

Your Attendance Is Cordially Required: Decision Expands Ability to Sue Directors in Delaware Courts

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A recent Delaware Supreme Court ruling makes it easier to impose personal jurisdiction on directors and officers of Delaware companies, even though it has long been true that they consent to being sued in Delaware courts by virtue of their agreement to serve as directors and officers of Delaware corporations.

Background of the Case

The suit involved Marc Hazout, a Canadian resident who is the CEO and a director of Silver Dragon Resources, a silver mining company headquartered in Ontario and incorporated in Delaware. Hazout negotiated a capital infusion of \$3.4 million from a group of investors based in Hong Kong. When completed, the terms of the infusion would have required the resignation of four directors and control of the company transferred from Hazout to the Hong Kong investors. The infusion was structured by a series of agreements, four of which specified that Delaware law was to govern, and one requiring that any dispute over the infusion be litigated in Delaware.

Before the agreements were signed, however, investor Tsang Mun Ting wired \$1 million of the \$3.4 million to Silver

Dragon, based on the assurance that Hazout and the other directors of the company would execute the agreements.

One of the directors, however, refused to sign. Rather than return the \$1 million, Hazout allowed Silver Dragon not only

ware court based on Section 3114 of Title 10 of the Delaware Code, the statute that deems directors and officers to have consented to the personal jurisdiction of the Delaware courts by virtue of agreeing to serve in that capacity in a Delaware corporation.

Why This Decision Is Notable

Delaware courts have historically interpreted Section 3114 to only impose personal jurisdiction on directors and officers of a Delaware corporation when claims against them were made for breach of fiduciary duty or other related violations of the Delaware General Corporation Law. Thus, this decision is notable because it expands the interpretation of the statute to allow directors and officers of Delaware corporations to be subject to the jurisdiction of Delaware courts when they are merely a necessary party (e.g., a person whose interests are impacted by the outcome of a lawsuit) or a proper party (someone who merely has a legal interest in a lawsuit), even if there are no claims for breach of fiduciary duty. If nothing else, it's a practical reminder to directors and officers of Delaware companies that, even if they have never been to Delaware, they can expect to be forced to appear in a Delaware



to keep the money but to send \$750,000 of it to another company that Hazout controlled. Tsang consequently sued Hazout in Delaware for fraud.

Hazout argued that Delaware had no jurisdiction over the claims because Tsang was neither a U.S. resident nor a stockholder of the company suing for breach of fiduciary duty.

The trial court found that Hazout could be sued in a Dela-

courtroom if they are deemed necessary parties to a lawsuit.

Legal Reasoning

Non-resident defendants are entitled to due process under the U.S. Constitution, but U.S. courts can't exercise jurisdiction unless a defendant has minimum contacts with the state—for example, visiting, selling goods, or being a company incorporated in the state—where the case is being brought. Prior Delaware decisions employed a narrower interpretation of Section 3114 due to concerns about whether a more expansive reading would satisfy the “minimum contacts” requirement.

The Delaware Supreme Court reasoned, however, that because Section 3114 requires that there be a close nexus between the claims against the corporation and those against the director and officer such that: “The claims against the director and officer involved conduct taken in his official corporate capacity. In other words, this safeguard ensures that the implied consent mechanism of Section 3114 only applies when a director or officer faces claims that arise out of his exercise of his corporate powers.”

Hazout, acting as a director and officer of the company, was “a necessary or proper party to a civil action brought in this State against the corporation of which he is an officer and director,” the court said. In addition, Hazout expressly consented to suit in Delaware for certain types of claims by virtue of his service

as an officer and director of the Delaware corporation.

Moreover, the court added that the dealings that gave rise to the suit were focused on a change of control of the Delaware corporation, and the parties to those dealings agreed to Delaware law as their common language of commerce. Thus, Hazout should not have been surprised or offended by Delaware's exercise of personal jurisdiction over him.

The court's conclusion was bolstered by the strong public policy that gives Delaware a legitimate interest in providing a forum for efficient redress of claims against a Delaware corporation and a fiduciary of that entity whose actions are at the heart of those claims. This approach also fosters judicial efficiency and avoids piecemeal litigation against a corporation and its directors and officers that might be required in a different forum.

The court explained that Tsang was a proper party because he had a tangible legal interest in the matter separate from the interest of the corporation. The Delaware General Assembly included safeguards in Section 3114 that protect against overreaching, because a non-resident officer and director can only be sued in a case in which the corporation itself is a party, and in which the officer and director is a necessary or proper party to that suit.

The court emphasized that it was not sufficient to find a director or officer to be a necessary or

proper party; the court must also find that the exercise of personal jurisdiction is consistent with the constitutional expectations of due process.

Directors and officers must understand that when they agree to serve in that capacity for a Delaware corporation, they also avail themselves of certain duties and protections of Delaware law, which include being subject to the jurisdiction of a Delaware court. In the case of *Hazout v. Tsang*, the director and officer was involved in his official capacity in negotiating contracts which chose Delaware law to govern the disputes that form the basis of the claims made against him.

In sum, the court explained that even though the parties involved were from Hong Kong and Canada, they understood through their written agreements that a common language of commerce was chosen to govern their respective actions and that Delaware was the expected forum to address those issues. The court therefore held that requiring the director and officer to defend the lawsuit in Delaware did not “offend traditional notions of fair play and substantial justice.” 

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