Chapter 1

Directors and Officers Liability

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1-1 INTRODUCTION

Corporate officers and directors have broad discretion to act on behalf of a corporation, but certain conduct may expose them to liability. Directors usually get the benefit of the business judgment rule (see below) as long as they are independent and act reasonably and in good faith. As discussed in detail below, claims that are most often brought against corporate officers and directors for wrongdoing relate to their duties of care and loyalty and include breach of fiduciary duty, failure of oversight, usurpation of corporate opportunities, and waste of corporate assets.[2] This chapter discusses the duties of officers and directors, the claims that may be asserted against them, and their defenses and rights with respect to such claims including protective measures to avoid liability.

[1.] The author wishes to thank Giovanna Ferrari and Sarah Fedner for their contributions to this chapter.

[2.] Directors and officers are also sometimes named as defendants in federal securities litigation involving alleged violations of the securities laws often but not always as class actions. Chapter 4, below deals with some common types of securities litigation. Chapter 1 covers the types of claims against officers and directors enumerated above that can be brought as individual actions, derivative actions, class actions, and multi-plaintiff actions.

1-2 DUTIES OF A DIRECTOR OR OFFICER

1-2:1 General Obligations of Directors and Officers

Under New York law, a corporation's directors and officers owe duties to protect the interests of corporations and "occupy positions of trust in relation to" the corporation and its shareholders.[3] Directors and officers owe fiduciary duties of care and loyalty to the corporation and its shareholders.[4] As part of their duty of loyalty to the corporation, directors and officers have a duty to exercise oversight as to the most important activities (sometimes referred to as "mission critical" activities) and to the management of significant risks of the corporation. They also have a duty not to take for the benefit to themselves, business opportunities that belong to the corporation.[5] New York law does not recognize a fiduciary duty to disclose all material information to shareholders as part of the duties of care and loyalty owed by directors and officers except in specific situations noted below, such as where the director or officer makes a statement and omits material information necessary to make the representations not misleading.[6] Of course, where statements are made, it is a violation if they are misleading.

1-2:1.1 Duty of Care

Under New York law, directors and officers have a fiduciary duty of care to the corporation and its shareholders.[7] For directors, this duty is codified in Section 717 of the Business Corporation Law, which provides that "[a] director shall perform his duties as a director, including his duties as a member of any committee of

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3. *Alpert v. 28 Williams St. Corp.*, 473 N.E.2d 19, 25-26 (N.Y. 1984); *Winter v. Anderson*, 275 N.Y.S. 373, 375-76 (N.Y. App. Div. 1934).

4. N.Y. Bus. Corp. Law § 717(a) (McKinney 2024); *Syracuse Television, Inc. v. Channel 9, Syracuse, Inc.*, 273 N.Y.S.2d 16, 27 (N.Y. Sup. Ct. 1966).

5. *In re Greenberg*, 614 N.Y.S.2d 825, 826-27 (N.Y. App. Div. 1994); *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 533-34 (N.Y. App. Div. 1989).

6. *Lindner Fund, Inc. v. Waldbaum, Inc.*, 589 N.Y.S.2d 560, 561 (N.Y. App. Div. 1992), *aff'd*, 624 N.E.2d 160 (N.Y. 1993); *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 357 (Del. Ch. 2008) (noting that the duty to disclose all material facts to shareholders in connection with a request for shareholder action is an application of the fiduciary duties of care and loyalty).

7. N.Y. Bus. Corp. Law § 717(a) (McKinney 2024); *Syracuse Television, Inc. v. Channel 9, Syracuse, Inc.*, 273 N.Y.S.2d 16, 27 (N.Y. Sup. Ct. 1966) (stating that directors and officers are charged with a duty of care in carrying out their corporate responsibilities).

the board upon which he may serve, in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances."[8] The duty of care requires directors and officers to act in an informed and reasonably diligent manner.[9]

In evaluating whether a director has complied with the duty of care, New York courts first determine if the business judgment rule applies with respect to a particular decision or judgment by the officer or director. The business judgment rule will protect directors as to decisions or judgments as to which the director or officer is independent and has exercised reasonable care in good faith. If it is found to apply, the business judgment rule means that courts will give great deference to decisions or actions of a board member, board or committee of the board and are likely to find such a decision or action to be fair to the corporation and shareholders.[10] The action or decision will have a rebuttable presumption of being fair and appropriate where the business judgment rule applies. The business judgment rule is discussed in detail in Section 1-2:3, below.

1-2:1.2 Duty of Loyalty

Directors and officers have a fiduciary duty of "undivided and unqualified loyalty to the corporation."[11] The fiduciary duty of loyalty imposes on corporate directors an obligation not to adopt or promote personal interests that are inconsistent with the interests of their corporation.[12] Accordingly, a director or officer is not permitted to derive a personal profit at the expense of the corporation other than when approved by non-conflicted directors.[13]

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8. N.Y. Bus. Corp. Law § 717(a) (McKinney 2024).

9. *Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 273 (2d Cir. 1986); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 362 (N.Y. Sup. Ct. 2005).

10. *Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 273 (2d Cir. 1986).

11. *Foley v. D'Agostino*, 248 N.Y.S.2d 121, 128 (N.Y. App. Div. 1964) (citation omitted); *see also Limmer v. Medallion Grp., Inc.*, 428 N.Y.S.2d 961, 963 (N.Y. App. Div. 1980) (stating that the duty of loyalty "encompasses good faith efforts to insure that their personal profit is not at the expense of the corporation"); *Fortunatas Grex Int'l Inc. v. Bakhshi*, No. 153337/12, 2013 WL 3724925, at *7 (N.Y. Sup. Ct. Mar. 13, 2013) (same).

12. *Aon Risk Servs., N.E. v. Cusack*, No. 651673/11, 2011 N.Y. Misc. LEXIS 6392 (N.Y. Sup. Ct. Dec. 20, 2011); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 357 (N.Y. Sup. Ct. 2005).

13. *In re Greenberg*, 614 N.Y.S.2d 825, 826-27 (N.Y. App. Div. 1994); *Bertoni v. Catucci*, 498 N.Y.S.2d 902, 904-05 (N.Y. App. Div. 1986); *Bernheim v. 136 E. 64th St. Corp.*, 512 N.Y.S.2d 825, 826 (N.Y. App. Div. 1987).

Directors and officers must not allow their private interests to conflict with corporate interests[14] and they must treat all shareholders fairly.[15]

1-2:2 Reliance on Advice of Experts and by Third Parties and on Records

In discharging their fiduciary duty of care, directors are permitted by Business Corporation Law Section 717 to rely on advice, information, opinions, reports, or statements, including financial statements and other financial data, prepared by counsel, public accountants or other persons as to matters that the director reasonably believes to be within such person's professional or expert competence.[16] A director's reliance on such advice or information must be in good faith and be considered by a director with the degree of care that an ordinarily prudent person would use.[17] A director may only invoke the protection of Section 717 if reliance on the advice at issue was reasonable. Based on Section 717, courts have upheld directors' defenses of good faith reliance on auditors,[18] accountants,[19] financial advisors,[20] attorneys,[21] and subject matter experts. However, courts have explained that a director may not

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14. *Foley v. D'Agostino*, 248 N.Y.S.2d 121, 128 (N.Y. App. Div. 1964) (officers and directors "may not assume and engage in the promotion of personal interests which are incompatible with the superior interests of their corporation"); *Ritani, LLC v. Aghjayan*, 880 F. Supp. 2d 425, 454 (S.D.N.Y. 2012) (same).

15. *RSL Commc'ns PLC ex rel. Jervis v. Bildirici*, 649 F. Supp. 2d 184, 199 (S.D.N.Y. 2009), *aff'd*, 412 F. App'x 337 (2d Cir. 2011) (Summary Order); *Alpert v. 28 Williams St. Corp.*, 473 N.E.2d 19, 25-26 (N.Y. 1984); *see Bryan v. W. 81st St. Owners Corp.*, 589 N.Y.S.2d 323, 324 (N.Y. App. Div. 1992) (explaining that "[i]t is not necessary to plead that the directors acted in self-interest; pleading unequal treatment of shareholders will suffice" to show a breach of the duty of loyalty).

16. N.Y. Bus. Corp. Law § 717(a) (McKinney 2024).

17. N.Y. Bus. Corp. Law § 717(a) (McKinney 2024).

18. *Simon v. Castello*, 172 F.R.D. 103, 107 (S.D.N.Y. 1997) (defendant-directors were entitled to rely on audited financial statements).

19. *Berman v. Le Beau Inter-Am., Inc.*, 62 B.R. 262, 267-68 (S.D.N.Y. 1986) (directors were acting in good faith, and therefore had the right to rely upon the financial statements of the company's accountants, reports prepared by attorneys and the approval given by bank-lenders).

20. *Buffalo Forge Co. v. Ogden Corp.*, 555 F. Supp. 892, 904 (W.D.N.Y.) (reliance on financial advisors was appropriate), *aff'd*, 717 F.2d 757 (2d Cir. 1983).

21. *Stoner v. Walsh*, 772 F. Supp. 790, 803 (S.D.N.Y. 1991) (board permitted to rely on designated committee of three outside directors to investigate litigation demand and report to the full board); *Berman v. Le Beau Inter-Am., Inc.*, 62 B.R. 262, 267-68 (S.D.N.Y. 1986); *Buffalo Forge Co. v. Ogden Corp.*, 555 F. Supp. 892, 904 (W.D.N.Y.), *aff'd*, 717 F.2d 757 (2d Cir. 1983) (reliance on outside counsel was appropriate).

"mindlessly defer" to expert advice without conducting his or her own review of the relevant facts.[22] If directors have information that contradicts the information provided by a third party, then their reliance on the third party's statements may be considered unreasonable. Facts and circumstances concerning the reliability of the person providing advice should be considered with reasonable care by a director in reaching a conclusion.[23]

The Court of Appeals addressed this issue in *Kimmell v. Schaefer*, holding that a director could not avoid liability for negligent misrepresentation by asserting that he relied on financial projections provided by corporate employees in making representations to the plaintiffs because he "had no basis for assessing [the employees'] competence, and failed to make any inquiry into the basis or methodology of the projections."[24] Although directors may rely on the advice and reports of financial and legal advisors, "directors have some oversight obligations to become reasonably familiar with an opinion, report, or other source of advice before becoming entitled to rely on it."[25] Directors risk liability for breach of fiduciary duty if they rely on proposals by self-interested management and do not perform their own inquiry.[26]

1-2:3 The Business Judgment Rule

New York law recognizes a presumption, known as the business judgment rule, which protects corporate directors who "act in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes."[27] As the Court of Appeals has observed, "the business judgment doctrine, at least

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22. *Macnish-Lenox, LLC v. Simpson*, 851 N.Y.S.2d 64 (Table), 2007 WL 3086028, at *12 (N.Y. Sup. Ct. 2007).

23. *Stephens v. Nat'l Distillers & Chem. Corp.*, Nos. 91 Civ. 2901, 2902, 1996 WL 271789, at *6-8 (S.D.N.Y. May 21, 1996).

24. *Kimmell v. Schaefer*, 675 N.E.2d 450, 455 (N.Y. 1996).

25. *Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 275 (2d Cir. 1986); *Macnish-Lenox, LLC v. Simpson*, 851 N.Y.S.2d 64 (Table), 2007 WL 3086028, at *12 (N.Y. Sup. Ct. 2007).

26. *Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 277 (2d Cir. 1986).

27. *In the Matter of Comverse Tech., Inc., Derivative Litig.*, 866 N.Y.S.2d 10, 16 (N.Y. App. Div. 2008) (quoting *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979)); *Carroll v. Radoniqi*, 963 N.Y.S.2d 97, 98 (N.Y. App. Div. 2013); *Deblinger v. Sani-Pine Prods. Co.*, 967 N.Y.S.2d 394, 396-97 (N.Y. App. Div. 2013) (issue of fact as to whether director's decision to pay herself compensation after the corporation no longer had active ongoing business to conduct was protected by the business judgment rule).

in part, is grounded in the prudent recognition that courts are ill equipped and infrequently called on to evaluate what are and must be essentially business judgments."[28] Therefore, courts generally accord great deference to board actions taken by independent directors who are reasonably informed on the issue in question. The business judgment rule presumption is rebuttable and may be rebutted by evidence that the directors breached a fiduciary duty by engaging in self-dealing, making decisions tainted by conflicts of interests, or acting fraudulently, dishonestly or in bad faith or failing to act with reasonable diligence in informing herself of relevant facts and circumstance.[29] The mere fact that a shareholder plaintiff alleges that he disagrees with a board's decision or that the decision was imprudent is insufficient to overcome the presumption.[30] However, once the business judgment presumption is rebutted (for example, by showing the director has a conflict of interest), the burden shifts to the defendant director to prove that the challenged decision was fair to the corporation.[31]

A director may be deemed to have a conflict of interest and lacks independence where he or she stands to receive a personal benefit from the transaction at issue that is different from that received by all shareholders, or where a director with no personal interest in a transaction is controlled by an interested director.[32] Conversely,

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28. *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979); *In re Perry Koplik & Sons, Inc.*, 476 B.R. 746, 795 (Bankr. S.D.N.Y. 2012), *adopted in part*, 499 B.R. 276 (S.D.N.Y. 2013), *aff'd*, 567 F. App'x 43 (2d Cir. 2014) (Summary Order).

29. *In re Eugenia VI Venture Holdings, Ltd. Litig.*, 649 F. Supp. 2d 105, 126 (S.D.N.Y. 2008), *aff'd*, 370 F. App'x 197 (2d Cir. 2010); *Auerbach v. Bennett*, 393 N.E.2d 994, 1000-01 (N.Y. 1979); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 357 (N.Y. Sup. Ct. 2005); *Kamin v. Am. Exp. Co.*, 383 N.Y.S.2d 807, 811 (N.Y. Sup. Ct.), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1976); *Irene David Realty, Inc. v. Moyal*, 967 N.Y.S.2d 41, 42 (N.Y. App. Div. 2013); *Ochiagha v. Onwuachu*, No. 103566/12, 2012 WL 6629767, at *6-7 (N.Y. Sup. Ct. Nov. 27, 2012) (allegations of bad faith will rebut the presumption of the business judgment rule).

30. *In the Matter of Comverse Tech., Inc., Derivative Litig.*, 866 N.Y.S.2d 10, 16 (N.Y. App. Div. 2008); *Board of Mgrs. of Essex House Condo.v. Manhattan L.B. Living Tr.*, 906 N.Y.S.2d 770 (Table), 2009 WL 3853853, at *2 (N.Y. Sup. Ct. 2009).

31. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 357 (N.Y. Sup. Ct. 2005); *In re Perry Koplik & Sons, Inc.*, 476 B.R. 746, 803 n.307 (Bankr. S.D.N.Y. 2012), *adopted in part*, 499 B.R. 276 (S.D.N.Y. 2013), *aff'd*, 567 F. App'x 43 (2d Cir. 2014) (Summary Order).

32. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 357 (N.Y. Sup. Ct. 2005); *see also Marx v. Akers*, 666 N.E.2d 1034, 1042 (N.Y. 1996) (stating that a director is considered interested in a transaction if the director stands to receive "a direct financial benefit from the transaction which is different from the benefit to shareholders generally" and dismissing claim for breach of fiduciary duty based on alleged domination by CEO because complaint failed to allege adequately that he had "coercive control of the Board"); *Stein v.*

if a director does not receive a direct financial benefit from a transaction that is different from that received by other shareholders, he or she will generally not be considered interested.[33] Directors may be considered interested where they award themselves excessive compensation.[34] "Once a prima facie showing is made that directors have a self-interest in a particular corporate transaction, the burden shifts to them to demonstrate that the transaction is fair and serves the best interests of the corporation and its shareholders."[35]

Moreover, even if directors are independent and not self-interested, their actions will only be protected by the business judgment rule to the extent that any action was taken using a reasonable process in arriving at a business judgment.[36] Where directors' "'methodologies and procedures' are 'so restricted in scope, so shallow in execution, or otherwise so *pro forma* or halfhearted as to constitute a pretext or sham,' then inquiry into their acts is not shielded by the business judgment [rule]."[37]

1-3 TYPES OF CLAIMS AGAINST DIRECTORS AND OFFICERS

As an initial matter, it is well established that issues concerning corporate governance are most often controlled by the law of the state of incorporation.[38] This rule is often referred to as the "internal affairs" doctrine. New York law should be applied to issues regarding

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Immelt, 472 F. App'x 64, 66 (2d Cir. 2012) (Summary Order) (explaining standard for director self-interest).

33. *Shapiro v. Rockville Country Club, Inc.*, 802 N.Y.S.2d 717, 720 (N.Y. App. Div. 2005).

34. *Marx v. Akers*, 666 N.E.2d 1034, 1042 (N.Y. 1996) ("if the board votes directorial compensation for itself, the board is interested") (citation omitted); *A.X.M.S. Corp. v. Friedman*, 948 F. Supp. 2d 319, 335 (S.D.N.Y. 2013) (directors interested in their employment agreements and salary arrangements "since they stood to benefit from them whereas [the corporation] did not").

35. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984).

36. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 362-63 (N.Y. Sup. Ct. 2005); *In re Perry Koplik & Sons, Inc.*, 476 B.R. 746, 795 (Bankr. S.D.N.Y. 2012) ("directors and officers of a company must earn the protections of the business judgment rule by meeting minimum standards of care in the *process* by which their decisions are made"), *adopted in part*, 499 B.R. 276 (S.D.N.Y. 2013), *aff'd*, 567 F. App'x 43 (2d Cir. 2014) (Summary Order).

