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Prediction Protection: The Delaware Supreme Court's *Amylin* Footnote

A footnote in the Delaware Supreme Court's summary affirmance of the Chancery Court's Amylin Pharmaceuticals *decision made some corporate commentators question whether the Supreme Court was trending toward a substantive evaluation of the fiduciary duty of care. In our view, however, the Supreme Court's footnote simply follows well-established precedent and confirms that the Delaware courts will not require directors to predict the future in making business judgments.*

by John Mark Zeberkiewicz and Blake Rohrbacher

The Delaware Supreme Court recently affirmed the Court of Chancery's May 2009, opinion in *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.* in a summary order.[1] The Court of Chancery had held that the board of directors of Amylin Pharmaceuticals did not breach its duty of care in approving an indenture containing a so-called proxy put provision (*i.e.*, a debt-acceleration clause triggered by an unapproved change in a majority of the board).[2] Such a summary affirmance would ordinarily engender little discussion among practitioners—the debates over the merits of the case, after all, had been aired months before—but a three-sentence footnote in the Supreme Court's order has triggered questions (at least in the blogging world) about whether the Supreme Court is trending toward a substantive evaluation of due care.[3] To the contrary, we suggest that the Supreme Court's footnote merely recognized, pursuant to well-established precedent, that directors do not breach their duties of care by failing to take into consideration information that did not exist at the time of the decision but, in hindsight, now appears obvious.

The Chancery Court's Opinion

The *Amylin* litigation grew out of a proxy contest in which insurgents Eastbourne Capital Management, L.L.C. and Icahn Partners LP each nominated five directors for election to Amylin's 12-member board.[4] Amylin's bond indenture contained a fairly standard "fundamental change" clause providing that the noteholders would have the right to demand redemption of all or a portion of their notes at face value if at any time the "Continuing Directors" did not constitute a majority of Amylin's board. The indenture defined the term "Continuing Directors" to include the individuals constituting Amylin's board on the date the notes were issued, as well as any new directors whose election to Amylin's board, or whose nomination for election, "was approved by at least a majority of the directors then still in office (or a duly constituted committee thereof) either who were directors on the

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[issue date of the notes] or whose election or nomination for election was previously so approved."[5]

At the time of the proxy contest, Amylin's board consisted of 12 directors; thus, the election of seven or more of the insurgents' nominees, if not approved by the incumbents, would have caused a fundamental change, triggering the put right in favor of the noteholders. Given market conditions, this put right would have occurred at a time when the notes were trading at a deep discount—and at a time when Amylin did not have the financial resources available to redeem the notes.[6] To avoid this drastic outcome, Amylin's board "approved" the insurgent nominees as "Continuing Directors" for purposes of the indenture, while continuing to oppose the insurgents and to recommend its own slate for purposes of the proxy contest.[7]

A stockholder brought suit, claiming, among other things, that the board breached its fiduciary duty of care in adopting the indenture "insofar as the Indenture contained the Continuing Directors provisions."[8] Plaintiff's claim was based largely on the fact that the board's Pricing Committee, which was charged with approving the indenture, never learned, during its approval process, that the indenture contained the "Continuing Directors" provision.[9]

Citing the Supreme Court's teachings on the duty of care from *Brehm v. Eisner*,[10] the *Amylin* Court framed the relevant question as follows: "was the board of Amylin (or its delegate, the Pricing Committee) grossly negligent in failing to learn of the existence of the Continuing Directors provisions?"[11] The Court determined that the answer to this question was no.

