

The Delaware Court of Chancery Finds Negotiated Settlement with CEO a Proper Exercise of Business Judgment

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The Court of Chancery's ruling in *Lululemon* is the most recent example of the Delaware courts' deference to a board of directors' business judgment. The plaintiff's rush to file suit resulted in numerous pleading deficiencies, which the disgruntled shareholder was ultimately unable to overcome. While *Lululemon* is largely defined by the shortcomings of the plaintiff, the court provides valuable insight on the processes undertaken by the board in carrying out its duties.

Lululemon focuses on the board's decision to enter into a separation agreement and pay Laurent Potdevin a \$5 million severance, instead of terminating the former chief executive for cause. The complaint accused Potdevin of creating a toxic culture that endorsed patriarchal beliefs and promoted a "boys club"-like atmosphere. Following a pair of undescribed incidents involving Potdevin, the board discussed at a dinner following a board meeting how to handle the executive. Thereafter, the board met five additional times to discuss Potdevin, and hired outside counsel to undertake an investigation. Upon receipt of the investigative report, the board authorized the chairman to negotiate the terms of Potdevin's departure, which resulted in a \$5 million severance in exchange for a full release and private departure from the company.

It is etched in the bedrock of the State of Delaware that the board of directors shall bear responsibility for the management of the company. The board is presumed to have acted in the best interests of the company. This standard requires an aggrieved shareholder to make a formal demand to the board of directors to investigate and pursue its claim prior to the shareholder filing suit, or, in the alternative, to demonstrate that a demand would have been futile. Where a shareholder fails to make a pre-suit demand, as was the case in *Lululemon*, the court will dismiss the lawsuit unless the shareholder can show that a majority of the board of directors was interested in the transaction, or that the decision was not the result of a valid business judgment. Even when viewing the complaint in a light most favorable to the shareholder, the Court of Chancery dismissed the lawsuit, based on the plaintiff's failure to overcome the demand requirement.

Despite the plaintiff's numerous shortcomings, the court's analysis of certain aspects of the board's decision-making process proves

most valuable. While the plaintiff placed a large emphasis on the informal, undocumented meetings of the board, the Vice Chancellor was not convinced. First, the record established that the board discussed Potdevin's conduct and the best course of action in a formal setting. Second, the pleadings indicated that the "off the record" conversations encouraged an open dialogue on the record regarding the matter. Third, although the court views un-minuted meetings suspiciously, the plaintiff failed to plead "other compelling facts" similar to those found in *Texlon* and *Feuer* to support demand futility. Viewing the decision to pursue a settlement in terms of the board's authority to set executive compensation, the court found that the negotiated settlement was a proper exercise of business judgment.