Tuesday, October 21
9:00 am-10:30 am

412 Care & Feeding of the Board: Liability Issues for Board Members

Candice Aaron
Vice Chair, Corporate Governance Group
Saul Ewing LLP

Stephanie Daley-Watson
Vice President, Secretary, and Associate General Counsel
Safeco Corporation

Jane Orenstein
Previous Vice President and General Counsel
Imperium Renewables

This material is protected by copyright. Copyright © 2008 various authors and the Association of Corporate Counsel (ACC).
Materials may not be reproduced without the consent of ACC.
Reprint permission requests should be directed to ACC's Legal Resources Department at ACC: 202/293-4103, ext. 338; legalresources@acc.com

Faculty Biographies

Candice Aaron

Candice Aaron is a partner in the litigation department and vice chair of the corporate governance practice group for Saul Ewing LLP in Wilmington, DE. She concentrates her practice in corporate litigation, with an emphasis on complex business and transactional litigation in the Delaware courts and Delaware governance.

Prior to joining Saul Ewing, Ms. Aaron was an associate in the Wilmington law firm of Richards, Layton & Finger. In this capacity she focused her practice primarily on transactional and commercial litigation, and counseling Delaware corporations and other entities and their directors and members on corporate governance and fiduciary duties.

Ms. Aaron received a BA from the University of Michigan and is a graduate of the University of Pennsylvania School of Law.

Stephanie Daley-Watson

Stephanie Daley-Watson is vice president, secretary, and associate general counsel for Safeco Insurance in Seattle.

Prior to joining Safeco, Ms. Daley-Watson was of counsel at Perkins Coie LLP in Seattle where her practice focused on corporate finance, venture capital finance, federal securities law, mergers and acquisitions, executive compensation, and corporate governance. Ms. Daley-Watson has also served as corporate counsel at Metawave Communications Corporation, and previously worked as an associate in the Washington, DC office of Kutak Rock.

Ms. Daley-Watson received a BA from Washington State University, and is a graduate of the University of Denver College of Law.

Jane A. Orenstein

Jane A. Orenstein has over 25 years of experience counseling private and public companies, most recently as vice president, general counsel, and secretary of Imperium Renewables, Inc. in Seattle.

Prior to joining Imperium Renewables, Ms. Orenstein served as assistant general counsel and then general counsel of Shurgard Storage Centers, Inc., which was acquired in 2006 by Public Storage, Inc. Ms. Orenstein has advised boards of directors on issues surrounding mergers and acquisitions, hostile takeovers, recapitalizations, cross-border ventures, and corporate governance matters. She began her career as a deputy attorney general in the California Department of Justice and also served as a section chief for the Resolution Trust Corporation.

Ms. Orenstein received a BA from the University of California, Los Angeles and is a graduate of the University of Southern California Law Center.

Care and Feeding of the Board: Liability Issues for Board Members

Basic Framework and Overarching Obligations

"Where an informed director acts in good faith and is independent and disinterested, there can be no liability for corporate loss." *Gagliardi v. Trifoods, Int'l, Inc.*, 683 A.2d 1049 (Del. Ch. 1996).

Duty of Care

- Informed decisionmaking
- Monitoring of operations and compliance
- Review of controls and risk management
- Utilizing capable advisors and professionals
- Succession planning

Informed Decisionmaking

- As the Delaware Supreme Court has explained, "[d]ue care in the decision-making context is process due care only" and courts do not "measure, weigh, or quantify directors' judgments [and] do not even decide if they are reasonable in the context." *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000).
- Process is important –
  - Consider all reasonably available material information
  - Take adequate time and care to examine that information. *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

Review of Controls and Risk Management

- Directors who take steps "to assure a reasonable information and reporting system exists" will not be subject for personal liability if that system fails and the company suffers harm. *Stone*, 911 A.2d at 370.
- Directors can protect themselves by
  - receiving and approving suitable company policies and procedure
  - delegating to employees and departments the responsibility for taking the actions required by those policies
  - monitoring compliance with those policies by relying on periodic reports from employees
  - directly or through the audit committee review whether management has adopted proper risk assessment and risk management policies and procedures and established and maintained adequate internal controls and procedures for financial reporting and compliance with law

Monitoring Operations and Compliance

- Directors must exercise broad oversight over the company's operations.
  - This means not that the board be involved in the daily operations of the company but that it receive financial information that readily enables it to understand results of operations, variations from budget, trends in the business and industry, and significant press and analyst reports on the company, as well as sufficient information to monitor internal controls and management.
- Directors will only be liable for failure of oversight where they "utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, they consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369 (Del. 2006).
- The Delaware Court of Chancery recently applied *Stone* to hold that directors who knowingly failed to actively participate in the company's sale process not only breached the duty of care but could be held liable for acting in bad faith for their inaction in the face of a known duty to act. *See Ryan v. Lyondell Chemical Co.*, 2008 WL 2923427 (Del. Ch. July 29, 2008).

Utilizing Capable Advisors and Professionals

- Section 141(e) of the Delaware General Corporation Law protects members of a board who rely in good faith upon the books and records of the corporation, opinions, reports or statements presented by corporate officers or by reports of outside experts selected with reasonable care. *See* 8 *Del. C.* § 141(e).
- Directors who rely on experts (and management) in exercising their oversight responsibilities have necessarily met their obligations and made good faith efforts to be informed of relevant facts. In re Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996).
- Reliance will not protect directors if
  - they did not in fact rely on the expert or do so in good faith
  - they did not reasonably believe that the expert's advice was within the expert's professional competence
  - the expert was not selected with reasonable care and the faulty selection process was attributable to the directors
  - the directors nonetheless failed to consider additional material information regardless of the expert's advice or lack of advice
  - the decision of the Board was so unconscionable as to constitute waste or fraud

Succession Planning

- Recent Wall Street problems emphasize the importance of the board's role in planning for succession of top management
- Competence is not enough – integrity and dedication of top management is critical in enabling a board to meet all of its responsibilities

Disinterestedness and Independence

- A director may not maintain impartiality if she is *interested* in the transaction such that she appears on both sides of a transaction or has a material personal financial interest in the decision which is separate from that to be received by some or all stockholders, or if she is *not independent* because her decision is based on extraneous considerations or influences. *See Orman v. Cullman*, 794 A.2d 5 (Del. Ch. 2002).
- Nomination by a controlling stockholder or social friendships with interested parties are not enough
- A showing of self-dealing, such as payment of fees by an interested party, may be sufficient. *See, e.g., Aronson*, 473 A. 2d at 816.
- Noneconomic interests "so substantial that they cause reasonable doubt about the director's ability to act impartially" are problematic. *See In re Oracle Corp. Derivative Litigation*, 824 A.2d 917 (Del. Ch. 2003).

Duty of Loyalty

- Disinterestedness and independence means that the board should make decisions "on the merits of the issue rather than being governed by extraneous considerations or influences." *Kaplan v. Wyatt*, 499 A.2d 1184 (Del. 1985).
- Complete disclosure to stockholders and the board is a component of loyalty

Disclosure

- The duty of loyalty requires directors to disclose all material facts to stockholders fully and fairly when seeking stockholder action. *See Stroud v. Grace,* 606 A.2d 75, 84 (Del. 1992).
- Directors must also disclose material facts (including self-interestedness) to each other

Avoiding Liability by Focusing on Process

- A carefully planned, executed and documented process can immunize a board's decision or render it difficult to challenge

Minutes and Recordkeeping

- Thoughtful, comprehensive minutes, when properly prepared and reviewed by the board, can protect directors from liability if a decision turns out not to have been a good one
- Bad minutes get bad results – *See In re Netsmart Techs., Inc. S'holder Litig.,* 924 A.2d 171 (Del. Ch. 2007).
- Clear, comprehensive materials from meetings that are maintained as part of the minutes provide additional protection

Process Protections

- Minutes and recordkeeping
- Reliance on management and advisors
- Charters, codes, guidelines and checklists
- Confidentiality
- Board, committee and management evaluations
- Major transactions
- Related-party transactions
- Independent committees
- Board committees

Charters, Codes, Guidelines and Checklists

- Audit, nominating and compensation committee charters
- Code of ethics and set of policies and procedures for reviewing related party transactions
- Board governance guidelines and policies
- Beware of overdoing it and exposing the board to liability

Confidentiality

- Directors owe a broad legal duty of confidentiality to the corporation with respect to information they learn in the course of their duties
- Directors with "dual directorships" need to be particularly cognizant of this duty

Major Transactions

- Major transactions (acquisitions, mergers, spinoffs, investments and financing) require careful structuring so that the board receives the information necessary to make an informed and reasoned decision
- No need for special committees if there is no conflict of interest concern (business, family, and employment relationships with the other party should be considered)
- Support by management is key, but outside advisors not required if the board and company has requisite internal expertise
- Proper diligence and consideration is important, including a two-step process in especially complicated or sensitive transactions
- Remember that you are creating a record to protect the company and the board from liability

Board, Committee and Management Evaluations

- Certain exchanges (e.g., NYSE) require annual evaluations
- You can hire outside experts to help
- How, when, and if evaluations are done is a subjective decision
- Evaluations can be written or verbal – note that privilege does not apply to documents and minutes created as part of the evaluation process

Related-Party Transactions

- Full disclosure, and careful consideration of best practices is essential
- Include discussion of the company's "policies and procedures for the review, approval or ratification of related party transactions" in disclosure
- Consider written policy

Board Committees

- Audit
- Compensation
- Nominating and Governance

Avoiding Liability in Considering Transactions

- Duties of a buyer's board
- Duties of a seller's board
- What is the role of in-house counsel?

Special or Independent Committees

- Use of an independent committee can trigger more deferential review -- *See In re W. Nat'l Corp. S'holders Litig.,* 2000 Del. Ch. LEXIS 82 (Del. Ch. May 22, 2000).
- Independent committees have little liability–avoiding effect if they are not truly independent -- *Cf. In re Tele-Communications, Inc. S'holders Litig.,* 2005 Del. Ch. LEXIS 206 (Del. Ch. Dec. 21, 2005) and *Kahn v. Lynch Communication Sys, Inc.,* 638 A.2d 1110 (Del. 1994).
- Delegation of broader power to act will provide greater protection to the board and the committee -- *See Gesoff v. IIC Indus. Inc.,* 2006 Del. Ch. LEXIS 91 (Del. Ch. May 18, 2006).

Duties of a Buyer's Board

- Deal protection vs. fiduciary "outs"
- Continually reassess transaction
- Keep stockholders informed
- Follow terms of agreement

Duties of a Seller's Board

- Independent process showing exercise of business judgment
- Deal with conflicts
- Role(s) of advisors
- Communication with stockholders and stakeholders – *See In re Lear Corp. S'holder Litig., 926 A.2d 94 (Del. Ch. 2007).*
- **Maximize Shareholder Value**
- Don't
  - keep multiple draft copies of minutes
  - provide different information to potential purchasers
  - think "one-size fits all" for deal protections and market checks
  - forget about the utility of voting agreements
  - underestimate significance of full disclosure

Avoiding Liability in Making Business Investment Decisions

- Avoiding interested transactions and decisions using committees or disinterested directors
- The cleansing effect of disclosure and ratification

What is the Role of In-house Counsel?

- Counselor
- Communicator
- Conflict spotter
- Negotiator
- Mediator
- Company officer

Avoiding interested transactions and decisions using committees or disinterested directors

- Nothing inherently improper about interested transactions – may provide unique efficiencies
- Appropriate for an informed board, on proper record, to approve interested transactions through disinterested directors or via a committee
- If you choose to use a committee, control and document the process -- *Netsmart,* 924 A.2d 171.
  - Ensure the committee is actively involved in diligence and negotiations
  - Ensure the committee has equal access to information as the insiders
  - Tailor the process to the situation

The Cleansing Effect of Disclosure and Ratification

- Statutory protection exists where interested transactions are fully disclosed to, and approved by, a majority of disinterested stockholders. *See* 8 *Del. C.* § 144.
- Where an interested transaction is negotiated by an independent committee and subject to the approval of a majority of disinterested stockholders, challenging the transaction will be more difficult. *See In re Cox Communications, Inc. S'holders Litig.*, 2006 Del. Ch. LEXIS 158 (Del. Ch. Aug. 18, 2006); *Gantler v. Stephens*, 2008 Del. Ch. LEXIS 20 (Del. Ch. Feb. 14, 2008).

Best Practices in Derivative Litigation

- Consider early and often whether separate counsel should be retained for the company, the board, and inside/outside directors
- Take affirmative steps to protect the company's privilege
- Consider forming special litigation committee to consider/take over litigation

Avoiding Liability in Derivative Litigation and Investigations

- Best practices in derivative litigation
- Special litigation committees
- Best practices when facing an investigation or inquiry from outside or within the company

Special Litigation Committees

- The committee must be active and involved in order to receive deference from the Court. *See Conrad v. Blank*, 2007 Del. Ch. LEXIS 130 (Del. Ch. Sept. 7, 2007); *Sutherland v. Sutherland*, 2008 WL 1932374 (Del. Ch. May 5, 2008).
- A special litigation committee with the power to bring claims against the company will receive more judicial deference. *See Ryan*, 2007 WL 4259557.
- Committee should have its own self-selected, self-engaged independent advisors
- Special consideration required to protect the privilege where some members of the board are implicated

Best Practices in an Investigation/Inquiry from Outside or Within the Company

- Identify key players and secure documentation
- Consider whether the common interest doctrine will apply prior to sharing privileged information with the board
- Committee's findings should be shared with only those individuals who genuinely need to know and are not implicated
- Implicated individuals should be allowed access to that information only in their role as corporate fiduciaries
- Consider getting confidentiality agreements
- Document limitations and conditions placed on the sharing of any privileged company information with defendants or targets
- Defensively plan the process and any documents created in the course of the investigation with an eye toward disclosure
- Give investigatory committee power to institute litigation or take actions

Exculpation

- Statutory exculpation is available for breach of the duty of care -- 8 *Del. C.* § 102(b)(7)
- Scope of exculpation is limited – will not protect actions taken in bad faith or a breach of the duty of loyalty
- Corporation must opt-in to statute

After on Storm – Advancement and Indemnification

- Review bylaws & charter
- Discuss state law protection with counsel
- Make changes to D&O coverage
- Indemnification agreements
- Communicate with directors

Advancement

- Companies are allowed to grant advancement of expenses to directors and officers facing litigation. *See* 8 *Del. C.* § 145.
- Permissive, not mandatory, so check your governing documents
- Undertaking usually required
- Courts stringently enforce advancement rights – once you opt in, you're in all the way. *See Barrett v. Amer. Country Holdings, 951 A.2d 735 (Del. Ch. June 20, 2008).*

Indemnification

- Statutory – 8 *Del. C.* § *145*
- Charter/bylaws – consider and be aware of scope of coverage, carveouts in governing documents
- Contractual – agreements between the company and its directors

D&O Insurance

- Ensure policies are up to date and expansive
- Study retentions and exclusions carefully so the board understands where they are protected and where they are exposed
- Consider the financial strength of the company issuing the policies
- Consider “side-A” coverage (separate supplemental policies covering directors individually in the event of a bankruptcy)

Company X Policy Statement on Related Person Transactions

Including Procedures for their
Identification, Review and Approval or Ratification

Adopted by the Board of Directors on January 30, 2008

I. Policy Statement and Background

With limited exceptions, the Securities and Exchange Commission ("SEC") requires public disclosure of transactions involving public companies when persons having certain relationships with such companies have a material interest in the transaction. These transactions are called "Related Person Transactions" and are explained in more detail below.

Related Person Transactions can raise questions as to whether they are consistent with the best interests of a company and its shareholders. Such transactions have come under increasing scrutiny in recent years. As a general matter, Company X avoids such transactions. However, the company recognizes that on occasion, depending on the particular circumstances, such transactions may be appropriate. Company X reserves flexibility to enter into or ratify such transactions, provided that the Board of Directors, acting through the Audit Committee or as otherwise described in this policy, determines that the transaction is not inconsistent with the best interests of Company X and its shareholders.

Historically, Company X's practice has been to regularly gather information regarding such transactions, so as to facilitate their review and approval by the Audit Committee. The purpose of this policy statement is to refine and memorialize, in writing and in one document, Company X's policies and procedures for the review and approval or ratification of such transactions. This policy has been approved by the Board of Directors and will be administered by the Audit Committee of the Board of Directors. The Audit Committee may amend this policy from time to time.

II. Roles and Responsibilities

Timely and appropriate identification, analysis and treatment of Related Person Transactions require the cooperation of numerous individuals and groups, whose roles and responsibilities with respect to Related Person Transactions are highlighted below:

- **Corporate Legal:**
  - stay informed of relevant rules and regulations on Related Person Transactions
  - educate Company X management and board
  - regularly collect relevant information from executive officers, directors and business groups as to the identity of Related Persons and potential Related Person Transactions

    - analyze information collected, including whether a potential transaction involves a Related Person Transaction
    - summarize and present information to Audit Committee and others when appropriate
    - analyze appropriate disclosure treatment

- **Audit Committee:**
    - review and assess Related Person Transactions and Ordinary Course Business Relationships
    - approve or ratify Related Person Transactions and Ordinary Course Business Relationships when appropriate
    - review and update this policy
    - stay informed of relevant rules and regulations
    - Audit Committee Chair: review potential Related Person Transactions between regular Audit Committee meetings

- **Executive Officers and Directors:**
    - timely and fully respond to inquiries regarding the identity of Related Persons (including Immediate Family Members and Affiliated Entities) and potential Related Person Transactions
    - promptly update Corporate Legal upon any changes to such information, or upon becoming aware of any proposal for a potential Related Person Transaction
    - inform Immediate Family Members and Affiliated Entities of the Related Person Transaction disclosure requirements and that Company X maintains board-level oversight over such transactions

III. Definitions and Technical Guidance

Affiliated Entity. An "Affiliated Entity" is any organization or entity with which any Related Person has either of the following relationships:

- The Related Person is an executive officer of the entity; or
- The Related Person's ownership interest in the entity, when combined with that of all other Related Persons, exceeds 10%.

Amount Involved. The "Amount Involved" must be computed by determining the dollar value involved in the transaction, including all periodic payments or installments, or in the case of indebtedness, the largest amount outstanding and interest payable during the year.

Direct or Indirect Material Interest. Whether a "direct or indirect material interest" exists is a matter of judgment based on applicable legal principles, and must be determined on a case-by-case basis. An indirect material interest can arise through a Related Person's affiliation with an entity or organization that is a participant in the transaction. For example, depending on the circumstances, employment with, or significant shareholdings in, an organization involved in a transaction with Company X could give rise to an indirect material interest in that transaction.

If the Related Person's interest arises in the following manner, the law provides that the Related Person is deemed not to have an indirect material interest in the transaction:

- The Related Person is a director of the corporation or other organization party to the transaction;
- The Related Person (together with all other Related Persons) holds less than a 10% equity interest in the other organization party to the transaction;
- The Related Person is both a director and less than 10% owner as described above; or
- The Related Person is a limited partner in a partnership in which that person and all other Related Persons have an interest of less than 10%, so long as the person holds no other position with the partnership, such as general partner or employee.

Immediate Family Member. An "Immediate Family Member" means a person having any of the following relationships with the Related Person in question:

- Child or stepchild
- Parent or stepparent
- Spouse
- Sibling
- Mother-in-law or father-in-law
- Son-in-law or daughter-in-law
- Sister-in-law or brother-in-law
- Any person sharing one's household (except tenants or employees)

Related Person. A "Related Person" means any of the following:

- Any director (or nominee for director) of Company X Corporation
- Any executive officer of Company X Corporation
- Any person who was, but is not currently, a director of officer of Company X Corporation during Company X's last fiscal year
- Any person or entity with beneficial ownership of 5% or more of the outstanding stock of Company X Corporation
- Any Immediate Family Member of any person listed above

Related Person Transaction. A "Related Person Transaction" is a transaction in which Company X was or is to be a participant and the amount involved exceeds $120,000 and in which any related person had or will have a direct or indirect material interest.

Transaction. A "Transaction" includes, but is not limited to, any transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships. A charitable contribution may be a transaction.

IV. Procedures for Identifying Potential Related Person Transactions

Annual D&O Questionnaire. On an annual basis, each of the directors and executive officers will complete a Director and Officer (D&O) Questionnaire prepared by Corporate Legal that requests, among other items, information regarding their business and non-profit affiliations, their Immediate Family Members, and the business and non-profit affiliations of their Immediate Family Members.

Nominees and New Appointments. Any person nominated to stand for election as a director or appointed as a director or executive officer will complete a D&O Questionnaire promptly upon such person's nomination or before such person's appointment, except that if it is impracticable for an executive officer to submit such information in advance of appointment, the person may submit the information promptly following appointment.

Quarterly Inquiry. On a quarterly basis, Corporate Legal will distribute an inquiry to the executive officers and directors regarding any potential Related Person Transactions and changes to previously provided information. Corporate Legal will compile and review the information received and will distribute a report to the Audit Committee if any potential Related Person Transactions are identified or otherwise as may be appropriate. Corporate Legal will compile and update a master list of Related Persons and distribute it quarterly to appropriate Company X departments for review and identification of potential Related Person Transactions.

Duty to Update. Directors and executive officers are expected to promptly notify Corporate Legal of any updates to information most recently provided. For example, this would include notification regarding changes to the person's Immediate Family Members and the business affiliations of the person or his or her Immediate Family Members.

V. Special Procedures Regarding Ordinary Course Business Relationships with Company X.

Pre-Approval Requirement. Purchases of insurance or surety products in the ordinary course of business from Company X by a Related Person, or by an Affiliated Entity, require Audit Committee pre-approval. Such purchases, which may or may not give rise to Related Person Transactions, are called "Ordinary Course Business Relationships" for purposes of this policy. Any such relationships existing when this policy is adopted are exempt from pre-approval and are ratified by adoption of this policy. In the event that Ordinary Course Business Relationships are entered into inadvertently without Audit Committee pre-approval, such transactions may be ratified by the Audit Committee, if appropriate, pursuant to the Ratification Procedures set forth in Section VII below, or terminated.

The Audit Committee will consider such Ordinary Course Business Relationships on a case-by-case basis, taking into consideration the factors listed under Section VI below under the caption "Audit Committee Consideration," with special emphasis on the likelihood that premium payments or potential claims activity could give rise to a Related Person Transaction or impose a disclosure obligation for other reasons, impair a director's independence, or give rise to a conflict of interest.

Upon initiation of any claims activity with respect to an Ordinary Course Insurance Relationship, the Related Person must promptly notify Corporate Legal. In appropriate cases, Corporate Legal will report such claims activity to the Audit Committee, another independent board committee or the full Board of Directors.

VI. Approval Procedures

When a potential Related Person Transaction is identified before it is entered into, the transaction will be permitted to occur only upon completion of the following steps:

Disclosure of Information. The Related Person involved, as well as the Company X business leader responsible for the transaction, will provide information to Corporate Legal of all relevant facts and circumstances regarding the proposed transaction, including:

- the Related Person's relationship to Company X and a full disclosure of that person's interest in the transaction;
- the proposed aggregate value of the transaction, and a description of any relevant payment terms;
- the benefits to Company X of the proposed transaction;
- the extent of the Related Person's interest in the transaction;
- the availability of other sources of comparable products or services; and
- an assessment of whether the proposed transaction is on terms comparable to those available to an unrelated third party or to employees generally, as applicable.

Assessment by Corporate Legal. Corporate Legal will assess whether the proposed transaction is a Related Person Transaction for purposes of this policy. If Corporate Legal determines that the proposed transaction involves a Related Person Transaction, it will be submitted to the Audit Committee for consideration at the next Audit Committee meeting or, in those instances in which Corporate Legal, in consultation with the Chief Executive Officer or Chief Legal Officer, determines that it is not practicable or desirable to wait until the next Audit Committee meeting, to the Audit Committee Chair, pursuant to delegated authority to act on behalf of the committee between meetings.

Audit Committee Consideration. The Audit Committee or Chair will consider all relevant facts and circumstances concerning the proposed transaction, including, as applicable:

- the benefits to Company X;
- impact on director independence;*
- availability of other sources for comparable products or services;
- terms of the transaction versus terms available to unrelated third parties or to employees generally;
- whether the proposed transaction presents, or appears to present, a conflict of interest;* and
- any other legal, regulatory or other considerations relevant to the transaction.

*NOTE: The legal and Company X policy requirements regarding director independence and conflicts of interest present concepts that are separate from, but often interrelated with, the SEC's rules regarding related person transactions. These requirements must also be considered in any situation involving a potential Related Person Transaction, and their consideration will typically require coordination with the Nominating/Governance Committee or the Board of Directors.

No member of the Audit Committee will participate in any review, consideration or approval of any Related Person Transaction with respect to which he or she, or any of his or her Immediate Family Members, has an interest, other than to provide relevant facts regarding the transaction. If the Chair approves or ratifies a Related Person Transaction between meetings, the Chair will make a report to the Audit Committee regarding his or her decision at the committee's next meeting.

VII. Ratification Procedures

If a Related Person Transaction is identified after it has already been entered into, it will be promptly submitted to the Audit Committee or the Audit Committee Chair, who will consider the transaction taking into consideration the information and factors described above. Based on the conclusions reached, the Audit Committee or Chair will evaluate all options, including but not limited to ratification, amendment or termination of the Related Person Transaction.

VIII. Review of Ongoing Transactions

At the Audit Committee's first meeting of each fiscal year, it will review all known Related Person Transactions, including any previously approved or ratified Related Person Transactions that remain ongoing. Based on all relevant facts and circumstances, taking into consideration Company X's contractual obligations, the Committee will determine if it is in the best interests of Company X and its shareholders to continue, modify or terminate the Related Person Transaction.

IX. Standing Approval of Certain Transactions

The following transactions are deemed to be pre-approved for purposes of this policy.

Employment of executive officers. An employment relationship or transaction and related compensation by Company X of an executive officer if:

- the related compensation is required to be reported in the proxy statement under Item 402 of the SEC's compensation disclosure rules, or
- the related compensation was approved by the Compensation Committee, would be required to be reported in the proxy statement under Item 402 if the individual were a "named executive officer," and the individual is not an Immediate Family Member of another Related Person.

Director compensation. Any compensation paid to a director if the compensation is reported in Company X's proxy statement under Item 402.

Certain transactions with other companies. Any transaction:

- where the rates or charges are determined by competitive bids,
- that involves rendering services as a common or contract carrier or public utility at rates or charges fixed in conformity with law or governmental authority, or
- that involves services as a bank depositary of funds, transfer agent, registrar, trustee or under a trust indenture or similar services.

Transactions where all shareholders receive proportional benefits. Any transaction where the Related Person's interest arises solely from the ownership of Company X's equity securities and all holders of that class of equity received the same benefit on a pro rata basis, such as dividends.

DIRECTOR INDEPENDENCE POLICY
(Adopted January 30, 2008)

General Statement

It is not possible to anticipate, or explicitly to provide for, all circumstances that might be viewed as a conflict of interest that would impact a directors' ability to exercise his or her independent judgment. Accordingly, the Board when making its "independence" determination must broadly consider all relevant facts and circumstances, including those described below. No director qualifies as "independent" unless the Board affirmatively determines that such director has no relationships with Company X that would impair his or her independence. Except under the circumstances set forth below, it is not Company X's policy to preclude independence on the basis of ordinary course commercial business relationships between Company X and an entity with which a director has a relationship.

Definition of Independent Director

"Independent director" means a person who is not an officer or employee of Company X or its subsidiaries (collectively, "Company X") or any other individual having a relationship, which, in the opinion of Company X's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

A director cannot be independent if the director has any one or more of the following disqualifying relationships:

- The director is currently employed or has been employed by Company X within the last three years (employment as an interim Chairman or CEO will not disqualify a director from being considered as an independent director, or an immediate family member is, or has been within the last three years, an executive officer of Company X.

- The director or an immediate family member is a current partner of a firm that is Company X's internal or external auditor; the director is a current employee of such a firm; the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance or tax compliance (but not tax planning) practice; or the director or an immediate family member was within the last three years (but is no longer) a partner or employee of such a firm and worked on Company X's audit within that time.

- The director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of Company X's present executive officers at the same time serves or served on that company's compensation committee.

- The director has received, or has an immediate family member who has received from Company X in excess of $120,000 in direct compensation during any twelve-month period within the last three years, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), payments arising solely from investments in Company X's securities, compensation paid to an immediate family member who is a non-executive employee of Company X or benefits under a tax-qualified retirement plan or non-discretionary compensation.

- The director is a current employee, or an immediate family member is a current executive officer, of a company to which Company X made, or from which Company X received, payments for property or services (other than those arising solely from investments in Company X's securities or payments under non-discretionary charitable contribution matching programs) in an amount which, in any of the last three fiscal years, exceed two percent (2%) of such other company's consolidated gross revenues, or $1,000,000, whichever is more. (Both the payments and the consolidated gross revenues to be measured shall be those reported in the last completed fiscal year.)

An "immediate family member" for purposes of disqualifying relationships includes the director's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, and anyone (other than domestic employees) who shares the director's home.

References to the "company" include any parent or subsidiary in a consolidated group with the company.

Definition of Independent Director for Audit Committee Purposes

Audit committee members must be independent in accordance with the rules promulgated under the Sarbanes-Oxley Act of 2002. Accordingly, in addition to the independence requirements described above, no audit committee member may receive any consulting, advisory or other compensatory fees, directly or indirectly, from Company X (other than for service as a director). Indirect acceptance of compensatory payments includes payments to spouses, minor children or stepchildren sharing a home with the director, as well as payments accepted by an entity in which an audit committee member is a partner, member, officer such as a managing director occupying a comparable position or executive officer, or occupies a similar position (except limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to Company X) and which provides accounting, consulting, legal, investment banking or financial advisory services to Company X or any of its subsidiaries. Further, an audit committee member may not be an "affiliated person" (as such term is now or in the future defined in the Securities Exchange Act of 1934, as amended) of Company X or any of its subsidiaries (apart from his or her capacity as a member of the board and any board committee).

Modifications to Guidelines

These guidelines are subject to future changes as the Nominating/Governance Committee may find necessary or advisable for Company X in order to achieve its objectives or as required by law or pursuant to the rules and regulations of the exchange or market on which Company X's securities are listed or traded.

X COMPANY
AUDIT COMMITTEE CHARTER

Adopted by the Board of Directors January 30, 2008

I. Purpose

The purposes of the Audit Committee are to:

(1) oversee the accounting and financial reporting processes of the Corporation, its disclosure controls and procedures and its systems of internal control over financial reporting,
(2) approve prior to appointment the engagement of the Corporation's independent registered public accounting firm ("independent auditor") and in connection therewith to review and evaluate the independent auditor's compensation, qualifications and independence,
(3) pre-approve the services provided by our independent auditors,
(4) monitor the performance of the independent auditors,
(5) provide guidance to and monitor the performance of the Corporation's internal audit organization,
(6) monitor the Corporation's approach to business ethics and compliance with legal and regulatory requirements, implement required procedures,
(7) review and pre-approve related person transactions,
(8) prepare the report required by the rules of the Securities and Exchange Commission to be included in the Corporation's annual proxy statement; and
(9) provide guidance and monitor performance in connection with special projects as requested from time to time by the Board.

II. Appointment, Removal and Organization

The Audit Committee members shall be appointed annually by the Board of Directors upon the recommendation of the Nominating/Governance Committee and consist of not less than three members. The Audit Committee chair shall rotate every five years, unless a different rotation is required by law or upon the Nominating/Governance Committee's determination.

The members of the Audit Committee shall meet the independence, experience and expertise requirements for members of public company Audit Committees under the Securities Exchange Act of 1934, as amended, and the rules and regulations of the New York Stock Exchange. The Board of Directors shall determine annually whether any member of the Audit Committee is an "Audit Committee financial expert" as required by the Securities and Exchange Commission. Audit Committee members shall not simultaneously serve on the Audit Committees of more than two other public companies unless the Board determines that such simultaneous service would not impair the director's ability to effectively serve on Company X's board. The Audit Committee Chair may only serve as the Chair of one other public company Audit Committee.

The Audit Committee shall meet as often as deemed necessary, but not less than five times annually.

The Audit Committee shall keep minutes of its meetings and make regular reports on its activities to the Board of Directors.

III. Authority and Responsibilities

The Audit Committee shall:

1. Have sole authority to appoint and terminate the Corporation's independent auditor. The Audit Committee shall be directly responsible for the compensation and oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purposes of preparing or issuing an audit report or performing other audit, review or attest services for the Corporation. The independent auditor shall report directly to the Audit Committee.

2. Approve in advance all audit and permitted non-audit services (including the fees and terms thereof) to be provided by the independent auditor, subject to any exception permitted by law or regulation.

3. The Audit Committee may form and delegate authority to subcommittees consisting of one or more members when appropriate, including the authority to grant pre-approvals of audit and permitted non-audit services, provided that decisions of such subcommittee to grant pre-approvals shall be presented to the full Audit Committee at its next scheduled meeting.

4. Review the performance of the independent auditor of its audit responsibilities.

5. Meet with the independent auditor before the audit to review its planning and staffing and the audit approach to be used.

6. Discuss the annual audited financial statements and quarterly financial statements with management and the independent auditor, including the Corporation's disclosure in its periodic reports under "Management's Discussion and Analysis of Financial Condition and Results of Operations."

7. Review disclosures made to the Audit Committee by the Corporation's Chief Executive Officer and Chief Financial Officer during their certification process for the Form 10-K and Form 10-Q about any significant deficiencies in the design or operation of disclosure controls and procedures and internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Corporation's internal controls.

8. Review with the independent auditor the completed audit, including a review of any major issues regarding accounting and auditing principles and practices, the adequacy of internal controls that could significantly affect the Corporation's financial statements, and any management letter provided by the auditor and the Corporation's response to that letter and review any difficulties the auditor encountered in the course of its audit work (including any restrictions on the scope of the auditor's activities or on access to information, and any significant disagreements with management) and management's response.

9. Obtain and review, at least annually, a report by the independent auditor describing: (i) the auditor's internal quality control procedures; (ii) any material issues raised by the most recent internal quality control review or peer review of the auditor, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the auditor, and any steps taken to address these issues; and (iii) all relationships between the auditor and the Corporation. Evaluate the qualifications, performance and independence of the independent auditor, including considering whether the auditor's quality controls are adequate and the provision of permitted non-audit services is compatible with maintaining the auditor's independence, and taking into account the opinions of management and internal auditors. The Audit Committee shall present its conclusions with respect to the independent auditor to the Board.

10. Review any major changes to the Corporation's accounting principles and practices as may be suggested by management.

11. Review the internal audit function with the head of internal audit, management and the independent auditor, including the independence, authority and reporting obligations of the internal audit function; review the proposed internal audits before they occur; review in a high-level, summary fashion the results of internal audits; and, review the coordination of audits by both the independent auditor and internal auditor.

12. Review the appointment, replacement, reassignment or dismissal of the Corporation's head of internal audit.

13. Review and pre-approve all related person transactions.

14. Review the Corporation's approach to business ethics and compliance with the law.

15. Establish procedures for the receipt, retention, and treatment of complaints received by the Corporation regarding accounting, internal accounting controls, or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

16. Discuss with management earnings press releases, including the use of "pro forma" or "adjusted" non-GAAP information, and financial information and earnings guidance provided to analysts and rating agencies. Such discussion may be done generally (consisting of discussing the types of information to be disclosed and the types of presentations to be made).

17. Have sole authority to retain and terminate independent legal, accounting or other advisors who provide services to the Audit Committee and receive funding for such advisors.

18. Review management's approach to enterprise risk management and the establishment of and compliance with risk processes and controls.

19. Meet separately, periodically, with management, the internal auditor and the independent auditor.

20. Set clear hiring policies for employees or former employees of the independent auditor.

21. Report regularly to the Board of Directors.

22. Undertake an annual performance evaluation of the Audit Committee.

23. Review this charter annually and recommend proposed changes to it to the Board of Directors.

IV. Limitations of the Audit Committee's Role

The Board of Directors in adopting this charter specifically acknowledges that it is not the responsibility of the Audit Committee to plan or to conduct audits or to determine that the Corporation's financial statements are complete and accurate and are in accordance with accounting principles generally accepted in the United States. Those are responsibilities of management and the independent auditor. In addition, it is not the responsibility of the Audit Committee to assure compliance with laws and regulations applicable to the Corporation's operations. That is the responsibility of management.

COMPANY X CORPORATION
GOVERNANCE GUIDELINES

Adopted by the Board of Directors on January 30, 2008

The following corporate governance guidelines have been amended and restated by the Board of Directors of Company X Corporation upon the recommendation of its Nominating/Governance Committee to assist the Board in the exercise of its duties. These guidelines reflect the Board's commitment to ensuring its effectiveness and desire to enhance shareholder value over the long-term.

These guidelines are subject to future refinement or changes as the Board may find necessary or advisable for Company X in order to achieve these objectives.

1. Director Composition and Qualifications

(A) A majority of directors shall meet the criteria for independence required by the New York Stock Exchange and as reflected in Company X's director independence policy. In addition, directors should be free from conflicts of interest or an appearance of conflict that, in the opinion of the Board of Directors, would interfere with the director's exercise of independent judgment.

(B) Company X's bylaws provide that the size of the Board shall be set by resolution. Based upon Company X's present circumstances the Board believes a Board of between nine and 15 directors is appropriate. The Board periodically evaluates whether a larger or smaller Board would be preferable as well as whether to add directors.

(C) The Board, upon the recommendation of the Nominating/Governance Committee, will annually appoint a non-management director to serve either as its Lead Director or as Chairman of the Board. The Lead Director shall serve for no more than five consecutive years.

(D) The Board will decide from time-to-time based on the then relevant factors whether the positions of CEO and Chairman of the Board may be held by the same person.

(E) The Nominating/Governance Committee of the Board of Directors is responsible for reviewing with the Board, on an annual basis, the requisite skills and characteristics of new Board members as well as the composition of the Board as a whole. This assessment will include members' qualification as independent, as well as consideration of diversity, age, skills, and experience in the context of the make-up of the Board. Nominees for vacancies on the Board will be selected by the Nominating/Governance Committee in accordance with its established policies and principles and such nominees will be recommended to the full Board for approval. In connection with their renomination to the Board, the Nominating/Governance Committee will review each existing director's qualifications to remain on the Board.

(F) When a director's principal occupation or business association changes substantially during his or her tenure as a director (other than as a result of normal retirement), that director shall tender his or her resignation for consideration by the Nominating/Governance Committee. The Nominating/Governance Committee will review the offered resignation and recommend action to the Board. It is not Company X's policy that in every instance when a director's principal occupation or business association changes substantially during his or her tenure as a director that the offered resignation should be accepted.

(G) The Nominating/Governance Committee will assess whether a potential new Board member or an existing director has sufficient time to devote to the substantial duties and responsibilities of a member of the Board. Generally, directors should not serve on more than three other public company boards. However, an Audit Committee member shall serve on no more than two other public company audit committees unless the Board determines that such simultaneous service would not impair the director's ability to effectively serve on Company X's board. Service on an audit committee of a wholly owned subsidiary will not count so long as the director also serves on the audit committee of the subsidiary's parent. In addition, the Audit Committee Chair may only serve as the chair of one other public company Audit Committee. Directors shall advise the Chairman of the Board, the Lead Director, as the case may be, and the Chairman of the Nominating/Governance Committee in advance of accepting an invitation to serve on another public company board.

(H) The normal retirement age for a director is 72. The Board has not established term limits.

3. Lead Director Role and Responsibilities

(A) The Lead Director exists to assure the strength and vitality of the independent directors in their role on behalf of the shareholders. It is a configuration chosen to assure the effectiveness of Company X's independent directors while avoiding the risk of confusion about the primary business leadership role of the Chairman and CEO in directing the company.

(B) The Lead Director shall:

i) Stay regularly informed on the strategy of the company and its evolution.

ii) Stay informed about critical issues and performance of the company.

iii) Serve as a liaison between the Chairman and independent directors.

iv) Work with the chair of Nominating/Governance Committee on Board composition, structure, performance and any additional governance matters.

v) Work with the chair of Compensation Committee on Chairman and CEO performance reviews, compensation and succession planning.

vi) Work with independent directors and the Chairman to set the agenda for board meetings.

vii) Preside at all meetings of the board or shareholders where the Chairman is not present.

viii) Organize and preside at executive sessions of the Board.

ix) Know the senior leadership of the company and be a point of contact for their concerns.

x) Participate in exit interviews of resigning senior managers to determine whether their departure reflects problems with the CEO or other company issues.

xi) Serve as the point of contact for shareholder concerns.

4. Director Responsibilities

(A) The basic responsibility of a director is to discharge the director's duties in good faith, with the care an ordinary prudent person in a like position would exercise under similar circumstances, and in a manner he or she reasonably believes to be in the best interests of Company X.

(B) A director is expected to attend Board meetings and meetings of committees on which the director serves, and to spend the time needed and meet as frequently as necessary to properly discharge the director's responsibilities. A director should review all materials provided by Company X before any board or committee meeting of which the director is a member.

(C) In discharging their duties, the directors are entitled to rely on the honesty and integrity of Company X's senior executives and its outside advisors and auditors, so long as such reliance is not unwarranted. The directors shall also be entitled to (i) have Company X purchase reasonable directors' and officers' liability insurance on their behalf, and (ii) the benefits of indemnification to the fullest extent permitted by law and Company X's articles of incorporation and bylaws.

(D) Any director may suggest the inclusion of items on the meeting agenda. Any director may raise meeting subjects not on the agenda for a regularly scheduled meeting. The Board will review Company X's long-term strategic plans annually during at least one Board meeting.

(E) Non-management directors will meet without management in executive session at least quarterly. The Lead Director or non-management Chairman of the Board shall preside at these meetings and the director's identity will be disclosed in the annual proxy statement.

(F) The Chief Executive Officer as well as other senior management are responsible for speaking on Company X's behalf, including establishing effective communications with Company X's constituents. The Chairman is the spokesperson for the Board. Individual directors, however, may meet or otherwise communicate with various constituents regarding Company X with the prior authorization of the Board. This guideline is not intended to limit or inhibit the ability of any Company X employee or shareholder from in good faith raising a concern about the conduct of Company X's business or the reporting of its financial results.

(G) Taking into account the policy set forth above, a shareholder email box has been established so that shareholders may communicate with non-management directors as a whole or the Lead Director individually. The Lead Director or non-executive Chairman, as the case may be, monitors this shareholder communication mechanism, forwards communications to the appropriate committee(s) or non-management director(s) and facilitates an appropriate response. All shareholder communication mechanisms are disclosed in the annual proxy statement along with the title of the individual responsible for monitoring and facilitating responses to shareholder communications received through these mechanisms.

5. Board Committees

(A) The Board shall establish and maintain these standing committees: an Audit Committee; a Compensation Committee; a Finance Committee; and a Nominating/Governance Committee.

(B) All of the members of the Audit, Compensation and Nominating/Governance Committees will be independent under the criteria established by the New York Stock Exchange, applicable federal securities laws and as reflected in the director independence policy established by the Nominating/Governance Committee. Furthermore, the Audit Committee members shall have the expertise and experience required by the Securities and Exchange Commission and the New York Stock Exchange.

(C) Committee members will be appointed annually by the Board upon recommendation of the Nominating/Governance Committee with consideration of the desires of individual directors. It is the policy of the Board that the Chair of

each Board committee will rotate at least every five years, unless a different rotation is required by law or upon the Nominating/Governance Committee's determination. The Board may establish or disband additional committees as necessary or appropriate.

(D) Each standing committee will have its own charter, which will be posted on Company X's website. The charters will set forth the purposes, goals and responsibilities of the committees as well as qualifications for committee membership, procedures for committee member appointment and removal, committee structure and operations, committee reporting to the Board, and provide that each committee annually evaluate its performance.

(E) The chair of each committee, in consultation with committee members, will determine the frequency and length of the committee meetings consistent with any requirements set forth in the committee's charter. The chair of each committee, in consultation with the appropriate members of the committee and management, will develop the committee's agenda. The notice, agenda and materials for each standing committee meeting will be furnished to each director and each director is invited to observe all standing committee meetings.

(F) Each committee has the sole power to hire and determine the engagement terms and authorize Company X to pay the fees of independent legal, financial or other advisors as they deem necessary to fulfill such committee's responsibilities.

(G) The Board shall also have an Executive Committee whose purpose shall be to meet on an emergency basis when the Board is not in session. Such committee shall have power to act on behalf of the Board pursuant to authority delegated by the Board.

6. Director Access to Officers, Employees and Advisors

Directors have full access to officers and employees of Company X as well as Company X's outside advisors.

7. Director Compensation

The form and amount of director compensation shall be recommended to the Board by the Nominating/Governance Committee in accordance with the policies and principles set forth in its charter. The Nominating/Governance Committee shall conduct an annual review of director compensation.

8. Stock Ownership Expectation

(A) By December 31, 2008 or within six years of joining the Board, whichever is later, directors are expected to own at least 10,000 shares or vested restricted stock rights.

9. Director Orientation and Continuing Education

(A) All new directors must participate in Company X's orientation program. This orientation will include meetings with or presentations by senior management to familiarize new directors with Company X's strategic plans, its significant financial, accounting and risk management issues, its compliance programs, its governance guidelines, its Code of Business and Financial Conduct and Ethics, its principal officers, and its internal audit structure and independent auditors.

(B) All directors may attend all or part of the orientation program. Furthermore, Company X will provide opportunities for its directors to attend continuing education programs, which will include information about industry trends as well as corporate governance matters, and will conduct such programs as it sees fit from time to time.

(C) Every two years, each director must attend a continuing education program (for instance a Company X sponsored in-house program or a program accredited by RiskMetrics/Institutional Shareholder Services or similar organization) in order to, among other things, satisfy the qualification and expertise requirements of the Securities and Exchange Commission and the New York Stock Exchange.

10. CEO Evaluation and Management Succession

(A) The Compensation Committee will conduct an annual review of the CEO's performance, as set forth in its charter. The evaluation of the CEO should be a comprehensive process, based on both qualitative and quantitative factors, including actual performance of the business and long-term business and financial goals. The non-management directors will review the Compensation Committee's report.

(B) The Compensation Committee will make an annual report to the Board regarding succession planning. The entire Board shall work with the Compensation Committee to evaluate potential successors to the CEO and, to the degree that the Board determines it necessary or appropriate, other members of senior management. The CEO should provide recommendations and evaluations of potential CEO successors as well as for other members of senior management, along with a review of any development plans recommended for such individuals.

11. Annual Performance Evaluation

Under the guidance of the Nominating/Governance Committee, the Board of Directors will conduct an annual self-evaluation to determine whether it and its committees are functioning effectively.

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

WILLIAM J. BARRETT, EDWIN W. ELDER, MARTIN L. SOLOMON, and WILMER J. THOMAS, JR.,

Plaintiffs,

v.

AMERICAN COUNTRY HOLDINGS, INC., a Delaware corporation,

Defendant.

C.A. No. 3071-VCS

OPINION

Date Submitted: May 14, 2008
Date Decided: June 20, 2008

Matthew E. Fischer, Esquire, Kirsten A. Zeberkiewicz, Esquire, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; Lewis J. Liman, Esquire, Michele Kenney, Esquire, CLEARY GOTTLIEB STEEN & HAMILTON LLP, New York, New York, *Attorneys for Plaintiffs.*

Kevin F. Brady, Esquire, Jeremy D. Anderson, Esquire, CONNOLLY BOVE LODGE & HUTZ LLP, Wilmington, Delaware; Harold J. Ruvoldt, Jr., Esquire, Cathy Fleming, Esquire, NIXON PEABODY LLP, New York, New York, *Attorneys for Defendant.*

STRINE, Vice Chancellor.

A corporation has accused its former directors of engaging in intentional fraud in their official capacities. The former directors have a clear right to have their fees advanced to defend themselves against those charges. To date, however, a directors and officers' ("D & O") insurance policy has covered their fees, but the former directors brought this suit because the policy limits were nearly exhausted.

The corporation has refused to acknowledge the former directors' right to advancement despite the clear terms of the certificate of incorporation of the corporation they served as directors. It has done so because the former directors refused to accept settlement proposals in the underlying securities litigation, each of which required the entry of a judgment in favor of the corporation in that suit and the assignment of any rights the former directors have against the D & O insurer. Because the corporation has offered not to collect on the judgment, the corporation argues that the former directors have forfeited their right to advancement by unreasonably refusing settlement. The corporation makes this outlandish argument even while admitting that the former directors have received millions of dollars in advanced fees from the D & O insurer under a reservation of rights, and that the policy requires them to obtain approval from the D & O insurer before settling. That approval has not been forthcoming, in large measure because the corporation wishes to extract the judgment from the former directors and wield it as a club against the D & O insurer in a bad faith action it has pending against the insurer. Thus, the corporation says that even though the former directors must breach their contract with the D & O insurer to agree to the settlements it has proposed, the

former directors' failure to do so has rendered them ineligible to receive the contractual advancement benefits due them.

The corporation's position is remarkable, but in a regrettable way. Its stockholders will now endure not only the cost of honoring the corporation's promise to the former directors, but also the costs needlessly run up by the corporation because it chose to assert a baseless and illogical defense that wasted the resources of the former directors, this court, and the corporation itself.

If a corporation sues its former directors for intentional fraud in their official capacity and owes those directors advancement rights, it has no right to require them to accept a judgment against themselves of any kind, much less to say that the officials whose reputations and wealth the corporation has put at risk lose their advancement rights by failing to agree to such a demand. The very purpose of an advancement right is to enable a corporate official to protect herself against claims of official wrongdoing. If the corporation here wishes to drop its suit, it is free to do so. But it has no right to breach its obligation to those it has sued on the pretense that the former directors will not agree to the entry of an adverse judgment in a securities case. The former directors have every right to defend the case and to seek a complete vindication, one which will minimize the reputational consequences they have already suffered as a result of the corporation's charges of intentional fraud.

Equally obvious is that the former directors do not have to engage in behavior that will breach their obligations under the D & O policy. Although the corporation raises all sorts of arguments as to why the former directors face no material risk of liability to the

insurer, those arguments are self-serving, weak in material respects, and, most important, irrelevant. The former directors have no duty to take legally problematic action simply because the corporation that has sued them wants them to do so. Again, if the corporation wishes to drop its suit against the former directors, it is free to do so. What it is not free to do is to condition the former directors' advancement rights on their willingness to suffer a judgment and put themselves in the midst of a struggle between the corporation and their D & O insurer.

A judgment and order shall be entered for the former directors and all of their fees and expenses in this case shall be paid by the corporation.

I. Factual Background

Before 2002, Kingsway Financial Services, Inc. ("Kingsway") and American Country Holdings, Inc. ("American Country") were both publicly traded insurance holding companies that conducted business as property and casualty insurers through their respective subsidiaries. On April 5, 2002, Kingsway completed a tender offer for American Country shares that eventually resulted in American Country becoming a wholly-owned subsidiary of Kingsway. The plaintiffs in this action, William J. Barrett, Edwin W. Elder, Martin L. Solomon, and Wilmer J. Thomas, Jr., (collectively, the "Former Directors") were directors of American Country at the time of that acquisition.

On July 25, 2003, Kingsway, American Country, and several other Kingsway subsidiaries filed a lawsuit in the U.S. District Court for the Southern District of New York (the "Fraud Action") stemming from Kingsway's acquisition of American Country. Because Kingsway now controls American Country and its other subsidiaries, those

corporations have taken similar positions in the Fraud Action, and Kingsway appears to have directed settlement negotiations for that Action, I will generally refer to all the plaintiffs in the Fraud Action and the defendant in this case as simply Kingsway.

In the Fraud Action, Kingsway makes claims against the Former Directors; John Dore, American Country's former chief executive officer; Karla Violetto, American Country's former chief financial officer; and PricewaterhouseCoopers, American Country's independent auditor. In particular, Kingsway argues that it was misled about American Country's financial health before its acquisition of American Country because the Former Directors and other defendants in the Fraud Action made intentionally inaccurate and misleading disclosures that understated American Country's reserves. The complaint in the Fraud Action charges the Former Directors with conduct that Kingsway's counsel acknowledges would be criminal if proven.[1]

Because the claims in the Fraud Action were made against the Former Directors in their roles as directors of American Country, the legal fees incurred by the Former Directors in connection with that proceeding have been paid by Great American Insurance Company ("Great American") under a $10 million insurance policy covering American Country's former directors and officers (the "D & O Policy"). Dore and Violetto, as American Country's former officers, are also covered by the D & O Policy. Great American has advanced fees to the Former Directors under a reservation of the right to demand repayment if it is later determined that the claims in the Fraud Action were not covered by the D & O Policy. That reservation is important because if the

[1] Trial Transcript ("Tr.") at 193.

Former Directors are later found liable for intentional fraud, their conduct would likely be deemed to be both "deliberately fraudulent [and] criminal," behavior that is explicitly excluded from coverage under the D & O Policy.[2] In the event of such a finding, the Former Directors would not be entitled to coverage under the D & O Policy for any judgment against them and could be required by the insurer to repay the fees and costs previously advanced to them in the Fraud Action.[3]

Early on in the Fraud Action, Kingsway seems to have focused on a strategy that centered more on extracting as much of the cash value of the D & O Policy as it could than on proving its claims against the defendants and collecting a judgment entered against them. That is, Kingsway sought to monetize the D & O Policy by getting Great American to agree to settlements whereby it would pay over a substantial portion of the Policy limits in exchange for a settlement releasing some number of the individual defendants, who were insureds under the D & O Policy. To that end, on August 23, 2004, Kingsway offered to drop all of its claims against the Former Directors, Dore, and Violetto and give them a complete release in return for an $8.5 million payment from Great American.[4] That sum, together with the attorneys' fees Great American had already paid, would have pushed the total expenses paid under the D & O Policy to within $1 million of the Policy limits. Any settlement by the defendants in the Fraud

[2] JX 2 ("D & O Policy") § 4 (a)(2).
[3] *Id.* §§ 4(a)(2), 7(e)(4).
[4] JX 84. That settlement would have allowed Kingsway to continue its suit against another deep pocket, American Country's independent auditor, PricewaterhouseCoopers.

Action was subject to approval by Great American under the terms of the D & O Policy, which states the following:

> The Insured shall not incur Costs of Defense, or admit liability, offer to settle, or agree to any settlement in connection with any Claim *without the express prior written consent of the Insurer*, which consent shall not be unreasonably withheld. . . . Any Loss resulting from any admission of liability, agreement to settle, or Costs of Defense incurred prior to the Insurer's consent shall not be covered hereunder.[5]

In this particular case, Great American was being asked to pay over almost the entire Policy and it refused. Instead, Great American made a counteroffer to pay Kingsway $500,000. Kingsway rejected that offer.

With the parties unable to reach a settlement, the Fraud Action proceeded for the next several years and the D & O Policy was materially drawn down by defense costs. In July of 2007, under $5 million of coverage remained on the D & O Policy and the parties were about to begin an expensive round of depositions. Therefore, it was increasingly likely that the D & O Policy would be expended before the conclusion of the Fraud Action. Sensing that, the Former Directors brought this action on July 5, 2007, seeking a declaratory judgment that they were owed advancement for their defense of the Fraud Action, so that they would receive seamless coverage once the Policy limits were exhausted. Article Eighth of American Country's charter required that American Country advance legal expenses to former officers and directors "to the fullest extent permitted by . . . Section 145" of the DGCL.[6] The Former Directors wrote to Kingsway

[5] D & O Policy § 7(a) (emphasis added).
[6] JX 1, art. Eighth (emphasis added); 8 *Del. C.* § 145.

to confirm their entitlement to advancement on November 6, 2003, April 12, 2004, and June 5, 2007, but never received a positive response.

Kingsway was unhappy that the D & O Policy limits that it had hoped to secure as a recovery in the Fraud Action were going to be used solely to provide a defense for the defendants Kingsway had accused of fraud. Kingsway therefore began to develop an unusual plan to hold Great American responsible to it for damages. This involved arguing that Great American had acted in bad faith by refusing the August 2004 settlement proposal that had demanded $8.5 million. Kingsway did not raise this argument until November 15, 2007, as a counterclaim in an interpleader lawsuit that I will soon describe, but began laying the groundwork for that claim as early as July 2007. As it would later argue, Kingsway's theory was that Great American "allowed the limits of the [D & O] Policy to erode . . . to the point . . . that the [remaining] sum [was] not sufficient to settle all the claims against the [Former Directors, Violetto, and Dore]."[7]

On July 9, 2007, Kingsway made a settlement proposal for remainder of the D & O Policy. Under its terms, the Former Directors and Violetto would have been dismissed as defendants in the Fraud Action and received releases. But the settlement proposal had a couple of hitches. Defendant Dore, American Country's former CEO, was not included and he would have still faced suit from Kingsway. But Dore was also an insured under the D & O Policy, which by the terms of the settlement would have been

[7] JX 34 ¶ 50.

exhausted and unable to provide defense costs to him.[8] The settlement proposal also required the Former Directors to agree "to appear voluntarily when requested by [Kingsway] to provide truthful testimony in any proceedings" and that they assign to Kingsway any claims that they had "against any and all third parties [including Great American] related to th[e Fraud Action] or the business of American Country or Kingsway."[9] These terms were clearly designed to set up the planned bad faith claims against Great American. As discussed, the Former Directors could not agree to this settlement under the D & O Policy without Great American's "express prior written consent."[10] The July 9 proposal expired by its own terms at 5 p.m. the next business day. The Former Directors asked Kingsway to give Great American additional time to consider the proposal, which Great American had requested. Even though the Kingsway offer required Great American to address important conflicts among its insureds and, if accepted, could give rise to further disputes, Kingsway refused to give Great American more time and its offer expired.

