When Navigating Stormy Waters, Directors Must Steer the Ship Toward the Best Interests of Stockholders

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The Delaware Court of Chancery denied a motion to dismiss a class action brought by stockholders of Tangoe, Inc., arising from a take-private sale of the company to Marlin Equity Partners, Asentinel LLC, and TAMS Inc.1 Reinforcing the well-settled principle that a board of directors must act in the best interest of stockholders, the court held that the plaintiffs adequately pled that the board steered the company toward an ill-advised, self-interested sale and away from stockholders' interests when Tangoe was in the "midst of a storm."

Case Background

Tangoe stockholders sued the company's former directors, alleging that they breached their fiduciary duties by moving forward with the sale of the company. The sale was tendered after the board filed false financial statements, after Tangoe's stock was delisted by the NASDAQ exchange, and while a restatement of audited financials was pending with the SEC. The defendants moved to dismiss the action, arguing that they were entitled to deference under the business judgment rule for the sale as established in *Corwin v. KKR Fin. Holdings LLC*,2 because a majority of stockholders had tendered their shares. The defendants also asserted that dismissal was proper under an exculpatory charter provision under 8 Del. C. § 102(b)(7).

The Court's Decision

In denying the directors' motion to dismiss, the court held that the board failed to provide stockholders with any audited financial statements or updates on the restatement process in advance of the stockholder vote—information that was highly important to a stockholder during the pending restatement process when access to publicly filed, updated financial statements was limited. Because the plaintiffs' well-pled allegations set forth that they were prevented from voting on the sale with full knowledge of the facts, and because it was reasonably conceivable that stockholders were uninformed, the court held that Corwin's business judgment rule did not apply to cleanse the transaction.

The court also held that the plaintiffs pled a non-exculpated claim for breach of the duty of loyalty given the timing and structure of the sale, because the board received significant equity awards that were triggered by a change in control of the company, thus incentivizing the sale and supporting an inference that defendants acted in self-interest. Additionally, the court stated that the board acted under the threat of proxy contest, which further supported the inference of its material self-interest. Therefore, the court declined to dismiss the case at the pleading stage.

Key Takeaways

The court's holding that the business judgment rule would not cleanse the transaction must be considered in the procedural context in which this case was decided (i.e., a motion to dismiss). A board's risky or difficult decisions will still be given business judgment deference if made during difficult times, but at the pleading stage, directors must show that stockholders were fully informed of all "material aspects of the storm," including how the company got caught in it, alternative courses, and the bases for the board's chosen course.

[1] *In re Tangoe, Inc. Stockholders Litig.*, C.A. No. 2017-0650-JRS, 2018 WL 6074435 (Del. Ch. Nov. 20, 2018).
[2] 125 A.3d 304 (Del. 2015) (holding that a transaction is subject to the business judgment rule when it is approved by the fully informed, uncoerced vote of disinterested stockholders).