

Delaware Supreme Court: Plaintiffs Raised a Reasonable Doubt as to the Disinterestedness of a Director Who Co-Owned a Plane with the Controlling Stockholder and Two Directors Who Had Business Relationships with the Controlling Stockholder

12.19.16



(Article from *Securities Law Alert*, December 2016)

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On December 5, 2016, the Delaware Supreme Court revived a derivative action brought in connection with claims concerning stock sales by the company's former CEO and controlling stockholder (the "controller") and other company insiders. *Sandys v. Pincus*, 2016 WL 7094027 (Del. 2016) (Strine, C.J.). In addition to the three board members who were interested in the transactions at issue, the Delaware Supreme Court found the complaint raised a reasonable doubt as to the independence of three other directors based on allegations that one director co-owned a plane with the controller and two directors had "interlocking [business] relationships" with him.

Allegation of a Director's Co-Ownership of an Airplane with the Controlling Stockholder Is Sufficient to Support an Inference That the Director Cannot Act Impartially

The Delaware Supreme Court found the co-ownership of an airplane "create[d] a pleading stage inference that [the director] cannot act independently of [the controller]." The court reasoned that "[c]o-ownership of a private plane involves a partnership in a personal asset that is not only very expensive, but also requires close cooperation in use." The court found the arrangement "suggestive of the type of very close personal relationship that, like family ties, one would expect to heavily influence a human's ability to exercise impartial judgment."

The Delaware Supreme Court recognized that plaintiff offered only cursory allegations regarding the implications of the airplane co-ownership. Nevertheless, the court found that even under the "elevated" pleading standard that applies "in the demand excusal context," a plaintiff does not have to "plead a detailed calendar of social interaction to prove that directors have a very substantial relationship rendering them unable to act independently of each other." The court explained that "[a] plaintiff is only required to plead facts supporting an inference . . . that a director cannot act impartially." Here, the Delaware Supreme Court found the facts alleged "support[ed] an inference that [the director] would not be able to act impartially when deciding whether to move forward with a suit implicating a very close friend with whom she and her husband co-own a private plane."

Allegations of a Director’s Business Relationships with the Controlling Stockholder Raise an Inference That the Director Cannot Act Impartially

The Delaware Supreme Court then considered allegations that two directors had “a mutually beneficial network of ongoing business relations” with both the controller and an outside director who sold company stock in the transactions at issue. The court found that “it is reasonable to expect” that “a mutually beneficial ongoing business relationship . . . might have a material effect on the parties’ ability to act adversely toward each other.” The court observed that “[c]ausing a lawsuit to be brought against another person is no small matter, and is the sort of thing that might plausibly endanger a relationship.”

The Delaware Supreme Court also found it significant that the board had allegedly already determined that both directors did not qualify as independent directors pursuant to the NASDAQ Listing Rules. The court stated that “[t]he NASDAQ rules’ focus on whether directors can act independently of the company or its managers has important relevance to whether they are independent for purposes of Delaware law.” The Delaware Supreme Court determined that “if a director cannot be presumed capable of acting independently because the director derives material benefits from her relationship with the company,” then the director “necessarily cannot be presumed capable of acting independently of the company’s controlling stockholder.”

In a Dissenting Opinion, Justice Valihura Expresses Her View That Plaintiff Failed to Rebut the Presumption of Independence That Applies in the Demand Futility Context

Justice Valihura dissented from Chief Justice Strine’s opinion based on her view that the allegations were insufficient to rebut the presumption of independence that applies in the demand futility context.

With respect to the two directors who had business relationships with the controlling stockholder, Justice Valihura observed that “plaintiff failed to plead any facts about the size, profits or materiality” to the two directors of the alleged “investments or interests” that raised a potential conflict of interest. She also noted “the lack of any explanation as to why [the two directors] were identified as ‘not independent’ for NASDAQ purposes.”

With respect to the director who co-owned an airplane with the controlling stockholder, Justice Valihura stated that plaintiff alleged only a “business relationship” between the director and the controller based on their co-ownership. She emphasized that “[n]othing more is alleged, let alone facts suggesting [any] kind of familial loyalty and intimate friendship.” While Justice Valihura acknowledged that “it may be reasonable to infer some kind of collaborative relationship given the nature of the asset,” she stated that she did “not believe the bare allegation in the [c]omplaint [rose] to the level of creating a reasonable doubt as to [the director’s] ability to carry out her fiduciary duties.”

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