The Chancery Court found that the Pricing Committee's conduct was not of the type "generally imagined when considering the concept of gross negligence, typically defined as a substantial deviation from the standard of care."[12] The Pricing Committee had, before approving the indenture, "retained highly-qualified counsel" and "sought advice from Amylin's management and investment bankers."[13] Moreover, the Pricing Committee "asked its counsel if there was anything 'unusual or not customary'" in the terms of the notes under the Indenture, and was advised that there was not.[14] The Court did not place a burden on the Pricing Committee to do its own legal work: "Certainly," the Court stated, "no one suggests that the directors' duty of care required them to review, discuss, and comprehend every word of the 98-page Indenture."[15]

The Supreme Court's Order and What It Meant

In one sentence, the Supreme Court affirmed the Chancery Court's order and judgment based on the reasoning set forth in the Chancery Court's opinion.[16] But the Supreme Court added a footnote stating that the Chancery Court's "determination was correct, not only for the reasons made explicit in [its] opinion, but also for one that is implicit: no showing was made that approving the 'proxy put' [in June 2007] would involve any reasonably foreseeable material risk to the corporation or its stockholders."[17] That risk "materialized only months later, and was aggravated by the unexpected, cataclysmic decline in the nation's financial system and capital markets beginning in the Spring of 2008."[18] This footnote—with its overtones of concern over financial realities—has caused some to question whether the Supreme Court is trending toward some type of "substantive due care" review.[19]

We suggest that the correct reading of the Supreme Court's footnote is as an affirmation of well-established precedent regarding the courts' respect for directors' business judgment. As the Supreme Court itself previously stated in *Brehm*,"[d]ue care in the decisionmaking context is *process* due care only."[20] Moreover, to find a breach of the duty of care when the directors' process includes reliance on an expert, the *Brehm* Court suggested that a plaintiff would have to demonstrate that

> (a) the directors did not in fact rely on the expert; (b) their reliance was not in good faith; (c) they did not reasonably believe that the expert's advice was within the expert's professional competence; (d) the expert was not selected with reasonable care by or on behalf of the corporation, and the faulty selection process was attributable to the directors; (e) the subject matter . . that was material and reasonably available was so obvious that the board's failure to consider it was grossly negligent regardless

> of the expert's advice or lack of advice; or (f) that the decision of the Board was so unconscionable as to constitute waste or fraud.[21]

The Chancery Court covered (a) through (d) fairly well in its opinion,[22] and (f) was not really a live issue. In our reading, the Supreme Court's *Amylin* footnote was only an affirmation that (e)—whether the subject matter was "so obvious that the board's failure to consider it was grossly negligent regardless of the expert's advice"—was not met. Since the country's economic collapse happened long after the Pricing Committee approved the indenture, and was not a "reasonably foreseeable material risk to the corporation" at the time,[23] the Supreme Court merely clarified that the Pricing Committee's conduct was outside the realm of gross negligence under all of *Brehm*'s factors.

In short, the Supreme Court in its *Amylin* footnote merely seemed to be saying to all, including potential plaintiffs, that the current state of our economy was, at least at one point in the past, not obvious to everyone. The mere fact that a board's pre-meltdown decision turns out to have been unfortunate in the post-meltdown world does not mean that the board breached its duty of care. In other words, the Delaware Supreme Court is underscoring the point that directors are not required to be fortune tellers. Directors who cannot predict the future are not necessarily grossly negligent. Indeed, it is a fundamental principle of the business judgment rule that a "board's decision, otherwise properly based, could be wrong and still withstand attack."[24] The Chancery Court's *Amylin* decision confirms that directors will be protected in relying in good faith on their professional advisors, and the Supreme Court's *Amylin* footnote confirms that they will be protected in relying in good faith on the information available to them at the time, even if they are later proved wrong.[25]

Conclusion

Some have questioned what the Delaware Supreme Court was doing in dropping a footnote to its otherwise-summary affirmance. In our view, the Supreme Court merely was following its long-standing teachings on the duty of care and clarifying that directors cannot be held to have breached their duties of care by failing to predict the future. So long as directors properly rely on their experts, and so long as those experts advise the board as to matters within their competence—including by being "mindful of the board's continuing duties to the stockholders to protect their interests"[26]—the Delaware courts should uphold those directors' business judgments, no matter what the future holds.

