

# The Rights and Duties of Blockholder Directors

By J. Travis Laster\* and John Mark Zeberkiewicz\*\*

*Delaware corporate law embraces a “board-centric” model of governance contemplating that, as a general matter, all directors will participate in a collective and deliberative decision-making process. Rather than serving as a justification for a board majority to disempower directors elected or appointed by or at the direction of a particular class or series of stock or an insurgent group—which we refer to as “blockholder” directors—this system recognizes the need for a balancing of both majority and minority rights. In this article, we review the rights and duties of all directors and highlight cases where both board majorities and blockholder directors have overstepped their bounds. We caution that board majorities should deliberate carefully before taking action that limits a blockholder director’s rights or excludes the blockholder director from participation in fundamental corporate matters. At the same time, we caution that blockholder directors should take care when exercising their rights, given that their affiliation with investors may make them vulnerable to duty of loyalty claims. We urge both sides to proceed with a sense of empathy toward the other and seek to make reasonable accommodations, and we emphasize the role that experienced corporate counsel can play in mediating disputes, resolving tensions, and striking the appropriate balance in the boardroom.*

## INTRODUCTION

Delaware corporate law rests on the bedrock principle that directors of a Delaware corporation owe fiduciary duties to the corporation for the benefit of all of its stockholders. To fulfill their fiduciary duties, each director must exercise his independent judgment on corporate matters. A director cannot delegate his decision-making responsibility to or defer to the wishes of a subset of the stockholder base, regardless of whether that subset represents a transitory stockholder majority,<sup>1</sup>

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\* J. Travis Laster is a Vice Chancellor of the Court of Chancery of the State of Delaware.

\*\* John Mark Zeberkiewicz is a director of Richards, Layton & Finger, P.A. in Wilmington, Delaware. Richards, Layton & Finger, P.A., was involved in some of the cases discussed herein. The opinions expressed in this article are those of the authors and not those of Richards, Layton & Finger or its clients.

1. See *In re Lear Corp. S’holder Litig.*, 967 A.2d 640, 655 (Del. Ch. 2008) (“Directors are not thermometers, existing to register the ever-changing sentiments of stockholders. . . . During their term of office, directors may take good faith actions that they believe will benefit stockholders, even if they realize that the stockholders do not agree with them.”); *Paramount Commc’ns Inc. v. Time Inc.*, Civ. A. Nos. 10866, 10670, 10935, 1989 WL 79880, at \*30 (Del. Ch. July 14, 1989) (“The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm.”), *aff’d in pertinent part*, 571 A.2d 1140 (Del. 1989); *TW Servs.*,

comprises the holders of a particular class or series of stock with the special right to elect that particular director,<sup>2</sup> or consists of a single controlling stockholder.<sup>3</sup> Incumbent directors often invoke their need to exercise independent fiduciary judgment in M&A settings to justify maintaining the board's chosen course of action rather than choosing an alternative that many stockholders favor.<sup>4</sup> But the

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Inc. v. SWT Acquisition Corp., Civ. A. Nos. 10427, 10298, 1989 WL 20290, at \*8 n.14 (Del. Ch. Mar. 2, 1989) ("While corporate democracy is a pertinent concept, a corporation is not a New England town meeting; directors, not shareholders, have responsibilities to manage the business and affairs of the corporation, subject however to a fiduciary obligation.").

2. See, e.g., *Phillips v. Insituform of N. Am., Inc.*, Civ. A. No. 9173, 1987 WL 16285, at \*10 (Del. Ch. Aug. 27, 1987) (holding that Delaware law "does not recognize a special duty on the part of directors elected by a special class to the class electing them"); see also *In re Trados Inc. S'holder Litig.*, Civ. A. No. 1512-CC, 2009 WL 2225958, at \*7 (Del. Ch. July 24, 2009) (stating that, "in circumstances where the interests of the common stockholders diverge from those of the preferred stockholders, it is possible that a director could breach her duty by improperly favoring the interests of the preferred stockholders over those of the common stockholders" and that the "plaintiff can avoid dismissal if the Complaint contains well-pleaded facts that demonstrate that the director defendants were interested or lacked independence with respect to this decision"). Cf. *Red Oak Fund, L.P. v. Digirad Corp.*, Civ. A. No. 8599-VCN, 2013 WL 5740103, at \*13 (Del. Ch. Oct. 23, 2013) (rejecting insurgent's claim that the board of directors failed to disclose information that would have been helpful to the insurgent because such a duty "clash[ed] with the well-established principles that teach that disclosure of material information . . . must be to all stockholders to inform their voting decisions," such that, if the board in fact owed a duty to disclose the information, "it would have to have been a duty the Board owed to all stockholders" and not a specific duty owed to the insurgent).

3. See *Klaassen v. Allegro Dev. Corp.*, Civ. A. No. 8626-VCL, 2013 WL 5967028, at \*11 (Del. Ch. Nov. 7, 2013) (stating that "corporate directors do not owe fiduciary duties to individual stockholders" but rather "to the entity and to the stockholders as a whole" and that the proposition remains true "even if a single stockholder holds a controlling block"); *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 387 (Del. Ch. 2004) ("The reality is that controlling stockholders have no inalienable right to usurp the authority of boards of directors that they elect. That the majority of a company's voting power is concentrated in one stockholder does not mean that that stockholder must be given a veto over board decisions when such a veto would not also be afforded to dispersed stockholders who collectively own a majority of the votes. Like other stockholders, a controlling stockholder must live with the informed (i.e., sufficiently careful) and good faith (i.e., loyal) business decisions of the directors unless the DGCL requires a vote. That is a central premise of our law, which vests most managerial power over the corporation in the board, and not in the stockholders.").

4. The Airgas, Inc. board's defense against Air Products and Chemicals, Inc.'s hostile takeover attempt—where "Air Products' advances [were] ongoing for over sixteen months, and Airgas's use of its poison pill [provided] the Airgas board over a full year to inform its stockholders about its view of Airgas's intrinsic value and Airgas's value in a sale transaction"—is one of the more notable examples. See *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 57 (Del. Ch. 2011). While the court found that "[a] board cannot 'just say no' to a tender offer," it held that, under Delaware law, a board that in good faith identifies a legitimate threat to the corporate enterprise may take measures to block the bid, thus effectively forcing the hostile bidder to use the ballot box to elect a board majority supportive of the bid. *Id.* at 54. (At the first annual meeting of Airgas's stockholders following Air Products' bid, Air Products had succeeded in electing three of its nominees to Airgas's staggered board. Once installed, however, those directors sided with the incumbents. As the court noted: "Air Products got what it wanted. Its three nominees got elected to the Airgas board and then questioned the directors about their assumptions. (They got answers.) They looked at the numbers themselves. (They were impressed.) They requested outside legal counsel. (They got it.) They requested a third outside financial advisor. (They got it.) And in the end, they joined in the board's view that Air Products' offer was inadequate." *Id.* at 123.) In addressing whether Airgas's board had perceived a legitimate threat, the court posed the following question: "[I]f a majority of stockholders want to tender into an inadequately priced offer, is that substantive coercion? Is that a threat that justifies continued maintenance of the poison pill? Put differently, is there evidence in the record that Airgas stockholders are so 'focused on the short-term' that they would 'take a smaller harvest in the swelter of August over a larger

principles apply equally to intra-board disputes among directors, and they have particular salience when one director is perceived—accurately or inaccurately—to be exercising directorial powers for the benefit of a subset of the stockholder base. Typically this problem arises when one or more directors have been designated by a particular class or series of stockholders or were appointed at the behest of an insurgent group. We refer to these directors as “blockholder directors.”<sup>5</sup>

This article discusses the rights and duties of blockholder directors. It starts from the premise that Delaware corporate law embraces a “board-centric” model of governance. This model expects that all directors will participate in a collective and deliberative decision-making process, and it therefore requires balancing both majority and minority rights. Properly understood, board-centrism is not a justification for a board majority to disempower a blockholder director. At the same time, individual director rights should not become a bludgeon for a boardroom bully to get his way. Not surprisingly, Delaware cases provide examples of situations where board majorities<sup>6</sup> and blockholder directors<sup>7</sup> have overstepped their bounds.

## I. DELAWARE’S BOARD-CENTRIC SYSTEM OF GOVERNANCE

Section 141(a) of the General Corporation Law of the State of Delaware (the “DGCL”) provides that the corporation’s business and affairs are managed by or under the direction of its board of directors.<sup>8</sup> This broad grant of authority confirms that the board of directors—not individual directors, officers, or stockholders—is ultimately responsible for the management of the corporation.<sup>9</sup> The

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one in *Indian Summer?*” *Id.* at 111. On that point, the court found that there was evidence from which it could be inferred that stockholders would tender into an inadequate offer, including that arbitrageurs, many of whom had purchased Airgas stock below the bid price, would be willing to tender into the offer regardless of Airgas’s long-term value. *Id.*

5. Others have called them “constituency directors.” E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761 (2008).

6. See, e.g., *Blaustein v. Lord Baltimore Capital Corp.*, Civ. A. No. 6685-VCN, 2013 WL 1810956 (Del. Ch. Apr. 30, 2013), *aff’d*, 84 A.3d 954 (Del. 2014); *Intrieri v. Avatex Corp.*, Civ. A. No. 16335-NC, 1998 WL 326608 (Del. Ch. June 12, 1998).

7. See, e.g., *Shocking Techs., Inc. v. Michael*, Civ. A. No. 7164-VCN, 2012 WL 4482838, at \*10 (Del. Ch. Oct. 1, 2012); see generally *Zaucha v. Brody*, Civ. A. No. 1568-NC, 1997 WL 305841, at \*3 (Del. Ch. June 3, 1997) (“Although we are not aware of any case where a director has been accused of inequitably manipulating the corporate governance process to oust other directors, presumably the prohibition against inequitable conduct would also apply to a dissident director.”), *aff’d*, 697 A.2d 749 (Del. 1997).

