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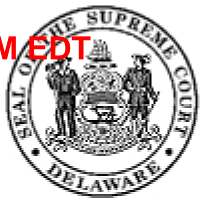

IN THE SUPREME COURT OF THE STATE OF DELAWARE

RICHARD W. SCHOON, Plaintiff Below, Appellant, v. DARYL D. SMITH, JOHN F. BECKERT, MARK C. GWILLIM, CONRAD A. PLIMPTON, and TROY CORPORATION, a Delaware corporation, Defendants Below, Appellees.	**PUBLIC VERSION** FILED October 5, 2007 On Appeal from C.A. No. 1753-N in the Court of Chancery of the State of Delaware

APPELLANT'S REPLY BRIEF

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INTRODUCTION

In this case of first impression, this Court should hold that a director has standing to assert a derivative claim on behalf of the corporation he serves when a majority of the board is conflicted. If a director identifies corporate wrongdoing, and if a majority of the board is interested or not independent, then the director should be able to protect the corporation's interests by bringing a derivative claim. A rule that denies derivative standing to directors would handcuff and muzzle precisely those individuals in whom stockholders and courts place their greatest trust.

Troy argues against director derivative standing based on fear: fear of a flood of director strike suits, and fear that a rogue director will veto board action with threats of litigation. Fear is a poor guide and worse jurist. And Troy's fears lack substance.

There will not be an onslaught of director strike suits. As the ALI concluded, "there is little, if any, evidence of [director derivative standing] abuse." 2 PRINCIPLES OF CORP. GOV. § 7.02(c) at cmt. h. Delaware's experience confirms this: Were directors clamoring to sue, the issue would have been resolved long ago. Directors also will be restrained by the collegiality of the boardroom and the corporation's ability to sue the director (as Troy has) for purportedly breaching his fiduciary duties.

Nor will there be a rogue director veto. A director only will be able to sue derivatively if he can overcome the same demand futility standard that governs stockholder derivative suits. This procedural hurdle adequately protects corporations. Nor does a finding of demand

futility divest the board of its management powers, as the board can reassert its authority by forming a special litigation committee. Delaware law already permits stockholders to pursue derivative litigation upon a showing of demand futility, even if the stockholder has only a nominal position.

Troy's arguments overstate the case. As Troy itself recognizes, many directors own stock. *See* AB 19 n.10.[1] All of Troy's specters thus already haunt the boardroom, because a stockholder-director already can bring a derivative claim in his stockholder capacity.

While recognizing director derivative standing would have minimal impact, denying directors standing would send a significant message to directors, stockholders, and corporate America. It would create a "Wall Street Rule" for directors, in which a director who learns of board-level misconduct and is stymied by a conflicted board must either turn a blind eye to the wrongdoing and or offer her resignation. If the board remains conflicted and intransigent, she has no other effective option. If she publicizes her concerns, she risks a lawsuit for defamation and breach of fiduciary duty. If she seeks a stockholder champion, she faces the same risks.

A director should have another course of action available. A director should have standing to bring a derivative claim when a majority of the board is conflicted. The Opinion should be reversed.

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[1] Citations to Appellant's Opening Brief on appeal are cited as "OB ___." Citations to Appellees' Answering Brief on appeal are cited as "AB ___."

REPLY

In this appeal from a dismissal for lack of standing, the allegations of the Complaint must be taken as true. *See, e.g., Conte Bros. Auto., Inc. v. Quaker State-Slick 50, Inc.*, 165 F.3d 221, 224 (3d Cir. 1998). As alleged in the Complaint, Troy's Board is comprised of Schoon and four conflicted directors. Troy cannot legitimately claim that "[t]he place for Schoon to have made his arguments about the merits of [board] decisions was in the boardroom, not before this Court" (AB 3). The Complaint alleges with particularity how the Board is dominated by Smith, who permits neither debate nor disagreement. Nor does the Complaint assert claims about good faith disagreements over issues of strategy, as Troy suggests (*see* AB 1, 3, 15, 20). The Complaint instead advances serious charges of self-dealing and entrenchment against conflicted fiduciaries.

