



Delaware Chancery Court Allows Preferred Stockholder Derivative Action

Posted by William Savitt, Wachtell, Lipton, Rosen & Katz on Saturday May 22, 2010

Editor's Note: [William Savitt](#) is a partner in the Litigation Department of Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum by Mr. Savitt, [David E. Shapiro](#) and [Ryan A. McLeod](#), and relates to the decision of the Chancery Court of Delaware in *MCG Capital Corp. v. Maginn*, which is available [here](#).

In a recent decision, the Delaware Court of Chancery for the first time held that preferred stockholders have standing to bring derivative suits on behalf of a corporation. *MCG Capital Corp. v. Maginn*, C.A. No. 4521-CC (Del. Ch. May 5, 2010).

The plaintiff was the sole holder of Jenzabar, Inc.'s preferred stock but held no common stock of the corporation. Plaintiff brought suit alleging that the board's decision to pay certain compensation to executive management breached fiduciary duties owed to the corporation and violated both the corporation's charter and contractual consent rights. Resolving an issue of first impression under Delaware law, the Court held that "preferred shareholders have standing to bring derivative claims unless the ability to bring a derivative claim has been expressly limited in the articles, preferred stock designations, or some other appropriate document." Delaware corporations are thus now on notice that preferred stockholders presumptively have the same rights as common stockholders to attack corporate action through derivative litigation. At the same time, the Court indicated that express limitations on preferred holder derivative standing will be enforced.

Coming in the wake of the Supreme Court's 2007 *Gheewalla* decision, which explained that the creditors of a corporation may bring derivative suits once the corporation is insolvent, *MCG Capital Corp.* expands the universe of potential derivative plaintiffs, and, accordingly, potential derivative liability. Nevertheless, and in accordance with Delaware's longstanding policy favoring private ordering, the Chancellor took pains to reassure Delaware companies that limitations on such standing will be respected if clearly set forth in the charter or the preferred stock's designations.