[8] At that time, Dore had been receiving advancement of legal fees from a separate agreement with American Country. The continuation of American Country's advancement of fees to Dore was not assured, however. Kingsway had attempted to terminate Dore's advancement rights using arguments it admits are nearly identical to those it has raised in this proceeding. Kingsway Pre-Trial Op. Br. at 18 ("[American Country] moved to vacate [an] advancement order in the Illinois case, *Dore v. American Country Holdings, Inc. et al.*, Case No. 03 CH 8189, Hon. Peter J. Flynn, Cook County Circuit Court, County Department, Chancery Division, on the same grounds and on the same essential terms of settlement as here — that it was unreasonable for Dore to reject settlement proposals which did not implicate his personal assets. On February 15, 2008 Judge Flynn denied [American Country's] motion to vacate the advancement order (Order dated March 14, 2008).").
[9] JX 48 ¶¶ 3, 6.
[10] D & O Policy § 7(a).

Realizing that it was being targeted by Kingsway, Great American responded by filing an interpleader complaint in the U.S. District Court for the Southern District of New York against Dore, Violetto, and the Former Directors on July 18, 2007 (the "Interpleader Action"). In the Interpleader Action, Great American attempted to turn over the remainder of the D & O Policy to the court "to resolve multiple and competing demands to the remaining proceeds of the Policy by the Interpleader-Defendants, which may expose Great American to liability."[11]

Around this time, Kingsway began to obsess over the idea of having the Former Directors agree to a judgment against themselves in the Fraud Action as a method of achieving a monetary recovery from Great American. The basic concept Kingsway came up with was that the Former Directors would stipulate to the entry of an adverse judgment for a particular dollar amount and assign any claims that they had against Great American to Kingsway. As counsel for Kingsway, Mr. Ruvoldt — who came up with this oddment — stated at trial, he believed that Kingsway needed to show that the Former Directors had suffered a "detriment" in order for Kingsway to be able to pursue the Former Directors' bad faith claims that would be assigned to it.[12] To be as concrete as one can be about Ruvoldt's stratagem, Kingsway wanted the entry of a judgment against the Former Directors with a dollar figure that exceeded the $10 million limits of the

[11] JX 11 ¶ 4.
[12] Tr. at 225-26. Kingsway also sought to pursue bad faith claims against Great American through American Country. On April 24, 2008, the judge presiding over the Interpleader Action ruled that Kingsway had standing to bring such claims because American Country was a party to the D & O Policy. Kingsway Post-Trial Op. Br. at 6 n.23.

D & O Policy.[13] Kingsway could then sue on the assigned claims, arguing that the Former Directors could have settled earlier within the Policy's limits with the bulk of those funds compensating Kingsway and not going to litigation costs, but was prevented from doing so by the bad faith of Great American. That, anyway, is what I glean Kingsway's gambit to have been.

Beginning on July 16, 2007, Kingsway proffered a number of settlement proposals based on this convoluted approach. Every settlement proposal that Kingsway made after that time included an assignment of claims against Great American from the Former Directors to Kingsway. The "detriment" part was trickier. Kingsway knew that the Former Directors would not agree to have a judgment entered against them that would allow Kingsway to collect against their personal assets, particularly for an amount in excess of the $10 million D & O Policy limits. Kingsway tried to entice the Former Directors to its approach by suggesting that they agree to suffer a judgment at a high nominal amount and make an assignment of any claims they had against Great American but receive a covenant from Kingsway that it would not execute against their personal assets.

Throughout the remainder of 2007 and in early 2008, Kingsway and the Former Directors continued to talk settlement. Defendant Violetto, the former chief financial officer, also participated in these discussions. The premise of all of Kingsway's deals after July 16, 2007, which Kingsway refers to as the "core terms" of its settlement

[13] Tr. at 152.

offers,[14] was that the Former Directors were to agree to a stipulated judgment and an assignment of claims but also receive some sort of comfort that Kingsway would not seek to recover against their personal assets in the form of covenants not to collect the settlement amount from the Former Directors or execute the judgment against their assets. Put bluntly, Kingsway wanted the Former Directors to give it a club to beat Great American with and to do so without Great American's consent.

By July of 2007, Kingsway knew from the Former Directors that Great American would not consent to any settlement that included an assignment of rights under the D & O Policy.[15] Likewise, it knew that, under the terms of the D & O Policy, no assignment of the Former Directors' interest would be binding upon Great American unless Great American had consented to the assignment.[16] Undaunted, Kingsway insisted that the Former Directors help it strengthen its bad faith case by including an assignment term.[17] The first of Kingsway's set of settlement offers reflecting the "core terms" was delivered orally on July 16, 2007. It transmitted two more draft settlement proposals to the Former Directors on September 4 and October 19, and one final settlement offer on January 17, 2008.[18] For their part, the Former Directors responded with various proposed changes and tried to find a meaningful settlement that would be beneficial to them and acceptable to Great American.

[14] Kingsway Post-Trial Op. Br. at 3.
[15] Kingsway Post-Trial Ans. Br. at 3.
[16] *See* D & O Policy § 9(j).
[17] *See* JX 59; JX 70; JX 73.
[18] JX 59; JX 70; JX 73.

At first, Kingsway's proposals required that judgments be entered against each of the Former Directors for $16 million, but later proposals reduced this requirement to a judgment against only one of the Former Directors, to be chosen by the Former Directors, for $13.5 million.

Great American was reticent to agree to a settlement engineered to set up a lawsuit against it. Kingsway knew this but argued that the Former Directors should settle, even if it caused them to breach the D & O Policy by not obtaining Great American's approval. As a witness at trial, Kingsway's counsel, Ruvoldt, admitted that Kingsway was asking the Former Directors to breach that contract and that such a breach could lead to the Former Directors becoming liable to Great American:

> [Q.] I think . . . you acknowledged that you were asking my clients to breach the Great American D and O insurance policy, correct?
> A. I think what I said was it didn't matter to us whether they did or not. I understood the risk.
> Q. It didn't matter to who, [American Country] and Kingsway?
> A. It didn't matter to us, nor do I think it economically should matter to them.
> COURT: Well, I want you then to be clear. If they had settled this without prior permission of the insurer, they would be in breach, right?
> A. They would be in breach.
> Q. And "cost of defense" is defined as a loss in the policy?
> A. Cost of defense is defined as a loss.
> Q. So they would be liable to Great American for all the costs of defense that Great American paid them up to that point in time.
> A. They and the company would, yes.
> Q. But they would be directly liable to Great American, right?
> A. I believe the language is the company and the insured, yes.
> Q. Well, then, answer my question. They would be directly liable to Great American.
> A. Yes.[19]

[19] Tr. at 199-200; *see* D & O Policy §§ 3(d), (7)(a).

Breaching the D & O Policy as part of a deal to give Kingsway more claims on which to sue Great American was not a trouble-free move for the Former Directors. As noted previously, Great American had advanced fees to the Former Directors under a reservation of rights.[20] Faced with a settlement that involved the Former Directors assigning claims against Great American to Kingsway, Great American would have understandably considered its own self-interest and contractual rights in responding.

One option for Great American, as Ruvoldt admitted at trial, would be to argue that the Former Directors had engaged in behavior that was outside the D & O Policy's area of coverage because it involved intentional fraud.[21] This could have resulted in a claim by Great American to recoup funds from the Former Directors.

Even more certainly, the settlements Kingsway proposed did not make the Fraud Action rear-view window material for the Former Directors. Rather, the subject matter of that suit would likely simply have arisen again in the bad faith litigation between Kingsway and Great American. Kingsway understood this and demanded that the Former Directors provide ongoing cooperation in the planned bad faith litigation and certain other proceedings as a term of settlement. In the October 19, 2007 settlement proposal in particular, Kingsway gave itself the authority to "designate counsel to appear on behalf of the [Former Directors], which counsel the [Former Directors] shall cooperate

[20] *See* Tr. at 141-42 (Ruvoldt: "If [the Former Directors] are finally found liable in a case where the company is under a reservation of rights, as I understand the policy, it would not be a covered claim.").
[21] Tr. at 192.

with."[22] That is, the plain terms of that proposal required the Former Directors to allow a party who had sued them for securities fraud to select their attorneys.

Various other terms of the several settlement offers were similarly motivated by Kingsway's desire to buttress its bad faith claims against Great American. For example, the September 4, 2007 proposal required that the Former Directors "stipulate and agree that [they] [were] liable to Plaintiffs for *negligent breach* of their fiduciary duties,"[23] because an intentional breach would have excluded the directors from coverage under the terms of the D & O Policy. That same proposal also contained an erroneous representation by the Former Directors that Great American had consented to the settlement.[24]

Eventually, the Former Directors firmly decided against agreeing to a settlement of the nature Kingsway was advocating. Kingsway then came up with the theory that the Former Directors' refusal to settle was unreasonable and deprives them of their otherwise clear right to advancement. At the trial in this case on April 24, 2008, that was the only defense presented by Kingsway.

I address that defense now.

II. Legal Analysis

Kingsway admits that Article Eighth of American Country's certificate of incorporation provides the Former Directors with a clear right to advancement for the defense of the Fraud Action. But it says that this clear right is subject to an implied

[22] JX 70 § 9(d).
[23] JX 59 (emphasis added).
[24] *Id.* § 7(i).

condition of reasonableness,[25] and that the Former Directors are unreasonably defending against the Fraud Action when they could have gotten out of it cost-free. As a consequence for the Former Directors' obstinate refusal to recognize their own self-interest, Kingsway says they have forfeited their right to advancement. As Kingsway puts it, because the Former Directors "unreasonabl[y] reject[ed] [Kingsway's] settlement proposals, advancement of their expenses and fees in defending the [Fraud] Action is no longer necessary or reasonabl[e] under Section 145."[26] This is a truly astounding argument, in the sense that it is stunning for its lack of basis in law, logic, or common sense.[27]

Kingsway filed the Fraud Action accusing the Former Directors of intentional fraud. The Former Directors are under *no obligation* to settle that case for anything other than a full release and dismissal of claims. If the Former Directors wish to vindicate their good names by having a court adjudicate the claims Kingsway itself has brought, they are

[25] *See Citadel Holding Corp. v. Roven*, 603 A.2d 818, 823 (Del. 1992) ("Under both the statute and the Agreement, the corporation's obligation to pay expenses is subject to a reasonableness requirement.").
[26] Kingsway Post-Trial Ans. Br. at 1 n.2.
[27] Judge Flynn of the Chancery Division of the Cook County Circuit Court in Illinois rejected essentially the same argument in a dispute between Kingsway and American Country's former CEO, Dore, over an indemnification agreement that was governed by Delaware law. Kingsway Pre-Trial Op. Br. at 18. He reasoned that the purpose of Delaware law on advancement and indemnification would be eviscerated if an indemnitor could "cram down a settlement" by offering a proposal that cancels a defendant's advancement rights. Former Directors' Pre-Trial Ans. Br. Ex. A (Tr. of Oral Argument (Feb. 15, 2008) at 33, *Dore v. American Country Holdings, Inc. et al.*, Case No. 03 CH 8189, Hon. Peter J. Flynn, Cook County Circuit Court, County Department, Chancery Division). As Judge Flynn put it, if such a settlement offer could cut off a corporate official's right to advancement, a settlement offer "would become a weapon . . . to punish and in effect, threaten a defendant. If you don't settle on my terms, not only are you going to be stuck defending this case, but you're going to have to defend it out of your own pocket. In litigation this size that's a pretty heavy threat." *Id.*

entitled to do so and to put up a vigorous defense.[28] An important part of the policy rationale supporting indemnification and advancement is that corporate officials should be able to defend not only their pocketbooks, but also their good names.[29] It is cute for counsel for Kingsway to argue that the Former Directors' voluntary acceptance of a judgment against themselves in a fraud case has only a remote and speculative relationship to their reputations and future prospects to serve as directors of other corporations,[30] but entirely unconvincing. Perhaps Kingsway's counsel have entered into such voluntary and public judgments in malpractice cases as a basis for permitting plaintiffs to go after their firms' malpractice carriers. More likely, they have not. But what they have suggested that the Former Directors do is no different and if the analogy stings, it proves the pertinent point. No judgment in a fraud or other reputation-implicating case is cost-free.

[28] *Cf. Reddy v. Elec. Data Sys. Corp.*, 2002 WL 1358761, at *6 (Del. Ch. June 18, 2002), *aff'd*, 820 A.2d 371 (Del. 2003) (holding that a former director was entitled to advancement for claims that alleged he had misappropriated funds for his personal benefit).

[29] As Chief Justice Veasey explained in *VonFeldt v. Stifel Financial Corp.*:

> We have long recognized that Section 145 serves the dual policies of: (a) allowing corporate officials to resist unjustified lawsuits, secure in the knowledge that, if vindicated, the corporation will bear the expense of litigation; and (b) encouraging capable women and men to serve as corporate directors and officers, secure in the knowledge that the corporation will absorb the costs of defending their honesty and integrity.

714 A.2d 79, 84 (Del. 1998); *see also Homestore, Inc. v. Tafeen*, 888 A.2d 204, 211 (Del. 2005) ("Advancement is an especially important corollary to indemnification as an inducement for attracting capable individuals into corporate service.").

[30] *E.g.*, Kingsway Post-Trial Ans. Br. at 3 ("[W]hile a judgment could *possibly* inflict reputational harm, whether a consent judgment that expressly provides for no admission of liability would *actually* inflict a reputational injury that caused economic harm is purely speculative.") (emphasis in original). *But see* Tr. at 203-04 (Ruvoldt: "There is some degree of reputational risk [to a judgment entered without admission of liability]. . . . There are circumstances under which reputational damage could cause economic damage, yes.").

Bottom line: the Former Directors have no duty at all to suffer a judgment just because a plaintiff like Kingsway wants one. If Kingsway wants to terminate the Fraud Action, it can dismiss its claims against the Former Directors with prejudice. Kingsway can then press whatever claims *it* has against Great American on *its* own. A defendant who faces claims of official wrongdoing and who is owed advancement rights is entitled to have those rights honored precisely so that she can defend her good name and personal wealth.

That general proposition is enough to dispose of this case. But the more particular facts also refute Kingsway's position.

Kingsway has not proposed anything that promises peace to the Former Directors. Rather, all of its proposals seek to embroil the Former Directors in the dispute between Kingsway and Great American. Kingsway's bad faith suit had as its original premise that Great American had a duty to use the D & O Policy limits to pay Kingsway $8.5 million. But if the underlying conduct of the defendants in the Fraud Action was not covered by the D & O Policy — and if Kingsway's pleadings in the Fraud Action are taken literally, the conduct was not covered — one would think that Great American would raise that argument responsively in the bad faith suit.[31] This could result in the Former Directors facing the same charges they now face, but in a different forum. Furthermore, because the Former Directors would have breached their promise to Great American by settling without its consent and on terms clearly designed to make Great American a more

[31] *See* Tr. at 192-93 (Ruvoldt testifying that Kingsway "runs the risk" of that defense to its bad faith claims and that "what the [Former Directors] are presently accused of could be a crime"); D & O Policy § 4(a)(2).

vulnerable target for Kingsway, Great American would have every rational incentive to exercise all of its possible legal rights against the Former Directors, including seeking recoupment of the fees it had advanced.

In response to these realities, Kingsway has offered up a host of assurances by its outside counsel, Ruvoldt, who invented its stratagem for targeting Great American. These assurances can even been seen as humorous, because they include the notion that the Former Directors have nothing to fear if Great American sues them because Kingsway will indemnify them under American Country's charter! What could be more comforting?!

Likewise, Kingsway — which is now attempting to sue Great American for compensatory and punitive damages well in excess of the $10 million D & O Policy limits[32] — argues that the Former Directors have nothing to fear from Great American because Great American's filing of the Interpleader Action prevents it from enforcing the terms of the D & O Policy. Kingsway pulled out this argument for the first time in its post-trial answering brief, and it was therefore not fairly presented.[33] And even if it was,

[32] JX 34 ¶¶ 58-60.

[33] *In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *18 (Del. Ch. Aug. 18, 2006) (determining that an "argument [wa]s untimely because it was not addressed in the pre-trial order and was not raised until trial"); *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 62 (Del. Ch. 2001) (finding that a party waived an argument by not addressing it in its opening post-trial brief). In its post-trial opening brief, Kingsway brought up a related, but different argument. As best as can be discerned from its cursory presentation, that argument was that because Great American "expressed its disinterest" in the D & O Policy, it would likely not have sued the Former Directors, and that any breach of contract was therefore not material. *See* Kingsway Post-Trial Op. Br. at 5. Kingsway did not cite any authority in support of that argument, which was phrased as a factual argument about Great American's motives, rather than as an argument that Great American was legally prohibited from asserting its rights under the D & O Policy as a

the argument does not sustain Kingsway's position. Kingsway claims the New York law it has cited suggests that if an insurer interpleads a policy, then it has no further interest in receiving any funds *within* the policy limits.[34] One can doubt whether that rationale denies Great American the right to make counter-claims in the situation Kingsway is trying to gin up. In Kingsway's dream, it takes a $13.5 million judgment against the Former Directors, and uses that sum as the focus of its bad faith claims (based on its own claims and the bad faith claims assigned to it by the Former Directors). In this scenario, Great American faces the prospect of paying out $23.5 million, or $13.5 million more than the D & O Policy limits.[35] The idea that Great American's filing of the Interpleader Action addressing the remainder of the D & O Policy limits forecloses it from exercising its pre-existing contractual rights in these circumstances is not self-evident, nor is it established by the cases Kingsway proffered for the first time in its very last brief.[36] Certainly, it seems reasonable for the insurer to defend itself by arguing that it went the

result of having filed the Interpleader Action. In any event, Kingsway raised even that argument too late in the litigation for it to be fairly presented.

[34] *See* Kingsway Post-Trial Ans. Br. at 3-4 nn.15, 16.

[35] This is because the $13.5 million judgment is in addition to the $10 million D & O Policy limits, which will soon be entirely exhausted by defense costs, if it has not been already.

[36] The reasoning behind those cases is that an insurer may not enforce technical requirements of an insurance policy when the insurer no longer has any interest in the dispute. *See, e.g.*, *Provident Mut. Life Ins. Co. of Philadelphia v. Vergara*, 1995 WL 571874, at *2 (S.D.N.Y. Sept. 27, 1995) ("The insurer waives precise compliance with the terms of a change of owner or beneficiary provision once it institutes an interpleader action and submits the insurance policy proceeds to the court, *thereby withdrawing itself from the action.*") (emphasis added); *Considine v. Considine*, 255 A.D. 876, 877, 7 N.Y.S.2d 834, 835-36 (N.Y. Sup. Ct. 1938) ("There were in the policy provisions reserving the right of the insured to change the beneficiary, regulating the manner in which such change might be made, as well as for formal assignments. . . . In this case all these provisions were waived on its part when the company interpleaded, paid the money into court and left the claimants to settle the controversy between themselves.") (internal citations omitted). That reasoning does not apply here, given Kingsway's own motives in seeking relief from Great American that well exceeds the Policy limits.

extra mile in tendering defense costs in a situation where the underlying conduct alleged was outside the scope of coverage, and that if Kingsway and the Former Directors wish to (as Great American would undoubtedly put it) collude to expose Great American to liability beyond the Policy limits, then Great American should be free to use all its contractual rights, including its right to recoup the defense costs it previously advanced.

Again, however, what is most important is the fact that the Former Directors have no duty to put themselves in a position where questions like these are relevant to their lives. The Former Directors are clearly entitled to advancement and Kingsway is just as clearly forbidden from burdening their rights in the manner it has. If Kingsway wants to tangle with Great American, it is free to do so. But it is not free to withhold advancement from the Former Directors as some form of pressure strategy to extract assignments, judgments, breaches of contract, and pledges of cooperation from them. That is precisely what Kingsway has done, with no rational, good faith basis in law.

Sadly, Kingsway's stockholders will end up paying for this time- and resource-wasting litigation. In accord with the Supreme Court jurisprudence mandating "fees on fees" in advancement actions,[37] Kingsway must pay all the fees and expenses of the Former Directors' counsel.[38] And, an all too often ignored factor in these kind of cases is

[37] *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002).

[38] Even absent this rule, Kingsway's frivolous defense in this case would likely require the imposition of an award of attorneys' fees under the bad faith exception to the American rule. *Nagy v. Bistricer*, 770 A.2d 43, 64-65 (Del. Ch. 2000); *see also* DONALD J. WOLFE AND MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY, § 13-3[b] (2008) ("[B]ad faith sufficient to justify an award of attorney's fees will be found where judicial intervention is necessary to secure clearly defined and established rights or where a defendant's actions are designed to force a party to resort to litigation for the purpose of causing unreasonable delay.").

that the stockholders will also end up footing the bill for the company's own counsel. The accumulation of cases like this, where the stockholders get it coming and going because of the corporation's refusal to honor mandatory advancement contracts, is regrettable, and at some point, a case of sufficient dollar value will arise such that a board is sued for wasting the corporation's resources by putting up a clearly frivolous defense.[39] On the upside, it may be difficult for even the most innovative of lawyers to outdo the defense advanced here, whereby the right to defend one's self is supposedly lost by a refusal to suffer an adverse judgment, commit a breach a contract, and become a potential target of a D & O insurer that has advanced substantial defense costs under a reservation of rights.

III. Conclusion

For the foregoing reasons, the Former Directors are entitled to advancement of their legal fees in the Fraud Action and their fees and costs for prosecuting this case. Counsel for the Former Directors shall 1) promptly file an affidavit setting forth the basis

[39] One wishes that the tsunami of regret that swept over corporate America regarding mandatory advancement contracts would have been followed by the more careful tailoring of advancement provisions, with a diminishment (especially as to officers) of the mandatory term that seems to so bother directors faced with the responsibility of actually ensuring that the corporation honors its contractual duties once a (typically) former officer is sued or prosecuted for fraud or other serious wrongdoing. Although it is uncomfortable to cause the corporation to advance millions in fees to a former officer the current board believes engaged in serious misconduct, it does stockholders no service for a board to refuse to do so when the advancement obligation is clear. If the directors in such a situation truly wish to serve the stockholders, they should fix what they can by revising the corporation's advancement obligations on a going-forward basis. To breach a contract because you do not like its terms while refusing to change it when you have the authority to do so is hard to explain as an act of appropriate fiduciary fortitude.

for the fees and costs number, which the court shall use in its judgment,[40] and 2) submit a final judgment and order, with approval as to form, within 10 days.

[40] Unfortunately, there are several other ways in which Kingsway has made this litigation far more expensive and time-consuming than necessary. The baseless defense it was left with at trial is simply the last vestige of its defensive strategy. Kingsway is therefore in no position to delay this litigation further with nit-picking over the costs the Former Directors have had to incur to vindicate a clear legal right, when Kingsway could simply have done what it should from the beginning and honored its obligations.

22

GRANTED

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

TEACHERS' RETIREMENT SYSTEM OF LOUISIANA,

Plaintiff,

v.

MAURICE R. GREENBERG, EDWARD E. MATTHEWS, HOWARD I. SMITH and C.V. STARR & CO., INC.,

Defendants,

and

AMERICAN INTERNATIONAL GROUP, INC., a Delaware corporation,

Nominal Defendant.

C.A. No. 20106-VCS

ORDER

WHEREAS, on March 30, 2007, Nominal Defendant American International Group, Inc. ("AIG") produced a log identifying documents withheld from its document production on privilege grounds in response to discovery requests served in the above-captioned action;

WHEREAS, on April 30, 2007, Defendant Howard I. Smith moved to compel the production of certain documents designated as privileged by AIG (the "Motion") and Defendants Maurice R. Greenberg and Edward E. Matthews (together with Smith, the "Individual Defendants") joined in the Motion;

WHEREAS, during argument held on June 13, 2007, the Court noted that, under Delaware law, as former directors of AIG, the Individual Defendants were "essentially within the

AIG family" for purposes of the Motion (Tr. at 139:23-24) and that, as such, the sharing of certain privileged materials with the Individual Defendants would not constitute a waiver of AIG's privilege and should not be construed as such by the Individual Defendants, or by any other individual or entity seeking to utilize AIG's disclosure of privileged materials as evidence of waiver in this or any other proceeding;

WHEREAS, the Court also recognized that the sharing of certain privileged materials with former AIG directors arises out of their substantive right under Delaware law to rely on advice of counsel as set forth in 8 *Del. C.* § 141(e) ("Section 141(e)") (Tr. at 95-96);

WHEREAS, the Court also noted that the fact that this case was a derivative action brought on behalf of AIG also had relevance, insofar as there is a community of interest among the plaintiffs as derivative plaintiffs and AIG, which might justify disclosure of privileged materials to the derivative plaintiffs, *see Garner v. Wolfinbarger,* 430 F.2d 1093 (5th Cir. 1970), and its progeny, and that such disclosure under *Garner* and its progeny would not waive the privilege as to plaintiffs or prosecuting authorities in other types of cases with interests not aligned with AIG;

WHEREAS, the Court further stated that there exist "legitimate concerns about waiver and confidentiality" (Tr. at 139:16-17) and since the Court was "conscious of the need to protect the Company's privilege and to limit [the Individual Defendants'] access" to privileged materials (Tr. at 133:10-11), the Court delineated numerous "limitations that are designed to ensure . . . AIG's privilege" is protected from any future arguments of waiver in this proceeding, any collateral proceeding or any other proceeding in which the parties may be involved (Tr. at 139:21-22); and

WHEREAS, the production of documents by AIG to the Individual Defendants pursuant to this Order shall not constitute a waiver of AIG's attorney-client privilege, because, under Delaware law, the Individual Defendants, as former directors of AIG, are entitled to access to certain of AIG's privileged documents generated during their tenure as directors of AIG by virtue of their status as former directors and/or to support their Section 141(e) defense;

IT IS HEREBY ORDERED that the Motion is GRANTED as follows:

1. Within 5 days of the entry of this Order, AIG shall produce to counsel for the Individual Defendants the following documents:

(a) All documents from or to outside or in-house counsel for AIG concerning legal advice provided to AIG that, on their face, appear to have been directed or provided to, or generated by, the Individual Defendants, including the documents listed on AIG's privilege log as P-6, P-9, P-13, P-26, P-27, P-36, P-58, P-66, P-68, P-89, P-433, P-440, P-445, P-446, P-461, P-635, P-650, P-653, P-657 and P-808.

(b) All documents from or to outside or in-house counsel for AIG concerning legal advice provided to AIG that, on their face, appear to have been directed or provided to members of the Board of Directors of AIG (the "Board") other than the Individual Defendants, including the documents listed on AIG's privilege log as P-50, P-652, P-655, P-656 and P-700.

(c) All documents from or to outside or in-house counsel for AIG that, on their face, directly concern this action or the related investigation of the Special Litigation Committee, including the documents listed on AIG's privilege log as P-16, P-17, P-37, P-50, P-359, P-360, P-652, P-655, P-656, P-661 and P-700.

(d) All documents identified on AIG's privilege log that request or reflect legal advice from outside or in-house counsel for AIG concerning protocols for handling the types of transactions or business relationships being challenged in this litigation.

(e) All documents identified on AIG's privilege log that reflect or request legal advice from outside or in-house counsel for AIG concerning the transactions or business relationships being challenged in this litigation, to the extent that such documents fairly indicate on their faces, in substance or context, that any of the Individual Defendants (or the Board) may have directly or indirectly relied upon, and/or that it was intended that any of the Individual Defendants (or the Board) would directly or indirectly rely upon, the legal advice reflected or requested therein.

(f) To the extent that any documents on AIG's privilege log not specifically identified above fall within the above categories, or to the extent that AIG has withheld from production any additional documents that fall within the above categories but has not yet identified them on its privilege log, any such documents shall likewise be produced in accordance with this paragraph. To the extent that AIG locates any additional documents in the future that fall within the above categories, they shall promptly be produced to counsel for the Individual Defendants.

(g) AIG shall produce a supplemental privilege log reflecting any additional privileged documents it has located to date but not yet identified within 5 days of the entry of this Order.

2. Within 20 days of the entry of this Order, counsel for the Individual Defendants will participate in a meet-and-confer with counsel for AIG wherein counsel for the Individual Defendants will set forth, for each Individual Defendant, a "reasoned articulation" of the

"legitimate basis" for the "scope" of the Individual Defendants' Section 141(e) defense. (Tr. at 133:1-14). The substance of the discussions to be had and documents exchanged during the meet-and-confer shall be designated "Confidential" pursuant to the Confidentiality Order in this action.

3. Within 10 days following the meet-and-confer described in paragraph 2 above, AIG shall produce any privileged documents that fall within the scope of the Individual Defendants' Section 141(e) defense, whether or not such documents are identified on AIG's privilege log, to the extent that such documents were not already produced pursuant to paragraph 1 above. To the extent that AIG locates any additional privileged documents in the future that fall within the scope of the Individual Defendants' Section 141(e) defense, they shall promptly be produced to counsel for the Individual Defendants.

4. If there are disagreements between the parties regarding the scope of the Individual Defendants' Section 141(e) defense (as set forth in paragraph 2 above) or the scope of the documents to be produced by AIG consistent with the Individual Defendants' Section 141(e) defense (as set forth in paragraph 3 above), then the parties may seek relief from the Court, and documents subject to any dispute shall be submitted to the Court for *in camera* review, to the extent the Court wants to conduct such a review.

5. Any production of privileged documents pursuant to this Order shall be limited to those documents generated during the time period the Individual Defendants served on the Board. Any documents produced pursuant to this Order shall only be disclosed to the Individual Defendants who were members of the Board at the time the documents were generated. After AIG has produced all privileged documents required to be produced by this Order, and after the Individual Defendants have identified to AIG the privileged documents upon which they intend

to rely for purposes of their Section 141(e) defense, the Individual Defendants shall confer about the production of such documents to Plaintiff's counsel. The Individual Defendants shall not disclose the privileged materials produced pursuant to this Order to any other party to this proceeding, including Plaintiff or Defendant C.V. Starr & Co., Inc., without the consent of AIG or further Order of the Court. The Individual Defendants may, with five (5) days advance notice to AIG to provide AIG the opportunity to object, use any privileged materials produced pursuant to this Order at the deposition or during the trial testimony of any person who, on the face of such documents, appears to have prepared or received the documents.

6. The documents produced to the Individual Defendants pursuant to this Order shall be designated "Confidential" vis-à-vis the Individual Defendants pursuant to the Confidentiality Order.

7. For the reasons set forth in the transcript of the June 13, 2007 argument and ruling, the fact of production of any privileged documents by AIG to the Individual Defendants in this action pursuant to this Order will not constitute a waiver of the privilege as it attaches to these documents in question, or be used by the Individual Defendants to argue that AIG has waived its privilege with respect to any privileged materials in this or any other proceeding.

8. C.V. Starr & Co., Inc., Starr International Company, Inc., as well as the Individual Defendants and any entity they control or with which they are affiliated, may not use the production of these privileged documents as the basis for an argument of waiver in any other proceeding.

9. The Individual Defendants are prohibited from utilizing any of the privileged documents produced by AIG pursuant to this Order in any other proceeding, unless such documents are also ordered to be produced in the other proceeding.

____

Vice Chancellor

Court: DE Court of Chancery

Judge: Strine, Leo E

File & Serve reviewed Transaction ID: 15526303

Current date: 7/11/2007

Case number: 20106-VCS

Case name: CONF ORD AND PROTECT ORDER Teachers Retirement System of Louisiana vs American International Group

I have considered the concern raised about the Starr revision proposed by Mr. Bouchard. The approach taken by Mr. Bouchard is entirely reasonable and fairly implements the concern expressed by AIG.

/s/ Judge Leo E Strine

IN THE SUPREME COURT OF THE STATE OF DELAWARE

WILLIAM STONE AND SANDRA STONE, derivatively on behalf of Nominal Defendant AmSOUTH BANCORPORATION,	§	No. 93, 2006
Plaintiffs Below, Appellants,	§	Court Below – Court of Chancery of the State of Delaware, in and for New Castle County
v.	§	C.A. No. 1570-N
C. DOWD RITTER, RONALD L. KUEHN, JR., CLAUDE B. NIELSEN, JAMES R. MALONE, EARNEST W. DAVENPORT, JR., MARTHA R. INGRAM, CHARLES D. McCRARY, CLEOPHUS THOMAS, JR., RODNEY C. GILBERT, VICTORIA B. JACKSON, J. HAROLD CHANDLER, JAMES E. DALTON, ELMER B. HARRIS, BENJAMIN F. PAYTON, and JOHN N. PALMER,	§	
Defendants Below, Appellees,	§	
and	§	
AmSOUTH BANCORPORATION,	§	
Nominal Defendant Below, Appellee.	§	

Submitted: October 5, 2006
Decided: November 6, 2006

Before **STEELE**, Chief Justice, **HOLLAND, BERGER, JACOBS**, and **RIDGELY**, Justices (constituting the Court *en Banc*).

Upon appeal from the Court of Chancery. **AFFIRMED**.

Brian D. Long, Esquire (argued) and Seth D. Rigrodsky, Esquire, of Rigrodsky & Long, P.A., Wilmington, Delaware, for appellants.

Jesse A. Finkelstein, Esquire, Raymond J. DiCamillo, Esquire, and Lisa Zwally Brown, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, David B. Tulchin, Esquire (argued), L. Wiesel, Esquire, and Jacob F. M. Oslick, Esquire, of Sullivan & Cromwell LLP, New York, New York, for appellees.

HOLLAND, Justice:

This is an appeal from a final judgment of the Court of Chancery dismissing a derivative complaint against fifteen present and former directors of AmSouth Bancorporation ("AmSouth"), a Delaware corporation. The plaintiffs-appellants, William and Sandra Stone, are AmSouth shareholders and filed their derivative complaint without making a pre-suit demand on AmSouth's board of directors (the "Board"). The Court of Chancery held that the plaintiffs had failed to adequately plead that such a demand would have been futile. The Court, therefore, dismissed the derivative complaint under Court of Chancery Rule 23.1.

The Court of Chancery characterized the allegations in the derivative complaint as a "classic *Caremark* claim," a claim that derives its name from *In re Caremark Int'l Deriv. Litig.*[1] In *Caremark*, the Court of Chancery recognized that: "[g]enerally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation . . . only a sustained or systematic failure of the board to exercise oversight–such as an utter failure to attempt to assure a

[1] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996).

reasonable information and reporting system exists–will establish the lack of good faith that is a necessary condition to liability."[2]

In this appeal, the plaintiffs acknowledge that the directors neither "knew [n]or should have known that violations of law were occurring," *i.e.*, that there were no "red flags" before the directors. Nevertheless, the plaintiffs argue that the Court of Chancery erred by dismissing the derivative complaint which alleged that "the defendants had utterly failed to implement any sort of statutorily required monitoring, reporting or information controls that would have enabled them to learn of problems requiring their attention." The defendants argue that the plaintiffs' assertions are contradicted by the derivative complaint itself and by the documents incorporated therein by reference.

Consistent with our opinion in *In re Walt Disney Co. Deriv Litig*, we hold that *Caremark* articulates the necessary conditions for assessing director oversight liability.[3] We also conclude that the *Caremark* standard was properly applied to evaluate the derivative complaint in this case. Accordingly, the judgment of the Court of Chancery must be affirmed.

[2] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d at 971; *see also David B. Shaev Profit Sharing Acct. v. Armstrong*, 2006 WL 391931, at *5 (Del. Ch.); *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003).
[3] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006).

Facts

This derivative action is brought on AmSouth's behalf by William and Sandra Stone, who allege that they owned AmSouth common stock "at all relevant times." The nominal defendant, AmSouth, is a Delaware corporation with its principal executive offices in Birmingham, Alabama. During the relevant period, AmSouth's wholly-owned subsidiary, AmSouth Bank, operated about 600 commercial banking branches in six states throughout the southeastern United States and employed more than 11,600 people.

In 2004, AmSouth and Amsouth Bank paid $40 million in fines and $10 million in civil penalties to resolve government and regulatory investigations pertaining principally to the failure by bank employees to file "Suspicious Activity Reports" ("SARs"), as required by the federal Bank Secrecy Act ("BSA")[4] and various anti-money-laundering ("AML") regulations.[5] Those investigations were conducted by the United States

[4] 31 U.S.C. § 5318 (2006) *et seq.* The Bank Secrecy Act and the regulations promulgated thereunder require banks to file with the Financial Crimes Enforcement Network, a bureau of the U.S. Department of the Treasury known as "FinCEN," a written "Suspicious Activity Report" (known as a "SAR") whenever, *inter alia*, a banking transaction involves at least $5,000 "and the bank knows, suspects, or has reason to suspect" that, among other possibilities, the "transaction involves funds derived from illegal activities or is intended or conducted in order to hide or disguise funds or assets derived from illegal activities. . . ." 31 U.S.C. § 5318(g) (2006); 31 C.F.R. § 103.18(a)(2) (2006).
[5] *See, e.g.*, 31 C.F.R. § 103.18(a)(2) (2006).

Attorney's Office for the Southern District of Mississippi ("USAO"), the Federal Reserve, FinCEN and the Alabama Banking Department. No fines or penalties were imposed on AmSouth's directors, and no other regulatory action was taken against them.

The government investigations arose originally from an unlawful "Ponzi" scheme operated by Louis D. Hamric, II and Victor G. Nance. In August 2000, Hamric, then a licensed attorney, and Nance, then a registered investment advisor with Mutual of New York, contacted an AmSouth branch bank in Tennessee to arrange for custodial trust accounts to be created for "investors" in a "business venture." That venture (Hamric and Nance represented) involved the construction of medical clinics overseas. In reality, Nance had convinced more than forty of his clients to invest in promissory notes bearing high rates of return, by misrepresenting the nature and the risk of that investment. Relying on similar misrepresentations by Hamric and Nance, the AmSouth branch employees in Tennessee agreed to provide custodial accounts for the investors and to distribute monthly interest payments to each account upon receipt of a check from Hamric and instructions from Nance.

The Hamric-Nance scheme was discovered in March 2002, when the investors did not receive their monthly interest payments. Thereafter,

Hamric and Nance became the subject of several civil actions brought by the defrauded investors in Tennessee and Mississippi (and in which AmSouth also was named as a defendant), and also the subject of a federal grand jury investigation in the Southern District of Mississippi. Hamric and Nance were indicted on federal money-laundering charges, and both pled guilty.

The authorities examined AmSouth's compliance with its reporting and other obligations under the BSA. On November 17, 2003, the USAO advised AmSouth that it was the subject of a criminal investigation. On October 12, 2004, AmSouth and the USAO entered into a Deferred Prosecution Agreement ("DPA") in which AmSouth agreed: first, to the filing by USAO of a one-count Information in the United States District Court for the Southern District of Mississippi, charging AmSouth with failing to file SARs; and second, to pay a $40 million fine. In conjunction with the DPA, the USAO issued a "Statement of Facts," which noted that although in 2000 "at least one" AmSouth employee suspected that Hamric was involved in a possibly illegal scheme, AmSouth failed to file SARs in a timely manner. In neither the Statement of Facts nor anywhere else did the USAO ascribe any blame to the Board or to any individual director.

On October 12, 2004, the Federal Reserve and the Alabama Banking Department concurrently issued a Cease and Desist Order against AmSouth,

requiring it, for the first time, to improve its BSA/AML program. That Cease and Desist Order required AmSouth to (among other things) engage an independent consultant "to conduct a comprehensive review of the Bank's AML Compliance program and make recommendations, as appropriate, for new policies and procedures to be implemented by the Bank." KPMG Forensic Services ("KPMG") performed the role of independent consultant and issued its report on December 10, 2004 (the "KPMG Report").

Also on October 12, 2004, FinCEN and the Federal Reserve jointly assessed a $10 million civil penalty against AmSouth for operating an inadequate anti-money-laundering program and for failing to file SARs. In connection with that assessment, FinCEN issued a written Assessment of Civil Money Penalty (the "Assessment"), which included detailed "determinations" regarding AmSouth's BSA compliance procedures. FinCEN found that "AmSouth violated the suspicious activity reporting requirements of the Bank Secrecy Act," and that "[s]ince April 24, 2002, AmSouth has been in violation of the anti-money-laundering program requirements of the Bank Secrecy Act." Among FinCEN's specific determinations were its conclusions that "AmSouth's [AML compliance] program lacked adequate board and management oversight," and that

"reporting to management for the purposes of monitoring and oversight of compliance activities was materially deficient." AmSouth neither admitted nor denied FinCEN's determinations in this or any other forum.

Demand Futility and Director Independence

It is a fundamental principle of the Delaware General Corporation Law that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ."[6] Thus, "by its very nature [a] derivative action impinges on the managerial freedom of directors."[7] Therefore, the right of a stockholder to prosecute a derivative suit is limited to situations where either the stockholder has demanded the directors pursue a corporate claim and the directors have wrongfully refused to do so, or where demand is excused because the directors are incapable of making an impartial decision regarding whether to institute such litigation.[8] Court of Chancery Rule 23.1, accordingly, requires that the complaint in a derivative action "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the

[6] Del. Code Ann. tit. 8, § 141(a) (2006). *See Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993).
[7] *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984).
[8] *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

plaintiff desires from the directors [or] the reasons for the plaintiff's failure to obtain the action or for not making the effort."[9]

In this appeal, the plaintiffs concede that "[t]he standards for determining demand futility in the absence of a business decision" are set forth in *Rales v. Blasband.*[10] To excuse demand under *Rales*, "a court must determine whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[11] The plaintiffs attempt to satisfy the *Rales* test in this proceeding by asserting that the incumbent defendant directors "face a substantial likelihood of liability" that renders them "personally interested in the outcome of the decision on whether to pursue the claims asserted in the complaint," and are therefore not disinterested or independent.[12]

[9] Ch. Ct. R. 23.1. Allegations of demand futility under Rule 23.1 "must comply with stringent requirements of factual particularity that differ substantially from the permissive notice pleadings governed solely by Chancery Rule 8(a)." *Brehm v. Eisner*, 746 A.2d at 254.
[10] *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).
[11] *Id.* at 934.
[12] The fifteen defendants include eight current and seven former directors. The complaint concedes that seven of the eight current directors are outside directors who have never been employed by AmSouth. One board member, C. Dowd Ritter, the Chairman, is an officer or employee of AmSouth.

Critical to this demand excused argument is the fact that the directors' potential personal liability depends upon whether or not their conduct can be exculpated by the section 102(b)(7) provision contained in the AmSouth certificate of incorporation.[13] Such a provision can exculpate directors from monetary liability for a breach of the duty of care, but not for conduct that is not in good faith or a breach of the duty of loyalty.[14] The standard for assessing a director's potential personal liability for failing to act in good faith in discharging his or her oversight responsibilities has evolved beginning with our decision in *Graham v. Allis-Chalmers Manufacturing Company*,[15] through the Court of Chancery's *Caremark* decision to our most recent decision in *Disney*.[16] A brief discussion of that evolution will help illuminate the standard that we adopt in this case.

Graham and Caremark

Graham was a derivative action brought against the directors of Allis-Chalmers for failure to prevent violations of federal anti-trust laws by Allis-Chalmers employees. There was no claim that the Allis-Chalmers directors knew of the employees' conduct that resulted in the corporation's liability. Rather, the plaintiffs claimed that the Allis-Chalmers directors *should have*

[13] Del. Code Ann. tit. 8, § 102(b)(7) (2006).
[14] *Id.*; *see In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006).
[15] *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125 (Del. 1963).
[16] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006).

known of the illegal conduct by the corporation's employees. In *Graham*, this Court held that "*absent cause for suspicion* there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists."[17]

In *Caremark*, the Court of Chancery reassessed the applicability of our holding in *Graham* when called upon to approve a settlement of a derivative lawsuit brought against the directors of Caremark International, Inc. The plaintiffs claimed that the Caremark directors should have known that certain officers and employees of Caremark were involved in violations of the federal Anti-Referral Payments Law. That law prohibits health care providers from paying any form of remuneration to induce the referral of Medicare or Medicaid patients. The plaintiffs claimed that the *Caremark* directors breached their fiduciary duty for having "allowed a situation to develop and continue which exposed the corporation to enormous legal liability and that in so doing they violated a duty to be active monitors of corporate performance."[18]

In evaluating whether to approve the proposed settlement agreement in *Caremark*, the Court of Chancery narrowly construed our holding in *Graham* "as standing for the proposition that, absent grounds to suspect

[17] *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d at 130 (emphasis added).
[18] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996).

deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf."[19] The *Caremark* Court opined it would be a "mistake" to interpret this Court's decision in *Graham* to mean that:

> corporate boards may satisfy their obligation to be reasonably informed concerning the corporation, without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance.[20]

To the contrary, the *Caremark* Court stated, "it is important that the board exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility."[21] The *Caremark* Court recognized, however, that "the duty to act in good faith to be informed cannot be thought to require directors to possess detailed

[19] *Id.* at 969.
[20] *Id.* at 970.
[21] *Id.*

information about all aspects of the operation of the enterprise."[22] The Court of Chancery then formulated the following standard for assessing the liability of directors where the directors are unaware of employee misconduct that results in the corporation being held liable:

> Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation, as in *Graham* or in this case, . . . only a sustained or systematic failure of the board to exercise oversight–such as an utter failure to attempt to assure a reasonable information and reporting system exists–will establish the lack of good faith that is a necessary condition to liability.[23]

Caremark Standard Approved

As evidenced by the language quoted above, the *Caremark* standard for so-called "oversight" liability draws heavily upon the concept of director failure to act in good faith. That is consistent with the definition(s) of bad faith recently approved by this Court in its recent *Disney*[24] decision, where we held that a failure to act in good faith requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence).[25] In

[22] *Id.* at 971.
[23] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d at 971.
[24] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006).
[25] *Id.* at 66.

14

Disney, we identified the following examples of conduct that would establish a failure to act in good faith:

> A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties. There may be other examples of bad faith yet to be proven or alleged, but these three are the most salient.[26]

The third of these examples describes, and is fully consistent with, the lack of good faith conduct that the *Caremark* court held was a "necessary condition" for director oversight liability, i.e., "a sustained or systematic failure of the board to exercise oversight–such as an utter failure to attempt to assure a reasonable information and reporting system exists . . . ."[27] Indeed, our opinion in *Disney* cited *Caremark* with approval for that proposition.[28] Accordingly, the Court of Chancery applied the correct standard in assessing whether demand was excused in this case where failure to exercise oversight was the basis or theory of the plaintiffs' claim for relief.

It is important, in this context, to clarify a doctrinal issue that is critical to understanding fiduciary liability under *Caremark* as we construe

[26] *Id.* at 67.
[27] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).
[28] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d at 67 n.111.

15

that case. The phraseology used in *Caremark* and that we employ here—describing the lack of good faith as a "necessary condition to liability"—is deliberate. The purpose of that formulation is to communicate that a failure to act in good faith is not conduct that results, *ipso facto*, in the direct imposition of fiduciary liability.[29] The failure to act in good faith may result in liability because the requirement to act in good faith "is a subsidiary element[,]" i.e., a condition, "of the fundamental duty of loyalty."[30] It follows that because a showing of bad faith conduct, in the sense described in *Disney* and *Caremark*, is essential to establish director oversight liability, the fiduciary duty violated by that conduct is the duty of loyalty.

This view of a failure to act in good faith results in two additional doctrinal consequences. First, although good faith may be described colloquially as part of a "triad" of fiduciary duties that includes the duties of care and loyalty,[31] the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but

[29] That issue, whether a violation of the duty to act in good faith is a basis for the direct imposition of liability, was expressly left open in *Disney*. 906 A.2d at 67 n.112. We address that issue here.
[30] *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003).
[31] *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

indirectly. The second doctrinal consequence is that the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith. As the Court of Chancery aptly put it in *Guttman*, "[a] director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest."[32]

We hold that *Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.[33] Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities,[34] they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.[35]

[32] *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003).
[33] *Id.* at 506.
[34] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006).
[35] *See Guttman v. Haung*, 823 A.2d at 506.

Chancery Court Decision

The plaintiffs contend that demand is excused under Rule 23.1 because AmSouth's directors breached their oversight duty and, as a result, face a "substantial likelihood of liability" as a result of their "utter failure" to act in good faith to put into place policies and procedures to ensure compliance with BSA and AML obligations. The Court of Chancery found that the plaintiffs did not plead the existence of "red flags" – "facts showing that the board ever was aware that AmSouth's internal controls were inadequate, that these inadequacies would result in illegal activity, and that the board chose to do nothing about problems it allegedly knew existed." In dismissing the derivative complaint in this action, the Court of Chancery concluded:

> This case is not about a board's failure to carefully consider a material corporate decision that was presented to the board. This is a case where information was not reaching the board because of ineffective internal controls. . . . With the benefit of hindsight, it is beyond question that AmSouth's internal controls with respect to the Bank Secrecy Act and anti-money laundering regulations compliance were inadequate. Neither party disputes that the lack of internal controls resulted in a huge fine--$50 million, alleged to be the largest ever of its kind. The fact of those losses, however, is not alone enough for a court to conclude that a majority of the corporation's board of directors is disqualified from considering demand that AmSouth bring suit against those responsible.[36]

[36] *Stone v. Ritter*, C.A. No. 1570-N (Del. Ch. 2006) (Letter Opinion).

This Court reviews *de novo* a Court of Chancery's decision to dismiss a derivative suit under Rule 23.1.[37]

Reasonable Reporting System Existed

The KPMG Report evaluated the various components of AmSouth's longstanding BSA/AML compliance program. The KPMG Report reflects that AmSouth's Board dedicated considerable resources to the BSA/AML compliance program and put into place numerous procedures and systems to attempt to ensure compliance. According to KPMG, the program's various components exhibited between a low and high degree of compliance with applicable laws and regulations.

The KPMG Report describes the numerous AmSouth employees, departments and committees established by the Board to oversee AmSouth's compliance with the BSA and to report violations to management and the Board:

> **BSA Officer.** Since 1998, AmSouth has had a "BSA Officer" "responsible for all BSA/AML-related matters including employee training, general communications, CTR reporting and SAR reporting," and "presenting AML policy and program changes to the Board of Directors, the managers at the various lines of business, and participants in the annual training of security and audit personnel[;]"

[37] *Beam ex rel. Martha Stewart Living Omnimedia Inc. v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).

BSA/AML Compliance Department. AmSouth has had for years a BSA/AML Compliance Department, headed by the BSA Officer and comprised of nineteen professionals, including a BSA/AML Compliance Manager and a Compliance Reporting Manager;

Corporate Security Department. AmSouth's Corporate Security Department has been at all relevant times responsible for the detection and reporting of suspicious activity as it relates to fraudulent activity, and William Burch, the head of Corporate Security, has been with AmSouth since 1998 and served in the U.S. Secret Service from 1969 to 1998; and

Suspicious Activity Oversight Committee. Since 2001, the "Suspicious Activity Oversight Committee" and its predecessor, the "AML Committee," have actively overseen AmSouth's BSA/AML compliance program. The Suspicious Activity Oversight Committee's mission has for years been to "oversee the policy, procedure, and process issues affecting the Corporate Security and BSA/AML Compliance Programs, to ensure that an effective program exists at AmSouth to deter, detect, and report money laundering, suspicious activity and other fraudulent activity."

The KPMG Report reflects that the directors not only discharged their oversight responsibility to establish an information and reporting system, but also proved that the system was designed to permit the directors to periodically monitor AmSouth's compliance with BSA and AML regulations. For example, as KPMG noted in 2004, AmSouth's designated BSA Officer "has made annual high-level presentations to the Board of Directors in each of the last five years." Further, the Board's Audit and Community Responsibility Committee (the "Audit Committee") oversaw

AmSouth's BSA/AML compliance program on a quarterly basis. The KPMG Report states that "the BSA Officer presents BSA/AML training to the Board of Directors annually," and the "Corporate Security training is also presented to the Board of Directors."

The KPMG Report shows that AmSouth's Board at various times enacted written policies and procedures designed to ensure compliance with the BSA and AML regulations. For example, the Board adopted an amended bank-wide "BSA/AML Policy" on July 17, 2003–four months before AmSouth became aware that it was the target of a government investigation. That policy was produced to plaintiffs in response to their demand to inspect AmSouth's books and records pursuant to section 220[38] and is included in plaintiffs' appendix. Among other things, the July 17, 2003, BSA/AML Policy directs all AmSouth employees to immediately report suspicious transactions or activity to the BSA/AML Compliance Department or Corporate Security.

Complaint Properly Dismissed

In this case, the adequacy of the plaintiffs' assertion that demand is excused depends on whether the complaint alleges facts sufficient to show that the defendant *directors* are potentially personally liable for the failure of

[38] Del. Code Ann. tit. 8, § 220 (2006).

non-director bank *employees* to file SARs. Delaware courts have recognized that "[m]ost of the decisions that a corporation, acting through its human agents, makes are, of course, not the subject of director attention."[39] Consequently, a claim that directors are subject to personal liability for employee failures is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[40]

For the plaintiffs' derivative complaint to withstand a motion to dismiss, "only a sustained or systematic failure of the board to exercise oversight–such as an utter failure to attempt to assure a reasonable information and reporting system exists–will establish the lack of good faith that is a necessary condition to liability."[41] As the *Caremark* decision noted:

> Such a test of liability–lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight–is quite high. But, a demanding test of liability in the oversight context is probably beneficial to corporate shareholders as a class, as it is in the board decision context, since it makes board service by qualified persons more likely, while continuing to act as a stimulus to *good faith performance of duty* by such directors.[42]

The KPMG Report–which the plaintiffs explicitly incorporated by reference into their derivative complaint–refutes the assertion that the

[39] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d at 968.
[40] *Id.* at 967.
[41] *Id.* at 971.
[42] *Id.* (emphasis in original).

directors "never took the necessary steps . . . to ensure that a reasonable BSA compliance and reporting system existed." KPMG's findings reflect that the Board received and approved relevant policies and procedures, delegated to certain employees and departments the responsibility for filing SARs and monitoring compliance, and exercised oversight by relying on periodic reports from them. Although there ultimately may have been failures by employees to report deficiencies to the Board, there is no basis for an oversight claim seeking to hold the directors personally liable for such failures by the employees.

With the benefit of hindsight, the plaintiffs' complaint seeks to equate a bad outcome with bad faith. The lacuna in the plaintiffs' argument is a failure to recognize that the directors' good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both, as occurred in *Graham*, *Caremark* and this very case. In the absence of red flags, good faith in the context of oversight must be measured by the directors' actions "to assure a reasonable information and reporting system exists" and not by second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome.[43] Accordingly, we

[43] *Id.* at 967-68, 971.

hold that the Court of Chancery properly applied *Caremark* and dismissed the plaintiffs' derivative complaint for failure to excuse demand by alleging particularized facts that created reason to doubt whether the directors had acted in good faith in exercising their oversight responsibilities.

Conclusion

The judgment of the Court of Chancery is affirmed.

24

EFiled: May 5 2008 1:27PM EDT
Transaction ID 19686003
Case No. 2399-VCL

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

MARTHA S. SUTHERLAND, as Trustee of the Martha S. Sutherland Revocable trust dated August 18, 1976, Plaintiff, v. PERRY H. SUTHERLAND, TODD L. SUTHERLAND, and MARK B. SUTHERLAND, Defendants, and DARDANELLE TIMBER CO., INC., and SUTHERLAND LUMBER SOUTHWEST, INC., Nominal Defendants.	)	C.A. No. 2399-VCL

MEMORANDUM OPINION AND ORDER

Submitted: February 7, 2008
Decided: May 5, 2008

J. Travis Laster, Esquire, Matthew F. Davis, Esquire, ABRAMS & LASTER, LLP, Wilmington, Delaware; Bonita L. Stone, Esquire, Stewart T. Kusper, Esquire, KATTEN MUCHIN ROSENMAN LLP, Chicago, Illinois, *Attorneys for the Plaintiff.*

Robert S. Saunders, Esquire, SKADDEN ARPS SLATE MEAGHER & FLOM, LLP, Wilmington, Delaware, *Attorneys for the Individual Defendants.*

A. Gilchrist Sparks, III, Esquire, S. Mark Hurd, Esquire, Jay N. Moffitt, Esquire, MORRIS NICHOLS ARSHT & TUNNELL, LLP, Wilmington, Delaware, *Attorneys for the Nominal Defendants.*

LAMB, Vice Chancellor.

This case concerns a derivative (and double derivative) complaint filed by a 25% stockholder of a closely held corporation with the support of her brother, who is also a 25% stockholder of the corporation. In response to the matters alleged in the complaint, the companies established a one-man *Zapata* special litigation committee to conduct an investigation. The committee has finished its investigation, memorialized its findings in a written report, and concluded that it is not in the best interests of the companies to pursue the litigation. Relying on the special litigation committee's report and conclusions, the companies have filed a motion to dismiss the complaint.