Schoon is an independent director

REDACTED He is a CPA who provides tax, accounting, and financial advice. He is not a "hired gun" for a "special interest constituency group" (AB 20 n.11), nor did he bring this case "to further Steel's efforts to achieve liquidity" (AB 3).[2] On remand, Troy can litigate these matters if it wishes. Troy's charges are not part of the record on appeal.

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[2] Troy miscites a purported finding regarding Schoon's role as a representative of Steel. The Chancery Court expressly held that the "views expressed at the June 8 hearing about Schoon's purpose in making his demand, and the recapitulation of those views at pages 3-4 of the Memorandum Opinion are mere *dicta* and do no constitute judicial findings that could have preclusive effect in any other litigation between these parties." *Schoon v. Troy Corp.*, C.A. No. 1677 (Del Ch. July 24, 2006)(*see* AR1).

ARGUMENT

I. THE TRIAL COURT ERRED IN REJECTING DIRECTOR DERIVATIVE STANDING.

"[D]irectors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of its shareholders." *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993). This duty may require directors to take action against a fellow director or controlling stockholder. *See Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1055-56 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005). A plaintiff can state a claim for breach of fiduciary against directors who improperly fail to file suit on the corporation's behalf. *See AIG Ret. Servs., Inc. v. Barbizet*, C.A. No. 974-N, 2006 WL 1980337, at *7 (Del. Ch. July 11, 2006). A plaintiff likewise can state a claim for breach of fiduciary against directors who fail to take action, including legal action, against a corporate CEO for related party transactions. *See In re infoUSA, Inc. S'holders Litig.*, C.A. No. 1956-CC, 2007 WL 2419611, at *25 (Del. Ch. Aug. 13, 2007). If a director has a fiduciary duty to take action, if a lawsuit is the necessary action, and if the director can be held liable for failing to proceed with a lawsuit, then a director necessarily must have standing to sue derivatively on behalf of the corporation if the majority of the board is conflicted.

A. Section 327 Limits Stockholder Derivative Actions And Does Not Speak To Director Derivative Actions.

According to Troy, "[i]t is fundamental Delaware law that a plaintiff must be a shareholder … to prosecute a derivative action." AB 5. Troy claims that Section 327 establishes this purportedly

"fundamental" rule and makes clear that only stockholders can bring derivative actions. AB 6-9. Troy is wrong.

Earlier this year, this Court held definitively that "the creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties." *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, __ A.2d __, 2007 WL 1453705, at *7 (Del. May 18, 2007). There is no statute that authorizes creditor derivative suits. Section 327 does not speak of creditors. The existence of creditor derivative standing is grounded in equity, just as the derivative action itself was "developed in equity" so that suit could be brought "in the corporation's name where those in control of the company refused to assert a claim belonging to it." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984). The derivative action is inherently equitable. *See Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 548 (1949); OB 21-22.

In support of its "stockholders only" argument, Troy cites a host of cases addressing derivative actions brought *by stockholders* that apply Section 327 to hold (not surprisingly) that a stockholder must own stock contemporaneously with the lawsuit and continuously since the wrong. *See* AB 5-8, 10-11. Troy gives primacy of place to *Harff v. Kerkorian*, 324 A.2d 215, 218 (Del. Ch. 1974), *aff'd in part, rev'd in part on other grounds,* 347 A.2d 133 (Del. 1975), and contends that Schoon quotes *Harff* "out of context." AB 5.

Harff speaks clearly and precisely to the nature of Section 327: "[W]hen read literally, Section 327 does not provide that only

stockholders have standing to sue derivatively. *It must be recognized, however, that Section 327 does not create the right to sue derivatively but rather restricts that right.*" AB 6 (quoting *Harff*, 324 A.2d at 218; emphasis in AB). That is precisely Schoon's point. This Court and the Court of Chancery, as courts of equity, gave life to and determine who has standing to bring a derivative action. Prior to the adoption of Section 327's predecessor, "a stockholder was not required to be the owner of the shares at the time of the transaction of which he complained" to bring a derivative suit. *Rosenthal v. Burry Biscuit Corp.*, 60 A.2d 106, 110 (Del. Ch. 1948). The General Assembly adopted what is now Section 327 "to prevent what has been considered an evil, namely, the purchasing of shares in order to maintain a derivative action designed to attack a transaction which occurred prior to the purchase of the stock." *Id.* at 111.