37. *Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 274 (2d Cir. 1986) (finding a breach of the duty of due care) (quoting *Auerbach v. Bennett*, 393 N.E.2d 994, 1003 (N.Y. 1979)).

38. *Hart v. GM Corp.*, 517 N.Y.S.2d 490, 492 (N.Y. App. Div. 1987); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 347 n.14 (N.Y. Sup. Ct. 2005).

the corporate governance of corporations that are incorporated in New York without regard to the state in which the claim is brought. From a procedural perspective, shareholders may sue officers and directors in three ways. First, shareholders may assert claims directly against corporate officers and directors for wrongdoing in connection with their service to the corporation and the shareholders. Second, in instances where a corporate action affects many or all shareholders, such as a proposed change of control transaction, shareholders may assert class action claims against officers and directors. Third, subject to certain requirements discussed below, shareholders may bring claims against directors and officers derivatively on behalf of the corporation to remedy wrongs and/or injuries suffered by the corporation. Among the substantive claims that are most commonly asserted against officers and directors include claims for breach of one or more fiduciary duty, failure of oversight, usurpation of corporate opportunities, corporate waste and securities law claims.[39]

1-4 DIRECT ACTIONS

Shareholders may bring direct claims against corporate officers and directors to remedy wrongs to the corporation or its shareholders.[40] Such direct claims include claims for breach of fiduciary duty.[41] In addition, where a corporation does not have publicly traded shares, the shareholders may under certain circumstances petition for the involuntary dissolution of a corporation. Where the directors or those in control of a non-public corporation that does not have shares listed on a national securities exchange are "guilty of illegal, fraudulent or oppressive actions toward the complaining shareholders" or looting, wasting or diverting for non-corporate purposes the property or assets of the corporation, "[t]he holders of shares representing twenty percent or more of the votes of all

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[39] It is beyond the scope of this chapter to broadly discuss federal securities law claims, which are also frequently brought against directors.

[40] *See Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *9-10 (E.D.N.Y. Sept. 22, 1997) (shareholders sought to enjoin a merger); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 343 (N.Y. Sup. Ct. 2005) (shareholders challenged a merger).

[41] *See, e.g.*, *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 343 (N.Y. Sup. Ct. 2005) (shareholders alleged direct claims for breach of fiduciary duty against directors based on their approval of a merger); *see also Fortunatas Grex Int'l Inc. v. Bakhshi*, No. 153337/12, 2013 WL 3724925, at *8 (N.Y. Sup. Ct. Mar. 13, 2013) (shareholder alleged direct and derivative claim for breach of fiduciary duty).

outstanding shares of a corporation . . . may present a petition for dissolution"[42] of the corporation.

1-5 CLASS ACTIONS

Where directors and officers have taken actions that affect all shareholders or all shareholders with a common characteristic, a shareholder may assert class action claims against officers and directors on behalf of such a class of shareholders. For example, shareholder class actions for breach of fiduciary duty challenging a change in corporate control, such as a proposed merger or acquisition, became extremely common beginning in the late 1990s.[43] In some situations, they were filed with little basis.[44]

Merger-related class actions became extremely common between 2012 and 2016 with over 90% of public company mergers being subjected to such lawsuits. These merger-related lawsuits were frequently settled cheaply with only some minor additional disclosures allegedly benefitting plaintiff, attorneys' fees going to the plaintiff's lawyers and a broad release given to defendants.[45]

In many disclosure-only settlements, there seemed to be no significant benefit to shareholders in the settlement terms,[46] despite the plaintiffs' lawyers getting legal fees and the defendant often getting a very broad release.[47] A respected federal circuit court

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42. N.Y. Bus. Corp. Law § 1104-a(a) (McKinney 2024); *In re Behedo* (*Brother's Staffing Inc.*), No. 23745/12, 2013 WL 3069319, at *1 (N.Y. Sup. Ct. June 17, 2013) (plaintiff commenced an action for dissolution pursuant to Business Corporation Law § 1104-a(a)(1)).

43. *See, e.g.*, *Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *9-10 (E.D.N.Y. Sept. 22, 1997) (shareholders sought to enjoin a merger); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 343 (N.Y. Sup. Ct. 2005) (shareholders challenged the fairness of a proposed merger).

44. *See* Richard Kapnick, *Evaluating Attorney Fee Requests in Mergers and Acquisitions Litig.*, 856 PLI/Lit 269 (Apr. 8, 2011) (noting that "many mergers and acquisitions transactions continue to be challenged by sometimes flimsy and opportunistic complaints").

45. *E.g.*, *In re Wm. Wrigley Jr. Co. S'holders Litig.*, No. 3750-VCL, 2009 WL 154380, at *5-6 (Del. Ch. Jan. 22, 2009) (shareholder class action settlement did not provide any monetary relief for the plaintiff shareholders, but required a modification of disclosures regarding the merger and an award of attorneys' fees to plaintiffs' counsel).

46. *See generally* Gregory A. Markel & Gillian Groarke Burns, *Expert Q&A on Judicial Activism and Disclosure-Only Settlements in Delaware*, Prac. L. 22-25 (Aug./Sept. 2016); Gregory A. Markel et al., *Delaware Judges Have Been Heard*, Law360 (Feb. 2, 2016), *available at* https://www.cadwalader.com/uploads/books/25f908c44dc7fc6fc5a0cd481079f775.pdf (last visited Feb. 29, 2024).

47. *See generally* Gregory A. Markel et al., *Delaware Judges Have Been Heard*, Law360 (Feb. 2, 2016), *available at* https://www.cadwalader.com/uploads/books/25f908c44dc7fc6fc5a0cd481079f775.pdf (last visited Feb. 29, 2024).

judge called such settlements a "racket."[48] This situation began to change in Delaware, and other jurisdictions when courts refused to approve settlements not providing material benefit to class members.[49] New York courts sometimes seem to be somewhat more tolerant of disclosure-only settlements.[50]

After the decision in *Trulia*,[51] disclosure-only settlements have largely disappeared in Delaware Chancery Court. Chancery Court judges will not approve such settlements unless the added disclosure from the settlement is determined to be of material value to the plaintiff class and the release to defendants is not unreasonably broad. Before long a new phenomenon arose known as "mootness fees." Many merger-related cases began to be brought in federal courts rather than in Delaware Chancery. These cases typically end by additional disclosure being made by the acquired company and a fee being paid to plaintiff's lawyer, and the case is voluntarily dismissed. Because it is a voluntary dismissal, in most instances court approval is not required.[52] The main beneficiary of these fees appeared to be a small group of plaintiffs' lawyers who frequently bring these class actions and then agree to dismiss them in a settlement that involves a fee to the plaintiffs' lawyers and the plaintiff class getting only an often worthless additional disclosure. Many commentators, including some plaintiffs' side attorneys, view mootness fee cases to often be blatantly abusive.

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48. *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718, 724 (7th Cir. 2016).

49. *See, e.g.*, *In re Trulia, Inc., Stockholder Litig.*, 129 A.3d 884 (Del. Ch. 2016); *In re BTU Int'l, Inc. Stockholders Litig.*, No. 10310-CB (Del. Ch. Feb. 18, 2016) (transcript); *In the Matter of Allied Healthcare S'holder Litig.*, 26 N.Y.S.3d 212 (Table), 49 Misc. 3d 1210(A) (N.Y. Sup. Ct. Oct. 23, 2015); *Gordon v. Verizon Commc'ns, Inc.*, No. 653084/13, 2014 WL 7250212, at *3, *7 (N.Y. Sup. Ct. Dec. 19, 2014); *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718 (7th Cir. 2016); *City Trading Fund v. Nye*, No. 651668/2014, 2015 WL 93894, at *13, *19 (N.Y. Super. Ct. Jan. 7, 2015) (characterizing proposed supplemental disclosures as grossly and utterly immaterial).

50. *See, e.g.*, *In re Trulia, Inc., Stockholder Litig*., 129 A.3d 884 (Del. Ch. 2016); *In re BTU Int'l, Inc. Stockholders Litig*., No. 10310-CB (Del. Ch. Feb. 18, 2016) (transcript); *In the Matter of Allied Healthcare S'holder Litig*., 26 N.Y.S.3d 212 (Table), 49 Misc. 3d 1210(A) (N.Y. Sup. Ct. Oct. 23, 2015); *Gordon v. Verizon Commc'ns, Inc*., No. 653084/13, 2014 WL 7250212, at *3, *7 (N.Y. Sup. Ct. Dec. 19, 2014); *In re Walgreen Co. Stockholder Litig*., 832 F.3d 718 (7th Cir. 2016); *City Trading Fund v. Nye*, No. 651668/2014, 2015 WL 93894, at *13, *19 (N.Y. Super. Ct. Jan. 7, 2015) (characterizing proposed supplemental disclosures as grossly and utterly immaterial).

51. *See generally* Gregory A. Markel et al., *Delaware Judges Have Been Heard*, Law360 (Feb. 2, 2016), *available at* https://www.cadwalader.com/uploads/books/25f908c44dc7fc6fc5a0cd481079f775.pdf (last visited Mar. 1, 2024).

52. *See generally* Gregory A. Markel & Sarah A. Fedner, *Two Areas for Reform of Securities Litigation*, The Review of Securities & Commodities Regulation (2020).

1-6 SECURITIES LITIGATION UNIFORM STANDARDS ACT (SLUSA)

Shareholders cannot bring state law claims for fraud in connection with the purchase or sale of securities on behalf of a class of 50 or more persons because such claims are preempted by the federal Securities Litigation Uniform Standards Act (SLUSA).[53] There are certain exceptions to this rule. There is a statutory provision permitting claims under the Securities Act of 1933 to be brought in either federal or state court. In 2018, the United States Supreme Court resolved this issue in *Cyan, Inc. v. Beaver County Employees Retirement Fund*.[54] Some issues relating to *Cyan* are controversial. It is now possible to bring cases that are actually substantially the same in both state and federal court if the names of the plaintiffs are different. It is beyond the scope of this chapter to go into detail on this issue, but see footnoted article.[55]

Other than the exceptions provided for, if a material misrepresentation or omission in connection with the purchase or sale of securities is a necessary element of the state law claim that is asserted on behalf of a class, then it will be precluded.[56] SLUSA was enacted to place limits on the ability of plaintiffs to avoid the heightened pleading requirements for securities fraud set forth in the Private Securities Litigation Reform Act of 1995 by filing securities class actions in state court.[57] SLUSA applies to "covered securities," which are those "'traded nationally and listed on a regular national exchange' or 'issued by an investment company

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53. 15 U.S.C. § 78bb(f)(1); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 83-84 (2006); *In re Fannie Mae 2008 Sec. Litig.*, 891 F. Supp. 2d 458, 479 (S.D.N.Y. 2012) (discussing requirements to trigger SLUSA preclusion), *aff'd*, 525 F. App'x 16 (2d Cir. 2013) (Summary Order).

54. *Cyan, Inc. v. Beaver Cnty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018). *See also* Gregory A. Markel et al., *Supreme Court Affirms State Courts' Jurisdiction Over 1933 Act Claims*, Seyfarth Shaw LLP (Mar. 22, 2018).

55. *See generally* Gregory A. Markel & Sarah A. Fedner, *Two Areas for Reform of Securities Litigation*, The Review of Securities & Commodities Regulation (2020).

56. *See In re Stillwater Cap. Partners Inc. Litig.*, 851 F. Supp. 2d 556, 569 (S.D.N.Y. 2012); *Yale M. Fishman 1998 Ins. Tr. v. Gen. Am. Life Ins. Co.*, No. 11 Civ-1284, 2013 WL 842642, at *6 (S.D.N.Y. Mar. 7, 2013) (explaining that "SLUSA bars class actions brought under state law that allege a 'misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security'") (citation omitted).

57. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 82 (2006); *RGH Liquidating Tr. ex rel. Reliance Grp. Holdings, Inc. v. Deloitte & Touche LLP*, 955 N.E.2d 329, 333-34 (N.Y. 2011).

that is registered, or that has filed a registration statement, under the Investment Company Act of 1940.'"[58] SLUSA contains an exemption, commonly known as the "Delaware carve-out," for class actions brought under the law of the state in which the securities issuer is incorporated that involve the purchase or sale of securities by the issuer or its affiliate exclusively from or to the holders of the same type of securities.[59] The Delaware carve-out is often applied in the context of class action litigation involving a merger or tender offer.[60] As a result, such claims may be brought as class actions under state law.

1-7 SHAREHOLDER DERIVATIVE SUITS

Shareholder derivative litigation is a unique form of litigation subject to special pleading and standing rules. Derivative claims are claims that belong to and are for the benefit of a corporation.[61] Like other corporate decisions, the decision whether to prosecute such claims generally rests with the board of directors.[62] Because derivative claims belong to and are for the benefit of the relevant corporation and the board is the decision-maker for a corporation, a shareholder cannot commence a derivative case on behalf of a corporation without making a demand to the board that the board of directors commence litigation that the shareholder seeks to have pursued, that the board decides to purse or adequately plead that demand is excused because the Board is not capable or willing to make an

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58. *Romano v. Kazacos*, 609 F.3d 512, 517, 520 n.3 (2d Cir. 2010) (quoting 15 U.S.C. §§ 77r(b), 78bb(f)(2)).

59. *Feiner Fam. Tr. v. Xcelera Inc.*, No. 10-cv-3431, 2010 WL 3184482, at *5 (S.D.N.Y. Aug. 9, 2010); *Indiana Elec. Workers Pension Tr. Fund, IBEW v. Millard*, No. 07 Civ. 172, 2007 WL 2141697, at *3 (S.D.N.Y. July 25, 2007).

60. *Indiana Elec. Workers Pension Tr. Fund, IBEW v. Millard*, No. 07 Civ. 172, 2007 WL 2141697, at *8 (S.D.N.Y. July 25, 2007).

61. *Auerbach v. Bennett*, 393 N.E.2d 994, 1000-01 (N.Y. 1979); *see also Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 95 (1991) (stating that "[t]he derivative form of action permits an individual shareholder to bring 'suit to enforce a *corporate* cause of action against officers, directors, and third parties'") (citation omitted); *Meseonznik v. Govorenkov*, 960 N.Y.S.2d 50 (Table), 2012 WL 4017363, at *10 (N.Y. Sup. Ct. 2012).

62. *Auerbach v. Bennett*, 393 N.E.2d 994, 1000-01 (N.Y. 1979); *Gorbrook Assocs. v. Silverstein*, 965 N.Y.S.2d 851, 858 (N.Y. Dist. Ct. 2013) (stating, in a derivative action, "[t]he business of a corporation is managed by its board of directors. . . . The decision to institute litigation rests within the discretion of the board of directors.") (citations omitted).

independent decision on whether to bring the claim.[63] The demand requirement reflects "the basic principle of corporate governance that the decisions of a corporation—including the decision to initiate litigation—should be made by the board of directors or the majority of shareholders."[64] A complaint in a derivative action brought by someone outside of the board, must describe with particularity either efforts made to get the board to bring the action or why demand on the board would be futile and therefore excused.[65] Assuming that demand is excused by a court, and consistent with the rules explained in the succeeding sections, to have standing to assert derivative claims, in New York and a number of other states a plaintiff must be a shareholder at the time that the suit is filed, and at the time of the transaction or other actions at issue.[66]

1-7:1 Derivative Suits Defined

Unlike lawsuits a plaintiff brings on his or her own behalf, a shareholder derivative suit asserts on behalf of a corporation claims belonging not to the shareholder, but to the corporation.[67] The corporation, therefore, receives any recovery for derivative claims up to the amount of damages proven by plaintiffs.[68] As the Appellate Division, First Department, stated, "[t]he Court of Appeals has 'historically been reluctant to permit shareholder derivative suits, noting that the power of courts to direct the management of a corporation's affairs should be exercised with

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63. N.Y. Bus. Corp. Law § 626 (McKinney 2024).

64. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 101 (1991) (citation omitted).

65. *See* Sections 1-7:2 and 1-7:3, below.

66. N.Y. Bus. Corp. Law § 626 (McKinney 2024).

67. *Plymouth Cnty. Ret. Ass'n v. Schroeder*, 576 F. Supp. 2d 360, 368 (E.D.N.Y. 2008); *Marx v. Akers*, 666 N.E.2d 1034, 1036-37 (N.Y. 1996); *Auerbach v. Bennett*, 393 N.E.2d 994, 1000-01 (N.Y. 1979); *Meseonznik v. Govorenkov*, 960 N.Y.S.2d 50 (Table), 2012 WL 4017363, at *10 (N.Y. Sup. Ct. 2012).