Following discovery, the plaintiff resists the motion, arguing that the committee lacked independence, did not act in good faith, conducted an unreasonable investigation, and lacked reasonable bases for its conclusions. Having considered the briefs, affidavits, and arguments of the parties, the court concludes that the special litigation committee has not satisfied the court that it acted in good faith and conducted a reasonable investigation. Therefore, the motion to dismiss will be denied.

I.[1]

Dardanelle Timber Company is a family owned and operated Delaware corporation, which, in part through its wholly owned subsidiary Southwest, Inc., is in the business of operating retail lumber yards and stores. Both companies were founded by Dwight D. Sutherland, Sr. ("Dwight Sr."), who served as president until his death in October 2003.

Approximately three decades ago, Dwight Sr. gave 25% of Dardanelle's common stock to each of his children: Martha, Dwight Jr., Perry, and Todd. At the time, Dwight Sr. and his wife Norma jointly owned all of Dardanelle's preferred stock, which carries voting rights. After Dwight Sr.'s death, the shares of preferred stock were transferred to a trust for Norma's benefit.

Despite the even split of the common equity between the siblings, Perry and Todd have voting control over Dardenelle and Southwest because Perry is the trustee for Norma's trust, and Todd has allied himself with Perry. Perry and Todd constitute a majority of Southwest's three-member board, a majority of Dardanelle's board, and serve as the principal officers of both companies. Mark Sutherland, the third individual defendant, is a cousin and serves as the third director of both Dardanelle and Southwest. Martha was a director of Southwest

[1] The facts of the case are extensively set forth in two prior opinions of the court. *See Sutherland v. Sutherland*, No. 2399, 2007 WL 1954444 (Del. Ch. July 2, 2007); *Sutherland v. Dardanelle Timber Co.*, No. 671, 2006 WL 1451531 (Del. Ch. May 16, 2006).

until February 20, 2004. On that date, Dardanelle, the sole stockholder of Southwest, called an annual meeting for Southwest at which the number of Southwest directors was reduced to three and each of Perry, Todd, and Mark was elected to the board, in effect removing Martha from Southwest's board of directors.[2]

Relying upon the documentation she received as a result of a hard-fought action brought pursuant to 8 *Del. C.* § 220, Martha filed this suit on September 6, 2006. The complaint is in three counts: the first is for breach of fiduciary duty and asserts claims derivatively on behalf of Dardanelle; the second count is for waste; the third count is for breach of fiduciary duty and asserts double derivative claims on behalf of Southwest. Although not a named plaintiff, Dwight Jr., a lawyer, supports Martha in bringing this action.

Centrally, the complaint alleges that the individual defendants have used the companies' "corporate funds and assets for personal benefit."[3] Specifically, the complaint asserts that Perry and Todd have caused the companies to pay for (1) personal flights they have taken on the corporate airplane; (2) personal tax and accounting services provided to them by Cimarron Lumber & Home Supply Company, Ltd., a Dardanelle affiliate; (3) use of a facility commonly known as the

[2] The next day, Perry, Todd, and Mark approved employment agreements for Perry and Todd.
[3] Compl. ¶ 98.

Maysville Training Center for personal vacations; and (4) "things [such] as rental cars, expensive hotels, limousines, club memberships, chartered private railroad cars for extended personal trips, private parties and personal living expenses, among many others."[4]

The complaint also challenges the decision to purchase the aircraft in the first instance, alleging that the aircraft serves no legitimate business purpose. The complaint further alleges that Perry and Todd's decision to approve their own employment agreements at a February 21, 2004 board meeting constitutes waste and a breach of fiduciary duty. Martha asserts that the agreements pay Perry excessively for "part-time" work and contain excessive perquisites, such as payment for personal use of the aircraft and for personal tax and accounting services. Finally, the complaint bases its breach of fiduciary duty and waste claims on allegations that the individual defendants' improperly caused Dardanelle to spend over $500,000 to defend against Martha's section 220 action, and improperly amended Dardanelle's bylaws pursuant to 8 *Del. C.* § 102(b)(7) to include a limitation of liability provision.

In response to the September 6 complaint, the boards of directors of both Dardanelle and Southwest amended the companies' bylaws by unanimous written consent. The written consents increased the number of directors from three to four,

[4] *Id.* ¶ 64.

appointed Bryan Jeffrey as a member of each board, and formed a special litigation committee consisting solely of Jeffrey (the "SLC"). Jeffrey was given final and binding authority with respect to the claims asserted in the September 6 complaint. He then hired independent counsel.

Following a December 18, 2006 hearing, the court agreed to stay this action while Jeffrey conducted his investigation. On March 26, 2007, Jeffrey filed his report with the court, concluding that the companies should not pursue any of the claims alleged in the September 6 complaint. Dardanelle and Southwest, relying on that report, then moved to dismiss. Martha conducted limited discovery into the independence and good faith of the SLC, as well as the reasonableness of the SLC's investigation and conclusions. She now opposes the companies' motion to dismiss, arguing that the SLC was not independent, lacked good faith, conducted an unreasonable investigation, and lacked reasonable bases for its conclusions.

II.

The parties agree that *Zapata Corporation v. Maldonado*[5] and its progeny articulate the legal standard governing this court's decision whether to grant the SLC's motion. A motion to dismiss brought in response to a report of an SLC is a hybrid motion created by *Zapata* which takes qualities from a Court of Chancery Rule 41(a)(2) motion to dismiss and a Court of Chancery Rule 56 motion for

[5] 430 A.2d 779 (Del. 1981).

summary judgment.[6] As such, a *Zapata* motion "is addressed necessarily to the reasonableness of dismissing the complaint prior to trial without any concession of liability on the part of the defendants and without adjudicating the merits of the cause of action itself."[7] Under *Zapata*, then, the court makes inquiry into whether the special committee was independent, whether the investigation was conducted in good faith, and whether the committee had a reasonable basis for its conclusion.[8]

The SLC is not entitled to any presumptions of independence, good faith, or reasonableness.[9] Rather, the corporation has the burden of proof under Rule 56 standards, which require the corporation to establish the absence of any material issue of fact and its entitlement to relief as a matter of law.[10] In addition, as the court in *Kaplan v. Wyatt* noted, the motion must be supported by a thorough record.[11] "[I]t seems . . . that what the Committee did or did not do, and the actual existence of the documents and the persons purportedly examined by it, should constitute the factual record on which the decision as to the independence and good faith of the Committee, and the adequacy of its investigation in light of the

[6] *Kaplan v. Wyatt*, 484 A.2d 501, 506-07 (Del. Ch. 1984).
[7] *Id.* at 507; *see also Katell v. Morgan Stanley Group, Inc.*, No. 12343, 1995 WL 376952, at *12 (Del. Ch. Jun. 15, 1995).
[8] *Zapata*, 430 A.2d 779; *Lewis v. Fuqua*, 502 A.2d 962, 966 (Del. Ch. 1985); *Kaplan*, 484 A.2d at 506.
[9] *Id.*
[10] *Zapata*, 430 A.2d 779; *Lewis*, 502 A.2d at 966.
[11] *Kaplan*, 484 A.2d at 506.

derivative charges made, must be based."[12] Each side has the opportunity to make a record on the motion.[13] If the court is satisfied with the SLC's independence and good faith, and the reasonableness of its inquiry, the court may nonetheless exercise its own business judgment and deny the motion to dismiss.[14]

III.

A. Independence

To establish independence, the court must be persuaded that the SLC "can base its decision on 'the merits of the issue rather than being governed by extraneous consideration or influences.'"[15] As the court in *In re Oracle Corporation Derivative Litigation* noted, the inquiry into the independence of SLC members is a narrow one.[16] The court conducts the inquiry without regard to whether the members acted in good faith, or conducted a reasonable

[12] *Id.* at 519.
[13] *Zapata*, 430 A.2d 779; *Lewis*, 502 A.2d at 966.
[14] *Kaplan*, 484 A.2d at 509. "This discretionary step is designed to prevent situations where the Special Committee complied with all the technical requirements of *Zapata*, but the outcome violates the spirit of that procedure." *Katell*, 1995 WL 376952, at *13.
[15] *Katell*, 1995 WL 376952, at *7 (quoting *Kaplan*, 499 A.2d at 1189); *see also In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 938 (Del. Ch. 2003) (stating "[t]he question of independence 'turns on whether a director is, *for any substantial reason*, incapable of making a decision with only the best interests of the corporation in mind'") (quoting *Parfi Holding AB v. Mirror Image Internet, Inc.*, 794 A.2d 1211, 1232 (Del. Ch. 2001)).
[16] *See In re Oracle*, 824 A.2d at 947. In *Oracle*, the SLC interviewed 70 witnesses, met with its counsel 35 times for a total of 80 hours, and produced a report totaling 1,110 pages–excluding appendices and exhibits. Nonetheless, the court found that the members lacked independence, and denied the SLC's motion to dismiss.

investigation.[17] Rather, the court investigates the members' personal interest in the disputed transactions, and "scrutinizes the members' relationship with the interested directors."[18] It should be noted that one-member SLCs are less insulated from the influence of interested directors,[19] and are closely scrutinized.[20]

Martha points to four facts to establish Jeffrey's lack of independence. In making this argument, Martha relies heavily on the heightened burden that one-member SLCs face. First, Martha points out that Jeffrey destroyed notes he took during witness interviews. She asserts that "[t]he conscious destruction of interview notes by Jeffrey and SLC Counsel . . . rebuts the bald contention that Jeffrey's independence somehow is shown . . . ."[21] Second, Martha argues that Jeffrey had a prior relationship with Mark Sutherland that the SLC acknowledged, but failed to sufficiently disclose. According to Martha, the SLC disclosed that Jeffrey knew Mark socially while Mark and his wife lived in Little Rock, Arkansas–where Jeffrey still lives and works–and that Jeffrey did substantial accounting work for Mark's wife, preparing quarterly and other financial

[17] *See id.* at 947 (finding that SLC members were not independent, even though "nothing in this record leads me to conclude that either of the SLC members acted out of any conscious desire . . . to do anything other than discharge their duties with fidelity," and concluding that such an inquiry "is not the purpose of the independence inquiry").
[18] *Katell*, 1995 WL 376952, at *8 (citing *Lewis*, 502 A.2d at 967); *see also Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc.*, No. 13950, 1997 WL 305829, at *10 (Del. Ch. May 30, 1997).
[19] *In re Oracle*, 824 A.2d at 940 (noting that "[a] small number of directors feels the moral gravity–and social pressures– of [the duty to decide whether to sue fellow directors] alone").
[20] *See Lewis*, 502 A.2d at 967.
[21] Pl.'s Ans. Br. 16.

statements for her antique business over some unknown period of time. However, Martha argues, Jeffrey has failed to disclose the extent of that work, including the amount of compensation Jeffrey received.

Third, Martha argues that Jeffrey has a financial interest in this litigation sufficient to question his independence. Specifically, Martha points to the $250 per hour Jeffrey receives for his service as a director of the companies, and the retention of Jeffrey's firm to do $25,000 worth of "clerical work" related to the investigation. Finally, Martha contends that Jeffrey, Dardanelle, and Southwest have an ongoing "secret financial relationship" under which the companies pay Jeffrey his $250 hourly rate for work unrelated to his duties as a director. In support, Martha points to the fact that Jeffrey attended a store inventory in Texas after the report was issued, for which he was paid his hourly rate.

Although the SLC in this case had only one member, it has met its burden to show the absence of material fact about its independence. First, previous decisions of this court have flatly rejected the argument that an SLC acts improperly when its members and counsel destroy their original, handwritten interview notes.[22] Regardless, such an argument is irrelevant to an inquiry into the SLC's independence, as it more properly reflects on the SLC's good faith.[23]

[22] *See Kaplan*, 484 A.2d at 517, 520. *See*, however, the discussion regarding the deficiency of the interview summaries prepared by the Special Committee or its counsel at Section III.B.2, *infra*.
[23] *See id.* at 517.

Second, Martha unfairly characterizes the amount of information the record contains as to Jeffrey's prior relationship with Mark. The SLC provided a sworn interrogatory answer indicating Jeffrey had prepared periodic financial statements for Mark's wife's antique business, and that the amount billed and paid for that work did not exceed $5,000. Likewise, Jeffrey testified at his deposition that he performed accounting work for Mark's wife 10-15 years ago, that the financial statements were prepared monthly or quarterly, and that he had not seen or spoken with Mark or Mark's wife since Mark's relocation to Kansas City six years ago. Even in the context of a one-member SLC, this *de minimus* relationship ending six years ago does not raise a material question as to Jeffrey's independence. Indeed, as the court stated in *In re Oracle Securities Litigation*, "business dealings seldom take place between complete strangers and it would be a strained and artificial rule which required a director to be unacquainted or uninvolved with fellow directors in order to be regarded as independent."[24]

Further, the mere fact Jeffrey received his standard hourly rate for his work is of no consequence; anyone who conducted the investigation would have asked to be compensated, and it was reasonable to pay Jeffrey his standard hourly rate. Also, there is no suggestion that the approximately $64,000 Jeffrey received for his work, and the $25,000 his firm received for its work, were so large as to render

[24] 852 F. Supp. 1437, 1442 (N.D. Cal. 1994) (applying Delaware law).

Jeffrey dependent upon or beholden to that compensation, thereby tainting his independence. In short, as this court has previously held, Jeffrey's compensation is not reason in itself to find he lacked independence.[25]

Finally, with regard to the alleged "secret financial relationship" between Jeffrey and the companies, Jeffrey testified at his deposition that he viewed his attendance at the store inventory as part of his duties as a director. As Jeffrey explained, his counsel told him he was not on the board simply as an SLC member, but as a full member of the board. As such, counsel rightly informed Jeffrey that he should take an active role in informing himself of the companies' business. Jeffrey's visit to the store was left unmentioned in the report because it had not occurred at the time the report was written. There was nothing about the visit suggesting Jeffrey lacks independence. Thus, Martha has not identified any facts suggesting Jeffrey lacks independence.

To the contrary, numerous facts demonstrate that Jeffrey was, in fact, independent. Jeffrey testified that his friend Harry Cummins, then the United States Attorney for the Eastern District of Arkansas, and not the interested

[25] *See In re Limited, Inc.*, No. 17148, 2002 WL 537692, at *4 (Del. Ch. Mar. 27, 2002) (stating "[a]llegations as to one's position as a director and the receipt of director's fees, without more, however, are not enough for purposes of pleading demand futility"); *Grobow v. Perot*, 539 A.2d 180, 188 (Del. 1988) (stating that allegations that the directors were paid for their services as directors, "without more, do not establish any financial interest" sufficient to find the directors lacked independence") *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

directors, identified Jeffrey as a potential board candidate. Also, outside the *de minimis* contact Jeffrey had with Mark's wife, Jeffrey had no previous relationship with any of the defendants.[26] Jeffrey hired independent counsel to support him in his investigation,[27] and is, himself, a named partner in a reputable Arkansas accounting firm. Thus, Jeffrey had a strong incentive to act independently from Perry, Todd, and Mark, thereby maintaining his credibility and reputation.[28] For these reasons, the court finds that Jeffrey was independent.

B. Good Faith And Reasonable Investigation

The SLC's report in this case outlines an investigation that was, in many respects, exhaustive and time-consuming. The SLC reviewed documents relating to 78 flights paid for by Dardanelle or Southwest between October 2001 and December 2006 in order to determine how many times Perry and Todd took personal flights on the companies' aircraft, and how many of those were either paid for by Perry and Todd or included in their W-2s as compensation.[29] The SLC also

[26] *See Carlton Inv.*, 1997 WL 305829, at *11 (finding SLC members disinterested where they did not have "any prior affiliation" with the company or any of the defendants).
[27] *Katell*, 1995 WL 376952, at *10; *see also Carlton Inv.*, 1997 WL 305829, at *11.
[28] *See Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1052 (Del. 2004) (holding that "[t]o create a reasonable doubt about an outside director's independence, a plaintiff must plead facts that would support the inference that because of the nature of a relationship or additional circumstances other than the interested director's stock ownership or voting power, the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director").
[29] The SLC concluded that 19 of those flights were personal flights taken by Perry, 15 of which were added as income to Perry's W-2 s, and four Perry paid for personally. The SLC concluded that no other flights should have been billed to Perry. Similarly, the SLC concluded that Todd was invoiced for personal flights 20 times and that, based on conversations with the lead pilot of

interviewed several Cimarron employees to determine how much work Cimarron did for Perry and Todd, and how billing rates for that work were determined. Nonetheless, significant errors or shortcomings exist in the SLC's report that undermine the court's confidence in the SLC's entire investigation. The most salient of these are discussed below.

1. Failure To Investigate The Leo King Payments

Dardanelle made two payments totaling $95,950 to a Leo King for improvements King made to Perry's house in 2000 and 2001. These amounts are reflected in Perry's 2000 and 2001 W-2s, and represented a large portion of Perry's total compensation of approximately $170,000 for each year. Despite this fact, the SLC's report omits any mention of these payments, including who approved the payments or how they were approved. Rather, it was Martha who, having discovered evidence of the payments during review of the 14,000 documents the SLC produced as a result of discovery, presented the evidence to the court.

Jeffrey submitted an affidavit as part of the companies' reply brief stating he was aware of the payments when writing the report. At oral argument, counsel for the SLC reiterated that the SLC was aware of the payments to King.[30] Counsel

the aircraft, no other flights should have been billed to Todd personally. The SLC states that it verified that Todd, not the companies, paid for those 20 flights.
[30] At oral argument, counsel suggested that Dwight Sr. had authorized the King payments. When asked for the source of that information, counsel responded that Perry had told them, but that there was no written record of such authorization. Hr'g Tr. 29-30. As discussed in further detail herein, the SLC's summary of its interview with Perry makes no mention of this line of

offered the explanation that the SLC excluded mention of the payments from the report because Perry's compensation was reasonable even including those payments, and because any claims related to the payments were subject to a strong statute of limitations defense.

This explanation is entirely insufficient. Notably, while omitting reference to these large payments, the SLC found it useful to include exculpatory information of a similar character from the same time period, stating "the Special Committee concludes that Perry purchased certain construction materials at cost from Cimarron in 1999-2000, a benefit generally available to the members of the Sutherland family, which in all events did not constitute self-dealing as there was no detriment to either Cimarron or the companies."[31] The incongruity between omitting analysis of the large, possibly suspicious payments, yet referencing the innocent, generally available discount, raises significant questions as to the good faith of the SLC's work.

These questions are made all the more significant when the court considers that the King payments go to the very heart of Martha's complaint and, even taken individually, represent the largest payments to Perry that either party has identified. If the SLC believed there were strong defenses to claims premised on the King

questioning, or Perry's responses, thus precluding the court's investigation into counsel's representation.

[31] Report 118.

payments, then the SLC should have included that analysis in its report. In this case, where an SLC seeks to wrest control of litigation from 50% stockholders in a closely held corporation, the SLC's decision not to conduct that analysis, but, instead, to omit any mention of the King payments, gives rise to substantial questions concerning the reasonableness and good faith of the SLC's investigation.

2. The Interview Summaries

Related to the King issue is the perfunctory nature of the SLC's interview memoranda. Several of the most important interview summaries fail to record the witnesses' answers at all. Instead, there is just a thumbnail summary of the areas covered during the SLC's interviews. Without this information, the court is unable to ascertain the reasonableness of the SLC's investigation.

For example, the summary of the SLC's interview with Perry notes merely that Perry "responded to questions from the Special Committee regarding stays at the Lowell Hotel, explained that he had invited Todd on certain trips on the aircraft as his guest, and responded to questions about the construction of his home, the history of the Sutherland family and companies and the Companies' current real estate holdings."[32] The summary gives no indication as to how extensively the SLC questioned Perry about these allegations, and does not contain any record of what the SLC learned from Perry.

[32] Moffit Aff. Ex. F at 3.

In addition, although the SLC's counsel stated at the hearing that Perry reported that Dwight Sr. authorized the King payments, the Perry interview summary makes no mention of that fact. Indeed, the Perry interview summary does not record that the SLC asked any questions about the King payments at all. At most, the summary simply states that the SLC asked questions about the construction of Perry's home, which may only be a reference to the fact that Sutherland family members were able to purchase building supplies from Cimarron at a wholesale price. In short, interview summaries such as Perry's do not assure the court of the good faith or integrity of the SLC's work.

3. Failure To Conduct A Reasonable Investigation Of Payment Of Personal Expenses By The Companies

During an interview with the SLC, Martha and Dwight Jr. urged the SLC to inspect the companies' general ledgers for evidence that the companies paid Perry's and Todd's personal expenses. The SLC agreed to investigate the ledgers. However, the desultory investigation Jeffrey undertook raises additional questions about the reasonableness and good faith of that investigation.

Jeffrey testified at his deposition that he traveled to Kansas City to review the general ledgers, and arrived at the companies' offices at 8:30 in the morning. After meeting with members of the accounting department, Jeffrey began reviewing the general ledgers. According to Jeffrey, he began by reviewing the

ledgers of the past three or four years, and reviewed mainly travel accounts and miscellaneous expense accounts. Over the course of his review, Jeffrey noticed that Perry had a vendor number and asked the accounting department to run a report listing each check made to Perry between 2001 and 2006. Jeffrey reviewed the resulting report for any instances of checks written to Perry for reimbursement of his personal expenses. Jeffrey also spot-checked between 5 and 10 invoices to test whether or not the accounting records were accurate. He left at 3:30 p.m., having taken an hour lunch.

Perhaps more notable than what Jeffrey did is what Jeffrey did not do. Jeffrey testified at his deposition that, although he is a certified public accountant, he did not arrive at the companies' offices with a plan for how he was going to conduct the review. He did not take any notes. Thus, there is no written record of what he did. Jeffrey testified that he did not review a statistically significant number of invoices when testing whether the accounting records were accurate. He did not verify that the vendor number he asked the accounting department to run was Perry's only vendor number. And he conducted no search for payments the companies may have made to third parties on Perry's behalf. For instance, if Perry used Maysville and Maysville then invoiced the companies rather than Perry, Jeffrey's investigation would not have found the check sent to Maysville on

Perry's behalf.[33] Nor, as Jeffrey testified, would he have found checks the companies made to credit card issuers on Perry's behalf. Indeed, Jeffrey testified that his review of the ledgers would have failed to capture the two large payments made to King on Perry's behalf.

Given the importance of the general ledgers to claims alleged in the complaint, as well as the fact that this case involves a one-man SLC seeking to seize control of litigation from 50% stockholders of the companies, the SLC has not proven the reasonableness of its investigation into claims that the companies paid Perry's and Todd's personal expenses. Therefore, the motion to dismiss will be denied because "the SLC's selective investigation . . . [does] not adequately address all of [Martha's] claims."[34] Further, because the court finds sufficient cause to reject the SLC's report in light of the above problems, the court need not

[33] It should be noted that nothing in the SLC's report indicates that the SLC reviewed all of Maysville's invoices to ensure that Perry and Todd, rather than the companies, were billed for their personal visits. Rather, the SLC identifies in the report the dates on which Perry and Todd used Maysville for personal reasons–with little indication as to how those dates were determined–and states it verified that all invoices from Maysville to Perry and Todd were included in their W-2s. *See* Report 48-50.

[34] *Electra Inv. Trust, PLC v. Crews*, No. 15890, 1999 WL 135239, at *6 (Del. Ch. Feb. 24, 1999). The court also notes that, as explained in a prior opinion in this case, the report is wholly devoid of citations to key documents or interview summaries. *See Sutherland v. Sutherland*, No. 2399, 2008 WL 571253 (Del. Ch. Feb. 14, 2008). In addition, the SLC did not enter any of the underlying documents, interview summaries, affidavits, or deposition transcripts into the record until it filed its reply to Martha's opposition. Needless to say, these facts do not enhance the court's confidence in the SLC. Not only does the lack of a record hinder the court's, and the plaintiff's, ability to scrutinize the SLC's good faith, independence, and reasonableness, it also suggests that the SLC has not taken its obligation seriously and has not acted in good faith.

consider the other arguments asserted by Martha in opposition to the companies' motion.[35]

IV.

For the reasons stated above, the defendants' motion to dismiss is DENIED.

IT IS SO ORDERED.

[35] *See Electra*, 1999 WL 135239, at *5 & n.8. Specifically, Martha argues that the SLC's remaining conclusions were unreasonable and were the result of an unreasonable investigation.

COURT OF CHANCERY
OF THE
STATE OF DELAWARE

JOHN W. NOBLE
VICE CHANCELLOR

417 SOUTH STATE STREET
DOVER, DELAWARE 19901
TELEPHONE: (302) 739-4397
FACSIMILE: (302) 739-6179

August 29, 2008

Robert J. Kriner, Jr., Esquire
Chimicles & Tikellis LLP
One Rodney Square
P.O. Box 1035
Wilmington, DE 19899-1035

Edward P. Welch, Esquire
Skadden, Arps, Slate, Meagher
& Flom LLP
One Rodney Square
P.O. Box 636
Wilmington, DE 19899-0636

Daniel A. Dreisbach, Esquire
Richards, Layton & Finger, P.A.
One Rodney Square
P.O. Box 551
Wilmington, DE 19899-0551

Re: Ryan v. Lyondell Chemical Company, et al.
C.A. No. 3176-VCN
Date Submitted: August 20, 2008

Dear Counsel:

The individual defendant members of the board of directors of Defendant Lyondell Chemical Company ("Lyondell" or the "Company") seek certification of an interlocutory appeal of a portion of the Court's July 29, 2008, Memorandum

Opinion[1] and Order (the "Opinion") denying them, at least for the moment, on the basis of a limited summary judgment record,[2] the protection of Lyondell's exculpatory charter provision for potential breaches of their fiduciary duty of care in connection with the sale of the Company to Basell AF for $13 billion in July 2007.[3] The Court determined that the record did not clearly demonstrate the absence of issues of material fact with respect to the Board's good faith discharge of its known fiduciary duties in connection with the sale,[4] and, therefore, the Court could not yet

[1] *Ryan v. Lyondell Chem. Co.*, 2008 WL 2923427 (Del. Ch. July 29, 2008). References to the Opinion here are to its slip form. The factual background of this case is set forth at length in the Opinion. Pertinent facts are repeated here as appropriate.

[2] Defendants made a tactical choice to seek summary judgment very early in this case, and, consequently, they relied upon a record developed in connection with related preliminary injunction litigation in Texas. Here, Ryan filed his Complaint on August 20, 2007; Defendants moved to dismiss and to stay discovery on September 12, 2007; the Basell defendants then moved for summary judgment on September 27, 2007. The Defendants joined in Basell's motion for summary judgment on November 21, 2007, but they did not separately brief their arguments in defense of Ryan's allegations against them; instead, they relied upon the Basell defendants' briefs, which focused primarily (at least in their opening brief) on addressing Ryan's aiding and abetting claims. The Court heard oral argument on the motions for summary judgment less than a week later.

[3] Defendants point out that Lyondell, the nominal defendant, did not owe fiduciary duties to the Lyondell stockholders and, accordingly, should have been dismissed. *See, e.g., In re Wheelabrator Techs., Inc. S'holders Litig.*, 1992 WL 212595, at *9 (Del. Ch. Sept. 1, 1992). Ryan has not disputed this contention. The Defendants are correct, and the Court's failure to dismiss Lyondell from this action was an inadvertent oversight. In accordance with Court of Chancery Rule 60(a), an order will be entered granting judgment in favor of Lyondell and dismissing it from this action. For purposes of this letter opinion, the term "Defendants" refers only to the individual defendants, the members of Lyondell's board.

[4] *See* Opinion at 5, 6, 7 n.11, 37-46, 51, 53, 56, 64 n.129, and 72-73. *But see id.* at 46 n.92 ("As the Court considers the record, the better inference, especially considering the potential

August 29, 2008
Page 3

determine the legal effect of Lyondell's exculpatory charter provision.[5] In particular, on the summary judgment record before the Court, it appeared that: (1) the directors *knew*, based on the filing of a Schedule 13D with the Securities and Exchange Commission in May 2007, that the Company was "in play;"[6] (2) despite having that knowledge, the directors did *nothing* (or virtually nothing) to prepare or to develop a strategy—consistent with the principles of *Revlon*[7] and its progeny—for maximizing shareholder value in connection with a possible sale of the Company;[8] (3) the directors did nothing (or virtually nothing) pre-signing to confirm

consequences from losing the Basell Proposal, likely favors the Lyondell Defendants. The Court, however, cannot take the better inference on summary judgment to the exclusion of a less compelling, but still reasonable, inference.").

[5] The Basell defendants mentioned Lyondell's exculpatory charter provision in support of their motion for summary judgment on Ryan's aiding and abetting claims in a footnote in their opening brief, in which, as noted, the Defendants joined. The Basell defendants also asserted the Section 102(b)(7) argument in their reply brief (in which the Defendants again joined) but their argument hinged on their hardly surprising view that, at best, Ryan's *Revlon* claims amount only to violations of the Defendants' duty of care. On the current record, however, the Court cannot adopt Defendants' "strictly duty of care" gloss on the facts.

[6] Not only did the directors *know* that the Company was "in play" following the 13D filing, they cloaked themselves in the fact that it effectively put a "For Sale" sign on the Company and no bids were forthcoming. *See, e.g.*, Reply Br. in Supp. of Basell's Mot. for Summ. J. at 11; Tr. of Oral Arg. Nov. 27, 2007 at 31 ("[COUNSEL FOR LYONDELL DEFENDANTS]: The only relevance of the 13D . . . is that it put the company in play as the market reflected and as also this Court has noted in several cases."); *see also id.* at 31, 87.

[7] *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

[8] This is not to say that the filing of a 13D automatically triggers "*Revlon* duties." The Defendants concede and, in fact, argue vigorously that the 13D filing in May 2007 effectively put the Company "in play." See *supra* note 6. Thus, it is in that context that the Court makes its comments about the significance of the 13D in this instance.

August 29, 2008
Page 4

that a better deal could not be obtained;[9] (4) the directors did nothing (or virtually nothing) to negotiate on Basell's offer;[10] and (5) the directors did nothing (or virtually nothing) post-signing to verify that a better deal could not have been obtained.[11] From those simple and as yet unexplained facts, it is possible to draw the reasonable inference, at least for purposes of denying summary judgment on the current record, that the directors *may have* consciously disregarded their known fiduciary obligations in a sale scenario.[12] Thus, in the Opinion, the Court questioned

[9] As the Court noted in the Opinion, idle speculation by the investment bankers that it was unlikely another bidder would top Basell's offer, without more, does not suffice to warrant summary judgment on this record. Opinion at 39 n.82.

[10] The directors essentially took the price offered by Basell and promptly conceded on the deal protections. Maybe the price was a "take-out" bid, but, on this record, when one looks to the two months of inactivity and the perfunctory fairness opinion, that fact alone does not justify the grant of summary judgment.

[11] Where a company sits on the market for a period of time after a deal is announced without the emergence of a competing bid, that fact can be evidence that the directors obtained the highest value attainable for the company. *E.g., In re Pennaco Energy, Inc. S'holders Litig.*, 787 A.2d 691, 707 (Del. Ch. 2001). On summary judgment, however, given other facts in the record, that is not sufficient to warrant summary judgment.

[12] The directors have not suggested that they did not understand that the well-settled value maximization principles of *Revlon* and its progeny would govern the discharge of their fiduciary obligations in this context. Implicit in their flogging of the premium price that happened to land in their laps in July 2007, however, is the directors' apparent belief that they should be relieved of those obligations based upon their disinterest, a premium price, a fairness opinion, and the mere passage of time after the deal is announced. In the case of a board, such as this, that has no "traditional" loyalty conflicts (e.g., improper motive or impermissible pecuniary interest) that argument may have considerable appeal, but that is not the present state of our law. As the Court reads our *Revlon* jurisprudence and understands the principles of a fiduciary relationship, the directors' obligations in connection with a sale of the corporate enterprise do not ebb and flow on

August 29, 2008
Page 5

whether, on a more fully developed record, that failure to act might rise to the level of "something more" than a mere violation of the board's fiduciary duty of care,[13] and, accordingly, it denied summary judgment in order to clarify and develop the record further in that regard.[14] Nonetheless, Defendants contend that the Court committed reversible error by denying them the protection of Lyondell's exculpatory charter provision because, in their view, the Court improperly conflated possible violations only of the Board's duty of care (i.e., gross negligence) with a violation of the good faith component of the duty of loyalty as defined in *Stone v.*

the fortuities of an offered deal premium and the ability to secure an expensive fairness opinion that (Quelle surprise!) concludes that the offer is "fair" to the shareholders.

[13] Opinion at 54 ("This may not be a case, however, where a board of directors simply botched the process in some careless or even grossly negligent manner; instead, this is a board of directors that appears never to have engaged fully in the process to begin with despite *Revlon*'s mandate. Thus, the good faith aspect of the duty of loyalty may be implicated, which precludes a Section 102(b)(7) defense to Ryan's *Revlon* and deal protection claims."). Alternatively, when the record is properly developed, the Court may well conclude that the Defendants made a good faith effort to comply with their *Revlon* duties under the circumstances and that any procedural shortcomings amount only to a violation of the directors' fiduciary duty of care, thus, entitling them to the protection of Lyondell's exculpatory charter provision. Moreover, a third alternative still exists—the Court might conclude that the process implemented by the directors under all the circumstances was reasonable under *Revlon* and its progeny and, thus, find that no breach of fiduciary duty occurred at all. The record, at this preliminary stage, simply is not sufficiently developed to rule out all material fact issues, and the Court may not weigh the evidence to reach those conclusions.

[14] Indeed, a trial court should deny summary judgment where it appears necessary or desirable to amplify the record in order to clarify the application of the law to the facts. *AeroGlobal Capital Mgmt., LLC v. Cirrus Indus., Inc.*, 871 A.2d 428, 444 (Del. 2005).

August 29, 2008
Page 6

Ritter[15] and *In re Walt Disney Company Derivative Litigation*[16] (i.e., intentional dereliction or conscious disregard of fiduciary duties).

In the Opinion, the Court perhaps did not expound in sufficient detail upon its reasons for denying the directors the protection of Lyondell's exculpatory charter provision. A fair reading of the Opinion, however, plainly reveals that the Court's concern about the application of a Section 102(b)(7) defense on this rudimentary summary judgment record is whether by taking no discernible action to prepare for a possible sale of the Company in light of the 13D filing, and then, later, by doing nothing (or virtually nothing) actively to confirm that Basell's offer really was the "best" deal reasonably available, the Defendants may have exhibited a "conscious disregard" for their known fiduciary obligations in a sale scenario. Thus, the Court did not apply an inappropriate concept or definition of "bad faith" in this context under the controlling Delaware Supreme Court precedents, and it did not "resolve" a substantial issue or "determine" a legal right. It simply denied a motion for summary judgment on a sparse preliminary injunction record where the facts, unfortunately, suggest an inference of conscious board inaction in the face of a

[15] 911 A.2d 362 (Del. 2006).

[16] 906 A.2d 27 (Del. 2006) [hereinafter *Disney*].

August 29, 2008
Page 7

known duty to act.[17] Accordingly, because the criteria of Delaware Supreme Court Rule 42(b) governing certification of an interlocutory appeal have not been met, the Defendants' motion must be denied.[18]

A. *The Directors' Good Faith and Section 102(b)(7) Under These Circumstances*

Before proceeding with an analysis of Defendants' motion for certification of an interlocutory appeal, the Court digresses briefly to expand its analysis of the Section 102(b)(7) issue.

Defendants latch on to a single line in the Court's seventy-three page Opinion—*"the board's failure to engage in a more proactive sale process may*

[17] Contrary to the Defendants' assertions that the Opinion threatens to unleash a liability crisis similar to that experienced in the wake of *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), the Court's decision, as Ryan correctly points out in his brief opposing certification of an interlocutory appeal, will in no way impede a properly motivated and unconflicted corporate director who attempts to discharge his fiduciary obligations in good faith from successfully asserting a Section 102(b)(7) defense on a fully developed summary judgment record (or at any other proper procedural stage, for that matter). Moreover, unlike the situation presented in *Van Gorkom* where the directors found themselves between that proverbial rock and a hard place through no fault of their own and attempted, in good faith, to discharge their fiduciary duties under the circumstances—the motivating purpose behind the adoption of Section 102(b)(7)—the directors in this instance walked into a potential liability trap with their eyes wide open: they *knew* the Company was "in play," they *knew* what the proper discharge of their fiduciary obligations in connection with a sale of control demanded, and yet they appear, on the limited record before the Court, to have done *nothing* to prepare for a possible sale.

[18] The question of whether *"Revlon* duties," as that concept has evolved in Delaware law, should apply with full force in the context of a disinterested and independent board is not an issue presently framed in this litigation.

August 29, 2008
Page 8

constitute a breach of the good faith component of the duty of loyalty as taught in Stone v. Ritter"[19]— in order to support their argument that the Court has "conflated" a mere breach of the duty of care (i.e., gross negligence) with a finding that the Directors acted in "bad faith." The purportedly offending line, however, does not even appear in the section of the Opinion addressing Defendants' Section 102(b)(7) argument.[20] In fact, nowhere in Defendants' motion for certification of an interlocutory appeal, where they repeatedly disparage the Opinion for applying an "incorrect" formulation of the definition of "bad faith," do they even cite to the Court's actual analysis of the Section 102(b)(7) issue where it explicitly quoted the Delaware Supreme Court's formulation of "bad faith" from *Stone v. Ritter*.[21]

Furthermore, semantics and the Court's decision not to incant *Disney*'s iteration of a definition of "bad faith" conduct aside, the Opinion clearly questions whether the Defendants "engaged"[22] in the sale process—i.e., diligently and

[19] Defs.' Mem. of Law in Supp. of their Application for Certification of Interlocutory Appeal ("Defs.' Mem.") at 7 (emphasis in original) (quoting Opinion at 32-33).

[20] Opinion at 54-56.

[21] *Id.* at 55 (quoting *Stone*, 911 A.2d at 370). The definition of "bad faith" articulated in *Stone* tracks precisely the same definition of "bad faith" articulated in *Disney*, 906 A.2d at 67.

[22] "Engage, vb. To employ or involve oneself; to take part in; to embark on." BLACK'S LAW DICTIONARY 570 (8th ed. 2004) (footnote not in original text); "Engage, vb, vi, 2b: to employ or involve oneself; c: to take part : PARTICIPATE." WEBSTER'S THIRD NEW INT'L DICTIONARY (UNABRIDGED) 751 (1993) (emphasis in original).

August 29, 2008
Page 9

faithfully undertook to discharge their known fiduciary obligations—in a manner consistent with the Delaware Supreme Court's teachings in *Revlon* and its progeny.[23] This is where the 13D filing in May 2007 and the subsequent two months of (apparent) Board inactivity become critical. Although the Court acknowledges that the testimony in the record suggests that the Board was *generally knowledgeable* about the value of the Company (e.g., they appear to have been updated at least on an annual basis), the Directors made *no apparent effort* to arm themselves with *specific knowledge* about the present value of the Company in the May through July 2007 time period, despite *admittedly knowing* that the 13D filing in May 2007 effectively put the Company "in play," and, therefore, presumably, also knowing that an offer for the sale of the Company could occur at any time.[24] It is these facts that raise the specter of "bad faith" in the present summary judgment

[23] Opinion at 54, 56.
[24] One could argue (as Defendants seem to) that the fairness opinion and other professional advice after-the-fact were enough to satisfy the single-bidder exception to a more robust sale process recognized in *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279 (Del. 1989). Perhaps that view will carry the day when the Court is in a position to weigh the evidence and find the facts. On summary judgment, however, regardless of how attractive that inference may be, it does not exclude the other possible inference that had the Board been sufficiently attentive to discharging its known fiduciary obligations and done something more beforehand to study the market and the interest of other buyers perhaps the outcome would have been different (i.e., the shareholders could possibly have received more value for their shares).

August 29, 2008
Page 10

record, which, in turn, colors the Court's view, at least for the moment, of the directors' later "negotiations"[25] with Basell and their inability to attempt to discharge their known fiduciary obligations after the fact due to the deal protections to which they had agreed. Perhaps in the Opinion, however, the Court was not as clear as it might have been in this regard.

In *Disney*, the Delaware Supreme Court approved of the Chancellor's formulation of one possible definition of director misconduct amounting to bad faith—"intentional dereliction of duty, a conscious disregard for one's responsibilities."[26] The Supreme Court was clear, however, that liability in those

[25] The Court uses this term loosely to describe the directors' actions in considering Basell's offer.
[26] 906 A.2d at 64, 67. The Court in *Stone* also adhered to the *Disney* definition of "bad faith." 911 A.2d at 370 ("Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith." (citing *id.*)). In the Opinion, this Court followed precisely the definition of "bad faith," and the consequent basis for potential liability, articulated by the Delaware Supreme Court in *Disney* and *Stone*, *see* Opinion at 65 ("Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith." (quoting *Stone*, 911 A.2d at 370)), and held that, at least for the time being, the directors were not entitled to the protection of Lyondell's exculpatory charter provision because it was not clear from the record that the conduct at issue here amounts only to a violation of the directors' duty of care. Moreover, consistent with *Disney*, the Court noted that conduct that is not in good faith or that amounts to a violation of the duty of loyalty is not exculpable under the plain language of Section 102(b)(7). *Id.* at 54-55, 56 n.11. Defendants may disagree with the Court's interpretation of the facts in the limited summary judgment record, but the Court did not affirmatively misstate the current law, and it certainly did not create new law equating a pure violation of the duty of care with a failure to act in good faith. *See id.* at 32-33 ("If [Ryan] only succeeded in [proving a breach of the directors' duty of care at trial], however, the Lyondell

August 29, 2008
Page 11

instances is *not* predicated upon the breach of the fiduciary duty of care; rather, liability results from the breach of the separate and distinct duty of good faith.[27] The

stockholders would not be entitled to money damages, the only remedy now otherwise available, because Lyondell had an exculpatory charter provision adopted in accordance with 8 *Del. C.* § 102(b)(7). Accordingly, Ryan can only prevail on his *Revlon* claims by overcoming the protection afforded to the Board by Lyondell's exculpatory charter provision; in other words, because the Board was independent and not impermissibly motivated by self-interest, Ryan must demonstrate that the Board either failed to act in good faith in approving the merger or otherwise acted disloyally."); *id.* at 54 ("This may not be a case, however, where a board of directors simply botched the process in some careless or even grossly negligent manner; instead, this is a board of directors that appears never to have engaged fully in the process to begin with despite *Revlon*'s mandate. Thus, the good faith aspect of the duty of loyalty may be implicated, which precludes a Section 102(b)(7) defense to Ryan's *Revlon* and deal protection claims. . . . With a record that does not clearly show the Board's good faith discharge of its *Revlon* duties, however, whether the members of the Board are entitled to seek shelter under the Company's exculpatory charter provision for procedural shortcomings amounting to a violation of their known fiduciary obligations in a sale scenario presents a question of fact that cannot now be resolved on summary judgment.") (internal citations omitted)).

[27] Now, in light of *Stone*, it is the duty of loyalty that serves as the legal framework for liability for a failure to act in good faith. But simply because the basis for legal liability is academically distinguishable does not mean that conduct possibly amounting only to a breach of the duty of care will necessarily be factually distinguishable from conduct resulting also in a breach of the good faith component of the duty of loyalty. *See Disney*, 906 A.2d at 65 ("[I]n the pragmatic, conduct-regulating legal realm which calls for more precise conceptual line drawing, the answer is that grossly negligent conduct, without more, does not and cannot constitute a breach of the fiduciary duty to act in good faith. The conduct that is the subject of due care may overlap with the conduct that comes within the rubric of good faith in a psychological sense, but from a legal standpoint those duties are and must remain quite distinct."); *see also id.* at n.104 ("An example of such overlap might be the hypothetical case where a director, because of subjective hostility to the corporation on whose board he serves, fails to inform himself of, or to devote sufficient attention to, the matters on which he is making decisions as a fiduciary. In such a case, two states of mind coexist in the same person: subjective bad intent (which would lead to a finding of bad faith) and gross negligence (which would lead to a finding of a breach of the duty of care). Although the coexistence of both states of mind may make them indistinguishable from a psychological standpoint, the fiduciary duties that they cause the director to violate—care and good faith—are legally separate and distinct."). In the Opinion, the Court decided that there were material fact questions that raised an issue of whether the directors' failure to act in the face of a known duty to

August 29, 2008
Page 12

Supreme Court further explained that although it could demarcate three points in the spectrum of fiduciary conduct deserving of a "'bad faith' pejorative label," the historical and statutory distinction between a violation of the duty of care and a violation of the duty to act in good faith (even though both can be said to fall within the realm of "bad faith") was important because of the potential consequences flowing from that distinction.

At one end of the spectrum, the Supreme Court identified a category of acts involving non-exculpable, "so-called 'subjective bad faith,' that is, fiduciary conduct motivated by an actual intent to do harm."[28] The Court further described those acts as involving conduct constituting "classic, quintessential" bad faith. In

act amounted to something more than a simple violation of the duty of care (i.e., gross negligence). In other words, this is an instance where issues of care and loyalty (good faith, in this context) bleed together under the facts presented in the summary judgment record, and, therefore, the Court was unable to ascertain, at least at this point, the ultimate effect of Lyondell's exculpatory charter provision in this context. The Court was careful to explain, however that, ultimately, a determination that the directors' failed to act in "good faith" could result in liability only because in that instance the directors will have violated their duty of loyalty. Opinion at 54-56. Thus, the Court did not conflate good faith into a theory that would result in legal liability for a breach of only the directors' duty of care, notwithstanding a Section 102(b)(7) charter provision. Unfortunately, at this preliminary stage of this case, it is difficult to frame the issue in a manner that does not, to some extent, track closely with those facts suggesting only an apparent failure to act with appropriate care; it remains to be seen whether the directors' acts (or failure to act) reach into the realm of non-exculpable bad faith. *See, e.g., Desimone v. Barrows*, 924 A.2d 908, 935 (Del. Ch. 2007).

[28] *Disney*, 906 A.2d at 64.

August 29, 2008
Page 13

this case, no such acts are alleged. Nor could the facts adduced in the record support any finding of an actual intent to do harm to the corporation and the shareholders.

At the opposite end of the "bad faith" spectrum, the Supreme Court identified acts exhibiting only a lack of due care—"that is, fiduciary action taken solely by reason of gross negligence and without any malevolent intent."[29] In that regard, the Court observed that "grossly negligent conduct, without more, does not and cannot constitute a breach of the fiduciary duty to act in good faith."[30] The Supreme Court explained that the distinction between gross negligence and non-exculpable "bad faith" (i.e., that elusive something "more") has important consequences in Delaware's jurisprudence and corporate statutory scheme because, for example, director conduct amounting *only* to a violation of the duty of care, but otherwise taken in good faith, is exculpable under 8 *Del. C.* § 102(b)(7) or indemnifiable under 8 *Del. C.* § 145.

In between the aforementioned points along the "bad faith" conduct spectrum, however, the Delaware Supreme Court identified a third category of acts—intentional dereliction of duty or a conscious disregard of one's responsibilities.

[29] *Id.*
[30] *Id.* at 65.

August 29, 2008
Page 14

Such misconduct, according to the Court, is "properly treated as a non-exculpable, non-indemnifiable violation of the fiduciary duty to act in good faith."[31] The Supreme Court explained:

> [T]he "universe of fiduciary misconduct is not limited to either disloyalty in the classic sense (i.e., preferring the adverse self-interest of the fiduciary or of a related person to the interest of the corporation) or gross negligence. Cases have arisen where corporate directors have no conflicting self-interest in a decision, yet engage in misconduct that is more culpable than simple inattention or failure to be informed of all facts material to the decision. To protect the interests of the corporation and its shareholders, fiduciary conduct of this kind, which does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence should be proscribed. A vehicle is needed to address such violations doctrinally, and that doctrinal vehicle is the duty to act in good faith.[32]

The Court further elaborated that because "Section 102(b)(7)(ii) expressly denies money damage exculpation for 'acts or omissions not in good faith . . . the statutory denial of exculpation for [such acts] must encompass the intermediate category of misconduct . . . ."[33] Thus, one possible (but not the only) formulation of the definition of misconduct falling within this intermediate category is "where the

[31] *Id.* at 66.
[32] *Id.*
[33] *Id.* at 67.

fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."[34]

In the context of a motion for summary judgment, it is not necessary (or prudent) for the Court to determine precisely where, on these facts, the line falls between exculpable, "bad faith" conduct (i.e., gross negligence amounting only to a violation of the duty of care) and a non-exculpable, knowing disregard of the directors' known fiduciary obligations in a sale scenario.[35] It suffices that, on this limited record, there exists apparent and unexplained director inaction despite their knowing that the Company was "in play" and their knowing that *Revlon* and its progeny mandated certain conduct or impeccable knowledge of the market in pursuit of the best transaction reasonably available to the stockholders in a sale scenario.[36] As a result of that apparent and unexplained inaction in the face of a

[34] *Id.* at 67 (quoting *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005)); *see also Stone*, 911 A.2d at 370 ("Where directors fail to act in the face of a known duty of act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith."); Opinion at 55 (quoting *Stone*).

[35] To the extent the Opinion did not include this exhaustive analysis of the provenance of the concept of "bad faith" the Court was applying in denying summary judgment on a very limited record, it is now clarified in that regard.

[36] There is no single "blueprint" the directors must follow, and the possible methods by which they might have conducted a "reasonable" sale process under *Revlon* and its progeny are multitudinous. *Barkan*, 567 A.2d at 1286. As the Court noted in the Opinion, perhaps the process chosen by the Board in this instance ultimately will be deemed "reasonable" under all the circumstances when

well-settled and well-known duty to act, the Court finds itself somewhere in the intermediate grey area of conduct identified by the Delaware Supreme Court as deserving of the "bad faith pejorative label." Whether the directors have crossed the line into a cognizable violation of the good faith component of the duty of loyalty is not clear, but, in any event, the possibility of "bad faith" *on this record* raises questions of material fact regarding the directors' entitlement to exculpation, and the record must be amplified to determine the proper application of Lyondell's exculpatory charter provision under these circumstances.

Under the Defendants' self-serving view of the record, where one simply ignores (1) the fact of the 13D filing in May 2007, (2) the fact the directors acknowledge that the 13D put the Company in play, and (3) the (apparent) fact of the directors' subsequent two months of slothful indifference despite *knowing* that the Company was in play, the Court probably would have to agree that "on [that] record there is simply no issue whatsoever of material fact about intentional or

the record is more fully developed. Thus, the Court is not suggesting that the directors conduct in this case *is* necessarily an example of bad faith, non-exculpable conduct, thus, exposing them to personal liability. Instead, the Court is saying that it *may be* such conduct, but that it is necessary to develop the record more fully in order to make that determination. As the Court stated in the Opinion, whether that requires only a more fully-developed presentation on summary judgment or a trial remains to be seen.

August 29, 2008
Page 17

conscious wrongdoing by the Lyondell board."[37] Unfortunately, and notwithstanding Defendants' wishes to the contrary and their trumpeting of the "blowout" premium in an effort to distract from those important facts, that is *not* the record that presently exists. In the sale of control context, no case under Delaware law has yet recognized the Lyondell directors' (apparent) "do nothing, hope for an impressive-enough premium, and buy a fairness opinion" approach to discharging a director's fiduciary obligations when selling the corporate enterprise; perhaps, under the circumstances, that process, eventually, will be deemed "reasonable" on a more complete record, but there is nothing in Delaware's corporate law that renders the process so self-evidently reasonable that the directors are per force deemed to have acted in good faith and entitled to summary judgment on what amounts to nothing more than a barebones preliminary injunction record.[38]

[37] Defs.' Mem. at 13.

[38] Once again, the Court emphasizes that this is summary judgment and the record, as it presently stands, is nothing more than the record prepared for the preliminary injunction hearing in Texas. Based upon the apparent and, thus far, unexplained inaction of the directors in the two months preceding Basell's offer despite knowing that the Company was "in play," Ryan is entitled to probe into the directors' motives and actions to determine whether they undertook to discharge their known fiduciary obligations in a sale scenario in good faith under the circumstances.

In short, the predicament in which the directors presently find themselves is entirely of their own making and the result of their impatience with the litigation process. That is perhaps understandable, but in these unusual circumstances where the directors were not in fact engaged in any type of sale process before deciding on short notice to sell the Company, Ryan is entitled to look into their actions to satisfy himself and the Court that the directors were sufficiently attentive

August 29, 2008
Page 18

The directors, in essence, seek to rely exclusively on the fortuity of an offered deal premium and an after-the-fact fairness opinion to sustain their conduct under the circumstances or, at the very least, their entitlement to exculpation for money damages.[39] They argue that, under the deadline imposed by Basell, they made a reasonable effort to inform themselves about the offer and that, even if they lacked complete knowledge to properly judge the adequacy of the offer, they violated only their duty of care. In the seven days during which the board considered Basell's offer, the Defendants' argument may be correct that only their duty of care is implicated. The problem, however, is that there was a two month window in which the directors knew (or should have known) that the Company was on the market and that they might receive an offer at any time. It is during those two months where they apparently chose not to take any specific action to prepare for a possible offer and sale.

to their fiduciary duties. Yes, undeniably, the directors, in this instance, managed to achieve a good result, but a fiduciary's discharge of his duties and obligations are not judged merely by the result he achieves.

[39] The directors may well have had sufficient knowledge of Lyondell's market in the summer of 2007 to satisfy *Barkan*'s single-bidder sale strategy. If that is so, the record simply is underdeveloped in that regard, and, thus, the directors are left with only a premium offer and a fairness opinion to support their argument that they acted properly under the circumstances.

August 29, 2008
Page 19

Moreover, after remaining passive for two months while knowing that the Company was "in play," when Basell finally delivered its offer, the directors did nothing (or virtually nothing) to verify the superiority of Basell's offer (aside from recognizing an obvious premium and obtaining a fairness opinion). Thus, when one views the totality of the directors' conduct on this record, that leads the Court to question whether they may have disregarded a known duty to act and may not have faithfully engaged themselves in the sale process in a manner consistent with the teachings of *Revlon* and its progeny. Whether that apparent failure to act ultimately rises to the level of something "more" that constitutes "bad faith" sufficient to deprive the directors' of the protection of Lyondell's exculpatory charter provision remains to be seen.[40] On summary judgment, however, it suffices that Ryan has established an issue of material fact with respect to the directors' diligent and faithful discharge of their known "*Revlon* duties," and for that reason the directors'

[40] *See* Opinion at 46 n.92 ("As the Court considers the record, the better inference, especially considering the potential consequences from losing the Basell Proposal, likely favors the Lyondell Defendants. The Court, however, cannot take the better inference on summary judgment to the exclusion of a less compelling, but still reasonable inference.").

August 29, 2008
Page 20

motion for summary judgment was properly denied to allow the parties to develop a better record of the directors' efforts in connection with the sale to Basell.[41]

B. *The Interlocutory Appeal*

Defendants' motion for certification of an interlocutory appeal is governed by Supreme Court Rule 42(b). In order to certify an appeal for interlocutory review under that rule, the Court's order must: (1) determine a substantial issue, (2) establish a legal right, and (3) comply with one of the additional five criteria listed in Rule 42(b)(i)-(v).[42] The Supreme Court typically accepts interlocutory appeals only where the circumstances are "extraordinary" or "exceptional."[43] In this

[41] Defendants posit that it "simply cannot be" that corporate directors acted in "bad faith" where they were properly motivated and incentivized to maximize shareholder value, generally aware of the value of the company, and able to secure and recommend a premium offer to the shareholders. Maybe so. The record as it presently stands, however, contains unexplained director inaction despite the Defendants' admittedly knowing that the Company was "in play" and also their presumably knowing the requirements of *Revlon* and its progeny for discharging their fiduciary duties in a sale scenario. Maybe the Defendants were motivated by a "good faith" belief that the Company was not in imminent danger of being sold; maybe they had a "good faith" belief that they knew what the Company was worth and were capable of evaluating any offers and negotiating with potential acquirers; or maybe, although it may be unlikely, they were not being attentive to their fiduciary obligations. Summary judgment is inappropriate where such questions exist in the record.

[42] DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 14.04, at 14-6 (2008).

[43] *Ryan v. Gifford*, 2008 WL 43699, at *4 (Del. Ch. Jan. 2, 2008).

August 29, 2008
Page 21

instance, Defendants essentially seek leave to appeal the Court's denial of summary judgment where the Court determined that it would be necessary and desirable to clarify the factual record in certain respects in order to determine the legal effect of Lyondell's exculpatory charter provision under these circumstances. Because the Court's Opinion does not satisfy the criteria of Supreme Court Rule 42, the Court must deny certification of Defendants' interlocutory appeal.

First, the Court's Opinion does not determine and resolve a substantial issue. In denying the Defendants, *for the time being*, the protection of Lyondell's exculpatory charter provision pending further development of the record with regard to the directors' good faith efforts to discharge their known fiduciary duties in connection with the sale of the Company to Basell, the Court, according to the Defendants, applied an incorrect concept of "bad faith." They advance this argument despite the Court's *quoting directly* the Delaware Supreme Court's definition of "bad faith" from *Stone v. Ritter*.[44] Defendants' argument is nothing more than an attempt to manufacture a legal issue to compensate for their failure to develop a sufficient factual record to enable the Court to conclude on summary

[44] Opinion at 55.