Harff dealt with an attempt to bring a derivative suit by holders of convertible subordinate debentures. The debenture-holders argued that while they were not stockholders, they had standing under Section 327 because "the convertibility of their debentures into common stock … provides them with the necessary standing to sue." 324 A.2d at 218. The Court of Chancery and this Court rejected this argument, holding that "Delaware law seems clear that stockholder status at the time of the transaction being attacked and throughout the litigation is essential." AB 6 (quoting *Harff*, 324 A.2d at 218-19; emphasis in AB).

Harff held that a party who claims standing based on some form of stockholder status must satisfy Section 327. *Harff* did not hold that

only stockholders could bring derivative actions. If it did, it would conflict directly with this Court's recent decision in *Gheewalla*.

The other stockholder standing cases on which Troy relies likewise address situations in which a plaintiff sued based on his status *as a stockholder* and was found to have lacked standing under Section 327 because the plaintiff acquired his stock after the wrong or lost it in a subsequent transaction.[3] Like *Harff*, these decisions hold that plaintiffs who rely on their stockholder status to provide standing must satisfy Section 327. These cases do not speak to whether parties relying on a different basis for standing, such as creditor or director status, can bring a derivative action.

Rather than suggesting that only stockholders can bring derivative actions, the language of Section 327 implicitly recognizes that parties other than stockholders could have standing to bring derivative actions. Section 327 states that "In any derivative suit *instituted by a stockholder of a corporation*, it shall be averred …." This language envisions a universe in which a number of corporate constituencies could bring derivative actions, including stockholders. Section 327 then speaks to that subset of derivative actions

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[3] *See* AB 7-8 (citing *Leighton v. Lewis*, 577 A.2d 753 (Del. 1990) (ORDER) (finding that stockholder who did not purchase his stock "until sometime after the … alleged breach of fiduciary duty" lacked standing *qua* stockholder under Section 327); *7547 Partners v. Beck*, 682 A.2d 160, 163 (Del. 1996) (finding that stockholders who did not receive shares until after alleged wrong lacked standing *qua* stockholders under Section 327); *Lewis v. Anderson*, 477 A.2d 1040, 1045 (Del. 1984) (finding that stockholder who received stock of acquirer in stock-for-stock merger lacked standing lacked standing *qua* stockholders under Section 327) *accord Bradley v. First Interstate Corp.*, 748 A.2d 913 (Del. 2000) (ORDER) (same); *In re Beatrice Cos.*, 522 A.2d 865 (Del. 1987) (ORDER) (same)).

"instituted by a stockholder." A different reading would render superfluous the phrase "instituted by a stockholder." This Court has explained, however, that when interpreting a statute, it is "important to give effect to the whole statute, and leave no part superfluous." *Keeler v. Harford Mut. Ins. Co.*, 672 A.2d 1012, 1016 (Del. 1996) (citing 2A Norman J. Singer, SUTHERLAND STATUTORY CONSTRUCTION § 46.06 (1995)). Troy's reading violates this basic principle.

In defense of its "stockholders-only" reading of Section 327, Troy offers its own canon of instruction: *expressio unius est exclusion alterius,* which Troy describes as the principle that "where … the persons and things to which [a statute] refers are affirmatively … designated, there is an inference that all omissions were intended by the legislature." AB 6-7 (quoting *Norman v. Goldman*, 173 A.2d 607, 610 (Del. Super. 1961)). Applied to Section 327, the affirmative designation of "any derivative suit instituted by a stockholder" as the group of suits in which a complaint must "aver … that the plaintiff was a stockholder of the corporation at the time of the transaction" does not exclude the possibility of derivative suits brought by directors. It instead excludes director-initiated lawsuits from the group in which the complaint must "aver … that the plaintiff was a stockholder of the corporation at the time of the transaction." Troy's canon supports Schoon's reading.