8. DEL. CODE ANN. tit. 8, § 141(a) (2011).

9. See *McMullin v. Beran*, 765 A.2d 910, 916 (Del. 2000) (“One of the fundamental principles of the Delaware General Corporation Law statute is that the business affairs of a corporation are managed by or under the direction of its board of directors.” (citing DEL. CODE ANN. tit. 8, § 141(a)); see also *Norte & Co. v. Manor Healthcare Corp.*, Civ. A. Nos. 6827, 6831, 1985 WL 44684, at \*3 (Del. Ch. Nov. 21, 1985) (“Stockholders are the equitable owners of the corporation’s assets. However, the corporation is the legal owner of its property and the stockholders do not have any specific interest in the assets of the corporation. Instead, they have the right to share in the profits of the company and in the distribution of its assets on liquidation. Consistent with this division of interests, the directors rather than the stockholders manage the business and affairs of the corporation and the directors,

DGCL's approach to corporate governance thus rests on the premise of director primacy and has been described as "board-centric."<sup>10</sup>

To say that Delaware has a board-centric model of governance, however, is not to expect the board to be involved in every decision—or even most decisions. Few modern corporations could function effectively if that was the norm. In fact, it is the rare corporation that is actually "managed by" the board; most corporations are managed "under the direction of" the board.<sup>11</sup> Thus, although "ultimate responsibility" for the direction and management of the corporation lies with the board,<sup>12</sup> "the law recognizes that corporate boards, comprised as they traditionally have been of persons dedicating less than all of their attention to that role, cannot themselves manage the operations of the firm, but may satisfy their obligations by thoughtfully appointing officers, establishing or approving goals and plans and monitoring performance."<sup>13</sup> While "it is the elected board of directors that bears the ultimate duty to manage or supervise the management of the business and affairs of the corporation," the duties of a board that oversees professional management ordinarily entail the obligation "to establish or approve the long-term strategic, financial and organizational goals of the corporation; to approve formal or informal plans for the achievement of these goals; to monitor corporate performance; and to act, when in the good faith, informed judgment of the board it is appropriate to act."<sup>14</sup>

By vesting corporate power in the board of directors, section 141(a) implies that it is the board collectively as a deliberative body, and not a particular subset of directors, that must exercise its authority. A board only can act properly

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in carrying out their duties, act as fiduciaries for the company and its stockholders." (citations omitted)).

10. See Bradley R. Aronstam & David E. Ross, *Retracing Delaware's Corporate Roots Through Recent Decisions: Corporate Foundations Remain Stable While Judicial Standards of Review Continue to Evolve*, 12 DEL. L. REV. 1, 27 (2010) (citing Delaware's "board-centric paradigm"); see also *In re CNX Gas Corp. S'holders Litig.*, Civ. A. No. 5377-VCL, 2010 WL 2705147, at \*10 (Del. Ch. July 5, 2010) (describing role of director primacy and board centrism in Delaware law); cf. *Klaassen v. Allegro Dev. Corp.*, Civ. A. No. 8626-VCL, 2013 WL 5967028, at \*15 (Del. Ch. Nov. 7, 2013) (discussing a competing line of cases and questioning implications of decisions for board centrism).

11. See *In re OPENLANE, Inc. S'holders Litig.*, Civ. A. No. 6849-VCN, 2011 WL 4599662, at \*6 (Del. Ch. Sept. 30, 2011) ("OPENLANE also appears to be one of those seemingly few corporations that is actually 'managed by' as opposed to 'under the direction of' its board of directors.").

12. *Grimes v. Donald*, Civ. A. No. 13358, 1995 WL 54441, at \*1 (Del. Ch. Jan. 11, 1995), *aff'd*, 673 A.2d 1207 (Del. 1996).

13. *Id.* at \*8.

14. *Id.* at \*1. Section 141(a) recognizes this practical reality by providing that the board may manage or "direct" the management of the corporation's business and affairs. DEL. CODE ANN. tit. 8, § 141(a) (2011). So does section 141(e), which extends protection from liability to directors who rely in good faith on other committees of the board, on officers and employees of the corporation, and on experts and advisors who the board reasonably believes are acting within their professional or expert competence and who have been selected with reasonable care. *Id.* § 141(e) ("A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.").

after there has been an opportunity for all directors to participate in the board's decision-making process. The right of every director to have an opportunity to participate in deliberations, and the concomitant right of every other director to benefit from each director's insights, has been recognized in Delaware since 1915. In *Lippman v. Kehoe Stenograph Co.*,<sup>15</sup> the Court of Chancery stated: "Each member of a corporate body has the right to consultation with the others and has the right to be heard upon all questions considered."<sup>16</sup> This rationale animated the *Lippman* court's specific holding that directors may not act by proxy.<sup>17</sup> "Discretionary powers, questions of policy, business administration, all imply the personal attendance at the meeting, so that each director may have the benefit of not only the vote, but the voice of every other director, or at least of enough other directors to constitute a quorum."<sup>18</sup>

The court in *Lippman* addressed action at a traditional meeting where directors would attend in person, which is one of the ways that a board can act.<sup>19</sup> In two subsections addressing the other means by which directors can act, section 141 reinforces the concept of collective deliberation: (i) telephonic meetings and (ii) action by written consent. Technology has changed since 1915, and the DGCL understandably permits directors to meet telephonically or by other means of communications equipment by which all persons can hear each other.<sup>20</sup> Section 141 specifies, however, that a board meeting conducted in this fashion is only

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15. 95 A. 895 (Del. Ch. 1915).

16. *Id.* at 899.

17. *Id.* at 897. The *Lippman* court elaborated at length on this concept:

I am inclined to think that there is a deeper reason [for not permitting action by proxy] based on the association of each director with each of the others, of which association none of the associates can divest himself while remaining a member. In other words, a director cannot authorize any one to act for him, because his associates are entitled to his judgment, experience and business ability, just as his associates cannot deprive him of his rights and powers as director. . . . A director cannot vote by proxy, because his personal judgment is necessary, and he cannot delegate his duties, or assign his powers. Neither can he abdicate them. If not present in person to give out, or receive, business knowledge needed in conducting the affairs of the company he has not performed his duty, because he has not in fact participated in the deliberations of the board. However fully informed he may have been with everything that took place at the meeting, and every word uttered there, and though he afterwards, with this knowledge, approved of and assented to all that was there said and done, still the safe and logical principle persists that he was not validly such a participant in its deliberations and actions as to validate by a subsequent approval thereof the minutes of a meeting at which he was not in fact present in person. To hold any other view, whatever other courts have held, would be opening a door to wide misunderstandings which the stricter rule avoids.

*Id.* at 897, 899. The logical corollary can be seen in *Abercrombie v. Davis*, where the Court of Chancery invalidated an agreement that purported to bind directors in their capacity as such, noting that the agreement "limit[ed] in a substantial way the freedom of director decisions on matters of management policy" and therefore "violate[d] the duty of each director to exercise his own best judgment on matters coming before the board." 123 A.2d 893, 899 (Del. Ch. 1956), *rev'd on other grounds*, 130 A.2d 338 (Del. 1957). The Delaware courts have continued to point to the key role of directors, as articulated in *Abercrombie*, as the basis for the rule that "directors of a corporation cannot act by proxy." See also *In re Acadia Dairies, Inc.*, 135 A. 846, 847 (Del. Ch. 1927).

18. *Lippman*, 95 A. at 899.

19. DEL. CODE ANN. tit. 8, § 141(b) (2011).

20. *Id.* § 141(i).

valid if *all directors* are able to participate and hear one another.<sup>21</sup> The presiding director or even a board majority cannot put one or more directors on mute.

A board of directors also can act by unanimous written consent in lieu of a meeting.<sup>22</sup> The requirement of unanimity for action without a meeting is perhaps the strongest manifestation of the DGCL's expectation that every director will have the opportunity to participate in board decision making. If collective director participation were unimportant, then the delivery of affirmative consents by the number of directors sufficient to take action at a meeting at which all directors were present should constitute board action. Such an approach would parallel the standard for stockholder action by written consent.<sup>23</sup> But this possibility was considered and rejected during the major revision of the DGCL that occurred in 1967. Professor Ernest Folk, the reporter for the committee that shepherded the revisions, addressed the issue in his report:

It is occasionally suggested that non-unanimous written consents should be [] effective. . . . On this theory, a written consent by a majority of directors would be as effective as majority action taken at a duly called meeting. This could, however, raise serious questions as to whether the non-consenting directors had received notice, whereas unanimous written consent ipso facto proves notice actually received. Besides raising more questions than it would solve[,] permitting non-unanimous written consents would make serious inroads upon the concept of meetings as forums in which ideas are exchanged ad [sic] (hopefully) a consensus reached.<sup>24</sup>

The requirement of unanimous written consent applies even if particular directors perceive themselves to have a disabling self-interest.<sup>25</sup> In rejecting an argument that a written consent was valid despite the absence of consents from the conflicted directors, the Court of Chancery has explained, section 141(f) requires "unanimity of the entire board, not just the unanimity of the disinterested directors."<sup>26</sup>

## II. BLOCKHOLDER DIRECTORS AND BOARD DISAGREEMENTS

Early Delaware cases typically dealt with blockholder directors in the parent-subsubsidiary context.<sup>27</sup> In recent years, blockholder director issues have arisen

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21. *Id.*

22. *Id.* § 141(f).

23. *Id.* § 228(a).

24. ERNEST L. FOLK III, REVIEW OF THE DELAWARE CORPORATION LAW FOR THE DELAWARE CORPORATION LAW REVISION COMMITTEE 61 n.2 (1965–67).

25. *Solstice Capital II, Ltd. P'ship v. Ritz*, Civ. A. No. 278-N, 2004 WL 765939, at \*1 (Del. Ch. Apr. 6, 2004).

26. *Id.*

27. See, e.g., *Warshaw v. Calhoun*, 221 A.2d 487, 492 (Del. 1966) ("Individuals who act in a dual capacity as directors of two corporations, one of whom is parent and the other subsidiary, owe the same duty of good management to both corporations."); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 719 (Del. 1971) ("Sinclair nominates all members of Sinven's board of directors. The Chancellor found as a fact that the directors were not independent of Sinclair. Almost without exception, they were officers, directors, or employees of corporations in the Sinclair complex. By reason of Sinclair's domination, it is clear that Sinclair owed Sinven a fiduciary duty.").

with greater frequency and in a variety of contexts. One common situation involves venture-backed private companies that are organized such that control at the board level is divided between the founders, who hold common stock, and one or more of the venture capital funds, which own one or more series of preferred stock. It is not uncommon for the certificate of incorporation to grant the holders of the different series of preferred stock separate rights to elect directors. Another common blockholder director situation involves public companies that have been the subject of a short-slate proxy contest. A hedge fund or activist investor often leads the proxy contest and may place director representatives on the board as a result of a settlement or a successful vote. The right to appoint a director also may accompany a so-called private-investment-in-public-equity, or PIPE, transaction.

