

Chancery Describes Standard of Review for Demand Refusal Decision

By **Robert B. Little and Madison Jones**

On May 8, Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery issued an opinion clarifying the standard of review applicable to a board of directors' decision to refuse a stockholder demand to bring litigation on behalf of the corporation. In *Ironworkers District Council of Philadelphia & Vicinity Retirement & Pension Plan v. Andreotti*, C.A. No.9714-VCG (Del. Ch. May 8, 2015), the court granted a motion to dismiss a stockholder complaint alleging the board of DuPont improperly refused a stockholder demand to sue certain DuPont officers and directors for breaches of fiduciary duties related to the company's high-stakes patent infringement dispute with Monsanto. The court reviewed the board's decision not to pursue the claims under the business judgment standard, stating that the relevant question is whether the board, in declining the stockholder demand, "was grossly negligent in failing to inform itself, or intentionally acted in disregard of the company's best interests."

The Ironworkers plaintiff's demand related to DuPont's attempts to develop a genetically modified seed technology that could compete

with Monsanto's "Roundup Ready" technology between 2006 and 2012. DuPont had access to Roundup Ready pursuant to a licensing agreement with Monsanto, which prohibited commercialization of any product that combined a competitor technology with Roundup Ready. After attempts to develop a standalone competitor technology proved disappointing, DuPont began development of a product that combined the DuPont technology with Roundup Ready. Although Monsanto and certain of DuPont's employees expressed concern that commercialization of the product would violate the licensing agreement, development continued, and in 2009, Monsanto sued DuPont in federal district court alleging breach of the licensing agreement and patent infringement. In 2012, the court ruled in Monsanto's favor, and the parties ultimately settled in 2013, with DuPont agreeing to pay Monsanto \$1.75 billion. The litigation also resulted in sanctions against DuPont based on the court's finding that it had litigated in



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bad faith. Following the litigation, which the court described as "disastrous" for DuPont, the Ironworkers plaintiff and other DuPont stockholders made demands on DuPont's board to investigate and consider suit against certain of the company's officers and directors for breaches of fiduciary duties related to the development of the products and the Monsanto lawsuit.

In response to the various demands, the board formed a special committee of independent directors, each of whom had joined the board after the commencement of the Monsanto litigation, to review the demands. The special committee retained outside counsel and conducted a nine-month-long investigation that culminated in a 179-page report,

ultimately recommending against pursuit of any stockholder derivative claim. The full board reviewed and adopted the report and formally rejected the various stockholder demands. The Ironworkers plaintiff subsequently filed its complaint with the court, alleging that failure to pursue the claims was a breach of fiduciary duty. The defendants moved to dismiss for failure to state a claim for a derivative action.

A stockholder derivative claim may be brought in Delaware either by first making a demand on the board to bring the claim or by bringing a case without first making a demand on the board on the basis that doing so would be futile because the board is incapable of making an impartial decision. If a stockholder plaintiff makes a demand on the board before filing suit, as in this case, it “tacitly concedes the independence of a majority of the board to respond,” the effect of which is that the “demand is treated as any other disinterested and independent decision of the board—it is subject to the business judgment rule,” the court said. Therefore, in order to survive a motion to dismiss, the plaintiff must plead facts in its complaint that raise a reasonable doubt that the board’s denial of the stockholder demand was (1) informed (i.e., not grossly negligent), consistent with its duty of care, and (2) in good faith, consistent with its duty of loyalty. The court examined the actions of the board and its special committee and found that the board was, in light

of the extensive investigation and report authored by the special committee, adequately informed (or at least not grossly negligent).

To raise a reasonable doubt about the board’s good faith, the plaintiff was tasked with pleading facts showing that, “despite the facial independence of the board,” the board’s decision was “so inexplicable that a court may reasonably infer that the directors must have been acting for a purpose unaligned with the best interest of the corporation.” Such a standard “goes far beyond showing a questionable or debatable decision” and encompasses “a motive to harm, or [acting] with indifference to harm that will necessarily result from the challenged decision,” the court said. The court characterized the plaintiff’s pleading as a “vehement” disagreement with the committee’s conclusions but held that a disagreement does not alone constitute the requisite pleading of “particularized facts that create a reasonable doubt that the [b]oard acted in what it perceived as the best interests of the corporation.” The court also focused on the committee’s assessment of the relative weight of the risks and costs associated with pursuing the plaintiff’s claims against the possible value of such claims to DuPont. In light of this assessment by the committee, the court determined that the board’s decision was not so clearly erroneous as to raise a reasonable doubt about the board’s good faith. Accordingly, the court granted the motion to dismiss.

Ironworkers clarifies that the standard of review in stockholder demand refusal cases, which implicitly acknowledge that a disinterested and independent board rejected the demand, is the business judgment rule. To survive a motion to dismiss, a plaintiff in such a case must allege facts that raise a reasonable doubt that the board acted in an informed manner and in good faith. In this case, where the board (through an independent committee) performed a lengthy investigation into the claims with the assistance of outside advisers, documented its findings in an exhaustive report and weighed the risks and costs of the litigation against its potential benefits to the company, the court was able to cast aside any notion that the board was grossly negligent or that it acted to harm the company.

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