If the General Assembly had wanted to say in Section 327 that "only stockholders can bring derivative suits," it could have done so quite easily. The General Assembly also could have said that "In any derivative suit, it shall be averred in the complaint that the

plaintiff was a stockholder...." Either alternative would have rendered unnecessary this Court's recent decision in *Gheewalla* and decades of litigation by creditors asserting derivative claims. The General Assembly did neither. It rather limited stockholder derivative actions, while recognizing that other constituencies could be permitted in equity to sue derivatively.

In a variant of its *exclusio unius* argument, Troy tries to rehabilitate its reading of Section 327 by pointing to other sections of the Delaware General Corporation Law that explicitly confer standing to sue on directors, citing §§ 211, 220(d) and 225. *See* AB 8-9. Each of these statutes confers an express right of action for a director to sue *individually.* Their existence does not speak to the right to a director to derivatively when the board as a whole is conflicted or disabled.[4] This is the right which Schoon submits a director of a Delaware corporation must possess.

B. Rule 23.1 Limits Stockholder Derivative Actions And Does Not Speak To Director Derivative Actions.

The same analysis that defeats Troy's reliance on Section 327 applies equally to Rule 23.1, where Troy advances the same purported textual basis for exclusive stockholder standing and draws the same

[4] The history of § 220(d) supports Schoon's position, not Troy's. In *Henshaw v. American Cement Corp.,* 252 A.2d 125, 129 (Del. Ch. 1969), the Court of Chancery recognized a director's right to obtain books and records as a matter of common law, despite language in § 220 granting that right to stockholders and the absence of any language granting that right to directors. *Henshaw* implicitly rejected Troy's argument that an explicit grant of stockholder standing precludes director standing. *Henshaw* instead recognized a director's right to books and records as a necessary corollary to a director's fiduciary obligations, just as Schoon contends. The General Assembly did not

inference from decisions addressing stockholder standing and focusing on stockholder status. Once again, Troy ignores the actual language of Rule 23.1, which does not speak to, and implicitly recognizes the possibilities of, derivative actions brought by other corporate constituencies. Once again, Troy ignores this Court's decision in *Gheewalla* and the numerous cases recognizing creditor derivative standing when a corporation is insolvent, a concept that is inconsistent with Troy's view.

Troy does offer one new theory as to why Rule 23.1 precludes director derivative standing. According to Troy, "Schoon's argument logically means that the stringent particularized pleading requirements of Section 23.1 are inapplicable to directors." AB 11. Wrong. What Schoon's argument instead means is that the particularized pleading requirements of Rule 23.1 do not apply to directors by rule, but may apply as a matter of common law.

The absence of a rule-based pleading requirement for director derivative suits does not render Schoon's argument "absurd[]" or his reading of Rule 23.1 "tortured," as Troy claims (AB 11-12). There currently is no Delaware case holding that creditors must make a demand or plead with particularity in order to proceed with a derivative claim. Although this Court could hold as a matter of common law that a particularity standard applies, Rule 23.1 neither requires it nor precludes it. The fact that stockholders must meet a

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act until twelve years later, in 1981, when it codified the common law right in § 220(d).

particularity standard likewise does not preclude other corporate constituencies from potentially having standing to sue derivatively.

This Court need not reach the particularity issue. It was not addressed in the Opinion and has not been raised properly on appeal. If this Court reverses the Opinion, then the Court of Chancery can decide in the first instance whether particularity is required. Schoon believes his pleading meets a particularity standard in any event.

C. Troy Misreads *Moran*.

Troy next argues that the Court of Chancery's decision in *Moran v. Household Int'l, Inc.*, 490 A.2d 1059 (Del. Ch.), *aff'd,* 500 A.2d 1346 (Del. 1985), resolved the question of derivative standing. *See* AB 12-13. Troy does not contend the matter was addressed on appeal in *Moran*, and Troy thus necessarily agrees that director derivative standing poses a question of first impression for this Court.