Regardless of how a blockholder director joins the board, the result can be unsettling. The duty to monitor corporate performance is one area where conflicts involving blockholder directors can arise. Blockholder directors with large ownership stakes often have more “skin in the game” than traditional outside directors and hence have a greater economic motivation to monitor management. If blockholder directors have been elected by or appointed at the behest of insurgents, then they may join the board with a platform for change that includes fixing perceived oversight failures. Blockholder directors thus frequently have different views about matters like the type and degree of information that management should provide, the timeliness of management’s responsiveness, and what issues should be vetted with the board. One person’s monitoring is another’s harassment.

Decisions where the DGCL requires board-level action provide specific occasions for conflict. Mergers, charter amendments, and sales of all or substantially all of the corporation’s assets require board action.<sup>28</sup> Other areas where Delaware decisions require board involvement include the statutorily mandated duty to determine the value of the property acquired as consideration for shares of stock<sup>29</sup> and the duty to fix the consideration received for the creation and issuance of stock options.<sup>30</sup> Delaware decisions have invalidated corporate actions where the DGCL called for a board determination followed by a stockholder vote, and the corporation did not follow the required sequence.<sup>31</sup> The Delaware Supreme Court has held that when a board must make a determination, it must do so on an informed basis and cannot justify its decision based on what happens

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28. See DEL. CODE ANN. tit. 8, § 242 (2011) (amendments to the certificate of incorporation); *id.* § 251 (mergers); *id.* § 271 (sale of all or substantially all of the corporation’s assets).

29. *Id.* §§ 152, 153; see, e.g., *Field v. Carlisle Corp.*, 68 A.2d 817 (Del. Ch. 1949).

30. DEL. CODE ANN. tit. 8, § 157 (2011); see, e.g., *Olson v. ev3, Inc.*, Civ. A. No. 5583-VCL, 2011 WL 704409 (Del. Ch. Feb. 21, 2011).

31. See, e.g., *Blades v. Wisheart*, Civ. A. No. 5317-VCS, 2010 WL 4638603 (Del. Ch. Nov. 17, 2010), *aff’d sub nom. Wetzel v. Blades*, 35 A.3d 420 (Del. 2011) (table) (invalidating a charter amendment not authorized in the precise sequence required by section 242 of the DGCL); *Tansey v. Trade Show News Networks, Inc.*, Civ. A. No. 18796, 2001 WL 1526306, at \*7 (Del. Ch. Nov. 27, 2001) (invalidating a merger not authorized in the precise sequence required by section 251).

after the fact.<sup>32</sup> The Delaware Supreme Court also has held that when a board has a duty to recommend a transaction to stockholders, the board must maintain a truthful and accurate recommendation until the stockholder vote.<sup>33</sup>

The necessity for board involvement in these areas means that any disagreements between a blockholder director and the rest of the board cannot be swept under the rug. Unfortunately, in an effort to avoid or delay conflict, management teams sometimes try to delay the point in time at which they inform the board

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32. This was the most famous of several important holdings in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). The plaintiff in *Van Gorkom* brought a class action challenging a cash-out merger of defendant Trans Union Corporation into a wholly owned subsidiary of Marmon Group, Inc. After trial, the Court of Chancery granted judgment in favor of the defendants based, in part, on a finding that the Trans Union board “had acted in an informed manner so as to be entitled to the protection of the business judgment rule in approving the cash-out merger.” *Id.* at 864. On appeal, the plaintiff argued that the Court of Chancery had erred by giving the director defendants credit for information presented to them *after* the original merger agreement was executed. *Id.* at 887. The Delaware Supreme Court agreed with the plaintiff, holding that directors have a duty under section 251 of the DGCL to act in an informed and deliberate manner in determining whether to approve a merger prior to its submission to stockholders and that the Trans Union directors breached their duty of care. *Id.* at 873–74 (“Certainly in the merger context, a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement.”); *see also* Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc., 532 A.2d 1324, 1338 (Del. Ch. 1987) (holding that the board, “in carrying out its affirmative duty to protect the interests of the minority, could not abdicate its obligation to make an informed decision on the fairness of the merger by simply deferring to the judgment of the controlling stockholder”).

33. *See In re Primedia S’holders Litig.*, 67 A.3d 455, 490–92 (Del. Ch. 2013). This holding was an equally important, albeit less frequently acknowledged, result of *Van Gorkom*. In defending against the plaintiff’s claims in *Van Gorkom*, the director defendants pointed to the minutes of a meeting held after the original merger agreement was signed. The minutes reflected that the board believed that it had three options: “(1) to ‘continue to recommend’ the [] merger; (2) to ‘recommend that the stockholders vote against’ the [] merger; or (3) to take a noncommittal position on the merger and ‘simply leave the decision to stockholders.’” *Van Gorkom*, 488 A.2d at 887–88. The Delaware Supreme Court rejected options (2) and (3) as “not viable or legally available to the Board under 8 Del. C. § 251(b).” *Id.* at 888. The Delaware Supreme Court explained that “[t]he Board could not remain committed to the . . . merger and yet recommend that its stockholders vote it down; nor could it take a neutral position and delegate to the stockholders the unadvised decision as to whether to accept or reject the merger.” *Id.* The Delaware Supreme Court also rejected the argument that the board’s fiduciary duties gave it the option to terminate the merger (i.e., option 2). Instead, the court stated that “the second course of action would have clearly involved a substantial risk—that the Board would be faced with suit by [the buyer] for breach of contract.” *Id.* The court’s reasoning was that, in the absence of an express fiduciary out contained in the merger agreement, “the Board was not ‘free’ to withdraw from its agreement . . . by simply relying on its self-induced failure to have reached an informed business judgment at the time of its original agreement.” *Id.*; *see also* Transcript of Oral Argument at 91, *Global Asset Capital, LLC v. Rubicon US REIT, Inc.*, C.A. No. 5071-VCL (Del. Ch. Nov. 16, 2009) (“I don’t regard fiduciary outs as inherent in every agreement. I think that would be contrary to Supreme Court precedent.”); *see generally* J. Travis Laster, *Omnicare’s Silver Lining*, 38 J. CORP. L. 795, 818–27 (2013) (discussing ability of informed and loyal board under Delaware law to enter into exclusive merger agreement without a fiduciary out). Years after *Van Gorkom*, the Delaware General Assembly amended section 251 of the DGCL to provide that the terms of a merger agreement could permit a board of directors to submit the merger agreement to a vote of stockholders even if the board determines, “at any time subsequent to declaring [the merger agreement’s] advisability[,] that the agreement is no longer advisable and recommends that the stockholders reject it.” 71 Del. Laws ch. 339, § 44 (1998). In 2003, the Delaware General Assembly expanded the “change of recommendation” provisions included in section 251 to all matters that may be submitted to a vote of stockholders. *See* DEL. CODE ANN. tit. 8, § 146 (2011). These statutory provisions reinforce the board’s obligation to update its recommendation, although they permit a transaction agreement to provide that it will remain in effect notwithstanding a change of recommendation.

about the transaction, or limit the scope of the information they provide. Management teams also may communicate with subsets of directors. As with the appropriate level of director oversight, reasonable minds can disagree about when the board should be brought into the transaction planning process and how much involvement and information is sufficient.

If the majority directors have come to view a blockholder director as a dissident, or obstructionist, or out of step with the rest of the board, they may be inclined to discount that director's views.<sup>34</sup> There is a risk that, if the majority directors have come to view a blockholder director in that fashion, then they may come to believe that it does not matter whether such blockholder participates in board meetings, because he would not be able to convince the board as a whole to take a different action and would in any event be outvoted. Delaware law, however, does not countenance this argument. As the court in *Lippman* explained, "it is presumed that if the absent members had been present they might have dissented and their arguments might have convinced the majority of the un wisdom of their proposed action, and thus have produced a different result."<sup>35</sup> Consequently, every blockholder director has the right to participate in deliberations of the full board, regardless of the views of a majority of the directors or how the majority may feel about a particular director.

### III. CORE DIRECTOR RIGHTS

What, then, are the core board rights that all directors should enjoy, regardless of affiliation? The DGCL's board-centric structure suggests the answer. Given that the DGCL allocates fundamental decision-making power to the board as a whole, and not to any individual director *qua* director, all directors must have the opportunity to participate meaningfully in any matter brought before the board and to discharge their oversight responsibilities. In more granular terms, directors must be afforded, at a minimum, (i) proper notice of all board meetings, (ii) the opportunity to attend and to express their views at board meetings, and (iii) access to all information that is necessary or appropriate to discharge their fiduciary duties, including the opportunity to consult with officers, employees, and other agents of the corporation. Delaware law clearly protects these rights of directors, regardless of whether they were designated by or at the direction of a specific stockholder or group of stockholders. Less clear, however, is what a particular director can do with the information, such as whether the director can share it with the stockholder he represents. Also unclear is the degree to which, or the circumstances under which, the board can limit (or effectively restrict or circumvent) a blockholder director's exercise of any such rights.

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34. The technical term for this habit is "reactive devaluation." See Lee Ross & Constance Stillinger, *Barriers to Conflict Resolution*, 7 NEGOTIATION J. 389, 394-95 (1991). Reactive devaluation is a cognitive bias that results in persons having a tendency to devalue ideas that are believed to have originated from an antagonist. See *id.*

35. *Lippman v. Kehoe Stenograph Co.*, 95 A. 895, 899 (Del. Ch. 1915).

### A. THE RIGHT TO NOTICE OF MEETINGS

Although the DGCL does not expressly address the nature, form, or timing of notices to directors of board meetings, Delaware law clearly requires that all directors be given notice. This requirement is a natural extension of Delaware's board-centric model of governance. To be able to participate in the board's decision-making process, every director must have a reasonable opportunity to attend each meeting of the board. Thus, the right to proper notice of, and to be present at, each meeting of the board flows from the directors' bedrock right to participate in board meetings. With respect to regular meetings of the board, the requirement is frequently satisfied. Regular meetings are scheduled well in advance; each director has ample advance notice of the scheduled meeting dates and times and can adjust his schedule accordingly.

The same is not true for special meetings, which by definition do not occur on a regular schedule established well in advance. For action at a special meeting of the board to be valid, each director must receive sufficient notice of the meeting such that he will have a reasonable opportunity to attend and participate in the meeting. In general, for notice of a special meeting to be properly given, the person or body calling the meeting must satisfy the minimum requirements set forth in the bylaws governing notice of special meetings. Whether a notice is proper under the circumstances, however, may be subject to equitable review.