68. *Marx v. Akers*, 666 N.E.2d 1034, 1036-37 (N.Y. 1996); *Prime Mover Cap. Partners L.P. v. Elixir Gaming Techs., Inc.*, 898 F. Supp. 2d 673, 691 (S.D.N.Y. 2012) ("Recovery in a derivative action inures to the corporation"), *aff'd*, 548 F. App'x 16 (2d Cir. 2013) (Summary Order); *Meseonznik v. Govorenkov*, 960 N.Y.S.2d 50 (Table), 2012 WL 4017363, at *10 (N.Y. Sup. Ct. 2012); *Gorbrook Assocs. v. Silverstein*, 965 N.Y.S.2d 851, 858 (N.Y. Dist. Ct. 2013) ("Any recovery from a shareholder's derivative sui[t] inures to [the corporation] and not to the shareholder who initiated the suit.") (citation omitted).

restraint.'"[69] However, where permitted, derivative litigation allows shareholders to assert claims on behalf of the corporation against the corporation's officers, directors, large shareholders, and others.[70]

Derivative actions that are filed in New York state courts are governed by Section 626 of the Business Corporation Law. Section 626 provides that, to bring a derivative action, a shareholder must be a shareholder at the time he or she brings the action and at the time of the transaction at issue in the lawsuit. A shareholder derivative complaint "shall set forth with particularity the efforts of the plaintiff to secure the initiation of such action by the board or the reasons for not making such effort."[71]

In addition to satisfying the pleading requirements of Section 626, a plaintiff asserting derivative claims must also comply with the heightened pleading requirements of Civil Practice Law and Rules (CPLR) 3016(b), which provides that "[w]here a cause of action . . . is based upon misrepresentation, fraud, mistake, willful default, breach of trust or undue influence, the circumstances constituting the wrong shall be stated in detail."[72] Applying Rule 3016(b), New York courts have repeatedly held that the required "detail" must consist of *factual* allegations, not conclusory allegations or mere recitations of the elements of the claim. Length does not by itself meet pleading standards.[73] New

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69. *In the Matter of Comverse Tech., Inc., Derivative Litig.*, 866 N.Y.S.2d 10, 14-15 (N.Y. App. Div. 2008) (quoting *Marx v. Akers*, 666 N.E.2d 1034, 1037 (N.Y. 1996)); *see also Levy v. Huszagh*, No. 11-cv-3321, 2012 WL 4512038, at *4 (E.D.N.Y. Sept. 28, 2012) ("Because derivative actions inherently interfere with the managerial discretion of corporate boards, New York courts have 'historically been reluctant to permit shareholder derivative suits, noting that the power of the courts to direct the management of a corporation's affairs should be exercised with restraint.'") (quoting *Marx v. Akers*, 666 N.E.2d 1034, 1037 (N.Y. 1996)).

70. *Plymouth Cnty. Ret. Ass'n v. Schroeder*, 576 F. Supp. 2d 360, 368 (E.D.N.Y. 2008); *In re Bank of N.Y. Derivative Litig.*, Nos. 99 Civ. 9977 (DC), 99 Civ. 10616 (DC), 2000 WL 1708173, at *1 (S.D.N.Y. Nov. 14, 2000); *Levy v. Huszagh*, No. 11-cv-3321, 2012 WL 4512038, at *1 (E.D.N.Y. Sept. 28, 2012).

71. N.Y. Bus. Corp. Law § 626(b), (c) (McKinney 2024).

72. N.Y. C.P.L.R. § 3016(b) (McKinney 2023); *see* N.Y. Bus. Corp. Law § 626(b) (McKinney 2024).

73. *See Sargiss v. Magarelli*, 909 N.E.2d 573, 575 (N.Y. 2009); *Precision Concepts, Inc. v. Bonsanti*, 569 N.Y.S.2d 124, 125 (N.Y. App. Div. 1991) (dismissing complaint containing "a series of lengthy allegations" because notwithstanding their length the claims were "for the most part, conclusory in nature"); *Atlantic Beach Realty Grp., Inc. v. Ceslow*, No. 15246-2011, 2012 WL 5830123, at *7 (N.Y. Sup. Ct. Nov. 5, 2012) ("Here, the allegations of fraud fail to satisfy the requirements of CPLR 3016(b) as they are bare and conclusory, without any supporting detail.").

York courts have emphasized the distinction between the notice pleading requirements of CPLR 3013[74] and the particularity requirements of CPLR 3016,[75] stating that "CPLR 3016 (subd. [b]) imposes a more stringent standard of pleading than the generally applicable 'notice of transaction' rule of CPLR 3013, and complaints based on fraud or breach of trust which fail in whole or in part to meet this special test of factual pleading have consistently been dismissed."[76] Thus, courts consistently dismiss shareholder derivative actions where the complaint contains conclusory allegations of wrongdoing by corporate officers and directors and fails to plead with particularity the wrongful acts committed by *each* defendant.[77]

"The purposes of the demand requirement are to (1) relieve courts from deciding matters of internal corporate governance by providing corporate directors with opportunities to correct alleged abuses, (2) provide corporate boards with reasonable protection from harassment by litigation on matters clearly within the discretion of the directors, and (3) discourage 'strike suits' commenced for personal gain rather than for the benefit of the corporation."[78] The demand requirement recognizes that the decision whether to assert claims on behalf of the corporation is generally a decision

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74. N.Y. C.P.L.R. § 3013 (McKinney 2023).

75. N.Y. C.P.L.R. § 3016 (McKinney 2023).

76. *Williams v. Upjohn Health Care Servs., Inc.*, 501 N.Y.S.2d 884, 886 (N.Y. App. Div. 1986) (quoting *Lanzi v. Brooks*, 388 N.Y.S.2d 946, 947-48 (N.Y. App. Div. 1976), *aff'd*, 373 N.E.2d 278 (N.Y. 1977)); *see also Sargiss v. Magarelli*, 909 N.E.2d 573, 575 (N.Y. 2009) (noting that a complaint may be sufficient under Section 3016(b) if the factual allegations give rise to a 'reasonable inference" of fraud) (citation omitted); *Mazeh Constr. Corp. v. VNB N. Y. Corp.*, 953 N.Y.S.2d 550 (Table), 2012 WL 2097690, at *4 (N.Y. Sup. Ct. 2012) ("CPLR 3016(b) is satisfied when the facts suffice to permit a 'reasonable inference' of the alleged misconduct") (citations omitted).

77. *See Greenberg v. Acme Folding Box Co.*, 374 N.Y.S.2d 997, 1001 (N.Y. Sup. Ct. 1975) (dismissing a shareholder derivative action where the complaint consisted of "conclusory allegations of breaches of fiduciary duty unsupported by factual assertions of specific wrongdoing," rendering it "impossible to ascertain what wrongful act each defendant is alleged to have engaged in"); *Melucci v. Sackman*, 961 N.Y.S.2d 359 (Table), 2012 WL 5192763, at *10 (N.Y. Sup. Ct. 2012) (dismissing a derivative action and noting that the complaint is deficient due to its "failure to allege acts of the individual defendants or to provide the specific facts, other than speculation, upon which the derivative claims are based").

78. *Marx v. Akers*, 666 N.E.2d 1034, 1037 (N.Y. 1996); *Bansbach v. Zinn*, 801 N.E.2d 395, 400-01 (N.Y. 2003); *see also Stoner v. Walsh*, 772 F. Supp. 790, 803 (S.D.N.Y. 1991) (noting that "demand is intended to serve the strong state policy of discouraging strike suits"); *Barr v. Wackman*, 329 N.E.2d 180, 186 (N.Y. 1975) (explaining that the demand requirement is a "prophylactic device . . . designed to weed out unnecessary or illegitimate shareholder derivative suits").

for the board of directors.[79] Section 626(c)'s requirement that a plaintiff plead with particularity that he or she made a demand or why demand would be futile "is intended to balance the right of a board to manage the corporation's business with the need for shareholders to be able to safeguard the company's interests when its officers or directors fail to discharge their responsibilities."[80] A shareholder demand must give the directors adequate notice of the potential claim so that they can consider whether it is in the corporation's best interest to assert the claim.[81]

In response to a shareholder demand, the board can either decide to commence an action on behalf of the corporation or refuse the demand.[82] Although the board of directors is not required to commence litigation, the directors have a fiduciary duty to evaluate the claims raised in the demand.[83] If the board adopts the theory of the demand and commences litigation itself, the shareholder who made the demand will be precluded from filing a derivative action.[84]

When shareholder derivative actions are filed in federal court, Federal Rule of Civil Procedure 23.1's pleading rules apply. Rule 23.1 requires that in any derivative action, the complaint must allege "with particularity . . . any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members of the board[,] and . . . the reasons for not obtaining the action or not making the effort."[85] Rule 23.1 is a procedural requirement that permits the federal courts to determine whether the allegations of the complaint are sufficiently specific to allege satisfaction of the demand

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79. *Chan v. Mui*, No. 92 Civ. 8258, 1993 WL 427114, at *5 (S.D.N.Y. Oct. 20, 1993) (explaining that the purpose of the demand requirement is to give the derivative corporation itself the opportunity to bring a lawsuit to permit directors to maintain their role as "conductors of the corporation's affairs") (citation omitted); *Marx v. Akers*, 666 N.E.2d 1034, 1037 (N.Y. 1996).

80. *In the Matter of Comverse Tech., Inc., Derivative Litig.*, 866 N.Y.S.2d 10, 15 (N.Y. App. Div. 2008).

81. *Stoner v. Walsh*, 772 F. Supp. 790, 796 (S.D.N.Y. 1991) (citing *Barr v. Wackman*, 329 N.E.2d 180, 185-86 (N.Y. 1975)).

82. *Rafiy v. Javaheri*, 927 N.Y.S.2d 554, 558-59 (N.Y. Sup. Ct. 2011); *see also Miller v. Schreyer*, 683 N.Y.S.2d 51, 54 (N.Y. App. Div. 1999) (noting that the board may initiate litigation on behalf of the corporation in response to a shareholder demand).

83. *Rafiy v. Javaheri*, 927 N.Y.S.2d 554, 558-59 (N.Y. Sup. Ct. 2011).

84. *Rafiy v. Javaheri*, 927 N.Y.S.2d 554, 558-59 (N.Y. Sup. Ct. 2011).

85. Fed. R. Civ. P. 23.1(b)(3).

requirement.[86] The substantive law of the state of incorporation, however, determines what the required elements of a proper demand are or whether demand is properly excused as futile.[87]

1-7:2 Demand Futility

As noted above, a shareholder asserting derivative claims must allege "with particularity the efforts of the plaintiff to secure the initiation of such action by the board or the reasons for not making such effort."[88] Under New York law, demand will be excused as futile where a complaint alleges with particularity that (1) "a majority of the board of directors is interested in the challenged transaction"; (2) "the board of directors did not fully inform themselves about the challenged transaction to the extent reasonably appropriate under the circumstances"; or (3) "the challenged transaction was so egregious on its face that it could not have been the product of sound business judgment of the directors."[89] Director interest is established by either a director's self-interest in the matter or a loss of independence due to domination and control by a self-

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86. *See Cordts-Auth v. Crunk, LLC*, 815 F. Supp. 2d 778, 793 (S.D.N.Y. 2011), *aff'd*, 479 F. App'x 375 (2d Cir. 2012) (Summary Order); *Stoner v. Walsh*, 772 F. Supp. 790, 795 (S.D.N.Y. 1991).

87. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96-100 (1991); *Scalisi v. Fund Asset Mgmt., L.P.*, 380 F.3d 133, 138 (2d Cir. 2004); *Stoner v. Walsh*, 772 F. Supp. 790, 795 (S.D.N.Y. 1991); *Stein v. Immelt*, 472 F. App'x 64, 65-66 (2d Cir. 2012) (Summary Order).

88. N.Y. Bus. Corp. Law § 626(c) (McKinney 2024); *In re Bank of N.Y. Derivative Litig.*, Nos. 99 Civ. 9977 (DC), 99 Civ. 10616 (DC), 2000 WL 1708173, at *1 (S.D.N.Y. Nov. 14, 2000); *Tong v. Hang Seng Bank, Ltd.*, 620 N.Y.S.2d 42, 43-44 (N.Y. App. Div. 1994); *Stein v. Immelt*, 472 F. App'x 64, 65-66 (2d Cir. 2012) (Summary Order); *Forbush v. Goodale*, No. 33538/2011, 2013 WL 664189, at *3 (N.Y. Sup. Ct. Feb. 4, 2013).

89. *Marx v. Akers*, 666 N.E.2d 1034, 1040-41 (N.Y. 1996) (affirming dismissal of derivative complaint on the ground that demand was not excused because the outside directors awarded excessive compensation to themselves and corporate executives in that less than a majority of the directors were alleged to have received such compensation); *Stein v. Immelt*, 472 F. App'x 64, 65-66 (2d Cir. 2012) (Summary Order); *Hildene Cap. Mgmt., LLC v. Friedman, Billings, Ramsey Grp., Inc.*, No. 11 Civ. 5832, 2012 WL 3542196, at *3 (S.D.N.Y. Aug. 15, 2012); *Plymouth Cnty. Ret. Ass'n v. Schroeder*, 576 F. Supp. 2d 360, 369-70 (E.D.N.Y. 2008) (holding that demand was excused because the complaint sufficiently alleged wrongdoing by the board to raise a doubt as to the directors' impartiality); *In re Omnicom Grp. Inc. S'holder Derivative Litig.*, 842 N.Y.S.2d 408, 410-11 (N.Y. App. Div. 2007) (reversing decision denying motion to dismiss because the complaint failed to allege with particularity that the directors approved a transaction that "was so egregious on its face that it could not have been the product of [their] sound business judgment") (citation omitted); *Forbush v. Goodale*, No. 33538/2011, 2013 WL 664189, at *4 (N.Y. Sup. Ct. Feb. 4, 2013) (holding that demand was excused as futile because "the complaint asserts particularized facts that allege that a majority of the board of directors either had a self-interest in the challenged transaction and that they would be incapable of making an impartial decision as to whether to bring suit").

interested controlling party.[90] Directors are considered to be self-interested in a challenged transaction where they expect to receive a direct financial benefit from the transaction that is different from the benefit to shareholders generally.[91]

Demand will also be excused where a plaintiff sets forth particularized allegations that the directors participated or acquiesced in wrongful transactions.[92] However, a conclusory allegation that directors are interested because they are substantially likely to be liable for their actions is insufficient to establish demand futility on this basis.[93] It is well established under New York law that "simply naming every director as a defendant in a complaint along with conclusory allegations of wrongdoing or control by wrongdoers is insufficient to make the directors interested for purposes of pleading demand futility."[94] It would eviscerate the demand requirement to hold otherwise because it is easy in many cases to name all directors as defendants and in such cases, if the rule accepted such an allegation as adequate, demand would always be deemed futile where the majority of directors are named as defen-

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90. *Bansbach v. Zinn*, 801 N.E.2d 395, 402-03 (N.Y. 2003); *Stein v. Immelt*, 472 F. App'x 64, 66 (2d Cir. 2012) (Summary Order).

91. *Marx v. Akers*, 666 N.E.2d 1034, 1042 (N.Y. 1996); *Forbush v. Goodale*, No. 33538/2011, 2013 WL 664189, at *3 (N.Y. Sup. Ct. Feb. 4, 2013).

92. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 262 (2d Cir. 1984); *M+J Savitt, Inc. v. Savitt*, No. 08 Civ. 8535, 2009 WL 691278, at *5 (S.D.N.Y. Mar. 17, 2009); *Haggiag v. Brown*, 728 F. Supp. 286, 296 (S.D.N.Y. 1990); *Forbush v. Goodale*, No. 33538/2011, 2013 WL 664189, at *3-4 (N.Y. Sup. Ct. Feb. 4, 2013).

93. *M+J Savitt, Inc. v. Savitt*, No. 08 Civ. 8535, 2009 WL 691278, at *5 (S.D.N.Y. Mar. 17, 2009); *Wandel ex rel. Bed Bath & Beyond, Inc. v. Eisenberg*, 871 N.Y.S.2d 102, 104-05 (N.Y. App. Div. 2009).

94. *Stoner v. Walsh*, 772 F. Supp. 790, 802 (S.D.N.Y. 1991); *Bansbach v. Zinn*, 801 N.E.2d 395, 402-03 (N.Y. 2003); *see also In re Bank of N. Y. Derivative Litig.*, Nos. 99 Civ. 9977 (DC), 99 Civ. 10616 (DC), 2000 WL 1708173, at *1 (S.D.N.Y. Nov. 14, 2000) (noting that demand is not excused where the complaint merely names a majority of the directors as defendants and pleads conclusory allegations of wrongdoing); *Lewis v. Anselmi*, 564 F. Supp. 768, 772 (S.D.N.Y. 1983) (holding that demand was not excused where all of the directors were named as defendants and the complaint alleged that demand was futile because "a request for the Board to redress the wrongs would be asking them to sue themselves"); *Hildene Cap. Mgmt., LLC v. Friedman, Billings, Ramsey Grp., Inc.*, No. 11 Civ. 5832, 2012 WL 3542196, at *3 (S.D.N.Y. Aug. 15, 2012) ("Merely naming directors (or the trustee) as defendants or alleging that they may be liable is not sufficient to render demand futile"); *Grontas v. Kent N. Assocs.*, No. 603482/09, 2012 WL 4739172, at *19 (N.Y. Sup. Ct. Sept. 26, 2012) ("According to the Court of Appeals, 'it is not sufficient, however, merely to name a majority of the [board of] directors as parties defendant with conclusory allegations of wrongdoing or control by wrongdoers. This pleading tactic would only beg the question of actual futility and ignore the particularity requirement of the statute.'") (quoting *Barr v. Wackman*, 329 N.E.2d 180, 186 (N.Y. 1975)).

dants no matter how frivolous or conclusory the claim against some or all of them.

To show that directors are not independent because they are dominated and controlled by persons who are interested in the transaction, the plaintiff must set forth specific allegations that the interested directors or other party have coercive powers over the independent directors.[95]

In addition, courts may hold that demand is futile where a plaintiff pleads particularized facts alleging that the board's action was not the product of sound business judgment based on reasonable knowledge or investigation of the issue.[96] For example, demand should be considered futile where a complaint alleges that directors took action without reasonably informing themselves of the relevant circumstances or identifies specific examples of publicly available and other information that the directors should have considered if they had been acting with reasonable diligence.[97]

Another variation is illustrated where the Supreme Court, Appellate Division, First Department reinstated a derivative action alleging that the defendant officers and directors improperly backdated stock options. The court held that the complaint alleged with particularity that the board and compensation committee

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95. *Health-Loom Corp. v. Soho Plaza Corp.*, 618 N.Y.S.2d 287, 288 (N.Y. App. Div. 1994); *Bansbach v. Zinn*, 801 N.E.2d 395, 403 (N.Y. 2003) (plaintiff sufficiently showed domination and control by chairman and CEO where board continued to advance his legal fees even though he admitted in open court that he implicated the corporation in criminal conduct).