August 29, 2008
Page 22

judgment that the directors' perceived procedural shortcomings in connection with the sale of the Company to Basell amounted only to a breach of the directors' fiduciary duty of care. Thus, notwithstanding Defendants' consternation over the outcome on their summary judgment motion, the reports of the death of Section 102(b)(7) (and the consequent possibility for the "resuscitation" of a *Van Gorkom*-esque liability crisis) in Delaware law are greatly exaggerated both with regard to the application of Lyondell's exculpatory charter provision in this case, and certainly with regard to the application of a Section 102(b)(7) provision defense in any other case.

In considering the Defendants' Section 102(b)(7) defense on the limited summary judgment record, the Court simply looked to controlling Supreme Court precedents defining "bad faith" misconduct, and determined that issues of material fact existed regarding the directors' entitlement to the shield of Lyondell's exculpatory charter provision in light of an apparent failure to act despite the directors' knowledge that the Company was in play as of May 2007 and their knowledge that *Revlon* and its progeny require a board to make a diligent and good

August 29, 2008
Page 23

faith effort to attempt to secure the best transaction reasonably available to the stockholders.[45] To the extent the Opinion did not expound in sufficient detail regarding the Court's basis for determining that issues of material fact exist in the record, which preclude an application of the law regarding the directors' entitlement to exculpation to the facts at this time, the Opinion has been clarified in accordance with the Court's analysis above. Accordingly, for the reasons discussed herein, the Court's Opinion did nothing more than to assess the application (or potential application) of well-settled law under the peculiar and underdeveloped facts of this case, and, consequently, it did not determine a substantial issue material to the parties' dispute.

Second, the Opinion did not establish a legal right. Defendants assert in their brief in support of their motion for certification of an interlocutory appeal that

[45] *See, e.g., Equity-Linked Investors, L.P. v. Adams*, 705 A.2d 1040, 1054 (Del. Ch. 1997) (Under *Revlon*, "the board's duty of loyalty requires it to try in good faith to get the best price reasonably available. . . ."). Unlike a *Caremark* scenario in which director bad faith misconduct can be exhibited by a sustained and systematic failure of oversight, in the sale context, it seems that the directors (more than likely) have only one shot. They either choose to engage diligently and faithfully in the sale process to discharge their fiduciary obligations toward the corporation and the shareholders, or they do not. Here, unfortunately, there is unexplained inaction despite the directors' knowing that the Company was in play. Whether that inaction ultimately is fatal to the Defendants' entitlement to exculpation for any breaches of their duty of care is an open question of fact, but, in light of that inaction, the Court cannot conclude that there is no possible issue of "bad faith" in this record.

August 29, 2008
Page 24

"[h]ere the Court's decision to deny Defendants' motion for summary judgment under the erroneous legal definition of 'bad faith' – thereby depriving them of the protections of the Company's Section 102(b)(7) exculpatory charter provision and subjecting them to potential personal liability – clearly diminished Defendants' legal rights."[46] The Defendants' interpretation of the Opinion—that they have been "deprived" of the protection of the Company's exculpatory charter provision—is not only inaccurate, but, in fact, the Court stated repeatedly throughout the Opinion that on a more developed factual record the directors may very well either prevail on the merits of Ryan's *Revlon* claims or, alternatively, on their Section 102(b)(7) defense.

Moreover, under Supreme Court Rule 42, "a legal right is established where the court determines an issue essential to the position of the parties regarding the merits of the case, and a legal right generally is not established where either party may yet prevail at trial."[47] The Opinion clearly does not preclude the Defendants from prevailing on their Section 102(b)(7) defense at trial, or even on further motion practice after the factual record is better developed; the Court simply denied the defendants' motion for summary judgment *on the current record* in light of the open

[46] Defs.' Mem. at 18.
[47] WOLFE & PITTENGER, *supra* note 42, § 14.04[b], at 14-8 to -9.

August 29, 2008
Page 25

issues of material fact. Defendants can still prevail on their Section 102(b)(7) exculpatory charter provision defense once they establish (assuming they are able to do so) that the potential procedural shortcomings under *Revlon* and its progeny in fact amount to nothing more than a breach of their fiduciary duty of care. Accordingly, the Opinion did not establish a legal right.

Lastly, Defendants argue that interlocutory review of the Court's conclusion with respect to their Section 102(b)(7) defense might terminate the litigation or otherwise serve the interests of justice. Indeed, an early application of Lyondell's exculpatory charter provision to the facts of this case could be dispositive of Ryan's claims and could save the directors the time and expense of continuing to defend this litigation. Thus, an interlocutory appeal could terminate the litigation, which satisfies Supreme Court Rule 42(b)(v).[48]

[48] With that conclusion and in light of the discussion above, it is not necessary to consider the Defendants' argument that the Opinion "conflicts" with other Court of Chancery decisions, Defs.' Mem. at 21 n.12, or their conclusory argument that the "issue relates to the application of an important Delaware statute that should be settled by the Delaware Supreme Court." This is not an issue of first impression with regard to the application or interpretation of Section 102(b)(7)—it is merely an issue of applying well-settled law and legal principles to the unique, and not fully developed, facts of this case. The Court's decision to deny summary judgment to amplify the record for that purpose is hardly exceptional.

August 29, 2008
Page 26

Accordingly, because the Opinion did not determine a substantial issue or establish a legal right, the Defendants have failed to satisfy the standards of Supreme Court Rule 42.

C. *Conclusion*

For the foregoing reasons, the Defendants' motion for certification of an interlocutory appeal must be denied.[49]

An appropriate order will be entered.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-K

[49] The Defendants have argued that this action should be stayed pending appeal. The Court will stay this action pending the Delaware Supreme Court's resolution.

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

WALTER E. RYAN, JR., individually and on behalf of all others similarly situated,	:	
Plaintiff,	:	
v.	:	**C.A. No. 3176-VCN**
LYONDELL CHEMICAL COMPANY, DAN F. SMITH, CAROL A. ANDERSON, SUSAN K. CARTER, STEPHEN I. CHAZEN, TRAVIS ENGEN, PAUL S. HALATA, DANNY W. HUFF, DAVID J. LESAR, DAVID J.P. MEACHIN, DANIEL J. MURPHY, WILLIAM R. SPIVEY, BASELL AF, and BIL ACQUISITION HOLDINGS LIMITED,	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: December 5, 2007
Date Decided: July 29, 2008

Pamela S. Tikellis, Esquire, Robert J. Kriner, Jr., Esquire, A. Zachary Naylor, Esquire and Scott M. Tucker, Esquire of Chimicles & Tikellis LLP, Wilmington, Delaware and Clinton A. Krislov, Esquire and Jeffrey M. Salas, Esquire of Krislov & Associates, Ltd., Chicago, Illinois, Attorneys for Plaintiff.

Jesse A. Finkelstein, Esquire, Daniel A. Dreisbach, Esquire, Geoff G. Grivner, Esquire, Meghan M. Dougherty, Esquire, and Meredith M. Stewart, Esquire of Richards, Layton & Finger, P.A., Wilmington, Delaware, and David D. Sterling, Esquire and Paul R. Elliott, Esquire of Baker Botts LLP, Houston, Texas, Attorneys for Defendants Lyondell Chemical Company, Dan F. Smith, Carol A. Anderson, Susan K. Carter, Stephen I. Chazen, Travis Engen, Paul S. Halata, Danny W. Huff, David J. Lesar, David J.P. Meachin, Daniel J. Murphy, and William R. Spivey.

Edward P. Welch, Esquire, Edward B. Micheletti, Esquire, Jenness E. Parker, Esquire, Rachel I. Jacobs, Esquire, and Joseph O. Larkin, Esquire of Skadden, Arps, Slate, Meagher & Flom LLP, Wilmington, Delaware, Attorneys for Defendants Basell AF and BIL Acquisition Holdings Limited.

Noble, Vice Chancellor

I. INTRODUCTION

In this shareholder class action, Plaintiff Walter E. Ryan, Jr. ("Ryan") challenges the $13 billion cash for shares merger transaction (the "Merger") among Defendant Basell AF ("Basell"), its acquisition subsidiary, Defendant BIL Acquisition Holdings Limited,[1] and Defendant Lyondell Chemical Company ("Lyondell" or the "Company"). Before the Court are Defendants' motions for summary judgment.[2] On its face, the Merger offering the Lyondell stockholders $48 per share in cash, a substantial premium to market,[3] was very attractive; indeed, the Lyondell stockholders voted overwhelmingly in its favor, and the Merger was consummated on December 20, 2007.[4] Once one scratches the patina of this "blowout" market premium, however, a troubling board process emerges.

When this transaction materialized in the late spring and early summer of 2007, Lyondell was a financially strong and viable company. It was not in financial distress; it was not looking to raise capital; it was not looking to spin-off one of its divisions; and it was not otherwise "for sale" or "on the auction block." Lyondell's board of directors (the "Board") had neither sought the advice of investment bankers to value the Company, nor was it actively seeking strategic business partners.[5]

In response to Basell's unsolicited offer for the Company, the Board avoided an active role in negotiating the Merger, instead delegating much of that task to Lyondell's Chairman and Chief Executive Officer, Dan F. Smith ("Smith"). The Board never conducted a formal pre-signing market check to determine whether a better price could be obtained; in addition, it was not able to negotiate successfully for a post-signing go-shop period and, thus, did nothing post-signing to confirm that a better price could not have been obtained. The final merger agreement also employed several deal protection devices, including a no-shop provision, matching rights, and a $385 million break-up fee.[6] Moreover, the whole deal was considered, negotiated, and approved by the Board in less than seven days.

[1] References to Basell may also include BIL Acquisition Holdings Limited, as appropriate.

[2] Lyondell and the individual defendants (sometimes, collectively, the "Lyondell Defendants") have moved separately for summary judgment and have joined in Basell's brief in support of its motion for summary judgment. Throughout this memorandum opinion, "Defendants" refers collectively to all of the defendants.

Ryan has filed a brief in opposition to Defendants' motions; however, he seeks additional discovery pursuant to Court of Chancery Rule 56(f) and, therefore, asserts that resolution of the motions at this point is premature.

[3] Characterized by the Defendants as a "blowout" price, $48 per share represents a 45% premium over the closing share price on May 10, 2007, the last trading day before the public became aware of Basell's interest in Lyondell, and a 20% premium over Lyondell's closing price on July 16, 2007, the day before the Merger was publicly announced.

[4] The Merger has occurred and the Court cannot undo it. Ryan did not seek any interim equitable relief.

[5] As will later be discussed, a Basell affiliate's acquisition of a right to purchase a block of Lyondell shares and its related Schedule 13D filing with the SEC in May 2007 effectively put the Company (and the market) on notice that some transaction might be in the offing. The Board did not respond to that development as if the Company were actively "in play"; instead, it opted for a more conservative "wait and see" approach because the Company "had not been put up for sale and [the Board] still had no intent of selling." Transmittal Affidavit of Scott M. Tucker Exhibit ("Tucker Ex. ___") 1 (Deposition of Dan F. Smith at 35).

[6] Lyondell also had a shareholder rights plan (*i.e.*, a "poison pill"). The Board eventually pulled the pill with respect to Basell but, otherwise, the pill remained "active" against other unsolicited bids.

It is against that factual backdrop that Ryan brought this action and the Court considers the present motions. Notwithstanding the premium price and enthusiastic shareholder approval, Ryan alleges that the directors were looking out only for their own self-interest and that the process by which the Merger was approved and recommended to the Lyondell stockholders was fatally flawed for three reasons. First, the Board began and concluded its review of the transaction over the course of a mere seven day period. Given the frenetic pace at which this deal evolved, Ryan contends that the Board could not possibly have informed itself as to the value of the Company and the wisdom of this transaction for the Lyondell stockholders. Second, the Board never conducted a market check or otherwise "shopped" Basell's offer to determine if $48 per share was indeed the highest value reasonably attainable by the Lyondell stockholders. Third, Ryan claims that the deal protection devices agreed to by the Board were unreasonable and essentially "locked up" this transaction for Basell by precluding other bidders from making an offer for the Company.

Ryan also alleges that the Lyondell Defendants breached their disclosure duties in connection with the proxy materials soliciting stockholder approval of the Merger. Consequently, the Lyondell stockholders, in Ryan's view, were uninformed in their decision to approve the Merger at $48 per share. Finally, in

addition to the preceding claims against the Lyondell Defendants, Ryan asserts aiding and abetting claims against the Basell Defendants.

The Board counters that it was adequately informed of the value of Lyondell both in the then-current mergers and acquisitions market and as a going concern. In its view, the financial projections and valuations prepared by Lyondell management were adequate to navigate the negotiation phase of the Merger,[7] and it points out that, in any event, Basell's offer ultimately was blessed with a fairness opinion by Lyondell's independent investment banker, Deutsche Bank. The Lyondell Defendants also contend that it was well known to the markets that the Company was in play long before the Merger was announced and that not even a serious expression of interest, much less a competing bid, was forthcoming. In addition, from the time when the Merger was announced until it closed, no topping bid was received, which, they claim, is further proof that Basell had offered a superior premium for the Company. In short, the Board claims to have known the market in the summer of 2007 and the status of other potential acquirers, and it was reasonably confident, particularly given Basell's substantial initial offer, that another bid was unlikely.

As for Ryan's criticisms of the mechanics of the sale process, the Board maintains that it considered the possibility of conducting an auction, but the

[7] Indeed, management's projections were more bullish than the investment banker's projections of Lyondell's future performance.

directors worried that a poorly received auction would have risked losing Basell's offer and depressed the value attainable by the shareholders. In addition, the directors contend that they pushed Basell as far as it would go on price, and they even sought other consideration, such as a go-shop and a significant reduction in the break-up fee—concessions Basell simply would not give. More importantly, however, in the view of the Board, all of this was adequately disclosed to the shareholders and they had a very simple choice to make: take Basell's enticing offer or reject it and wait for something better to come along (or just continue with Lyondell's successful operation). The Lyondell stockholders overwhelmingly chose to sell.

This case arises from the intersection of two fundamental tenets of Delaware corporate law. The first set of principles, known colloquially as "*Revlon* duties,"[8] requires a board, when it undertakes a sale of the company, to set its singular focus on seeking and attaining the highest value reasonably available to the stockholders. The Defendants extol the virtues of the "blowout" price paid by Basell. In this instance, however, the Board took no affirmative action to confirm that a better deal could not be obtained and, for summary judgment purposes, the record does not show that the Board was so knowledgeable about the value of the Company that no further effort was appropriate.

[8] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

The second set of principles, generally addressed in *Unocal*[9] and *Omnicare*,[10] requires that deal protection measures must not be preclusive or coercive and, more importantly for present purposes, that such measures be reasonable in light of the circumstances. The Defendants support the deal protection measures by arguing that they were reasonable and necessary to secure Basell's offer for the Lyondell shareholders. They have not, however, been able to explain why deal protection measures of the scope adopted were appropriate under these circumstances. In short, the Board did nothing (or virtually nothing) to confirm the superiority of the price but, nonetheless, it provided Basell a full complement of deal protections. Maybe the price was the "blowout" the Defendants proclaim it to have been—it certainly was a "fair" price—and maybe the deal protection measures were reasonable and proportionate to the risks that the deal would not materialize otherwise, but those conclusions cannot be reached on the current record on summary judgment where the Court is precluded from choosing between plausible inferences. Accordingly, for the reasons that will be developed below, the Lyondell Defendants' motion for summary judgment with

[9] *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).
[10] *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003).

respect to Ryan's *Revlon* claims and his challenge to the deal protection measures will be denied.[11]

With respect to Ryan's other claims against the Lyondell Defendants—his structural loyalty and disclosure claims—the Court grants the Lyondell Defendants' motion. The undisputed evidence shows that the members of the Board were not motivated by self-interest to approve the Merger. Moreover, Ryan has not challenged the independence of the ten non-management directors from the proponents of this transaction. As for the disclosure claims, the proxy materials sent to the Lyondell stockholders disclosed, in a full and accurate manner, most of the material information to which the stockholders were entitled. One minor, although perhaps material, defect exists in the disclosures concerning Deutsche Bank's financial analyses.[12] Nevertheless, the Court concludes that, at worst, the failure to disclose amounted only to a breach of the Board's duty of care. Accordingly, Lyondell's exculpatory charter provision adopted in accordance with

[11] The Lyondell Defendants invoke the exculpatory provision of the Company's charter authorized by 8 *Del. C.* § 102(b)(7). As explained more fully *infra* in Section III(B)(2)(d), that defense is not now available on summary judgment because the Board's apparent failure to make any effort to comply with the teachings of *Revlon* and its progeny implicates the directors' good faith and, thus, their duty of loyalty, thereby, at least for the moment, depriving them of the benefit of the exculpatory charter provision.

The Lyondell Defendants also point to the overwhelming support of their shareholders for the transaction as a basis for claiming shareholder ratification. Ratification, at this point, does not meet the objectives of the Lyondell Defendants for the reasons discussed *infra* in note 129.

[12] Ryan made no effort to seek interim injunctive relief—even though he had ample time—that easily could have resulted in the cure of any minor defect that may have existed in the proxy disclosures.

8 *Del. C.* § 102(b)(7) precludes an award of money damages resulting from this breach of the Board's fiduciary duties, and, thus, the Lyondell Defendants are entitled to summary judgment on these claims.

Finally, Ryan seeks to impose liability on the Basell Defendants as aiders and abetters of the Lyondell Defendants' fiduciary breaches. Basell, however, as demonstrated by the undisputed material facts of record, negotiated at arm's-length with an independent Board. Accordingly, the Basell Defendants are entitled to summary judgment on Ryan's aiding and abetting claims.

II. FACTUAL BACKGROUND

A. *The Parties*

Ryan was the owner of an unspecified number of shares of Lyondell common stock.

Lyondell is a Delaware corporation consisting primarily of two divisions—commodity chemicals and refining. It was the third-largest independent, publicly traded chemical company in North America, as well as a leading global manufacturer of chemicals and plastics, a refiner of heavy, high-sulfur crude oil, and a significant producer of fuel products.

Smith was Lyondell's Chairman and Chief Executive Officer. Defendants Carol A. Anderson, Susan K. Carter, Stephen I. Chazen, Travis Engen, Paul S. Halata, Danny W. Huff, David J. Lesar, David J.P. Meachin, Daniel J. Murphy,

and William R. Spivey were well-credentialed, independent directors of Lyondell (collectively, the "Independent Directors").[13] The Independent Directors, together with Smith, constituted the entire eleven-member Board (sometimes, also, collectively, the "Individual Defendants" or the "Board").

Basell, a Luxembourg company with joint ventures and manufacturing operations in nineteen countries, is the global leader in polyolefin technology, production, and marketing. It is privately owned by Access Industries ("Access"), which is not a party to this lawsuit. BIL Acquisition Holdings Limited is a Delaware corporation formed by Basell for the purpose of effecting the Merger.[14]

B. *Background of the Merger*

Access and Basell first expressed interest in Lyondell in April 2006 at an introductory meeting between Smith and Leonard Blavatnik ("Blavatnik"), the Chairman and President of Access. Smith informed Blavatnik that Lyondell was not for sale but that the Board was always willing to consider proposals to create value for its shareholders. That introductory meeting led to subsequent discussions,[15] and Basell eventually sent a letter of interest to Lyondell offering to buy the Company within a range of $26.50 to $28.50 per share. The Board

[13] Ryan does not allege, nor has he offered any evidence to suggest, that the Independent Directors were beholden to any of the proponents of this transaction.
[14] As noted, "Basell" may refer collectively to Basell AF and BIL Acquisition Holdings Limited.
[15] A potential purchase price range of $24 to $27 per share had been suggested in the early discussions.

considered that offer, but determined that it was inadequate and not in the best interests of the Lyondell stockholders.[16]

After Basell's solicitation in the late summer of 2006, Lyondell did not receive any other indications of interest, nor was it in a position that would have required the Board to raise capital or seek out a strategic partner. In fact, the Company was quite strong and financially viable—it had retired several billion dollars of debt under its long range strategic plan, and it planned to pay down an additional two billion dollars of debt by the end of 2008. In addition, Lyondell was active in the mergers and acquisitions market as a buyer, and it hoped its continued efforts to retire debt would improve its credit rating and, therefore, its access to the credit markets. The Company anticipated that these efforts would continue to translate into positive performance of its stock price over both the near and long term. Thus, Lyondell was not prepared (or looking) to sell itself in the spring of 2007 when Blavatnik (through an Access affiliated company) acquired a right to purchase all of the Lyondell shares owned by Occidental Petroleum Corporation ("Occidental"), Lyondell's second largest shareholder.[17]

[16] Transmittal Affidavit of Jenness E. Parker Exhibit ("Parker Ex. ___") 11 (letter from Lyondell to Blavatnik and Access rejecting offer). At the time, Lyondell had just acquired CITGO Petroleum Corporation's interest in a refining joint venture between the two companies; thus, the Board believed that better value would be achieved for the stockholders by following Lyondell's strategic plan. Tucker Ex. 1 (Smith Dep. at 17; 23-28).
[17] At the time, Occidental owned 20,990,070 shares, approximately 8.3% of the outstanding Lyondell stock (the "Occidental bloc"). The Occidental bloc was sold through a series of

The Occidental bloc was subject to a shareholders agreement, which contained, among other things, a standstill provision and limitations on the disposition of the Lyondell securities. At a board meeting on May 3, 2007, Stephen Chazen ("Chazen"), a director of Lyondell and Occidental's Chief Financial Officer, informed Smith and the Board of Occidental's intention to sell its stake in Lyondell, through a securities intermediary, in a manner legitimately designed to avoid and terminate the shareholders agreement. In addition, Chazen informed the Board of his belief (though, he was not certain) that Blavatnik and Access would purchase the Occidental bloc.[18] That development raised concerns, but the Board did not take any specific action in response.[19]

agreements and forward contracts. Blavatnik intended eventually to acquire the entire Occidental bloc. Tucker Ex. 4 (Schedule 13D).

[18] Tucker Ex. 3 (Definitive Proxy Statement (the "Proxy") at 19). Ryan disputes the Proxy's representation that Chazen identified Blavatnik and Access as the potential purchaser of the Occidental bloc during the May 3, 2007, Board meeting because, according to the minutes of that meeting, Chazen stated that "he is not aware for certainty [sic] of the identity of the ultimate buyer." Tucker Ex. 5. The minutes, however, do not necessarily contradict the Proxy. Tucker Ex. 3 (Proxy at 19). Smith's deposition confirms the Proxy's representation that Occidental had informed Lyondell that Blavatnik might be the acquirer of its shares:

> Q. Did you have any inkling, prior to May 11th, that Mr. Blavatnik was in the process of trying to acquire Lyondell shares?
>
> A. Yes. Third party, if you will. Again, through the disclosures in here, you see that Occidental had told us of their intent to exit their position. And in the process of doing that, shared with us that they thought through this complicated sequence of events, that it was likely that Mr. Blavatnik was recipient, on the other end, ultimately of these shares.

Tucker Ex. 1 (Smith Dep. at 33).

[19] In all likelihood, the Board probably realized that, even if it wanted to, it could not prevent Occidental from selling its shares to Blavatnik (or to anyone else for that matter); the record is

11

On May 11, 2007, an Access affiliate[20] filed a Schedule 13D with the Securities and Exchange Commission ("SEC") disclosing its right to acquire the Occidental bloc through a series of forward contracts with Merrill Lynch, Pierce Fenner & Smith, Inc. The 13D further stated Blavatnik's intent possibly to engage Lyondell in discussions regarding various transactions between Lyondell and other Access affiliates. In response, the Board convened a special meeting that same day to discuss Blavatnik's move and his possible intentions with respect to the Company. The Board decided, however, that no immediate response was required and that it would await the reaction of the market and Lyondell's major shareholders to Blavatnik's move. It also decided to wait and see if any suitors would express an interest in the Company in light of the 13D's signal to the market that Lyondell was "in play."

clear that Occidental found a loophole in the shareholders agreement. Ryan has made much ado in his brief and at oral argument about the Board's failure to act in response to this development, but he has not articulated a persuasive argument for why it even matters in the grand scheme of this transaction. The Occidental bloc was not a control bloc and, in reality, gave Blavatnik only minimal, if any, leverage in his bid to acquire the Company. For better or for worse, the sale of the Occidental bloc was legitimately designed to avoid the operation of the shareholders agreement, and the fact of the matter is that it ultimately had little effect, if any, on the course of events leading to Basell's offer for Lyondell, except that it may have signaled to the market that Lyondell was "in play."

[20] AI Chemical Investments, LLC, a Delaware limited liability company, was formed for the purpose of acquiring the Occidental bloc. Blavatnik is the sole member of that company. For purposes of this memorandum opinion, the Court may refer to the acquisition entity that filed the 13D as either "Access" or "Blavatnik."

12

That wait was not long. Three days later, on May 14, 2007, a representative of Apollo Management, L.P. ("Apollo"), a private equity group that was active in the commodity chemicals segment of the market, contacted Smith to see if Lyondell management would be interested in a management-led leveraged buyout transaction. Smith flatly rebuffed Apollo's solicitation, however, apparently because he and the other members of Lyondell management viewed such transactions as fraught with inherent conflicts of interest for both management and the Board.[21] Aside from Apollo's passing overture on the heels of Blavatnik's 13D filing, Lyondell received no other expressions of interest. The market, as expected, reacted favorably to the 13D filing, with Lyondell's common stock trading up from a closing price of approximately $33 on May 10, 2007, to approximately $37 on May 11, 2007, the day the 13D filing was made public (a one-day gain of about 11%). Lyondell's stock price continued to oscillate around $37 over the ensuing weeks[22] with the market atwitter in anticipation of a deal.[23]

Despite the market's expectations, all remained quiet on the Access front. Smith and Blavatnik attempted to schedule a meeting, but their conflicting travel schedules prevented that from occurring sooner than July 9, 2007. In the meantime, Smith met with Basell's Chief Executive Officer, Volker Trautz

[21] Tucker Ex. 1 (Smith Dep. at 40-42).
[22] Parker Ex. 5 (Stock Price Data).
[23] *See, e.g.*, Parker Ex. 10 (Joseph Chang, *Blavatnik puts Lyondell in Play*, ICIS CHEMICAL BUSINESS, May 21, 2007)

("Trautz"), in London in early June. Evidently, Smith was contemplating (or, at least, anticipating an offer for) a possible sale of the Company to Basell by that point and, according to an email sent from Trautz to Blavatnik, Smith had suggested to Trautz that a price of $48 per share for Lyondell would be "justified."[24] The Board, however, was largely unaware of Smith's activities and contacts with Blavatnik and Trautz during this period. Moreover, despite the signals sent to the market by Blavatnik's 13D filing in May (and Smith's apparent anticipation of a transaction), the Board was indolent, making no effort to value the Company or to assess what options might be on the table *if* Basell (or another acquirer) made a move to acquire Lyondell.

On June 26, 2007, in a perhaps unexpected turn of events from Lyondell's perspective, Basell and Huntsman Corporation ("Huntsman"), another chemical manufacturer, announced a $9.6 billion transaction whereby Basell would acquire Huntsman for $25.25 per share in cash. For the moment, it appeared that Access had moved on and set its sights on another target. On July 4, 2007, however, Huntsman announced that it had received a competing proposal of $27.25 per share in cash from Hexion Specialty Chemicals, Inc. ("Hexion"), an Apollo affiliate, and was pursuing discussions on that proposal under the "fiduciary out" provision in its

[24] Tucker Ex. 13 (Email from Trautz to Blavatnik).

merger agreement with Basell. Blavatnik immediately contacted Smith to confirm their previously scheduled meeting on July 9. Smith did not inform the Board of this development.

At the meeting on July 9, 2007, Blavatnik expressed to Smith his interest in an all-cash acquisition of Lyondell. Blavatnik initially suggested that he could pay $40 per share for the Company. Smith informed Blavatnik that he would relay any serious offer to the Board but also that he viewed $40 per share as too low and believed the Board would agree. Over the course of the meeting, Blavatnik eventually increased his offer to a range between $44 and $45 per share. Smith reiterated that he would relay any serious offers, but he again told Blavatnik that, in his opinion, it was doubtful that the Board would accept an offer in that range; Smith further advised that if Blavatnik was serious about acquiring Lyondell, he should make his "best" offer for the Company because it really was not on the market. Blavatnik told Smith he needed more time to consider his position and he requested Smith to call him from the airport later that day before Smith left for a previously scheduled Board meeting in Holland. As requested, Smith called Blavatnik shortly before his flight was scheduled to depart and Blavatnik made his "best" offer for the Company: $48 per share in cash[25] if the Board would sign a

[25] Blavatnik's offer of $48 per share for Lyondell caused great consternation for the Basell and Access executives involved in this transaction, or so the Defendants want the Court to believe. *See, e.g.*, Parker Ex. 7 (Email from Alan Bigman to Blavatnik ("I am uncomfortable with the

merger agreement by July 16, 2007, and agree to a $400 million break-up fee[26] (the "Basell Proposal"[27]). Blavatnik further stated that the Basell Proposal would have committed financing, so there would be no financing contingency.[28] Smith agreed to take the Basell Proposal to the Board.

C. *The Board's "Hasty" Consideration of the Basell Proposal*

Smith called a special meeting of the Board upon his arrival in Holland on July 10, 2007, to announce and discuss the Basell Proposal.[29] During a fifty minute meeting, Smith presented Blavatnik's offer and the Board held preliminary discussions. The Board reviewed certain valuation materials regarding the

[Lyondell] valuation—it is almost $5 billion more than we were offering a year ago and over $2 billion more than we were discussing just a few weeks ago. The issue with [Merrill Lynch] . . . is another indication that we're on the edge here.")); Parker Ex. 7 (Email from Philip Kassin to Lincoln Benet ("I hate the deal at $48. . . .")); Tucker Ex. 9 (Kassin Dep. at 36 (noting that $48 was, in his view, a "ludicrous" price for Lyondell); *id.* at 95 ("MR. STERLING: [W]hy did you vote against the deal in your capacity as a [Basell] board member? MR. KASSIN: I felt that 48 was too full a price based on both intrinsic valuation as well as market valuation of Lyondell. MR. STERLING: And I believe you said . . . Mr. Volker Trautz voted the same way you did? MR. KASSIN: I do not know on the Basell record whether he voted against it. I do know as some of the exhibits that have been shown, that Mr. Trautz was not in agreement with the 48."); *id.* at 103 ("MR. KASSIN: [T]he line was in the sand that Mr. Blavatnik drew that we were going to do this at 48. My job was to get out and get financing of this at 48. I felt the 48 was a ridiculous price and we should have bought Huntsman instead. And I was very concerned about getting my financing.")).

[26] Other deal protection measures (a no-shop provision and matching rights) were included in the merger agreement as the result of later negotiations.

[27] Basell was the Access subsidiary (and operating entity) designated to acquire Lyondell.

[28] Indeed, the Lyondell transaction came on the cusp of the credit crunch that slowed large-scale merger activity in the latter part of 2007 and thereafter, and the Basell executives were worried that they might not get adequate financing. *See generally* Tucker Ex. 9 (Kassin Dep. at 103-05).

[29] The Board was overseas at the time for a previously scheduled board meeting and several days of activities related to Lyondell's operations abroad.

Company which Lyondell management had prepared for the Board's regular meetings scheduled for July 11 and 12, 2007. The Board also discussed the status of Hexion's and Basell's offers for Huntsman, as well as the likelihood that another party might be interested in acquiring Lyondell. At the conclusion of the meeting, the Board directed Smith to seek a written offer from Basell, including detailed information about its financing. The Board then recessed its deliberations on the Basell Proposal until July 11. Smith, as directed by the Board, contacted Blavatnik who promised that the Board would receive a written proposal and details on his financing in due time. In the meantime, however, Blavatnik stated that he needed a firm indication of interest in the Basell Proposal from the Board by the end of the day on July 11, the deadline for Basell to propose a higher price for Huntsman, if it so desired.

The Board reconvened on July 11 to consider further the Basell Proposal and Blavatnik's request for a firm indication of interest. During a forty-five minute meeting, the Board claims to have thoroughly considered several aspects of the Basell Proposal, including: comparing the benefits to the Lyondell stockholders of the Basell transaction with those of remaining independent, the valuation of certain Lyondell assets, the process likely to be involved in a transaction with Basell, engaging the services of an investment bank to serve as a financial advisor for the Basell Proposal, and the impact of Basell's possible acquisition of Huntsman on its

ability also to acquire Lyondell at some later date.[30] Smith also advised the Board that there had been no specific discussions with Blavatnik about whether members of Lyondell management would be offered positions in the post-merger company.[31] Thus, after "careful" consideration, the Board formally authorized Smith to negotiate with Blavatnik regarding the Basell Proposal. The Board also decided to reconvene to consider the matter further on July 16, the deadline to accept the Basell Proposal, but the directors agreed to be available in the meantime if needed by management.

[30] Tucker Ex. 3 (Proxy at 22). Specifically, the meeting minutes describe the Board's discussion as follows:

> The Board discussed that only the Board has final approval authority to recommend a merger or cash offer to the shareholders . . . . Discussions ensued regarding the potential path forward to maximize shareholder value, whether to remain a stand-alone entity and pursue the current Long Range Plan or to proceed with a potential transaction . . . . The Board then discussed the potential terms of the transaction, including the cash offer and the fact that the Board would insist upon no financing or other contingencies (except regulatory or shareholder approvals). The Board compared this potential transaction to Mr. Blavatnik's current proposed transaction with Huntsman Chemicals. The Board discussed the impact on the Company's stock price and other negative factors if this transaction were to be announced but not successfully completed. There was an extensive discussion of strategic paths for the Company as compared to this potential transaction, including the potential value of the refinery, the China joint venture and other developments in the Company's Long Range Plan . . . . A discussion followed regarding disclosure obligations, potential timing of discussions and timing for a special meeting of the Board to consider the proposed transaction. The Board then discussed the status of the proposed Basell transaction with Huntsman and the impact on this potential transaction between Lyondell and Basell . . . . The Board then discussed Mr. Blavatnik's background and history and their fiduciary duties as discussions progress."

Parker Ex. 3 (Minutes of July 11, 2007 board meeting).

[31] Tucker Ex. 3 (Proxy at 22); Parker Ex. 3 (Minutes of July 11, 2007 board meeting).

Following the board meeting on July 11, work on the Basell Proposal moved forward quickly. Smith advised Blavatnik that the Board was favorably inclined to the transaction. Representatives of Basell and Lyondell discussed Basell's preliminary due diligence requests and the terms of a confidentiality agreement. Lyondell also retained the services of Deutsche Bank Securities, Inc. ("Deutsche Bank") to serve as its financial advisor for the Basell Proposal.[32] In addition, Basell abandoned its pursuit of Huntsman and issued a press release stating that it would not increase its bid for that company.[33]

On July 12, 2007, the Board met again for its previously scheduled regular meeting to discuss the routine business of Lyondell; it also held an executive session during that meeting to discuss the merits of the Basell Proposal without members of Lyondell management, other than Smith, present. Meanwhile, representatives of Lyondell and Basell were discussing the terms of Basell's financing, overseeing the due diligence process, and negotiating the terms of a definitive merger agreement. Deutsche Bank, for its part, was working feverishly to put together a fairness opinion for the Basell Proposal. That effort included compiling a list of potential strategic partners who might be interested in Lyondell,

[32] The written engagement letter was signed on July 14, 2007. Parker Ex. 13.
[33] Hexion and Huntsman announced a definitive merger agreement valued at approximately $10.6 billion (including assumption of certain debt) on July 12, 2007, and paid Basell a $200 million break-up fee under the Basell-Huntsman merger agreement.

but, in accordance with Lyondell's instructions, Deutsche Bank did not attempt to solicit any competing offers for the Company.

Due diligence and negotiation of the terms of the merger agreement continued throughout July 13 and 14. On July 15, 2007, Smith contacted Blavatnik to discuss the status of the Basell Proposal and the proposed terms of the merger agreement. He stated that the Board was concerned that this transaction had moved quickly and that it wanted to be certain it had attained the best price for the Lyondell stockholders. Smith therefore requested four concessions from Blavatnik: (1) an increase in Basell's offer price; (2) a go-shop provision in the merger agreement to allow the Board to seek other potential buyers for a period of forty-five days following the execution of the merger agreement; (3) a break-up fee of 1% during the go-shop period; and (4) a reduction in the $400 million break-up fee after the go-shop period ended. Those requests, evidently, were not well received by an incredulous Blavatnik who stated unequivocally that he had offered his best price and a substantial premium for Lyondell and that it was essential to him that the transaction be agreed to and finalized quickly upon his terms. He nevertheless relented and agreed to reduce the break-up fee from $400 million to $385 million as a showing of good faith; otherwise, he flatly refused Smith's attempts to improve the terms of the deal.

The Board received the proposed merger agreement and related materials late in the day on July 15, 2007, and a letter detailing the fully committed financing for the Basell Proposal on July 16.[34] The Board then convened its previously scheduled meeting to address the proposed merger between Basell and Lyondell. The Board initially discussed the general terms and conditions of the merger agreement, which included several deal protection devices: a $385 million termination fee,[35] a no-shop clause, and matching rights for Basell. In addition to the deal protection measures contained in the merger agreement, Lyondell had in place a previously adopted shareholder rights plan (*i.e.*, a "poison pill"), which it later pulled with respect to the Basell Proposal.[36] The Board also heard presentations from Lyondell management and from Lyondell's legal advisors concerning the structure of the transaction and its ability to consider superior proposals, should any emerge, under a typical "fiduciary out" provision in the merger agreement.[37]

[34] Tucker Ex. 17.
[35] The termination fee amounts to approximately 3% of the equity value of this transaction, or approximately 2% of Lyondell's enterprise value.
[36] Because the Board did not pull the pill altogether, the rights plan technically remained in effect against other potential bidders for Lyondell. Ryan asserts that the Board's failure to pull the pill served as yet another draconian deal protection for the Basell Proposal. Although the Board could not have employed the plan to thwart another bidder for Lyondell to Basell's benefit under Delaware law, see *infra* note 93, the existence of a poison pill was yet another hurdle (*i.e.*, transaction cost) a potential bidder would have to overcome to acquire Lyondell and, thus, may have deterred potential bidders to some limited extent.
[37] Tucker Ex. 14 (Merger Agreement § 4.2).

Lyondell's financial advisor, Deutsche Bank, then presented its financial analyses and conclusions regarding the financial fairness of the Basell Proposal, as well as its opinion as to the likelihood that Lyondell might receive a superior proposal. Deutsche Bank had performed several valuation exercises in an effort to assess the fairness of the Basell Proposal,[38] using both more "bullish" financial projections based on Lyondell management's views (the "Management Case") and more "conservative" financial projections based on a consensus equity analyst view (the "Street Case"). Given the Management Case financial projections, the DCF and LBO analyses yielded a valuation range for Lyondell between $37 and $47 per share and $44.75 and $51.50 per share, respectively.[39] Given the Street Case financial projections, the DCF and LBO analyses yielded a valuation range for Lyondell between $30 and $39 per share and $32.25 and $38.50 per share, respectively.[40] The maximum projected value for Lyondell—$58.50 per share—was derived under a sum of the parts comparable company analysis, with certain *pro forma* adjustments.[41] On the basis of its various analyses, Deutsche Bank concluded that $48 per share was indeed a fair price for the Lyondell stockholders.

[38] The valuation exercises included: an historical stock price performance analysis; an analysis of selected publicly traded "competitor" companies; an analysis of selected precedent transactions; a discounted cash flow analysis ("DCF"); and a leveraged buyout analysis ("LBO").
[39] Tucker Ex. 25 (Fairness Presentation at 17, 25, 27).
[40] *Id.* (Fairness Presentation at 17, 26, 28).
[41] *Id.* (Fairness Presentation at 17, 21).

The investment bankers also identified for the Board twenty other companies that might have an interest in acquiring Lyondell, but they presented various reasons why they believed no other suitor had yet come forward with a bid and why, in their opinion, none would be likely to top Basell's offer of $48 per share.

After listening to the presentations of management and its legal and financial advisors and fully appreciating that Blavatnik was driving a very hard bargain vis-à-vis their fiduciary obligations in a sale scenario, the Board deliberated on the Merger. Thereafter, the Board voted unanimously to approve and recommend the Merger to the Lyondell stockholders. Basell's offer presented an opportunity for the stockholders to earn a substantial premium over the market price of Lyondell shares and, in the view of the Board, was simply too good not to pass along for their consideration.[42]

The Merger was jointly announced by Lyondell and Basell before the opening of the markets on July 17, 2007. A preliminary proxy statement was filed with the SEC on August 14, 2007. The Proxy was filed on October 12, 2007.[43] A

[42] Indeed, the Board recognized the risk that *failing* to pass along such a premium offer likely would have subjected them to a host of lawsuits from disgruntled shareholders. *See, e.g.*, Tucker 1 (Smith Dep. at 55-56 ("MR. ODDO: What were your thoughts about the 48-dollar proposal? MR. SMITH: Golly gee, that's a lot of money. If that's not a take-out, I've never seen a take-out price. If you look at the prospects, if you look [at] the way the market valued us . . . we got the value up into the low 30s . . . [Lyondell was] pretty well valued in the market at that level. This was 50 percent greater than that value. When I looked at our prospects, if we did everything right and had all the breaks over the next five years, frankly, I couldn't see that we could get to a market price of 48. That was one where the shareholders would fire us if we didn't take it.")).
[43] Tucker Ex. 3.

special meeting of the Lyondell stockholders was held on November 20, 2007, to consider the proposed merger with Basell. The Merger garnered the near unanimous support of the Lyondell stockholders voting at the meeting,[44] and the transaction closed on December 20, 2007.

D. *The Litigation in Texas and Delaware*

The first shareholder class action lawsuit challenging the Merger, and raising claims similar to those asserted by Ryan in this action, was filed in Texas on July 23, 2007.[45] Ryan, although not a party to that suit, actively participated in the Texas litigation, specifically in order to prepare for a preliminary injunction hearing, which was held there on November 9, 2007.[46] In connection with that effort, Ryan received nearly 200,000 pages of documents and has had an opportunity to depose several witnesses concerning the Merger.

[44] 168,008,513 shares out of 253,625,523 outstanding Lyondell shares (approx. 66.23%) were voted at the meeting. The results of the vote on the Merger were as follows:

	FOR	AGAINST	ABSTAIN
BENEFICIAL COMMON	166,033,511	715,935	358,891
REGISTERED COMMON	861,770	31,992	6,414
TOTAL SHARES VOTED	166,895,281	747,927	365,305
% OF VOTED	99.33%	0.44%	0.21%
% OF OUTSTANDING	65.80%	0.29%	0.14%

Chart adapted from Parker Ex. 15.
[45] *Plumbers and Pipefitters Local 51 Pension Fund v. Lyondell Chemical Co.*, Cause No. 2007-43958 (80th Jud. Cir. Harris Cty., TX). Ryan filed this action on August 20, 2007.
[46] The Texas court denied the preliminary injunction by an order dated November 13, 2007. Ryan did not seek a preliminary injunction (or any other expedited action) in this proceeding.

E. *The Additional Discovery Sought by Ryan in his Rule 56(f) Application*

Ryan claims that resolution of the Defendants' motions for summary judgment would be premature and prejudicial because he still needs a wide-ranging assortment of discovery in order to respond adequately to the motions. In particular, Ryan seeks the depositions of *all* the Individual Defendants (except Smith and Travis Engen ("Engen"), Lyondell's "lead" independent director, who were deposed in the Texas litigation) to illuminate his fiduciary duty claims. He also seeks to depose other employees of Lyondell and Deutsche Bank regarding his allegations of deficiencies in Deutsche Bank's fairness opinion and the Proxy. In addition, he also seeks to depose Blavatnik and various other representatives and employees of Basell in connection with his aiding and abetting claims. Finally, he claims that, if nothing else, he has not had an adequate opportunity to review the 200,000 pages of documents produced by the Defendants.

III. ANALYSIS

A. *Standards Governing Defendants' Motions for Summary Judgment*

The summary judgment standard is well-known. In order to prevail, the moving party must demonstrate that there is no genuine issue as to any material fact and that it is entitled to judgment as a matter of law.[47] Where the moving party supports its motion by affidavit and sufficient evidence to warrant summary

[47] Ct. Ch. R. 56(c); *see, e.g., HIFN, Inc. v. Intel Corp.*, 2007 WL 1309376, at *9 (Del. Ch. May 2, 2007); *In re Oracle Corp. Deriv. Litig.*, 867 A.2d 904, 926 (Del. Ch. 2004).

judgment, the burden shifts to the non-moving party to rebut the evidence presented by setting forth specific facts showing a genuine issue for trial; the non-moving party may not rest upon mere allegations and general denials.[48] In considering the summary judgment record, however, the Court is not permitted to weigh the evidence, and all reasonable inferences from the record presented must be drawn in favor of the non-moving party to determine the existence *vel non* of disputed material facts.[49] "[I]f from the evidence produced there is a reasonable indication that a material fact is in dispute or if it appears desirable to inquire more thoroughly into the facts in order to clarify application of the law, summary judgment is not appropriate."[50] With those principles in mind, the Court moves to the merits of Defendants' motions.

B. *The Merits of Defendants' Motions for Summary Judgment*

1. The General Duty of Loyalty Claims[51]

Ryan advances three arguments in support of his claim that the Individual Defendants breached their duty of loyalty to the Lyondell stockholders. First, he

[48] Ct. Ch. R. 56(e); *see, e.g., HIFN, Inc.*, 2007 WL 1309376, at *9; *In re Oracle Corp. Deriv. Litig.*, 867 A.2d at 926.
[49] *AeroGlobal Capital Mgmt., LLC v. Cirrus Indus., Inc.*, 871 A.2d 428, 444 (Del. 2005); *see also Izquierdo v. Sills*, 2004 WL 2290811, at *2 (Del. Ch. June 29, 2004) ("On a motion for summary judgment, judges may only determine whether or not there is a genuine issue as to a material fact; they may not try that issue.").
[50] *AeroGlobal*, 871 A.2d at 444.
[51] All of Ryan's loyalty claims, except those related to his *Revlon* claims, his deal protection claims, and his disclosure claims, are lumped together in this section for convenience.

claims that the Independent Directors were improperly motivated to approve the Basell Proposal because they stood to reap a financial "windfall" through the early vesting of stock options in connection with the Merger. Second, he claims that Smith was improperly motivated and biased in his negotiation and consideration of the Basell Proposal by his right to receive certain change-in-control payments (in addition to the early vesting of his stock options), as well as by his desire to negotiate continued employment with the post-merger company. Finally, Ryan alleges that Chazen acted disloyally by allowing Occidental to structure the sale of the Occidental bloc in such a way as to avoid the restrictions (or spirit) of the shareholders agreement. That action and the Board's failure to respond, in Ryan's view, set in motion the chain of events leading to an inevitable sale of the Company to Basell.

(a) *The Independent Directors neither had an Impermissible Financial Interest in the Basell Proposal nor were Beholden to any Proponent of this Transaction*

Ryan has not produced any facts to suggest that the Independent Directors were improperly interested in the Basell Proposal or otherwise personally conflicted as a result of the cash payments they would receive for their Lyondell stock and options. In his Complaint, Ryan produced a chart showing that, as a result of the Merger, the Independent Directors stood to gain anywhere between $233,000 and $3.75 million, depending upon the number of shares and options

they owned.[52] In his brief opposing summary judgment, Ryan further asserted that the financial benefits accruing to the Lyondell directors were "much more beneficial than what the average shareholder [would] receive." This contention apparently flows from the fact that the Independent Directors were entitled to have their stock options vested and cashed out in connection with the Merger as opposed to waiting for those benefits to accrue over a longer term if Lyondell remained independent.

Ryan's bald allegations and the paucity of facts he marshals to support this contention do not make for a case of improper interest and disloyalty on the part of the Independent Directors. The vesting of stock options in connection with a merger does not create a *per se* impermissible interest in the transaction.[53] If it could, then directors would be faced with a proverbial Catch-22 requiring them either to forego the options (a rightfully earned component of their compensation) or to accept their rightfully earned compensation and risk a breach of their duty of loyalty. Such an irrational system would deprive the board of a strong incentive to maximize value.[54]

[52] Compl. ¶ 93.

[53] *See, e.g., Krim v. ProNet, Inc.*, 744 A.2d 523, 528 (Del. Ch. 1999). The general rule is not ironclad, however, because, for example, one could imagine a scenario where a board surreptitiously grants itself valuable stock options on the eve of a merger that might then constitute a disabling self-interest.

[54] *Cf. Orman v. Cullman*, 794 A.2d 5, 27 n.56 (Del. Ch. 2002) ("A director who is also a shareholder of his corporation is more likely to have interests that are aligned with other

Furthermore, it is well-settled that "[a] director is considered interested when he will receive a personal financial benefit from a transaction that is not equally shared by the stockholders."[55] No such benefits exist for the Lyondell directors. Where, as here, the options vesting in connection with a merger were awarded as part of an established compensation plan, the accelerated vesting does not confer a special benefit upon the directors. The options, instead, are a legitimately earned benefit and, in fact, provide the directors with a powerful incentive to seek a transaction offering the highest value per share; thus, the vesting of the directors' options advanced the desired result of aligning the Board's interests with those of the Lyondell stockholders.[56] Ryan's hyperbole aside, the directors' options were paid at $48 per share (less the strike price)—the exact same benefit conferred upon *all* Lyondell stockholders.[57] Thus, Ryan cannot demonstrate that the Independent Directors received a benefit not shared equally by the Lyondell stockholders, and

shareholders . . . as it is in his best interest, as a shareholder, to negotiate a transaction that will result in the largest return for all shareholders.").

[55] *In re Western Nat'l Corp. S'holders Litig.*, 2000 WL 710192, at *11 (Del. Ch. May 22, 2000) (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

[56] *See, e.g., In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 1006 (Del. Ch. 2005) (noting that stock and options provide "a rational incentive" for directors to pursue more lucrative offers); *In re Pennaco Energy, Inc. S'holders Litig.*, 787 A.2d 691, 709 (Del. Ch. 2001) ("[T]he board's grant of options to itself . . . was consistent with a policy of aligning the board's interests with those of the stockholders. This is a permissible purpose.").

[57] *Cf. Gilbert v. El Paso Co.*, 575 A.2d 1131, 1146 (Del. 1990) (where board members did not stand on both sides of transaction, right to tender their own shares did not confer a special benefit not also extended to all shareholders).

so he fails to establish a breach of the Independent Directors' duty of loyalty.[58] The Defendants, therefore, are entitled to summary judgment on these claims.[59]

(b) *Ryan's Complaints about Chazen and the Sale of the Occidental Bloc are Much Ado about Nothing*

In his brief, and particularly at oral argument, Ryan belabored his point that the sale of the Occidental bloc contravened the spirit of the shareholders agreement governing those shares. He argues this event transpired as a result of grievous acts of disloyalty by Chazen and the Board and rendered Basell's acquisition of Lyondell inevitable. Ryan's vociferous protestations notwithstanding, however, the sale of the Occidental bloc does not support any meritorious loyalty claim.

At best, Ryan raises an argument that the Board acted disloyally by standing idly by and allowing Lyondell's second-largest shareholder to divest its holdings through a loophole in the shareholders agreement. As a practical matter, however, there was nothing the Board could have done to prevent that from occurring. The

[58] The Court also notes in passing that Ryan does not argue that the Independent Directors are not, in fact, independent. Indeed, there are no facts to suggest that the Independent Directors are beholden to any proponent of this transaction. As such, Ryan cannot prevail on his duty of loyalty claims on a theory that the Independent Directors lacked independence to consider impartially the Basell Proposal.

[59] Because Ryan has not challenged the Independent Directors' independence from Smith, it is not necessary to consider in any detail whether Smith's personal financial interest (payment of his Lyondell stock and options, plus certain other change-in-control payments) or his alleged interest in employment with the post-merger company amounted to a breach of his duty of loyalty. Even if it is assumed that those interests did amount to material self-dealing, the Merger nevertheless was considered and approved by ten other directors whose independence from Smith is unchallenged. Accordingly, the Court grants summary judgment dismissing Ryan's general loyalty claims based upon the alleged benefits flowing to Smith by way of the Merger.

shareholders agreement permitted a sale of the entire Occidental bloc through certain machinations, and Occidental exploited the opportunity. That, it seems, amounts to nothing more than an astute reading of the shareholders agreement. The Board's decision not to respond under those circumstances was not an unreasonable exercise of its business judgment and, thus, not the act of corporate treachery Ryan alleges.[60]

In short, the Court does not need to conjure the spirit of the shareholders agreement to determine that Ryan has not raised even the specter of a legitimate loyalty claim regarding this aspect of his case. The Defendants, therefore, are entitled to summary judgment.

2. Ryan's *Revlon* Claims

This case presents a somewhat novel factual scenario for application of sale of control jurisprudence. Lyondell was neither in financial distress nor actively seeking a sale of assets, an investment of capital, strategic partnerships, or any other type of transaction before announcing the Merger. The Board, for all intents and purposes, did very little, if anything, to "seek" the best transaction available to

[60] Even if the Court were to assume that there was some action the Board could have taken in response to the sale of the Occidental bloc, Ryan has not set forth any cogent reasons for why this transaction matters in the broader context of the Merger. Through its acquisition of the Occidental bloc, Access secured only an 8% interest in Lyondell. That was obviously a toehold position, but it was not a control position and it afforded Access no opportunity to control the action of the Board.

the Lyondell stockholders. Essentially, the Board acted as a passive conduit to the stockholders for an unsolicited, attractive bid for the Company. Thus, the nub of Ryan's complaints in this case is whether the Board adequately fulfilled its fiduciary obligations under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[61] once it embarked down a relatively short path toward the sale of the Company.

In substance, Ryan complains about the process employed by the Board in agreeing to sell the Company to Basell. Those complaints relate primarily to the Board's fiduciary duty of care, and on summary judgment the Court cannot conclude that Ryan would be unable to prove a breach of that duty at trial. If he only succeeded in that endeavor, however, the Lyondell stockholders would not be entitled to money damages, the only remedy now otherwise available, because Lyondell had an exculpatory charter provision adopted in accordance with 8 *Del. C.* § 102(b)(7).[62] Accordingly, Ryan can only prevail on his *Revlon* claims by overcoming the protection afforded to the Board by Lyondell's exculpatory charter provision;[63] in other words, because the Board was independent and not

[61] 506 A.2d at 173.
[62] 8 *Del. C.* § 102(b)(7) provides, in pertinent part, that a Delaware corporation may adopt in its charter "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for money damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) for any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law . . . ."
[63] *See, e.g., Goodwin v. Live Entm't, Inc.*, 1999 WL 64265, at *6 (Del. Ch. Jan. 25, 1999).

impermissibly motivated by self-interest, Ryan must demonstrate that the Board either failed to act in good faith in approving the Merger or otherwise acted disloyally. As explained below, the Board's failure to engage in a more proactive sale process may constitute a breach of the good faith component of the duty of loyalty as taught in *Stone v. Ritter*.[64] For this reason, the Court must deny summary judgment on Ryan's *Revlon* claims.

(a) *The Board's Obligations in a Sale of Control*

The board of directors is tasked with managing the business and affairs of a Delaware corporation[65] and, ordinarily, its decisions are shielded from intense *post hoc* judicial review by the business judgment rule.[66] When a board of directors undertakes a sale of the company for cash, however, its actions are subject to enhanced judicial scrutiny. Thus, the ordinarily deferential "rational basis" review gives way to "an intensified form of review involv[ing] two 'key features': (a) a judicial determination regarding the adequacy of the decision-making process employed by the directors, including the information on which the directors based

[64] 911 A.2d 362 (Del. 2006).

[65] 8 *Del. C.* § 141(a).

[66] The business judgment rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Ordinarily, the burden rests on the plaintiff to rebut the presumption by proving either (1) that the directors were interested or lacked independence to assess the merits of the transaction; or (2) that the challenged transaction otherwise was not the product of a valid exercise of business judgment. *Globis Partners, L.P. v. Plumtree Software, Inc.*, 2007 WL 4292024, at *4 (Del. Ch. Nov. 30, 2007).

their decision; and (b) a judicial examination of the directors' actions in light of the circumstances then existing."[67] Additionally, the burden is shifted to the directors to prove "that they were adequately informed and acted reasonably."[68]

The directors' efforts are measured by the teachings of *Revlon* and its progeny which demand a singular focus on "the maximization of the company's value . . . for the stockholders' benefit."[69] The so-called "*Revlon* duties" are not unique fiduciary obligations, but they do guide a board in the discharge of its unyielding fiduciary duties of care and loyalty in the sale context.[70] Concepts such as "maximization of value," "auctioning the company to the highest bidder," "seeking the best transaction," and "securing the best price," which predominate in *Revlon* jurisprudence, suggest that in most instances a board contemplating a sale

[67] *In re Toys "R" Us, Inc.*, 877 A.2d at 1000 (citing *Paramount Commc'ns, Inc. v. QVC Networks, Inc.*, 637 A.2d 34, 45 (Del. 1994)).

[68] *Id.*

[69] *Revlon*, 506 A.2d at 182. Of course, maximizing value does not necessarily mean securing the offer with the highest dollar value.