The Delaware cases addressing the sufficiency of notice of board meetings have traditionally described actions taken at a meeting for which notice was not properly given as "void."<sup>36</sup> In *Klaassen v. Allegro Development Corp.*,<sup>37</sup> however, the Court of Chancery considered whether such precedent in fact required a finding that the actions were "void"—in the sense that they would be deemed invalid from the outset and therefore not susceptible to cure by ratification<sup>38</sup>—or whether it gave rise to a finding that the actions were "voidable" and therefore susceptible to cure.<sup>39</sup> *Klaassen* involved an action brought pursuant to section 225 of the DGCL in which Eldon Klaassen sought a determination that he remained CEO of Allegro Development Corporation because the rest of the board had failed to give him advance notice that they would be considering his removal at a regular board meeting. Klaassen also sought a determination that he had filled a vacant board seat that the CEO had the power under a stockholders' agreement to fill and that, as the holder of nearly all of Allegro's common stock (which constituted a majority of Allegro's voting power), he had validly removed two incumbent directors and filled the resulting vacancies. The other four directors who participated in the disputed meeting contended that they had removed Klaassen as CEO and appointed a new CEO, and that the

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36. See *infra* note 41.

37. Civ. A. No. 8626-VCL, 2013 WL 5739680 (Del. Ch. Oct. 11, 2013), *aff'd*, 82 A.3d 730 (Del. 2013) (table).

38. *Id.* at \*15.

39. *Id.*

new CEO occupied a board seat designated under the stockholders' agreement for the CEO.<sup>40</sup>

As a result of the interplay between the stockholders' agreement and Allegro's charter, some (but not all) of Klaassen's actions were valid. Most significantly, he was unable to accomplish one of his principal goals—re-appointing himself as CEO—despite the other directors' failure to give Klaassen advance notice that they would be considering his removal at a regularly scheduled board meeting. Klaassen argued that he was entitled to advance notice of this particular item of business under four Delaware Chancery Court decisions which, he claimed, created “a special equitable notice requirement for an officer who is also a director and who can exercise a right that could potentially change the composition of the board.”<sup>41</sup> Klaassen argued that, because he was not given prior notice that his removal would be considered, he was denied the opportunity to exercise his voting power to defend himself, and the board's action to remove him was therefore invalid.<sup>42</sup>

Klaassen waited a long time before bringing his section 225 action, which rendered his claims vulnerable to the equitable defense of laches.<sup>43</sup> To avoid the laches defense, Klaassen argued that the lack of notice rendered the board actions void, rather than voidable, and that void acts could not be ratified or protected by equitable defenses.<sup>44</sup> After reviewing Delaware authorities addressing the distinction between void and voidable acts, the Court of Chancery concluded that “Delaware law distinguishes between (i) a failure to give notice of a board meeting in the specific manner required by the bylaws and (ii) a contention that the lack of notice was inequitable. In the former scenario, board action taken at the meeting is void. In the latter scenario, board action is voidable in equity, so equitable defenses apply.”<sup>45</sup> Klaassen claimed an equitable notice right, which could be and was defeated by the equitable defense of laches.

Affirming the Court of Chancery's judgment, the Delaware Supreme Court held that Klaassen's claim was equitable such that the board's removal of Klaassen

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40. *Id.* at \*1.

41. *Id.* at \*14. The four decisions on which Klaassen relied were *Fogel v. U.S. Energy Systems, Inc.*, Civ. A. No. 3271-CC, 2007 WL 4438978 (Del. Ch. Dec. 13, 2007); *Adlerstein v. Wertheimer*, Civ. A. No. 19101, 2002 WL 205684 (Del. Ch. Jan. 25, 2002); *VGS, Inc. v. Castiel*, Civ. A. No. 17995, 2000 WL 1277372 (Del. Ch. Aug. 31, 2000), *aff'd*, 781 A.2d 696 (Del. 2001) (order); and *Koch v. Stearn*, Civ. A. No. 12515, 1992 WL 181717 (Del. Ch. July 28, 1992). *Klaassen*, 2013 WL 5739680, at \*14 n.6.

42. *Id.* at \*14.

43. See *Reid v. Spazio*, 970 A.2d 176, 182–83 (Del. 2009) (“Laches is an equitable defense born from the longstanding maxim ‘equity aids the vigilant, not those who slumber on their rights.’ Although there is no hard and fast rule as to what constitutes laches, it is generally defined as an unreasonable delay by the plaintiff in bringing suit after the plaintiff learned of an infringement of his rights, thereby resulting in material prejudice to the defendant. Therefore, ‘laches generally requires the establishment of three things: first, knowledge by the claimant; second, unreasonable delay in bringing the claim; and third, resulting prejudice to the defendant.’” (citations and notes omitted)).

44. *Klaassen*, 2013 WL 5739680, at \*15.

45. *Id.* at \*19. Since *Klaassen*, sections 204 and 205 of the DGCL, which allow for the ratification of “defective corporate acts,” including acts taken in contravention of the bylaws, have become effective. See DEL. CODE ANN. tit. 8, §§ 204, 205 (2011).

was voidable, not void, and subject to the equitable defenses.<sup>46</sup> The Delaware Supreme Court agreed that the language of prior opinions had been imprecise and overruled those decisions “[t]o the extent that [they] can fairly be read to hold that board action taken in violation of an equitable rule is void.”<sup>47</sup> The Supreme Court reiterated that “corporate directors are not required to be given notice of regular board meetings.”<sup>48</sup> The Supreme Court also confirmed that, if the bylaws do not contain any notice requirements regarding agenda items to be presented at regular board meetings, then advance notice of those matters is not required.<sup>49</sup> Because Klaassen had been removed at a regular meeting, those rules permitted the other directors to forgo giving Klaassen advance notice that they were planning to remove him.

It is important, however, to consider the negative implications of the Supreme Court’s opinion—particularly in situations when a board plans to act at a special meeting. If a blockholder director becomes viewed by a majority of the board as an adversary, there may be a tendency on the part of the remaining directors or incumbent management to withhold notice from the blockholder director until shortly before the meeting, or to omit reference to specific agenda items. This type of conduct not only raises equitable concerns, it has the potential of resulting in a violation of the bylaws’ notice provisions, thus rendering the acts taken at any meeting void.<sup>50</sup>

## B. THE RIGHT TO RECEIVE AND CONSIDER INFORMATION

To be able to participate meaningfully in the board’s decision-making process, all directors also must have access to information regarding the business and affairs of the corporation. A director cannot make intelligent decisions if he does not have sufficient information regarding the matter under consideration. Access to information is a predicate to a director’s discharge of his fundamental duty of care.<sup>51</sup> The Delaware courts have accordingly been highly protective of directors’

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46. *Klaassen v. Allegro Dev. Corp.*, No. 583, 2013, 2014 WL 996375, at \*1 (Del. Mar. 14, 2014).

47. *Id.* at \*8.

48. *Id.* at \*6.

49. *Id.*

50. For example, the Court of Chancery enjoined a transaction by which Morgans Hotel Group Co. would exchange one of its key assets, the Delano South Beach Hotel in Miami, for shares of preferred stock and bonds held by Yucaipa Companies LLC and would issue stock to existing shareholders. *Kalisman v. Friedman*, C.A. No. 8447-VCL (Del. Ch. May 14, 2013) (telephonic rulings of the court from oral argument on plaintiffs’ motion for a preliminary injunction). The court stated that it was “enjoining the defendants from implementing any of the resolutions taken by the board on March 30, 2013 because of inadequate notice and other process failures.” *Id.* at 5. After noting that the injunction would continue until the earlier of trial on the merits or the board’s decision with respect to the transaction at a properly noticed meeting, the court stated: “I’m not saying how the board has to decide at its redone meeting. Part of the premise of Delaware law is that people will talk about [] things and, with the benefit of having time to actually consider the materials and raise points that 400 pages of documents might suggest, could potentially reach different conclusions than were reached before.” *Id.* at 6–7.

51. See *Henshaw v. Am. Cement Corp.*, 252 A.2d 125, 128 (Del. Ch. 1969) (stating that “in order to meet his obligation[s],” a director “must have access to books and records; indeed he often has a duty to consult them”).

informational rights. In *Holdgreiwe v. Nostalgia Network, Inc.*, the Court of Chancery stated that “[t]he rights of directors to access[] the corporate books and records are recognized by Delaware law as of fundamental importance and a necessary concomitant to the imposition upon directors of fiduciary duties.”<sup>52</sup>

Given the manner in which information is generally furnished to directors (i.e., by or at the direction of the corporate secretary or other members of management), it is critical for the full board to impress upon management their duty to discharge such duty fairly and impartially. In *Intrieri v. Avatex Corp.*, the Court of Chancery stated that a sitting director “certainly is entitled to receive whatever the other directors are given.”<sup>53</sup> In *Hall v. Search Capital*, then-Vice Chancellor Jacobs noted that management “cannot pick and choose which directors will receive . . . information.”<sup>54</sup> The need for an even playing field flows from the foundational premise of director deliberation. Informational asymmetries will necessarily affect the tenor of the discussion and bias the decision-making process. Failure to provide equal access to information impinges on the statutory structure of collective decision making established by section 141(a). The failure by an officer or director to provide information regarding the corporation to the board, or a group of directors who direct that information not be furnished to one or more directors, may constitute a breach of fiduciary duty on the part of the officers or directors responsible for the failure.<sup>55</sup>

Notably, however, the right to receive information is not limited to information distributed by management, nor is it limited to matters that management has included in the agenda for the board’s meeting. As indicated above, directors are required to discharge a key oversight function. In discharging their duty of oversight, directors must have access to information regarding the corporation and its operations, including information that management may prefer that they not see. Therefore, a director generally has the right to request and receive information beyond that which management furnishes to the board in connection with regular or special board meetings, or in connection with any request for action by consent in lieu of a meeting. Directors’ informational rights are effectively guaranteed by statute.<sup>56</sup> The Delaware courts have described the directors’ right to

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52. Civ. A. No. 12914, 1993 WL 144604, at \*3 (Del. Ch. Apr. 29, 1993).

53. Civ. A. No. 16335-NC, 1998 WL 326608, at \*1 (Del. Ch. June 12, 1998); see also *Hall v. Search Capital Grp., Inc.*, Civ. A. No. 15264, 1996 WL 696921, at \*2 (Del. Ch. Nov. 15, 1996) (“Absent a governance agreement to the contrary, each director is entitled to receive the same information furnished to his or her fellow board members.”).

54. *Hall*, 1996 WL 696921, at \*2.

