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Delaware's First Read on the DGCL Section 144 Safe Harbor

Recently in *Ayers v. Foley*, the Delaware Court of Chancery issued an opinion (by Vice Chancellor Will) interpreting for the first time certain provisions in the 2025 amendments to Section 144 of the Delaware General Corporation Law (“DGCL”), the landmark statutory reforms that provide safe harbor protections for certain conflicted transactions. The practical takeaway of *Ayers* is that Section 144 has raised the bar materially for rebutting the presumption of director independence at the pleading stage for publicly listed corporations when the board has determined that a director satisfies the exchange’s independence requirements because of the statute’s “substantial and particularized facts” pleading requirement. Significantly, the court reached this conclusion in the context of determining the issue of demand futility, reasoning that the heightened pleading standard in Section 144 is not confined to the safe harbors in Section 144 and was intended to apply broadly to other contexts as well. *Ayers* also reaffirms that when directors approve their own compensation, they are necessarily interested and their actions continue to be subject to entire fairness review.

The dispute in *Ayers* concerned two decisions made by the compensation committee of the board of directors of Fidelity National Financial, Inc. (“FNF”) regarding: (a) annual non-employee director compensation over a three-year period and (b) a one-time equity grant (the “Equity Grant”) to the non-executive chairman (and founder). Given the significance of the Equity Grant, the compensation committee conditioned its approval on review and approval by an independent related person transaction committee, which approved the grant after reviewing market data from an independent compensation consultant. An FNF stockholder sued derivatively challenging the director compensation and the Equity Grant.

Due to the derivative nature of plaintiff’s claims, the court engaged in a demand futility analysis at the pleadings stage, which looks at whether the plaintiff is excused from making a pre-derivative suit demand on the board because at least half of the board is interested in the transaction due to a director (1) receiving a material personal benefit, (2) facing a substantial likelihood of liability or (3) lacking independence from someone who is interested under (1) or (2). Over plaintiff’s objection, the court analyzed the director compensation and the Equity Grant decisions separately, finding that the two decisions were discrete. The court reasoned that, although the compensation committee considered both matters at the same meeting, and approved one of them (director compensation) at that meeting, approval of the Equity Grant involved a separate process led by the related person transaction committee that concluded two weeks later. Absent particularized facts showing a quid pro quo or linkage, the court held the two compensation decisions had to be analyzed separately.

Key aspects of the court’s analysis concerning the statutory safe harbor include the following:

- *Section 144(d)(2)’s heightened presumption for director disinterestedness extends to—and therefore sets a new, higher pleading standard for—demand futility analyses.* DGCL Section 144(d)(2) establishes a heightened presumption of disinterestedness to directors of listed corporations who are not a party to the challenged transaction and whom the board has determined to be independent under stock exchange rules. The court held that this presumption is not confined to the safe harbors set forth in Section 144 and applied it to its demand futility analysis relating to the Equity Grant. The court reasoned that the legislature limited other provisions of Section 144 to specific situations but included no such limiting language in paragraph (d)(2), reflecting an intent for the heightened presumption to apply broadly to contexts outside of Section 144.

The heightened presumption of disinterestedness created by Section 144(d)(2) requires that a plaintiff must plead “substantial and particularized facts” of a material interest or material relationship to rebut the presumption. The court read this language to be more exacting than the existing “particularity” requirement in the demand futility context. The addition of “substantial” means that a plaintiff must plead “specific, non-conclusory facts of sufficient qualitative significance to support a reasonable inference of a material interest or relationship that would impair the director’s objective judgment.” Thus, it is the quality, not the mere quantity, of the allegations that matters—“a collection of trivial facts” will not satisfy the standard “simply by force of accumulation.” The practical effect of the court’s conclusion is to raise materially the pleading standard for demand futility where the heightened presumption applies. In *Ayers*, the allegations of overlapping board service, minority sports-team co-investments and other business connections with the chairman were insufficient to show that a majority of the board lacked independence from the chairman so as to render demand futile under prong three of the demand futility analysis noted above.

- *Application of the safe harbor in Section 144(a)(1) and the corporation’s exculpatory charter provision means that a plaintiff must sufficiently plead bad faith to establish demand futility.* Section 144(a)(1) provides that a conflicted director transaction may not be the subject of equitable relief, or give rise to an award of damages, against a director if it is approved, in good faith and without gross negligence, by the fully informed vote of a majority of the disinterested directors on the board or a board committee. The court reasoned that application of Section 144(a)(1)’s safe harbor combined with the Section 102(b)(7) exculpatory provision in FNF’s charter meant that the plaintiff must plead particularized facts indicative of bad faith to show that the directors faced a substantial threat of liability and thus that demand would be futile under prong two of the demand futility analysis noted above. In *Ayers*, the process related to the Equity Grant undercut the allegations of bad faith because the compensation committee relied on an outside compensation consultant, negotiated the award downward and conditioned its own approval on the separate review and approval of the related person transaction committee.
- *Director compensation decisions remain subject to entire fairness review absent disinterested stockholder approval.* When directors approve their own pay, they are inherently interested. This can be cleansed by obtaining the approval of a majority of the votes cast by the corporation’s disinterested stockholders under the safe harbor in Section 144(a)(2). In *Ayers*, no disinterested stockholder approval was sought for the director compensation at issue. Defendants instead relied on the safe harbor in Section 144(a)(3), which insulates an interested director from liability if the transaction is fair to the corporation and its stockholders. This standard tracks the common law of entire fairness review that takes into account financial (fair price) and process (fair dealing) considerations in a unitary analysis. The court cited precedent holding that unfair dealing is effectively established at the pleading stage for self-compensation claims and held that unfair price had been adequately alleged based on evidence that the non-employee directors’ compensation outpaced peers even though the company lagged on certain market capitalization, revenue and net income metrics. The court then concluded that the breach of fiduciary duty claim survived against the compensation committee members who approved the director compensation awards but would be dismissed as to the directors who merely received compensation without participating in its approval, reasoning that they could not be liable absent allegations they knowingly accepted wrongful awards.

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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 issues addressed in this memorandum should be directed to:

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