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Court of Chancery Holds That Directors Cannot Be Dismissed From Challenge to
Controlling Stockholder Merger Subject to Entire Fairness Review

The Delaware Court of Chancery recently refused to dismiss disinterested directors from a case challenging the merger of a company and its majority stockholder, holding that the directors remained subject to trial in a freeze-out transaction governed by the entire fairness standard of review. [*In re Cornerstone Therapeutics Inc. Stockholder Litig.*, C.A. No. 8922-VCG \(Del. Ch. Sept. 10, 2014\)](#).

The case arose from a merger between Cornerstone Therapeutics and its majority stockholder, Chiesi Farmaceutici S.p.A. After the majority stockholder informed the board of its interest in taking the company private, the board formed a special committee of disinterested directors, which retained legal and financial advisors and ultimately negotiated the transaction. Although the merger was approved by more than 80% of the minority stockholders, it had not been made contingent on a non-waivable majority-of-the-minority condition at the outset of negotiations and therefore did not qualify for deferential business judgment review under the Delaware Supreme Court's [recently announced standards](#) for controlling stockholder mergers.

Conceding that entire fairness review thus applied to claims against the controlling stockholder, the disinterested directors nevertheless sought to be dismissed from the case at the pleading stage because they were exculpated from personal liability by Cornerstone's charter. They argued that to burden unaffiliated directors with proving entire fairness, particularized pleadings were required that, if true, would raise an inference that such directors breached a non-exculpated duty. Otherwise, the disinterested directors argued, they would be required to defend claims through trial even when the complaint did not plead facts that could support liability.

The Court of Chancery observed "there is much ... to recommend such a pleading requirement" and that defendants' arguments were "by no means without persuasive force." But the Vice Chancellor nevertheless found that "controlling case precedent directs that negotiating and facilitating directors must await a developed record, post-trial, before their liability is determined"—even where a complaint contains no well-pleaded facts that could, if proved, justify liability against the exculpated directors.

Cornerstone reconfirms that unless transactions with a controlling stockholder are structured so as to receive deferential business judgment review, even disinterested independent directors protected by exculpatory provisions will be subjected to protracted litigation. To ensure that directors are protected in such circumstances, boards should take care to ensure that any sale process is thoughtfully structured to account for potential conflicts and supported by an appropriate contemporaneous record of careful board process.

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