The Standing Demand Committee as a Response to Entire Fairness Litigation

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Increasingly, corporations and fiduciaries have faced enhanced litigation risk arising from entire fairness claims challenging related-party transactions and other transactions implicating unique interests of corporate fiduciaries. While most relevant for controlled public corporations, this risk is also pertinent for public and private corporations with significant nonmajority holders. Indeed, the prospect of costly entire fairness litigation is not limited to the M&A transactions that have historically been the focus of stockholder litigation and can encompass, for example, insider-led financings and compensation awards to influential founders. And when it arises, the risk of entire fairness litigation can alone supply plaintiffs with considerable settlement leverage.

But as the Delaware Supreme Court has confirmed in recent years, challenges to these types of commercial arrangements and related-party transactions in the course of business are, in most cases, derivative claims. And, while the Delaware Supreme Court declined to offer the reprieve from entire fairness standard of review in *In re Match Group Derivative Litigation* that was hoped for by some, the Supreme Court's decision in *Match* did reiterate that "it remains a 'cardinal precept' of Delaware law that independent and disinterested directors are generally in the best position to manage a corporation's affairs, including whether the corporation should exercise its legal rights," "even when it involves a controlling stockholder." Thus, for a stockholder to gain standing to prosecute entire fairness challenges derivatively, the stockholder generally must establish demand futility by alleging particularized facts raising a reasonable doubt as to the independence and disinterestedness of at least half of the board.

Various dynamics may nevertheless limit the effectiveness of Delaware's demand futility requirement as a safeguard against corporate claims that it is not in a corporation's best interests to pursue. For example, controlled companies utilizing the "controlled company exemption" offered by the New York Stock Exchange and NASDAQ are not required to have an independent board majority. Moreover, demand futility is generally resolved at the motion to dismiss phase based on the specified facts alleged by the stockholder in its own complaint, which are accepted as true even if cherry-picked or inaccurate, and all reasonable factual inferences that logically flow from these alleged facts. The nature of this pleading-stage determination may bolster a stockholder's demand futility arguments and could lead to a finding of demand futility based on allegations and inferences that may not hold true.

As more thoroughly reviewed in my recent article, "A Corporate Governance Solution to the Inefficiencies of Entire Fairness," 79 Bus. Law. 993 (2024), a potential solution for corporations seeking to mitigate the growing risks and costs of entire fairness litigation is the proactive establishment of an independent board committee vested with the power and authority to consider and take action in respect of any derivative litigation demands and related matters. This solution aligns with existing Delaware law, reindorsed by the Delaware Supreme Court in *Match*, that views independent directors as "generally in the best position" to manage derivative claims. As the article more thoroughly explains, specific statutory authority in Delaware's General Corporation Law, longstanding foundational principles of Delaware corporate law, and an overlooked aspect of the seminal duty of oversight case *Marchand v. Barnhill*, support the conclusion that the establishment of a standing demand committee can result in demand futility being assessed based on the independence and disinterestedness of the members of the committee, rather than the independence and disinterestedness of the entire board. In other words, it can result in demand futility being assessed based on the

independence of the committee members, who are presumably appointed to the committee, at least in large part, due to their independence, and without being negatively affected by the array of potentially interested directors—such as executive directors, founders, family members of interested persons, and representatives of large investors—whose presence on the board often undermines efforts to defend allegations of demand futility. This would solidify independent director authority over derivative claims and promote the efficient management of derivative claims, while reducing the costs of opportunistic derivative litigation currently faced by many corporations. Importantly, the standing demand committee may achieve these objectives without necessarily invoking the heightened standard of review that applies when a special litigation committee investigates and seeks dismissal of previously filed litigation.

The implementation of a standing demand committee is a viable solution for not only newly public corporations conducting IPOs, but also many existing public and private corporations. While the article specifically addresses the effect of a standing demand committee established by charter provision, it further posits that a charter amendment may not necessarily be needed to produce this shift in the assessment of demand futility where an independent demand committee is otherwise established to protect a corporation's derivative litigation rights. As the Delaware Supreme Court explained nearly 100 years ago in *Sohland v. Baker*: "The right of a stockholder to file a derivative action to litigate corporate rights is ... solely for the purpose of preventing injustice, where it is apparent that material corporate rights would not otherwise be protected." And for public corporations with existing controlling stockholders, the Delaware Supreme Court's recent decision rejecting the application of entire fairness to Tripadvisor, Inc.'s proposed move to Nevada in *Maffei v. Palkon* bolsters the conclusion, further explained in the article, that there is reason to believe that the protections of the business judgment rule should adhere to the establishment of a standing demand committee on a "clear day."

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