Troy reads *Moran* as holding that the director in that case could not assert **any** claim that could have been asserted by stockholders. AB 13. Troy thus draws no distinction between individual claims that belong to the stockholders and derivative claims that belong to the corporation. Schoon agrees that *Moran* held that a director cannot bring individual claims that belong to stockholders. This is precisely what the language of *Moran* says: "[T]here is no Delaware statute which authorizes an individual action by a director, *qua* director, to correct wrongs alleged to have been inflicted on shareholders." 490 A.2d at 1071. This language does not speak to a *derivative* action by a director to correct wrongs alleged to have been inflicted *on the corporation*.

Ironically, Troy's summary of *Moran's* holding comports with Schoon's reading of the case. According to Troy, the *Moran* court "found that Moran had no standing as a director to bring claims on behalf of Household's stockholders." AB 13. This is exactly how Schoon reads *Moran.* The individual claims that belonged to Household's stockholders only could be asserted by those stockholders. There was no logical basis for Moran *qua* director to assert their individual claims. The *Moran* court then held that the claims were in fact derivative, concluded that the requirements of Rule 23.1 were met with respect to the stockholder plaintiffs in the case, and therefore did not reach the issue of director derivative standing. In any event, *Moran* is not binding on this Court, for which director derivative standing is clearly an issue of first impression.

D. Trust Law And The ALI Principles Of Corporate Governance Are Persuasive.

In his opening brief, Schoon explained that authority from the field of trust law, to which Delaware courts often look when giving content to the fiduciary duties of directors, further supports the conclusion that directors have standing to sue derivatively. Under trust law, one trustee has standing to sue a co-trustee on behalf of the trust. RESTATEMENT (SECOND) OF TRUSTS § 200 (1959 & Supp. 2005) at cmt. e ("If there are several trustees, one or more of them can maintain a suit against another to compel him to perform his duties under the trust, or to enjoin him from committing a breach of trust, or to compel him to redress a breach of trust committed by him."). By analogy, one director should have standing to sue his co-directors on behalf of the corporation.

Troy literally has no answer to this authority. Troy instead asserts that the trust law analogy fails "because of [Schoon's] lack of status as a beneficiary." AB 17. This completely misses the point. Schoon does not have standing by analogy because trust beneficiaries can sue trustees derivatively. Schoon has standing by analogy because trustees can sue co-trustees derivatively.

Troy also criticizes the ALI's Principles of Corporate Governance, which recognize that a director is entitled to sue derivatively on behalf of the corporation he serves. *See* 2 PRINCIPLES OF CORP. GOV. § 7.02(c) (1992 & Supp. 2006). Troy would have this Court believe that all of the ALI Principles, including director derivative standing, express outlier positions at odds with Delaware law. AB 22 (citing Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 Bus. Law. 503, 515 (1989)). Not so. The ALI's central proposal was a "universal demand" rule, which was inconsistent with Delaware's historic approach of permitting a stockholder to choose whether or not to make a demand. This proposal was criticized by Chief Justice Veasey and Professor Dooley. *See* 44 Bus. Law at 515. Chief Justice Veasey and Professor Dooley did not criticize the concept of director derivative standing, which is not at odds with Delaware law. They did not even mention it. Certainly they would have were it as heretical as Troy contends.

Troy also suggests this Court should discount the ALI Principles "particularly because Delaware's General Assembly has declined to adopt [them] in the decade and a half since their final promulgation

in 1992." AB 20. It is hardly surprising that the General Assembly has not intruded on this Court's careful development of the common law of corporations by adopting the principles wholesale. The General Assembly's inaction is particularly understandable given the ALI's explicit recognition that the principles "can be implemented by judicial decision or rule…." *Id.* at cmt. b.

Whatever other positions the ALI may have taken, its analysis of director derivative standing is trenchant, logical, and persuasive:

> The implicit rationale … is that a director who discovers illegal or fraudulent behavior has a fiduciary duty to act to prevent its consummation or continuation. The necessary response may sometimes require litigation (just as a trustee may be required to defend the trust estate) … [D]enying the director the right to sue could render the director unable to fulfill effectively the director's fiduciary duty to the corporation, and might as a practical matter increase the director's own exposure to liability if no other means were available to oppose questionable transactions or conduct. Furthermore, particularly in the closely held corporation, a director will typically learn of an impending fraud or the misdeed well before the shareholders and is thus in a superior position to seek an injunction or other preventative remedy.