96. *M+J Savitt, Inc. v. Savitt*, No. 08 Civ. 8535, 2009 WL 691278, at *7 (S.D.N.Y. Mar. 17, 2009); *Levy v. Huszagh*, No. 11-cv-3321, 2012 WL 4512038, at *4 (E.D.N.Y. Sept. 28, 2012) (acknowledging that demand is excused when "a complaint alleges with particularity that the challenged transaction was so egregious on its face that it could not have been the product of sound business judgment," but holding that the allegations in the instant action did not satisfy that standard because plaintiff did not allege that at the time of the board's decision the directors knew yet concealed facts) (citation omitted).

97. *In re Bank of N. Y. Derivative Litig.*, Nos. 99 Civ. 9977 (DC), 99 Civ. 10616 (DC), 2000 WL 1708173, at *2 (S.D.N.Y. Nov. 14, 2000); *see also M+J Savitt, Inc. v. Savitt*, No. 08 Civ. 8535, 2009 WL 691278, at *7 (S.D.N.Y. Mar. 17, 2009) (finding that there are no specific allegations that the board simply rubber-stamped decisions by failing to inform themselves or were willfully blind); *see also Miller v. Schreyer*, 683 N.Y.S.2d 51, 55 (N.Y. App. Div. 1999) (holding that demand was futile where directors failed to implement oversight procedures that would have uncovered an improper scheme spanning five years and failed to commence an investigation after discovering the purported wrongdoing); *cf. Stein v. Immelt*, 472 F. App'x 64, 65-66 (2d Cir. 2012) (Summary Order) (finding that demand was not excused by the board of directors failure to "fully inform themselves about the challenged transaction" where the complaint did not plead any facts with particularity supporting the charge that the board did not fully inform itself under the circumstances) (quoting *Marx v. Akers*, 666 N.E.2d 1034, 1041 (N.Y. 1996)).

failed to oversee adequately the stock option granting process and that demand was therefore futile.[98] The court noted that the directors allegedly approved backdated option grants without knowing the date on which the options were awarded or to whom they were awarded and concluded that the directors' decisions were not protected by the business judgment rule because "approval of a decade's worth of backdated stock options simply does not qualify as a legitimate exercise of business judgment."[99]

On the other hand, the Appellate Division has held that under some circumstances "a corporation's refusal to provide information to its shareholders is not . . . a circumstanc[e] where demand is excused."[100]

1-7:3 Demand Refused

As noted above, a shareholder asserting derivative claims must allege "with particularity the efforts taken to secure the initiation of such action by the board or the reasons for not making such effort."[101] Mere allegations (that a shareholder plaintiff asked the board of directors to commence an action and they did not do so) are insufficient to satisfy the requirement that the complaint plead with particularity the efforts that the plaintiff made to obtain the commencement of litigation by the board.[102] Rather,

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98. *In the Matter of Comverse Tech., Inc., Derivative Litig.*, 866 N.Y.S.2d 10, 16 (N.Y. App. Div. 2008).

99. *In the Matter of Comverse Tech., Inc., Derivative Litig.*, 866 N.Y.S.2d 10, 16-17 (N.Y. App. Div. 2008); *see also Plymouth Cnty. Ret. Ass'n v. Schroeder*, 576 F. Supp. 2d 360, 371-72 (E.D.N.Y. 2008) (holding that demand was excused where certain directors were interested in the demand because they "received backdated stock options and, therefore, directly benefited from the backdating scheme"). *But see Wandel ex rel. Bed Bath & Beyond, Inc. v. Eisenberg*, 871 N.Y.S.2d 102, 105-06 (N.Y. App. Div. 2009) (allegations of stock options backdating lacked the requisite particularity to support a finding of demand futility).

100. *Wyatt v. Inner City Broad. Corp.*, 987 N.Y.S.2d 148, 148 (N.Y. App. Div. 2014).

101. N.Y. Bus. Corp. Law § 626(c) (McKinney 2024); *Gorbrook Assocs. v. Silverstein*, 965 N.Y.S.2d 851, 857 (N.Y. Dist. Ct. 2013) ("Pursuant to [Business Corporation Law section] 626(c), [shareholder] was obligated to set forth in the complaint (petition) with particularity of [sic] his efforts to secure the initiation of the summary proceeding by the board of directors or set forth in the complaint the reasons for not making such a demand.").

102. *See Kalin v. Xanboo, Inc.*, 526 F. Supp. 2d 392, 410 (S.D.N.Y. 2007) (dismissing shareholder derivative complaint for failure to allege the details of the demand with particularity); *M+J Savitt, Inc. v. Savitt*, No. 08 Civ. 8535, 2009 WL 691278, at *8 (S.D.N.Y. Mar. 17, 2009) (plaintiff's letter, which was not sent to all board members and did not specify any potential causes of action but generally asked to raise issues for discussion, was not an adequate demand letter); *Stoner v. Walsh*, 772 F. Supp. 790, 797 (S.D.N.Y. 1991) (dismissing claims in derivative complaint based on allegations that were not included in the plaintiff's demand letters).

the complaint must allege what wrongful conduct the shareholder asked the board to address and the reasons that board action was necessary.[103]

In order to satisfy the demand requirement, "a plaintiff must plead with particularity not only that a demand was made, but also that refusal of the demand was wrongful."[104] To determine whether a board's rejection of a shareholder demand was protected by the business judgment rule and therefore not wrongful, courts consider: (1) whether a majority of the directors were disinterested and independent with respect to the demand and (2) whether the board employed "appropriate and sufficient investigative procedures" with respect to the demand.[105] If these requirements are met, there is a presumption that a board's decision is the product of a valid business judgment and courts generally do not permit discovery to support a claim that demand was wrongfully refused.[106] In evaluating whether demand was wrongfully refused, courts may consider responses to demand letters sent by the board.[107]

Courts reject allegations that directors lack independence with respect to a demand merely because the demand names all current directors as potential defendants.[108] Likewise, the fact that a corporation's directors and officers liability insurance policy contains an exclusion for lawsuits between parties insured by the same policy, also known as an insured versus insured exclusion, is insufficient to render a director interested with respect to a decision to reject a demand.[109]

Allegations that directors want to continue to receive director fees or benefits are insufficient to show that a director was not independent when rejecting a demand.[110] Conclusory allegations in

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[103] *See Kalin v. Xanboo, Inc.*, 526 F. Supp. 2d 392, 410 (S.D.N.Y. 2007); *Stoner v. Walsh*, 772 F. Supp. 790, 797 (S.D.N.Y. 1991); *Cordts-Auth v. Crunk, LLC*, 815 F. Supp. 2d 778, 793 (S.D.N.Y. 2011), *aff'd*, 479 F. App'x 375 (2d Cir. 2012) (Summary Order) (finding that plaintiff's demand letter was inadequate because it did not apprise defendants of any potential cause of action).

[104] *Kenney v. Immelt*, 981 N.Y.S.2d 636 (Table), 2013 WL 5976625, at *7 (N.Y. Sup. Ct. 2013).

[105] *Stoner v. Walsh*, 772 F. Supp. 790, 800 (S.D.N.Y. 1991); *Auerbach v. Bennett*, 393 N.E.2d 994, 1000-01 (N.Y. 1979).

[106] *See Stoner v. Walsh*, 772 F. Supp. 790, 800 (S.D.N.Y. 1991).

[107] *See Stoner v. Walsh*, 772 F. Supp. 790, 796-97 (S.D.N.Y. 1991).

[108] *Stoner v. Walsh*, 772 F. Supp. 790, 803-04 (S.D.N.Y. 1991).

[109] *Stoner v. Walsh*, 772 F. Supp. 790, 805 (S.D.N.Y. 1991).

[110] *Stoner v. Walsh*, 772 F. Supp. 790, 805 (S.D.N.Y. 1991).

a demand that directors and officers "fail[ed] to prevent business setbacks" or paid excessive compensation to the officers and directors who allegedly harmed the corporation are likewise insufficient to show that directors are interested or lack independence with respect to the rejection of a demand.[111] Particularity in pleading why a demand is inadequate is required. Unsupported conclusory allegations that a board's investigation of a demand was conducted in bad faith or was a sham are insufficient to show that the board's procedures were inadequate.[112]

1-7:4 Standing

As noted above, a shareholder asserting derivative claims must be able to show that he or she was a shareholder at the time he or she brought the action and at the time of the relevant transaction.[113] Ownership at the time of the alleged wrong, known as the contemporaneous ownership requirement, "originated in the [f]ederal courts to preclude a shareholder from manufacturing diversity jurisdiction by transferring stock to a nonresident after a cause of action has accrued."[114] This rule was adopted by New York

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111. *Stoner v. Walsh*, 772 F. Supp. 790, 804 (S.D.N.Y. 1991).

112. *Stoner v. Walsh*, 772 F. Supp. 790, 806-07 (S.D.N.Y. 1991).

113. N.Y. Bus. Corp. Law § 626(b) (McKinney 2024); *Roy v. Vayntrub*, 841 N.Y.S.2d 221 (Table), 2007 WL 1218356, at *5 (N.Y. Sup. Ct. 2007) (explaining that plaintiff need not have owned stock in the company during the entire course of all relevant events, however a proper plaintiff must have acquired his or her stock in the corporation before the core of the allegedly wrongful conduct transpired); *SC Note Acquisitions, LLC v. Wells Fargo Bank, N.A.*, 934 F. Supp. 2d 516, 529 (E.D.N.Y. 2013) (explaining that "the Second Circuit has held that although a plaintiff need not have owned stock 'in the company during the entire course of all relevant events,' a plaintiff 'must have acquired his or her stock in the corporation before the core of the allegedly wrongful conduct transpired'") (quoting *In re Bank of N.Y. Derivative Litig.*, 320 F.3d 291, 298 (2d Cir. 2003)), *aff'd*, 548 F. App'x 741 (2d Cir. 2014) (Summary Order); *Karfunkel v. USLIFE Corp.*, 455 N.Y.S.2d 937, 939 (N.Y. Sup. Ct. 1982) (holding that "[i]t is settled law that plaintiff must demonstrate that she was a shareholder at the time of the transaction, at the time of trial and at the time of entry of judgment"), *aff'd*, 469 N.Y.S.2d 1020 (N.Y. App. Div. 1983); *Zentz v. Int'l Foreign Exch. Concept, L.P.*, 965 N.Y.S.2d 180, 180-81 (N.Y. App. Div. 2013) (affirming grant of motion to dismiss where "defendants produced uncontroverted documentary evidence conclusively establishing that the plaintiff was not a shareholder at the time the action was commenced. Accordingly, the plaintiff cannot maintain any claims in a shareholder's derivative capacity"); *see also Chan v. Mui*, No. 92 Civ. 8258, 1993 WL 427114, at *6 (S.D.N.Y. Oct. 20, 1993) (noting that Section 626 does not require plaintiff to allege explicitly his status as a shareholder in the complaint).

114. *Independent Inv'r Protective League v. Time, Inc.*, 406 N.E.2d 486, 488 (N.Y. 1980); *see also SC Note Acquisitions, LLC v. Wells Fargo Bank, N.A.*, 934 F. Supp. 2d 516, 528-29 (E.D.N.Y. 2013) ("Under both the Federal Rules of Civil Procedure and New York law, a plaintiff does not have standing to bring a derivative suit unless she owned shares in the corporation at the time of the alleged wrongdoing. . . . The 'main purpose' of the con-

state courts and legislatures to prevent persons from speculating in litigation by buying stock for the purpose of bringing suit based on alleged past mismanagement.[115]

Because the contemporaneous ownership rule seeks to foster public policy by inhibiting speculation in litigation, it is "rigorously enforced."[116] If a stockholder voluntarily disposes of his or her stock, then his or her interest in derivative claims will be terminated and he or she will lack standing to institute or continue the suit.[117] In addition, if a corporation is acquired by or merged with another corporation, the stockholder will lose standing to maintain the derivative action.[118] If a shareholder loses derivative standing as the result of a merger, then he or she may be able to assert "double derivative claims" on behalf of the acquiring corporation for wrongs to the acquired corporation.[119] Where permitted, a double derivative claim is one brought by a pre-merger shareholder of the acquired company in a stock-for-stock merger who continues to hold the acquired shares of the acquiring company postmerger (or in some instances shareholders of a subsidiary corporation that was injured by actions of a parent company or its board or officers can bring a double derivative action naming directors or officers of the parent as a defendant). In that instance, the shareholder can sue on behalf of the acquirer for injury to the acquired company that occurred pre-merger. The rationale for double derivative actions is that a shareholder of the acquired company who remains a shareholder

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temporaneous ownership rule is to 'prevent courts from being used to litigate purchased grievances.'") (quoting *In re Bank of N.Y. Derivative Litig.*, 320 F.3d 291, 293, 297 (2d Cir. 2003)) (other citations omitted), *aff'd*, 548 F. App'x 741 (2d Cir. 2014) (Summary Order).

115. *Independent Inv'r Protective League v. Time, Inc.*, 406 N.E.2d 486, 488 (N.Y. 1980).

116. *Independent Inv'r Protective League v. Time, Inc.*, 406 N.E.2d 486, 488 (N.Y. 1980); *Zentz Int'l Foreign Exch. Concepts, L.P.*, 939 N.Y.S.2d 745 (Table), 2011 WL 5009553, at *8 (N.Y. Sup. Ct. 2011), *aff'd*, 965 N.Y.S.2d 180 (N.Y. App. Div. 2013); *Pessin v. Chris-Craft Indus., Inc.*, 586 N.Y.S.2d 584, 586-87 (N.Y. App. Div. 1992) (explaining that the contemporaneous ownership rule is strictly applied).

117. *Independent Inv'r Protective League v. Time, Inc.*, 406 N.E.2d 486, 488 (N.Y. 1980).

118. *Bronzaft v. Caporali*, 616 N.Y.S.2d 863, 864-65, 867 (N.Y. Sup. Ct. 1994) (explaining that if plaintiff's shares are disposed of during the pendency of the action, such as through a cash-out merger, the action abates); *see also Zentz Int'l Foreign Exch. Concepts, L.P.*, 939 N.Y.S.2d 745 (Table), 2011 WL 5009553, at *8 (N.Y. Sup. Ct. 2011) (plaintiff was barred from bringing derivative claims because it was no longer a shareholder at the time the action commenced because the corporation had repurchased its shares), *aff'd*, 965 N.Y.S.2d 180 (N.Y. App. Div. 2013).

119. *See Pessin v. Chris-Craft Indus., Inc.*, 586 N.Y.S.2d 584, 588 (N.Y. App. Div. 1992); *Kaufman v. Wolfson*, 151 N.Y.S.2d 530, 533-34 (N.Y. App. Div. 1956).

post acquisition has an interest in wrongs suffered by the acquiring corporation resulting from wrongs to the acquired corporation.[120]

Some courts have recognized a limited exception to the contemporaneous ownership rule where the plaintiff alleges a continuous wrong.[121] Under the "continuous wrong" theory, a plaintiff can challenge a corporate action that occurred before he or she became a shareholder if that action was part of a continuing fraud or impropriety that had begun but had not concluded at the time the plaintiff became a shareholder. In determining whether a wrong complained of is a continuous wrong, courts examine when the specific acts of the alleged wrongdoing occurred, not when their effect was felt. Mere conclusory language in the complaint cannot transform a completed wrong into a continuous wrong.[122]

1-7:5 Special Litigation Committees

As discussed above, a shareholder may make a demand or file a derivative action alleging that demand would have been futile and is therefore excused. If a majority of the directors or corporate officers are involved in the transactions at issue, then a board will often designate or establish a committee of disinterested directors and delegate to the committee the right to investigate the claims alleged and make a recommendation to the board on further steps. Depending on the circumstances, the board may also delegate the authority to the committee to make decisions on the matters at issue.[123] The committee may be an existing committee of the board, such as an audit committee, or a special committee created to deal with the issue. Under Section 717(a)(3) of the Business

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120. *See Pessin v. Chris-Craft Indus., Inc.*, 586 N.Y.S.2d 584, 588 (N.Y. App. Div. 1992); *Kaufman v. Wolfson*, 151 N.Y.S.2d 530, 532-34 (N.Y. App. Div. 1956).

121. *Chaft v. Kass*, 241 N.Y.S.2d 284, 286-87 (N.Y. App. Div. 1963); *Ripley v. Int'l Rys. of Cent. Am.*, 188 N.Y.S.2d 62, 78-79 (N.Y. App. Div. 1959), *aff'd*, 171 N.E.2d 443 (N.Y. 1960); *SC Note Acquisitions, LLC v. Wells Fargo Bank, N.A.*, 934 F. Supp. 2d 516, 529 (E.D.N.Y. 2013) ("The continuing wrong doctrine is generally considered an 'equitable exception to the contemporaneous ownership rule. . . . [W]hen a series of wrongful transactions is alleged and some of them transpired before plaintiff became a shareholder but others took place subsequent to that date, the shareholder's action may be maintained only on the basis of the later events.'") (quoting *In re Bank of N.Y. Derivative Litig.*, 320 F.3d 291, 297-98 (2d Cir. 2003)) (alteration in original), *aff'd*, 548 F. App'x 741 (2d Cir. 2014) (Summary Order).