[70] "'*Revlon* duties' refer only to a director's performance of his or her duties of care . . . and loyalty in the unique factual circumstance of a sale of control over the corporate enterprise." *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 731 (Del. Ch. 1999). The Court's ordinary measuring sticks for violations of the duty of care (*i.e.*, gross negligence) and the duty of loyalty (*e.g.*, impermissible interest, lack of independence, or "bad faith") still apply. With respect to the duty of care, the board of directors has the burden of establishing that it undertook reasonable efforts to secure the *material* facts necessary to assess competently the adequacy and desirability of a particular transaction as contrasted with some alternative. The Court, of course, is mindful that reasonableness, not flawlessness, is the ultimate test. *In re Pennaco Energy, Inc.*, 787 A.2d at 705. With respect to the duty of loyalty, the Court must be satisfied that the directors were not motivated by any self-interest that is antithetical to the interests of the stockholders and that the process employed by the board demonstrates a reasonable, good faith effort to discharge its fiduciary obligations in the sale of control context. *See Stone*, 911 A.2d at 370.

of control is duty bound to engage actively in the sale process.[71] Nevertheless, Delaware courts have not delineated the precise contours of a sale process because every transaction is different and every board confronts unique circumstances.[72]

One limited exception to the active sale process generally contemplated by *Revlon* jurisprudence is described in *Barkan v. Amsted Industries*.[73] There, the Delaware Supreme Court held that *Revlon* does not mandate that every change in control of a Delaware corporation be preceded by a "heated" bidding contest with multiple bidders; a sale to a single bidder without canvassing the market also is permissible where the board possesses "a body of reliable evidence with which to evaluate the fairness of the transaction."[74] Thus, in the sale scenario, a sufficient

[71] Indeed, in the wake of *Revlon*, many cases suggested that when a board of directors undertakes a sale of the company, it can satisfy its "*Revlon* duties" by engaging in a proactive sale process designed to secure the best transaction available to the shareholders. Thus, in broad brush, one could reasonably discern from *Revlon* jurisprudence that, in most instances, a board of directors would be well-advised to do *something* to test the adequacy of an offer or to demonstrate otherwise that a proposed deal maximizes stockholder value. *See, e.g., McMullin v. Beran*, 765 A.2d 910, 918 (Del. 2000) (in pursuing the best value reasonably available for all stockholders, "the directors must be especially diligent. . . ."); *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 66 (Del. 1989) (discussing "a board's active and direct role in the sale process."). As this Court more recently noted, the hallmark of a "paradigmatic" *Revlon* claim is a supine board. *In re Toys "R" Us, Inc.*, 877 A.2d at 1002.

[72] *See, e.g., Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989) ("[T]here is no single blueprint a board must follow to fulfill its duties.").

[73] 567 A.2d at 1279. The parties have not argued the *Barkan* line of cases in their summary judgment papers. Where, as here, a board of directors elects a passive sale process, *Barkan* is a critical subset of the Court's *Revlon* analysis.

[74] *Id.* at 1287. "The corollary to this is clear: when [a board does] not possess reliable evidence of the market value of the *entity* as a whole, the lack of an active sales effort is strongly suggestive of a *Revlon* breach." *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 195 n.76 (Del. Ch. 2007).

body of reliable evidence demonstrating competent knowledge of the company's market may also be persuasive evidence of the directors' good faith discharge of their fiduciary duties and pursuit of the best transaction available to the stockholders. As with the particular mechanism of the sale process, however, Delaware courts are loathe to mandate the methods by which a board must acquire "reliable" market evidence.[75] Similarly, there is no specific quantum of evidence

[75] *Barkan*, 567 A.2d at 1287. In *Barkan*, for example, the Delaware Supreme Court was satisfied that the Amsted Industries board had amassed a sufficient body of evidence against which to judge the adequacy and fairness of the favored leveraged buyout transaction in a single-bidder sale scenario. First, the Amsted Industries board took a proactive role in collecting relevant market information. For example, in response to the acquisition of a sizeable number of shares by a sophisticated investor, the Amsted Industries board retained an investment banker to provide advice on possible responses to that acquisition and the possibilities it presented. The board also formed a special committee of disinterested directors to consider any change in control transactions that might develop. Additionally, over a period of ten months, while it sensed that a transaction was in the offing, the Amsted Industries board considered numerous valuations of the company, both optimistic and pessimistic, in order to determine the propriety of a management-led leveraged buyout transaction and, as a consequence, to orient itself as to the value of the company in the market. Second, the Amsted Industries board was confronted by declining economic performance, which tended to support an inference that the management buyout transaction offered the best value attainable by the shareholders; in addition, the management-sponsored buyout proposal benefited from unique tax advantages, which, in turn, also supported an inference that no other bidder would be likely to top management's offer. Finally, the Delaware Supreme Court was satisfied that the implicit market check that had occurred during the ten months preceding the management proposal, and the lack of other bids during that time period, was "supportive of the board's decision to proceed." Thus, all of that information coupled with the independent advice the special committee and the full board received in connection with the proposed transaction throughout the process constituted a sufficient body of evidence against which the board was able to judge the fairness of the proposed management buyout transaction to the shareholders.

On the other hand, for example, in *In re Netsmart Technologies, Inc.*, 924 A.2d at 195-99, this Court was critical of the Netsmart board's decision not to solicit interest from a targeted group of strategic buyers based upon its limited knowledge, from previous experiences, that no strategic buyer would be interested in acquiring Netsmart. The Court observed that Netsmart's prior attempts to solicit interest in a sale of the company did not reflect more recent changes in the company's assets and marketability and, in any event, failed to account for any changes that might have occurred on the targeted buyers' side in the interim between earlier solicitations and

that will be deemed "sufficient," and the Court must perform a fact-intensive, case-by-case assessment of the adequacy of a board's knowledge of the markets.[76]

In short, *Revlon* does not demand a perfect process.[77] The ultimate question is whether the process implemented by the board was a reasonable effort to advance the interests of the shareholders under the circumstances. A board of directors has considerable latitude in structuring the sale process, provided that it acts with demonstrable diligence in the pursuit of the best transaction reasonably available. With these principles in mind, the Court turns to an assessment of the Board's efforts in this case.

(b) *The Process Employed by the Board*

Although the Lyondell Defendants have not explicitly pursued a *Barkan* argument on summary judgment, there is some evidence in the record to suggest

the proposed sale. The Court also noted that in the "niche," micro-cap market in which Netsmart operated, and particularly for the reasons identified by the Netsmart board as making it difficult to attract market attention, the board could not rely upon the implicit post-signing market check technique employed (and tacitly approved of) in other, large-cap sale cases. The Court stated, "In the case of a niche company like Netsmart, the potential utility of a sophisticated and targeted sales effort seems especially high." *Id.* at 197. In short, the Netsmart board failed to demonstrate a sufficient body of market knowledge to justify its decision to abstain from soliciting bids from a targeted group of strategic buyers, and instead to focus only on a limited auction among selected financial buyers.

[76] *Barkan*, 567 A.2d at 1288 ("The evidence that will support a finding of good faith in the absence of some sort of market test is by nature circumstantial; therefore, its evaluation by a court must be open-textured. However, the crucial element supporting a finding of good faith is knowledge. It must be clear that the board had sufficient knowledge of relevant markets to form the basis for its belief that it acted in the best interests of the shareholders.").

[77] *See, e.g., In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 118 (Del. Ch. 2007) ("Reasonableness, not perfection, measured in business terms relevant to value creation, rather than by what creates the most sterile smell, is the metric.").

that the Board had a "sufficient" body of reliable evidence with which to judge the adequacy of the Basell Proposal.[78] First, the Board was active, sophisticated and generally aware of the value of the Company and the conditions of the markets in which the Company operated.[79] The depositions of Smith and Engen capably demonstrate this. The Board was routinely advised of the financial outlook for the Company. Lyondell's long range plan was updated and presented to the Board at least annually. In addition, Lyondell was involved in negotiations for the purchase of its refining joint venture with CITGO in mid-2006. Certainly, a great deal can change in market conditions in one year's time, but, nevertheless, the process involved in the acquisition of the balance of the refining joint venture is at least some evidence of a relatively recent opportunity for the Board to investigate thoroughly the market value of a substantial segment of the Company and to consider its longer term prospects for the stockholders.

The Board also was aware of Apollo's (the only other company to express even a passing interest in Lyondell) negotiations with Huntsman and the general status of other players in the chemical mergers and acquisitions market. At the

[78] There is no evidence of a proactive sales process (*e.g.*, a market check or an auction). The main thrust of the Lyondell Defendants' arguments on summary judgment is that the Basell Proposal was self-evidently the best deal available to the Lyondell stockholders, thereby satisfying the Board's *Revlon* objective. Implicit in that argument, then, is reliance on a basis of market knowledge from which to draw that conclusion.

[79] *Cf. In re Pennaco Energy, Inc.*, 787 A.2d at 706 (Where a board's knowledge of the company has not been seriously challenged, "[t]here is no basis to believe that the board itself did not have a sound basis to evaluate the price at which a sale of the company would be advantageous.").

time, Apollo was proposing a nearly $11 billion deal with Huntsman. The notion that Apollo (or Access, for that matter) could promptly have acquired and integrated Lyondell on the heels of Huntsman is unduly optimistic. In addition, the Board had other reasons to suspect that another bidder might not emerge. In particular, Smith noted Lyondell's unique amalgamation of "castoffs of other companies."[80] Indeed, according to Smith, many of Lyondell's competitors (and potential acquirers) were exiting Lyondell's "specialty businesses" segment of the market, which had contributed to Lyondell's success in acquiring other companies over the years. Thus, in his opinion, the universe of potential buyers who would be looking for assets like those of Lyondell was small.[81]

The Board also was presented with detailed financial analyses of the Company and the Basell Proposal from both management and Deutsche Bank. All of those analyses appear to have indicated that Basell's offer for Lyondell was fair and that the probability of a topping bid was slight, if not non-existent.[82]

[80] Tucker Ex. 1 (Smith Dep. at 18-19).
[81] *Id.*
[82] A fairness opinion coupled with idle speculation as to why no other company would submit a competing bid for Lyondell, particularly given Lyondell's instruction to Deutsche Bank not to solicit competing bids, does not demonstrate a satisfactory discharge of the directors' *Revlon* duties on summary judgment. At most, Deutsche Bank's fairness opinion indicates that Basell's offer was "financially fair" to the Lyondell stockholders, but that is far from saying it was the "best" deal reasonably available. This is not to say, however, that a fairness opinion might not buttress other efforts of a board to meet the expectations of *Revlon*.
It also bears noting, that a simple question lurks beyond these summary judgment motions: even if Ryan ultimately succeeds in establishing a compensable *Revlon* claim, how will damages be proven in this case, given that Basell's offer was a "fair" price?

Moreover, the Company had, at least to some extent, been on the market since May 13, 2007, two months before the Board's receipt of the Basell Proposal, when Blavatnik filed his 13D with the SEC. Other than the casual inquiry from Apollo, no one had expressed an interest in Lyondell despite seemingly widespread knowledge that it was "in play."

In addition, Smith, who arguably had the greatest knowledge of the Company and its markets, reported to the Board that he had negotiated a material increase in Basell's offer through his discussion with Blavatnik and had concluded that $48 per share was the best price then available. In the Board's view, based on the evidence of Smith's efforts, the premium represented by the Basell Proposal was likely to preclude all but the most aggressive bidders from engaging in a competitive sale process. Finally, in addition to relying on the market evidence available to it in July 2007, the Board argues that after the deal was announced, no indications of interest or topping bids were received during the four intervening months between the announcement and the shareholder vote on the Merger, and, thus, it relies upon an implicit post-signing market check to validate that it had in fact received top dollar for the Company.[83]

[83] *Compare In re Pennaco Energy, Inc.*, 787 A.2d at 707 (Where the board "carefully balanced" single-bidder strategy with allowance for an effective post-signing market check, the fact that no higher bid came forth after the deal was announced was "'evidence that the directors, in fact, obtained the highest and best transaction reasonably available.'" (citation omitted)).

On the other hand, one can also reasonably question the adequacy of the Board's knowledge and efforts on numerous fronts. First, this agreement materialized very quickly. The entire deal was negotiated, considered, and agreed to in less than seven days. That is not an impossible feat to pull off,[84] but it does give pause as to how hard the Board really thought about this transaction and how carefully it sifted through the available market evidence.[85] According to minutes of its meetings that week, the Board formally met to discuss the Basell Proposal for a total of no more than six or seven hours, with half, if not more, of that time accruing the day it reviewed the final terms of the merger agreement and voted to approve the deal. Those statistics do not inspire confidence that the Board carefully considered all of the alternatives available to Lyondell.

The Defendants also argue stridently that Blavatnik's 13D filing effectively put a "For Sale" sign on the Company and that no bidders were forthcoming. That may be true, but one may wonder if that same fact should have prompted the Board to take some action *in anticipation* of a possible proposal from Basell or another suitor,[86] even if it had no specific intention of selling at the time. The Board did

[84] *See, e.g., In re Lear Corp.*, 926 A.2d at 118 (noting that, in the deal context, a week is not an impossibly short period of time for a board to consult with advisors, strategize on price and deal term objectives, and negotiate a deal).

[85] See generally *supra* note 30 and accompanying text.

[86] *See, e.g., Barkan*, 567 A.2d at 1282 (board retains investment banker to counsel it regarding possible responses to a widely recognized, sophisticated investor's acquisition of a significant number of the company's shares); *In re CheckFree Corp. S'holders Litig.*, 2007 WL 3262188, at *1 (Del. Ch. Nov. 1, 2007) (company anticipates being acquired and retains investment banker);

not retain an investment banker or even ask management to prepare projections and valuations of the Company before the Basell Proposal was delivered by Smith. The Board also never made an effort to conduct a formal market check of any kind; instead, it languidly awaited overtures from potential suitors reacting to Blavatnik's 13D filing. The Defendants argue that the writing regarding the fate of Lyondell clearly was on the wall for all in the market to see, but the Board either failed to read it or simply chose to ignore it as evidenced by the extent of its efforts in the two months preceding the Basell Proposal.[87]

The Court also notes that there is very little evidence that the Board actually negotiated on the Basell Proposal or actively participated in the sale process. Other than a brief discussion of Blavatnik's possible intentions following the 13D filing in May, the Board did not undertake a serious effort to prepare for a possible sale of the Company. Smith, however, appears to have engaged in substantial preparations for a possible offer from Blavatnik and Access. For example, he met with Trautz in early June and (perhaps) suggested a price of $48 per share for the Company. Smith also scheduled a meeting with Blavatnik to discuss the 13D filing and a possible transaction. The Board, meanwhile, appears to have been unaware of these events until July 10 when Smith announced the Basell Proposal.

In re Toys "R" Us, Inc., 877 A.2d at 982-83 (board hires investment bankers to develop options when sensing that financial pressures may necessitate a sale of corporate assets).

[87] Of course, when the news of Basell's bid for Huntsman broke in late June, one could infer that the Board (understandably) would not have expected a proposal for Lyondell just a few weeks later.

Although "casual" discussions about possible deals and joint ventures were a regular occurrence in Lyondell's industry, and although it was within Smith's authority to engage in such discussions without express Board approval,[88] one might reasonably argue under these circumstances that Smith's conversations with Trautz and Blavatnik were different and that the Board should have been consulted sooner and given an opportunity to shape the negotiating strategy before a firm (and possibly final) offer was on the table.

Finally, the Board's reliance on an implicit post-signing market check in this case cannot be sustained on summary judgment based on the current record. Unlike the facts of *In re Pennaco Energy, Inc.*,[89] for example, the Board has not satisfactorily demonstrated an assiduous balancing of its "single bidder strategy" with an effective and relatively unencumbered post-signing market check.[90] First, the Pennaco board demonstrated satisfactory knowledge of the market to justify its pursuit of a single-bidder strategy. For example, in response to growing market interest in an acquisition of the company, the Pennaco board developed a pitch book, which included the financial data it shared with the investment community, to provide to any potential buyer who expressed an interest in acquiring the company. In the months preceding the merger, several companies expressed an

[88] Tucker Ex. 6 (Engen Dep. at 39).
[89] 787 A.2d at 691.
[90] One should also keep in mind, however, the procedural posture of *Pennaco*: a motion for preliminary injunction.

interest and received the pitch book. When the eventual acquirer, Marathon Oil, finally sought additional due diligence pursuant to a confidentiality agreement, the Pennaco board actively engaged itself in the oversight of that process and the subsequent negotiations.

Second, the Pennaco board pushed back against Marathon with respect to the merger price, and it was able to negotiate a substantial reduction in the break-up fee demanded by Marathon. The board also retained a fiduciary out that would permit it to speak with other potential acquirers under certain conditions. Moreover, in addition to the board's efforts to retain its agility to respond to a superior bid, it appeared that Pennaco's financial advisor actually contacted certain strategic buyers in violation of the no-shop clause in the Marathon merger agreement. Thus, under those circumstances, the Court was satisfied that the board had adequately balanced its single bidder sale strategy with a sufficient post-signing market check, and, therefore, it concluded that the shareholder plaintiffs were not likely to succeed on their *Revlon* claims.

In this case, by contrast, the Board made little comparable effort prior to receiving the Basell Proposal. For example, in response to speculation in the market resulting from Blavatnik's 13D filing and the early indication of interest from Apollo, the Board did nothing to evaluate the Company for a possible sale or to begin exploring a strategy for maximizing value for the shareholders. In

addition, in the months preceding the Basell Proposal, Smith appears to have engaged in substantive discussions regarding a possible transaction with Trautz, and eventually Blavatnik, all unbeknownst to the Board. Thus, unlike the Pennaco board that at least arguably had an opportunity to participate in shaping and directing the negotiating strategy with Marathon, the Lyondell Board was largely out of the loop until the very end of the process when it, more or less, ceremonially approved the deal Smith had negotiated.

Moreover, once it was included in the sale process, there is no significant evidence that the Board negotiated the Basell Proposal or seriously pushed back against Blavatnik and Basell with respect to the offer price or the deal protections. Although the deal protections agreed to in this case may have been similar to those agreed to in *Pennaco* or may seem "typical" in deals of this nature, as explained more fully below, the Court is not satisfied, on this summary judgment record, at least, that they were the result of a reasonable exercise of the Board's business judgment and did not amount to a "formidable barrier" to the emergence of a superior bid. Finally, the Board's decision to disregard the possibility of conducting even a discrete and targeted market check to pitch a sale of the entire Company or the possibility of breaking it up into more valuable parts, particularly given Lyondell's unique market niche and Smith's assessment that few companies

would be interested in acquiring Lyondell *in toto*, cannot be justified on the limited record presently before the Court.[91]

In sum, the process chosen by the Board is troubling under *Revlon*. It is difficult for the Court to conclude on this record, after giving Ryan the benefit of all reasonable inferences, that the process employed by the Board was a "reasonable" effort to create value for the Lyondell shareholders under these circumstances.[92] For that reason, summary judgment on Ryan's *Revlon* claims is denied.

(c) *The Deal Protection Measures*

Ryan also challenges the reasonableness of the Board's decision to grant Basell considerable deal protections for the Merger—namely, a $385 million termination fee, matching rights, a no-shop provision, and the residuum of the poison pill.[93] In his view, the deal protection measures, although perhaps not

[91] *Compare In re Netsmart Techs., Inc.*, 924 A.2d at 195-99.

[92] As the Court considers the record, the better inference, especially considering the potential consequences from losing the Basell Proposal, likely favors the Lyondell Defendants. The Court, however, cannot take the better inference on summary judgment to the exclusion of a less compelling, but still reasonable, inference.

[93] Whether the existence of the poison pill had any meaningful effect on potential acquirers is debatable, but unlikely, even though it might have added minimally to the overall transaction cost. A poison pill "does not deter rival bidders from expressing their interest in acquiring a corporation." *Barkan*, 567 A.2d at 1287. As the Delaware Supreme Court explained in *Barkan*: "Because potential bidders know that a pill may not be used to entrench management or to unfairly favor one bidder over another, they have no reason to refrain from bidding if they believed they can make a profitable offer for control of the company." *Id.* Thus, although one might agree with Ryan that the better course of action would have been for the Board to have pulled the pill altogether to avoid this *post hoc* inquiry, the mere presence of the pill likely did not have a substantial deterrent effect on other potential bidders for Lyondell.

objectionable when standing alone, in the aggregate precluded other bids for the Company and left the Lyondell shareholders with no choice but to accept Basell's offer. In short, he argues that the Board's decision to grant such strong deal protections effectively rendered the Merger a *fait accompli* and was unreasonable under the circumstances facing the Board in July 2007.

Deal protection measures, of course, are not necessarily impermissible. Reasonable deal protections can serve numerous important purposes, including the fostering of deal certainty for both the target and the acquirer. Furthermore, deal protections can provide a rational economic incentive for a bidder to offer "top dollar" for a target company—a benefit that is consistent with the target board's *Revlon* objective—because it can be reasonably confident that its efforts will not be thwarted by a marginally more attractive jumping bid.[94] Despite those laudable benefits, however, Delaware law does not bestow upon a board of directors

[94] By discouraging other bidders to an extent, reasonable deal protections can encourage first-acquirers to offer top dollar for a company at the outset. *See, e.g.*, Shawn J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of* Omnicare v. NCS Healthcare, Inc., 29 J. CORP. LAW 569 (2004). Without some form of protection, however, a first-acquirer might reasonably fear that its offer will simply be used as a stalking horse for a better offer and that it might eventually lose the deal. *Cf. Omnicare*, 818 A.2d at 932 ("Defensive devices taken to protect a merger agreement executed by a board of directors are intended to give that agreement an advantage over any subsequent transactions that materialize before the merger is approved by the stockholders and consummated. This is analogous to the favored treatment that a board of directors may properly give to encourage an initial bidder when it discharges its fiduciary duties under *Revlon*."). The latter scenario might disadvantage shareholders by encouraging a lower opening bid by the first-acquirer, if it anticipates a bidding war for the company. If no other bidders emerge to compete with the lower opening bid, stockholders wind up losing out on value and the first-acquirer ends up with the company for less than it was otherwise willing to spend (assuming the shareholders did not simply walk away from the deal). Thus, perceived deal protections may serve an important function in maximizing shareholder value.

"unbridled discretion" to consent to deal protection measures in derogation of their unyielding fiduciary duties toward the shareholders.[95] Thus, the Board's decision to accede to Blavatnik and Basell's demands for deal protections must withstand enhanced judicial scrutiny.[96]

Ryan concedes that none of the deal protection measures agreed to by the Board is preclusive or coercive when standing alone.[97] He focuses instead on the cumulative effects of the deal protections acting in concert to argue that they precluded other bids for the Company which, in turn, coerced the Lyondell shareholders to accept the Basell Proposal for want of a meaningful choice. The latter argument concerning the coerciveness of the deal protections in this case may be dispensed with quickly; the former, however, requires more thorough consideration.

[95] *Id.*

[96] *E.g.*, *In re Toys "R" Us, Inc.*, 877 A.2d at 1016; *In re Lear Corp.*, 926 A.2d at 119-20; *Orman v. Cullman*, 2004 WL 2348395, at *6-8 (Del. Ch. Oct. 20, 2004); *see also Omnicare*, 818 A.2d at 930-33; *Unocal*, 493 A.2d at 953-55. One might read *Omnicare* to suggest that deal protection measures must withstand the enhanced judicial scrutiny test prescribed by *Unocal*. The better reading of *Omnicare*, however, is that the Delaware Supreme Court reconfirmed that enhanced judicial scrutiny, regardless of the particular analytical framework, is the appropriate test for this Court to apply when reviewing a board's decision to grant deal protections. *Unocal* is but one formulation of enhanced scrutiny that might be applied; it is not, however, the only test, nor is it necessarily appropriate in all circumstances. Thus, *Omnicare* did not mark an analytical sea change; instead, it is consistent with numerous cases in which this Court has carefully scrutinized a board's decision to grant deal protections before according it the deference normally given to directors' business decisions. *See In re Toys "R" Us, Inc.*, 877 A.2d at 1016 (citations omitted).

[97] *See* Tr., Oral Argument, Nov. 27, 2007, at 73, 76.

Deal protections and other provisions in a merger agreement are said to be coercive when they have the effect of causing a shareholder to vote in favor of a transaction for reasons other than its merits.[98] There is nothing structurally coercive about the Basell Proposal, however. In fact, contrary to Ryan's conclusory assertions, the Lyondell shareholders had a legitimate choice when considering the Basell Proposal—they could have rejected it and let Lyondell continue with its successful operation.[99] There were no voting agreements by controlling shareholders that preordained approval of the Merger before the shareholders voted, nor were there any threats from Lyondell management or the Board that the shareholders would suffer adverse consequences by voting against the deal. In addition, there was no provision in the merger agreement whereby Basell would be paid a termination fee upon a simple "no" vote by the shareholders. Thus, there is no reason why the Lyondell shareholders could not

[98] *Orman*, 2004 WL 2348395, at *7 (citing *Williams v. Geier*, 671 A.2d 1368, 1382-83 (Del. 1996)).

[99] In this context, where Lyondell was a very viable entity, it is difficult to imagine how the combination of these deal protection measures could be said to "coerce" the shareholders into voting for the Basell Proposal. Ryan's view is that by deterring other bids for the Company, the Lyondell shareholders were left with Basell as their only option (*i.e.*, they were coerced into voting for this deal because it was the only one ever presented); on the contrary, however, a reasonable alternative to the Basell Proposal under these circumstances would have been to reject that offer and allow Lyondell to continue under its seemingly successful long range plan. In other words, the Lyondell shareholders were not confronted with a Hobson's choice of taking Basell's offer because it was the only offer on the table or watching their investment suffer serious harm. A different perspective, of course, might emerge if, for example, the target company is approaching insolvency.

vote the Merger up or down on its merits, and, therefore, the structure of the deal was not coercive.

Ryan's arguments concerning the aggregate preclusive effect of the deal protections are more compelling,[100] but they beg the broader, and more problematic, question of the reasonableness of the Board's decision to grant considerable protection to a deal that may not have been adequately vetted under *Revlon*. In particular, the problem lies primarily in the Board's decision to tie its hands with a no-shop, even with the requisite fiduciary out, under the circumstances of this case. In other words, where there is lingering doubt as to the Board's efforts to ensure that it had secured the "best" transaction available to the Lyondell shareholders before it endorsed the transaction,[101] the Court also should be skeptical of the wisdom of the Board's decision to grant considerable deal protections, simply as a matter of course, that limited its ability to discharge

[100] The deal protections agreed to in this case are not novel and, perhaps, could even be said to appear regularly, in one form or another, in deals of this magnitude. One thus can surmise that an aggressive suitor probably would not have been deterred. That argument is unavailing in the first instance on summary judgment because the Court cannot weigh the evidence to draw definitively that conclusion. But, in any event, enhanced judicial scrutiny of the Board's decision to accede to such provisions in the merger agreement does not contemplate reflexive approval of a "typical" mix of deal protections. Ultimately, the reasonableness of a particular mix of deal protections is context specific and does not lend itself to an algebraic formulation such that "x" amount of market check, knowledge, or raw premium to market entitles the board to agree to "y" level of deal protections as a matter of course. *Louisiana Mun. Police Employees' Ret. Sys. v. Crawford*, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007).

[101] *E.g.*, the lack of a proactive pre-signing market check or sufficient evidence of market knowledge justifying a single-bidder strategy under *Barkan*.

proactively its fiduciary obligations after the fact.[102] On summary judgment, without undisputed and sufficient evidence of either a proactive market check or that the Board, in fact, "*knew*" that it had secured the best deal reasonably available to the stockholders, one cannot exclude the inference that the deal protections agreed to by the Board served no purpose other than to squelch even the remotest possibility of a competing bid that might have increased the price for the stockholders.[103]

The Board argues that Basell demanded the deal protections as a condition of making the offer, but that argument is unpersuasive. First, there is no evidence that the Board put up much resistance to avoid conceding on all the protections Basell sought. Second, there is no persuasive evidence in the present record that Basell was going to walk away from the deal if it did not receive all the protections it demanded. The Court, thus, is not persuaded that a difficult and demanding buyer justifies a board's acquiescing in merger provisions that may undermine (to

[102] *Paramount Commc'ns, Inc. v. QVC Networks, Inc.*, 637 A.2d 34, 48 (Del. 1994) ("[Contractual provisions such as a no-shop], whether or not they are presumptively valid in the abstract, may not validly define or limit the directors' fiduciary duties under Delaware law or prevent the [directors from carrying out their fiduciary duties under Delaware law."]

[103] There is something of an unavoidable tension between the rationale supposedly supporting deal protection measures in a competitive market and the Defendants' argument here. They have contended that the Basell proposal constituted a "blowout" price, one that simply by its magnitude meant that there would be no one else willing to enter into any competition to acquire Lyondell. If so, what purpose did the deal protections serve? Maybe it is simply a matter of "belts and suspenders." On the other hand, maybe someone—a knowledgeable someone—had material doubts about whether the price itself would scare off any potential poacher.

some extent) the interests of the stockholders under the circumstances—at least, not without adequate evidence that the board really had no choice but to accept the conditions or lose the offer.[104]

Alternatively, the Board contends that the sheer magnitude of the transaction premium warranted, or at least justified, its decision to grant considerable deal protections to secure the Basell Proposal for the shareholders. That may be so, but a premium to market alone does not satisfy *Revlon*—or necessarily warrant concession to any form of deal protection the buyer demands. The Board had *some* evidence (to be sure) that the Basell Proposal was a "good" deal for the shareholders—for example, no serious suitors had emerged after Access' 13D filing in May 2007, the Basell Proposal offered a healthy premium to Lyondell's clear day trading price, and Deutsche Bank anointed the deal with a fairness opinion. On the other hand, however, the fairness opinion does nothing more than show that Basell was offering a "fair" price for Lyondell because it fell more or less in the middle of the various valuation ranges calculated by Deutsche Bank. Moreover, the Board did *nothing* (or virtually nothing, at least on this record) to study the market carefully or to prepare itself in anticipation of an offer for the Company. Essentially, the Board argues that it just *knew* when the Basell Proposal landed in its lap that it was a great deal and a "blowout" price for the shareholders

[104] *See, e.g.*, *Orman*, 2004 WL 2348395, at *8.

and that no other bidder could (or would) top it. For the reasons discussed above, however, it has not satisfactorily demonstrated that knowledge for summary judgment purposes.

In sum, although deal protections are part of the mergers and acquisitions landscape and can serve numerous important purposes for both the target and the acquirer, the reasonableness of the Board's decision to grant this particular mix of deal protections under the circumstances presented is a question of fact that cannot be resolved on summary judgment. After trial, or perhaps on a more complete summary judgment record, the Court may be satisfied that the Board in fact secured the "best" deal available to the shareholders, or, at the very least, that it undertook to discharge its *Revlon* duties in good faith under the circumstances. If that is so, then perhaps its decision to accede to this particular mix of deal protections also will be deemed reasonable. On summary judgment, however, where the Court cannot weigh the evidence presented and is required to draw any reasonable inference in favor of Ryan, the non-moving party, and where there is considerable doubt as to the adequacy of the Board's efforts under *Revlon*, the Court cannot conclude that the Board's decision to agree to this particular mix of deal protections was reasonable. Accordingly, summary judgment is denied.

(d) *The Board's Shortcomings under* Revlon *May Implicate the Duty of Loyalty which Precludes a Section 102(b)(7) Defense on Summary Judgment*

The Lyondell Defendants argue that even if the Court concludes, as it has, that for summary judgment purposes the Board's efforts under *Revlon* were insufficient, they nevertheless are entitled to summary judgment because those perceived shortcomings amounted to nothing more than a breach of the duty of care and Lyondell has adopted an exculpatory charter provision in accordance with 8 *Del. C.* § 102(b)(7) to preclude an award of damages for such a breach of duty. This may not be a case, however, where a board of directors simply botched the sale process in some careless or even grossly negligent manner; instead, this is a board of directors that appears never to have engaged fully in the process to begin with, despite *Revlon*'s mandate. Thus, the good faith aspect of the duty of loyalty may be implicated, which precludes a Section 102(b)(7) defense to Ryan's *Revlon* and deal protection claims.[105]

Although the so-called *Revlon* duties are not unique fiduciary obligations, they act as a source of certain guidelines for the discharge of a director's fiduciary duties of care and loyalty in a sale scenario. As discussed in the preceding

[105] Because the Board's decision to grant Basell considerable deal protections is inextricably related to the discharge of its *Revlon* duties under these circumstances, the Court concludes that a Section 102(b)(7) defense does not absolve the directors of liability on the deal protection claims either, at least at this stage of the proceedings.

sections, the adequacy of the Board's sale efforts under the *Revlon* line of cases has been called into doubt. The record does not demonstrate that the Board engaged in an active sale process; in fact, to the contrary, it made no discernible effort at salesmanship either before or after the Merger was announced. Furthermore, although the Board perhaps had adequate information about the market to satisfy the narrow *Barkan* exception to a more robust sale process, on summary judgment it has not carried that burden. In short, the Board has not satisfactorily demonstrated an undertaking of the careful process envisioned by cases such as *Revlon*,[106] *Barkan*,[107] and *QVC*[108] for discharging the directors' unremitting duty of care in a sale of control.

In *Stone v. Ritter*, the Delaware Supreme Court held that "the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith."[109] The Court went on to state, "Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith."[110] One consequence if directors act disloyally

[106] 506 A.2d at 173.
[107] 567 A.2d at 1279.
[108] 637 A.2d at 34.
[109] 911 A.2d at 370.
[110] *Id.*

or not in good faith is that the protections of an exculpatory charter provision do not attach.[111]

The record, as it presently stands, does not, as a matter of undisputed material fact, demonstrate the Lyondell directors' good faith discharge of their *Revlon* duties—a known set of "duties" requiring certain conduct or impeccable knowledge of the market in the face of Basell's offer to acquire the Company. Perhaps with a more fully developed record or after trial, the Court will be satisfied that the Board's efforts were done with sufficient good faith to absolve the directors of liability for money damages for any potential procedural shortcomings. With a record that does not clearly show the Board's good faith discharge of its *Revlon* duties, however, whether the members of the Board are entitled to seek shelter under the Company's exculpatory charter provision for procedural shortcomings amounting to a violation of their known fiduciary obligations in a sale scenario presents a question of fact that cannot now be resolved on summary judgment.

[111] *See* 8 *Del. C.* § 102(b)(7) which provides, in pertinent part, that Delaware corporations may adopt in their charter "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for money damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) for any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law . . . ."

3. Disclosure Claims

The Court turns now to Ryan's disclosure claims.[112] Under Delaware law, when a board of directors seeks stockholder approval of a proposed corporate transaction, it must disclose fully and fairly all *material* facts and information within its control.[113] An omitted fact will be deemed material if there is "'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'"[114] "The burden of *demonstrating a disclosure violation and of establishing the materiality of requested information* lies with the plaintiff."[115]

Ryan's veritable cornucopia of unsupported complaints and allegations regarding the perceived inadequacies of the disclosures in the Proxy ranges from dissatisfaction with the process surrounding Deutsche Bank's engagement,[116] to quibbles with the substance of Deutsche Bank's valuation work,[117] and to consternation over the Board's failure to self-flagellate with respect to its efforts in considering the merits of the Basell Proposal.[118] By and large, however, the disclosure violations alleged in Ryan's brief, most, evidently, warranting nothing

[112] Compl. ¶¶ 80-89; *see also* Pl.'s Opp'n to Basell's Mot. for Summ. J. at 20-22, 35-44. In his Complaint, Ryan asserts ten disclosure claims. In his brief in opposition to the pending motions for summary judgment, he asserts nineteen or twenty-one (depending on which section of his brief one reads) bullet-pointed disclosure violations; most of those are supported only by cursory argument.

The Court also notes that Ryan's Complaint, which was filed before the issuance of the Proxy, alleges disclosure claims based upon the preliminary proxy statement. In his brief, however, he focuses on disclosure issues allegedly plaguing the Proxy. As a technical matter, the Court could consider those claims, raised for the first time in opposition to Defendants' motions for summary judgment, to be outside the scope of this action. *See, e.g., Rosser v. New Valley Corp.*, 2005 WL 1364624, at *8 (Del. Ch. May 27, 2005). The parties nevertheless have joined debate over the merits of Ryan's disclosure claims. Furthermore, in fairness to Ryan, one could argue that at least some of the disclosure claims articulated in his brief grow out of or relate to the disclosure claims alleged in his Complaint; moreover, to the limited extent his disclosure claims have any merit, it does not appear that the preliminary proxy differs materially from the definitive proxy or that the alleged material deficiencies of the former document were cured in the latter.

[113] *Stroud v. Grace*, 606 A.2d 75, 85 (Del. 1992). The so-called duty of disclosure, of course, is not an independent fiduciary duty standing on the same footing as the fiduciary duties of care and loyalty. *In re CheckFree Corp.*, 2007 WL 3262188, at *2.

[114] *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (adopting materiality standard articulated by the United States Supreme Court in *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

[115] *In re CheckFree Corp.*, 2007 WL 3262188, at *2 (emphasis added) (citation omitted). Whenever a board of directors communicates with stockholders about a proposed corporate transaction, there likely will always be some additional detail that one could argue ought to have been disclosed in the proxy materials. But a duty to disclose is not a mandate for prolixity. Indeed, on numerous occasions, this Court has observed that "[b]alanced against the requirement of complete disclosure is the pragmatic consideration that creating a lenient standard for materiality poses the risk that the corporation will 'bury the shareholders in an avalanche of trivial information, a result that is hardly conducive to informed decisionmaking.'" *Skeen v. Jo-Ann Stores, Inc.*, 1999 WL 803974, at *4 (Del. Ch. Sept. 27, 1999) (quoting *TSC Indus.*, 426 U.S. at 448), *aff'd*, 750 A.2d 1170 (Del. 2000). Thus, if a stockholder is to advance successfully a disclosure claim, it is critical that he pinpoint the precise information that he believes should have been disclosed and proffer a reason why that information would have been material.

[116] *E.g.*, Pl.'s Opp'n to Basell's Mot. for Summ. J. at 42-43. None of these claims is alleged in the Complaint.

[117] *E.g.*, Compl. ¶¶ 86, 89; Pl.'s Opp'n to Basell's Mot. for Summ. J. at 39-42. Mere quibbles with the substance of an investment banker's work (*e.g.*, mere disagreement with the banker's subjective judgments regarding proper earnings multiples) does not suffice to state a disclosure claim. *See, e.g., In re JCC Holding Co., Inc. S'holders Litig.*, 843 A.2d 713, 721 (Del. Ch. 2003).

[118] *E.g.*, Compl. ¶¶ 81, 87; Pl.'s Opp'n to Basell's Mot. for Summ. J. at 43-44. "The directors' duty of disclosure does not oblige them to characterize their conduct in such a way as to admit wrongdoing." *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 143 (Del. 1997).

more than passing mention in bullet points, fall woefully short of the mark.[119] Even under the charitable standards of summary judgment, his allegations largely fail to identify any information that would have altered the "total mix" of information available to the Lyondell stockholders in considering how to vote on the Merger. From the thicket, however, emerges one minor, although perhaps material, problem.

The Proxy devotes nearly seven pages to a generally fair and adequate description of the valuation work performed by Deutsche Bank. The problem lies in the disclosures concerning the discounted cash flow analyses. In performing the DCF, Deutsche Bank expressly relied upon two sets of financial projections—a more bullish set, provided by Lyondell management (the "Management Case"), and a more conservative set, obtained from the Institutional Brokers' Estimate System (I/B/E/S) (the "Street Case").[120] Deutsche Bank highlighted the differences between the two sets of financial projections in its presentation to the Board, and it expressed its opinion that a DCF analysis using both financial cases was appropriate to achieve a fuller understanding of the adequacy of the Basell Proposal.

Deutsche Bank performed its DCF for both the Management Case and the Street Case by applying a range of discount rates from 9.5% to 11.5%. Deutsche Bank apparently selected that range based upon "its judgment of the estimated weighted average cost of capital of [selected comparable companies]."[121] As a result, the DCF analyses yielded valuation ranges between $37 and $47 per share under the Management Case and between $30 and $39 per share under the Street Case. Ryan points out, however, that Lyondell management had supplied Deutsche Bank with an internal WACC estimate of 8.25%.[122] For reasons that are not explained in the Proxy, Deutsche Bank did not perform its DCF analysis, even under the Management Case scenario, using management's estimate of the

[119] Merely rifling through the proxy statement and nitpicking undisclosed, marginally important details, as Ryan has done here (*i.e.*, bullet point argument), without sponsoring specific reasons to support the materiality of the undisclosed information will not suffice to state a cognizable disclosure claim.

[120] Only a summary of the Management Case financial projections was reported in the Proxy. Ryan complains that this partial disclosure of the financial projections relied upon by Deutsche Bank is inaccurate and misleading. The Court disagrees. There is no requirement that the Board disclose the investment banker's fairness presentation in its entirety. *See In re CheckFree Corp.*, 2007 WL 3262188, at *2; *see also In re Gen. Motors (Hughes) S'holder Litig.*, 2005 WL 1089021, at *16 (Del. Ch. May 4, 2005) ("'[A] disclosure that does not include all financial data needed to make an independent determination of fair value is not . . . *per se* misleading or omitting a material fact. The fact that the financial advisors may have considered certain non-disclosed information does not alter this analysis.'"), *aff'd*, 897 A.2d 162 (Del. 2006). Instead, stockholders are entitled to "a fair summary of the substantive work performed by the investment bankers upon whose advice the recommendation of their board as to how to vote on a merger or tender rely." *In re Pure Resources, Inc. S'holders Litig.*, 808 A.2d 421, 449 (Del. Ch. 2002). Such a summary must at least include a description of the valuation exercises underlying the fairness opinion, the "key assumptions" used in performing those exercises, and the range of values thereby generated. *Id.* In this case, the *Pure Resources* standard is satisfied by the Proxy's summary of the Management Case financial projections, which explicitly sets forth Lyondell's EBITDA estimates through 2011, and the other disclosures concerning the key assumptions underlying the various valuation exercises performed by Deutsche Bank (except as otherwise discussed herein), the descriptions of those valuation exercises, and the ranges of values thereby generated.

[121] Tucker Ex. 3 (Proxy at 33).

[122] Tucker Ex. 22.

discount rate. "As anyone who performs valuations knows, raising discount rates and lowering terminal multiples drives down the resulting value ranges."[123] Thus, in Ryan's view, the reported DCF valuations were misleadingly skewed downward by Deutsche Bank's inflated discount rate assumptions, and, consequently, the Basell Proposal appeared more attractive than it really was.

Although there may be a rational and acceptable reason for Deutsche Bank's decision to ignore the discount rate suggested by Lyondell management,[124] there is no indication in the Proxy that management even had suggested a discount rate (let alone one that was materially lower than the range of discount rates applied by Deutsche Bank), nor is there a satisfactory explanation for why Deutsche Bank did not use management's estimate of Lyondell's WACC to determine the appropriate range of discount rates to apply, even though Deutsche Bank otherwise purported to rely on management projections for its Management Case DCF. This information, although concededly a relatively minor detail, may have been material

[123] *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 76 (Del. Ch. 2007).

[124] Indeed, it would appear from the deposition of Kevin McQuilkin, the Deutsche Bank managing director who oversaw the preparation of the fairness opinion, that management's estimate of the weighted average cost of capital was deemed unreliable. Tucker Ex. 15 (McQuilkin Dep. at 39-44); *see also* Tucker Ex. 1 (Smith Dep. at 116-117 (explaining that management WACC was used only for internal benefits calculations)); Tucker Ex. 19 (Dep. of T. Kevin DeNicola at 66-67 ("I think the purpose of the engagement of Deutsche Bank was to provide an independent analysis for purposes of providing us financial guidance. So I wanted them to decide what they wanted to do as far as their methodologies, what assumptions they made. I didn't want to be involved in the discussion of how they came up with [things such as discount rates] necessarily. They were paid to be independent.")). If that is so, Ryan would be challenged to establish the materiality of the undisclosed management WACC estimate at trial.

to the Lyondell stockholders. At the very least, given Deutsche Bank's reliance on other management projections, one could argue that the Proxy should have included an explanation for Deutsche Bank's rejection of management's WACC assumption in selecting the discount rates for its DCF analyses.[125] On summary judgment, the Court must draw the inference in Ryan's favor, and, consequently, it cannot foreclose the possibility of finding a disclosure violation on that ground.

Notwithstanding the foregoing conclusion that the Board may have violated its disclosure duty, the Court also concludes that such a failure to disclose management's estimate of the DCF discount rate under these circumstances was, at worst, an oversight on the part of the Board, and, therefore, amounted to nothing more than a breach of the duty of care.[126] Ryan has not brought forth any evidence to suggest that the Board intentionally misled the shareholders by withholding additional disclosures concerning Deutsche Bank's selection of a discount rate for its various DCF analyses. Indeed, from the deposition of Kevin McQuilkin,[127] it may very well have been that the management estimate of the discount rate simply

[125] *In re Topps Co.*, 926 A.2d at 76 ("Subjective judgments like [discount rates] are, of course, not scientific, but highly-paid valuation advisors should be able to rationally explain them.").

[126] The failure to disclose materials facts can implicate both the duty of care and the duty of loyalty. In some instances, it may implicate both fundamental fiduciary obligations; in others, however, only one of the duties may be implicated. The sorting out of the particular fiduciary duty failing with respect to a particular disclosure violation requires a fact-intensive analysis. When there is no evidence of disloyalty or bad faith in connection with the failure to disclose, however, a Section 102(b)(7) provision will absolve the directors of monetary liability for their failure because only their duty of care is at issue. *In re Transkaryotic Therapies, Inc.*, --- A.2d ----, 2008 WL 2699442, at *8-11 (Del. Ch. June 19, 2008).

[127] Tucker Ex. 15.

was deemed unreliable and was, therefore, overlooked in the process of preparing the Proxy. In any event, absent any evidence suggesting something more nefarious than a mere oversight, the Court concludes that Lyondell's exculpatory charter provision absolves the Board of liability for money damages resulting from the alleged disclosure violation.[128] Accordingly, the Lyondell Defendants are entitled to summary judgment on all of Ryan's disclosure claims.[129]

[128] Although the Board is absolved of liability for money damages resulting from the potential disclosure violation under Lyondell's exculpatory charter provision, one also could make a compelling argument that all of Ryan's disclosure claims ought to be barred by the doctrine of laches. Delaware corporate law insists upon an informed stockholder franchise. *See, e.g., In re Lear Corp.*, 926 A.2d at 114-15 ("Delaware corporation law gives great weight to informed decisions made by an uncoerced electorate. When disinterested stockholders make a mature decision about their economic self-interest, judicial second-guessing is almost completely circumscribed by the doctrine of ratification."). The necessary predicate to implementing that policy, however, is adequate disclosure in the proxy solicitation materials *before* the shareholder vote. Thus, this Court has stated a clear preference for remedying disclosure problems through interim equitable relief whenever possible. *See, e.g., In re Transkaryotic Therapies, Inc.*, --- A.2d ----, 2008 WL 2699442, at *8-10 (discussing the history of Delaware's treatment of disclosure problems and explaining the basis for this Court's preference for an injunctive remedy). In addition to the pertinent public policy considerations, the Court explained the pragmatic considerations discouraging *ex post* litigation of disclosure claims in *In re Staples, Inc. S'holders Litig.*, 792 A.2d 934, 960 (Del. Ch. 2001):

> Delaware case law recognizes that an after-the-fact damages case is not a precise or efficient method by which to remedy disclosure deficiencies. A post-hoc evaluation will necessarily require the court to speculate about the effect that certain deficiencies may have had on a stockholder vote and to award some less-than-scientifically quantified amount of money damages to rectify the perceived harm.
>
> Therefore, our cases recognize that it is appropriate for the court to address material disclosure problems through the issuance of a preliminary injunction that persists until the problems are corrected. An injunctive remedy of that nature specifically vindicates the stockholder right at issue—the right to receive fair disclosure of the material facts necessary to cast a fully informed vote—in a manner that later monetary damages cannot and is therefore the preferred remedy, where practicable.

See also Gantler v. Stephens, 2008 WL 401124 at *19 n.136 (Del. Ch. Feb. 14, 2008) ("Courts have more flexibility in fashioning appropriate relief in response to this type of proxy-related disclosure claim when it is pressed as one for a preliminary injunction before the shareholder vote."); *In re Lear Corp.*, 926 A.2d at 115.

There may, of course, be situations where, for some reason, an injunctive remedy is not feasible. That would not have been the case here, however. Ryan filed this lawsuit just over a month after the Merger was announced, and a full three months before the stockholder vote. For whatever reason, he did not seek injunctive relief in this action. (Perhaps he believed that the parallel Texas litigation seeking such a remedy would suffice.) Had Ryan pursued such a course of action, the Court would have been in a position to fashion an effective remedy to correct the minor oversight with respect to a disclosure concerning management's estimate of the DCF discount rate. Ryan, however, sat on his rights.

The Defendants have not raised a laches defense to Ryan's disclosure claims, and, in any event, they are absolved of liability for the minor disclosure violation by virtue of Lyondell's Section 102(b)(7) provision. The Court pursues this aside, however, because, assuming money damages were available in this case, particularly nominal damages, they would have been an unsatisfactory salve for a disclosure violation that very easily could have been remedied if Ryan had acted more diligently. Prompt action by Ryan would have promoted Delaware's preference for an informed shareholder vote on the Merger, but his dilatory efforts, instead, thwarted achieving that goal. Thus, where, as here, a shareholder had ample opportunity to seek an injunctive remedy for a perceived disclosure violation, and where there is no evidence of a breach of the directors' duty of loyalty or good faith in connection with the disclosure, it may be appropriate to invoke the doctrine of laches to bar him from pursuing a claim for money damages.

[129] A brief digression on the Lyondell Defendants' belated shareholder ratification defense is warranted. The shareholders voted to approve the Merger on November 20, 2007, after Ryan had filed his answering brief in opposition to the Defendants' motions for summary judgment. The Defendants raised the ratification defense in their reply brief, and, consequently, Ryan has not had a fair opportunity to respond. Nevertheless, the Court will discuss some general observations with respect to the application of such a defense in this context.

But for a relatively minor disclosure violation, which the Court concludes resulted only from a breach of the Board's duty of care and, therefore, is immune from money damages under Lyondell's Section 102(b)(7) provision, the Lyondell Defendants would have an argument that the otherwise informed, disinterested, and uncoerced shareholder vote on the Merger ratified the transaction and any breaches of the Board's fiduciary duties that may have occurred in connection with the Merger. The Court declines to countenance that defense, at least at this stage of the proceedings, for two reasons. First, and more obvious, the mere fact that the Board is absolved of liability for money damages resulting from the potential disclosure violation does not erase the harmful effects it may have had on the shareholder vote on the Merger; thus, it cannot be said that the shareholder vote was "fully informed" for ratification purposes. Second, as elaborated below, the breach of the duty of loyalty in this case is predicated upon the directors' failure to discharge their *Revlon* duties in good faith; consequently, it would be inequitable to allow a shareholder vote on the Merger to remove from further judicial review a potential fundamental failure on the part of the Board to act in the best interests of the shareholders.

The "textured" law in Delaware regarding the effects of shareholder ratification, particularly with respect to duty of loyalty claims, was carefully examined and explained in *Solomon v. Armstrong*, 747 A.2d 1098, 1113-17 (Del. Ch. 1999). The Court began by observing, "A different rule exists for every permutation of facts that fall under the broad umbrella of 'duty of loyalty' claims." *Id.* at 1114-15. The Court went on, however, to discuss the effect of shareholder ratification in three typical fact patterns in which duty of loyalty claims arise. The first fact pattern is where directors engage in self-dealing transactions. Ratification in those instances is governed by statute, 8 *Del. C.* § 144, and the effect of a fully-informed vote of the shareholders is to sustain the protections of the business judgment rule. *Id.* at 1115-16. The second fact pattern is where a corporation engages in a transaction with its controlling stockholder (*e.g.*, a parent-subsidiary merger). In those instances, an informed ratification by the majority of the minority shifts the burden of proof on the issue of entire fairness from the controlling shareholder to the challenging shareholder. *Id.* at 1116-17. The third fact pattern is "where shareholder approval is sought (*e.g.*, approval of a merger) and where there is *no* controlling shareholder, control group, or dominating force." *Id.* at 1117 (emphasis in original). In those instances, the Court stated that the effects of shareholder ratification are "penetrating" and that absent doubts as the board's disinterest in the transaction at issue, "an informed and uncoerced shareholder vote on the matter provides an independent reason to maintain business judgment protection for the board's acts." *Id.*

This case, at first blush, arguably fits within the third category of loyalty cases described in *Solomon*. There is no controlling shareholder, control group, or dominating force which compromised the shareholders' ability to vote independently on the Basell Proposal. In addition, the shareholders had a considerable, even if imperfect, amount of information against which to judge for themselves the fairness and adequacy of the Basell Proposal. Thus, one could argue that the shareholder vote presents a compelling basis for sustaining the Board's efforts under the business judgment rule. On the other hand, however, the precise loyalty issue being challenged in this case—the Board's good faith discharge of its *Revlon* duties—arguably was not before the shareholders in voting on the Merger.

In *In re Santa Fe Pacific Corp.*, 669 A.2d 59, 67-68 (Del. 1995), for example, the target board of directors had adopted several defensive measures to thwart the proponent of a disfavored tender offer. When the merger transaction favored by the board was later approved by the shareholders, the directors argued ratification to foreclose the objecting shareholders' arguments that the directors had breached their fiduciary duties by erecting defensive measures against the competing tender offer. The Delaware Supreme Court concluded that shareholder ratification could not reach the board's unilateral decision to adopt the defensive measures prior to the vote on the merger because the teachings of *Unocal* and *Revlon*, in essence, rest upon "'the overriding importance of voting rights[]'" in connection with a change in corporate control. *Id.* at 67 (quoting *Paramount Commc'ns, Inc. v. QVC Networks, Inc.*, 637 A.2d 34, 42 (Del. 1994)). By the time the Santa Fe Pacific shareholders were asked to vote on the merger, the board's unilateral defensive actions against the disfavored tender offer had already worked their pernicious effects (*i.e.*, they foreclosed a "no" vote on the favored merger, which, in turn, would have enabled the shareholders to tender into the competing offer) and so the shareholders could not have approved the board's unilateral decision to erect defensive barriers against the competing offer. *Id.* at 68.

4. Ryan's Aiding and Abetting Claims Against Basell Also Fail

Finally, the Court turns to Ryan's aiding and abetting claims alleged against the Basell Defendants. A claim of aiding and abetting in a breach of fiduciary duty requires the plaintiff to establish: "(1) the existence of a fiduciary relationship; (2) the fiduciary breached its duty; (3) a defendant, who is not a fiduciary, knowingly participated in a breach; and (4) damages to the plaintiff resulted from the concerted action of the fiduciary and non-fiduciary."[130] However, "[t]his Court has consistently held that 'evidence of arm's-length negotiation with fiduciaries negated a claim of aiding and abetting, because such evidence precludes a showing that the defendants knowingly participated in the breach by the fiduciaries.'"[131]

Although in most instances the board's efforts in connection with securing the particular transaction to be voted upon by the stockholders will be subject to ratification by the fully informed, uncoerced shareholder vote, in this instance, the Court is persuaded that the rationale of *Santa Fe Pacific* ought to apply, at least for summary judgment purposes, to preclude a ratification defense from removing the Board's actions from further judicial review. As a threshold matter, untangling the care and loyalty issues in the *Revlon* and deal protection claims in this case is not an easy task. *See, e.g., id.* at 67 ("*Revlon* and *Unocal* and the duties of a board when faced with a contest for corporate control do not admit of easy categorization as duties of care or loyalty." (citation omitted)). More importantly, however, the Board's potential failure to discharge its fundamental *Revlon* duties in good faith prior to recommending and submitting the Merger to the shareholders may have undermined the voting process by depriving the shareholders of the assurance that the Board had diligently pursued the best transaction reasonably available to them. *Cf. QVC Networks, Inc. v Paramount Commc'ns, Inc.*, 635 A.2d 1245, 1266 (Del. Ch. 1993) ("What is at risk [in a change in corporate control] is the adequacy of the protection of the property interest of the shareholders who are involuntarily being made dependent on the directors to protect that interest.") The Lyondell shareholders were entitled to rely upon the Board to discharge its fiduciary obligations in good faith prior to recommending a particular change in control transaction, and, thus, they could not have been asked to ratify the Board's alleged unilateral decision to abdicate its fundamental fiduciary obligations in that regard simply by voting in favor of the Merger.

[130] *Globis Partners, L.P.*, 2007 WL 4292024, at *15.

[131] *In re Gen. Motors (Hughes)*, 2005 WL 1089021, at *26.

There is no evidence in the record to support an inference that the parties to this transaction did not deal with each other at arm's-length. Ryan points to the compressed timeline for this deal as evidence to suggest that Blavatnik "bullied" management and the Board into accepting the Basell Proposal in violation of their fiduciary duties, but that argument falls short. Basell certainly drove a hard bargain with the timeline it imposed on the Basell Proposal. A hard bargain, however, cannot suffice to establish an aiding and abetting claim where the parties negotiated at arm's-length.

