 443-46 (Del. Ch. 2002); *In re Siliconix Inc. S'holders Litig*, 2001 WL 716787 (Del. Ch. June 19, 2001) (note, though, that the controller in *Siliconix* did not promise to consummate a prompt short-form merger at the same price).

84. 2011 WL 6440761, at *20 n.70, *23 n.104.

85. In *In re Del Monte Foods Company Shareholders Litigation,* 25 A.3d 813 (Del. Ch. 2011), the Court of Chancery found on a preliminary record that a proposed $5.3 billion cash merger with a group of private equity buyers was potentially tainted by alleged misconduct by the target banker, with the alleged knowing participation of the buyers, so as to give rise to a likelihood of success on the merits of a claim of breach of fiduciary duty. The Court preliminarily enjoined the defendants from proceeding with a stockholder vote on the proposed transaction for a period of 20 days and further enjoined the defendants from enforcing certain deal protection measures in the merger agreement (including no solicitation, termination fee, and matching right provisions) pending the stockholder vote. *Id.* at 844. After the deal ultimately closed, the case was settled for $89.4 million, to be paid in part by the conflicted financial advisor.

86 2012 WL 653845, at *5-10 (Del. Ch. Feb. 29, 2012).

87. *Id.* at *10 & n.51 ("[I]t appears unlikely that the independent directors of El Paso—who are protected by an exculpatory charter provision—could be held liable in monetary damages for their actions."); *Del Monte*, 25 A.3d at 838 ("[T]he plaintiffs face a long and steep uphill climb before they could recover money damages from the independent, outside directors on the Board.").

88. 2011 WL 6440761, at *31.

Copyright © 2012 CCH Incorporated. All Rights Reserved.
Reprinted from *Insights* April 2012, Volume 26, Number 4, pages 27-37,
with permission from Aspen Publishers, a Wolters Kluwer business, New York, NY,
1-800-638-8437, www.aspenpublishers.com.

Wolters Kluwer
Law & Business