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## Delaware Supreme Court Refines Director Independence Analysis

In *Delaware County Employees Retirement Fund, et al. v. Sanchez, et al.*, the Delaware Supreme Court held that stockholder plaintiffs in a derivative action adequately alleged facts to support a pleading-stage inference that a director was not independent from an interested director due to their close, 50-year friendship and significant business relationships consistent with that friendship. The court thus reversed the Delaware Court of Chancery's holding on the defendants' motion to dismiss that the plaintiffs had failed to adequately plead demand excusal. The court emphasized that Delaware courts must analyze all the particularized facts pled by the plaintiffs "in their totality and not in isolation from each other."

This action originated in a transaction between Sanchez Resources, LLC ("Sanchez Resources"), a private company that was wholly owned by the family of A.R. Sanchez, Jr., and Sanchez Energy Corporation ("Sanchez Energy"), a public corporation in which Mr. Sanchez's family is the largest stockholder bloc and that is dependent on Sanchez Resources for all management services. The transaction involved substantial cash payments from Sanchez Energy to Sanchez Resources in consideration of the purchase of interests in certain properties, among other matters. The board of directors of Sanchez Energy (the "Board") was comprised of five members, two of whom were Mr. Sanchez and his son. Mr. Sanchez's son also serves as Sanchez Energy's President and CEO.

Without first making a demand on the Board, certain stockholder plaintiffs sued derivatively on behalf of Sanchez Energy, alleging that the transaction unfairly benefitted Sanchez Resources to Sanchez Energy's detriment. The plaintiffs alleged that demand was excused because a majority of the Board's directors were not disinterested and independent in considering the transaction. The parties agreed that Mr. Sanchez and his son were not disinterested in considering the transaction, but disputed whether a third director, Alan Jackson, was independent from Mr. Sanchez. The plaintiffs alleged that:

- Mr. Sanchez and Mr. Jackson had been close friends for over 50 years. Consistent with that friendship, Mr. Jackson donated \$12,500 to Mr. Sanchez's gubernatorial campaign in 2012.
- Mr. Jackson's personal wealth is largely attributable to business interests over which Mr. Sanchez has substantial influence. Specifically, Mr. Jackson and his brother are both primarily employed as executives at an insurance agency that is wholly owned by a corporation of which Mr. Sanchez is the largest stockholder and a non-independent director. Further, both work on the Sanchez Energy and Sanchez Resources accounts at the insurance agency.

- Mr. Jackson earned \$165,000 as a Sanchez Energy director, which represented approximately 30-40% of his total income in calendar year 2012.

On the defendants' motion to dismiss, the Court of Chancery concluded that the plaintiffs' allegations were insufficient to overcome the presumption that Mr. Jackson was independent from Mr. Sanchez and dismissed the action for failure adequately to plead demand excusal. The Court of Chancery's analysis appeared to consider the allegations related to the two men's 50-year friendship separately from the allegations of their business relationships.

On appeal, the court reversed, holding that the plaintiffs' allegations, when considered "in their totality," supported a pleading inference that Mr. Jackson could not act independently of Mr. Sanchez. In so doing, the court focused on the following:

- *The court reasoned that detailed allegations of a close, 50-year friendship weigh in favor of a pleading inference that a director lacks independence.* The court emphasized that, at the pleading stage, a lack of independence turns on "whether the plaintiffs have pled facts from which the director's ability to act impartially on a matter important to the interested party can be doubted because that director may feel either subject to the interested party's dominion or beholden to that interested party." A strong, 50-year friendship is "likely considered precious by many people." Thus, "when a close relationship endures for that long, a pleading inference arises that it is important to the parties."
- *The court differentiated between allegations of a close, long-term friendship and allegations of more superficial relationships.* The court distinguished its opinion in *Beam v. Stewart*, 845 A.2d 1040 (Del. 2004), which held that allegations of "thin social-circle" friendships, such as moving in the same business and social arenas, or a mere characterization of friendship as "close," is not enough to negate independence for demand excusal purposes. The court explained that "deeper human friendships" such as those existing in the case at hand could have "the effect of compromising a director's independence," unlike those alleged in *Beam*.
- *The court concluded that the detailed allegations of Mr. Sanchez and Mr. Jackson's business relationships together with the allegations of their close friendship were sufficient to allege a lack of independence.* The court explained that the plaintiffs' allegations regarding the men's business relationships buttressed the "contention that they are confidantes and that there is a reasonable doubt" that Mr. Jackson "can act impartially in a matter of economic importance" to Mr. Sanchez personally. Moreover, the plaintiffs' allegations created a "pleading stage inference" that Mr. Jackson's economic positions derived in large part from his 50-year close friendship, and that he is in these positions because Mr. Sanchez "trusts, cares for, and respects him."

Because this opinion was decided in the context of the defendants' motion to dismiss, we note that it remains to be seen how the Court of Chancery will hold on remand on a more developed record.

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