55. See, e.g., *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009) (holding that the alleged efforts of two officers to “sabotage” a due diligence process in a change-of-control context made it reasonable to infer that those officers had breached their fiduciary duties).

56. DEL. CODE ANN. tit. 8, § 220(d) (2011) (“Any director shall have the right to examine the corporation’s stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to the director’s position as a director. The Court of Chancery is hereby vested with the exclusive jurisdiction to determine whether a director is entitled to the inspection sought. The Court may summarily order the corporation to permit the director to inspect any and all books and records, the stock ledger and the list of stockholders and to make copies or extracts therefrom. The burden of proof shall be upon the corporation to establish that the inspection such director seeks is for an improper purpose. The Court may, in its discretion, prescribe any limitations or conditions

information as “essentially unfettered in nature.”<sup>57</sup> As a general matter, so long as the director’s request is for a “proper purpose”—that is, a purpose that is reasonably related to the director’s position as a director—a court will order the corporation to provide the director with access to the information he seeks.<sup>58</sup>

In situations in which a blockholder director who is viewed as an adversary serves on the board, the risk that information will be doled selectively in “one-on-one” meetings or in small-group communications becomes heightened. A similar but related risk—that the distribution of information will be delayed until the proverbial last moment—is likewise present. In many cases, the directors who have the trust and ear of management generally will have had an opportunity to preview the information (or will be familiar with the substance). The blockholder director, on the other hand, will not have had an opportunity to review the information and evaluate the merits or wisdom of any proposed course of action. These types of restrictions on the flow of information present grave equitable concerns. Any officers or directors who engage in selective or manipulative information sharing will be hard pressed to justify their actions from a fiduciary duty standpoint. As detailed at length above, Delaware law’s board-centric model of governance presumes that the corporation is being managed and directed by directors who are operating on the basis of full information—and who have an opportunity to present their views to all other directors, so that the board as a group can make what it believes to be the best decision. Accordingly, it will generally be difficult for management to justify withholding information from one or more specific directors, although there are circumstances under which such treatment may be warranted.<sup>59</sup>

An equally important aspect of the director’s right to information is the ability to access privileged materials. In *Moore Business Forms, Inc. v. Cordant Holdings Corp.*, the Court of Chancery explained that, as a general matter, “a corporation cannot assert the privilege to deny a director access to legal advice furnished to the board during the director’s tenure.”<sup>60</sup> The rationale for this rule is that “all directors are responsible for the proper management of the corporation, and thus, should be treated as a ‘joint client’ . . . when legal advice is rendered to the corporation through one of its officers or directors.”<sup>61</sup>

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with reference to the inspection, or award such other and further relief as the Court may deem just and proper.”) Notably, the statutory predicates for a director’s demand for books and records are less restrictive than those applicable to a stockholder’s request for books and records. See *id.* § 220(a)–(c).

57. *Schoon v. Troy Corp.*, Civ. A. No. 1677-N, 2006 WL 1851481, at \*1 n.8 (Del. Ch. June 27, 2006) (quoting Transcript of Record at 3, *Milstein v. DEC Ins. Brokerage Corp.*, Civ. A. Nos. 17586, 17587 (Del. Ch. Feb. 1, 2000)).

58. *Schoon*, 2006 WL 1851481, at \*1 (denying a director’s request for access to information on the grounds that the request was not made for a purpose related to his directorial duties).

59. See, e.g., *Kalisman v. Friedman*, Civ. A. No. 8447-VCL, 2013 WL 1668205, at \*4–5 (Del. Ch. Apr. 17, 2013) (noting circumstances under which a director’s access to privileged information may be restricted).

60. Civ. A. Nos. 13911, 14595, 1996 WL 307444, at \*4 (Del. Ch. June 4, 1996).

61. Donald J. Wolfe, Jr. & Michael A. Pittenger, *CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY* § 7.02[d], at 7-52 (2014); see *Moore*, 1996 WL 307444, at \*4 n.4 (same); *Kirby v. Kirby*, 1987 WL 14862, at \*7 (Del. Ch. July 29, 1987) (same).

In practical terms, this rule means that, in the event a dispute arises over the types of information that the corporation has been providing (or failing to provide) to directors or over the timing of the distribution, and the aggrieved blockholder director decides to file suit, the corporation may not be able to invoke the attorney-client privilege to protect the correspondence and documents in which the incumbent management strategized over what materials to provide to which directors and when to provide them.

### C. ACCESS TO PERSONAL ADVISORS

Consistent with their duty of care, directors must have an opportunity to review and consider all information material to the decision they are being asked to make. Thus, directors generally must have the right to consult with their own counsel and other advisors to assist in their evaluation of the materials presented to them by management or their fellow directors.

While there are no clear Delaware cases on point, a strong argument may be made, by analogy to section 220(d) of the DGCL, that directors generally cannot be prevented from consulting with their own advisors in discharging their fiduciary duties. Even before the enactment of the current iteration of section 220(d), the Delaware courts had recognized an almost absolute right of directors to examine the corporation's books and records, and to rely on advisors in doing so.<sup>62</sup> An early Delaware case explained that "the right of a Director to examine books grows out of the fact that he is a representative of all the stockholders and, in a sense, a managing partner of the corporation."<sup>63</sup> The opinion further explained that "it is such Director's right and, perhaps, his duty to satisfy himself of the correctness of corporate procedure and to familiarize himself with the company's affairs."<sup>64</sup> Because a director, in seeking to examine the corporation's records, acts as a representative of all stockholders, a "director need not state to his fellow Directors the reason for a desired examination by him of the corporate records, and [his] fellow Directors cannot require such reasons."<sup>65</sup> Having provided this analysis, the decision then addressed the narrow question of whether the director was required to be personally present to conduct the inspection of corporate records, or whether that inspection could be conducted through agents:

There is no question of any delegation of authority or duty resting upon the Director. That authority and duty still remain. There is merely the employment of assistance in acquiring the information requisite in one in a position of trust and responsibility. Our Courts in recent years have seen the directorate of a corporation include those of a foreign nation without any ability to speak or read the English language and to whom, without assistance the corporate books would have no meaning. We have seen a Director totally unable to see. Any requirement that these Directors

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62. *State ex rel. Dixon v. Mo.-Kan. Pipe Line Co.*, 36 A.2d 29 (Del. Super. Ct. 1944).

63. *Id.* at 31.

64. *Id.*

65. *Id.*

be personally present at any examination of corporate books or records would, we think, be wholly devoid of reason.<sup>66</sup>

While not squarely addressing the issue of whether a director may have his attorneys present at a meeting of the board, this reasoning—that the director remains the responsible fiduciary and that the advisors serve to facilitate the director's fiduciary decision-making function—supports the argument that individual directors generally should be permitted to have their advisors present for board meetings to assist with the discharge of their duties on behalf of the corporation and all of its stockholders.<sup>67</sup> There is arguably no principled distinction between what is necessary for a director to understand fixed information created in the past (i.e., books and records) as opposed to information being presented to the board in real time. By analogy, a director generally should be able to have a personal advisor present in the boardroom to assist the director in understanding the information being presented for the purpose of discharging his fiduciary duties to the corporation and all of its stockholders.

The idea that directors could bring personal advisors into the boardroom, however, is understandably not warmly received by management, corporate counsel, and other directors. There is a natural concern that if a director brings a lawyer or other advisors to the meeting, then those advisors will speak out and dominate the conversation. There is also an understandable concern that if one director retains and brings personal counsel or advisors, then other directors will feel the need to bring their own personal advisors. The number of people involved in the meeting could grow to the point where the meeting becomes dysfunctional.

As with many issues, there is a range of reasonable positions on the use of advisors, as well as points where a court would grant equitable relief, either to the director or to the remainder of the board. For example, the premise of board-centric governance is that the directors have the right to deliberate and share views at the meeting. If a director was using counsel or other advisors as his mouthpiece or to dominate a meeting or advocate an agenda that diverges from the director's duty to advance the interests of the corporation and all of its stockholders, a board would have stronger grounds to regulate the involvement of those advisors. A line could be drawn between having the advisors present so they could hear the proceedings and assist the director versus allowing the advisors to participate actively in the meeting. By contrast, if management was making a presentation about a highly technical issue and the director wanted the assistance of a technical expert who could question management, then a restriction barring the advisor from participating may be more difficult to justify. Reflecting the need for case-by-case balancing, a leading treatise states that “[a]s a

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66. *Id.* at 32.

67. See *Holdgreiwe v. Nostalgia Network, Inc.*, Civ. A. No. 12914, 1993 WL 144604, at \*7 (Del. Ch. Apr. 29, 1993) (refusing to permit a director to inspect books and records using conflicted professionals, such as “accountants, lawyers or other advisors,” thereby implying that he could use other, non-conflicted advisors).

general rule, directors may be allowed to have their own counsel present, but a board of directors may be able to exclude a director's personal lawyer.<sup>68</sup> The same treatise suggests that the certificate of incorporation and bylaws may restrict the presence of non-directors at board meetings.<sup>69</sup> How a court rules in a particular dispute involving a director's personal advisors will likely depend heavily on the facts and equities of the case and whether the respective parties involved appear to have acted reasonably.

#### IV. CORE DIRECTOR DUTIES

A director's rights flow from his *statutory* obligation to manage and oversee the business and affairs of the corporation and his fiduciary obligations to do so loyally and with due care. But at the same time, the director's fiduciary obligations impose duties upon the director. At their core, a director's fiduciary duties require that the director act prudently and in good faith "to promote the value of the corporation for the benefit of its stockholders."<sup>70</sup> The reference to "stockholders" means all of the corporation's stockholders as a collective.<sup>71</sup> It means the stockholders as a whole, without reference to any of their special contractual rights, which is what academics refer to as the "single owner standard."<sup>72</sup> Because blockholder directors are often affiliated with entities whose interests may differ from those of the stockholders as a whole, and because blockholders are often dual fiduciaries who also owe a duty of loyalty to their differently situated entities, this standard poses particular risks for blockholder directors.

One heightened risk faced by a blockholder director is an inference of conflict that may arise from a different investment time horizon. Under the DGCL, unless a Delaware corporation provides otherwise in its certificate of incorporation, its existence is perpetual.<sup>73</sup> Capital that is provided to the corporation in exchange for an equity interest in the corporation, whether the investment is made in the form of shares of common stock or preferred stock, is permanent capital.<sup>74</sup> The directors' fiduciary duties therefore require that they maximize the value of the corporation over the long term for the benefit of the providers of long-term (i.e., presumptively permanent) capital.<sup>75</sup>

Blockholder directors, however, may have different investment horizons and objectives. Activist investors are frequently viewed as event-driven, short-term investors—a reputation that is not entirely undeserved. In a memorandum dated

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68. 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS* § 4.8[B], at 4-25 (Supp. 2014) (footnote omitted).

