

Delaware Supreme Court Affirms Dismissal of Derivative Action Alleging Directors Improperly Failed to Stop or Sanction Corporate CEO's Alleged Sexual Misconduct

December 2001

In a case involving underlying allegations that a high-profile corporate CEO sexually harassed various female employees, the Delaware Supreme Court unanimously affirmed the dismissal of a derivative suit against ICN Pharmaceuticals, Inc. ("ICN") and its directors, holding that the complaint did not contain sufficiently particularized allegations to create a reasonable doubt that demand on the board was excused because the directors were not disinterested and independent or their decisions were not protected by the business judgment rule. *White v. Panic*, 2001 WL 1191452 (Del. Oct. 3, 2001) (en banc).

According to the complaint, several female ICN employees had filed suit against the company alleging that Milan Panic, ICN's founder and CEO and the Prime Minister of Yugoslavia from 1992 to 1993, had sexually harassed them. The complaint, which was based primarily on an article published in a national news magazine, further alleged that ICN had paid a combined \$3.5 million to settle eight different harassment suits against Panic. Plaintiff claimed that ICN's directors were aware of Panic's asserted misconduct for many years, but protected him by using company funds to settle the claims, failed to sanction him for his misconduct, and never required him to reimburse the company for the cost of settling the suits. Plaintiff also alleged that the directors approved a short-term loan to Panic to permit him to pay a \$3.5 million settlement in a paternity suit, then guaranteed a bank loan to replace the short-term loan. In return, Panic pledged 150,000 of his personal ICN stock options.

Plaintiff filed his complaint in the Court of Chancery without making a pre-suit demand on the company's board. Defendants filed a motion to dismiss contending that plaintiff had failed to show demand was futile and thus excused. The Court of Chancery ruled that demand was not excused because the complaint failed to raise a reasonable doubt that the directors were disinterested or that their actions were the protected by the business judgment rule. Accordingly, the Court of Chancery dismissed the complaint with prejudice.

The Delaware Supreme Court affirmed. As the court recognized, "[t]he decision to approve a settlement is entitled to the same presumption of good faith as other business decisions taken by a disinterested, independent board. Similarly, the board's decision not to seek contribution from persons involved in the conduct underlying a suit against the corporation is a business decision within the discretion of the board." Although the court noted that the directors were aware of the suits against Panic and approved the settlement of the claims, these facts alone did not show that the directors knew the claims had merit or that Panic had engaged in the alleged misconduct. The court also determined that the allegations did not show that the directors had intentionally decided not to sanction Panic or not take measures to stop future misconduct. Thus, since the complaint failed to allege, inter alia, the board's assessment of the claims, the amount of alleged damages in each case, and the amount of each purported settlement, the court held that plaintiff had failed to adequately allege that the board's decisions were "anything other than routine business decisions in the interests of the corporation." Finally, the court held that the decision to guarantee a loan to Panic, who provided collateral in the form of stock options, was not so one-sided as to constitute corporate waste.