The record is, instead, replete with evidence of arm's-length dealings between Basell and Lyondell. For example, Smith negotiated over Basell's offer price during the course of the July 9, 2007, meeting where he and Blavatnik discussed a possible transaction between Basell and Lyondell. In addition, the Board instructed Smith to seek additional concessions on the Basell Proposal, which he did. Blavatnik refused those requests, but, nevertheless, such evidence is strongly suggestive of an arm's-length and adversarial process. There also is no evidence to suggest that Basell representatives participated in Lyondell board meetings or that Basell otherwise injected itself into the Board's process of approving the Basell Proposal. Moreover, the Board consisted almost entirely of disinterested and independent directors and there is nothing in the record to suggest that Basell exercised dominion over the Board.

In sum, there is no support in the record for Ryan's claim that Basell aided and abetted a breach of the Board's fiduciary duties. On the contrary, the record—as a matter of undisputed fact—clearly demonstrates that the parties to this transaction dealt with each other at arm's-length. The Board was disinterested and independent of Basell, and the latter was unable to exercise control over the former. As such, Ryan cannot demonstrate that Basell knowingly participated in a breach of the Board's fiduciary duties, and the Basell Defendants, therefore, are entitled to summary judgment.

C. *Ryan's Application for Additional Discovery under Rule 56(f)*

In addition to filing a substantive response to the Defendants' motions, Ryan has also filed an affidavit under Court of Chancery Rule 56(f) contending that he requires additional discovery to properly oppose the motions for summary judgment.[132] Rule 56(f) affords the Court broad discretion to allow a party opposing summary judgment to take additional discovery, upon timely application, provided that (1) the party opposing summary judgment has identified, with some degree of specificity, the additional facts sought by the requested discovery;[133] and (2) the facts sought, if they exist, are known only by the party moving for summary

[132] Ct. Ch. R. 56(f) provides: *When affidavits are unavailable.* Should it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition, the Court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just.

[133] *See, e.g.*, *von Oppel v. Youbet.com, Inc.*, 2000 WL 130625, at *1 (Del. Ch. Jan. 26, 2000) (citation omitted).

judgment.[134] The Court's denial of several aspects of the pending summary judgment motions has mooted much of Ryan's application. The Court, nevertheless, must address his Rule 56(f) affidavit in the context of the claims which have been dismissed: the structural loyalty claims, the disclosure claims, and the aiding and abetting claims against the Basell Defendants.

Ryan's application fails in the first instance because it is untimely. Basell filed its motion for summary judgment on September 27, 2007, and its opening brief in support of its motion on October 12, 2007. Ryan sought no discovery in this action[135] from that time until he filed his Rule 56(f) application in conjunction with filing his answering brief, which, incidentally, occurred only after he obtained an extension of its due date.[136] Moreover, the parties and witnesses Ryan seeks to depose have been well-known to him at least since he filed this action, and he was free to notice their depositions at any time. Ryan attributes his failure to focus his attention on this action to his participation in the Texas action. That was his choice, and, absent a stay authorized by this Court, he had an obligation to diligently prosecute this action as well.

[134] *See, e.g., Scharf v. Edgcomb Corp.*, 2000 WL 1234650, at *2 (Del. Ch. Aug. 21, 2000) (citation omitted).

[135] Ryan did, however, participate in the discovery process in the Texas litigation.

[136] On November 8, 2007, Ryan moved for an extension of time to file his Answering Brief, which was then due on November 9, 2007. LEXIS Trans. I.D. No. 16986950 (Motion, Nov. 8, 2007). The Court convened for a teleconference on November 9, 2007 to discuss Ryan's request, and the Court granted an extension to November 14, 2007 for Ryan to file his Answering Brief. LEXIS Trans. I.D. No. 17047806 (Transcript, Nov. 9, 2007).

More importantly, however, Ryan has not identified with any degree of precision the facts he intends to elicit to contest the Defendants' motions for summary judgment. Instead, he alleges, in conclusory fashion, that he needs the depositions of no less than fifteen additional witnesses and additional time to review the nearly 200,000 pages of documents already produced by the Defendants, apparently because the documents are not in an easily searchable format.[137] In short, Ryan's application is not a carefully developed plan to discover relevant facts, but instead appears to be a haphazard effort evincing little more than a bare attempt to engage in a fishing expedition in search of a viable cause of action. That is not a proper use of Rule 56(f). Ryan's application for additional discovery, accordingly, will be denied for the following reasons in particular.[138]

1. Deposition of, and Documents from, Blavatnik and Other Basell Representatives

Ryan asserts that depositions of Blavatnik and other Basell representatives, such as Basell CEO Trautz, are necessary to prove his aiding and abetting claims. As the Court determined *supra* in Section III(B)(4), however, the aiding and abetting claims against the Basell Defendants fail for reasons that these depositions and document productions would not change. Accordingly, the Court concludes

[137] The Defendants maintain that the documents are searchable and that they have offered to show Ryan how to search the documents.

[138] The Court does not address the additional discovery sought under Rule 56(f) for claims that have survived summary judgment.

that they would not lead to the discovery of additional relevant information, and this request is denied.

2. Depositions of Deutsche Bank Representatives

The Court addresses this category as it might apply to Ryan's disclosure claims. Ryan seeks to depose several Deutsche Bank representatives, including Chris Towery and John Anos. Ryan makes no effort to identify who Messrs. Towery and Anos are or what their involvement was with the Basell Proposal and Lyondell.[139] In any event, Ryan has already had an opportunity to depose Kevin McQuilkin, the Deutsche Bank managing director who directly oversaw the preparation of the fairness opinion concerning the Basell Proposal,[140] and he has not pointed to any specific deficiencies in McQuilkin's knowledge regarding Deutsche Bank's preparation of its fairness opinion. As such, the Court concludes that McQuilkin provided adequate detail about Deutsche Bank's fairness opinion and that additional discovery from Deutsche Bank witnesses would not reveal any new or useful information. Accordingly, Ryan's request for additional discovery from Deutsche Bank is denied.

[139] Apparently, Anos and Towery participated on the Deutsche Bank team that prepared the fairness opinion. Tucker Ex. 15 (McQuilkin Dep. at 12-15).
[140] *Id.* (McQuilkin Dep. at 12-13).

3. 200,000 Pages of Documents

Ryan asserts that 200,000 pages of documents, in a non-searchable format, were "just recently" received prior to filing his brief and Rule 56(f) affidavit. Ryan further contends that it will be necessary to review all of the documents by hand in order for his counsel to begin taking depositions—a process, which according to Ryan, "may take months" since the documents are not searchable. The Court acknowledges the inherent difficulty in reviewing 200,000 pages of documents, but Ryan has not set forth a sufficient reason for the Court to determine that, with an appropriate level of effort to review the documents, he could not have gotten the job done in time to take additional discovery, if necessary, and to adequately respond to the Defendants' motions. Accordingly, his request for additional time to review documents is denied.

IV. CONCLUSION

The denial in part of the Lyondell Defendants' motion is driven more by the constraints of a summary judgment process than it is by our corporate law. The price—$48 per share—was undeniably a fair one and may well have been the best that could reasonably have been obtained in that market or any market since then. When control of the corporation is at stake, however, directors of a Delaware corporation are expected to take context-appropriate steps to assure themselves and, thus, their shareholders that the price to be paid is the "best price reasonably

available." The Court cannot conclude on the limited record before it that, as a matter of undisputed material fact, the directors acted appropriately under the circumstances of this case. Whether that can be demonstrated for summary judgment purposes on a more complete record or at trial, of course, remains to be seen.

For the foregoing reasons, the Court grants summary judgment on all claims in favor of the Basell Defendants and against Ryan. The Court also grants summary judgment in favor of the Lyondell Defendants and against Ryan on the structural loyalty claims and all disclosure claims. Otherwise, the Lyondell Defendants' motion for summary judgment is denied. To the extent that it is not moot, the Court also denies Ryan's application for additional discovery pursuant to Court of Chancery Rule 56(f).

An implementing order will be filed.

H In re Lear Corp. Shareholder Litigation
Del.Ch.,2007.

Court of Chancery of Delaware.
In re LEAR CORPORATION SHAREHOLDER LITIGATION.
C.A. No. 2728-VCS.

Submitted: June 8, 2007.
Decided: June 15, 2007.

Background: Shareholders brought breach of fiduciary duty action against board of directors, seeking to enjoin upcoming merger that would take the corporation private, and claiming that board had failed to disclose material facts in connection with the proposed merger. Shareholders moved for a preliminary injunction.

Holdings: The Court of Chancery, Strine, Vice Chancellor, held that:
(1) shareholders were not likely to succeed, for purposes of a preliminary injunction, on claim that proxy statement was materially misleading because it omitted an early discounted cash flow (DCF) model prepared by corporation's investment banker;
(2) proxy statement was not materially misleading regarding the pre-signing and post-signing market checks;
(3) shareholders were likely to succeed on claim that proxy statement was materially misleading by failing to disclose how merger addressed chief executive officer's (CEO) personal financial concerns;
(4) limited preliminary injunction would be issue requiring supplemental disclosure regarding merger's affect on CEO's personal financial concerns; and
(5) shareholders were not likely to succeed, for purposes of a preliminary injunction, on their *Revlon* claim that board of directors breached its fiduciary duty to secure highest price reasonably available.

Limited preliminary injunction issued.

West Headnotes

[1] Corporations 101 584

101 Corporations
101XIV Consolidation
101k584 k. Rights and Remedies of Dissenting Stockholders. Most Cited Cases
In order to obtain a preliminary injunction against a merger, plaintiffs must convince a court that their claims have a reasonable likelihood of ultimate success, that they face irreparable injury if an injunction does not issue, and that the balance of the equities favors the grant of an injunction.

[2] Corporations 101 583

101 Corporations
101XIV Consolidation
101k583 k. Assent of Stockholders. Most Cited Cases
Directors of Delaware corporations have a duty to disclose the facts material to their stockholders' decisions to vote on a merger.

[3] Corporations 101 584

101 Corporations
101XIV Consolidation
101k584 k. Rights and Remedies of Dissenting Stockholders. Most Cited Cases
Shareholders challenging proposed merger that would take corporation private were not likely to succeed on claim that proxy statement provided to shareholders by board of directors failed to disclose a material fact because it omitted an earlier discounted cash flow (DCF) model prepared by corporation's investment banker, for purposes of a preliminary injunction against shareholder vote on such merger, as such model was the first of eight drafts of DCF models circulated before investment banker made a final presentation to corporation's board later in the same day, there was no evidence that such model was regarded as reliable either by the senior bankers in charge of the deal or by corporation's management, and proxy statement appeared to fairly disclose management's best estimate of corporation's future cash flows and the DCF model using those estimates that the investment banker believed to be the most reliable.

[4] Corporations 101 583

101 Corporations
101XIV Consolidation
101k583 k. Assent of Stockholders. Most Cited Cases
Proxy statement provided to shareholders by board of directors in connection with proposed merger that would take corporation private fairly disclosed the material facts regarding pre-signing and post-signing market checks, for purposes of determining whether or not board breached its duty to disclose facts material to shareholders' decision to vote on the merger; proxy statement made it clear that pre-signing market check was a very discrete solicitation of financial buyers conducted in a hurried fashion, statement made plain that buyer would not have kept his offer on the table if the board had engaged in a full-blown pre-signing auction, and statement disclosed that the board realized the importance of

the post-signing shopping period and sought in negotiations both to lengthen such period and obtain a commitment from buyer that buyer would vote his shares in favor of a superior proposal embraced by the corporation.

[5] Corporations 101 584

101 Corporations
101XIV Consolidation
101k584 k. Rights and Remedies of Dissenting Stockholders. Most Cited Cases
Shareholders challenging proposed merger that would take corporation private were likely to succeed on claim that proxy statement provided to shareholders by board failed to disclose a material fact by not disclosing personal financial interest in the merger on the part of corporation's chief executive officer (CEO), who had negotiated merger agreement for the board, for purposes of a preliminary injunction against a shareholder vote on the merger; corporation was involved in an industry that was having financial difficulties, before buyer made proposal to take corporation private CEO had approached the board regarding his concerns that his wealth largely consisted of unsecured retirement benefits and corporation's stock that would be jeopardized if industry conditions forced corporation into bankruptcy, and merger agreement allowed CEO to cash out his equity stake in corporation and allowed CEO to secure a short-term schedule for the payout of his retirement benefits.

[6] Corporations 101 316(4)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k316 Dealings with Corporation or Shareholders
101k316(4) k. Ratification. Most Cited Cases
When disinterested stockholders make a mature decision about their economic self-interest, judicial second-guessing is almost completely circumscribed by the doctrine of ratification.

[7] Corporations 101 584

101 Corporations
101XIV Consolidation
101k584 k. Rights and Remedies of Dissenting Stockholders. Most Cited Cases
The irreparable injury prong of the preliminary injunction standard is satisfied, in stockholder actions challenging mergers, when it is shown that the stockholders are being asked to vote without knowledge of material facts, because it deprives stockholders of the chance to make a fully-informed decision whether to vote for a merger, dissent, or make the oft-related decision whether to seek appraisal.

[8] Corporations 101 584

101 Corporations
101XIV Consolidation
101k584 k. Rights and Remedies of Dissenting Stockholders. Most Cited Cases
Limited preliminary injunction would be issued, preventing shareholder vote on proposed merger that would take corporation private, until a supplemental disclosure was made regarding merger's affect on chief executive officer's (CEO) personal finances by addressing CEO's desire to cash out his equity stake in corporation and securing a short-term schedule for the payout of his otherwise unsecured retirement benefits, as shareholders challenging merger were likely to succeed on claim that proxy statement failed to disclose a material fact by not providing such information, shareholders were being asked to vote on the merger without knowledge of such information, and risks presented by the injunction persisted only so long as necessary to ensure appropriate disclosure before the merger vote.

[9] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
When a board of directors has decided to sell a corporation for cash or engage in a change of control transaction, it must act reasonably in order to secure the highest price reasonably available.

[10] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
The duty of a board to act reasonably, when proposing to sell a corporation for cash or engage in a change of control transaction, is just that, a duty to take a reasonable course of action under the circumstances presented.

[11] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Because there can be several reasoned ways to try to maximize value, when a board proposes to sell a corporation for cash or engage in a change in control transaction, a court cannot find fault so long as the directors chose a reasoned course of action.

[12] Corporations 101 584

101 Corporations
101XIV Consolidation
101k584 k. Rights and Remedies of Dissenting Stockholders. Most Cited Cases
Shareholders challenging merger that would take corporation private were not likely, for purposes of a preliminary injunction, to succeed on their *Revlon* claim that board breached its duty to secure highest price reasonably available, though board allowed chief executive officer (CEO) to negotiate merger agreement and merger would allow CEO to cash out his significant equity stake and obtain an early payout of his otherwise unsecured retirement benefits, as the board's overall approach to obtaining the best price was reasonable; board had previously signaled a willingness to ponder the merits of unsolicited offers by eliminating poison pill, proposed buyer had already increased value of corporation by purchasing a significant stake in it, board rejected an open auction because it risked loosing buyer's bid, agreement contained a 45 day go-shop period as a market check, and termination fee of 2.4% of enterprise value if a superior deal emerged was not unreasonable.

[13] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
When determining whether a board of directors breached its *Revlon* duty when proposing to sell a corporation for cash or engaging in a change of control transaction, reasonableness, not perfection, measured in business terms relevant to value creation, rather than by what creates the most sterile smell, is the metric.

***96** Pamela S. Tikellis, Esquire, Chimicles & Tikellis, LLP, Wilmington, Delaware, for Plaintiff.
Seth D. Rigrodsky, Esquire, Brian D. Long, Esquire, Rigrodsky & Long, P.A., Wilmington, Delaware; Ann K. Ritter, Esquire, Motley Rice, LLC, Mount Pleasant, South Carolina, Co-Chairs of Plaintiffs' Executive Committee.
Kevin G. Abrams, Esquire, J. Travis Laster, Esquire, Steven M. Haas, Esquire, Nathan A. Cook, Esquire, Abrams & Laster, LLP, Wilmington, Delaware, for the Lear Defendants.
Matthias Lydon, Esquire, Norman Beck, Esquire, Winston & Strawn, LLP, Chicago, Illinois, of Counsel to Lear Corporation.
Kenneth J. Nachbar, Esquire, Jay N. Moffitt, Esquire, William E. Green, Jr., Esquire, Morris Nichols Arsht & Tunnell, Wilmington, Delaware, for Defendants AREP Car Acquisition Corp., American Real Estate Partners, LP, and Vincent J. Intrieri.

OPINION

STRINE, Vice Chancellor.

I. *Introduction*

Lear Corporation is one of the world's leading automotive interior systems suppliers.***97** It is among the Fortune 200, and its shares trade on the New York Stock Exchange. Although Lear is a large corporation, it remains highly dependent on the success of the corporations who sell cars and trucks-as those corporations are Lear's customers. In particular, although Lear has broadened its customer base to become more global, the majority of its revenues continue to be derived from sales to American manufacturers, and within that sector, Lear's revenues also tilt toward supplying components for SUVs and light trucks. As is widely known, the American automobile industry has suffered during the past several years and sales of SUVs and light trucks have declined as gas prices have increased. Lear suffered along with it, as the ratings given to its debt and as the bankruptcy rumors concerning the company reflected. In the midst of a restructuring to keep itself healthy, along came Carl Icahn.

In early 2006, Icahn took a large, public position in Lear stock. Given Icahn's history of prodding issuers toward value-maximizing measures, this news bolstered Lear's flagging stock price. Later in 2006, Icahn deepened his investment in Lear, by purchasing $200 million of its stock-raising his holdings to 24%-through a secondary offering. The funds raised in that private placement were used by Lear to reduce its debt and help with its ongoing restructuring.

Icahn's purchase led the stock market to believe that a sale of the company had become likely. Icahn's investment also combined with another reality: Lear's board had eliminated the corporation's poison pill in 2004, and promised not to reinstate it except in very limited circumstances.

In early 2007, Icahn suggested to Lear's CEO that a going private transaction might be in Lear's best interest. After a week of discussions, Lear's CEO told the rest of the board. The board formed a Special Committee, which authorized the CEO to negotiate merger terms with Icahn.

During those negotiations, Icahn only moved modestly from his initial offering price of $35 per share, going to $36 per share. He indicated that if the board desired to conduct a pre-signing auction, it was free to do that, but he would pull his offer. But Icahn made it clear that he would allow the company to freely shop his bid after signing, during a so-called go-shop period, but only so long as he received a termination fee of approximately 3%.

The board did the deal on those terms. After signing, the board's financial advisors aggressively shopped Lear to both financial and strategic buyers. None made a topping bid during the go shop period. Since that time, Lear has been free to entertain an unsolicited superior bid. None has been made.

Stockholders plaintiffs have moved to enjoin the upcoming merger vote, arguing that the Lear board breached its *Revlon* [FN1] duties and has failed to disclose material facts necessary for the stockholders to cast an informed vote.

FN1. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del.1986).

In this decision, I largely reject the plaintiffs' claims. Although the Lear Special Committee made an infelicitous decision to permit the CEO to negotiate the merger terms outside the presence of Special Committee supervision, there is no evidence that that decision adversely affected the overall reasonableness of the board's efforts to secure the highest possible value. The board retained for itself ***98** broad leeway to shop the company after signing, and negotiated deal protection measures that did not present an unreasonable barrier to any second-arriving bidder. Moreover, the board obtained Icahn's agreement to vote his equity position for any bid superior to his own that was embraced by the board, thus signaling Icahn's own willingness to be a seller at the right price. Given the circumstances faced by Lear, the decision of the board to lock in the potential for its stockholders to receive $36 per share with the right for the board to hunt for more emerges as reasonable. The board's post-signing market check was a reasonable one that provided adequate assurance that no bidder willing to materially top Icahn existed. Thus, I conclude that it is unlikely that the plaintiffs would, after trial, succeed on their claims relating to the sale process.

That said, I do find that a very limited injunction is in order. As noted, the Special Committee employed the CEO to negotiate deal terms with Icahn. But the proxy statement does not disclose that shortly before Icahn expressed an interest in making a going private offer, the CEO had asked the Lear board to change his employment arrangements to allow him to cash in his retirement benefits while continuing to run the company. The board was willing to do that, and even engaged a compensation consultant to generate potential options, but the consultant advised that accommodations of the type the CEO desired might draw fire from institutional investors, a factor that deterred the CEO from immediately accepting any renegotiation of his retirement benefits.

Because the CEO might rationally have expected a going private transaction to provide him with a unique means to achieve his personal objectives, and because the merger with Icahn in fact secured for the CEO the joint benefits of immediate liquidity and continued employment that he sought just before negotiating that merger, the Lear stockholders are entitled to know that the CEO harbored material economic motivations that differed from their own that could have influenced his negotiating posture with Icahn. Given that the Special Committee delegated to the CEO the sole authority to conduct the merger negotiations, this concern is magnified. As such, an injunction will issue preventing the vote on the merger vote until such time as the Lear shareholders are apprised of the CEO's overtures to the board concerning his retirement benefits.

II. *Factual Background*

A. *The Company And Its Industry*

Lear is one of the world's leading automotive interior systems suppliers, manufacturing complete automotive seat and electrical distribution systems and select electronic products. It is among the 150 largest companies in the United States with net sales of $17.8 billion to customers spanning the globe. The company is publicly traded on the New York Stock Exchange and has over 100,000 employees in over 200 facilities worldwide.

Despite its size and prominence in its market, Lear has been a troubled company in a depressed industry. The “Big Three” North American automotive manufacturers, Ford, General Motors, and DaimlerChrysler, which combined to account for over 65% of Lear's sales, have all been struggling due to high energy prices, increased prices of key commodities and raw materials, and heightened global competition. Further, Lear's highest margin products are components for SUVs and light trucks, a segment that has been hard hit by rising gasoline prices and concern over climate change.

***99** In addition to battling difficult market conditions, in 2005 and 2006, Lear faced the maturation of large amounts of debt. Concerns that the company would default on these obligations spurred bankruptcy rumors. Although Lear never defaulted, it came close to allowing the circling rumors to become reality.

Lear is managed by an eleven member board of directors. Only two board members-Robert E. Rossiter, Lear's chief executive officer, and James H. Vandenberghe, Lear's chief financial officer-are officers of the company. A third member of the current board, Vincent Intrieri, is affiliated with Icahn but independent for other purposes. The rest are directors whose independence the plaintiffs have not successfully questioned.

In 2005, the Lear board initiated a strategic planning process. As part of that process, Lear engaged J.P. Morgan Securities, Inc. (“JPMorgan”) to provide advisory services. Throughout 2006, Lear divested underperforming business units and restructured its debts. The Lear board also contemplated expanding its international business to reduce its reliance on the Big Three.

During this process, the well-known investor Carl Icahn made his first investment in Lear. Believing Lear's equity to be undervalued, Icahn purchased $100 million worth of Lear's common stock (about 4.9% of the total shares outstanding) at $16 to $17 per share beginning in March 2006. In the months after that investment, Lear's stock price increased in value, trading in around $20 per share.

Icahn's initial investment generated interest in Lear from private equity fund Cerberus Capital Management LP. On April 11, 2006, Lear's CEO, Rossiter, and other members of management met with Cerberus in New York. At the meeting, Cerberus pitched the idea of taking Lear private, but

Rossiter indicated that he was unwilling to do a leveraged buyout given the low $16-17 market price then prevailing. The brief discussion terminated with Rossiter noting that he “ha[d] shareholders ... to protect” and that he “felt uncomfortable talking about it.”

After fielding the interest generated by Icahn's investment, Rossiter and the Lear management team once again focused on implementing its new strategic initiatives. As part of that process, management presented a long-term financial plan based on the company's new strategy to the Lear board in July 2006. That “July 2006 Plan” reflected the company's restructured debt service obligations, the sale of Lear's underperforming interiors business, and contained aggressive changes to streamline the company's operations. It projected three business cases: an improvement case representing the best case scenario for emerging from the company's woes; a partial improvement case projecting somewhat less success in restructuring; and a sensitivity case accounting for many more problems and payments, including a 10% decline in North American production and $200 million in supplier support payments, financing fees, and additional investments necessary to turn Lear around. As a result of these differing outlooks, the midpoints of the DCF valuations for the three plans (from most to least optimistic) were $39.71, $30.22 and $18.00 per share, representing the possibility for material improvement from the company's then-existing market value of $21 per share.

Enticed by what he still considered to be a below-market stock price, Icahn again sought to increase his position in Lear. On October 2006, after making open market purchases bringing his interest to nearly 10%, Icahn sought to push his investment in Lear's common stock over the 15% threshold of 8 *Del. C.* § 203. To that end, ***100** he negotiated with the Lear board and ultimately agreed to a secondary offering of $200 million worth of Lear common stock. The terms of that offering included a per share price of $23, a waiver of the provisions of 8 *Del. C.* § 203, and a cap on Icahn's total holdings at 24%. In this process, Icahn did not have to negotiate a waiver of Lear's shareholder rights plan because Lear had allowed its plan to expire in December 2004 and had adopted corporate governance policies prohibiting such measures in the future absent a shareholder vote or consent of a majority of Lear's independent directors. The private placement closed on October 17, 2006, bringing Icahn's total holdings in Lear to 24% (including his 16% equity position and an additional 8% exposure through related financial instruments). As a result of these holdings, Icahn became Lear's largest investor and was able to appoint his lieutenant Intrieri to the Lear board to monitor his investment.

It is vital to note that Lear offered two of its other large shareholders the opportunity to participate in the October 2006 private placement on the same terms as Icahn. But both declined at the time saying the $23 per share price was too high. Now, however, one of those two shareholders, Pzena Investment Management, claims that Lear is worth $60 per share.

Immediately following Icahn's investment, Lear's common stock shot up in price. It rose over 15% on the first day of trading after the announcement and crossed the $30 per share threshold on October 26, 2006. Over the final months of 2006 and during the pre-merger period of 2007, Lear's stock traded within a range of a few dollars above or below that mark.

Having weathered the threatened storm of bankruptcy in 2005 and 2006, Lear's CEO, Robert Rossiter, sought to secure his personal financial position in the closing months of 2006. Rossiter, like many of Lear's top executives, had much of his personal wealth tied up in Lear stock, having reinvested in the company to help stave off its demise. Further, as the company's longest-serving executive with over 35 years experience, Rossiter had accumulated substantial benefits as part of his Supplemental Executive Retirement Plan and other non-qualified retirement plans (collectively, his “SERP”). These retirement benefits had a fully-vested value $14.6 million when Rossiter turned 65 in 2011, but they could be cashed out at a 9.6% annual penalty before that time. As such, Rossiter could access $10.4 million (roughly 70%) of his SERP benefits by mid-2007, *but only if he retired.*

Although its restructuring and Icahn's equity infusion had strengthened Lear's financial position, Rossiter knew that the company still had rough water to traverse. As Rossiter put it in an October 2006 e-mail, Lear was a “sick company operating in a sick industry.” His SERP benefits were not secured by specific Lear assets, and thus Rossiter worried that he would be treated like an unsecured creditor if Lear had to file for bankruptcy.

In November 2006, Rossiter approached the compensation committee and expressed his interest in accelerating his SERP payments to provide himself, and his family, with enhanced financial security. Rossiter felt this action was especially important because he could not easily liquidate his equity position due to management blackout trading periods and concerns that large sales by the Lear CEO would send a negative signal to the market and thereby diminish Lear's stock price. In response to Rossiter's inquiry, the compensation committee met and hired a compensation consulting firm, Towers Perrin, to prepare an analysis of Rossiter's SERP ***101** and to generate potential options for him to more quickly access his benefits.

In its reports, Towers Perrin presented five potential options to allow Rossiter to liquidate his retirement assets quickly while keeping his job and avoiding the full multi-million dollar haircut he would take by retiring early. Of those options, Towers Perrin recommended a plan on December 14 that would give Rossiter a $5 million lump sum payment immediately, three annual installment payments totaling another $5.4 million over the next three years, and a $3 million retention bonus payable if Rossiter remained with Lear through his 65th birthday. As a caveat to each of its options, Towers Perrin noted that there might well be adverse reactions from institutional investors, including the possibility that ISS, the influential proxy advisory firm, would support a withhold campaign against Lear and Rossiter in the future.

The compensation committee formally considered the Towers Perrin options on December 15 and conveyed them to Rossiter soon thereafter, explaining to him the financial and optical disadvantages inherent in selecting one of the available alternatives. Despite these hurdles, the Compensation Committee was willing to support Rossiter's selection from among the Towers Perrin options. Given the potential negative publicity and other problems, Rossiter did not jump at the chance to pursue any of the options. Whether to protect his own image, his full SERP, or Lear's future prospects, Rossiter declined to take any action on the matter before the new year. Rossiter never again pondered the difficult question of whether it was worth it to endure the public criticism he was likely to incur by accelerating his own benefits during a period of tumult in his industry. Icahn's proposal of a going private transaction preempted that thinking.

B. *The Merger Timeline*

On January 16, 2007, Rossiter met with Icahn over dinner in New York to discuss the changing automotive industry environment and its effect on Lear's competitive position. At that meeting, Rossiter was accompanied by Daniel Ninivaggi, Lear's chief administrative officer and general counsel. Ninivaggi came to Lear in 2003 from Winston & Strawn, LLP, the company's outside legal counsel, where he had been a partner. For his part, Icahn was joined by Vincent Intrieri, a senior officer of various Icahn affiliates and Icahn's appointee to the Lear board.

The topic of a potential transaction first arose when Rossiter lamented the volatile market conditions and the negative impact that it had on the company. In response to that comment, Icahn broached the possibility of acquiring Lear to allow the company to take a more long-term focus because it would be as a private company. Rossiter agreed that such a combination might be beneficial to Lear, and they began to explore the feasibility of that proposal.

Following the January 16 meeting, Rossiter, Icahn, Ninivaggi and Intrieri explored the process by which Icahn could obtain due diligence materials to review in support of a potential bid. The four spoke frequently, and the mood was friendly as Icahn expressed an interest in retaining the existing management of Lear, including Rossiter, Ninivaggi, the company's CFO Vandenberghe, and its COO and President Douglas DelGrosso. Also contributing to the collegial mood was Icahn's indication that he would not proceed with a hostile bid if the Lear board was not open to negotiating with him.

***102** After a week of discussions, on January 23, Rossiter began to inform the other members of the Lear board about the ongoing merger discussions. That day, Rossiter called two of Lear's independent directors, Larry McCurdy and James Stern, to inform them of what had transpired over the previous week. He also involved Lear's outside legal counsel,

Ninivaggi's former law firm, Winston & Strawn, in the discussions with Icahn for the first time. The following day, three more of Lear's independent directors-David Spalding, Henry Wallace, and Richard Wallman-were brought into the process, and, on January 25, the full board was convened.

At the January 25 board meeting, Ninivaggi presented the board with the status of the ongoing merger talks because Rossiter was traveling overseas on other business. Once up to speed, the board formed a “Special Committee” to oversee the merger process. As is typical of such committees, the Lear Special Committee was empowered to evaluate and negotiate proposals from Icahn and to consider alternatives thereto. Unlike similar committees in some other contexts, however, the defendants admit that the Lear Special Committee was formed to facilitate swifter responses than could be achieved by the full board, not to act as substitute for conflicted management. The three independent directors appointed to the Special Committee-McCurdy (the Committee's chairman), Stern, and Wallace-were selected based on their industry expertise and experience in the merger and acquisition arena.

Upon its formation, the Special Committee did not insert itself or its advisors into the merger negotiations. The Special Committee stood back from the front lines of due diligence and the negotiation of price and other merger terms. Because the Special Committee did not view the Icahn overture as presenting a conflict situation for Rossiter or his subordinates-or at least not one that required the Special Committee to take the lead-it allowed Rossiter to spearhead the negotiations. The Committee believed him to be the most knowledgeable person regarding Lear, as an effective salesman, and thus the best negotiator. Plus the Committee planned to keep management on a “short leash”.

Lear secured a confidentiality agreement from Icahn and his affiliated entity, American Real Estate Partners, LP (“AREP”), which he planned to use to consummate the acquisition. Once the confidentiality agreement was delivered, Icahn and AREP began due diligence. As part of that process, meetings focusing on the Lear strategy encapsulated in the July 2006 Plan and its execution since it was formulated were held in New York on January 28 and 29 between the representatives and advisors of the companies. As a result of these discussions, the company requested that its financial advisor, JPMorgan, update the July 2006 Plan based on the current industry outlook. At the conclusion of the meetings, Icahn expressed his interest in continuing forward with a transaction and confirmed in general terms his intention to retain Lear's senior management.

The Special Committee was apprised of these developments at a meeting on January 30. During that session, it engaged the company's long-serving legal and financial advisors-Winston & Strawn and JPMorgan-as its own and hired Richards, Layton & Finger P.A. to provide additional advice on Delaware law. Consistent with its view throughout the process, the Special Committee did not see a material conflict between the interests of Lear, its public stockholders and its management in this process. As a result, the Special ***103** Committee considered the potential conflicts of interest the engagements of Winston & Strawn and JP Morgan posed, but it concluded that the benefits of hiring advisors already familiar with Lear warranted their retention.

The Special Committee's next meeting took place on February 1, 2007. The purpose of that meeting was to review management's revised financial projections. These revised figures took into account lower production forecasts for the Big Three auto manufacturers generated by J.D. Power & Associates and were generally more pessimistic than those underlying the July 2006 Plan. Eight drafts of the February 1 projections were prepared during the early morning hours of that day, but only the final version was presented to the Special Committee for consideration.

Price negotiations began on February 2. The Special Committee members absented themselves from that key task, delegating it to Rossiter as CEO. Rossiter included some of his subordinates, particularly Ninivaggi, in the negotiations at times. But neither JPMorgan nor any Special Committee member participated in those talks.

During one of many telephone calls on February 2, Icahn made an oral bid to acquire Lear at a price of $35 per share. As part of that offer, Icahn was willing to agree to a go-shop period during which Lear could actively solicit higher bids, but, in exchange, Icahn demanded a termination fee plus reimbursement of up to $20 million in expenses if his bid was topped. Rossiter responded that he could not support a deal on those terms. Nonetheless, he said he would take Icahn's offer to the Special Committee.

The Special Committee shared Rossiter's view that Icahn's initial proposal was inadequate and rejected Icahn's $35 bid. Although the Committee never determined what an appropriate price for the Lear equity would be, there is evidence the company expected a bid in the $36 to $38 range. Ninivaggi testified that he thought the offer would be between $36 and $37 per share. Rossiter said he thought that $35 was “a pretty low offer.”

Rossiter conveyed the Special Committee's message to Icahn on a call initiated immediately following the Special Committee's meeting. On that call, Rossiter was joined by the CFO, Vandenberghe; Lear's president and COO, Douglas DelGrosso; and by Winston & Strawn. Again, neither JPMorgan nor any of the Special Committee members took part in this discussion.

When Rossiter informed Icahn that the Special Committee had rejected his $35 per share offer, Icahn raised his bid by a quarter to $35.25. Acting on instinct rather than pausing to solicit the Special Committee's input, Rossiter rejected that new bid immediately based on his understanding of the Special Committee's position as expressed earlier in the evening on February 2. Later in the call, Icahn countered with another seventy-five cent jump to $36 per share, but identified that price as his highest and final offer. Taking Icahn at his word, Rossiter said he would convey that bid to the Special Committee the next day.

Before he conveyed Icahn's new position to the Special Committee or obtained any guidance on how best to respond, Rossiter reinitiated negotiations with Icahn on the morning of February 3 to see if he could improve the offer in hand. Icahn reiterated his position that he would not offer more than $36 per share, but he said that he would pay a reverse break-up fee if he breached the merger terms and he indicated that he could be flexible in negotiating the terms of the go-shop period and termination fee. Icahn also became, in his ***104** words, “a little peeved,” telling Rossiter “I told you I'm not going higher.... [R]est assured you got the best price you could have, don't come home tonight and think about whether you could have gotten more. You're not getting any[.]”

Having struck out on a higher price, Rossiter shared the $36 bid along with the additional information he had gleaned from Icahn with the Lear board at their meeting later in the day on February 3. Presented with a firm price for the first time, the Lear board debated the merits of a merger with Icahn, both with management and JPMorgan present, and then in an executive session of the independent directors. To assist in fleshing out the pros and cons of the proposed deal, JPMorgan presented an update to its February 1 financial analysis of Lear. After considering the multiple cases JPMorgan presented, the Special Committee determined that the most conservative of the projections, a variant of the July 2006 Plan's sensitivity case, was most representative of the current industry outlook. As a result they adopted those projections and dubbed them the “Long Range Plan with Current Industry Outlook.” The Special Committee desired a higher price but recognized that Icahn's offer was attractive in view of the risks Lear faced in achieving even its conservative projections.

In executive session, the Lear board also debated the merits of engaging in a more formal sale process or auction. Although this method might secure a premium bid, the board was concerned that it would disrupt the company's business and customer relationships or that it might cause Icahn to withdraw. The second was the board's larger concern, as Icahn had indicated that he would pull his offer if Lear chose to undertake a full-blown auction. Both Icahn and Lear recognized that Lear's stock was trading at a very high level-over twice the price at which Icahn made his initial investment-and that it might decline sharply if Icahn pulled out of discussions. Using that knowledge, Icahn told Lear that “if the company turned down [his] offer ... he would just sit back, remain a stockholder ... [and] in the event [Lear's] stock would drop back down to 30 or 29 ... he would come in later with a lower offer.”

In light of those potential pitfalls, the board decided that the go-shop structure of securing a firm commitment to merge before soliciting others was the best solution to maximize shareholder value. The

board did not endorse the terms that were contained in the draft merger agreement it received that evening, though, because it hoped a more favorable break-up fee and a longer shopping period could be obtained. Further, the Board insisted that Icahn sign a voting agreement to support a superior proposal before it would recommend his proposal.

Negotiations over those terms took place over the next three days and included in-person meetings on February 5 and 6. The results of those discussions were Icahn's agreement to a voting agreement of the type demanded by the Lear board, and to a termination fee, tiered to be lowest during the go-shop period and increase slightly thereafter. To obtain these terms, the Special Committee and Lear management at their direction rejected several less favorable proposals and continually sought further improvement of the Icahn offer.

On February 5, the status of the merger negotiations was formally disclosed. Lear issued a press release that day describing the talks, and Icahn filed a disclosure with the SEC relating to AREP's $36 per share proposal.

During the same period-from February 4 through February 7-the Special ***105** Committee engaged JPMorgan to solicit expressions of interest from third parties that might have an interest in acquiring Lear. Without time to conduct anything but a discrete canvass, the Committee merely tested the waters by contacting eight financial buyers with a listing of interest in the auto sector. Over the next four days, JPMorgan received three flat "no" responses and five tepid "maybes" from buyers who were of Icahn's $36 proposal. Neither JPMorgan nor Lear viewed any of these responses as a serious expression of interest as none of those potential buyers expressed even a concrete desire to pursue due diligence and none made even a preliminary proposal. Notably, Cerberus, which had indicated an expression in doing a deal with Lear in April 2006, was among the eight potential suitors contacted by JPMorgan. Its reaction was tepid the second time around, saying only that it would need to know more about the company.

On February 7, the Special Committee learned the results of JPMorgan's limited market canvass and reviewed the fairness opinion that JPMorgan prepared. That opinion expressed JPMorgan's view that the $36 per share compensation to be received by Lear stockholders was fair from a financial point of view given the opportunity to shop the deal after signing. JPMorgan buttressed its fairness opinion with a detailed presentation to the Special Committee, which provided a variety of analytical perspectives on Lear's value. In addition, Evercore LLC, an auto industry expert, rendered advice consistent with JPMorgan's view.

Taking that information into account, the Special Committee met and deliberated with its advisors, but was unable to reach a consensus. As a result, the Committee sought to continue its deliberations the next day. Icahn, however, had different ideas, again indicating that he would withdraw his offer if it was not accepted. In his words, he did not want his offer "hanging out there" to be used as a public stalking horse without the protection of a signed merger agreement. This threat had teeth because of the elevated price at which Lear's stock was trading and the likelihood that it would fall if no deal emerged. As a result, the Special Committee negotiated a one-day extension from Icahn and reached a decision on his proposal the following day.

On February 8, the Special Committee unanimously voted to support a merger with AREP at $36 per share. It noted that the price represented a 3.8% premium to the closing price on February 2, the day Icahn's first bid was received, a 46.4% premium to the price on the day Icahn's October 2006 private placement closed, and a 55.1% premium to the 52-week volume weighted average price of Lear's stock. On the basis of these premiums, the JPMorgan fairness opinion, Evercore's industry assessment, its limited pre-signing market check, and the contractual protections it had negotiated including the go-shop, the Special Committee concluded that signing up Icahn's $36 per share offer maximized the value Lear shareholders could obtain for their equity. The Lear board adopted the Special Committee's recommendation the same day, and the "Merger Agreement" was signed the next morning, on February 9.

To maximize the value of the go-shop provision, the Lear board authorized JPMorgan to begin soliciting interest as soon as the Merger Agreement was signed. Roughly two weeks later, on February 26, it also expanded the engagement of Evercore to have it help JPMorgan in soliciting and evaluating competing proposals. JPMorgan and Evercore each had ***106** a substantial financial incentive to secure a topping bid.

During the go-shop period, Lear's financial advisors contacted a total of 41 potential buyers, including 24 financial sponsors and 17 strategic acquirers. These presentations pitched the company as an acquisition target based on public information and promised access to a data room of non-public information and to company management if any of the buyers were willing to execute a confidentiality agreement. Only 8 of the 41 firms took this first step.

Cerberus was again among those contacted to consider a bid for Lear. It did not submit a bid despite being offered access to the additional information it indicated it would need to consider a bid when contacted by JPMorgan during the hurried pre-signing market canvass. This reaction was typical of the five financial buyers who showed faint interest when approached during the days before the Merger Agreement was signed. None made an offer for Lear.

By the end of the go-shop period on March 26, 2007, none of the buyers that were solicited had made even a preliminary bid. No unsolicited bids were tendered during this period either. Three firms, however, were still engaged in ongoing discussions. Two of those dropped out of the process soon after March 26. The one potential bidder remaining, Tata AutoComp Systems Limited ("TACO"), requested permission on May 9 to bring on two private equity sponsors to look at a possible joint acquisition. That consent was given on May 14. Despite this accommodation and multiple deadline extensions to submit a competing bid, neither TACO nor its consortium ever made an offer to purchase Lear. On May 30, TACO informed Lear that it was withdrawing from the process, and Lear conveyed that information to the court in a status update letter.

Unsatisfied with the substance of Lear's letter to the court, TACO wrote a letter to Ninivaggi lodging its complaints with the substance in and public disclosure of status letter. Those complaints included claims that the Lear data room was not fully stocked, that TACO was denied the unfettered access to management it desired, and more generally that TACO had not been appropriately treated as a bidder. A review of the record reveals that TACO's complaints are likely unfounded.

TACO is the American subsidiary of a large Indian automotive business. It was solicited early on in the go-shop process and did not make a timely response. It meandered into the process later on, claiming to need equity partners, and proposed shifting potential alliances with different advisors. Lear responded professionally throughout the process and tried to keep TACO in the game.[FN2] But ultimately TACO was unwilling to step up and make a bid, because it could not attract other likely sources of equity (many of which had already passed on Lear when solicited directly by Lear) and because its parent company would not take on the equity acquisition costs in the first instance, with the opportunity to find equity partners after closing. In this regard, it is also notable that Lear was offering stapled debt financing through JPMorgan that TACO could have accepted.

> FN2. Lear made its top managers available for lengthy meetings on several occasions and provided TACO and its shifting array of advisors and possible partners with adequate and timely due diligence, which was appropriately conditioned on safeguards to protect Lear's proprietary interests. TACO's protestations to the contrary are not convincing.

***107** Although the plaintiffs seized on the TACO letter as helpful to them, TACO's complaints are best understood as reflecting a desire on the part of TACO's parent not to be seen as lacking credibility as a buyer in an American market with which it has little experience. In that regard, it is telling that TACO complains that its TACO acronym was not used by Lear in its report to the court, and that Lear used the name Tata in describing this bidder. Of course, the T in TACO stands for Tata, the name of its parent. There is nothing to this issue. Lear has indicated that it will include TACO's letter in an 8-K and thus interested Lear stockholders can ponder it for themselves. About TACO, I need, and will, say no more.

In any event, as of the date of the hearing, no potential bidders were on the scene seeking to outbid Icahn.

C. *The Merger Terms*

1. *The Merger Agreement*

The Merger Agreement grants Icahn two primary deal protections for allowing its offer to be used as a stalking horse: a termination fee payable if Lear accepted a superior proposal from another bidder and matching rights in the event that a superior proposal is presented. In exchange, the Lear board secured an ability to actively solicit interest from third parties for 45 days (the so-called "go-shop" period), a fiduciary out that permitted the board to accept an unsolicited superior third-party bid after the go-shop period ended, a reverse termination fee payable if AREP breached the Merger Agreement, and a voting agreement that required Icahn, AREP, and their affiliates to vote their shares in favor of any superior proposal that AREP did not match.

The termination fee that AREP would be entitled to depended on the nature and timing of Lear's termination of the Merger Agreement. Both parties had a right to terminate the Merger Agreement if that Agreement was not approved by Lear's stockholders, but if no superior transaction was completed within a year of the negative stockholder vote, no termination fee was due. If, however, a superior proposal was accepted by Lear such that the company "substantially concurrently" terminated the Merger Agreement and entered into an alternate acquisition agreement, AREP was entitled to a termination fee contingent on the timing of termination. Likewise, AREP could claim a break-up fee if the Lear board withdrew its support (or failed to reconfirm its support when requested to do so) for the AREP offer.

In the event that AREP was entitled to a termination fee, the amount of that fee depended on the timing of the termination of the Merger Agreement. If the Agreement was terminated during the go-shop period, Lear was required to pay to AREP a fee of $73.5 million plus up to $6 million in reasonable and documented expenses. At most, this amounted to a payment of $79.5 million, which is 2.79% of the equity value of the transaction or 1.9% of the total $4.1 billion enterprise value of the deal. In the alternative, if the merger was called off after the go-shop period ended, AREP was entitled to a higher fee of $85.225 million as well as up to $15 million in expense reimbursements. This payment of roughly $100 million amounted to 3.52% of the equity, or 2.4% of the enterprise, valuation of Lear. Viewed in light of the 79.8 million Lear shares outstanding on a fully diluted basis at the time of the merger, the $79.5 million break-up fee due upon termination during the go-shop period translated into a willingness to pay a little less than a dollar more than Icahn's $36 bid. The $100 million fee equated to a bid increase of roughly $1.25 per share.

***108** In addition to these termination fees, AREP was protected by a contractual right to match certain superior bids that Lear received. If Lear fielded a superior proposal, the Merger Agreement forced Lear to notify AREP of the proposal's terms and afforded AREP ten days to determine whether it would increase its offer to match the superior terms. If the superior proposal was in excess of $37 per share, AREP only had a single chance to match, but if it did not cross that threshold, Lear was obligated to allow AREP three days to match each successive bid. In the event that AREP decided not a match a superior proposal, it was obligated to vote its bloc of shares in favor of that transaction under the voting agreement it executed in combination with the Merger Agreement. The combination of match rights with the voting agreement signaled the willingness of Icahn to be either a buyer or seller in a transaction involving Lear.

In exchange for the protections that Icahn and AREP received, the Merger Agreement permitted the Lear board to pursue other buyers for 45 days and then to passively consider unsolicited bids until the merger closed. But, once that 45-day window closed, a second phase, which might be called a "no-shop" or "window-shop" period, began during which the Lear board retained the right to accept an unsolicited superior proposal.

Lear was also protected in the event that AREP breached the Merger Agreement's terms by a reverse termination fee of $250 million. That fee would be triggered if AREP failed to satisfy the closing conditions in the Merger Agreement, was unable to secure financing for the $4.1 billion transaction, or otherwise breached the Agreement. But AREP's liability to Lear was limited to its right to receive this fee.

2. *Executive Retention And Compensation*

Outside of the Merger Agreement's four corners, Icahn also reached accord with key Lear managers to continue their employment with Lear. AREP agreed to retain three of Lear's senior executives: Rossiter, Vandenberghe, and DelGrosso. Delgrosso will serve as CEO of the surviving corporation; Rossiter will become Executive Chairman; and, Vandenberghe will be CFO and Vice Chairman. For his promotion to CEO, DelGrosso will get a salary increase from $925,000 to $1.15 million and a bonus pegged at 125% of his base salary. Rossiter will earn $50,000 in extra salary in his new role, going from $1.1 million to $1.15 million and Vandenberghe will make the same $925,000 annual salary that he earned before the merger. Rossiter and Vandenberghe will earn bonuses of 150% and 100% of their base salaries, respectively. These bonus percentages are the same as before the merger, but now they are guaranteed rather than contingent on Lear's performance.

Rossiter, Vandenberghe, and DelGrosso will also net material sums from their existing equity holdings in Lear as a result of the merger. Rossiter, Vandenberghe and DelGrosso own 358,297, 235,984 and 175,312 Lear shares, respectively. Each of these officers also holds large numbers of options and other securities redeemable for Lear common stock.

On an all in basis, Rossiter stands to receive $11.5 million for his Lear equity in the merger. Vandenberghe and DelGrosso will receive $7 million and $5 million respectively for their shares and options.

But, the three executive officers also amended their employment agreements so that the merger would not trigger the sizable change of control payments to which they would otherwise be entitled. ***109** In the event of a termination upon a change of control, Rossiter was entitled to $15.1 million in total termination benefits. Vandenberghe was entitled to $8.4 million in benefits, and DelGrosso would net nearly $6 million.

Each of these three executives also had accrued substantial retirement benefits based on their lengthy employment with Lear. As of the close of 2006, Rossiter, Vandenberghe, and DelGrosso could receive accumulated retirement benefits (accounting for early withdraw penalties) of $10 million, $5.5 million, and $1.2 million, respectively, if and only if they actually retired. If, however, these executives remained with the company until they fully vested in these plans by obtaining the age of 65 or meet certain other criteria, they stood to receive a substantially greater sum. For example, if Rossiter fully vested, he would earn the full amount of his accrued SERP benefits, which had a present value of $14.6 million.

Through the merger, Rossiter, Vandenberghe, and DelGrosso were able to access their full accrued benefits within two years, rather than waiting until they otherwise earned-out those benefits. To that end, their employment agreements were amended to provide that each of the continuing executives could elect to receive 70% of their accrued SERP benefits (without any reduction for early withdraw) [FN3] on January 15, 2008, and the remaining 30% of those benefits a year later on January 15, 2009. Through these amendments, the executives could take some solace that they would be able to more quickly convert unfunded promises that might never reach full value if the company went bankrupt into liquid assets beyond the reach of the company's creditors.

FN3. Lear's retirement and equity incentive plans are exceedingly complex. The merger proxy statement references an "accumulated benefit under the supplemental pension plans" as payable, which seems to indicate that no withdrawal penalty will be assessed, but the amendments to the executives' employment agreements (attached as an appendix to the proxy) say that benefits "shall ... be paid ... under the terms and conditions of such plans, programs, or arrangements," which may mean that the early withdraw haircut is still in effect. Moreover, nowhere in the proxy statement are total accrued retirement benefits, without the haircut, disclosed. Rather, the only figures presented are the end of year values of the plans for 2006 (likely included because the annual meeting for that year is the same day as the shareholder vote). In light of this textual confusion, the court has relied on the understanding advanced by plaintiffs, and not objected to by defendants, that the executives will receive their maximum accrued retirement benefits without penalty in two slugs, 70% in 2008 and 30% in 2009.

Importantly, these executives also secured the right to remain as well compensated executives and to share as equity investors in the future appreciation of Lear at the same time as they hedged against a decline in its prospects. As a result of the merger, Rossiter, Vandenberghe, and DelGrosso each will be granted options to purchase equity in the surviving entity, apparently with a strike price set at the merger price of $36. Rossiter and DelGrosso will be entitled to options for 0.6% of the total common stock and Vandenberghe will gain options for 0.4% of the equity. These options will have a ten year term and will vest in equal annual installments over a four year period, but will accelerate and vest upon a later change of control, and, in the case of Rossiter and DelGrosso, if they are terminated without cause or quit for good reason.

III. *Legal Analysis*

[1] The plaintiffs seek a preliminary injunction against the merger. The legal framework for evaluating such a motion is ***110** well-established, and requires the plaintiffs to convince the court that their claims have a reasonable likelihood of ultimate success, that they face irreparable injury if an injunction does not issue, and that the balance of the equities favors the grant of an injunction.FN4

FN4. *E.g., Revlon,* 506 A.2d at 179.

The plaintiffs' lengthy claims boil down to two alleged categories of breaches of the Lear board's fiduciary obligations. The first category involves a contention that the Lear board did not comply with its fiduciary duty to disclose all material facts relevant to the stockholders' decision whether to approve the merger. The second category of fiduciary breaches alleged by the plaintiffs comprises the various reasons the plaintiffs contend that the directors failed to take reasonable efforts to secure the highest price reasonably available for Lear shareholders.

I will set forth the plaintiffs' specific arguments and the relevant standards of review in the course of addressing those claims in the merits prong of the preliminary injunction analysis. Because I can efficiently apply the equitable balancing test that is crucial to the preliminary injunction standard in the context of dealing with the merits, I will do so.

I will begin those tasks by grappling with the plaintiffs' disclosure claims.

A. *The Plaintiffs' Disclosure Claims*

[2] Both parties acknowledge that directors of Delaware corporations have a duty to disclose the facts material to their stockholders' decisions to vote on a merger.FN5 The debate here is whether the supposed facts the plaintiffs claim are omitted meet the legal definition of materiality. That definition is also well-established and is one embraced by both our Supreme Court and the United States Supreme Court:

FN5. *Arnold v. Society for Savings Bancorp., Inc.,* 650 A.2d 1270, 1277 (Del.1994).

An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.... Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the “total mix” of information made available.FN6

FN6. *Zirn v. VLI Corp.,* 621 A.2d 773, 778-79 (Del.1993) (quoting *TSC Industries, Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976)).

In their complaint, the plaintiffs purport to set forth a Denny's buffet of disclosure claims. But, in their briefs, the plaintiffs argue only three of these supposed deficiencies in disclosure. I therefore only address those contentions, as the others have been waived.FN7

FN7. In their briefs, the plaintiffs attempt to preserve their additional disclosure claims listed in their complaint simply by referencing the complaint. That is not a proper way to brief issues and constitutes a waiver of those arguments. *Emerald Partners v. Berlin,* 2003 WL 21003437, at *43 (Del.Ch.2003), *aff'd,*840 A.2d 641 (Del.2003).

[3] The first disclosure claim the plaintiffs press involves the failure of the proxy statement to disclose one of the various DCF models run by JPMorgan during its work leading up to its issuance of a fairness opinion. The plaintiffs admit that the proxy statement provides a full set of the projections used by JPMorgan in the DCF it prepared that formed part of the basis of its fairness opinion. The plaintiffs also admit that the proxy statement discloses the range of values generated from a DCF analysis using a more optimistic set of ***111** projections derived from the July 2006 Plan, an analysis that was also fully disclosed in Lear's Rule 13E-3 public disclosure concerning the merger. To wit, the proxy statement informs shareholders that the more optimistic assessment based on the July 2006 Plan figures resulted in a range of values between $35.90 and $46.50 per share, a range that was *materially higher* than the $28.59 to $38.41 span contained in the undisclosed model.

But the plaintiffs quibble because they say that the proxy statement fails to disclose a DCF model prepared by a JP Morgan analyst early in the morning on February 1. That model used modestly more aggressive assumptions than those that formed the basis for the DCF model used in JPMorgan's final fairness presentation. Although this model was simply the first of eight drafts circulated before a final presentation was given to the Lear board later that day, the plaintiffs say that the omission of this iteration is material.

The problem for the plaintiffs is that they did not develop any evidence in discovery that suggested that this model was embraced as reliable by either the senior bankers in charge of the deal or by Lear management. From the record before me, it appears that the proxy statement fairly discloses the Lear management's best estimate of the corporation's future cash flows and the DCF model using those estimates that JPMorgan believed to be most reliable. The only evidence in the record about the iteration the plaintiffs say should be disclosed suggests that it was just one of many cases being prepared in Sinatra time by a no-doubt extremely-bright, extremely-overworked young analyst, who was charged with providing input to the senior bankers. As the plaintiffs admitted, they did not undertake in depositions to demonstrate the reliability of this iteration, much less that it somehow represented JPMorgan's actual best effort at valuing Lear's future cash flows. On this record, the plaintiffs have failed to demonstrate a reasonable likelihood of success on their claim that the proxy statement failed to disclose material facts regarding the value of Lear's future cash flows.

