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## Delaware Supreme Court Clarifies Officers' Fiduciary Duties, the Intersection of *Unocal*, Entire Fairness and Business Judgment Review, and the Common Law Shareholder Ratification Doctrine

The recent Delaware Supreme Court opinion in *Gantler v. Stephens* clarified issues of law that are of interest to corporate practitioners. *Gantler* arose out of the decision of the board of First Niles Financial, Inc., a holding company owning a small savings and loan association, to reject a possible opportunity to sell the company to a third party for a premium in favor of a "privatization" effected by reclassifying the First Nile common stock held by holders of 300 or fewer shares into new preferred stock that would pay higher dividends and have the same liquidation preference as the common stock, but would be stripped of voting rights except in the event of a proposed sale of the company. Plaintiffs alleged that after deciding that First Niles should put itself up for sale, the board violated its fiduciary duties by running a shoddy sale process that included, among other things, the board's sabotaging the third party offers by failing to comply in a timely manner with the bidders' due diligence requests. In reversing the Chancery Court's decision to grant a motion to dismiss three distinct breach of fiduciary duty claims, the Delaware Supreme Court reiterated or clarified several issues of Delaware law, including the following:

- *Allegations of a board's desire to maintain corporate control are insufficient on their own to rebut the business judgment presumption. However, where other facts support possible self-interest on the part of the directors, the business judgment presumption may be rebutted and instead, entire fairness review applied.* In order to rebut the business judgment presumption, plaintiffs must plead something more than a motive to retain corporate control, such as other facts sufficient to state a cognizable claim that the directors acted disloyally. In *Gantler*, the Court held that sufficient reasonable inferences of self interest could be drawn from the defendant directors' and officers' lack of cooperation with the third party due diligence requests. Further, as expected, in such a situation where the business judgment presumption is rebutted due to possible director self-interest, entire fairness review applies. Boards that are contemplating possible recapitalizations or restructurings, particularly in circumstances where

directors who are also shareholders may have business or other interests that arguably distinguish their personal interests in a proposed transaction from the interests of other shareholders, should be aware of this possible higher standard of review of their actions.

- *Unocal's enhanced scrutiny applies only where there is an allegation of improper "defensive" action by the Board. Rejecting an acquisition offer, without more, is not "defensive" action under Unocal.* The decision not to pursue a merger opportunity would normally be reviewed under the business judgment standard absent evidence that would support the application of a different standard. In *Gantler*, however, as we discussed above, the facts support the rejection of the business judgment presumption in favor of an entire fairness review. In either event, however, without allegations of additional "defensive" conduct on the part of the board, *Unocal's* enhanced scrutiny review is not applicable.
- *Officers of Delaware corporations have the same fiduciary duties as directors.* While both the Chancery Court and the Supreme Court have implied this holding before, the Supreme Court has now explicitly held that officers owe fiduciary duties of care and loyalty that are the same as those of directors of Delaware corporations.
- *Common law shareholder ratification is more limited than some have suggested.* In particular, shareholder ratification is limited to approving director action that does not legally require shareholder approval to become effective. In addition, shareholder ratification is limited to those director actions or conduct that shareholders are specifically asked to approve. For example, the ultimate approval of a merger transaction by the shareholders does not mean that the shareholders have ratified all related director actions, such as defensive measures that are taken in the context of those merger negotiations. Finally, the effect of shareholder ratification is not to extinguish all claims in respect of the ratified director action, but rather to subject the challenged director action to business judgment review. Practitioners who had previously thought that a shareholder vote would sanitize all aspects of a particular corporate decision should be aware of the significant boundaries that the Court has placed on the common law ratification doctrine in an effort to "restore coherence and clarity" to that doctrine.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning the issues addressed in this memorandum may be directed to Jeffrey D. Marell (212-373-3105), Marc E. Perlmutter (212-373-3144) or Frances Mi (212-373-3185).