69. *Id.* § 4.8[B], at 4-25 n.127.

70. *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010).

71. *See supra* note 1.

72. *See, e.g.*, Alan Schwartz, *The Fairness of Tender Offer Prices in Utilitarian Theory*, 17 J. LEGAL STUD. 165, 166 (1988).

73. DEL. CODE ANN. tit. 8, §§ 102(b)(5), 122(1) (2011).

74. *See In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 37-38 (Del. Ch. 2013).

75. The Delaware Supreme Court made a similar point in *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009), where it recognized that "enhancing the corporation's long term share value" is a "distinctively corporate concern." *Id.* at 706.

August 8, 2013, prominent corporate lawyer Martin Lipton described the pressures that U.S. companies face to deliver short-term results, stating:

These challenges are exacerbated by the ease with which activist hedge funds can, without consequence, advance their own goals and agendas by exploiting the current regulatory and institutional environment and credibly threatening to disrupt corporate functioning if their demands are not met. Activist hedge funds typically focus on immediate steps, such as a leveraged recapitalization, a split-up of the company or sales or spinoffs of assets or businesses that may create an increase in the company's near term stock price, allowing the activist to sell out at a profit, but leave the company to cope with the increased risk and decreased flexibility that these steps may produce.<sup>76</sup>

Chief Justice (then-Chancellor) Strine has expressed a similar degree of skepticism about the motives of so-called activist investors, stating:

[M]any activist investors hold their stock for a very short period of time and may have the potential to reap profits based on short-term trading strategies that arbitrage corporate policies. . . . [T]here is a danger that activist stockholders will make proposals motivated by interests other than maximizing the long-term, sustainable profitability of the corporation.<sup>77</sup>

Like the activist investors, many venture capital funds invest in start-up or mid-stage corporations with a particular investment horizon in mind, giving rise to the risk of proposals designed solely to provide an exit opportunity.<sup>78</sup> A blockholder director who also serves in a fiduciary capacity for such an investor can face a conflict of interest: the blockholder director's duties to the corporation require that the director manage for the long term, while the blockholder director's duties to the investor require that the director manage for an exit.

For a blockholder director, the conflict of interest poses serious risk because it creates exposure to a claim for a loyalty breach. Delaware law presumes that directors act loyally and in good faith, which is a subsidiary element of the duty of loyalty.<sup>79</sup> A plaintiff can rebut the presumption as to a particular director by showing that the director was interested in the transaction or was not independent of someone who was interested in the transaction.<sup>80</sup> But as the Delaware Supreme Court explained in *In re Walt Disney Co. Derivative Litigation*,<sup>81</sup> a plaintiff also can seek to rebut the presumption of loyalty by demonstrating that the

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76. Martin Lipton, *Current Thoughts About Activism*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Aug. 8, 2013, 9:15 AM), <http://blogs.law.harvard.edu/corpgov/2013/08/09/current-thoughts-about-activism/>.

77. Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 8 (2010) (footnote omitted).

78. See, e.g., *In re Trados Inc. S'holder Litig.*, Civ. A. No. 1512-CC, 2009 WL 2225958 (Del. Ch. July 24, 2009).

79. See *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 37 n.5 (Del. Ch. 2013).

80. See generally *Emerald Partners v. Berlin*, 726 A.2d 1215, 1221 (Del. 1999) (citing *Cinerama, Inc. v. Technicolor Inc.*, 663 A.2d 1156, 1162-64 (Del. 1995); *In re Tri-Star Pictures, Inc.*, Litig., 634 A.2d 319, 333 (Del. 1993)).

81. 906 A.2d 27 (Del. 2006).

director failed to pursue the best interests of the corporation and its stockholders (without regard to any special contractual rights) and therefore failed to act in good faith.<sup>82</sup> “A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation.”<sup>83</sup>

A common retort from blockholder directors is that if they were placed on the board by a particular constituency, they obviously are there to look out for that constituency. Not only should no one be surprised by this, those directors argue, but it should not give rise to a loyalty violation. But Delaware law has consistently rejected the concept of so-called “constituency directors.”<sup>84</sup> Instead, if a blockholder director acts to benefit the investor that appointed him to the exclusion or detriment of the corporation and its stockholders generally, then the business judgment rule would be rebutted as to that director.<sup>85</sup> If the board lacked a majority of disinterested, independent directors, or if the blockholder director’s conflict was not disclosed and was material, the directors would have to show that the result was entirely fair.<sup>86</sup> If the director took action unilaterally, then the director would have to demonstrate that his conduct was entirely fair and did not constitute bad-faith conduct.<sup>87</sup>

A breach of the duty of loyalty, including a failure to act in good faith, potentially carries heavy consequences. An exculpatory provision will not protect

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82. *Id.* at 53 (“Our law clearly permits a judicial assessment of director good faith for that former purpose [of rebutting the business judgment rule.]”); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 40 (Del. Ch. 2000) (“Under Delaware law, when a plaintiff demonstrates the directors made a challenged decision in bad faith, the plaintiff rebuts the business judgment rule presumption, and the burden shifts to the directors to prove that the decision was entirely fair to the corporation and its stockholders.”); *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 760–79 (Del. Ch. 2005) (conducting a director-by-director analysis to determine if the individual members of the board, none of whom were directly interested in the hiring or termination of the corporation’s president, acted in bad faith), *aff’d*, 906 A.2d 27 (Del. 2006).

83. *Disney*, 906 A.2d at 67; *accord* *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006) (“A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation . . . .”); *see* *Gagliardi v. TriFoods Int’l, Inc.*, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996) (defining a “bad faith” transaction as one “that is authorized for some purpose other than a genuine attempt to advance corporate welfare or is known to constitute a violation of applicable positive law”); *In re RJR Nabisco, Inc. S’holder Litig.*, Civ. A. No. 10389, 1989 WL 7036, at \*15 (Del. Ch. Jan. 31, 1989) (explaining that the business judgment rule would not protect “a fiduciary who could be shown to have caused a transaction to be effectuated (even one in which he had no financial interest) for a reason unrelated to a pursuit of the corporation’s best interests”).

84. *See generally* E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 *Bus. Law.* 761 (2008) (summarizing Delaware case law).

85. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (“[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.”); *see also* *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (noting that corporate fiduciaries “are not permitted to use their position of trust and confidence to further their private interests”).

86. *See In re Trados Inc. S’holder Litig.*, 73 A.3d 17 (Del. Ch. 2013).

87. *See, e.g., Shocking Techs., Inc. v. Michael*, Civ. A. No. 7164-VCN, 2012 WL 4482838, at \*10 (Del. Ch. Oct. 1, 2012).

against damages for disloyal or bad-faith acts.<sup>88</sup> Statutory indemnification also may not be available for bad-faith conduct.<sup>89</sup>

### A. CONFIDENTIALITY

Inherent in the duty of loyalty is an obligation to protect the corporation by maintaining the confidentiality of its sensitive information. The Court of Chancery held in *Henshaw v. American Cement Corp.*,<sup>90</sup> a decision from 1969, that a director owes a duty of confidentiality to the corporation. In *Shocking Technologies v. Michael*, a decision from 2012, a director was held to have breached his fiduciary duty of loyalty by providing confidential information to a potential investor.<sup>91</sup> The director was a classic blockholder director who represented holders of preferred stock.<sup>92</sup> Despite providing nearly 60 percent of the corporation's financing, certain late-round preferred stockholders had only secured a single board seat.<sup>93</sup> After experiencing financial difficulties and with a liquidity crisis looming, the corporation began identifying potential investors for another capital raise. The court noted that the blockholder director had expressed concerns about corporate governance and believed that he would have more leverage over governance matters if the corporation did not obtain outside financing and had to negotiate from a position of financial weakness.<sup>94</sup> The court found that he had shared information about the corporation's negotiating position with a potential investor, including the lack of competing bids,<sup>95</sup> and that, through an associate, he had tried to encourage the investor to take a hard line and not invest. The Court of Chancery held that the blockholder director had breached his duty of loyalty:

The steps that a shareholder-director may take to achieve objectives are not without limits. A director may not harm the corporation by, for example, interfering with crucial financing efforts in an effort to further such objectives. Moreover, he may not use confidential information, especially information gleaned because of his board membership, to aid a third party which has a position necessarily adverse to that of the corporation.<sup>96</sup>

At the same time, however, the court recognized that not every disclosure by a director will result in a breach of that director's duty of loyalty.

[F]air debate may be an important aspect of board performance. A board majority may not muzzle a minority board member simply because it does not like what

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88. DEL. CODE ANN. tit. 8, § 102(b)(7) (2011).

89. *Id.* § 145(a), (b).

90. 252 A.2d 125 (Del. Ch. 1969).

91. *Shocking Techs.*, 2012 WL 4482838, at \*10.

92. *Id.* at \*1 n.2.

93. *Id.* at \*2.

94. *Id.* at \*4.

95. *Id.* at \*7.

96. *Id.* at \*9.

she may be saying. . . . [C]riticism of the conduct of a board majority does not necessarily equate with criticism of the corporation and its mission.<sup>97</sup>

The court cautioned that “a dissident board member has significant freedom to challenge the majority’s decisions and to share his concerns with other shareholders.”<sup>98</sup>

To address the risk that a director may believe it is necessary to share confidential information, corporate counsel may suggest that all directors enter into confidentiality agreements. Delaware precedent supports a director taking the position that a confidentiality agreement is unnecessary because the director’s fiduciary duties already impose an obligation of confidentiality on the director. In *Henshaw*,<sup>99</sup> the Court of Chancery declined to require a director to sign a confidentiality agreement for precisely this reason. *Henshaw* was both a director of American Cement and the holder of approximately 15 percent of its outstanding stock.<sup>100</sup> At the time, American Cement had sued other members of its board for breach of fiduciary duty, and the list of agents and attorneys that *Henshaw* intended to use to inspect American Cement’s books and records included one of the defendants in that litigation and several members of the law firm representing the defendant.<sup>101</sup> Although there was good reason to question how *Henshaw* might use the information, the Court of Chancery did not require *Henshaw* to execute a confidentiality agreement, finding that his fiduciary duties provided American Cement with sufficient protection. The court explained that fear that a director “may abuse his position as a director and make information available to persons hostile to the [c]orporation or otherwise not entitled to it” does not provide grounds for the corporation to refuse to provide the information.<sup>102</sup> If the director “does violate his fiduciary duty in this regard, then the Corporation has its remedy in the courts.”<sup>103</sup> The fact that a director potentially faces a breach of fiduciary duty claim and remedial consequences if he misuses information suggests that a director’s need for information will be bona fide. The *Henshaw* court did, however, prohibit *Henshaw* from providing the documents to the defendants in the litigation involving American Cement and their counsel.