2 PRINCIPLES OF CORP. GOV. § 7.02(c) at cmt. h (emphasis added). This Court should adopt the ALI's position on this issue.

E. <u>Troy's Fear-Based Reasoning Is Not Well-Founded.</u>

At various points in its brief and building to a crescendo towards the conclusion, Troy predicts that horrible things will happen if this Court recognizes director derivative standing. This Court should not be swayed by Chicken Little advocacy.

Troy first predicts a flood of director derivative lawsuits if the Opinion is reversed. According to Troy, directors no longer will

engage in the "collegial resolution of intra-corporate disputes" but rather will free to run to court, resulting in "increased cost and frequency of derivative litigation." AB 22. Troy asks this Court to "[i]magin[e] the potential free-for-all…." AB 18.

Troy's concerns are flatly contradicted by experience and common sense. As Troy notes, this is an issue of first impression. *See* AB 8, 11, 15. The fact that not one director has tried to assert a derivative claim prior to this one hardly suggests that the flood gates will open. The ALI reached a similar conclusion, observing that "there is little, if any, evidence of [direct standing] abuse." *Id.* And there are quite powerful reasons why directors will not rush to sue. The sense of collegiality in a boardroom is quite strong; a director who sues his fellow directors has made a very difficult decision. Equally important, the director-plaintiff remains a fiduciary. If he has sued selfishly or in bad faith, he risks a potentially non-indemnifiable, non-exculpated claim for breach of the fiduciary duty. The threat of that claim alone is significant, and directors will think many times over before risking a heavy-handed corporate response. Thus when a director sues, a court can be confident that he truly believes the lawsuit has merit.

Troy next contends that granting derivative standing to directors would "improperly impinge on the fundamental right of the **board as a whole** to manage the business and affairs of the corporation." AB 19. According to Troy, "[a]ny time a single director disagreed with a business decision by the board, he could file a derivative suit to

seek to thwart the will of the majority of the board of directors." AB 20. Hardly.

Director derivative standing will not permit a single director to second-guess an entire board's business decisions. A director only will be able to sue derivatively **if the remainder of the board is conflicted.** In other words, the director will have to show demand futility. A director will have no ability to sue simply because he disagrees with his colleagues.

This is exactly the same power that stockholders now possess. *See Aronson*, 473 A.2d at 811. By establishing demand futility, a stockholder can remove a derivative action from the control of a board, subject to the board's ability to reassert its control through a special litigation committee. The same rules should apply to directors. There is no principled reason why the holder of a single share of stock can sue derivatively, yet a director with better information, an electoral mandate, and a duty to act, cannot.

Troy next foresees that director derivative standing will "chill directors' deliberative and collective decision-making process." AB 18. Troy warns that director standing will "discourage risk taking for fear that candid discussion among disagreeing board members would create a risk of time-consuming litigation." AB 21. Like Troy's other prophesies, this makes no sense. Many directors already have the ability to sue derivatively because, as Troy recognizes, they are also stockholders. *See* AB 19 n.10. Troy never explains why granting standing will loose a torrent of director derivative actions, while widespread stock ownership did not. If there were really boardroom

bullies using threats of "frivolous director lawsuits" to get their way, the problem already would exist.

Yet another of Troy's alarms sounds for the Court. According to Troy, the Delaware courts will have to face "many significant questions" if director derivative standing is recognized. AB 22. Such is the nature of the common law process. The Delaware courts have never decided critical questions of corporate governance with an eye to lightening judicial workloads. To the contrary, this Court has a proven the opposite by recognizing doctrines such as *Unocal* and *Zapata* that created "many significant questions" that are still with us today.