[4] The plaintiffs' second disclosure claim, which faults the Lear board for not disclosing certain aspects of the pre-signing and post-signing market checks, is equally without merit. For one thing, the claim is framed in argumentative terms, faulting the proxy statement for not confessing that Rossiter was supposedly predisposed solely toward financial buyers like Icahn and had no interest in a sale to a strategic acquirer. That sort of request for self-flagellation does not suffice as a disclosure claim.FN8 More substantively, the plaintiffs allege that the proxy statement does not fairly indicate how Icahn's tough negotiating posture limited Lear's ability to conduct a pre-signing market check. But the key facts are disclosed. It is clear that the only pre-signing market check was a very discrete solicitation of financial buyers, conducted in a hurried fashion beginning on February 4. The Merger Agreement was signed by February 9. No reasonable stockholder reading the proxy statement would likely be deceived into believing that any of those solicited would have had a rational ability to make a bid before February 9, unless they had already been coiled to strike. Any reasonable stockholder would read the proxy statement and conclude that the only genuine***112** market check was the one conducted after the Merger Agreement was executed.

FN8. E.g., *Brody v. Zaucha,* 697 A.2d 749, 754 (Del.1997); *accord Goodwin v. Live Entertainment, Inc.,* 1999 WL 64265, at *20 (Del.Ch.1999)(“[T]he fact that [defendants] did not characterize the course of events in a negative manner does not constitute a breach of the duty of disclosure.”), *aff'd,*741 A.2d 16 (Del.1999).

Furthermore, although the proxy statement does so rather matter-of-factly, it clearly indicates that Icahn made clear on February 2 that $36 was his “best and final offer,” Icahn's unwillingness throughout February 3 to change that price, and that, on the evening of February 4, Icahn had again resisted a

request to increase the price and had expressed an unwillingness “to further negotiate these transaction terms.” The proxy statement goes further and makes clear that Lear did not seek a price change after February 5-when Icahn and the company had already publicly disclosed his $36 bid-precisely because Icahn had said he would go no higher, but that Lear continued to negotiate over the termination fee and other terms. Anyone reading these facts would have concluded that Icahn had told Lear that he would not continue to keep an offer on the table if Lear intended to engage in a full-blown pre-signing auction. Given that the proxy statement makes plain that Icahn did not give Lear everything it desired in terms of its ability to shop after signing the Merger Agreement, it makes even more obvious that Icahn was not willing to be an amateur stalking horse-i.e., one without a definitive acquisition agreement containing a termination fee if another bidder ultimately prevailed. Similarly, I see no basis for the plaintiffs' contention that the proxy statement somehow fails to disclose that the go-shop period Icahn had assented to was somehow truncated from 60 to 45 days. There is evidence that Lear desired a 60 day go-shop period but none that Icahn ever assented to its wish. The proxy statement does not misrepresent the actual terms agreed to and this sort of minor back-and-forth need not be disclosed.

The reality is that the proxy statement fairly discloses that Lear did not do any meaningful pre-signing market check, that it merely made a few hasty phone calls to see whether it was missing any imminently available opportunity, and that Lear was depending on the post-signing go-shop process to be its real market check. The proxy statement also fairly discloses that the Lear board realized the importance of the post-signing shopping period, and sought to lengthen it and to strengthen its utility through means such as getting Icahn to promise to vote his shares in favor of a superior proposal embraced by Lear. Although the plaintiffs raise other quibbles about the description of the negotiating and shopping processes, they do not point to a material deficiency in the information provided by the proxy statement. That statement gives a materially accurate rendition of what the Lear board did and did not do to try to get the highest bid.

[5] The plaintiffs' final disclosure argument has more force, and is founded on a less argumentative, and more factually objective, variation of their concerns about Rossiter's motivations. The proxy statement fails to disclose the fact that, in late 2006, Lear's CEO Rossiter approached the board expressing a serious concern about whether it was in his best interest to continue as CEO in light of the financial risks that presented. In particular, Rossiter was concerned about having so much of his net worth tied up in Lear. So long as he continued to work as CEO, Rossiter could not cash in his substantial retirement benefits. If he retired immediately, having worked for Lear for 35 of his 60 years but not yet having fully vested by attaining the age of 65, Rossiter's accrued retirement benefits would be reduced by a 29% early withdraw penalty, and he would reap approximately $10.4 instead of $14.6 million. ***113** Because the bulk of those retirement benefits were not secured by any specific assets, Rossiter feared that he could be at risk in the event that an industry downturn-a realistic possibility for the American automotive industry, history suggests-forced Lear into bankruptcy, as he would just be an unsecured creditor.

Likewise, Rossiter owned a lot of Lear stock. As CEO, he faced two trading problems. For starters, he was locked out from selling in many periods because of concerns about insider trading liability. Relatedly, as CEO, if he took steps to sell large amounts of stock, it could signal a lack of confidence in the company, and lead to a decline in the stock price that would hurt his holdings and the company's future prospects. Although Rossiter, like most CEOs, was simply facing the portfolio risks that come with wealth attributable largely to labor at one firm, those risks were real, especially as he faced an age at which it would be more difficult for him to locate another CEO position. Put another way, Rossiter knew that his retirement nut was what it was from his years of labor, and he was wondering whether it was time to cash it out and take it with him.

Rossiter's concern was serious enough that he engaged his board, and the board, fearing his departure, employed an expensive compensation consultant, Towers Perrin, to provide it with options. Towers Perrin generated a formal report, which included options that were financially attractive to Rossiter. By these options, Rossiter's financial concerns would have been addressed. He would have secured his fortune for his family, and been able to continue as CEO without worrying that the bulk of his net worth remained at risk.

The Lear board seems to have been willing to provide these benefits to Rossiter but-and that “but” is important-the Towers Perrin report indicated that changes of this kind were likely to raise eyebrows among institutional investors and the proxy advisory firms who advise them. In an environment in which executive compensation was viewed with great suspicion generally, Lear was advised by Towers Perrin that it would have to do a selling job in order to avoid adverse consequences, which could include the possibility of a withhold vote campaign. Although not made explicit, one also suspects that industry conditions made these changes problematic. The auto industry was enduring pain, and this pain put pressure on industry employers to cut employment costs. At other corporations, this meant asking long-time employees and union laborers for wage and benefit concessions and, even worse, cutting jobs. In that environment, the desire of a well-compensated, Michigan-based CEO to secure his multi-million dollar retirement nest egg from the risks of a continuing industry downturn might not have been well received.

As of the end of 2006, Rossiter had therefore not embraced the board's willingness to provide him relief of the kind he desired. The defendants make much of this and say that Rossiter's non-acceptance makes the non-disclosure of his request to the board and its reaction immaterial.

I draw an entirely different inference. One can assume that Rossiter's motives for not accepting the options Towers Perrin presented were entirely worthy of respect and still conclude that these facts are material. It may well be that Rossiter believed that it would be bad for Lear for him to accept these concessions and subject Lear to the distractions of institutional investor objections and community criticism.

But if that was indeed the case, the materiality of these facts becomes even more obvious. So long as Lear remained a ***114** public company, Rossiter faced a conflict between his desire to secure his retirement nut and his desire to continue as a CEO. Yet, if a going private transaction was presented that cashed out the public stockholders at a premium, Rossiter could strike a deal with the buyer that allowed him to accomplish both of his desires. So long as the going private was consummated, Lear would no longer face the intense corporate governance and social responsibility scrutiny directed at public corporations. Likewise, a going private would allow Rossiter to turn his locked-up equity stake into liquid American greenbacks along with all the other public stockholders but with the chance (not available to them) for a future equity stake in Lear.

In his deposition testimony, Rossiter was forthcoming about the fact that he viewed a going private transaction as attractive. No doubt some of his reasons had nothing to do with his personal interests (e.g., the ability for Lears to carry on its business in an industry with great challenges and cyclical swings without worrying about quarterly earnings calls). But a going private also presented him with a viable route for accomplishing materially important personal objectives.

The following facts cement my view that the failure of the proxy statement to disclose Rossiter's negotiations with the board over his SERP and equity stake rises to the level of a material omission:

- Rossiter discussed a going private transaction with Icahn for more than a week before he disclosed Icahn's expression of interest to the board;
- The board thereafter permitted Rossiter to negotiate the key terms of the merger with Icahn outside the presence of any independent director or the Special Committee's investment banker without any specific pricing guidance from the Special Committee;
- The merger allows Rossiter to cash out all of his equity stake in Lear in one lump sum; and
- Icahn agreed to employment terms with Rossiter that allowed Rossiter to secure a short-term schedule for the payout of his retirement benefits, obtain an improved salary and bonus package, and secure a large grant of options giving him a lucrative upside if Lear performed well after the merger.

Put simply, a reasonable stockholder would want to know an important economic motivation of the negotiator singularly employed by a board to obtain the best price for the stockholders, when that

motivation could rationally lead that negotiator to favor a deal at a less than optimal price, because the procession of a deal was more important to him, given his overall economic interest, than only doing a deal at the right price. By saying this, I do not find that Rossiter acted in any way inappropriately, I am only saying that the stockholders would find it material to know the motivations he harbored that substantially differed from someone who only owned equity in Lear or who only served as an independent director of Lear.

[6][7][8] For these reasons, I conclude that the plaintiffs have established a reasonable probability of success on the merits as to one of their disclosure claims. Delaware corporation law gives great weight to informed decisions made by an uncoerced electorate.[FN9] When disinterested stockholders make a mature decision about their economic self-interest, judicial second-guessing is almost completely circumscribed***115** by the doctrine of ratification.[FN10] For that reason, our law has also found the irreparable injury prong of the preliminary injunction standard satisfied when it is shown that the stockholders are being asked to vote without knowledge of material facts, because it deprives stockholders of the chance to make a fully-informed decision whether to vote for a merger, dissent, or make the oft-related decision (relevant here) whether to seek appraisal.[FN11] Moreover, the risks presented by an injunction are modest as the injunction persists only so long as necessary to ensure appropriate disclosure before the merger vote.[FN12]

FN9. *E.g., Solomon v. Armstrong,* 747 A.2d 1098, 1117 (Del.Ch.1999), *aff'd,*746 A.2d 277 (Del.2000).

FN10. *E.g., In re PNB Holding Co. S'holders Litig.,* 2006 WL 2403999, at *14 (Del.Ch.2006) ("[O]utside the *Lynch* context, proof that an informed, non-coerced majority of the disinterested stockholders approved an interested transaction has the effect of invoking business judgment rule protection for the transaction and, as a practical matter, insulating the transaction from revocation and its proponents from liability.").

FN11. *E.g., ODS Technologies, Inc. v. Marshall,* 832 A.2d 1254, 1262 (Del.Ch.2003) ("The threat of an uninformed stockholder vote constitutes irreparable harm."); *In re Pure Resources, Inc. S'holders Litig.,* 808 A.2d 421, 452 (Del.Ch.2002) ("[I]rreparable injury is threatened when a stockholder might make a tender or voting decision on the basis of materially misleading or inadequate information.").

FN12. *E.g., In re Staples, Inc. S'holders Litig.,* 792 A.2d 934, 960 (Del.Ch.2001) ("An injunctive remedy ... specifically vindicates the stockholder right at issue-the right to receive fair disclosure of the material facts necessary to cast a fully informed vote-in a manner that later monetary damages cannot and is therefore the preferred remedy, where practicable.").

Here, those factors counsel in favor of a very limited injunction prohibiting the procession of the merger vote until supplemental disclosure is made.

B. *The Plaintiffs' Revlon Claims*

[9][10][11] The other substantive claim made by the plaintiffs arises under the *Revlon* doctrine.[FN13] *Revlon* and its progeny stand for the proposition that when a board has decided to sell the company for cash or engage in a change of control transaction, it must act reasonably in order to secure the highest price reasonably available.[FN14] The duty to act reasonably is just that, a duty to take a reasonable course of action under the circumstances presented.[FN15] Because there can be several reasoned ways to try to maximize value, the court cannot find fault so long as the directors chose a *reasoned* course of action.[FN16]

FN13. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del.1986).

FN14. *E.g., Paramount Communications, Inc. v. QVC Network, Inc.,* 637 A.2d 34, 44 (Del.1994); *Revlon,* 506 A.2d at 184 n. 16.

FN15. *E.g., Barkan v. Amsted Industries, Inc.,* 567 A.2d 1279, 1286-87 (Del.1989).

FN16. *Id.*

[12] The plaintiffs contend that the negotiation of the merger was tainted by the Special Committee's decision to leave to Rossiter the challenging task of extracting from Icahn the best price and most beneficial terms. According to the plaintiffs, Rossiter's interest in securing his personal finances by obtaining a payout of his retirement nest egg (without penalty or adverse reaction) and by liquidating his equity stake in Lear (promptly and without a decline in share price) gave him a rational incentive to ensure a merger agreement that would help him achieve those objective was inked regardless of whether the merger was at the highest price or best terms that might be obtained.

When Icahn floated the idea of a going private deal in January to Rossiter, he ***116** presented Rossiter with the chance to have his major desires met. Because such a merger would allow all stockholders to sell at a premium, Rossiter could sell out his equity stake without a negative effect on Lear or running afoul of trading restrictions. Further, because Lear would cease to be a public company after a going private transaction, Rossiter's new employer would not care what ISS or other corporate governance commentators thought about its handling of its executives' retirement plans. If that employer believed it was in its interest to allow Rossiter to cash out his equity and benefits while continuing to work, it could do that without worrying about a withhold vote or other consequences.

Icahn's proposal, therefore, placed Rossiter in a fiduciary quandary. Although his equity interest in Lear gave him an incentive to increase its stock price, it also left him with non-diversifiable risk. While remaining as CEO, Rossiter could not simply sell out his entire equity stake, lest he signal a lack of confidence in the company. But, by leaving his equity in, a very large part of his personal wealth was entirely tied up in, and therefore dependent on, Lear's performance. Moreover, if Rossiter expected (as would be reasonable) to receive options in the equity of the company after the merger closed, the failure to get the optional price for Lear now would not hurt him as much as the public stockholders, because the lower merger price would likely set a lower strike price for the options he received in the post-merger Lear.

Retirement benefits presented a similar issue. As has been fully discussed, a going private transaction gave Rossiter a unique opportunity to reconcile his conflicting desires to secure his retirement nest egg from the risk of a future Lear bankruptcy and to remain as a Lear executive.

As a result of these internal conflicts, the plaintiffs submit that Rossiter was willing to accept any deal at a defensible price that allowed him to achieve his personal objectives rather than to hold out for (or trade away his personal benefits in exchange for) an increase in the deal price. As such, they say, his motives were not identical to those of Lear's public stockholders who single-mindedly want the highest price for their equity. For that reason, the plaintiffs argue that it was wrong for the Special Committee to charge Rossiter with dealing with a tough negotiator like Carl Icahn, because Rossiter's own self-interest (even if he strove to keep it under control) rendered him less likely to handle the task with the steely resolve required to garner a great price.

In response, the defendants claim that there is no evidence that Rossiter did anything improper. To the contrary, they point to Rossiter's proven record of fidelity to Lear and its stockholders and assert that given his experience and skill set, he was best positioned to skillfully advocate for the best merger price. The Special Committee also says that kept Rossiter under tight control. To find that the Special Committee fell short of its fiduciary obligations duty to pursue the highest value reasonably possible because they employed Rossiter as their bargaining agent would, the defendants believe, elevate a persnickety sense of Ivory Soap purity over business logic. Rossiter knew more about the company than anyone, was doggedly loyal, and was a persuasive salesman. Who better to do the job, especially given the Special Committee's close communications with him during the process?

This debate is an interesting one in which each side makes telling points. I agree with the plaintiffs that the Special Committee's approach was less than confidence-inspiring. Although I do not embrace***117** the notion that persons suffering from conflicts are invariably incapable of putting them aside, I cannot

ignore the reality that American business history is littered with examples of managers who exploited the opportunity to work both sides of a deal. In fact, it would be silly to premise a decision on the notion that compensation schemes intended to have powerful incentive effects-such as SERP programs and equity awards-are wholly benign and never, despite their intended purpose of creating alignment between the interests of managers and other stockholders, create incentives that actually give managers reasons to pursue ends not shared by the corporation's public stockholders. Therefore, I will not. Instead, I decide this motion recognizing that Rossiter, while negotiating the merger, had powerful interests to agree to a price and terms suboptimal for public investors so long as the resulting deal: (1) allowed him to promptly liquidate his equity holdings; (2) secured his ability to accelerate and cash-out his retirement benefits; and (3) gave him the chance to continue in his managerial positions for a reasonable time, with a continued equity stake in Lear that would allow him to profit from its future performance.[FN17] Given those considerations, a merger at a price lower than the $36 per share that Icahn is paying might well make personal economic sense for Rossiter, when the risks to him of managing Lear as a standalone public company are taken into account.[FN18]

FN17. These motives are also attributable to Vandenberghe and DelGrosso, who obtained similar compensation packages to Rossiter for their agreement to stay on with the surviving company. Ninivaggi's interests are less clear. Even though Ninivaggi refrained from negotiating his compensation package, Ninivaggi might rationally harbor expectations of a package akin to that received by his colleagues in top management.

FN18. For that reason, Rossiter's outright rejection of Icahn's $35.25 bid is relevant. He might well have returned to the Special Committee with only that offer, and a merger price less than $36 per share might have emerged based on that signal.

For these reasons, I believe it would have been preferable for the Special Committee to have had its chairman or, at the very least, its lead banker participate with Rossiter in the negotiations with Icahn. By that means, there would be more assurance that Rossiter would take a tough line and avoid inappropriate discussions that would taint the process. Similarly, if the Special Committee was to proceed as it did, by leaving the negotiations to Rossiter without direct supervision, it could have provided him with more substantial guidance about the strategy he was to employ. The defendants applaud Rossiter for getting Icahn to bid against himself, by increasing his offer in one call by a quarter, and then another seventy-five cents. What they slight is that Icahn both opened and closed the price negotiations by rapidly moving to $36, declaring that his best and final offer, and steadfastly refusing any further price negotiation. Indeed, when Icahn first did that in a call on the evening of February 2, Rossiter did not reconvene the Special Committee, which had just finished meeting telephonically, to discuss what to do with Icahn's new offer. Instead, he slept on it, then called Icahn in the morning to plead for a higher bid without a specific counter to make. Icahn told him the price negotiations were over. And they were. They ended without the Special Committee ever making a counter on price, leaving the Special Committee only to make specific suggestions regarding the deal protections Icahn would receive for his agreement to pay $36.

Although I do not, as will soon be seen, view this negotiation process as a disaster ***118** warranting the issuance of an injunction, it is far from ideal and unnecessarily raises concerns about the integrity and skill of those trying to represent Lear's public investors. In reflecting on why this approach was taken, I consider it less than coincidental that Rossiter did not tell the board about Icahn's interest in making a going private proposal until seven days after it was expressed. Although a week seems a short period of time, it is not in this deal context. In seven days, a newly formed Special Committee's advisors can help the Committee do a lot of thinking about how to go about things and what the Committee should seek to achieve; that includes thinking about the Committee's price and deal term objectives, and the most effective way to reach them.

The Lear Special Committee was deprived of important deliberative and tactical time, and, as a result, it quickly decided on an approach to the process not dissimilar to those taken on most issues that come before corporate boards that do not involve conflicts of interest. That is, the directors allowed the actual work to be done by management and signed off on it after the fact. But the work that Rossiter was doing was not like most work. It involved the sale of the company in circumstances in which Rossiter (and his top subordinates) had economic interests that were not shared by Lear's public stockholders.

[13] Acknowledging all that, though, I am not persuaded that the Special Committee's less-than-ideal approach to the price negotiations with Icahn makes it likely that the plaintiffs, after a trial, will be able to demonstrate a *Revlon* breach. To fairly determine whether the defendants breached their *Revlon* obligations, I must consider the entirety of their actions in attempting to secure the highest price reasonably available to the corporation. Reasonableness, not perfection, measured in business terms relevant to value creation, rather than by what creates the most sterile smell, is the metric.[FN19]

FN19. *E.g., QVC,* 637 A.2d at 45 (“[C]ourt[s] applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination.”).

When that metric is applied, I find that the plaintiffs have not demonstrated a reasonable probability of success on their *Revlon* claim. The overall approach to obtaining the best price taken by the Special Committee appears, for reasons I now explain, to have been reasonable.

First, as many institutional investors and corporate law professors have advocated that all public corporations should do, Lear had gotten rid of its poison pill in 2004. Although it is true that the Lear board had reserved the right to reinstate a pill upon a vote of the stockholders or of a majority of the board's independent directors, it was hardly in a position to do that lightly, given the potential for such action to upset institutional investors and the influential proxy advisory firm, ISS. At the very least, Lear's public elimination of its pill signaled a willingness to ponder the merits of unsolicited offers. That factor is one that the Lear board was entitled to take into account in designing its approach to value maximization.

Relatedly, Icahn's investment moves in 2006 also stirred the pot, as the plaintiffs admit. Indeed, they go so far as to acknowledge that Lear could be perceived as having been on sale from April 2006 onward. As the plaintiffs also admit, Icahn has over the years displayed a willingness ***119** to buy when that is to his advantage and to sell when that is to his advantage. The M & A markets know this. Icahn's entry as a player in the Lear drama would have drawn attention from buyers with a potential interest in investing in the automobile sector.

In considering whether to sign up a deal with Icahn at $36 or insist on a full pre-signing auction, these factors were relevant. No one had asked Lear to the dance other than Icahn as of that point, even though it was perfectly obvious that Lear was open to invitations. Although a formal auction was the clearest way to signal a desire for bids, it also presented the risk of losing Icahn's $36 bid. If Icahn was going to be put into an auction, he could reasonably argue that he would pull his bid and see what others thought of Lear before making his move. If the response to the auction was under whelming, he might then pick up the company at a lower price.

The Lear board's concern about this possibility was, in my view, reasonable, given the lack of, with one exception, even a soft overture from a potential buyer other than Icahn in 2006. That exception was a call that Rossiter had gotten from Cerberus when Lear's market price was still well below $20 per share. But that exception is interesting in itself. Once Icahn's second investment became public and his deepened position was announced in October 2006, Cerberus never made a move. Likewise, when Cerberus was contacted during the pre-signing market check and as part of the go-shop process, it never signaled a hunger for Lear or a price at which it would be willing to do a deal.

Also relevant to the question of whether an auction was advisable was the lack of ardor that other major Lear stockholders had for the opportunity to buy equity in the secondary offering along with Icahn. Although some of them are now touting the idea that

Lear is worth $60 per share, an idea whose implications I will discuss, they passed on the chance to buy additional stock at $23 per share in October 2006. Given this history, I cannot conclude that it was unreasonable for the Lear board not to demand a full auction before signing its Merger Agreement with Icahn. There were important risks counseling against such an insistence, especially if the board could to some extent have it both ways by locking in a floor of $36 per share while securing a chance to prospect for more.

Second, I likewise find that the plaintiffs have not demonstrated a likelihood of success on their argument that the Lear board acted unreasonably in agreeing to the deal protections in the Merger Agreement rather than holding out for even greater flexibility to look for a higher bid after signing with Icahn. In so finding, I give relatively little weight to the two-tiered nature of the termination fee. The go-shop period was truncated and left a bidder hard-pressed to do adequate due diligence, present a topping bid with a full-blown draft merger agreement, have the Lear board make the required decision to declare the new bid a superior offer, wait Icahn's ten-day period to match, and then have the Lear board accept that bid, terminate its agreement with Icahn, and “substantially concurrently” enter into a merger agreement with it. All of these events had to occur within the go-shop period for the bidder to benefit from the lower termination fee. This was not a provision that gave a lower break fee to a bidder who entered the process in some genuine way during the go-shop period-for example, by signing up a confidentiality stipulation and completing some of the key steps toward the achievement of a definitive merger agreement at a superior price. Rather, it was a provision that essentially ***120** required the bidder to get the whole shebang done within the 45-day window. It is conceivable, I suppose, that this could occur if a ravenous bidder had simply been waiting for an explicit invitation to swallow up Lear. But if that sort of Kobayashi-like buyer existed, it might have reasonably been expected to emerge before the Merger Agreement with Icahn was signed based on Lear's lack of a rights plan and the publicity given to Icahn's prior investments in the company.

That said, I do not find convincing the plaintiffs' argument that the combination of the fuller termination fee that would be payable for a bid meeting the required conditions after the go-shop period with Icahn's contractual match right were bid-chilling. The termination fee in that scenario amounts to 3.5% of equity value and 2.4% of enterprise value. For purposes of considering the preclusive effect of a termination fee on a rival bidder, it is arguably more important to look at the enterprise value metric because, as is the case with Lear, most acquisitions require the buyer to pay for the company's equity and refinance all of its debt. But regardless of whether that is the case, the percentage of either measure the termination fee represents here is hardly of the magnitude that should deter a serious rival bid. The plaintiffs' claim to the contrary is based on the median of termination fees identified in a presentation made by JPMorgan in two-tiered post-signing processes of 1.8% of equity value during the go-shop period and 2.9% thereafter. The plaintiffs also state that Icahn should have gotten a lower fee because he would profit from a topping bid through his equity stake. These factors are not ones that I believe would, after trial, convince me that the board's decision to accede to Icahn's demand for a 3.5% fee (2.8% during the go-shop) was unreasonable. Icahn was tying up $1.4 billion in capital to make a bid for a corporation in a troubled industry, was agreeing to allow the target to shop the company freely for 45 days and to continue to work freely with Lear concerning any emerging bidders during that process, and was agreeing to vote his shares for any superior bid accepted by the Lear board.

Likewise, match rights are hardly novel and have been upheld by this court when coupled with termination fees despite the additional obstacle they are present.[FN20] And, in this case, the match right was actually a limited one that encouraged bidders to top Icahn in a material way. As described, a bidder whose initial topping move was over $37 could limit Icahn to only one chance to match. Therefore, a bidder who was truly willing to make a materially greater bid than Icahn had it within its means to short-circuit the match right process. Given all those factors, and the undisputed reality that second bidders have been able to succeed in the face of a termination fee/matching right combination of this potency,[FN21] I am skeptical that a trial record would convince me that the Lear board acted unreasonably in assenting to the termination fee and match right provisions in the Merger Agreement.

FN20. *E.g., In re Toys 'R' Us, Inc. S'holder Litig.,* 877 A.2d 975, 980 (Del.Ch.2005) (finding that inclusion of a termination fee and the presence of matching rights in a merger agreement did not act as a serious barrier to any bidder willing to pay materially more for the target entity).

FN21. Defendants have cited 15 transactions within the past three years in which intervening bids were made despite termination fees of 3% or more and contractual match rights in the merger agreements. *See* Affidavit of William E. Green, Jr., Esquire at ¶¶ 3-17 (citing transactions).

Third, I consider the most unique of the plaintiffs' arguments, which is that the fact ***121** that the initial acquirer was Icahn, rendered any chance of a topping bid illusory. The argument is unique because it conflicts with other arguments that have featured prominently in the plaintiffs' submissions. For example, the plaintiffs have noted that the announcement of Icahn's investments in Lear, particularly his purchase of shares in a secondary offering in October 2006, led the market to believe Lear was open to a sale. After the Merger Agreement was signed, the plaintiffs note that Lear's stock price traded above the deal price of $36 because the markets expected that a higher priced deal would eventually be consummated. Both of those arguments are founded in the notion that Icahn's presence on the scene was, if anything, a value-boosting factor. To their credit, the plaintiffs admit that is the case, and they also acknowledge that Icahn has a history of making stock purchases and subsequent acquisition overtures, but then happily stepping aside and cashing in his equity stake at a substantial profit when other bidders submit more attractive offers.

But the plaintiffs say that buyers sense that Icahn finds something ineffably desirable about Lear, and that they would suffer retribution from Icahn if they got in the game. They base this assertion on some notes from JPMorgan indicating that a couple of parties did not want to tangle with Icahn. Those indications, however, do not imply that those parties were somehow frightened of Icahn. Rather, they are more indicative of a reluctance to get in a bidding war with a savvy player.

Candidly, the idea that other bidders were afraid of crossing Icahn on this deal emerges from this record as closer to mirth-producing, than injunction-generating. As documented by defendants' expert, in five of Icahn's ten acquisition attempts since 2000, other acquirers submitted topping bids. Moreover, in this case, as the plaintiffs point out, Icahn stands to profit handsomely if he is topped. AREP investors bought into its position at a price of well less than $23 on average. If Icahn is topped at, say, $39, they will receive that profit plus up to $100 million in termination fees and expense reimbursements due under the Merger Agreement. Sounds like a pretty good result for AREP's equity holders, particularly since it would involve none of the execution risks that will accompany a consummated acquisition.

To that same point, the signal that Icahn's voting agreement sends is also relevant. Icahn contractually promised to vote his equity in favor of a superior deal embraced by the Lear board. Given Icahn's past history of willingly accepting the premium profits that came to him from putting companies in play and bowing out when a more optimistic bidder emerged, these deal features make even more implausible the notion that fear of Carl Icahn rendered the shopping process futile.

I also perceive no reason why a strategic or financial bidder would have believed that Icahn's relationship with Lear's management made a topping bid inadvisable. It is, of course, a reality that there is not a culture of rampant topping among the larger private equity players, who have relationships with each other that might inhibit such behavior. But the plaintiffs have not done anything to show that such a culture, if it exists and if it can persist given the powerful countervailing economic incentives at work, inhibited a topping bid against Icahn. Even less have they shown that there was a perception that Lear's management was particularly enamored of Icahn, or that it would not work for another reputable financial buyer. In fact, the record is to the contrary, indicating that ***122** Rossiter and his subordinates were open to dealing with other credible bidders.

For a strategic player, it is even harder to perceive a barrier. By signing up a cash deal subject to *Revlon,* the Lear board had opened the door to a topping bid

by a strategic acquirer which would be free from the usual "merger of equal" issues like future headquarters location(s) and managerial retention and succession. As a result, a strategic buyer would seemingly have been presented with substantial freedom to develop a topping bid for Lear premised on a post-consummation business strategy that incorporated the greater synergies that arguably can be reaped in a cash conquest resulting in a combined asset base under the acquirer's sole control, as opposed to in friendly deals often involving awkward, compromised periods of governance under a pooled management team. At the very least, a credible strategic bidder knew that cash was king in the Lear process, and that as long as it topped Icahn (a bidder with a powerful incentive to stand aside if a strategic could pay a materially higher price because of synergies available to it) and had no regulatory obstacles precluding its ability to close a deal, the Lear board would have to embrace its offer.

Finally, the plaintiffs have attempted to persuade me that the Lear board has likely breached its *Revlon* duties because the it had hoped that Icahn would offer more than $36 per share, that some Lear stockholders think that $36 per share is too low, and because the plaintiffs have presented a valuation expert opining that the value of Lear was in the high-$30s to mid-$40s range. This is not an appraisal proceeding, and I have no intention to issue my own opinion as to Lear's value.

But what I have done is reviewed the record on valuation carefully. Lear is one of the nation's largest corporations. Before Icahn emerged, the stock market had abundant information about Lear and its future prospects. It valued Lear at much less than $36 per share-around $17 per share in March and April 2006. After Icahn emerged, the stock market perceived that Lear had greater value based on Icahn's interest and the likelihood of a change of control transaction involving a purchase of all of the firm's equity, not just daily trades in minority shares.

Although the $36 price may have been below what the Lear board hoped to achieve, they had a reasonable basis to accept it. The valuation information in the record, when fairly read, does not incline me toward a finding that the Lear board was unreasonable in accepting the Icahn bid. Although the plaintiffs' valuation expert originally opined that a fair range would be in the "high-$30s" to "mid-$40s," his DCF analysis suggests a range below the merger price, once that DCF analysis is properly adjusted to correct for errors in computing the discount rate he himself admits were either in error or inconsistent. When corrected to use an appropriate discount rate and to consider current industry circumstances, the plaintiff's own expert's DCF value for Lear based on its Long Range Plan with Current Industry Outlook ranges from $27.13 to $35.75. Moreover, to the extent that plaintiffs' expert relies upon the $45.19 median of his DCF models, that reliance appears questionable as those models produce a range between $9.81 and $107.54 per share.

At this stage, the more important point is this. The Lear board had sufficient evidence to conclude that it was better to accept $36 if a topping bid did not emerge than to risk having Lear's stock price return to the level that existed before the market drew the conclusion that Lear would be sold because Icahn had bought such a substantial stake. Putting aside ***123** the market check, the $36 per share price appears as a reasonable one on this record, when traditional measures of valuation, such as the DCF, are considered. More important, however, is that the $36 price has been and is still being subjected to a real world market check, which is unimpeded by bid-deterring factors.

If, as the plaintiffs say, their expert is correct that Lear is worth materially more than $36 per share and that some major stockholders believe that Lear is worth $60 per share, a major chance to make huge profits is being missed by those stockholders and by the market for corporate control in general. While it may be that that is the case, I cannot premise an injunction on the Lear board's refusal to act on an improbability of that kind.[FN22] Stockholders who have a different view on value may freely communicate with others, subject to their compliance with the securities laws, about their different views on value. Stockholders may vote no and seek appraisal.[FN23] But the plaintiffs are in no position ask me to refuse the Lear electorate the chance to freely determine whether a guaranteed $36 per share right now is preferable to the risks of continued ownership of Lear stock.

FN22. The plaintiffs have cited this court's recent decision in ***Netsmart*** as supporting their *Revlon* arguments. The differences between the two cases are worth noting. **Netsmart** was a microcap company with limited trading in its shares. Only one analyst covered it. Without engaging in any reliable pre-signing market check involving strategic acquirers, the **Netsmart** board signed up a merger agreement with a financial buyer containing a strict no-shop. In order to get in the game, any strategic acquirer would therefore have had to make a publicly-disclosed expression of interest to make a topping bid without access to due diligence or discussions with **Netsmart** management. Moreover, all of the strategic acquirers who might have had an interest in **Netsmart** were much, much larger and likely to see **Netsmart** as the sort of nice bolt-on one would add through a friendly process, not the type of key strategic move that would likely justify making a hurried unsolicited overture without prior discussions or information. *See generally, In re **Netsmart** Technologies, Inc. S'holder Litig.,* 924 A.2d 171 (Del.Ch.2007). By contrast, Lear is one of the largest corporations in the United States with deep analyst coverage. It got rid of its poison pill in 2004, signaling an openness to bids from that point forward. In 2006, when Carl Icahn came on the scene, even the plaintiffs admit that the market for corporate control knew Lear was essentially in play. Then, even after Icahn signed up his bid, over 40 strategic and financial bidders were invited to obtain due diligence in a non-public way in order to formulate topping bids. Put simply, unlike in ***Netsmart,*** no one had to discover Lear; they were invited by Lear to obtain access to key information and decide whether to make a bid.

FN23. *E.g., Toys 'R' Us,* 877 A.2d at 1023 ("[T]he bottom line is that the public shareholders will have an opportunity [ ] to reject the merger if they do not think the price is high enough in light of the Company's stand-alone value and other options."); *see also* 8 Del. C. § 262 (granting appraisal rights).

VI. *Conclusion*

For the foregoing reasons, the plaintiffs' motion for a preliminary injunction is largely denied, with the exception that a preliminary injunction will issue preventing the merger vote until supplemental disclosure of the kind required by the decision is issued. The defendants shall provide the court on June 18 their proposal as to the form of that disclosure, and the timing of its provision to stockholders. So long as the court is satisfied about substance and timing, the merger vote may be able to proceed as currently scheduled. The plaintiffs and defendants shall collaborate on an implementing order, which shall be presented on June 18 as well.

Del.Ch.,2007.
In re Lear Corp. Shareholder Litigation
926 A.2d 94

END OF DOCUMENT

In re **Netsmart** Technologies, Inc. Shareholders Litigation
Del.Ch.,2007.

Court of Chancery of Delaware,New Castle County.
In re **NETSMART** TECHNOLOGIES, INC. SHAREHOLDERS LITIGATION.
C.A. No. 2563-VCS.

Submitted: March 6, 2007.
Decided: March 14, 2007.

Background: Shareholders brought action seeking to halt corporation's merger with two private equity firms. Shareholders moved for a preliminary injunction.

Holdings: The Court of Chancery, New Castle County Strine, Vice Chancellor, held that:
(1) shareholders were not likely to prevail, for purposes of an injunction, on their claim that directors breached their *Revlon* duty in regard to the process used in dealing with private equity firms that participated in board's limited auction process; but
(2) shareholders were likely to prevail on their claim that the board breached its *Revlon* duty by inadequately exploring the option of a strategic buyer;
(3) failure of board to disclose to shareholders the final cash flow projections used by financial advisor in fairness opinion rendered disclosures to shareholders materially incomplete; and
(4) preliminary injunction would issue delaying shareholder vote until directors provided additional disclosures to shareholders.

Preliminary injunction granted.

West Headnotes

[1] Injunction 212 138.1

212 Injunction
212IV Preliminary and Interlocutory Injunctions
212IV(A) Grounds and Proceedings to Procure
212IV(A)2 Grounds and Objections
212k138.1 k. In General. Most Cited Cases
In order to warrant preliminary injunctive relief, plaintiffs must prove that: (1) they are likely to succeed on the merits of their claims; (2) they will suffer imminent, irreparable harm if an injunction is not granted; and (3) the balance of the equities weighs in favor of issuing the injunction.

[2] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
When it decides to sell the corporation for cash, the corporation's board assumes the fiduciary duty to undertake reasonable efforts to secure the highest price realistically achievable given the market for the corporation.

[3] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
A board of directors' fiduciary duty to secure the highest price realistically achievable, when the board decides to sell the corporation for cash, does not require every board to follow a judicially prescribed checklist of sales activities; rather, the duty requires the board to act reasonably, by undertaking a logically sound process to get the best deal that is realistically attainable.

[4] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Unlike the bare rationality standard applicable to garden-variety decisions subject to the business judgment rule, the *Revlon* standard, applicable when a board of directors decides to sell the corporation for cash, contemplates a judicial examination of the reasonableness of the board's decision-making process; this reasonableness review is more searching than rationality review, and there is less tolerance for slack by the directors.

[5] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Although the directors have a choice of means, they do not comply with their *Revlon* duties*,* applicable when a board of directors decides to sell the corporation for cash, unless they undertake reasonable steps to get the best deal.

[6] Corporations 101 320(13)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k320 Actions Between Shareholders and Officers or Agents
101k320(13) k. Injunction and Receiver. Most Cited Cases
Shareholders were not likely to prevail, for purposes of a preliminary injunction regarding corporation's merger with two private equity firms which intended to retain existing management, on their claim that corporation's directors breached their *Revlon* duties to take reasonable efforts to secure the highest price realistically achievable in regard to process directors used in dealing with private equity firms that participated in board's limited auction process; though when special committee was formed corporation's financial advisor was well along in its work with management and committee often deliberated with chief executive officer (CEO) at the table, committee considered and approved merger terms at executive sessions not attended by management, CEO did not have a pre-existing relationship with any of the invited bidders, none of the bidders offered materially more or less to management, and committee appeared to have proceeded in an appropriately price-driven manner.

[7] Corporations 101 320(13)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k320 Actions Between Shareholders and Officers or Agents
101k320(13) k. Injunction and Receiver. Most Cited Cases
Shareholders were likely to prevail, for purposes of a preliminary injunction regarding corporation's merger with two private equity firms which intended to retain existing management, on their claim that corporation's directors breached their *Revlon* duties to take reasonable efforts to secure the highest price realistically achievable because directors failed to take reasonable steps to explore whether strategic buyers might be interested in buying corporation; board's consideration of whether to seek out strategic buyers was cursory, corporation had in recent years been transformed through acquisitions and lucrative contracts such that sporadic contacts with possible strategic buyers by chief executive officer (CEO) and corporation's financial advisor three to seven years earlier were not reliable market checks, and there was a basis to perceive that management preferred private equity route as a strategic buyer would have less interest in retaining management.

[8] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
When directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market; however, when they do not possess reliable evidence of the market value of the entity as a whole, the lack of an active sales effort is strongly suggestive of a breach of their *Revlon* duties applicable when a board of directors decides to sell the corporation for cash.

[9] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Directors of Delaware corporations must disclose fully and fairly all material information within the board's control when they seek shareholder action.

[10] Corporations 101 198(3)

101 Corporations
101IX Members and Stockholders
101IX(B) Meetings
101k198 Proxies
101k198(3) k. Solicitation; Proxy

Statements. Most Cited Cases
An omitted fact from proxy material provided by a board of directors when seeking shareholder action is only material if there is a substantial likelihood that it would be considered important in a reasonable shareholder's deliberation and decision making process before casting his or her vote.

[11] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
In order for a fact not disclosed by a board of directors when seeking shareholder action to be material, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

[12] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Disclosures by directors when seeking shareholder action must provide a balanced, truthful and materially complete account of all matters they address.

[13] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
When stockholders must vote on a transaction in which they would receive cash for their shares, information regarding the financial attractiveness of the deal is of particular importance, as the stockholders must measure the relative attractiveness of retaining their shares versus receiving a cash payment, a calculus heavily dependent on the stockholders' assessment of the company's future cash flows.

[14] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Disclosures to shareholders by board of directors, when board was seeking shareholder approval of sale of corporation to two private equity firms which intended to retain existing managements, were not deficient because directors omitted “stay the course” projections regarding corporation's revenues and profits based on organic growth provided to board by corporation's executive vice president after some private equity firms had expressed preliminary interest in acquiring corporation, where board did provide to shareholders other projections on revenues and profits which were more current and more bullish, and the “stay the course” projections, though using a higher price-to-earnings multiple than the projections actually provided to shareholders, were more pessimistic.

[15] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Failure of board of directors to disclose to shareholders the final cash flow projections utilized by corporation's financial advisor in support of advisor's fairness opinion in regarded to sale of corporation, when board was seeking shareholder approval of sale of corporation to two private equity firms which intended to retain existing management, rendered the director's disclosures materially incomplete, as the shareholders would obviously find it important to know what management's and financial advisor's best estimate of corporation's future cash flows would be when making decision on whether to accept cash in return for forsaking an interest in corporation's future cash flow, particularly when buyers intended to retain management and management was to receive options in the corporation once it went private.

[16] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Once a board broaches a topic in its disclosures to shareholders when seeking shareholder action, a duty attaches to provide information that is materially complete and unbiased by the omission of material facts.

[17] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
When a banker's endorsement of the fairness of a transaction is touted to shareholders by the board of directors when the board is seeking shareholder approval of the transaction, the valuation methods used to arrive at that opinion as well as the key inputs and range of ultimate values generated by those analyses must also be fairly disclosed., and only providing some of that information is insufficient to fulfill the duty of providing a fair summary of the substantive work performed by the investment banker upon whose advice the recommendations of the board as to how to vote rely.

[18] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
Failure of board of directors to disclose to shareholders, when board was seeking shareholder approval of sale of corporation to two private equity firms which intended to retain existing management, that corporation's chief executive officer (CEO) had served on board of another corporation for which member of corporation's independent special committee had been CEO, was not material, as federal regulations and exchange rules addressed disclosures regarding past interlocking board service and the circumstances affecting the independent status of directors, and shareholders challenging the sale did not indicate whether the CEOs' respective service on each others' board overlapped, how material their service as outside directors was to each other as CEOs, and what remuneration they received for their board service.

[19] Corporations 101 318

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k318 k. Officer or Agent of Different Corporations. Most Cited Cases
Without more, directors are not deemed to lose their independence merely because they move in the same social circles or hold seats on the same corporate boards.

[20] Corporations 101 584

101 Corporations
101XIV Consolidation
101k584 k. Rights and Remedies of Dissenting Stockholders. Most Cited Cases
Preliminary injunction was warranted against procession of shareholder merger vote, in shareholder action seeking to halt corporation's merger with two private equity firms which intended to retain existing management, until board provided shareholders a fuller, more balanced description of the board's actions with regard to the possibility of finding a strategic buyer and until board provided financial advisor's final cash flow projections used in support of advisor's fairness opinion; shareholders were likely to prevail on their claim that directors breached their *Revlon* duty by not adequately exploring the sale of the corporation to a strategic buyer, disclosures to shareholders were materially incomplete without the final cash flow projections, there was a threat of irreparable harm if shareholders were not provided with such disclosures, but there was not a competing bidder for the corporation, and it would be impudent to enjoin the only deal on the table.

[21] Corporations 101 310(1)

101 Corporations
101X Officers and Agents
101X(C) Rights, Duties, and Liabilities as to Corporation and Its Members
101k310 Management of Corporate Affairs in General
101k310(1) k. In General. Most Cited Cases
When directors describe their decision-making process leading up to a merger, in disclosures to shareholders seeking shareholder action on the merger, they must do so in a fair and balanced way.

***174** Pamela S. Tikellis, Esquire, A. Zachary Naylor, Esquire, Chimicles & Tikellis, LLP, Wilmington, Delaware; Joseph A. Rosenthal, Esquire, Carmella P. Keener, Esquire, Jessica Zeldin, Esquire, Rosenthal, Monhait & Goddess, P.A., Wilmington, Delaware; Delaware Liaison Counsel for Plaintiffs.
Richard B. Brualdi, Esquire, The Brualdi Law Firm, New York, New York; Robert P. Frutkin, Esquire, The Law Offices Bernard M. Gross, P.C., Philadelphia, Pennsylvania, Attorneys for Plaintiff.
Chet B. Waldman, Esquire, Wolf Popper LLP, New York, New York; Eduard Korsinsky, Esquire, Zimmerman, Levi & Korsinsky, LLP, New York, New York, Members of Plaintiffs' Executive Committee.
Kurt M. Heyman, Esquire, Proctor Heyman LLP, Wilmington, Delaware; Edward F. Cox, Esquire, Kenneth J. King, Esquire, Emily Goldberg, Esquire, Patterson Belknap Webb & Tyler, LLP, New York, New York, Attorneys for Defendants Francis J. Calcagno, John S.T. Gallagher, Yacov Shamash and Joseph G. Sicinski.
Anne C. Foster, Esquire, Richards Layton & Finger, P.A., Wilmington, Delaware; Peter A. Mahler, Esquire, Farrell Fritz, P.C., New York, New York, Attorneys for Defendants **Netsmart** Technologies, Inc., James L. Conway, Gerald O. Koop, John F. Phillips, Kevin Scalia and Alan B. Tillinghast.
Kenneth J. Nachbar, Esquire, Morris Nichols Arsht & Tunnell, LLP, Wilmington, Delaware; William J. Sushon, Esquire, Aaron Weiss, Esquire, O'Melveny & Myers, LLP, New York, New York, Attorneys for Defendants NT Acquisition, Inc., ***175** NT Merger Sub, Inc., NT Investor Holdings, Inc., Bessemer Venture Partners LP and Insight Venture Partners LP.

OPINION

STRINE, Vice Chancellor.

I. *Introduction*

This case literally involves a microcosm of a current dynamic in the mergers and acquisitions market. **Netsmart** Technologies, Inc. has entered into a "Merger Agreement" with two private equity firms, Insight Venture Partners ("Insight") and Bessemer Venture Partners ("Bessemer"). If the $115 million "Insight Merger" (or "Merger") is consummated, **Netsmart's** stockholders will receive $16.50 per share and the buyers will take the micro-cap company, whose shares are currently listed on the NASDAQ, private.

Netsmart is a leading supplier of enterprise software to behavioral health and human services organizations and has a particularly strong presence among mental health and substance abuse service providers. It has been consistently profitable for several years and has effectively consolidated its niche within the healthcare information technology market. In October 2005, **Netsmart** completed a multi-year course of acquisitions by purchasing its largest direct competitor, CMHC Systems, Inc. ("CMHC"). After that acquisition was announced, private equity buyers made overtures to **Netsmart** management. These overtures were favorably received and management soon recommended, in May 2006, that the **Netsmart** board consider a sale to a private equity firm. Relying on the failure of sporadic, isolated contacts with strategic buyers stretched out over the course of more than a half-decade to yield interest from a strategic buyer, management, with help from its long-standing financial advisor, William Blair & Co., L.L.C., steered the board away from any active search for a strategic buyer. Instead, they encouraged the board to focus on a rapid auction process involving a discrete set of possible private equity buyers. Only after this basic strategy was already adopted was a "Special Committee" of independent directors formed in July 2006 to protect the interests of the company's non-management stockholders. After the Committee's formation, it continued to collaborate closely with **Netsmart's** management, allowing the company's Chief Executive Officer to participate in its meetings and retaining William Blair as its own financial advisor.

After a process during which the Special Committee and William Blair sought to stimulate interest on the part of seven private equity buyers, and generated competitive bids from only four, the Special Committee ultimately recommended, and the entire **Netsmart** board approved, the Merger Agreement with Insight. As in most private equity deals, **Netsmart's** current executive team will continue to manage the company and will share in an option pool designed to encourage them to increase the value placed on the company in the Merger.

The Merger Agreement prohibits the **Netsmart** board from shopping the company but does permit the board to consider a superior proposal. A topping bidder would only have to suffer the consequence of paying Insight a 3% termination fee. No topping bidder has emerged to date and a stockholder vote is scheduled to be held next month, on April 5, 2007.

A group of shareholder plaintiffs now seeks a preliminary injunction against the consummation of this Merger. As a matter of substance, the plaintiffs argue that the Merger Agreement flowed from a poorly-motivated and tactically-flawed sale process during which the **Netsmart** board ***176** made no attempt to generate interest from strategic buyers. The motive for this narrow search, the plaintiffs say, is that **Netsmart's** management only wanted to do a deal involving their continuation as corporate officers and their retention of an equity stake in the company going forward, not one in which a strategic buyer would acquire **Netsmart** and possibly oust the incumbent management team. The plaintiffs also insinuate that **Netsmart's** Chief Executive Officer, James L. Conway, was beguiled by the riches being received by CEOs of larger companies in private equity deals and sought to emulate their success. At the end of a narrowly-channeled search, the **Netsmart** directors, the plaintiffs say, landed a deal that was unimpressive, ranking at the low end of William Blair's valuation estimates.

The plaintiffs couple their substantive claims with allegations of misleading and incomplete disclosures. In particular, the plaintiffs argue that the Proxy Statement (the "Proxy"), which the defendants have distributed to shareholders in advance of their vote next month, omits important information regarding **Netsmart's** prospects if it were to remain independent. In the context of a cash-out transaction, the plaintiffs argue that the stockholders are entitled to the best estimates of the company's future stand-alone performance and that the Proxy omits them.

The defendant directors respond by arguing that they acted well within the bounds of the discretion afforded them by Delaware case law to decide on the means by which to pursue the highest value for the company's stockholders. They claim to have reasonably sifted through the available options and pursued a course that balanced the benefits of a discrete market canvass involving only a select group of private equity buyers (e.g., greater confidentiality and the ability to move quickly in a frothy market) against the risks (e.g., missing out on bids from other buyers). In order to stimulate price competition, the Special Committee encouraged submissions of interest from the solicited bidders with the promise that only bidders who made attractive bids would get to move on in the process. At each turning point during the negotiations with potential suitors, the Special Committee pursued the bidder or bidders willing to pay the highest price for the **Netsmart** equity. In the end, the directors argue, the board secured a deal with Insight that yielded a full $1.50 more per share than the next highest bidder was willing to pay.

Moreover, in order to facilitate an implicit, post-signing market check, the defendants say that they negotiated for relatively lax deal protections. Those measures included a break-up fee of only 3%, a "window shop" provision that allowed the board to entertain unsolicited bids by other firms, and a "fiduciary out" clause that allowed the board to ultimately recommend against pursuing the Insight Merger if a materially better offer surfaced. The directors argue that the failure of a more lucrative bid to emerge since the Merger's announcement over three months ago confirms that they obtained the best value available. Furthermore, the directors note that, unlike certain other private equity acquisitions, the Insight Merger is not one in which the selling company's CEO came out with a huge monetary win. Conway did all right for himself but not in any way that suggests that he received a windfall or had any particular reason to favor Insight over the other private equity bidders.

Lastly, the defendants note that most of the plaintiffs' disclosure claims are makeweight. As to the one they concede has the most color-which goes to the question ***177** of whether the Proxy discloses all the material information about management's estimates of **Netsmart's** future cash flows-the defendants claim to have gone as far as is required to disclose what reliable estimates existed.

In this opinion, I conclude that the plaintiffs have established a reasonable probability of success on two issues. First, the plaintiffs have established that the **Netsmart** board likely did not have a reasonable basis for failing to undertake *any* exploration of interest by strategic buyers. The record, as it currently stands, manifests no reasonable, factual basis for the board's conclusion that strategic buyers *in 2006* would not have

been interested in **Netsmart** as it existed *at that time.* Likewise, the board's rote assumption (encouraged by its advisors) that an implicit, post-signing market check would stimulate a hostile bid by a strategic buyer for **Netsmart**-a micro-cap company-in the same manner it has worked to attract topping bids in large-cap strategic deals appears, for reasons I detail, to have little basis in an actual consideration of the M & A market dynamics relevant to the situation **Netsmart** faced. Relatedly, the Proxy's description of the board's deliberations regarding whether to seek out strategic buyers that emerges from this record is itself flawed.

Second, the plaintiffs have also established a probability that the Proxy is materially incomplete because it fails to disclose the projections William Blair used to perform the discounted cash flow valuation supporting its fairness opinion. This omission is important because **Netsmart's** stockholders are being asked to accept a one-time payment of cash and forsake any future interest in the firm. If the Merger is approved, dissenters will also face the related option of seeking appraisal. A reasonable stockholder deciding how to make these important choices would find it material to know what the best estimate was of the company's expected future cash flows.

The plaintiffs' merits showing, however, does not justify the entry of broad injunctive relief. Because there is no other higher bid pending, the entry of an injunction against the Insight Merger until the **Netsmart** board shops the company more fully would hazard Insight walking away or lowering its price. The modest termination fee in the Merger Agreement is not triggered simply on a naked no vote, and, in any event, has not been shown to be in any way coercive or preclusive. Thus, **Netsmart's** stockholders can decide for themselves whether to accept or reject the Insight Merger, and, as to dissenters, whether to take the next step of seeking appraisal. In so deciding, however, they should have more complete and accurate information about the board's decision to rule out exploring the market for strategic buyers and about the company's future expected cash flows. Thus, I will enjoin the procession of the Merger vote until **Netsmart** discloses information on those subjects.

II. *Factual Background*

A. ***Netsmart's*** *Business As Of The Start Of 2006*

Netsmart is the leader in the behavioral healthcare information technology market. It provides enterprise software solutions to health and human services organizations, public health agencies, mental health and substance abuse clinics, psychiatric hospitals, and managed care organizations. Since its formation in 1992, **Netsmart** has accumulated over 1,300 customers, including over 30 state agencies, and has become the nation's largest supplier of automated computerized methadone dispensing systems, serving more than 400 of the 1,100 methadone clinics in the United States. ***178** Over the years, **Netsmart** grew primarily by consolidating other firms in its niche market, and in October 2005, capped off its strategy by acquiring its largest direct competitor, CMHC. By the close of 2005, the company was riding a tide of 30 consecutive quarters of consistent profitability, and, by any metric, was doing well.[FN1]

FN1. **Netsmart** continued to build on its strong performance in 2005 by inking the largest contract in its history in early 2006-a $19.8 million account with the state of North Carolina. *See* Second Amended Consolidated Complaint ("Complaint"), Ex. A at 1.

At the start of 2006, **Netsmart** was secure in its role as the largest player within its market niche. No other behavioral healthcare company possessed the financial wherewithal to acquire it.[FN2] **Netsmart's** client base included agencies in a majority of the states; its software was dominant among the nation's methadone clinics; and, most importantly, switching costs for those using its software were high. Likewise, the limited size of the behavioral healthcare software market also discouraged other large players from encroaching onto **Netsmart's** turf.

FN2. *See* Deposition of James L. Conway ("Conway Dep.") at 92.

Netsmart's management team had been in place for some time. In particular, **Netsmart** had stability in the top spot, as its CEO Conway had served in that position since the 1990s. Each of the other top executives saw themselves as potential successors to Conway, who was facing some serious health issues but desired to continue, yet each continued deferred to his authority. Among these top managers were Anthony Grisanti (Chief Financial Officer), Alan Tillinghast (Chief Technology Officer and Executive Vice President for Operations), and Kevin Scalia (Executive Vice President for Corporate Development). **Netsmart's** board of directors until December 2006 consisted of Conway, two former executives-Gerald O. Koop (former President) and John F. Phillips (former Vice President)-and four independent directors. The independent directors were Francis Calcagno (a managing director at the investment banking firm of Dominick & Dominick, L.L.C.), John S.T. Gallagher (CEO of Stony Brook University), Yacov Shamash (Vice President for Economic Development and Dean of the College of Engineering and Applied Sciences at Stony Brook University), and Joseph Sicinski (founder and chairman of the human resource firm, BDS Strategic Solutions, Inc.).[FN3]

FN3. In December 2006, after the Merger was adopted, Scalia and Tillinghast replaced Koop and Phillips on the board, but at all relevant times, the board was controlled by a majority of independent directors.

Although **Netsmart's** directors and manager could take some pride in the operational successes the company had enjoyed, they also faced challenges presented by **Netsmart's** unique position as both a relatively small firm and yet the largest company in its niche market. On December 31, 2005, **Netsmart** had 6,487,943 outstanding shares and its stock closed at $12.61 per share, resulting in a market value of its equity of approximately $81.8 million.[FN4] This micro-cap size and relatively thin float prevented many institutional investors from staking large positions in the company and dissuaded all but one research analyst from covering the company's stock. That exception might prove the rule.[FN5] Additionally, from what one can ***179** discern, **Netsmart** was negatively affected by the stratification of the American healthcare system, which appears to regard mental health and substance abuse services as tangential, rather than integral, to the core of healthcare. This caused business problems for **Netsmart** because the advantage the company obtained insofar as it could deliver software and related support services that met its clients' precise needs was accompanied by a corresponding difficulty in growing substantially beyond that space or attracting the interest of larger players in the broader healthcare IT market, who served providers of, for want of a better term, physical health services (think hospitals, e.g.).