122. *Chaft v. Kass*, 241 N.Y.S.2d 284, 286-87 (N.Y. App. Div. 1963); *Weinstein v. Behn*, 65 N.Y.S.2d 536, 540-41 (N.Y. Sup. Ct. 1946), *aff'd*, 75 N.Y.S.2d 284 (N.Y. App. Div. 1947).

123. *See Stoner v. Walsh*, 772 F. Supp. 790, 803 (S.D.N.Y. 1991); *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979).

Corporation Law, "a director who relies on the report of a duly designated board committee is not liable for a breach of fiduciary duty if such reliance was in good faith and the decision to rely was made with that degree of care a reasonable person would employ in similar circumstances."[124]

Provided that the directors on the special committee are disinterested and independent with respect to the alleged wrongdoing and perform their duties with reasonable diligence, the business judgment rule precludes judicial examination of the merits of their conclusions and decision.[125] A board that maintains decision-making for itself should consider both whether the members of a special committee are disinterested and independent and the adequacy of the process and procedures by which they evaluated the claims or demand.[126]

If decision-making is delegated to the special committee, and if the special committee's procedures "were so inadequate as to suggest fraud or bad faith," or its investigation was unreasonably restricted in scope, then the business judgment rule will not protect a special committee's decision or its members.[127] Likewise, the business judgment rule will not protect a special committee with delegated authority that fails to take what would be considered reasonable, prudent, and informative steps to address remediation misconduct discovered by an investigation.[128]

1-7:6 Derivative Versus Direct Actions

A shareholder may attempt to sue the officers and directors of a corporation in which it owns stock either directly or derivatively. As described above, a shareholder derivative claim is a claim that the shareholder asserts on behalf of the corporation to remedy

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124. *Stoner v. Walsh*, 772 F. Supp. 790, 803 (S.D.N.Y. 1991).

125. *Auerbach v. Bennett*, 393 N.E.2d 994, 1000-01 (N.Y. 1979); *see also Stoner v. Walsh*, 772 F. Supp. 790, 801 (S.D.N.Y. 1991) (stating that the business judgment rule applies to a special committee's decision as long as the members of the special committee are disinterested and independent and used "appropriate and sufficien[t] investigative procedures").

126. *Stoner v. Walsh*, 772 F. Supp. 790, 799 (S.D.N.Y. 1991); *Auerbach v. Bennett*, 393 N.E.2d 994, 1002-03 (N.Y. 1979).

127. *Stoner v. Walsh*, 772 F. Supp. 790, 799 (S.D.N.Y. 1991) (citing and quoting *Auerbach v. Bennett*, 393 N.E.2d 994, 1003 (N.Y. 1979)).

128. *In the Matter of Comverse Tech., Inc., Derivative Litig.*, 866 N.Y.S.2d 10, 18-19 (N.Y. App. Div. 2008).

an injury suffered by the corporation. A direct claim is a claim that a shareholder brings to remedy an injury that the shareholder directly suffered.[129] "[T]he proper inquiry in distinguishing between a direct and derivative claim is what is the nature of the harm alleged and who is principally harmed: the corporation or the individual shareholders."[130] A shareholder can only bring a direct, non-derivative claim against the corporation's officers and/or directors where there is a breach of a duty owed to the shareholder and the shareholder has suffered an injury distinct from the corporation.[131] If a plaintiff incorrectly brings a direct claim where a derivative action would be appropriate, then the case will be dismissed for lack of standing.[132] A plaintiff may assert both derivative and direct claims in the same complaint, but should separate direct and derivative claims into separate causes of action.[133]

New York courts have held that claims involving waste, mismanagement, and the payment of excessive compensation to officers resulting in the diminution in value of corporate assets are derivative, rather than direct, even though the alleged wrongdoing may have negatively affected the value of shareholders' stock.[134]

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129. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 348 (N.Y. Sup. Ct. 2005); *Vargas v. Hennigan*, 960 N.Y.S.2d 53 (Table), 2012 WL 5290355, at *1 (N.Y. App. Div. 2012) ("An action is direct, as opposed to derivative, if the thrust of the action is to vindicate the plaintiff's 'personal rights as an individual and not as a stockholder on behalf of the corporation.'") (citation omitted); *Grand Food Serv. LLC v. Grand Gifts & Café Inc.*, No. 654139/2012, 2013 WL 3491267, at *5 (N.Y. Sup. Ct. July 3, 2013) ("When a plaintiff seeks to recover for injury to the company, the plaintiff is asserting a derivative claim; if the plaintiff seeks damages for him or herself individually, this is a direct claim.").

130. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 348-49 (N.Y. Sup. Ct. 2005); *see also Abrams v. Donati*, 489 N.E.2d 751, 752 (N.Y. 1985) (affirming dismissal of claim improperly brought as a direct claim because the corporation suffered the alleged harm).

131. *Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *9 (E.D.N.Y. Sept. 22, 1997); *Hammer v. Werner*, 265 N.Y.S. 172, 179 (N.Y. App. Div. 1933) (stating that "[t]he fact that a particular act of directors may constitute a wrong to the corporation which may be righted ordinarily on behalf of the corporation does not bar a stockholder from having redress if that act effects a separate and distinct wrong to him independently of the wrong to the corporation").

132. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 347 (N.Y. Sup. Ct. 2005).

133. *See Abrams v. Donati*, 489 N.E.2d 751, 752 (N.Y. 1985); *Greenberg v. Falco Constr. Corp.*, 958 N.Y.S.2d 307 (Table), 2010 WL 3781279, at *3 (N.Y. Sup. Ct. 2010); *Vargas v. Hennigan*, 960 N.Y.S.2d 53 (Table), 2012 WL 5290355, at *1 (N.Y. App. Div. 2012) ("Plaintiff's 'intermingling of derivative and individual claims' requires the dismissal of the complaint without prejudice.") (citation omitted).

134. *See In re Stillwater Cap. Partners Inc. Litig.*, 851 F. Supp. 2d 556, 571 (S.D.N.Y. 2012) (holding that the failure to properly invest and value corporate assets and failure to sell assets in a timely manner were derivative claims for corporate mismanagement); *Abrams v. Donati*, 489 N.E.2d 751, 752 (N.Y. 1985) (holding that claims for mismanagement

On the other hand, a plaintiff would have a direct cause of action where the defendant was alleged to have intentionally understated the value of plaintiff's shares in order to repurchase them.[135] In an illustrative case, the court found that the actual value of the corporation's shares was unchanged and therefore, that the plaintiff suffered an individual, distinct harm that it could pursue directly.[136] Other claims that have been deemed to involve injuries to the shareholders, and thus to be eligible for a direct suit, include claims for misrepresentations to an individual shareholder in connection with the purchase or sale of securities and a denial of access to corporate books and records.[137]

Also instructive is *Higgins v. New York Stock Exchange*, in which the Court found that seatholders of the New York Stock Exchange (NYSE), who alleged that the NYSE undervalued their seats in connection with a merger, could pursue their claims directly.[138] The

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and diversion of corporate assets were derivative claims); *Hahn v. Stewart*, 773 N.Y.S.2d 297, 297 (N.Y. App. Div. 2004) (stating that "[c]ourts have repeatedly held that an allegation of diminution in the value of stock based on a breach of fiduciary duty gives rise to a derivative action only" and holding that claims for breach of fiduciary duty based on defendant's involvement in an insider trading scandal that harmed the corporation's goodwill and decreased the value of the corporation's stock were derivative) (citation omitted); *Albany-Plattsburgh United Corp. v. Bell*, 763 N.Y.S.2d 119, 122-23 (N.Y. App. Div. 2003) (finding claims for misappropriation and conversion of corporate assets as well as failure to render an accounting for the purportedly misappropriated assets were derivative); *Sook Hi Lee v. 401-403 57th St. Realty Corp.*, 759 N.Y.S.2d 873, 873 (N.Y. App. Div. 2003) (holding allegations of waste and mismanagement were derivative claims); *Fischbein v. Beitzel*, 721 N.Y.S.2d 515, 516 (N.Y. App. Div. 2001) (allegation that share price was depressed as a result of the payment of excessive compensation to executives amounted to a derivative claim); *Lister v. R & R Menswear, Ltd.*, No. 1959-2012, 2013 WL 1283762, at *6-7 (N.Y. Sup. Ct. Mar. 18, 2013) (dismissing claims for diversion of corporate assets and waste because they belonged to the corporation and could only be asserted as derivative claims); *Grand Food Serv. LLC v. Grand Gifts & Café Inc.*, No. 654139/2012, 2013 WL 3491267, at *6 (N.Y. Sup. Ct. July 3, 2013) (noting that allegations that individual "breached his fiduciary obligations to the corporation, undermined a corporate opportunity due to the corporation, and converted tangible property that belonged to the corporation" are allegations "addressing mismanagement of the corporation, and seeking damages on behalf of the corporation" that are "appropriately derivative claims").

135. *See Yatter v. William Morris Agency, Inc.*, 682 N.Y.S.2d 198, 199 (N.Y. App. Div. 1998).

136. *Yatter v. William Morris Agency, Inc.*, 682 N.Y.S.2d 198, 199 (N.Y. App. Div. 1998).

137. *See Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *9-10 (E.D.N.Y. Sept. 22, 1997) (claims that the proxy statement for a merger contained material omissions were claims that the shareholder plaintiffs could pursue directly, but claims for breach of fiduciary duty based on an allegedly unfair merger price were derivative); *Wallace v. Perret*, 903 N.Y.S.2d 888, 896-97 (N.Y. Sup. Ct. 2010); *Roy v. Vayntrub*, 841 N.Y.S.2d 221 (Table), 2007 WL 1218356, at *4 (N.Y. Sup. Ct. 2007).

138. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 354-55 (N.Y. Sup. Ct. 2005) (concluding that, "[a]s plaintiffs have asserted a wrong that is personal to NYSE seatholders and

court reasoned that the corporation benefitted from the transaction, while the individual seatholders lost equity.[139] Thus, there was no injury to the corporation, but there was alleged to be injury to the shareholders and a derivative action was not appropriate. In *Higgins*, the Court distinguished *Alpert v. NASD, LLC*, a case in which plaintiffs objected to the unwinding of a merger that would decrease the value of their seats on the American Stock Exchange.[140] In *Alpert*, the shareholders alleged that the corporation's value would decline as a result of the unwinding of the merger, whereas in *Higgins*, the shareholders would lose value directly because their seats were undervalued, while the corporation itself would likely benefit.[141] In *Alpert*, unlike in *Higgins*, there was injury to the corporation alleged and the plaintiffs' claims were derivative of those of the corporation.[142]

1-8 BREACH OF FIDUCIARY DUTY

Business Corporation Law Section 720 provides that an action may be brought against corporate officers or directors for breach of fiduciary duty.[143] Under New York law, the elements of a claim of breach of fiduciary duty are (1) the existence of a fiduciary relationship, (2) a knowing breach of that duty, and (3) damages caused directly by the defendant's misconduct.[144] Officers and directors may be sued for breach of fiduciary duty by shareholders or by the corporation. Depending on the allegations, shareholders may sue directors and officers either directly or derivatively on behalf of the corporation.[145]

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otherwise separate and distinct from a wrong to the NYSE, plaintiffs have sufficiently stated a direct claim against the NYSE defendants").

139. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 352-53 (N.Y. Sup. Ct. 2005).

140. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 354-55 (N.Y. Sup. Ct. 2005) (citing *Alpert v. NASD, LLC*, 801 N.Y.S.2d 229 (Table), 2004 WL 3270188, at *18 (N.Y. Sup. Ct. 2004)).

141. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 356-57 (N.Y. Sup. Ct. 2005).

142. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 355-56 (N.Y. Sup. Ct. 2005).

143. N.Y. Bus. Corp. Law § 720(a)(1)(A) (McKinney 2024).

144. *Johnson v. Nextel Commc'ns, Inc.*, 660 F.3d 131, 138 (2d Cir. 2011); *Armentano v. Paraco Gas Corp.*, 935 N.Y.S.2d 304, 306 (N.Y. App. Div. 2011); *Palmetto Partners, L.P. v. AJW Qualified Partners, LLC*, 921 N.Y.S.2d 260, 263-64 (N.Y. App. Div. 2011); *Deblinger v. Sani-Pine Prods. Co.*, 967 N.Y.S.2d 394, 396 (N.Y. App. Div. 2013).

145. *See* Section 1-7, above.

Officers and directors may be subject to liability for breach of the duty of care where they act in a situation in which they personally benefit from a decision or take an action that is not informed or based on reasonable inquiry and consideration.[146] In such cases, directors will not have the protection of the business judgment rule. Directors can also breach their fiduciary duty of care by mismanaging the corporation or failing to act after being alerted to red flags of potential wrongdoing at the corporation.[147] They may also face liability for failing to obtain available material information or for failing to make a reasonable inquiry into material matters.[148] Directors must do more than "passively rubber-stamp the decisions of the active managers."[149] In addition, directors must exercise due care in overseeing the outside advisors upon whom they rely.[150] Directors may where reasonable rely on information and/or opinions of advisors.[151]

Directors and officers may also be sued for breaching their duty of loyalty. The most common breach of the duty of loyalty arises where directors or officers have engaged in self-dealing.[152] For example, an officer or director may breach the duty of loyalty by

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146. *Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 275 (2d Cir. 1986); *Neogenix Oncology, Inc. v. Gordon*, 133 F. Supp. 3d 539, 556 (E.D.N.Y. 2015); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 361-62 (N.Y. Sup. Ct. 2005).

147. *See In re Optimal U.S. Litig.*, 813 F. Supp. 2d 351, 378-79 (S.D.N.Y. 2011); *In re Eugenia VI Venture Holdings, Ltd. Litig.*, 649 F. Supp. 2d 105, 125 (S.D.N.Y. 2008) (alleging that officers and directors breached their fiduciary duties by mismanaging the corporation in such a way that it caused the corporation to violate its loan agreement), *aff'd*, 370 F. App'x 197 (2d Cir. 2010) (Summary Order).

148. *Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 274-75 (2d Cir. 1986); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 362-63 (N.Y. Sup. Ct. 2005); *Lerner ex rel. GE Co. v. Immelt*, 523 F. App'x 824, 825 (2d Cir. 2013) (Summary Order) (alleging that directors and officers violated their duties of care and loyalty by engaging in "risky corporate transactions and disguising those risks with accounting fraud and misstatements").

149. *RSL Commc'ns PLC ex rel. Jervis v. Bildirici*, 649 F. Supp. 2d 184, 199 (S.D.N.Y. 2009) (citation omitted), *aff'd*, 412 F. App'x 337 (2d Cir. 2011) (Summary Order).

150. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 362-63 (N.Y. Sup. Ct. 2005); *RSL Commc'ns PLC ex rel. Jervis v. Bildirici*, 649 F. Supp. 2d 184, 199 (S.D.N.Y. 2009), *aff'd*, 412 F. App'x 337 (2d Cir. 2011) (Summary Order).

151. Reliance on experts is discussed in detail in Section 1-2:2, above.

152. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984) (explaining that the duty of loyalty derives from the prohibition against self-dealing that inheres in the fiduciary relationship); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 357 (N.Y. Sup. Ct. 2005) (complaint stated a claim for breach of the duty of loyalty); *Stafford v. Scientia Health Grp., Inc.*, 867 N.Y.S.2d 20 (Table), 2008 WL 2388686, at *9-10 (N.Y. Sup. Ct. 2008).

using corporate funds to pay for his or her personal expenses.[153] A breach of the duty of loyalty may arise if the corporation enters into a contract or transaction that is unfair to the corporation with one or more of its directors or an entity with which one or more of its directors is affiliated.[154] New York law provides specific rules for determining whether a director's approval of compensation for directors gives rise to a breach of the duty of loyalty. Section 713 of the Business Corporation Law states that, unless a corporation's certificate of incorporation provides otherwise, the fact that a board of directors approves the compensation of directors does not, without additional allegations of unreasonable self-dealing, give rise to a breach of the duty of loyalty.[155] A director who votes for an increase in the compensation of directors could be considered interested in that decision if he or she would receive an unreasonable personal financial benefit that is not shared by shareholders generally.[156] The approval of compensation to directors that is excessive or unfair to the corporation will likely call into question the directors' good faith.[157] Therefore, it is likely a breach of the duty of loyalty for a director to approve excessive or unfair compensation for directors.[158]

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153. *Aon Risk Servs., N.E. v. Cusack*, No. 651673/11, 2011 N.Y. Misc. LEXIS 6392 (N.Y. Sup. Ct. Dec. 20, 2011) (finding officer liable for breach of his fiduciary duty of loyalty by charging the corporation for his secret meetings with a competitor that he was planning to join).

154. *See* Section 1-18 below. N.Y. Bus. Corp. Law § 713 (McKinney 2024); *Alpert v. 28 Williams St. Corp.*, 457 N.Y.S.2d 4, 6 (N.Y. App. Div. 1982), *aff'd*, 473 N.E.2d 19 (N.Y. 1984); *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 363 (N.Y. Sup. Ct. 2005); *Danaher Corp. v. Chi. Pneumatic Tool Co.*, 633 F. Supp. 1066, 1070 (S.D.N.Y. 1986).

155. N.Y. Bus. Corp. Law § 713 (McKinney 2024); *see also Marx v. Akers*, 666 N.E.2d 1034, 1042 (N.Y. 1996) (noting that it is not per se improper for a corporate board to set director compensation unless the corporation's governing documents provide otherwise).

