

Delaware Chancery Court: A *Brophy* Insider Trading Claim May, Depending on the Circumstances, Be Premised on Trades by an Entity Affiliated With and Controlled by a Director

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On December 14, 2018, the Delaware Chancery Court held that plaintiffs adequately alleged demand futility by pleading that a majority of the company's directors faced a substantial likelihood of liability for insider trading under *Brophy v. Cities Service Co.*, 31 Del. Ch. 241 (Del. Ch. 1949).[1] *In re Fitbit Stockholder Derivative Litig.*, 2018 WL 6587159 (Del. Ch. 2018) (Slights, V.C.). In a case of first impression, the court considered whether "a fiduciary may be held liable on a *Brophy* claim for trades that an entity or fund associated with that fiduciary executed in its name." The court declined "to state a hard and fast rule," but found that plaintiffs adequately alleged that trades by entities affiliated with two of the directors could be attributed to those directors.

Plaintiffs alleged that one of the directors was a founder and managing member of a venture capital firm, while another director was a partner at a different venture capital firm. Both firms sold millions of the company's shares during the relevant time period. The court noted that the directors were "not simply board designees for their funds." Rather, plaintiffs alleged that "[b]oth directors share voting and dispositive power over the [company] stock owned by their respective funds." The court found plaintiffs adequately alleged that the directors "personally and materially profited from the challenged stock sales through their ownership and control of their affiliated funds."

Given these allegations, the court determined that "finding *ipso jure* that the [venture capital firms'] trades cannot be attributed to [the directors affiliated with those firms] would frustrate the policy that animates *Brophy*." The court reasoned that such a ruling "would permit a director to trade on inside material information without consequence just because the director did not trade personally but rather passed the information to an entity with which he is affiliated (and over which he exercised control) to do the trading." The court found that this "is not and cannot be our law." The court stated that "to allow these directors, through their controlled funds, to profit from inside information without recourse would be inconsistent with the policy of extinguishing all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation that undergirds Delaware's insider trading law."

[1] A *Brophy* claim “permits a corporation to recover from its fiduciaries for harm caused by insider trading.” *In re Fitbit Stockholder Derivative Litig.*, 2018 WL 6587159 (Del. Ch. 2018).

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