

**SECTION 102(b)(7) CHARTER PROVISIONS REMAIN POTENT WEAPONS  
 IN DEFENSE OF BREACH OF FIDUCIARY DUTY CLAIMS**

Vice Chancellor Noble's July 29, 2008 decision in *Ryan v. Lyondell Chem. Co.*, 2008 WL 2923427 (Del. Ch. July 29, 2008) denying the Lyondell directors' motion for summary judgment on the plaintiff's *Revlon* claims has been hailed by some as the "death of Section 102(b)(7)" by purportedly expanding the types of conduct that may expose directors to liability for money damages. Recent decisions from the Delaware Court of Chancery, however, demonstrate that Section 102(b)(7) remains a potent weapon in defending against breach of fiduciary duty claims.

In *Ryan*, a stockholder plaintiff challenged the sale of Lyondell Chemical Company to Basell AF at a 45% premium over market. Vice Chancellor Noble denied the defendants' motion for summary judgment and, in a subsequent opinion, denied the defendants' application for certification of an interlocutory appeal. *Ryan v. Lyondell Chem. Co.*, C.A. No. 3176-VCN (Del. Ch. Aug. 29, 2008). In his denial of the defendants' application, Vice Chancellor Noble reflected on his earlier decision and noted that "at least for the moment, on the basis of a limited summary judgment record, the protection of Lyondell's exculpatory charter provision for potential breaches of their fiduciary duty of care" should be denied the director-defendants. *Id.* at 2. Vice Chancellor Noble held that, on the limited summary judgment record before the Court, it appeared that the directors knew that Lyondell was "in play" and yet "did *nothing* (or virtually nothing) to ... maximiz[e] shareholder value." *Id.* at 3 (emphasis in original). Based on these "as yet unexplained facts," Vice Chancellor Noble held that it was possible to draw a reasonable inference that the director-defendants "*may have* consciously disregarded" their fiduciary duties – which could violate the duty of loyalty and fall outside of 102(b)(7). *Id.* at 4 (emphasis in original). Vice Chancellor Noble found himself "somewhere in the intermediate grey area of conduct identified by the Delaware Supreme Court as deserving of the 'bad faith pejorative label,'" and determined that he needed a fuller record to determine whether the directors' inaction "ultimately rises to the level of something 'more' that constitutes 'bad faith' sufficient to deprive the directors of the protection of Lyondell's exculpatory charter provision." *Id.* at 16, 19.

Vice Chancellor Noble repeatedly emphasized that he based his decision on a limited record in the summary judgment context, which required him to draw all reasonable inferences in favor of the plaintiff – even though he believed that the "better inference" favored the director-defendants. *Id.* at 2 n.4 (internal quotations and citations omitted). He called "the reports of the death of Section 102(b)(7) ... greatly exaggerated both with regard to the application of Lyondell's exculpatory charter provision in this case, and certainly with regard to the application of a Section 102(b)(7) provision defense in any other case." *Id.* at 22. Vice Chancellor Noble was right.

On the same day that Vice Chancellor Noble denied the interlocutory appeal in *Ryan*, Chancellor Chandler issued an opinion in *McPadden v. Sidhu*, 2008 WL 4017052 (Del. Ch. Aug. 29, 2008) *granting* the director-defendants' motion to dismiss for failure to state a claim and for failure to plead particularized facts excusing demand based on the company's Section 102(b)(7) charter provision. In *McPadden*, a stockholder plaintiff challenged a sale by i2 Technologies of TSC, one of its subsidiaries, to members of TSC's management for a price that was allegedly below market value.

Similar to the summary judgment posture in *Ryan*, the *McPadden* motion to dismiss required the Chancellor “to make all reasonable inferences that logically flow from the face of the complaint in favor of” the plaintiff. *Id.* at \*6. Chancellor Chandler found that the director-defendants’ actions, “beginning with placing [TSC management] in charge of the sale process of TSC and continuing through their failure to act in any way so as to ensure that the sale process employed was thorough and complete, are properly characterized as either recklessly indifferent or unreasonable.” *Id.* at \*10. Notwithstanding this finding, the Chancellor dismissed plaintiff’s claims against the 12 directors because plaintiff had not “sufficiently alleged” that the director-defendants acted in bad faith, because their alleged conduct did not amount to the “intentional dereliction of duty or the conscious disregard for one’s responsibilities.” *Id.* at \*9. The Chancellor noted that the case illustrates the “sometimes fine distinction between a breach of care (through gross negligence) and a breach of loyalty (through bad faith).” *Id.* at \*1.

Just four days after the *McPadden* and *Ryan* decisions, Vice Chancellor Strine issued his opinion in *In re Lear Corp. S’holder Litig.*, 2008 WL 4053221 (Del. Ch. Sept. 2, 2008) granting the defendants’ motion to dismiss plaintiffs’ duty of loyalty claims because plaintiffs had failed to demonstrate that the director-defendants’ conduct was outside the protections of the target’s Section 102(b)(7) provision. In *Lear*, plaintiffs challenged the decision of the target’s board of directors to approve a \$1.25 per share increase in the proposed merger price in exchange for a \$25 million “naked no-vote” termination fee (i.e., a fee payable to the proposed acquirer in the event the Lear stockholders voted down the proposed merger). In dismissing plaintiffs’ bad faith claim against the director-defendants, Vice Chancellor Strine cautioned that courts should “be extremely chary about labeling what they perceive as deficiencies in the deliberations of an independent board majority over a discrete transaction as not merely negligence or even gross negligence, but as involving bad faith.” *Id.* at \*11. He further elaborated that “[i]n the transactional context, a very extreme set of facts would seem to be required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties.” *Id.*

While Vice Chancellor Strine did not cite *Ryan* at all in his *Lear* opinion, some practitioners have speculated that the foregoing passages were directed at the *Ryan* opinion and were a none-too-subtle effort to abate any concerns that the proverbial “bad faith” sky was falling, and that directors of Delaware corporations face an increased risk of personal liability in the wake of the *Ryan* opinion. The recent *McPadden* and *Lear* opinions make clear that a Section 102(b)(7) charter provision is still a potent weapon in the arsenal of corporate directors defending against stockholder claims for breach of fiduciary duty.

***Morris Nichols was counsel to director-defendants in McPadden and the acquirer in Lear.***

**KENNETH J. NACHBAR**

302.351.9294

knachbar@mnat.com

**WILLIAM M. LAFFERTY**

302.351.9341

wlafferty@mnat.com

**JAY N. MOFFITT**

302.351.9123

jmoффitt@mnat.com

**LESLIE A. POLIZOTI**

302.351.9415

lpolizoti@mnat.com

Corporate and Business Litigation Group

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