Last, Troy urges this Court not to give standing to "[a] single director, who is not an owner and thus not a beneficiary of the duties owed by other directors, and who also has no economic interest in the outcome of the action that he seeks to pursue." AB 16. Troy claims that "[l]acking an economic interest in the outcome, Schoon's own interests cannot be directly aligned with the stockholders." *Id.*

The idea that an outside director's interests cannot be aligned with those of the corporation and its stockholders runs counter to the principal tenet of the business judgment rule: the presumption that directors act in good faith and in the best interests of the corporation they serve. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006); *Aronson*, 473 A.2d at 812. Delaware law consistently relies on outside directors to do exactly what Troy claims they cannot - act in the best interests of the corporation. Too many decisions to mention discuss the importance of outside

directors, not stockholder-directors. *See, e.g., Unocal v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) ("proof is materially enhanced, as here, by the approval of a board comprised of a majority of outside, independent directors"); *Aronson*, 473 A.2d at 812 (explaining that the protections of the business judgment rule "can only be claimed by disinterested directors"). Section 144(a)(1) does not speak of approval by stockholder-directors; it speaks of approval by "disinterested directors." 8 *Del. C.* § 144(a)(1).[5]

Troy's twisted stockholder-director argument is really another way of arguing that Schoon is not an adequate derivative plaintiff. That issue can be addressed after discovery, by motion, or at trial. It is not a reason to deny directors standing in the first place.

Troy closes by asking, "[i]f the stockholders are not complaining about board decisions, when then should a single, disgruntled director be afforded that right?" AB 23-24. Simple: A director often will be the party best positioned to identify, understand, and address

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[5] It is certainly true that equity ownership by directors is frequently beneficial and can serve to align the interests of an outside director with those of the stockholders as a whole. *See generally* R. Franklin Balotti, *et al.*, *Equity Ownership and the Duty of Care: Convergence, Revolution, or Evolution?*, 55 Bus. Law. 661, 692 (2000). This beneficial alignment does not mean that directors who are not stockholders lose their ability to represent the corporation. To the contrary, Delaware law recognizes that in certain circumstances, material incentives created by equity ownership can misalign director interests and render stockholder-directors less able to consider the best interests of the corporation. *See, e.g., In re Tele-Communications, Inc. S'holders Litig.*, C.A. No. 16470, 2005 WL 3642727, at *7 (Del. Ch. Dec. 21, 2005) (applying entire fairness where directors were interested as a result of ownership of materially more of one series of shares than another); *In re FLS Holdings, Inc. S'holders Litig.*, C.A. No. 12623, 1993 WL 104562, at *5 (Del. Ch. Apr. 21, 1993) (applying entire fairness where directors were interested as

corporate malfeasance. He is elected by the stockholders. He has a mandate to protect the corporation and a fiduciary obligation to do so. He should be among the first to learn of problems. He should be well-informed about the issues he faces and the efforts made to address them. If he decides to sue, he already will possess first-hand knowledge about the corporate wrongdoing. He also has significant information rights and the ability to access information.

Troy conspicuously avoids addressing directly the policy ramifications of rejecting director derivative standing. Once a director has raised his concerns and been rebuffed by a conflicted board, he has few meaningful alternatives. He can vote against the actions being taken by the majority and attempt to create a record in case a stockholder decides to request books and records or sue. He can stand idly by while he believes breaches of fiduciary duty are occurring. He can resign, leaving the corporation and its stockholders no better off. Or he can share information about the wrongdoing with stockholders so that they can initiate derivative litigation. If he does so, then his interested adversaries can sue him claiming breach of his obligation of confidentiality, defamation, or breaches of the duty of loyalty. Far better that the director have standing to sue derivatively, to file the matter under seal if appropriate, and to protect the interests of the corporation and all of its stockholders.

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a result of ownership of materially more of one class of shares than another).

CONCLUSION

It is unfathomable that the courthouse doors are closed to a director who wishes to bring a derivative action on behalf of the corporation he serves. There should not be a "Wall Street Rule" for directors. A director of a Delaware corporation should be able to sue derivatively when a majority of the board is conflicted. For all of the foregoing reasons, the Opinion should be reversed and the case remanded for further proceedings.

/s/ J. Travis Laster
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