In addition to being unnecessary, a confidentiality agreement could create difficulties for the director if the agreement required the director to take action in violation of his fiduciary duties. Assume, for example, that a director became aware of potential criminal conduct at the corporation and felt compelled to contact law enforcement. The director would face a direct conflict between the duty to report the conduct (as a means of protecting the corporation) and his contractual obligation to maintain the confidentiality of corporate information.<sup>104</sup>

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97. *Id.* at \*11.

98. *Id.*

99. *Henshaw v. Am. Cement Corp.*, 252 A.2d 125 (Del. Ch. 1969).

100. *Id.* at 127.

101. *Id.*

102. *Id.* at 129.

103. *Id.*

104. See *supra* note 33 and accompanying text.

Given these problems, directors are on solid ground when resisting confidentiality agreements. To the extent management and corporate counsel are concerned about a director's potential disclosure of confidential information, a better course would be to have the director confirm that he understands that his duty of loyalty includes a duty to maintain the confidentiality of sensitive information, and for the company to make clear to the director when it considers particular information to be sensitive and why. A director still may take the position that his fiduciary duties require disclosure of the confidential information, but the corporation in that situation will have created a strong record. By contrast, insisting on a confidentiality agreement may create the impression of an attempt by management to muzzle the director and give management a contractual veto over the director's exercise of his fiduciary duties.

## B. INFORMATION SHARING

The flipside of confidentiality is information sharing. A question that often arises in the blockholder director context is whether the blockholder director can share information with the stockholder that appointed the director. The intuitive response to this question varies widely depending on baseline expectations. When counsel work predominantly with public companies and are steeped in concerns about Regulation FD and insider trading, the intuitive response is strongly against any type of information sharing and in favor of an expectation that all confidential information remains in the boardroom and goes no further. When counsel work predominantly with privately held companies, particularly venture-backed start-ups, the intuitive response is precisely the opposite. Director representatives of venture capital firms report regularly to their firms and partners on the status of their investments, and those reports regularly include confidential information. For counsel who represent certain types of investors in publicly held firms—such as private equity firms, hedge funds, or activist investors—the expectation is often somewhere in between. Some investors will not want any confidential information so they are not restricted in their ability to trade. Other investors have a longer-term horizon and follow a model closer to that of a venture fund model that contemplates reporting regularly on or consulting with their partners about portfolio companies. Director representatives of these firms will expect to be able to share information and will seek to cabin any further dissemination and prevent misuse of the information at the investor level.

Delaware fiduciary duty law does not distinguish between publicly traded corporations and privately held companies.<sup>105</sup> The same rules regarding information sharing therefore apply in both contexts. Not surprisingly, therefore, Delaware law has developed a rule that accommodates information sharing. To the extent a director misuses confidential information or permits his affiliate to misuse confidential information, the corporation has a remedy against the director

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105. *Nixon v. Blackwell*, 626 A.2d 1366, 1379–80 (Del. 1993).

for breach of fiduciary duty. The corporation can also require the director's affiliate to enter into a confidentiality agreement that restricts the use or further dissemination of the information. Although it is likely not a good practice to attempt to insist that a director enter into a confidentiality agreement, there are no impediments to entering into such an agreement with the director's affiliate.

A series of Delaware cases establish the rule permitting information sharing, including *Kalisman v. Friedman*,<sup>106</sup> *Moore Business Forms, Inc. v. Cordant Holdings Corp.*,<sup>107</sup> and *AOC Limited Partnership v. Horsham Corp.*<sup>108</sup> The most recent decision, *Kalisman*, squarely presented the question of whether sharing was permitted when the parties had failed to address the matter. Jason Taubman Kalisman was a director of Morgans Hotel Group Co. and a founding member of OTK Associates, LLC, which held 13.9 percent of Morgans's outstanding common stock.<sup>109</sup> The other members of Morgans's board sought to restrict Kalisman's access to certain information on the basis that, among other things, he intended to share that information with OTK.<sup>110</sup> Relying on *Moore Business Forms*, *AOC*, and other cases, the court rejected this position, stating: "When a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director."<sup>111</sup>

This rule reflects the practical reality that director representatives in both public and private companies routinely share confidential corporate information with colleagues at their affiliated investment funds. The managing directors of these funds regularly meet to monitor their investments, and they routinely receive reports from their director designees on the performance of their portfolio companies.<sup>112</sup> In most cases, the blockholder directors themselves are managers or fiduciaries of the fund that made the investment, and the managers of the fund are often fiduciaries of the limited partners or other investors in the fund. A bright-line rule *against* information sharing would create the potential for breaches of duty at two levels: first at the corporate level by preventing the director representatives from engaging in behavior that is currently a normal part of the investment and monitoring process, and second at the fund level by preventing the director who was a fund fiduciary from sharing information that was material to the fund. Such a rule only would be honored in the breach. Rather than an actual rule to guide conduct, a rule against information sharing would put a cause of action in the hands of the corporation to use at its discretion. And if a corporation were to try to enforce it, a seemingly bright-line rule would turn out in practice to involve fact-laden litigation about the degree to

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106. Civ. A. No. 8447-VCL, 2013 WL 1668205 (Del. Ch. Apr. 17, 2013).

107. Civ. A. Nos. 13911, 14595, 1996 WL 307444 (Del. Ch. June 4, 1996).

108. Civ. A. No. 12480, 1992 WL 97220, at \*1 (Del. Ch. May 5, 1992).

109. *Kalisman*, 2013 WL 1668205, at \*6.

110. *Id.*

111. *Id.*

112. See, e.g., *In re Trados Inc. S'holder Litig.*, Civ. A. No. 1512-VCL, 2013 WL 4511262, at \*4-5 (Del. Ch. Aug. 16, 2013) (describing reports made by VC-fund blockholder directors to their respective funds with regard to Trados's performance).

which other directors knew about and consented to the sharing or engaged in similar information sharing themselves. The better approach, which Delaware has adopted, is therefore to permit information sharing and allow corporations to address risks by contracting with the affiliate and by enforcing the directors' fiduciary duties.

The implicit right to share information also comports with the Delaware Supreme Court's decision on derivative standing in *Schoon v. Smith*.<sup>113</sup> There, Richard W. Schoon was a director of Troy Corporation, having been appointed by a large stockholder. Schoon filed a derivative action on behalf of Troy alleging that his fellow directors had breached their fiduciary duties.<sup>114</sup> He claimed that, because he was a fiduciary, he should be afforded the same standing as a stockholder to bring a derivative suit.<sup>115</sup> The Delaware Supreme Court rejected his argument, noting that although the Delaware General Assembly would have the power to confer standing on directors to bring a derivative suit, it had not elected to do so.<sup>116</sup> The supreme court held that the common law only would recognize a director's right to sue in a case where otherwise there would be a "complete failure of justice."<sup>117</sup> The supreme court found that there would not be a complete failure of justice in *Schoon* because the stockholder with whom Schoon was affiliated could file the derivative action. Since Troy was privately held, the stockholder only could assert the claim if it had access to information that was available to Schoon as a director. Implicit in *Schoon*, therefore, is the premise that the director could convey information to the stockholder at whose direction he served.<sup>118</sup>

To reiterate, the ability of a blockholder director to convey information to the stockholder that placed him on the board does not mean that the fund or investor obtains the unfettered right to use the information in whatever manner it sees fit. Given the affiliation between the blockholder director and the stockholder and the understanding that information will flow from the blockholder director to the stockholder, the stockholder will be treated as a constructive insider for the purpose of the common law limitations on insider trading.<sup>119</sup> The corporation also could have a cause of action against the stockholder for any further

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113. 953 A.2d 196 (Del. 2008).

114. *Id.* at 199.

115. *Id.*

116. *Id.*; *cf.* CML V, LLC v. Bax, 6 A.3d 238 (Del. Ch. 2010), *aff'd*, 28 A.3d 1037 (Del. 2011). In *Bax*, the Court of Chancery held that section 18-1002 of the Delaware Limited Liability Company Act limited standing to bring a derivative claim to holders of membership interests in the limited liability company and their assignees, and that it did not extend standing to creditors of the limited liability company. *Id.* In affirming the ruling of the Court of Chancery, the Delaware Supreme Court stated: "[T]he General Assembly is free to elect a statutory limitation on derivative standing for [limited liability companies] that is different than that for corporations, and thereby preclude creditors from attaining standing. The General Assembly is well suited to make that policy choice and we must honor that choice. In this respect, it is hardly absurd for the General Assembly to design a system promoting maximum business entity diversity." CML V, LLC v. Bax, 28 A.3d 1037, 1043 (Del. 2011).

117. *Schoon*, 953 A.2d at 208.

118. *See id.* at 208-09.

119. *See Brophy v. Cities Serv. Co.*, 70 A.2d 5 (Del. Ch. 1949).

disclosure of confidential information that inflicted harm on the corporation. In other words, the director can share with his stockholder affiliate, but the ability to share within the silo does not permit sharing outside of the silo.

## V. COMMITTEES

A largely uncharted area under Delaware law is the ability of a board to use a committee to isolate a blockholder director. When faced with a blockholder director who is viewed as an adversary, boards often delegate certain responsibilities to a committee that excludes the disfavored director. Section 141(c) of the DGCL indisputably gives the board the power to delegate its duties to a committee,<sup>120</sup> but the equitable limitations on this delegation have yet to be explored. Can a committee of “all but one” be used to exclude a blockholder director from substantive board deliberations and decision making? If so, for how long can that committee be maintained? If a transaction requires board approval under the DGCL, can a committee conduct all of the substantive deliberations, make a recommendation to the full board, and then have the full board approve the transaction in a perfunctory vote taken in reliance on the committee’s recommendation? Equity undoubtedly has a role in deciding the issue. Decisions by fiduciaries under Delaware law are “twice-tested,’ once for statutory compliance and again in equity.”<sup>121</sup> Section 141(c) answers the legal issue. It does not answer the equitable issue.