156. *See Marx v. Akers*, 666 N.E.2d 1034, 1041-42 (N.Y. 1996); *see also A.X.M.S. Corp. v. Friedman*, 948 F. Supp. 2d 319, 335-36 (S.D.N.Y. 2013) (executives were interested because they stood to benefit from a vote on a budget that had provisions governing their salaries).

157. *See Marx v. Akers*, 666 N.E.2d 1034, 1042 (N.Y. 1996); *Deblinger v. Sani-Pine Prods. Co.*, 967 N.Y.S.2d 394, 397 (N.Y. App. Div. 2013).

158. *See Marx v. Akers*, 666 N.E.2d 1034, 1041-42 (N.Y. 1996); *Deblinger v. Sani-Pine Prods. Co.*, No. 01239/11, 2012 WL 1410078, at *4 (N.Y. Sup. Ct. Apr. 11, 2012), *aff'd*, 967 N.Y.S.2d 394 (N.Y. App. Div. 2013); *In re Perry H. Koplik & Sons, Inc.*, 476 B.R. 746, 803 (Bankr. S.D.N.Y. 2012) (approval of loan forgiveness for directors has "marked similarities" to approval for compensation and is subject to an affirmative showing that transaction is

Directors and officers also breach their fiduciary duty of loyalty when they usurp corporate opportunities for themselves or engage in a rival or competing business to the detriment of the corporation.[159] Directors also violate their fiduciary duties where they take actions that are designed to entrench management.[160]

Shareholder claims for breach of fiduciary duty are also frequently brought against corporate officers and directors in connection with mergers or other change of control transactions.[161] In battles for change in control, courts often will have to determine whether the business judgment rule applies.[162] The Business Corporation Law provides that when directors take action, including an action involving a change of control of the corporation, they may consider a number of factors. Specifically, directors are:

> entitled to consider, without limitation, (1) both the long-term and the short-term interests of the corporation and its shareholders and (2) the effects that the corporation's actions may have in the short-term or in the long-term upon any of the following: (i) the prospects for potential growth, development, productivity and profitability of the corporation; (ii) the corporation's current employees; (iii) the corporation's retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation; (iv) the corporation's customers and creditors; and (v) the ability of the

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fair to the corporation), *adopted in part*, 499 B.R. 276 (S.D.N.Y. 2013), *aff'd*, 567 F. App'x 43 (2d Cir. 2014) (Summary Order).

159. *See* Section 1-9, below. *Wolff v. Wolff*, 490 N.E.2d 532, 533-34 (N.Y. 1986); *In re Greenberg*, 614 N.Y.S.2d 825, 826-27 (N.Y. App. Div. 1994); *Alexander & Alexander of N. Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 533-34 (N.Y. App. Div. 1989); *Foley v. D'Agostino*, 248 N.Y.S.2d 121, 129 (N.Y. App. Div. 1964) (holding that "[d]espite the corporation's inability or refusal to act it is entitled to the officer's undivided loyalty") (citation omitted).

160. *See International Banknote Co. v. Muller*, 713 F. Supp. 612, 625 (S.D.N.Y. 1989) (granting motion for preliminary injunction of a corporate bylaw that the board approved without exercising proper diligence and for the purpose of entrenching management).

161. *Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *11-12 (E.D.N.Y. Sept. 22, 1997); *Higgins v. N. Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 361-63 (N.Y. Sup. Ct. 2005).

162. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264-65 (2d Cir. 1984) (noting that directors have wide latitude in deciding how to respond to unfriendly advances).

> corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business.[163]

New York law, unlike Delaware law, however, does not impose on directors a duty to maximize shareholder value in a merger or change of control transaction.[164] Rather, "[i]n New York, whether the defendants' conduct complied with their obligations turns not on the price at which they arrived, but on whether their actions complied with the business judgment rule."[165] Thus, the directors must use a reasonable process and act independently in arriving at their good faith business judgment of what is in the best interest of the corporation. The business judgment rule governs in those situations where the directors are not shown to have a self-interest in the transaction at issue and have used reasonable diligence in assessing the transaction.[166] If the directors are interested in the transaction, then the burden shifts to the directors to prove that the transaction is fair and reasonable to the corporation.[167] An evolving area of law is the question of whether shareholders, by a majority of the minority, may ratify transactions that benefit a controlling shareholder. Delaware law now permits such ratification where both a special committee and a majority of the minority approve the transaction.[168] The New York Court of Appeals, in a matter of

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163. N.Y. Bus. Corp. Law § 717(b) (McKinney 2024).

164. *Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *10 (E.D.N.Y. Sept. 22, 1997) (citing *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986)).

165. *Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *11 (E.D.N.Y. Sept. 22, 1997).

166. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264-65 (2d Cir. 1984); *Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *11 (E.D.N.Y. Sept. 22, 1997).

167. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264-65 (2d Cir. 1984) (holding that directors breached their fiduciary duties by transferring large blocks of stock to a subsidiary and employee stock option plan in response to a takeover threat because the directors' decision did not benefit the corporation and employees, but rather solidified management's control of the company); *In re Perry H. Koplik & Sons, Inc.*, 476 B.R. 746, 803 (Bankr. S.D.N.Y. 2012) ("Like any other interested transaction, directoral self-compensation decisions lie outside the business judgment rule's presumptive protection, so that, where properly challenged, the receipt of self-determined benefits is subject to an affirmative showing that the compensation arrangements are fair to the corporation."), *adopted in part*, 499 B.R. 276 (S.D.N.Y. 2013), *aff'd*, 567 F. App'x 43 (2d Cir. 2014) (Summary Order).

168. *See Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (holding that the effect of shareholder ratification by the uncoerced, informed vote of a majority of the minority stockholders of a controlled stockholder buyout that had been approved by an

first impression, adopted the Delaware Supreme Court's holding in *Kahn v. M & F Worldwide Corp.*,[169] a decision in which the court dismissed a challenge to a merger transaction between Kenneth Cole Productions, Inc. and its controlling stockholder Kenneth Cole that had been approved by 99.8 percent of disinterested stockholders and by a special committee.[170]

New York courts have found that deal protection provisions in merger and acquisition agreements such as breakup fees and financial incentives for the bidder may be the products of a valid business judgment and are not per se illegal.[171] However, as Delaware courts have concluded, deal protection provisions should not be unreasonable or fall clearly outside the range of reasonable business judgment, such as when a takeover defense would effectively preclude a higher competing bid for a company.[172] A breach of fiduciary duty may also be found where a board fails to supervise adequately a financial advisor to the corporation on the transaction or approves the use of a banker that has a conflict of interest.[173] Of course, directors must abide by the duty of care and can be subject to liability for breach of fiduciary duty where they make a decision to approve change of control transaction too quickly and based on limited information.[174]

In light of the Court of Appeals' decision in *Assured Guaranty (UK) Ltd. v. J.P. Morgan Investment Management Inc.*,[175] it is possible that there will be an increasing number of claims filed

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independent adequately empowered special committee was to require that the deferential business judgment standard of review govern the transaction).

169. *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

170. *See In re Kenneth Cole Prods., Inc.*, 52 N.E.3d 214, 216-17, 220-21 (N.Y. 2016).

171. *Minzer v. Keegan*, No. CV-97-4077, 1997 WL 34842191, at *12 (E.D.N.Y. Sept. 22, 1997) (holding that plaintiffs failed to show a likelihood of success on their breach of fiduciary duty claims where the challenged merger agreement included a $5 million breakup fee and lockup option for 19.9 percent of the acquired corporation's stock); *see also Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 273 (2d Cir. 1986) (applying New York law and noting that a "lock-up option" is a "takeover defensive tactic [that] is not per se illegal").

172. *See Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 50-51 (Del. 1994); *In re Smurfit-Stone Container Corp. S'holder Litig.*, C.A. No. 6164-VCP, 2011 WL 2028076, at *21 (Del. Ch. May 20, 2011).

173. *Higgins v. N.Y. Stock Exch., Inc.*, 806 N.Y.S.2d 339, 361-63 (N.Y. Sup. Ct. 2005). *See RBC Cap. Mkts., LLC v. Jervis*, 129 A.3d 816, 856-57 (Del. 2015).

174. *Hanson Tr. PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 275 (2d Cir. 1986).

175. *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt. Inc.*, 962 N.E.2d 765 (N.Y. 2011).

against corporate officers and directors for breach of fiduciary duty in connection with the sale of securities. In *Assured Guaranty*, the Court of Appeals resolved an uncertainty among New York's courts as to whether the Martin Act, which provides that the Attorney General of New York may investigate and enjoin fraud in connection with the sale of securities, preempts common law claims based on the sale of securities.[176] It held that an injured investor may assert a "common-law claim (for fraud or otherwise) that is not entirely dependent on the Martin Act for its viability" and that "[m]ere overlap between the common law and the Martin Act is not enough to extinguish common-law remedies."[177] Thus, shareholders are able to assert claims for breach of fiduciary duty against officers and directors based on the sale of securities that violate common law standards. For example, the Martin Act does not preempt claims against officers and directors for breach of fiduciary duty based on allegations that they wrongfully recommended that shareholders approve a merger without conducting due diligence.[178]

1-9 USURPING CORPORATE OPPORTUNITIES

The duty of loyalty that officers and directors owe to a corporation includes a duty not to usurp for themselves corporate opportunities that belong to the corporation.[179] The corporate opportunity doctrine prohibits officers and directors from diverting and exploiting, without the corporation's consent and for their own benefit, any business opportunity that rightfully belongs to the corporation.[180] For example, an officer or director should not

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176. *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt. Inc.*, 962 N.E.2d 765, 767 (N.Y. 2011); N.Y. Gen. Bus. Law §§ 352, 353 (McKinney 2024).

177. *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt. Inc.*, 962 N.E.2d 765, 770-71 (N.Y. 2011) (concluding that the plaintiff-investor's claims against a financial advisor for breach of fiduciary duty and gross negligence in connection with investments in purportedly high-risk securities were not precluded by the Martin Act).

178. *In re Stillwater Cap. Partners Inc. Litig.*, 851 F. Supp. 2d 556, 563 nn.4, 7 (S.D.N.Y. 2012).

179. *In re Greenberg*, 614 N.Y.S.2d 825, 826-27 (N.Y. App. Div. 1994); *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 533-34 (N.Y. App. Div. 1989).

180. *American Fed. Grp., Ltd. v. Rothenberg*, 136 F.3d 897, 906 (2d Cir. 1998); *Dorset Indus., Inc. v. Unified Grocers, Inc.*, 893 F. Supp. 2d 395, 413-14 (E.D.N.Y. 2012) (holding that the corporate opportunity doctrine did not apply to a supplier and wholesaler who had a contractual relationship because it only applies to "fiduciaries and employees within the same corporate entity"); *Design Strategies, Inc. v. Davis*, 384 F. Supp. 2d 649, 671-72 (S.D.N.Y. 2005), *aff'd*, 469 F.3d 284 (2d Cir. 2006); *Morales v. Galeazzi*, 898 N.Y.S.2d 240,

take the corporation's existing customers, establish a competing business, purchase property that the corporation plans to acquire or that is under lease to the corporation, divert business away from the corporation and to the officer or director, or take advantage of an offer initially made to the corporation or an offer that becomes known to the officer or director because of his or her position.[181] A director or officer's participation in a business similar to that of the corporation is permissible unless the director or officer's conduct "cripples or injures" the corporation.[182]

There are three different tests applied by New York courts to determine whether an opportunity should be considered a corporate opportunity.[183] Courts may analyze the issue under one or more of these tests.[184] The test most commonly used by New York courts is whether the corporation has an "interest" or "tangible expectancy" in the opportunity.[185] Tangible expectancy has been defined to mean "'something much less tenable than ownership,' but, on the other hand more certain than a 'desire' or 'hope.'"[186] Key to the determination of whether a corporation has a tangible expectation in an opportunity is the likelihood

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242 (N.Y. App. Div. 2010); *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 533-34 (N.Y. App. Div. 1989).

181. *Burg v. Horn*, 380 F.2d 897, 899-900 (2d Cir. 1967) (collecting cases); *Design Strategies, Inc. v. Davis*, 384 F. Supp. 2d 649, 671-72 (S.D.N.Y. 2005), *aff'd*, 469 F.3d 284 (2d Cir. 2006); *Grand Food Serv. LLC v. Grand Gifts & Café Inc.*, No. 654139/2012, 2013 WL 3491267, at *9-10 (N.Y. Sup. Ct. July 3, 2013) (denying motion to dismiss claim for usurpation of corporate opportunity where the co-owner and manager of a coffee shop concession business established a competing business and obtained a license for his new business that the coffee shop concession business needed).

182. *Howard v. Carr*, 635 N.Y.S.2d 326, 328 (N.Y. App. Div. 1995) (corporate officer breached his fiduciary duty to the corporation by operating a similar business that nearly drove the corporation out of business); *Foley v. D'Agostino*, 248 N.Y.S.2d 121, 128-29 (N.Y. App. Div. 1964); *Samy & Irina, Inc. v. Berezentseva*, 899 N.Y.S.2d 63 (Table), 2009 WL 2462649, at *5 (N.Y. Sup. Ct. 2009).

183. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 534-35 (N.Y. App. Div. 1989); *Grand Food Serv. LLC v. Grand Gifts & Café Inc.*, No. 654139/2012, 2013 WL 3491267, at *8-9 (N.Y. Sup. Ct. July 3, 2013).

184. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 534-35 (N.Y. App. Div. 1989); *Design Strategies, Inc. v. Davis*, 384 F. Supp. 2d 649, 671-74 (S.D.N.Y. 2005), *aff'd*, 469 F.3d 284 (2d Cir. 2006); *Moser v. Devine Real Est., Inc.* (*Fla.*), 839 N.Y.S.2d 843, 847-48 (N.Y. App. Div. 2007).

185. *Morales v. Galeazzi*, 898 N.Y.S.2d 240, 242 (N.Y. App. Div. 2010); *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 534-35 (N.Y. App. Div. 1989); *In re Greenberg*, 614 N.Y.S.2d 825, 826-27 (N.Y. App. Div. 1994); *American Fed. Grp., Ltd. v. Rothenberg*, 136 F.3d 897, 906 (2d Cir. 1998).

186. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 534 (N.Y. App. Div. 1989) (citation omitted).

that the corporation would have realized the opportunity.[187] For example, an officer or director may be liable for usurping a corporate opportunity where but for taking a business deal to benefit the officer or director individually, the corporation would have done the deal.[188] Courts will also consider whether a corporation has the ability to perform the work associated with a business opportunity in determining whether the corporation has a tangible expectancy.[189] An opportunity may not be considered a "business opportunity" where it would be a new line of business for the corporation.[190] Courts may also consider whether the third party, with whom the officer or director did business, would normally have done business with the corporation—if they would not have, a court typically will not find there to be a corporate opportunity.[191]

A second test looks at whether an opportunity is "necessary" or "essential" to the type of business conducted by the corporation.[192] If the opportunity usurped by the officer or director is in the same line of business as the corporation, and "the consequences of deprivation are so severe as to threaten the viability of the enterprise," then the officer or director may have violated the corporate opportunity doctrine.[193]

A final test considers whether, at the commencement of the fiduciary or employment relationship, the parties understood that

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187. *Design Strategies, Inc. v. Davis*, 384 F. Supp. 2d 649, 672 (S.D.N.Y. 2005), *aff'd*, 469 F.3d 284 (2d Cir. 2006); *Howard v. Carr*, 635 N.Y.S.2d 326, 328-29 (N.Y. App. Div. 1995).

188. *Howard v. Carr*, 635 N.Y.S.2d 326, 328 (N.Y. App. Div. 1995).

189. *Design Strategies, Inc. v. Davis*, 384 F. Supp. 2d 649, 672-73 (S.D.N.Y. 2005), *aff'd*, 469 F.3d 284 (2d Cir. 2006) (dismissing claim that employee diverted a business contract from the corporation to the employee because the corporation failed to demonstrate that it was capable of performing the work required by the contract).

190. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 535 (N.Y. App. Div. 1989) (rejecting as overbroad plaintiff's contention that a business opportunity should include an area "into which the corporation could naturally or easily expand").

191. *Moser v. Devine Real Est., Inc.* (*Fla.*), 839 N.Y.S.2d 843, 847-48 (N.Y. App. Div. 2007).

192. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 534-35 (N.Y. App. Div. 1989); *Design Strategies, Inc. v. Davis*, 384 F. Supp. 2d 649, 672 (S.D.N.Y. 2005), *aff'd*, 469 F.3d 284 (2d Cir. 2006); *Moser v. Devine Real Est., Inc.* (*Fla.*), 839 N.Y.S.2d 843, 847-48 (N.Y. App. Div. 2007); *Grand Food Serv. LLC v. Grand Gifts & Café Inc.*, No. 654139/2012, 2013 WL 3491267, at *9 (N.Y. Sup. Ct. July 3, 2013).

193. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 534-35 (N.Y. App. Div. 1989); *Design Strategies, Inc. v. Davis*, 384 F. Supp. 2d 649, 672 (S.D.N.Y. 2005), *aff'd*, 469 F.3d 284 (2d Cir. 2006); *Moser v. Devine Real Est., Inc.* (*Fla.*), 839 N.Y.S.2d 843, 847-48 (N.Y. App. Div. 2007); *Grand Food Serv. LLC v. Grand Gifts & Café Inc.*, No. 654139/2012, 2013 WL 3491267, at *9 (N.Y. Sup. Ct. July 3, 2013).

the officer or director might pursue opportunities related to or in competition with the corporation's business.[194] The determination of whether, under such circumstances, an officer or director will be liable for usurping a corporate opportunity by failing to offer opportunities to the corporation or may keep them for his or her separate business depends on the facts of each case.[195]

A shareholder may bring a derivative action on behalf of a corporation to obtain recovery for a director or officer's usurpation of a corporate opportunity.[196] The claim is derivative because the fiduciary duty not to usurp corporate opportunities is owed to the corporation, not the shareholders.[197] Therefore, any recovery following a successful suit against an officer or director should be for the corporation's benefit, not the benefit of the individual shareholders who asserted the claim.[198] The potential recovery may include lost profits, money damages for diversion of business, disgorgement of profits gained from the fiduciary's disloyalty, specific performance compelling the transfer of real property that was improperly diverted, or the imposition of a constructive trust over funds that were wrongfully transferred or converted.[199]

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194. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 535 (N.Y. App. Div. 1989); *Burg v. Horn*, 380 F.2d 897, 900 (2d Cir. 1967); *Grand Food Serv. LLC v. Grand Gifts & Café Inc.*, No. 654139/2012, 2013 WL 3491267, at *9 (N.Y. Sup. Ct. July 3, 2013).

195. *Burg v. Horn*, 380 F.2d 897, 900 (2d Cir. 1967) ("We think that under New York law a court must determine in each case, by considering the relationship between the director and the corporation, whether a duty to offer the corporation all opportunities within its 'line of business' is fairly to be implied."); *Glenn v. Hoteltron Sys., Inc.*, 547 N.E.2d 71, 74 (N.Y. 1989) (holding that directors of corporation that operated rental buildings had no duty to offer the corporation all similar properties that came to their attention where directors had separate, pre-existing real estate business).

196. *See Wolff v. Wolff*, 490 N.E.2d 532, 533 (N.Y. 1986); *Grand Food Serv. LLC v. Grand Gifts & Café Inc.*, No. 654139/2012, 2013 WL 3491267, at *5-6 (N.Y. Sup. Ct. July 3, 2013) (holding that a claim that the co-owner and manager of a business usurped a corporate opportunity was a derivative claim because the complaint sought compensation for wrongs committed against the corporation).

197. *See In re Greenberg*, 614 N.Y.S.2d 825, 826-27 (N.Y. App. Div. 1994); *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 542 N.Y.S.2d 530, 533 (N.Y. App. Div. 1989).

198. *See Glenn v. Hoteltron Sys., Inc.*, 547 N.E.2d 71, 74 (N.Y. 1989); *Wolf v. Rand*, 685 N.Y.S.2d 708, 710-11 (N.Y. App. Div. 1999).

199. *Yu Han Young v. Chiu*, 853 N.Y.S.2d 575, 576-77 (N.Y. App. Div. 2008); *Howard v. Carr*, 635 N.Y.S.2d 326, 329-31 (N.Y. App. Div. 1995); *American Fed. Grp., Ltd. v. Rothenberg*, 136 F.3d 897, 911 (2d Cir. 1998); *Revankar v. Tzabar*, 847 N.Y.S.2d 904 (Table), 2007 WL 2385091, at *14 (N.Y. Sup. Ct. 2007); *Gomez v. Bicknell*, 756 N.Y.S.2d 209, 214 (N.Y. App. Div. 2002) (noting that "the remedy for breach of fiduciary duty is not only to compensate for the wrongs but to prevent them").

1-10 PURCHASE AND SALE OF STOCK BASED ON INSIDE INFORMATION

New York law does not impose specific restrictions on the purchase or sale of stock in a corporation by the corporation's officers and directors.[200] A director or officer breaches his or her fiduciary duties, however, if he or she purchases or sells shares of the corporation's stock on the basis of nonpublic material information.[201] New York law requires that directors and officers account to the corporation for profits derived from the use of inside information regarding the corporation for personal gain.[202] Depending on the behavior in question and the nature of the information, federal securities law and criminal law may be implicated by trading on inside information. Those issues are beyond the scope of this chapter.

1-11 WASTE OF CORPORATE ASSETS

Corporate directors and officers may be subject to liability for corporate waste if they cause a "diversion of corporate assets for improper or unnecessary purposes."[203] Section 720 of the Business Corporation Law expressly provides that an officer or director may be sued for "waste of corporate assets due to any neglect of, or failure to perform, or other violation of his duties."[204] However, the burden for a plaintiff to establish a claim of corporate waste is

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200. *Patrick v. Allen*, 355 F. Supp. 2d 704, 714 (S.D.N.Y. 2005) (noting that "[m]ere attempts by a director to increase his stake in the company as a shareholder are not actionable as a breach of fiduciary duty"); *Hauben v. Morris*, 5 N.Y.S.2d 721, 730 (N.Y. App. Div. 1938), *aff'd*, 22 N.E.2d 482 (N.Y. 1939) (stating that "[o]rdinarily a director may deal in securities of his corporation without subjecting himself to any liability to account for profits, for the corporation as such has no interest in its outstanding stock or in dealings in its shares among its stockholders").

201. *Patrick v. Allen*, 355 F. Supp. 2d 704, 714 (S.D.N.Y. 2005); *Diamond v. Oreamuno*, 287 N.Y.S.2d 300, 304 (N.Y. App. Div. 1968), *aff'd*, 248 N.E.2d 910 (N.Y. 1969); *Fischer v. Guar. Trust Co.*, 18 N.Y.S.2d 328, 333 (N.Y. App. Div. 1940), *aff'd*, 34 N.E.2d 379 (N.Y. 1941).

202. *Frigitemp Corp. v. Fin. Dynamics Fund, Inc.*, 524 F.2d 275, 278 (2d Cir. 1975) (a fiduciary may be required to account for profits made through his use of confidential information); *Pergament v. Roach*, 859 N.Y.S.2d 898 (Table), 2008 WL 586253, at *5 (N.Y. Sup. Ct. 2008).

203. *SantiEsteban v. Crowder*, 939 N.Y.S.2d 28, 30 (N.Y. App. Div. 2012); *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370 (N.Y. App. Div. 1982); *Shapiro v. Rockville Country Club, Inc.*, 784 N.Y.S.2d 924 (Table), 2004 WL 398980, at *11 (N.Y. Sup. Ct. 2004), *aff'd*, 802 N.Y.S.2d 717 (N.Y. App. Div. 2005); *see Berman v. Le Beau Inter-Am., Inc.*, 62 B.R. 262, 267 (S.D.N.Y. 1986).

204. N.Y. Bus. Corp. Law § 720(a)(1)(B) (McKinney 2024).

very high. The plaintiff must establish that the corporation either received in return for its expenditure nothing of value or received something of some minor value that was clearly inadequate.[205] In addition, a plaintiff must show that the directors or officers acted to serve an outside interest.[206] Speculative allegations are insufficient to support a claim of waste.[207] If ordinary business people could differ as to whether the value the corporation received in return for its expenditure was sufficient, then the transaction will be upheld.[208] To defend against a claim of waste, a director can show that the transaction was made in good faith and fair to the corporation.[209] Examples of conduct that may constitute waste include board approval of excessive compensation to directors or officers or the lease of corporate property at a below-market rent.[210] The waste or gift of corporate assets is a void act that cannot be ratified by shareholders.[211]

1-12 CORPORATE LIABILITY FOR THE ACTS OF A PRINCIPAL

Under the doctrine of respondeat superior, a corporation, including a professional corporation, can be vicariously liable for the wrongful acts of its employees, officers and directors, provided that the individual was acting within the scope of his or her authority to act as an employee.[212] Such corporate liability can include intentional acts of the employee, so long as the employee was acting within the scope of employment when the intentional

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205. *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370 (N.Y. App. Div. 1982); *see Berman v. Le Beau Inter-Am., Inc.*, 62 B.R. 262, 267 (S.D.N.Y. 1986).

206. *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370-71 (N.Y. App. Div. 1982).

207. *Kassover v. Prism Venture Partners, LLC*, 862 N.Y.S.2d 493, 499 (N.Y. App. Div. 2008).

208. *Blake v. Blake*, 638 N.Y.S.2d 632, 633 (N.Y. App. Div. 1996); *see Berman v. Le Beau Inter-Am., Inc.*, 62 B.R. 262, 267 (S.D.N.Y. 1986).

209. *SantiEsteban v. Crowder*, 939 N.Y.S.2d 28, 30 (N.Y. App. Div. 2012); *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370 (N.Y. App. Div. 1982).

210. *Patrick v. Allen*, 355 F. Supp. 2d 704, 714-15 (S.D.N.Y. 2005); *Berman v. Le Beau Inter-Am., Inc.*, 62 B.R. 262, 267 (S.D.N.Y. 1986); *SantiEsteban v. Crowder*, 939 N.Y.S.2d 28, 30 (N.Y. App. Div. 2012); *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 371-72 (N.Y. App. Div. 1982). *But see Marx v. Akers*, 666 N.E.2d 1034, 1042-43 (N.Y. 1996) (holding that complaint did not state a claim for waste based on the payment of director compensation because the directors' decision was insulated from liability by the business judgment rule).

211. *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 371 (N.Y. App. Div. 1982).

212. *Szajna v. Rand*, 427 N.Y.S.2d 57, 58 (N.Y. App. Div. 1980); *Anderson v. Janson Supermarkets, LLC*, 934 N.Y.S.2d 32 (Table), 2011 WL 2859816, at *3 (N.Y. Sup. Ct. 2011).

acts occurred.[213] Additionally, a corporation may even be held criminally liable for the intentional acts of its employees, where the employees' acts (i) violate "positive prohibitions or commands of statutes regarding corporate acts," (ii) were authorized by corporate officers or committed with the officers' acquiescence, and (iii) were performed within the scope of the employee's authority.[214] In such situations, both the corporation and the corporate employee will be liable.[215] A corporation will not be vicariously liable, however, when the employee's act is not within the scope of the employee's duties and the corporation did not "condon[e], instigat[e] or authoriz[e]" the employee's wrongdoing, or where the employee's actions were motivated solely for personal gain unrelated to furtherance of the corporation's business.[216] Further, an employer will not be held vicariously liable for an employee's tortious conduct that the employer could not have reasonably expected.[217]

Corporations generally will not be exposed to liability for punitive damages based on the acts of their employees.[218] A corporation may be liable for punitive damages, however, where the senior directors or officers of the corporation authorized, participated in, or ratified the employees' wrongful conduct.[219] For example, this exception allows awards of punitive damages "where

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213. *Anderson v. Janson Supermarkets, LLC*, 934 N.Y.S.2d 32 (Table), 2011 WL 2859816, at *3 (N.Y. Sup. Ct. 2011).

214. *People v. Highgate LTC Mgmt., LLC*, 887 N.Y.S.2d 298, 301 (N.Y. App. Div. 2011) (citation omitted); N.Y. Penal Law § 20.20(2) (McKinney 2024).

215. *Bailey v. Baker's Air Force Gas Corp.*, 376 N.Y.S.2d 212, 215-16 (N.Y. App. Div. 1975).

216. *Milosevic v. O'Donnell*, 934 N.Y.S.2d 375, 375-76 (N.Y. App. Div. 2011); *Carnegie v. J.P. Phillips, Inc.*, 815 N.Y.S.2d 107, 108-09 (N.Y. App. Div. 2006); *Anderson v. Janson Supermarkets, LLC*, 934 N.Y.S.2d 32 (Table), 2011 WL 2859816, at *3 (N.Y. Sup. Ct. 2011).

217. *Carnegie v. J.P. Phillips, Inc.*, 815 N.Y.S.2d 107, 108-09 (N.Y. App. Div. 2006); *Anderson v. Janson Supermarkets, LLC*, 934 N.Y.S.2d 32 (Table), 2011 WL 2859816, at *3 (N.Y. Sup. Ct. 2011).

218. *Cohen v. Varig Airlines, S.A. Empresa de Viacao Aerea Rio Grandense*, 380 N.Y.S.2d 450, 463-64 (N.Y. Civ. Ct. 1975), *modified*, 390 N.Y.S.2d 515 (N.Y. Sup. Ct. App. T. 1976), *aff'd as modified*, 405 N.Y.S.2d 44 (N.Y. App. Div. 1978).

219. *Roginsky v. Richardson-Merrell, Inc.*, 378 F.2d 832, 842 (2d Cir. 1967) (noting that New York "adheres to the 'complicity rule,' holding the corporate master liable for punitive damages 'only when superior officers either order, participate in, or ratify outrageous conduct'") (citation omitted); *see also Rose v. Brown & Williamson Tobacco Corp.*, 809 N.Y.S.2d 784, 801-02 (N.Y. Sup. Ct. 2005) (noting that if corporate officers or directors sanction tortious conduct, the corporation may be liable for punitive damages); *Cohen v. Varig Airlines, S.A. Empresa de Viacao Aerea Rio Grandense*, 380 N.Y.S.2d 450, 463-64 (N.Y. Civ. Ct. 1975) (denying punitive damages award against a corporation where the corporation's executive management were not involved in the purported wrongdoing), *modified*, 390 N.Y.S.2d 515 (N.Y. Sup. Ct. App. T. 1976), *aff'd as modified*, 405 N.Y.S.2d 44 (N.Y. App. Div. 1978) (deny-

the officers or agents in whom the executive management of [the corporation's] affairs is vested have participated in the wrong by ordering the particular conduct or by issuing general orders which would naturally produce such wrongdoing, or by negligence in selecting, or retaining a known unfit employee, or by ratifying the culpable conduct" and in addition the requirements for punitive damages generally under New York law are met.[220]

1-13 LIMITATIONS ON LIABILITY SET FORTH IN THE CERTIFICATE OF INCORPORATION

Section 402(b) of the Business Corporation Law permits shareholders to adopt provisions in a corporation's certificate of incorporation eliminating or limiting the personal monetary liability of directors to the corporation and its shareholders, except in limited circumstances of disloyalty, bad faith, intentional misconduct, or personal interest.[221] Although there are only a few cases interpreting and applying Section 402(b), courts have dismissed claims against directors that do not implicate any of the four exceptions.[222]

1-14 RATIFICATION

If a majority of the shareholders of a corporation ratify a transaction undertaken by officers and directors that would otherwise be objectionable, then they will be precluded from challenging it.[223] Transactions that may be ratified by a shareholder

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ing punitive damages award against a corporation where the corporation's executive management were not involved in the purported wrongdoing).

220. *Cohen v. Varig Airlines, S.A. Empresa de Viacao Aerea Rio Grandense*, 380 N.Y.S.2d 450, 464 (N.Y. Civ. Ct. 1975), *modified*, 390 N.Y.S.2d 515 (N.Y. Sup. Ct. App. T. 1976), *aff'd as modified*, 405 N.Y.S.2d 44 (N.Y. App. Div. 1978); *see also Roginsky v. Richardson-Merrell, Inc.*, 378 F.2d 832, 843 (2d Cir. 1967) (noting that a drug manufacturer could be liable for punitive damages if it put a drug on the market without testing it or, after placing a drug on the market, "deliberately clos[ed] its eyes" to a danger associated with the drug).

221. N.Y. Bus. Corp. Law § 402(b) (McKinney 2024).

222. *See Glatzer v. Grossman*, 849 N.Y.S.2d 300, 301 (N.Y. App. Div. 2008); *Bildstein v. Atwater*, 635 N.Y.S.2d 88, 89 (N.Y. App. Div. 1995); *City of Tallahassee Ret. Sys. v. Akerson*, No. 601535/08, 2009 WL 6019489, at *8 (N.Y. Sup. Ct. Oct. 16, 2009); *cf. In re Metro. Life Deriv. Litig.*, 935 F. Supp. 286, 293 (S.D.N.Y. 1996) (approving settlement and noting that Section 402(b) only permits monetary recovery against directors in limited circumstances).

223. *See Lewis v. Dansker*, 357 F. Supp. 636, 644-45 (S.D.N.Y. 1973); *Blake v. Blake*, 638 N.Y.S.2d 632, 632-33 (N.Y. App. Div. 1996); *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370-71 (N.Y. App. Div. 1982); *Shapiro v. Rockville Country Club. Inc.*, 784 N.Y.S.2d 924 (Table), 2004 WL 398980, at *13 (N.Y. Sup. Ct. 2004), *aff'd*, 802 N.Y.S.2d 717 (N.Y. App. Div. 2005).

vote include contracts and transactions between a corporation and one or more of its officers or directors.[224] Certain transactions and acts are void by their very nature and cannot be ratified.[225] Void acts and transactions include a gift of corporate assets without consideration or waste of corporate assets.[226]

1-15 INDEMNIFICATION

1-15:1 Indemnification of the Corporation

Theoretically, a corporation could seek indemnification from its officers or directors where it is required to pay for a loss attributable to the wrongful acts of the directors or officers and the corporation is without fault.[227] Indemnification allows a person who is held vicariously liable to obtain indemnification from the person who committed the wrongdoing.[228] However, there are no reported New York cases approving the indemnification of a corporation by its directors and officers, and at least one court has expressed uncertainty as to whether a corporation can seek indemnification from its directors or officers under a respondeat superior theory.[229]

1-15:2 Indemnification of Directors and Officers

New York law permits but does not require a corporation to provide in its certificate of incorporation, bylaws, or other corporate documents for the indemnification of directors and officers for

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224. N.Y. Bus. Corp. Law § 713(a)(2) (McKinney 2024).

225. *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370 (N.Y. App. Div. 1982).

226. *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370 (N.Y. App. Div. 1982) (collecting cases); *Shapiro v. Rockville Country Club, Inc.*, 784 N.Y.S.2d 924 (Table), 2004 WL 398980, at *11 (N.Y. Sup. Ct. 2004), *aff'd*, 802 N.Y.S.2d 717 (N.Y. App. Div. 2005).

