

DELAWARE BUSINESS COURT INSIDER

Equity May Allow a Pro Rata Recovery in a Derivative Action

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By **Barry M. Klayman** and **Mark E. Felger** | July 06, 2022



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The Delaware Court of Chancery has broad discretion to tailor a remedy to suit a particular situation. The recovery in a derivative action generally goes to the corporation, but that rule is not absolute. Treatises and commentators have recognized that courts will grant pro rata recoveries where the equities demand it. In *Goldstein v. Denner*, C.A. No. 2020-1061-JTL, 2022 WL 1797224 (Del. Ch. June 2, 2022), Vice Chancellor J. Travis Laster discussed the circumstances under which the court might allow a pro rata recovery in the context of a derivative action. *Goldstein* dealt with a motion to dismiss insider trading claims. The lawsuit alleged a breach of fiduciary duty against officers and directors of Bioverativ, Inc., and investment fund Sarissa Capital Management and its affiliates in connection with the sale of Bioverativ to Sanofi S.A. Alex Denner, one of the directors of Bioverativ and a person in control of Sarissa, was accused of seeking to delay public knowledge of Sanofi's interest in Bioverativ while Sarissa secretly purchased shares of Bioverativ in such a manner as to avoid triggering disclosure requirements. The purchases and subsequent sales resulted in almost \$50 million in profits to Denner. Laster had previously denied motions to dismiss claims that the members of the Bioverativ board and three of the company's officers had breached their fiduciary duties during the sale process. See *Goldstein v. Denner*, 2022 WL 1671006 (Del. Ch. May 26, 2022). He had reserved decision on the insider trading and aiding and abetting allegations against Denner and Sarissa. They argued that the plaintiff had failed to state a reasonably conceivable claim

that Denner had breached his duty of loyalty by causing Sarissa to purchase shares of Bioverativ after he learned material, nonpublic information about Sanofi's interest in acquiring the company. They also argued that the plaintiff lost standing to pursue the insider trading claims when the transaction closed. The plaintiff explained that he was not pursuing the insider trading claims as derivative claims, but rather as a means of challenging the sale transaction. The defendants said that if that were the case, then the insider trading claims duplicated the sales process claims and should be dismissed on that basis. It is the vice chancellor's treatment of that argument that is of special interest.

Laster concluded that it was highly unlikely that the insider trading claims would be duplicative of the sale process claims. The principal question raised by the sales process claims was whether the sale process was outside the range of reasonableness due to a nonexculpated breach of fiduciary duty by Denner. The likely remedy would be an award of classwide damages based on the value that the stockholders would have received if the defendants had followed a reasonable process and obtained the best price reasonably available, either by closing the sale at a higher price or by causing Bioverativ to remain a stand-alone entity and capitalize on the company's business plan.

The insider trading claims, on the other hand, sought to show that Denner breached his fiduciary duties by engaging in insider trading. If those claims were proved, the remedy would be disgorgement of the profits that Denner made, regardless of whether the corporation had been harmed. Thus, the insider trading claims represented an independent and additional source of potential recovery from Denner.

Because a claim for breach of fiduciary duty is a creature of equity, the court has the power to craft a remedy that is appropriate based on the specific facts and equities of the case. A derivative claim most often means a corporate remedy, but not always. Laster noted that commentators and treatises have identified recurring scenarios that can support an investor-level recovery on an entity-level claim. Some examples include:

- Cases where the defendants are insiders who misappropriated corporate property such that an entity level recovery would return the property to the wrongdoers' control.
- Cases where an entity-level recovery would benefit "guilty" stockholders, but an investor-level recovery could be more narrowly tailored to benefit only "innocent" stockholders.
- Cases where the entity is no longer an independent going concern, such that channeling the recovery through the corporation is no longer feasible or a pro rata recovery is more efficient.

If the court decides to grant an investor level recovery, then each stockholder's award is computed by multiplying the sum which the corporation would have received had the individual recovery not been allowed by the ratio of that stockholder's shares to the total number of shares outstanding.

The vice chancellor observed that courts have granted pro rata recoveries in derivative actions at the request of settling defendants, resulting in their paying less in terms of the aggregate amount of damages. Defendants frequently use a variant of this approach to settle derivative actions in exchange for some form of stockholder-level consideration, such as a dividend to stockholders or a buyout of the minority.

These cases demonstrate that the functional and equitable equivalent of an entity-level recovery can be an investor-level recovery in which the injured investors receive their pro rata share of the amount that would otherwise be paid to the entity. In the *Goldstein* case, the vice chancellor recognized that he had the power to recast the disgorgement remedy that otherwise would have gone to the company as an investor-level recovery for the putative class represented by the plaintiff. The remedy that the putative class might receive could include disgorgement as a component even if the transaction price was unfair. If the plaintiff prevailed on the insider trading claims, the putative class would be entitled to receive the profits obtained by Denner. That would be in addition to any damages that the plaintiff would be entitled to were he to prevail on the sale process claims. Thus, the insider trading claims provide a nonduplicative avenue of recovery against the defendants.

Laster's opinion did not purport to break new ground. It recognized the power of equity to fashion appropriate remedies in specific cases. For those whose understanding is that a recovery in a derivative proceeding generally belongs to the corporation and not to the individual stockholders, the opinion collects abundant commentary and case law to show that in exceptional circumstances, the court will allow a pro rata recovery in a derivative action where to do otherwise would be inequitable.

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