



# DELAWARE COURT RULING OFFERS GUIDANCE ON DISCLOSURE OBLIGATIONS

by  
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On July 24, 2009 the Delaware Court of Chancery released its decision in *Wayne County Employees' Retirement System v. Corti*, 2009 Del. Ch. LEXIS 126 (Del. Ch. 2009). The court assessed the claims made by Activision shareholders against Activision's board of directors over a transaction that resulted in Vivendi S.A. obtaining a majority of the voting stock of Activision, Inc.—the makers of the computer game *World of Warcraft*.

The plaintiffs in the case alleged three violations: First, the board of directors failed to disclose sufficient information regarding the transaction; second, the specific board members in charge of negotiating the transaction put personal considerations ahead of their fiduciary responsibilities; and third, the board of directors failed in its fiduciary duty by allowing self-interested board members to steer the transaction.

The court rejected the three claims, and in the process penned a helpful discussion of the standards that the court will apply to future disclosure claims. Also instructive is the court's explanation of why the entrenchment claims were rejected and the court's discussion of what is required to successfully assert claims for breach of the duty of loyalty.

**Disclosure Obligations.** The court first recited the familiar disclosure obligations of directors. Specifically, it observed that “when a board of directors seeks shareholder action, the fiduciary duty of disclosure which is a specific application of the duties of care and loyalty requires that the board ‘disclose fully and fairly all material information within the board’s control.’” The court emphasized that a plaintiff bringing a disclosure claim must “identify the facts that are allegedly missing from the proxy statement and ‘state why they meet the materiality standard and how the omission caused injury.’” *Id.* at \*26, citing *Wayne County Employees' Retirement System v. Corti*, 954 A.2d 319, 330 (Del. Ch. 2008).

The court then explained the well-known standard of materiality as requiring the following:

to establish the materiality of omitted facts under Delaware law, a plaintiff must show a substantial likelihood that the omitted facts would have assumed actual significance in the deliberations of a reasonable stockholder because, if disclosed, those facts would have significantly altered the total mix of information available to the stockholders. *Id.*

By this standard, the plaintiffs contended that the board's inadequate disclosure constituted a breach of the duty of loyalty. However, the court emphasized that the complaint failed to adequately plead facts that state a claim for damages that were not barred by the provision in the certificate that, pursuant to 8 Del. C. Section 102(b)(7), eliminates the personal liability of Activision's directors for monetary liability for breaches of the duty of care. The court reasoned that a “mere conclusory allegation that the alleged disclosure violations also constitute a violation of the duty of loyalty is not sufficient to survive a motion to dismiss, particularly in light of the holding that the complaint fails to otherwise state a non-exculpated claim against the Director Defendants for breach of fiduciary duty.” *Id.* at \*32.

**Fiduciary Duty Claims.** To address the plaintiffs' claim that the Board had failed its fiduciary duties, the court reiterated that under Delaware law,

Directors of Delaware corporations are bound by the traditional fiduciary duties of care and loyalty. The appropriate starting place in evaluating plaintiff's fiduciary duty claims, however, is with the well established presumption of the business judgment rule, which reflects and promotes the role of the board of directors, and not the Court, as the appropriate body to manage the business and affairs of the corporation. The business judgment rule, of course, is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken is in the best interests of the company.

*Id.*, citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

Referring to the recent Delaware Supreme Court decision in *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 239 (Del. 2009), the court recited the standard set forth in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) that applies when a board of directors decides to sell control of the corporation, in which case the

board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise. Thus, a sale of control of the corporation does not implicate additional fiduciary duties, but instead requires the directors to exercise their fiduciary duties in the context of the particular decision being made.

*Id.* at \*33 (footnotes omitted.)

The court found that because Activision had a certificate containing a provision that bars claims for money damages against their directors based on breaches of the duty of care, in order to survive dismissal, plaintiff had to allege facts that were sufficient to state a claim that was not exculpated by the certificate, "such as a claim that the Director Defendants violated the duty of loyalty by, for example, acting in their own self-interest at the expense of the Company or otherwise failing to act in good faith." *Id.* at \*34.

After reciting the applicable facts as alleged, the court concluded that the complaint failed to state that the directors were interested in the transaction or otherwise violated their fiduciary duty of loyalty.

The court also dispelled any arguments that entrenchment was involved. Specifically, the court noted that the employment agreements of the two supposedly-self-interested directors, Kotick and Kelly, were approved by the directors which quashed any notion that the new employment agreements were either kept secret from the board or that the employment benefits were obtained without the knowledge of the Activision directors. Moreover, the court underscored that the plaintiff had not alleged facts to rebut the presumption that the members of the compensation committee exercised their independent and disinterested business judgment in approving the employment agreements. *See id.* at \*37, n. 52.

**Revlon Standard.** Finally, the opinion provided practical insights on the current state of the law in Delaware regarding the standard applied to directors involved in the sale of their companies. The court explained as follows:

Delaware law does not hold directors liable for failing to carry out a perfect process in a sale of control. Moreover, a provision in Activision's certificate exculpates Director Defendants from personal liability for monetary damages for breaches of the duty of care. Although plaintiff frames its attacks on the process employed by the Director Defendants as breaches of the duty of loyalty, the factual allegations in the complaint do not support such a claim.

*Id.* at \*51. The complaint failed to establish that the directors had a conflict of interest, nor did the complaint establish that the directors lacked independence.

**Conclusion.** Given the plaintiffs' inability to substantiate either its disclosure obligation claim or its fiduciary duty claim, the court ruled in favor of the board of directors. The high level of detail provided in this ruling should serve as a future roadmap for citizens of Delaware seeking to understand a board's obligation during a transaction.