NOTES

1. *San Antonio Fire & Police Pension Fund v. Amylin Pharms., Inc.* (*Amylin II*), 2009 WL 3182602 (Del. Oct. 5, 2009) (ORDER), *aff'g* 2009 WL 1337150 (Del. Ch. May 12, 2009).
2. *San Antonio Fire & Police Pension Fund v. Amylin Pharms., Inc.* (*Amylin I*), 2009 WL 1337150 (Del. Ch. May 12, 2009), *aff'd*, 2009 WL 3182602 (Del. Oct. 5, 2009) (ORDER).
3. *See*, *e.g.*, Amylin Pharmaceuticals and a Substantive Duty of Care?, *http://blogs.law.widener.edu/delcorp/de-corporate-law-news/* (Oct. 11, 2009); *see also* J. Robert Brown, "San Antonio Fire & Police v. Amylin: Delaware and the Ostrich Approach to Governance "(Judicial Speculation in Place of Board Consideration), *http://www.theracetothebottom.org/home/san-antonio-fire-police-v-amylin-delaware-and-the-ostrich-ap-2.html* (Oct. 28, 2009) (calling the Supreme Court's footnote "startling" and "inconsistent with everything that had happened in the case to date"); BFA, "Credit Crunch and Corporate Case Law," *http://www.thedefiningtension.com/2009/10/no-152-credit-crunch-and-corporate-case-law-1.html* (Oct. 9, 2009).
4. *Amylin I*, 2009 WL 1337150.
5. *Id.* at *2.
6. *See id.* at *1. The Court stated: "Because the notes are trading on a deeply discounted basis, any event threatening to trigger this provision poses a substantial economic problem for the corporation and its stockholders." *Id.* The Court also noted the Company's own disclosure that "[i]f triggered, the lenders under the Term Loan may terminate their commitments and accelerate our outstanding debt and the holders of our 2007 Notes may require us to repurchase the notes. We may not have the liquidity or financial resources to do so at the times required or at all." *Id.* at *4 n.7.
7. *See id.* at *1.
8. *Id.* at *10.
9. *Id.* Plaintiff also alleged that Amylin's CEO and CFO both admitted that they were not aware of the continuing director provision until they read about them in February 2009. *Id.* at *10 n. 42. The Court noted that this allegation, while it contained some "'shock value,'" did not bear on the question of the directors' due care. *Id.* The CFO was not a director, and the CEO, although a director, was not a member of the Pricing Committee. *Id.*
10. *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).
11. *Amylin I*, 2009 WL 1337150, at *10.
12. *Id.*
13. *Id.*
14. *Id.*; *see also id.* at *2 n.4.

15. *Id.* at *10; *see also Smith v. Van Gorkom*, 488 A.2d 858, 883 n.25 (Del. 1985) ("We do not suggest that a board must read *in haec verba* every contract or legal document which it approves . . . .").

16. *Amylin II*, 2009 WL 3182602, at *1.

17. *Id.* at *1 n.2.

18. *Id*.

19. *See* note 3 *supra*.

20. *Brehm*, 746 A.2d at 264.

21. *Id.* at 262.

22. *See Amylin I*, 2009 WL 1337150, at *10 ("The board retained highly-qualified counsel. It sought advice from Amylin's management and investment bankers as to the terms of the agreement. It asked its counsel if there was anything "unusual or not customary" in the terms of the Notes, and it was told there was not. Only then did the board approve the issuance of the Notes under the Indenture." (footnote omitted)).

23. *Amylin II*, 2009 WL 3182602, at *1 n.2.

24. *Reading Co. v. Trailer Train Co.*, 1984 WL 8212, at *4 (Del. Ch. Mar. 15, 1984).

25. *See, e.g.*, *Brehm*, 746 A.2d at 259 (stating that a "Board is responsible for considering only *material* facts that are *reasonably available*, not those that are immaterial or out of the Board's reasonable reach"), *quoted inAmylin I*, 2009 WL 1337150, at *10.

26. *Amylin I*, 2009 WL 1337150, at *10.

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