227. *M & T Mortg. Corp. v. White*, Nos. 04-CV-4775, -5620, 2009 WL 1010451, at *3 (E.D.N.Y. Apr. 14, 2009); *King v. Audax Constr. Corp.*, No. 02 CV 582, 2007 WL 2582103, at *11 (E.D.N.Y. Sept. 5, 2007); *Trustees of Colum. Univ. v. Mitchell/Giurgola Assocs.*, 492 N.Y.S.2d 371, 374 (N.Y. App. Div. 1985).

228. *Trustees of Colum. Univ. v. Mitchell/Giurgola Assocs.*, 492 N.Y.S.2d 371, 374-75 (N.Y. App. Div. 1985); *King v. Audax Constr. Corp.*, No. 02 CV 582, 2007 WL 2582103, at *11 (E.D.N.Y. Sept. 5, 2007); *Devonshire Surgical Facility, LLC v. Law Offs. of Leo Tekiel*, No. 105558/07, 2013 WL 3591515, at *4-5 (N.Y. Sup. Ct. July 9, 2013) (dismissing claim for indemnification where there was no valid claim based on vicarious liability).

229. *See Sherleigh Assocs. v. Patron Sys., Inc.*, No. 04CIV907JFK, 2005 WL 1902844, at *3 (S.D.N.Y. Aug. 9, 2005) (denying former corporate officer's motion for order barring the corporation from asserting indemnification claims against him, but noting that "the Court has found no authority exploring the issue of whether or not a corporation may seek indemnification from its directors or officers under a theory of *respondeat superior*").

judgments, fines, amounts paid in settlement, and attorneys' fees in connection with an action or proceeding relating to his or her service as a director or officer, provided that the director or officer acted in good faith and "for a purpose which he reasonably believed to be in . . . the best interests of the corporation[.]"[230] However, even if the corporation's governing documents do not specifically provide for indemnification, a court may order the corporation to indemnify its directors and officers under some circumstances.[231] To be entitled to non-contractual indemnification, the director or officer must show that he or she acted in good faith and in what he or she thought to be the corporation's best interests, and "that he had no reason to believe that his actions were unlawful."[232] Where an officer or director is sued in a shareholder derivative action as well, a corporation may indemnify the officer or director provided that he or she "acted, in good faith, for a purpose which he reasonably believed to be in . . . the best interests of the corporation[.]"[233]

If an officer or director is "successful, on the merits or otherwise," in defending a civil or criminal action, then indemnification is mandatory.[234] An officer or director is not "successful" for the purposes of mandatory indemnification if a favorable judgment or determination is pending on appeal.[235] If the officer or director has not been successful and indemnification is not mandatory, then the corporation may still indemnify the officer or director provided that such indemnification is authorized by (1) a quorum of the disinterested directors who are not parties to the action, (2) the board of directors, based on a written opinion of indepen-

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230. N.Y. Bus. Corp. Law § 722(a) (McKinney 2024); *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 205 (S.D.N.Y. 1993); *Titley v. Amerford Int'l Corp.*, 671 N.Y.S.2d 497, 497 (N.Y. App. Div. 1998); *Dankoff v. Bowling Proprietors Ass'n of Am., Inc.*, 331 N.Y.S.2d 109, 114 (N.Y. Sup. Ct. 1972) (holding that where the bylaws of the defendant corporation had a director indemnification provision, it was "unconscionable" for the corporation "to refuse to pay for the defense of an action, for acts of a director admittedly made in the best interests of the corporation").

231. N.Y. Bus. Corp. Law §§ 721-726 (McKinney 2024); *Booth Oil Site Admin. Grp. v. Safety-Kleen Corp.*, 137 F. Supp. 2d 228, 232 (W.D.N.Y. 2000); *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 205-06 (S.D.N.Y. 1993); *Titley v. Amerford Int'l Corp.*, 671 N.Y.S.2d 497, 497-48 (N.Y. App. Div. 1998).

232. *Titley v. Amerford Int'l Corp.*, 671 N.Y.S.2d 497, 497 (N.Y. App. Div. 1998).

233. N.Y. Bus. Corp. Law § 722(c) (McKinney 2024).

234. N.Y. Bus. Corp. Law § 723(a) (McKinney 2024); *Baker v. Health Mgmt. Sys., Inc.*, 264 F.3d 144, 150 (2d Cir. 2001); *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 205 (S.D.N.Y. 1993); *Haenel v. Epstein*, 450 N.Y.S.2d 536, 537 (N.Y. App. Div. 1982).

235. *Haenel v. Epstein*, 450 N.Y.S.2d 536, 537 (N.Y. App. Div. 1982).

dent legal counsel that advises that indemnification is proper, or (3) a vote of the shareholders.[236]

If the corporation refuses to indemnify a director or officer, then he or she may file an application for indemnification with the court. The director or officer may file the application in the civil action in which the expenses were incurred or other amounts were paid or in a separate proceeding in the New York Supreme Court.[237] Further, "[w]here indemnification is sought by judicial action, the court may allow a person such reasonable expenses, including attorneys' fees, during the pendency of the litigation as are necessary in connection with his defense therein. If the court shall find that the defendant has by his pleadings or during the course of the litigation raised genuine issues of fact or law."[238] Courts may also order the advance payment of litigation expenses to the extent that indemnification would be consistent with applicable law and with any indemnification provision in the corporation's governing documents.[239] To obtain an advance payment of litigation expenses, the director or officer must "by his pleadings or during the course of the litigation rais[e] genuine issues of fact or law."[240] This standard is less stringent than the standard applied in the context of a motion for summary judgment.[241] An advancement can be ordered even where the officer or director is alleged to have committed wrongdoing against the corporation, such as by breaching his or her fiduciary duties or engaging in intentional misconduct.[242] If, however, the officer or director is ultimately found to have engaged in the

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236. N.Y. Bus. Corp. Law § 723(b) (McKinney 2024); *Haenel v. Epstein*, 450 N.Y.S.2d 536, 537 (N.Y. App. Div. 1982).

237. N.Y. Bus. Corp. Law § 724 (McKinney 2024).

238. N.Y. Bus. Corp. Law § 724(c) (McKinney 2024).

239. *See Happy Kids, Inc. v. Glasgow*, No. 01 CIV. 6434, 2002 WL 72937, at *1 (S.D.N.Y. Jan. 17, 2002); *Sierra Rutile Ltd. v. Katz*, No. 90 Civ. 4913, 1997 WL 431119, at *1 (S.D.N.Y. July 31, 1997); *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 206 (S.D.N.Y. 1993); *Crossroads ABL LLC v. Canaras Cap. Mgmt., LLC*, 963 N.Y.S.2d 645, 645 (N.Y. Sup. Ct. 2013).

240. N.Y. Bus. Corp. Law § 724(c) (McKinney 2024); *Happy Kids, Inc. v. Glasgow*, No. 01 CIV. 6434, 2002 WL 72937, at *1 (S.D.N.Y. Jan. 17, 2002); *Sierra Rutile Ltd. v. Katz*, No. 90 Civ. 4913, 1997 WL 431119, at *1 (S.D.N.Y. July 31, 1997); *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 206 (S.D.N.Y. 1993).

241. *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 206 (S.D.N.Y. 1993).

242. *See Happy Kids, Inc. v. Glasgow*, No. 01 CIV. 6434, 2002 WL 72937, at *2-4 (S.D.N.Y. Jan. 17, 2002); *Sierra Rutile Ltd. v. Katz*, No. 90 Civ. 4913, 1997 WL 431119, at *1 (S.D.N.Y. July 31, 1997); *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 206 (S.D.N.Y. 1993) (advancement of legal expenses ordered despite the fact that corporation alleged RICO claim against former officer).

alleged wrongdoing, then the officer or director must repay any advancement of legal expenses to the corporation.[243]

Section 725 of the Business Corporation Law provides that indemnification is prohibited in certain situations.[244] First, indemnification is not allowed where the corporation is a foreign corporation and indemnification would be inconsistent with the laws of the foreign corporation's jurisdiction.[245] Second, indemnification is not permitted where it would be inconsistent with the corporation's governing documents.[246] Third, if there is a court-approved settlement of a proceeding, indemnification will not be allowed if it is inconsistent with the terms of the settlement.[247] In addition, indemnification is not permitted where "a judgment or other final adjudication adverse to the director or officer establishes that his acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled."[248]

1-16 INSURANCE

Corporations often have directors' and officers' liability insurance policies (D&O policies). While the specific policy will determine the particular coverage available to directors and officers, D&O policies typically cover two types of loss: (1) defense costs, and (2) losses resulting from settlement of claims for or actual liability.[249] Corporations often have both primary and excess liability policies

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243. N.Y. Bus. Corp. Law § 725(a) (McKinney 2024); *Sequa Corp. v. Gelmin*, 828 F. Supp. 203, 207 (S.D.N.Y. 1993) (noting that individual "may be required to repay these advances if [corporation] sustains its claims of fraud against him"); *Sierra Rutile Ltd. v. Katz*, No. 90 Civ. 4913, 1997 WL 431119, at *1 (S.D.N.Y. July 31, 1997).

244. N.Y. Bus. Corp. Law § 725(b)(1)-(3) (McKinney 2024).

245. N.Y. Bus. Corp. Law § 725(b)(1) (McKinney 2024); *Bear, Stearns & Co. v. D.F. King & Co.*, 663 N.Y.S.2d 12, 13 (N.Y. App. Div. 1997) (reversing order granting motion for advance indemnification because the corporation was a Delaware corporation and Delaware had no comparable statutory indemnification provision); *Stewart v. Continental Copper & Steel Indus., Inc.*, 414 N.Y.S.2d 910, 915-16 (N.Y. App. Div. 1979).

246. N.Y. Bus. Corp. Law § 725(b)(2) (McKinney 2024).

247. N.Y. Bus. Corp. Law § 725(b)(3) (McKinney 2024).

248. N.Y. Bus. Corp. Law § 721 (McKinney 2024); *Biondi v. Beekman Hill House Apt. Corp.*, 731 N.E.2d 577, 577-78, 580-81 (N.Y. 2000); *Bansbach v. Zinn*, 801 N.E.2d 395, 403-04 (N.Y. 2003); *Pilipiak v. Keyes*, 729 N.Y.S.2d 99, 99-100 (N.Y. App. Div. 2001).

249. *See, e.g.*, *In re Adelphia Commc'ns Corp.*, 302 B.R. 439, 443 (Bankr. S.D.N.Y. 2003) (noting that the two types of loss that are commonly covered by D&O policies are "(1) defense costs, and (2) actual liability for allegedly wrongful conduct").

that provide an aggregate limit of insurance coverage that often reaches the millions of dollars or tens of millions of dollars.[250]

D&O policies typically contain exclusions for claims or loss resulting from dishonest, fraudulent, or criminal acts or omissions, or personal profit gained by a director or officer to which he or she is not legally entitled.[251] In such instances, insurance coverage will not be available. In addition, a D&O policy may be deemed void if an insured makes an insurance claim that he or she knows to be false or fraudulent.[252] Moreover, a D&O policy may be found to be void if the policy was obtained through a material misrepresentation, even if the insured officers and directors had no knowledge of the fraud.[253] Where a D&O policy contains a severability provision providing that the policy shall be construed as a separate contract with each insured individual, however, coverage may only be barred for the insured individuals who participated in the fraud.[254]

1-17 CRIMINAL LIABILITY OF PERSONS ACTING OR UNDER A DUTY TO ACT FOR CORPORATIONS

Under New York law, a corporate officer or director may be found criminally liable for crimes committed in the course of his or her service as an officer or director. Section 20.25 of the Penal Law provides that "[a] person is criminally liable for conduct constituting an offense which he performs or causes to be performed in the name of or on behalf of a corporation to the same extent as if such conduct were performed in his own name or behalf."[255]

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250. *In re Adelphia Commc'ns Corp.*, 302 B.R. 439, 443-44 (Bankr. S.D.N.Y. 2003).

251. *SEC v. Credit Bancorp, Ltd.*, 147 F. Supp. 2d 238, 243 (S.D.N.Y. 2001); *National Union Fire Ins. Co. of Pitt. v. Xerox Corp.*, 792 N.Y.S.2d 772, 778-79 nn.4, 5 (N.Y. Sup. Ct. 2004) (D&O policy excluded coverage for ill-gotten gains), *aff'd*, 807 N.Y.S.2d 344 (N.Y. App. Div. 2006).

252. *See, e.g.*, *SEC v. Credit Bancorp, Ltd.*, 147 F. Supp. 2d 238, 246 (S.D.N.Y. 2001) (noting that an insurance policy may be void if the insured knowingly makes an insurance claim that is false or fraudulent).

253. *See American Int'l Specialty Lines Ins. Co. v. Towers Fin. Corp.*, No. 94 Civ. 2727, 1997 WL 906427, at *10 (S.D.N.Y. Sept. 12, 1997); *National Union Fire Ins. Co. of Pitt. v. Xerox Corp.*, 792 N.Y.S.2d 772, 781-82 (N.Y. Sup. Ct. 2004), *aff'd*, 807 N.Y.S.2d 344 (N.Y. App. Div. 2006).

254. *See Wedtech Corp. v. Fed. Ins. Co.*, 740 F. Supp. 214, 218-19 (S.D.N.Y. 1990); *cf. Continental Cas. Co. v. Marshall Granger & Co.*, 921 F. Supp. 2d 111, 120-21 (S.D.N.Y. 2013) (finding that D&O policy's "Innocent Insureds" clause was not a severability clause).

255. N.Y. Penal Law § 20.25 (McKinney 2024).

Pursuant to this statute, a corporate officer or director may face criminal liability for his or her actions, even if he or she was acting on behalf of the corporation, if he or she intentionally or willfully participates in criminal conduct.[256] In addition, an officer or director may be found criminally liable even if he or she only indirectly caused criminal conduct to take place, either by encouraging the conduct or by soliciting such conduct to occur on behalf of the corporation.[257]

1-18 DIRECTOR CONFLICTS OF INTEREST

A director may have a conflict of interest if he or she, or an entity in which he or she is an officer or director or has a substantial financial interest, enters into a contract or transaction with the corporation.[258] Section 713 of the Business Corporation Law provides procedures for evaluating transactions involving interested directors.[259] Such a contract or transaction will not be void or voidable by the corporation merely on the basis of the director's interest, provided that the material facts as to such director's interest in the transaction are disclosed in good faith to the board and the board or a committee thereof approves the transaction by a sufficient majority without counting the vote of the interested director.[260] Nor will the transaction be invalid if the material facts as to the director's interest are disclosed in good faith or known to the shareholders entitled to vote on the transaction and the transaction is approved by a vote of the shareholders.[261] If a contract or transaction involving an interested director is not approved in

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256. *See People v. Sakow*, 379 N.E.2d 1157, 1158-59 (N.Y. 1978); *People v. Adinolfi*, 823 N.Y.S.2d 662, 668-69 (N.Y. Cnty. Ct. 2006); *Kuriansky v. Azam*, 573 N.Y.S.2d 369, 373 (N.Y. Sup. Ct. 1991).

257. *See People v. Roth*, 576 N.Y.S.2d 968, 970 (N.Y. App. Div. 1991) (officers and directors could be held criminally liable for violating building and zoning rules where each defendant was an active participant in the operation of the plant, knew about the dangerous conditions in the plant, and made no effort to correct those conditions), *aff'd as modified*, 604 N.E.2d 92 (N.Y. 1992); *People v. Dean*, 368 N.Y.S.2d 349, 350-51 (N.Y. App. Div. 1975) (affirming conviction of corporation's sole active principal for issuing a bad check where, even though the principal never personally drew or signed a bad check on behalf of the corporation, he caused checks to be issued despite knowing that the corporation's bank account had insufficient funds).

258. N.Y. Bus. Corp. Law § 713(a) (McKinney 2024).

259. N.Y. Bus. Corp. Law § 713 (McKinney 2024).

260. N.Y. Bus. Corp. Law § 713(a)(1) (McKinney 2024).

261. N.Y. Bus. Corp. Law § 713(a)(2) (McKinney 2024).

accordance with the procedures set forth above, however, "the corporation may avoid the contract or transaction unless the party or parties thereto shall establish affirmatively that the contract or transaction was fair and reasonable as to the corporation at the time it was approved by the board, a committee [of the board] or the shareholders."[262] Examples of interested director transactions include, *inter alia*, retirement agreements with a director, agreements for payments to a director and leases between the corporation and an entity with which a director is affiliated or a sale of assets either by a director to the corporation or to a director from the corporation.[263] The Business Corporation Law provides separate rules for loans made by a corporation to a director.[264] A loan to a director must be approved by a majority vote of the shareholders entitled to vote unless the certificate of incorporation provides otherwise and the board determines that the loan benefits the corporation and the board approves the particular loan at issue or a general plan authorizing such loans.[265] An interested director transaction that involves a gift or waste of corporate assets will be invalid even if it is approved the board or shareholders.[266]

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262. N.Y. Bus. Corp. Law § 713(b) (McKinney 2024).

263. *Lewis v. S. L. & E., Inc.*, 629 F.2d 764, 770, 772 (2d Cir. 1980); *Freer v. Mayer*, 637 N.Y.S.2d 425, 426 (N.Y. App. Div. 1996); *Hakim v. Mahdavian*, 585 N.Y.S.2d 828, 829-30 (N.Y. App. Div. 1992).

264. N.Y. Bus. Corp. Law § 714 (McKinney 2024).

265. N.Y. Bus. Corp. Law § 714 (McKinney 2024) (noting that the same approval procedure applies when a corporation seeks to guarantee an obligation of one of its directors).

266. *See Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370-71 (N.Y. App. Div. 1982).