In considering how a court would approach a director’s claim that he was being inequitably excluded from the board’s deliberative process, it is necessary first to consider the purpose for which the committee was formed and the board’s reason for excluding the director. There is support in Delaware law for excluding a director from board deliberations, through the use of a committee or otherwise, when the individual has a direct conflict with the subject matter being discussed.<sup>122</sup> Delaware decisions have commented favorably on the practice of independent directors meeting in executive session without management or outside the presence of an interested or conflicted director. In *Disney*, for example, the Court of Chancery held that the board of directors acted properly in reviewing the Disney CEO’s decision to terminate Michael Ovitz, the company’s president and a director, during an executive session and waiting to inform Ovitz until after the meeting.<sup>123</sup> The termination was pre-planned, but rather than tell Ovitz about it beforehand or signal to the markets that a change was in the

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120. DEL. CODE ANN. tit. 8, § 141(c) (2011).

121. See *Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 641 (Del. Ch. 2013) (citing *Sample v. Morgan*, 914 A.2d 647, 672 (Del. Ch. 2007)); see also Adolphe A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (“[I]n every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a cestui que trust to the trustee’s exercise of wide powers granted to him in the instrument making him a fiduciary.”).

122. See *Moore Bus. Forms, Inc. v. Cordant Holdings Corp.*, Civ. A. Nos. 13911, 14595, 1996 WL 307444, at \*6 (Del. Ch. June 4, 1996).

123. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 44–45 (Del. 2006).

works, the board nominated Ovitz for an additional term as a director—an arguably deceptive act.<sup>124</sup> Similarly, in *In re Massey Energy Co. Derivative & Class Action Litigation*, outside directors met among themselves and had “back channel conversations” about a powerful chairman and CEO’s performance and his potential replacement; the Court of Chancery described those communications without intimating any criticism.<sup>125</sup> Likewise, in *Air Products & Chemicals, Inc. v. Airgas, Inc.*, the Court of Chancery noted favorably that Airgas’s independent directors had met outside of the CEO’s presence to affirm their collective position on resisting Air Products’ takeover attempt.<sup>126</sup> Reinforcing the point, the Court of Chancery has criticized boards for failing to deliberate outside of the presence of an interested director.<sup>127</sup> In *Grobow v. Perot*, the Court of Chancery, in addressing the plaintiffs’ claims that a stockholder demand that the board of General Motors Corporation bring suit over its repurchase of securities held by a company controlled by Ross Perot would have been futile, considered whether GM’s board could have properly considered the demand.<sup>128</sup> The stockholder-plaintiff pointed out that Perot did not attend the meeting at which the board approved the repurchase and argued that his absence suggested that GM’s directors acted to defend themselves against Perot. The Court of Chancery rejected this argument, finding that Perot did not threaten the directors’ incumbency. “[G]iven Perot’s clear financial self-interest in the matter to be considered and voted upon, it has not been shown that GM’s directors acted improperly in insisting that Perot not be present.”<sup>129</sup>

The Court of Chancery’s opinion in *Emerald Partners v. Berlin* also implies that directors could exclude an interested director from deliberations over the matter in which the director was interested.<sup>130</sup> In a post-trial decision, the Court of Chancery held that a transaction between May Petroleum, Inc. and its controlling stockholder Craig Hall, who also served as a May director, was entirely fair to the stockholders of May.<sup>131</sup> Hall negotiated the transaction with three disinterested directors of May, but those directors were not formally constituted as a special committee.<sup>132</sup> The Court of Chancery held that “all relevant aspects of the process . . . have been found probative of fair dealing, with one exception: the non-affiliated directors’ failure to exclude Hall and Berlin[, another director who was

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124. *Id.*

125. Civ. A. No. 5430-VCS, 2011 WL 2176479, at \*11–15 (Del. Ch. May 31, 2011).

126. 16 A.3d 48, 64 n.61 (Del. Ch. 2011).

127. See *Yucaipa Am. Alliance Fund II, L.P. v. Riggio*, 1 A.3d 310, 326–27 (Del. Ch. 2010) (noting that the presence of the founder and chairman interfered with free deliberations), *aff’d*, 15 A.3d 218 (Del. 2011) (table); *Emerald Partners v. Berlin*, Civ. A. No. 9700, 2003 WL 21003437, at \*28 (Del. Ch. Apr. 28, 2003) (“The single flaw in the non-affiliated directors’ decision-making process was their failure to insist that Hall and Berlin absent themselves entirely from that process.”), *aff’d*, 840 A.2d 641 (Del. 2003) (table).

128. 526 A.2d 914, 917 (Del. Ch. 1987), *aff’d*, 539 A.2d 180 (Del. 1988).

129. *Id.* at 922 n.11.

130. Civ. A. No. 9700, 2003 WL 21003437 (Del. Ch. Apr. 28, 2003).

131. *Id.* at \*1.

132. *Id.* at \*8, \*22.

formerly part of management,] from all of their meetings and deliberations relating to the merger.”<sup>133</sup>

At the same time, other decisions indicate that, to the extent a board may exclude a director through the use of a board committee, it only could do so if the director faces a specific and direct conflict of interest with respect to the matter under discussion. In *KLM v. Checchi*,<sup>134</sup> for example, the Court of Chancery considered whether the board of Northwest Airlines properly held a meeting without giving notice to directors who were officers of Northwest’s large minority stockholder, KLM.<sup>135</sup> The purpose of the meeting was to discuss whether a stockholder rights plan could be used to limit the actions KLM could take. KLM moved to compel discovery into what took place at the meeting, and the board responded that it had properly excluded the interested directors. This court granted the motion to compel, explaining:

It is far from clear, despite defendant’s argument to the contrary, that [the KLM directors] should or would have been recused from general discussions about the adoption of a shareholders’ rights plan. The mere fact that KLM had announced to the board of Northwest that if their view of their existing agreements with Northwest were frustrated by some board action that the board should expect litigation as a response may well serve to insulate them from discussions relating to the litigation but not from a discussion on the relative merits of a shareholders’ rights plan. A threat to enforce contractual rights does not require, or for that matter excuse, a meeting of the board of directors for the purposes of discussing a “poison pill” with KLM’s designated directors intentionally excluded.<sup>136</sup>

The Court of Chancery’s statements suggest that the board could exclude the KLM directors “from discussions relating to the litigation,” where the interests of the KLM directors were directly adverse, but not “from a discussion on the relative merits of a shareholders’ rights plan,” where the conflict was readily apparent but more attenuated.

Cases addressing a director’s right to information similarly suggest that any power to exclude one or more directors is limited to situations where there is a direct conflict that is readily apparent. As discussed, the right to information includes access to privileged material, and as a general rule, “a corporation cannot assert the privilege to deny a director access to legal advice furnished to the board during the director’s tenure.”<sup>137</sup> Nevertheless, Delaware cases have recognized that a board can withhold information from a director where the disfavored individual faces a clear and direct conflict. Thus, a board can withhold

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133. *Id.* at \*28; see also *Encite LLC v. Soni*, Civ. A. No. 2476-CC, 2008 WL 2973015, at \*7 (Del. Ch. Aug. 1, 2008) (noting in passing that “[b]ecause he was considered an interested director with respect to the Marsh Group bid, he was not permitted to participate in any board evaluation of the bids submitted by other parties”).

134. Civ. A. No. 14764-NC, 1997 WL 525861 (Del. Ch. July 23, 1997).

135. *Id.* at \*1.

136. *Id.*

137. *Moore Bus. Forms, Inc. v. Cordant Holding Corp.*, Civ. A. Nos. 13911, 14595, 1996 WL 307444, at \*4 (Del. Ch. June 4, 1996); see *id.* at \*6 (“Mr. Rogers was a member of that board, having the same status as the other directors. No basis exists to assert the privilege against him . . .”).

privileged information from a director once sufficient adversity exists between the director and the corporation such that the director could no longer have a reasonable expectation that he was a client of the board's counsel.<sup>138</sup> Similarly, a board may limit or block a director's access to particular types of corporate information if the director's "motives are improper, or . . . they are in derogation to the interests of the corporation."<sup>139</sup> And a corporation can withhold books and records from a director who seeks the information for an improper purpose.<sup>140</sup>

Given these precedents, it is apparent that if some level of conflict exists, a board may exclude a director by forming a duly empowered committee. That committee will be entitled to keep its deliberations private, at least for the time necessary for the committee to perform its work. What is not clear, and what must await an appropriate case, is whether a committee could be maintained indefinitely in the absence of a direct conflict, and the degree to which an excluded director would be entitled to some degree of information about the committee proceedings. If the director has been excluded for an extended period of time, and if the committee has been tasked with the full power of the board and is effectively carrying out the board's role, then the excluded director may have powerful equitable arguments in his favor. The DGCL establishes a board-centric system of corporate governance, not a committee-centric system, and the ability of a board majority to exclude minority directors stands in tension with the concepts of director involvement and collective deliberation that date back to *Lippman*. At some point, if the use of a committee appears abusive, a court of equity is likely to step in. Where that line is drawn will depend heavily on the facts of the case that presents the issue.

## CONCLUSION

Delaware's board-centric model rests on a norm of collective decision making. All directors have an equal right to participate, even those who may have an adversarial relationship with management or who may disagree with a majority of the board. One man's disgruntled dissident is another man's whistleblower, and the truth likely falls somewhere in between. Boards should therefore deliberate carefully before taking action that limits a blockholder director's rights or excludes the blockholder director. At the same time, a blockholder director should take care when exercising his rights as a director, recognizing that the blockholder affiliation may make him vulnerable to duty of loyalty claims. Ultimately, both sides should proceed with a sense of empathy toward the other and seek to make reasonable accommodations. Experienced corporate counsel will play a critical role in mediating disputes, resolving tensions, and achieving the right balance.

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138. See *SBC Interactive, Inc. v. Corporate Media Partners*, Civ. A. No. 15987, 1997 WL 770715, at \*6 (Del. Ch. Dec. 9, 1997).

139. *State ex rel. Farber v. Seiberling Rubber Co.*, 168 A.2d 310, 312 (Del. Super. Ct. 1961); see DEL. CODE ANN. tit. 8, § 220(d) (2011) (providing director with right of access to corporate books and records "for a purpose reasonably related to [his] position as director").

140. See DEL. CODE ANN. tit. 8, § 220(d); *Schoon v. Troy Corp.*, Civ. A. No. 1677-N, 2006 WL 1851481, at \*1 (Del. Ch. June 27, 2006) (noting that court had found that director sought information for an improper purpose where the director had an "undisclosed conflict of interest").