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Delaware Supreme Court Holds That Insider Trading Claims Alleging Misuse of Confidential Corporate Information Need Not Show Injury To the Corporation

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In *Kahn et al v. Kolberg Kravis Roberts & Co., L.P.*, No. 1808, 2011 WL 2447690 (Del. June 20, 2011), the Delaware Supreme Court reversed the dismissal of breach of fiduciary duty claims brought by minority shareholders against corporate officers and a controlling shareholder. The Supreme Court held that plaintiffs could state a claim seeking disgorgement by fiduciaries who allegedly profit from using confidential corporate information, even if the corporation did not suffer actual harm. In so holding, the Court rejected earlier, lower court precedent, and declined to limit the disgorgement remedy to a usurpation of corporate opportunity or cases where the insider used confidential corporate information to compete directly with the corporation.

Shareholders of Primedia, Inc. brought a derivative action against officers and directors of Primedia and against Kohlberg, Kravis, Roberts & Co. ("KKR"), which indirectly controlled a majority of Primedia's common stock. Plaintiffs alleged that the defendants breached their duty of loyalty by causing Primedia to call hundreds of millions of dollars of preferred stock that it was not yet obligated to redeem, enriching KKR at Primedia's expense. The complaint was amended several times — most recently to add a "*Brophy* claim" that the KKR defendants breached their fiduciary duties to Primedia by purchasing the preferred stock at a time when they possessed material, non-public information. A "*Brophy* claim" (*see Brophy v. Cities Serv. Co.*, 70 A.2d 5(Del. Ch. 1949)), is one in which a corporate fiduciary possesses material nonpublic company information and the corporate fiduciary uses that information improperly by making trades because he or she was motivated, in whole or in part, by the substance of that information. *See, e.g., In re Oracle Corp. Deriv. Litig.*, 867 A.2d 904, 934 (Del. Ch. 2004), *aff'd*, 872 A.2d 960 (Del. 2005).

The Delaware Court of Chancery granted the Primedia Special Litigation Committee's motion to dismiss the derivative claims. The court held that under the law as explained in *Pfeiffer v. Toll*, 989 A.2d 683 (Del. Ch. 2010), disgorgement was not an available remedy for the plaintiffs' *Brophy* claims because Primedia was not actually harmed. Plaintiffs appealed.

The Delaware Supreme Court reversed. The Court explained that in *Brophy*, a corporate employee acquired inside information that the plaintiff issuer was about to enter the market and purchase its own shares. Using this confidential information, the employee, who was not an officer, bought a large block of shares and, after the corporation's purchases had caused the price to rise, resold them at a profit. The court stated that because the employee occupied a position of trust and confidence within the corporation, his relationship was analogous to that of a fiduciary. The employee argued that the corporation failed to state a claim against him because the corporation suffered no loss through the purchase of its stock. The Delaware Supreme Court, however, disagreed, holding that "actual harm to the corporation is not required for a plaintiff to state a claim under *Brophy*."

The Supreme Court recognized that the *Brophy* court relied on the principles of restitution and equity for the proposition that a fiduciary cannot use confidential corporate information for his own benefit. The Court explained that public policy will not permit an employee occupying a position of trust and confidence toward his employer to abuse that relation to his own profit, regardless of whether his employer suffers a loss. Hence, the Court held that "[e]ven if the corporation did not suffer actual harm, equity requires disgorgement of that profit." The Court remanded and directed the trial court to analyze the *Brophy* claim "without any assumption that an element of harm to the corporation must exist before a disgorgement equitable remedy is available."

In its decision, the Delaware Supreme Court clarified that *Brophy* focused on preventing a fiduciary wrongdoer from being unjustly enriched based on the misuse of confidential corporate information. In so holding, the Court declined to adopt *Pfeiffer's* "thoughtful, but unduly narrow" interpretation of *Brophy* and its progeny. The Court also disagreed with *Pfeiffer's* conclusion that the purpose of *Brophy* is to "remedy harm to the corporation." This decision expands the availability of *Brophy* claims for insider trading, as potential plaintiffs need not prove a harm to the corporation before a disgorgement equitable remedy is available.

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