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Client Alert

November 2009

RECENT DELAWARE DECISION ADDRESSES DIRECTORS' FIDUCIARY DUTIES IN ALL-TOO-COMMON SCENARIO

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Before the advent of the current recession, many start-up and early-stage companies were able to attract investments from venture capital companies, so-called angel investors and other professional investors. These investments often were in the form of preferred stock of the company, which, among other things, afforded the preferred stockholders a preference over the company's common stockholders in the event of a sale or liquidation of the company or similar events. As the economy soured, the business of many of these companies faltered, presenting their boards of directors with the dilemma of whether to try to carry on the business or to accomplish a sale of the company or other transaction in order to salvage the remaining business and assets. This decision often places at odds the interests of the company's preferred stockholders and common stockholders and poses difficult issues for directors in fulfilling their fiduciary duties.

In a recent decision, *In re Trados, Inc. Shareholders Litigation*, the Delaware Chancery Court refused to dismiss claims by a common stockholder against a company's directors for breach of fiduciary duty arising out of a merger of the company in which there was no merger consideration available to pay common stockholders after the payment of the liquidation preference of the company's preferred stockholders. The Court noted that approval by directors of a transaction in which common stockholders receive no consideration due to the liquidation preference of preferred stockholders does not necessarily amount to a breach of the directors' fiduciary duty. According to the Court, however, when the interests of the common stockholders and of the preferred stockholders diverge, "generally it will be the duty of the board … to prefer the interests of the [holders of] common stock … to the interests created by the special rights, preferences, *etc.*, of preferred stock."

Under the specific facts of the *Trados* case, the Court found that the common stockholders might have been able to receive some consideration for their shares in the future if the company had continued to pursue its business plan and not entered into the merger. The Court also found that the directors' decision to approve the merger was not entitled to the normal presumptions of the business judgment rule, because four of the seven board members had been designated by the preferred stockholders and were dependent on the preferred stockholders for their livelihood, so they were "interested" in the merger transaction.

Based on the circumstances, the Court refused to dismiss the plaintiff common stockholder's claim that the board of directors breached its fiduciary duty by approving the merger where the common stockholders would receive no consideration and there was no need to merge or sell the company other than to satisfy the preferred stockholders' desire to obtain a return of a portion of their investment.