FN4. *See* Affidavit of Kenneth J. King, Esq. ("King Aff."), Ex. 5 at 41 & F-5 (**Netsmart** Technologies, Inc., Form 10-K (2005)).

FN5. Griffin Securities ("Griffin"), the lone firm covering **Netsmart**, "acted as a placement agent for the Company's private placement of equity and received cash compensation and warrants for such investment banking services" and "expects to receive, or intends to seek, compensation for investment banking services from the Company" in the future. *See* Affidavit of A. Zachary Naylor ("Naylor Aff."), Ex. 1 at 19.

B. ***Netsmart's*** *Prior Explorations Of Strategic Combinations*

The issues presented by **Netsmart's** size and market were not new ones in 2006. Although the CMHC acquisition at the end of 2005 materially enlarged the company, **Netsmart's** management had pondered the prospect of outgrowing its market for some time and considered what could be done to address that concern. In order to better understand the reaction of the **Netsmart** directors to the private equity attention the company received in 2006, it is therefore helpful to review the company's previous experience in investigating strategic combinations and sales.

Over the years, one option Conway considered to address the narrowness of **Netsmart's** market niche was finding a larger healthcare IT software firm to acquire **Netsmart** and add its software to their larger array of products and services. Conway first pursued that line of inquiry in the late 1990s. Beginning then and continuing with isolated contacts throughout the early 21st century, Conway engaged in very sporadic discussions with larger corporations that provided enterprise software solutions in the health services sector, including GE Medical Systems, Electronic Data Systems Corporation, and Perot Systems Corporation (all in the late 1990s) as well as Quality Systems, Inc. (2001), Cerner Corp. and Siemens Corp. (2003), and QuadraMed Corp. (2005).[FN6] According to Conway, he signaled in these discussions an interest on **Netsmart's** part in a strategic alliance, a signal that given **Netsmart's** tiny size relative to the companies Conway approached could only be rationally perceived as a green light for an acquisition proposal. Conway says that none of these occasional, informal discussions resulted in an expression of interest, stating that the problem was that **Netsmart's** market niche was simply too small on a stand-alone basis to make **Netsmart** an attractive acquisition target for a larger software provider in the health services sector.

FN6. As no specific dates for these sporadic

contacts were presented, I estimate these occurrence based on the vague recollections contained in the relevant depositions, which use broad strokes and relative dates to sketch these historical events. *See* Conway Dep. at 96-115; Deposition of Francis J. Calcagno ("Calcagno Dep.") at 31.

In November 2003, **Netsmart** engaged William Blair as its investment banker in connection with its desire to acquire CMHC, a desire that was not satisfied until October 2005. As part of its engagement of William Blair in 2003, **Netsmart** entered into an arrangement whereby Blair would have the right to a fee if **Netsmart** were eventually sold. That fee ***180** was set at 1.7% of the value of any sale of **Netsmart**.[FN7] This did not mean that William Blair was authorized to market **Netsmart** as if its board had decided to sell the company; rather, it simply gave Blair a right to compensation if the board later went down that road.

FN7. Calcagno Dep. at 45. William Blair was also entitled to $400,000 if it was selected to, and ultimately did, prepare a fairness opinion with regard to such a sale. *Id.*

From late 2003 through 2005, William Blair dropped **Netsmart's** name when it made cold calls on corporations in the healthcare industry in which it specialized. As is typical of investment bankers, Blair regularly trolled for business. According to Karl A. Palasz, the Blair partner who eventually ran the sales process leading to the Insight Merger, **Netsmart** was among a list of companies that William Blair mentioned in cold calls, a list that largely involved companies Blair did not represent.[FN8] In these cold calls, Blair did not say it represented **Netsmart** or that it was authorized to discuss a specific transaction.[FN9] Rather, one senses that it was just trying to take the temperature of prospective clients and see whether there were common interests among healthcare companies with whom it had contact that could lead to a fee-paying deal. William Blair says that the hook it baited with **Netsmart** did not attract a hit, suggesting, like Conway, that **Netsmart's** market niche did not appeal to the bigger healthcare software fish. Therefore, instead of being acquired, **Netsmart** made several acquisitions during the first half-decade of the new century, culminating in the purchase of CMHC.

FN8. Deposition of Karl A. Palasz ("Palasz Dep.") at 57-60.

FN9. *Id.*

C. ***Netsmart*** *Management Decides It Wants To Ride The Private Equity Wave*

The announcement of the CMHC acquisition in October 2005 caught the attention of some players in the capital-flush private equity sector. After that announcement, Vista Equity Partners ("Vista") approached William Blair and expressed a preliminary interest in acquiring **Netsmart**.[FN10] Upon learning of Vista's interest, William Blair told Conway, but Conway did not immediately inform the **Netsmart** board of this contact, an omission he now attributes to Vista's lack of seriousness and specificity.[FN11]

FN10. Vista is identified as "PE-1" in the Proxy. King Aff., Ex. 4 ("Proxy") at 15; *accord* Palasz Dep. at 36 (confirming that "the approach was made sometime in the fourth quarter of '05 with respect to Vista").

FN11. Conway Dep. at 78.

Then, on Valentine's Day 2006, Francisco Partners ("Francisco"), another private equity firm that, like Vista, specialized in investments in technology businesses, approached Kevin Scalia, **Netsmart's** Executive Vice President, to see whether **Netsmart** fancied being taken in friendly conquest.[FN12] This initial wooing was followed by a March 24, 2006 meeting between Vista and a group of **Netsmart's** key managers, including Conway. His interest piqued, Conway claims to have promptly informed the board of this expression of interest.[FN13]

FN12. Francisco is identified as "PE-2" in the Proxy. Proxy at 15; *accord* Conway Dep. at 84; Palasz Dep. at 40-41.

FN13. Conway Dep. at 87.

Thereafter, Conway and certain of his key advisors began chewing over options with William Blair. Their talks soon centered on the emerging deal structure of ***181** the year: a going private transaction led by a private equity buyer. Armed with active expressions of interest on that front, Conway asked Scalia to prepare a presentation for the **Netsmart** board outlining various strategic options available to **Netsmart**-including a going private transaction.

On May 11, 2006, the **Netsmart** board met and Scalia presented the options he developed. Among these options were the following: (1) continuing to build as a public company; (2) finding and selling the company to a strategic buyer; or (3) taking the company private by selling to a financial buyer.[FN14]

FN14. Naylor Aff., Ex. 2 at NET 00003.

To help the board assess these options, Scalia outlined his estimate of **Netsmart's** expected revenues and profits under its existing business plans. His "Stay the Course" projections served as a base case model illustrating his assessment of organic growth and the challenges **Netsmart** faced as a small public company.[FN15] Those challenges included the quarter-to-quarter pressures and compliance costs of public filings, the dependence on but lack of coverage by research analysts, and the necessity of acquiring new managerial talent in light of **Netsmart's** increased size.[FN16] As a public company, Scalia implied that **Netsmart** would be constrained to offer the incentives necessary to attract good candidates.[FN17]

FN15. *Id.* at NET 00004, Net 00008 & NET 00009. In addition to his base case scenario, Scalia also illustrated a scenario whereby **Netsmart** could accelerate its growth while remaining independent, through a more aggressive acquisition strategy. *See id.* at NET 00012 (presenting the "Accelerate the Course" model). But this strategy involved serious execution risk and uncertainty. *Id.* at NET 00013.

FN16. *Id.* at NET 00004.

FN17. *Id.*

Scalia also presented two scenarios involving a sale. The first slide focused on the possibility of a strategic acquisition. It was brief and to the point, stating: "A strategic sale is a good alternative but we did try it once before and there was no interest so a reasonable approach would be to run a parallel track with private equity." [FN18]

FN18. *Id.* at NET 00005.

Scalia's slide on the sale to a private equity buyer was more fulsome. The potential benefits of this alternative that he presented included: the ability to "operate [**Netsmart's**] business on a longer term rather than a quarterly basis," a chance to "add strength to the management team,""add industry and technical talent to the organization" and "increase [**Netsmart's**] effectiveness in product development," an opportunity to "address the issues of data sharing and interoperability without the short term impact issues," and the prospect of "eliminat[ing] public company costs at the rate of $1M to $1.5M per year." [FN19] Further, Scalia conveyed that this route could bear fruit, noting that "initial indications [of interest] are pretty good" and citing Vista, Francisco and two other private equity groups in support of that proposition.[FN20]

FN19. *Id.* at NET 00006.

FN20. *Id.*

Interestingly, another version of this same slide contained another bullet adding "Second bite at the apple" to the list of benefits in a private equity deal.[FN21] This reference obviously refers to the potential for management to not only profit from ***182** the sale of its equity (including exercised options) in the going private transaction itself, but from future stock appreciation through options they were likely to be granted by a private equity buyer, a class of buyers that typically uses such incentives to motivate managers to increase equity value.

FN21. *Id.* at NET 00054.

In summary, Scalia estimated that the company could be taken private by a private equity buyer in 2007 for a value that was attractive in a net present value comparison to the option of remaining independent.[FN22] To give him his due, Scalia also clearly illustrated that **Netsmart** had options for generating revenue and profit growth in the long-term that were also attractive. But the directional force of management's desires was manifest. In fact, minutes from a meeting held later that day by the independent directors of **Netsmart** focus largely on the option of going private.[FN23]

FN22. *Id.* at NET 00018 (projecting a private equity value for a 2007 transaction of over $163 million in comparison to $156 million for a strategic sale and between $116 million and $130 million for remaining independent).

FN23. During that meeting, Conway informed the independent directors that he and William Blair believed there to be serious interest by private equity players, and "a lengthy discussion ensued." Letter from Kurt M. Heyman, Esq. to the court (Mar. 7, 2007) ("Heyman Letter"), Ex. B at NET 02226.

After the meetings on May 11, management's focus on the going private option intensified. Over the following week, Scalia was working full bore with William Blair as it prepared its own assessment of these options.[FN24] Once that report was complete, a so-called "informal" board meeting was held on May 19. From there, things get fuzzy.

FN24. He was likely doing so before the May 11 meeting. The William Blair presentation on May 19 clearly includes elements, including projections of financial performance, taken from Scalia's work. *Compare* Naylor Aff., Ex. 2 at NET 00009 (projecting annual revenues of $60,478, $69,549, $79,982, $89,579, $100,329 for 2006 through 2010) *with* King Aff., Ex. 2 at SCYS 000544 (same).

At that meeting, which was dubbed "informal" because no minutes were taken memorializing its contents,[FN25] William Blair reiterated many of the concerns about **Netsmart's** then-existing market position previously discussed by Scalia.[FN26] From these premises, the William Blair slides recommended that **Netsmart** explore both a "going private transaction" and a "strategic sale."[FN27] Along with this advice, Blair provided the board with a large volume of valuation metrics to get a sense of what value **Netsmart** might capture in a sale. It also provided the board with five-year projections drawn (through 2011) based on Scalia's earlier management model containing figures through 2010.[FN28]

FN25. *See* Heyman Letter at 1 ("Minutes of the May 19, 2006 meeting do not exist, because, as explained in the Proxy, this was an 'informal meeting of the board of directors' at which William Blair 'made a general presentation regarding various strategic and financial alternatives for the Company.'") (citing King Aff., Ex. 4 at 15).

FN26. King Aff., Ex. 2 at SCYS 000535 & SCYS 000536. Blair's concerns included difficulty garnering the attention of investors and analysts, disproportional reporting and public company compliance costs that were material in relation to **Netsmart's** bottom line, and issues associated with **Netsmart's** strategy of "increasingly pursuing larger contracts with longer sales cycle[s]," which creates "lumpy revenue" and makes predicting financial results more difficult and renders year-over-year comparisons largely unhelpful. *Id.*

FN27. *Id.* at SCYS 000536.

FN28. *See* King Aff., Ex. 2 at SCYS 0005454.

Consistent with its slides indicating that **Netsmart** should explore a sale, William ***183** Blair dumped omnibus lists of possible financial and strategic buyers on the board, which apparently consisted of all the buyers William Blair could conceive of as having an interest or involvement in healthcare. For example, William Blair included HCA Inc., a huge hospital chain that was in the midst of going private itself, as a potential strategic acquirer. The reason why a hospital chain would buy a business providing software solutions to a large variety of mental health and substance abuse providers was not explained. More logically, the presentation also included a list of strategic players involved in the business of helping healthcare providers manage information through software and related technology.[FN29]

FN29. King Aff., Ex. 2 at SCYS 000561.

The most important aspect of the May 19 meeting, though, was the result of these various presentations and recommendations. The Proxy says that during this meeting an important strategic decision and a related tactical choice of similar import were both made. The strategic decision was to authorize William Blair to try to sell the company. The tactical choice was to focus on a sale to a private equity buyer and to eschew an active canvass of any strategic buyers. The Proxy describes these decisions and their rationale as follows:

On May 19, 2006, representatives of William Blair attended an informal meeting of the board of directors and made a general presentation regarding various strategic and financial alternatives for the Company.... It was concluded that William Blair should continue the exploration of a potential going-private transaction, given the Company's size and operating characteristics, as well as the relative advantages and disadvantages of continuing to operate as a public company.... In examining the potential for a transaction with strategic acquirers, it was determined that the potential strategic acquirers in similar segments would either believe that the Company's specific market segment was too narrow or have insufficient scale and resources to enable them to acquire a company of **Netsmart's** size. Furthermore, the board of directors and management considered the fact that **Netsmart** directly competes with these companies and ultimately made the determination that the risks involved in such an approach (including the risk of confidentiality leaks that would be detrimental to the Company in its sales efforts with customers and prospects) outweighed the benefits, especially given its previous preliminary discussions which did not result in material interest from potential strategic acquirers.[FN30]

FN30. Proxy at 15.

Frankly, there is no credible evidence in the record that buttresses this recollection of events. Due to the importance of this disclosure and its doubtful accuracy in light of the entire record, I address it in parts.

First, entirely absent from the record is any serious "examin[ation of] the potential for a transaction with strategic acquirers."[FN31] **Netsmart's** board never seriously considered whether the company, as it existed in May 2006, might potentially fit under the corporate umbrella of a larger healthcare enterprise software provider. The William Blair slides are replete with examples of firms in related industries that could have been approached, and Palasz admitted that William Blair believed, going into that meeting, that a transaction strategic***184** buyers should at least be explored.[FN32] But, there is no indication that management, William Blair, or the board considered how **Netsmart's** acquisition of its largest competitor, CMHC, and its concomitant attainment of dominance in its market niche might influence the ardor that any of these strategic buyers might feel. The supposed important decision-not reflected in any minutes or resolution-to forsake approaching these buyers appears to have only been justified by reference to the sporadic pitches to strategic players Conway and William Blair made over the prior decade. The relevance of these contacts will be discussed again shortly. For now, what is critical is that they do not reliably indicate that material interest from potential strategic acquirers did not exist because no contemporary search was conducted and these prior search attempts occurred when **Netsmart** was a very different (smaller and less consistently profitable) entity then it was in 2006.

FN31. *Id.*

FN32. *See* Palasz Dep. at 20 (indicating that as of May 19, William Blair did not "have any preference for one type of transaction over the other"); *see also* King Aff., Ex. 2 at SCYS 000536 (stating in William Blair's May 19 presentation that " **Netsmart** should at least explore ... [a] strategic sale" in addition to a "going-private transaction").

Second, there is little, if anything, to support the assertion in the Proxy that **Netsmart's** ability to sell its products would be hindered by discreet and professional overtures to select strategic players. Given **Netsmart's** size, any rational customer would recognize that it and other of its competitors could be subject to acquisition. Unlike another situation with which the court is familiar,[FN33] the record contains no information from which one could conclude that the potential acquisition of **Netsmart** by a larger healthcare IT company posed any colorable threat to prospective customers of **Netsmart**.[FN34] Further, given the lack of any record of the use of confidentiality agreements during the scattershot approaches made by Conway and Blair over the years, **Netsmart's** claim that overtures to much larger strategic buyers in 2006 would scare off customers creates cognitive dissonance. Those prior contacts were made when **Netsmart** was smaller and less secure in its market niche-that is, when it would seem to have had more to fear in terms of sales erosion from sending a signal that it was up for sale. Yet, despite those alleged contacts, **Netsmart** continued to make sales and gain new customers, which now face high switching costs should they consider abandoning **Netsmart**.[FN35]

FN33. I refer to the long struggle of Oracle to acquire PeopleSoft. In that case, PeopleSoft amassed a substantial amount of credible evidence showing that it faced great difficulty in making new sales of its enterprise while under the threat of a takeover by one of its few remaining direct competitors in its market space.

FN34. To the contrary, the record indicates that **Netsmart** faced little danger of losing existing customers simply by shopping the company. *See* Calcagno Dep. at 174-75 (explaining that

"there are barriers of entry for competitors to come into the business" such as "contracts with municipalities and proprietary software products" creating "high switching costs").

FN35. *Id.* (describing how the costs associated with switching from **Netsmart's** products to a competitor's offerings would be "a deterrent" to dropping **Netsmart**).

Put bluntly, the informal and haphazard market canvass **Netsmart's** board relied on was insufficient, and it is hard to glean from the record any convincing reason why a discreet, targeted, and controlled marketing effort directed towards select strategic buyers posed a threat to **Netsmart's** ongoing operations. The Proxy implies that the absence of evidence of this ***185** kind is irrelevant because there was no rational reason to believe that a search for a strategic buyer had any hope of success. But the foundation upon which that conclusion rests cannot bear that weight.

From there, the record gets even more diffuse. The defendants claim that the Proxy implicitly refers to two sets of prior contacts with strategic buyers, one set involving Conway and the other involving William Blair. These were the same contacts identified earlier, the quality and quantity of which require additional mention given the importance the defendants place upon them.

Conway's alleged exploration of a strategic combination spans, according to him, at least the seven-year period from 1999 to 2006. During that time, he says he spoke at one time or another with "at least a half a dozen" possible strategic acquirers-nearly one each year!-about the possibility of a strategic combination.[FN36] Conway's testimony about these efforts suggests they were sporadic at best, did not involve any confidentiality restrictions, and were more the product of happenstance than of a close examination of the market.[FN37] As important, most of them came when **Netsmart** was much smaller and less established as a firm.

FN36. Conway Dep. at 96.

FN37. *See* Conway Dep. at 96-110 (describing **Netsmart's** contacts with potential strategic acquirers and admitting that there had been no contact with Cerner, Siemens, or Perot in the last three years, with Quality Systems in the last five, or with QuadraMed in over a year); *see also* Calcagno Dep. at 29-33 (adding GE Medical and EDS Corp. to the list of strategic buyers contacted in the late 1990s but not resurfacing again).

The William Blair contacts are even less compelling. Between 2003 and 2006, William Blair claims that it bandied **Netsmart's** name about along with the names of other companies when it made cold calls on prospective clients in the healthcare sector.[FN38] Again, concerns about confidentiality seem to have been non-existent. Even more important, Palasz testified that most of the companies Blair mentioned in these cold calls were not its clients and that it had no authority to tell anyone that **Netsmart** was interested in a sale.[FN39] In fact, Palasz stated, "[T]here would be no reason for the potential acquirers to think that any of these companies would be, quote, unquote, on the block." [FN40] Nor is there any indication that William Blair actually targeted its pitches to a specific set of strategic players in the healthcare IT space for whom **Netsmart** might be a good fit and to whom the company might make a reasoned proposal.

FN38. *See* Palasz Dep. at 13 ("There were no formal activities during that time frame. As a matter of course in our healthcare information technology investment banking practice, we have discussions with many potential acquirers of firms. And in the course of those discussions, from time to time **Netsmart**, among other multiple companies, would be discussed as possible avenues of acquisition or expansion for those potential strategic acquirers.")

FN39. *See id.* at 59 (explaining that most of the companies' names used in these conversations were not Blair clients and that the company to whom the pitch was being made would not know whether the companies whose names Blair was mentioning were clients or not).

FN40. *Id.* at 58.

These erratic, unfocused, and temporally-disparate discussions by Conway and William Blair apparently constituted the information base that the board had at its disposal when it determined it was not worthwhile to seek out a strategic buyer in May 2006. Neither management nor William Blair seriously analyzed the healthcare IT universe as it existed at that time ***186** or considered which companies might find **Netsmart**, as it existed in 2006, to be attractive. As a result, there was apparently no consideration of making careful and focused approaches to a discrete set of larger players in the healthcare IT space who might wish to round out their enterprise software offerings, a method that would balance the utility of testing the marketplace against the confidentiality and other concerns that a broader canvass might threaten.

From the record, one gleans that the board, at best, quickly determined that strategic buyers were unlikely to be interested and eschewed any real look at them. In that thinking, they appear to have been influenced by management's and William Blair's favorable attitudes towards the private equity option.[FN41] Both believed that a private equity buyer could be found and seem to have touted the prevailing trend in the M & A markets, which involved private equity players pricing strategic buyers out of deals.[FN42] Additionally, the board also seems to have been influenced by William Blair into perceiving that all M & A situations were the same in the sense that the signing up of a publicly-announced deal for a micro-cap company like **Netsmart** would generate a reliable post-signing market check in the same way that similar announcements for large-cap companies like Paramount, Warner-Lambert, MCI, and more recently, Caremark, drew other interested strategic bidders into the process.[FN43]

FN41. *See, e.g.,* Palasz Dep. at 56 (indicating that William Blair, Conway, and the Special Committee all shared the same viewpoint in eschewing strategic buyers in favor of a private equity transaction).

FN42. This is a phenomenon that will be studied. The prior conventional wisdom was that strategic buyers could outbid private equity buyers because they could reap greater synergies. Some of the private equity players can now do synergistic deals because they own other companies and there is also a perception that a private corporation not subject to the constant minute-to-minute demands of the public market can execute an aggressive, multi-year business strategy with greater effectiveness. The evolving story also tends to involve more dubious claims about the avoidance of a material amount of the ongoing compliance costs associated with being a public firm, claims that seem questionable if the route of going public again within a half-decade or so remains a primary one for private equity firms. Will an accounting firm certify your going-public registration statement financials unless you are righteous with 404?

FN43. *See, e.g.,* Edward D. Herlihy, *Takeover Law and Practice 2006,* 1584 PLI/CORP 433, 447 (Jan. 24, 2007) (chronicling recent hostile deals, including "GE's bid for Honeywell after reports of a deal with United Technologies surfaced, Pfizer's bid for Warner Lambert after Warner Lambert announced a merger with American Home Products, AIG's bid for American General following its announcement of a transaction with Prudential PLC, SunTrust's attempt to break up the First Union/Wachovia merger, and Qwest's continued efforts to acquire MCI after MCI's board twice accepted lower bids from Verizon."); Robert E. Spatt, *The Four Ring Circus-Round Nine; A Further Updated View of the Mating Dance Among Announced Merger Partners and an Unsolicited Second or Third Bidder* (2005) (updating Spatt's original article, published at 1 No. 9 M & A LAW 1 (Feb.1998), and collecting instances of deal jumping for those attending the Tulane Corporate Law Institute).

In any event, given the un-minuted nature of the May 19 meeting and the lack of good recollection by the defendants involved, it is difficult to determine what exactly motivated the board's decision, or if decision is really even the right word. What is certain is this: despite William Blair's presentation including a litany of potential strategic buyers **Netsmart** might pursue, no effort was taken from that point forward to explore whether any of these buyers were interested in **Netsmart**. None.

***187** D. *Pursuit Of A Private Equity Deal Accelerates*

After the May 19 meeting, management and William Blair continued to collaborate on efforts to pursue a private equity deal. In early July, another private equity firm focused on companies in the software and healthcare markets, Thoma Cressey Equity Partners ("Cressey"),[FN44] approached **Netsmart** and expressed a preliminary interest in acquiring the company.[FN45] Without involvement of the board, a confidentiality agreement was inked and Cressey undertook some due diligence.[FN46] On July 7, Cressey made a preliminary, conditional proposal to acquire all of the company's shares for $15 apiece. That

same day, **Netsmart** stock closed at $12.81 per share on the NASDAQ.[FN47]

FN44. Thoma Cressey is referred to as "PE-3" in the Proxy. *See* Proxy at 15-16.

FN45. Palasz Dep. at 45-47.

FN46. Proxy at 15-16.

FN47. NTST: Historical Prices, Yahoo! Finance, http:// finance. yahoo. com/ q/ hp? s= NTST & a=06 & b=7 & c=2006 & d=06 & e=7 & f=2006 & g=d (last visited Mar. 14, 2007) (documenting the $12.81 closing price of **Netsmart** (NTST) shares on July 7, 2007); *accord* Calcagno Dep. at 132 (indicating that **Netsmart's** stock price at the time of the Cressey bid was "around $13").

From there, things began to move fast. On July 13, 2006, the board of directors met to consider the Cressey proposal. They decided to form a Special Committee of independent directors, with defendant Calcagno as Chairman, and defendants Gallagher, Shamash, and Sicinski as members. The Special Committee retained William Blair as its own advisor the next day.

At the same meeting, the Special Committee apparently decided on a very targeted approach to marketing the company, which involved an outreach to six private equity firms in addition to Cressey. These included Vista and Francisco, which had each already expressed an interest in a transaction with **Netsmart**, as well as four other firms-TA Associates, Summit Partners, Insight, and Technology Crossover Ventures-that William Blair said had each purchased healthcare software firms in the past.[FN48]

FN48. Calcagno Dep. at 75-76.

In the foregoing discussion, I use the word "apparently" because as with the meeting of May 19, no minutes exist for these Special Committee's deliberations that appear in the Proxy. As such, one cannot determine who was present for this meeting or what specifically was said or done. One might even reasonably speculate that no formal meeting took place as the Committee's chairman, Calcagno, testified that there were no Special Committee meetings at which minutes were not taken.[FN49] In that case, Calcagno may well have signed off on the shopping list suggested by William Blair outside of the meeting room.

FN49. *See* Calcagno Dep. at 124-25 (inquiring whether July 31 was the first meeting of the Special Committee because it was the earliest set of minutes produced and whether there were any Committee meetings at which minutes were not taken and receiving an "I don't know" and "No" in response).

Ultimately, four of the seven private equity firms involved in the limited auction responded to William Blair's initial overture in a positive way. The four were Vista, Francisco, Cressey, and Insight. After agreeing to sign confidentiality agreements in order to facilitate access to due diligence materials, each was given the opportunity to review a set of **Netsmart's** records during the latter half of July and asked to provide a preliminary proposal ***188** outlining the terms on which they might acquire **Netsmart** by August 1.

In what was to be the pattern throughout, the **Netsmart** side of the due diligence process was handled by company management with little involvement from the Special Committee or its advisors. This occurred despite the fact that **Netsmart** management was keenly interested in the future incentives that would be offered by the buyers, including what, if any, option pool would be offered to them in the resulting private company. Given its lack of participation in this process, the Special Committee had virtually no insight into how consistent management was in its body language about **Netsmart's** prospects to the various private equity firms in the bidding process. But no plausible allegations of favoritism by management toward particular private equity firms among the seven have been made by the plaintiffs, and no evidence from which one can infer that Conway or other **Netsmart** managers had any pre-existing relationship or bias toward any of the bidders has been presented.

On the eve of receiving expressions of interest, July 31, the Special Committee met in its first minuted meeting. At that session, which was attended by CEO Conway and **Netsmart's** general counsel, the Special Committee retained Patterson Belknap Webb & Tyler as its legal counsel.[FN50] The same day as it was retained, Patterson Belknap provided a review for the Special Committee of its legal obligations.[FN51]

FN50. King Aff., Ex. 9 at 1-2.

FN51. Proxy at 16.

E. *The Preliminary Bids Come In And The Board Confirms Its Prior Decision Not To Seek A Strategic Buyer*

On August 3, the Special Committee met to consider the preliminary bids its limited action had generated. Each of the preliminary bids contemplated, as one would expect from private equity buyers, a continuing role for existing management after the sale and the provision of equity incentives to them. Cressey declined to update its prior $15 per share expression of interest. The other expressions of interest were: Insight (at $15.40-$15.60 per share); Francisco ($15.75 to $16.75 per share); and Vista (at $17.00 per share).[FN52]

FN52. Proxy at 16.

The Special Committee, with involvement by Conway, again rejected any broader market canvass. Instead, it decided to offer the two bidders who made the most attractive offers the opportunity to conduct additional due diligence in contemplation of making final bids on August 28. In coming to the conclusion not to try to approach a broader range of bidders, the Special Committee relied in important part on the intuition that, so long as the Merger Agreement contained a fiduciary out and did not contain preclusive deal protections, other strategic or financial buyers with an interest would seize on the public announcement of a Merger Agreement as an invitation to make a topping bid.[FN53]

FN53. During the executive session on August 3, the Special Committee received advice to that effect: "Mr. Cox [of Patterson Belknap] explained deal terms, including fiduciary outs ... and modest break-up fees, that would permit a post-announcement market check in order to deal effectively with strategic investors that might offer a substantially higher price. William Blair confirmed this approach as its strategy for a post-announcement market check." King Aff., Ex. 10 at 4. At a later August 29 meeting, the Special Committee also relied on William Blair's supposed representation that it had contacted all the strategic identified buyers in its prior May 19 presentation. That representation, if made, could only refer to the cold calls previously described. It does not refer to any authorized marketing in 2006. *See* King Aff., Ex. 13 at 6.

***189** In August, Vista and Francisco conducted due diligence, without involvement by the Special Committee, and also had talks with Conway about incentives for management. When bids came in on August 28, Francisco's expression of interest had been reduced to $15 per share. Vista, meanwhile, submitted a bid of $16.75 per share. Insight, which had not been invited to the second round, continued to poke around the process, seeking to engage Conway's interest but being rebuffed.

On August 29, the Special Committee met. It received updated valuation figures from William Blair to use as a basis for assessing the bids and, more generally, the merits of pursuing a sale. The Special Committee discussed the relative advisability of **Netsmart** remaining independent as opposed to engaging in a going private transaction. Among the issues considered were **Netsmart's** current market valuation, serious health issues facing Conway and the succession issues that posed, and the company's need to raise large amounts of capital if it were to continue on its own. At the end of the discussion, the Special Committee asked Conway to leave and held an executive session during which it concluded that a transaction in the range proposed by Vista would be attractive and resolved to authorize William Blair to negotiate with Vista. The terms the Special Committee authorized Blair to seek included a purchase price of $17 per share (a quarter more than Vista's current bid), a 15-day exclusivity period (instead of the 25-day period Vista requested), and a break-up fee of no more than 3% in the final Merger Agreement.

Although Vista did not raise its price, an exclusivity agreement was struck allowing Vista an additional two weeks of due diligence. Again, **Netsmart** management, without the Special Committee's involvement, administered this process. At the end of Vista's review, disappointment resulted. Vista told Palasz of William Blair that it was no longer interested in making an offer at the $16.75 per share level and would only proceed at a level "materially south" of that number.[FN54] Palasz probed what that meant and came away with the reasonable impression it meant a bid of around $15 per share.[FN55]

FN54. Palasz Dep. at 88-89.

FN55. Palasz Dep. at 93-94 (confirming that "we are not talking about 25 or 50 cents in terms of ...

reduction" and that while not "absolutely defined" the approximate level was comparable to "Francisco ... at $15 a share").

William Blair and the Special Committee were not well pleased with Vista. They viewed them as having sported with the process. William Blair gave Vista the news that its reduced level of interest was not attractive. This put the onus on Vista to get its bid back up if it wished to stay in the game. Vista never did so and disappears from our story. A similar tack had been taken with Cressey earlier.

The peskiness of Insight, however, left the Special Committee with another option. On September 20, Insight had again approached Conway to inquire about the process and signaled an interest in making a bid higher than its prior $15.60 overture. Conway directed Insight to the Special Committee's advisor, William Blair. After Vista dropped its bid, William Blair followed up with Insight and determined it was serious. On September 27, the Special Committee met with its advisors as well as Conway. The Special Committee decided to give Insight, the highest bidder at that time, a chance to conduct due diligence in a tight timeframe.

***190** On October 4, that due diligence was completed and Insight made a written expression of interest at $16.40 a share. By that date, **Netsmart's** management was completing the retention of counsel for themselves, to negotiate the conditions on which they might be retained by a private equity buyer. The Special Committee had left that separate negotiation track to management.

On October 5, the Special Committee met to consider Insight's offer. It decided, with Conway's input and with guidance from its advisors, to suggest a $16.50 per share price to Insight. Insight responded favorably to William Blair's dangling of that price and the Special Committee authorized the execution of an exclusivity agreement with Insight the next day. That agreement gave Insight a period of exclusive due diligence in exchange for its obligation to deliver a draft purchase agreement meeting that price by October 23.

F. *Insight Wins The Bidding And Executes A Merger Agreement With* ***Netsmart***

At the end of October, Insight did not disappoint. Negotiations over a Merger Agreement ensued. The Special Committee sought the chance to actively shop **Netsmart**-through a "go shop" clause-after the Merger Agreement was publicly announced. Insight refused and the Special Committee relented, instead accepting a "window shop" provision that allowed **Netsmart** to consider an unsolicited proposal that met a more or less standard definition of a superior proposal. The parties also haggled over termination fee issues. For its part, the Special Committee extracted a 1% reverse break-up fee payable if Insight failed to close by exercise of its financing out. Insight obtained a break-up fee of 3% of the deal's implied equity value, inclusive of its expenses. But Insight's demand to trigger the break-up fee simply on a "naked no vote" of **Netsmart's** stockholders was rejected, and the triggers were tied to **Netsmart's** termination of the Merger Agreement in order to pursue a superior proposal.FN56

FN56. *See* King Aff., Ex. 17 at 5.

While the Special Committee haggled over the Merger Agreement, Conway and his top subordinate, Grisanti, bargained with Insight over their incentives. The Special Committee did not get itself involved in those discussions. But **Netsmart's** compensation committee, which included Calcagno, Sicinski, and Gallagher from the Special Committee, did meet with Conway and the legal advisors for management, to discuss the status of those talks.

By November 15, these parallel negotiations were both completed. Management had a tentative deal with Insight and the Special Committee's advisors had completed negotiating the Merger Agreement. Contrary to the plaintiff's early arguments, Conway did not come out of his negotiations with Insight a markedly richer man. It appears that his negotiations with Insight, as well as those of his subordinate Grisanti, who got a package proportionally identical to Conway's, were spirited and involved real give and take.FN57

FN57. Under his existing employment agreement with **Netsmart**, Conway earned a salary of $385,875 annually, was entitled to aggregate retirement benefits of between $679,000 and $821,000, and stood to receive a $2.3 million payment in the event of a change of control. King Aff., Ex. 6 at NET 02319 & NET 02320. He also owned 106,348 shares of stock and 142,500 options (roughly 3.7% of **Netsmart's** equity). Proxy at 26, 70-71. Following his negotiations with Insight, Conway entered into new agreements in which he accepted a reduced salary of $367,500, reduced benefits upon retirement, and a reduced one-time change-in-control payment of $1 million. King Aff., Ex. 6 at NET 02319-NET 02319. In exchange for these concessions, Conway will continue as CEO of **Netsmart** and can share in the future appreciation of the company by exercising options that will be granted to him at a strike price pegged to the consideration in the Merger ($16.50 per share) and equaling 2.25% of the surviving company's shares. Proxy at 8. Thus, it does not appear that Conway stands to receive a financial windfall.

***191** On November 16, William Blair made an updated financial presentation to the Special Committee providing it with valuation metrics to assess the $16.50 per share Insight offer. The Special Committee was also apprised that Insight intended to bring in another equity sponsor, Bessemer. Then, Patterson Belknap reviewed the terms of the Merger Agreement.

The next day the Special Committee met again and formally decided to recommend approval of the Merger Agreement, after receiving an oral fairness opinion from William Blair. The board then met and voted to approve the Merger Agreement, with Conway abstaining. The next day, November 18, Blair presented its final fairness opinion, and the Merger Agreement was executed as were new employment agreements for Conway and Grisanti that would become effective if the Merger were approved.

G. *The Deal Is Announced And The Shareholder Vote Is Scheduled*

On November 20, the Merger was publicly announced. That same week, several lawsuits seeking to halt the Merger were filed in this court. Those cases have since been consolidated into this action.

After this litigation commenced, the Special Committee met on December 21, 2006 and approved formal minutes for ten meetings ranging from August 10, 2006 through November 28, 2006.FN58 That tardy, omnibus consideration of meeting minutes is, to state the obvious, not confidence-inspiring, especially when considered along with the total absence of minutes for the May 19 board meeting and the lack of clarity whether the Special Committee ever met to approve the limited set of private equity firms to be canvassed.

FN58. *See* Affidavit of Scott M. Tucker, Esq. ("Tucker Aff."), Ex. 10 at SC 000321 (approving minutes for August 10, August 23, August 29, September 27, October 5, October 26, November 2, November 16, November 17, and November 28, 2006).

On December 21, 2006, **Netsmart** also filed its preliminary proxy with the Securities and Exchange Commission (the "SEC"). The SEC questioned whether the transaction was a Rule 13e-3 going private transaction, but, upon further investigation, concluded that the disclosure requirements of that section were inapplicable.FN59 **Netsmart's** definitive Proxy Statement was filed on February 28, 2007 and mailed to shareholders on March 2, 2007.FN60 The special meeting to consider the Merger will be held on April 5, 2007 at which time the stockholder vote is scheduled to take place.FN61

FN59. *See* King Aff., Ex. 6; DAB at 21.

FN60. **Netsmart** Technologies, Inc., Form 8-K (Mar. 5, 2007) at Ex. 1.

FN61. *Id.*

III. *Legal Analysis*

[1] The standard the court must apply to evaluate the plaintiffs' motion for preliminary injunction is familiar. In order to warrant injunctive relief, the plaintiffs must prove that: (1) they are likely to succeed on the merits of their claims; (2) they will suffer imminent, irreparable harm if an injunction is not granted; and (3) the balance of the equities weighs in ***192** favor of issuing the injunction.FN62 I begin my application of that standard with the plaintiffs' merits arguments, which come in two major categories. The first consists of their various arguments why the sales process leading up to the Merger was tainted. The second contains their contentions why the Proxy is materially deficient. After analyzing the merits argument in this order, I apply the remedial calculus contained in the rest of the preliminary injunction test.

FN62. *E.g.,* *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173, 179 (Del.1986).

A. *The Merits*

1. *The Alleged Flaws In The Sale Process*

[2][3] Having decided to sell the company for cash, the **Netsmart** board assumed the fiduciary duty to undertake reasonable efforts to secure the highest price realistically achievable given the market for the company.[FN63] This duty-often called a *Revlon* duty for the case with which it is most commonly associated [FN64]-does not, of course, require every board to follow a judicially prescribed checklist of sales activities.[FN65] Rather, the duty requires the board to act reasonably, by undertaking a logically sound process to get the best deal that is realistically attainable.[FN66] The mere fact that a board did not, for example, do a canvass of all possible acquirers before signing up an acquisition agreement does not mean that it necessarily acted unreasonably.[FN67] Our case law recognizes that are a variety of sales approaches that might be reasonable, given the circumstances facing particular corporations.[FN68]

FN63. *E.g., Revlon,* 506 A.2d at 184 N.16 ("The directors' role remains an active one, changed only in the respect that they are charged with the duty of selling the company at the highest price attainable for the stockholders' benefit."); *Paramount Communications, Inc. v. QVC Network, Inc.,* 637 A.2d 34, 44 (Del.1994) ("In the sale of control context, the directors must focus on one primary objective-to secure the transaction offering the best value reasonably available for the stockholders-and they must exercise their fiduciary duties to further that end.").

FN64. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del.1986).

FN65. *E.g., Barkan v. Amsted Industries, Inc.,* 567 A.2d 1279, 1286 (Del.1989) ("[T]here is no single blueprint that a board must follow to fulfill its duties.").

FN66. *E.g., QVC,* 637 A.2d at 45 ("[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination.").

FN67. *E.g., In re Toys 'R' Us, Inc. S'holder Litig.,* 877 A.2d 975, 1000 (Del.Ch.2005).

FN68. *See Barkan,* 567 A.2d at 1286-87 (describing different fact patterns and appropriate responses from corporate boards).

[4][5] What is important and different about the *Revlon* standard is the intensity of judicial review that is applied to the directors' conduct. Unlike the bare rationality standard applicable to garden-variety decisions subject to the business judgment rule, the *Revlon* standard contemplates a judicial examination of the reasonableness of the board's decision-making process.[FN69] Although linguistically not obvious, this reasonableness review is more searching than rationality review, and there is less tolerance for slack by the directors. Although the directors have a choice of means, they do not comply with their *Revlon* duties unless they undertake reasonable steps to get the best deal.

FN69. *See QVC,* 637 A.2d at 45.

***193** Here, the plaintiffs claim that the **Netsmart** directors acted unreasonably in two key respects. First, they argue that the Special Committee did not do a reasonable job of extracting the highest value from the limited universe of private equity bidders it sought out in the sales process. Second, they argue that the **Netsmart** board acted unreasonably by failing to conduct any canvass at all of possible strategic acquirers, leaving itself without any reliable basis to conclude that the Insight Merger it eventually landed was the best deal realistically achievable.

a. *Within The Confines Of Its Limited Auction Of Certain Private Equity Firms, Did The Board Likely Breach Its Revlon Duties?*

[6] The plaintiffs criticize the methods the Special Committee used in dealing with the seven private equity firms that participated in its limited auction process. Most notably, the plaintiffs allege that Conway was too influential in the Special Committee process. The plaintiffs also make more particular arguments, including contending that the Special Committee should have gone back to Vista again after it dropped its bid and sought to get it back in the game. They also insinuate that the Special Committee should have resumed contact with Cressey when Vista dropped out and should not have dealt solely with Insight at the end stage. I do not believe there is a reasonable probability that these arguments, at a later stage, will be successful.

There are admittedly questions that can be raised about how the Special Committee did its work with private equity buyers. By the time the Special Committee was formed, William Blair was well along in its work with management. Even when it was formed, the Special Committee largely deliberated with Conway right at the table, along with the company's general counsel, and other of Conway's subordinates. Although the Special Committee had executive sessions, it included in those sessions the same bank that had been working with management all along. As a result, one rationally doubts how confidential these sessions really were.

Yet, despite these doubts, the plaintiffs' allegations that Conway dominated the Special Committee and drove it toward an inferior offer are not convincing. Admittedly, the Special Committee conducted itself in a manner that invites stockholder suspicion.[FN70] Even recognizing that Conway, although CEO, did not have anything approaching the clout of a controlling stockholder, the Special Committee gave him virtually unlimited access to their deliberations, and let him direct the due diligence process without close oversight. But the fact that these practices predictably raise the suspicions of the plaintiffs does not mean that they actually caused harm to **Netsmart's** stockholders.[FN71] Upon ***194** close examination, the process used seems to have had no adverse consequences.

FN70. *Cf. In re SS & C Technologies, Inc. S'holders Litig.,* 911 A.2d 816, 820 (Del.Ch.2006) (emphasizing the need for independent directors to be active when addressing LBO transactions involving powerful economic incentives for management that might conflict with the interests of public stockholders).

FN71. The plaintiffs' arguments to the contrary rely on strained applications of two recent decisions: *In re Emerging Communications, Inc. S'holders Litig.,* 2004 WL 1305745 (Del.Ch.2004), and *In re Freeport-McMoran Sulphur, Inc. S'holder Litig.,* 2005 WL 1653923 (Del.Ch.2005). But those decisions focus on different situations in which management of the selling corporation had clear associations with the buyer and where members of the special committees themselves faced disabling conflicts as a result. *Emerging* involved a controlling stockholder merger in which both a majority of the full board and the special committee were found to be beholden to the company's Chairman and CEO, against whom the special committee was negotiating. *Freeport-McMoran* concerned a transaction in which the buyer and the seller shared common board members and where there were persuasive reasons to doubt the special committee's independence from the common directors. This case does not present conflicts of similar magnitude and, as a result, Conway's alleged involvement in the sale process is less troubling.

All told, the Special Committee formally met eleven times, with five of those meetings containing "Executive Sessions" in which management was asked to leave and only the committee members participated.[FN72] It was during those sessions that the Committee considered and approved the Merger terms,[FN73] and, aside from Conway's participation in the important strategic buyer debate, [FN74] resolved virtually every other issue not involving the due diligence process, which was discussed with Conway because he was facilitating it.

FN72. *See* King Aff., Exs. 10, 11, 13, 16 & 19 (containing minutes of the Special Committee's executive sessions).

FN73. King Aff., Ex. 19 at 4-8.

FN74. *See* King Aff., Ex. 10 at 4-5 (indicating that this conversation took place before Conway was asked to leave).

The Special Committee's and its advisors' involvement in the due diligence process was less vigorous. They let this process be driven by management. In easily imagined circumstances, this approach to due diligence could be highly problematic. If management had an incentive to favor a particular bidder (or type of bidder), it could use the due diligence process to its advantage, by using different body language and verbal emphasis with different bidders. "She's fine" can mean different things depending on how it is said.

One obvious reason for concern is the possibility that some bidders might desire to retain existing management or to provide them with future incentives while others might not. In this respect, the **Netsmart** Special Committee was also less than ideally engaged. Conway was left unattended to bandy such issues around with the invited bidders.

That said, I have no basis to conclude that these issues actually had any negative effect on the bidding process. Unlike some other situations, this was not one in which management came to the directors with an already baked deal involving a favorite private equity group. Conway had no pre-existing relationships with any of the invited bidders. None of the bidders was offering materially more or less to management.

Rather, at every turn, it appears that the Special Committee proceeded in an appropriately price-driven manner, dealing with the bidders or bidder, depending on the stage, that promised to pay the highest price. There is no evidence in the record that any bidder was ever put off the hunt by Conway because of his self-interest.

Indeed, the quibbles that the plaintiffs raise illustrate the Special Committee's tendency to deal with the bidder promising the highest price. When it chose to deal with Vista exclusively, it did so because Vista dangled a price of $16.75 per share. When Vista then failed to deliver and dropped down to the $15 range, the Special Committee's decision to give it the cold shoulder strikes me as entirely reasonable. Vista then knew it was up to it to get back into a more attractive range. Vista didn't need an engraved invitation to know it was its move.

Likewise, having already invited Cressey to improve its original, and never revised, offer into a comparable range, the Special Committee did not act unreasonably***195** by failing to go back to it, as the plaintiffs suggest they should have. Again, Cressey knew how to reach the Special Committee if it wanted to make a more attractive bid. Yet, Cressey never did more than hint that it might be willing to pay more and the board cannot be faulted for considering this whisper to lack seriousness.

Given the circumstances, therefore, I do not think it unreasonable that the Special Committee focused at the end stage on Insight and secured a deal with it at $16.50 per share. The mere fact that the Special Committee had, at one point, desired to get $17 per share from Vista, which had teased it with a $16.75 per share deal, did not mean that it should hold out for that price from Insight, at a later time when even Vista had dropped its interest well south of that level.

Finally, I perceive there to be no rational basis for the plaintiffs' argument that the Special Committee acted unreasonably by failing to demand a price increase from Insight when Insight brought in Bessemer as an equity partner. I don't know how this parses, frankly. Even accepting the principle that corporate boards should use the negotiating power they possess to extract a higher value for their shareholders,[FN75] it is unclear that the **Netsmart** board gained any real negotiating leverage by Insight's desire to include Bessemer. Further, given the size of **Netsmart**, this was not a situation in which "clubbing" posed a material threat to competitive bidding. As important, Bessemer was never even contacted by the Special Committee. It was not one of the chosen bidders and did not pair up with Insight rather than make an independent bid. It was brought in by Insight after Insight had prevailed in the Special Committee process. I suppose the Special Committee could have taken a flyer and asked Insight for more money or more lax deal terms because it had obtained a partner. If Insight had said, "come again, why?" I'm not sure what the Special Committee would have said, other than, "we had to give it a shot."

> FN75. *See* *QVC,* 637 A.2d at 51 (faulting Paramount's board for failing to use the enhanced negotiating leverage QVC's hostile bid provided and instead choosing to hide behind defensive measures already in place).

In sum, within the constraints of the limited process it undertook with the seven private equity firms, the Special Committee appears to have pursued the best deal it could get. Although some of its procedural choices were questionable, those choices do not seem to have had any negative effect on the result.

b. *Was The Board's Limited Action A Reasonable Approach To Maximizing Sale Value Given* ***Netsmart's*** *Circumstances?*

[7][8] The plaintiffs' second argument has much more force. That argument is that the Special Committee and **Netsmart** board did not have a reliable basis to conclude that the Insight deal was the best one because they failed to take any reasonable steps to explore whether strategic buyers might be interested in **Netsmart**.[FN76]

> FN76. "When ... directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market." *Barkan,* 567 A.2d at 1287. The corollary to this is clear: when they do not possess reliable evidence of the market value of the *entity* as a whole, the lack of an active sales effort is strongly suggestive of a *Revlon* breach.

I believe on this score that the plaintiffs are, if this preliminary record is indicative of the ultimate record in the case, likely to be successful on this point. For reasons I have noted, the board's consideration of ***196** whether to seek out strategic buyers was cursory and poorly documented at best. The decade-spanning, sporadic chats by Conway and William Blair are hardly the stuff of a reliable market check. That is especially so given the dynamism of the business world. What strategic buyers might have desired in 1999, 2001 or 2003 often will be very different than what they would desire in 2006. To that point, the key decision makers will often differ over time spans of that length. As important, **Netsmart** itself had been transformed through a host of acquisitions and lucrative contracts over that extended period. Finally, executives at large corporations are busy and are less likely to give serious attention to passing comments or diffuse cold calls made without any real authority than they are to respond to more concrete marketing efforts.

What was never done by Conway, William Blair, or the board was a serious sifting of the strategic market to develop a core list of larger healthcare IT players for whom an acquisition of **Netsmart** might make sense. Perhaps such an effort would have yielded no names. But it might have. Moreover, the mere fact that some healthcare IT players had not responded to less authoritative overtures in years long-past does not mean that they might not have taken a look at **Netsmart** in 2006.

Having embarked on the pursuit of a cash sale, it was incumbent upon the board to make a reasonable effort to maximize the return to **Netsmart's** investors. On the existing record, I cannot conclude that their approach to this issue is indicative of such an effort. As described previously, the downside to having ultimately approached strategic buyers early in the process seems quite limited, if extant. When compared to Scalia's and William Blair's early analyses, the initial expressions of interest were not compelling ones. Moreover, the ultimate results obtained by pursuing the directors' strategy of excluding strategic buyers were less than exciting, as measured by William Blair's final analyses. As plaintiffs point out, the implied transaction multiples that the Insight Merger ultimately entailed were all (except one) below both William Blair's median and mean for comparable transactions:[FN77]

> FN77. Proxy at 38-39.

Disclosed Deal Multiples	Netsmart @ $16.50/ share Implied Multiples	Selected Comparable Companies
Enterprise Value to Revenue (LTM)	1.82	

Enterprise Value to Revenue (2006E)	1.82
Enterprise Value to EBITDA (LTM)	11.3
Enterprise Value to EBITDA (2006E)	11.0
Enterprise Value to EBIT (LTM)	20.6
Enterprise Value to EBIT (2006E)	19.7

Similarly, the implied transaction value of $115 million of a $16.50 share price fell below even the lower range of William Blair's DCF value of **Netsmart**, which was $142 million to $202 million or roughly $20 to $29 per share.[FN78]

FN78. Proxy at 40.

In a targeted canvass, confidentiality issues could have been responsibly addressed, and there is no record basis to believe that strategic acquirers (which have their own confidentiality concerns) were more likely to leak than private equity firms. And, of course, Conway and ***197** William Blair claim to have tossed out **Netsmart's** name to strategic players through the years, when **Netsmart** was more, not less vulnerable, in terms of retaining and acquiring customers. And, like the canvass of private equity buyers, there was no need to fish with a seine net for strategic buyers. The Special Committee could have used a fly rod in that market, too.

Of course, one must confront the defendants' argument that they used a technique accepted in prior cases. The Special Committee used a limited, active auction among a discrete set of private equity buyers to get an attractive "bird in hand." But they gave **Netsmart** stockholders the chance for fatter fowl by including a fiduciary out and a modest break-up fee in the Merger Agreement. By that means, the board enabled a post-signing, implicit market check. Having announced the Insight Merger in November 2006 without any bigger birds emerging thereafter, the board argues that the results buttress their initial conclusion, which is that strategic buyers simply are not interested in **Netsmart**.

The problem with this argument is that it depends on the rote application of an approach typical of large-cap deals in a micro-cap environment. The "no single blueprint" mantra [FN79] is not a one way principle. The mere fact that a technique was used in different market circumstances by another board and approved by the court does not mean that it is reasonable in other circumstances that involve very different market dynamics.[FN80]

FN79. *See* *Barkan,* 567 A.2d at 1286.

FN80. An important recent decision of this court emphasizes that the reasonableness of a board's decisions in the M & A context turns on the circumstances. *See* *Louisiana Mun. Police Employee's Retirement System v. Crawford,* 2007 WL 582510, at *4 n. 10 (Del.Ch.2007) (requiring plaintiffs to "specifically demonstrate how a given set of deal protections operate in an unreasonable, preclusive or coercive manner," and likewise reminding defendants that they may not simply rely on notions of blanket rules (like a purported "3% rule" for termination fees) or "some naturally-occurring rate or combination of deal protection measures"). Not being cabined by a long set of per se rules, boards have great flexibility to address the particular circumstances they confront. But equitable principles, including the heightened reasonableness standard in *Revlon,* ensure that this broad discretion is not abused.

Precisely because of the various problems **Netsmart's** management identified as making it difficult for it to attract market attention as a micro-cap public company, an inert, implicit post-signing market check does not, on this record, suffice as a reliable way to survey interest by strategic players. Rather, to test the market for strategic buyers in a reliable fashion, one would expect a material effort at salesmanship to occur. To conclude that sales efforts are always unnecessary or meaningless would be almost un-American, given the sales-oriented nature of our culture.[FN81] In the case of a niche company like **Netsmart**, the potential utility of a sophisticated and targeted sales effort seems especially high.

FN81. The success of ebay is but one of the recent examples of how efforts at effective salesmanship-in that case by efficiently creating an international flea market-can pay off for sellers.

For example, **Netsmart** and its financial advisor could have put together materials explaining **Netsmart's** business, why it had attractive growth potential, and how **Netsmart's** products and services fit within the broader healthcare IT space. Those materials could have been tailored for a few logical buyers and William Blair could have used its (much touted by the defendants)***198** healthcare reputation to secure the attention of the key executives at those firms, the ones with decision-making authority over acquisitions. In seeking that attention, they would have had the credibility that flows from having actual authority to act as an agent for a principal willing to sell. Such an approach would have given these key players a reason to chew on the idea, consider making applications for resources to explore and finance a bid, and to otherwise do the other things necessary to get a large corporation to spend over $100 million.

In the absence of such an outreach, **Netsmart** stockholders are only left with the possibility that a strategic buyer will: (i) notice that **Netsmart** is being sold, and, assuming that happens, (ii) invest the resources to make a hostile (because **Netsmart** can't solicit) topping bid to acquire a company worth less than a quarter of a billion dollars. In going down that road, the strategic buyer could not avoid the high potential costs, both monetary (e.g., for expedited work by legal and financial advisors) and strategic (e.g., having its interest become a public story and dealing with the consequences of not prevailing) of that route, simply because the sought-after-prey was more a side dish than a main course. It seems doubtful that a strategic buyer would put much energy behind trying a deal jump in circumstances where the cost-benefit calculus going in seems so unfavorable. Analogizing this situation to the active deal jumping market at the turn of the century, involving deal jumps by large strategic players of deals involving their direct competitors in consolidating industries is a long stretch.

Similarly, the current market trend in which private equity buyers seem to be outbidding strategic buyers is equally unsatisfying as an excuse for the lack of *any* attempt at canvassing the strategic market. Given **Netsmart's** size, the synergies available to strategic players might well have given them flexibility to outbid even cash-flush private equity investors. Simply because many deals in the large-cap arena seem to be going the private equity buyers' way these days does not mean that a board can lightly forsake any exploration of interest by strategic bidders.[FN82]

FN82. Nor does the record indicate that the board reasonably determined (or even pondered the possibility) that there was extreme time urgency to take advantage of a private equity bubble that would soon pop; indeed, the initial expressions of interest and the eventual deal landed do not suggest that Insight, or any other of the bidders, were on undisciplined spending sprees.

In this regard, a final note is in order. Rightly or wrongly,

strategic buyers might sense that CEOs are more interested in doing private equity deals that leave them as CEOs than strategic deals that may, and in this case, certainly, would not. That is especially so when the private equity deals give management, as Scalia aptly put it, a "second bite at the apple" through option pools. With this impression, a strategic buyer seeking to top Insight might consider this factor in deciding whether to bother with an overture.

Here, while there is no basis to perceive that Conway or his managerial subordinates tilted the competition among the private equity bidders, there is a basis to perceive that management favored the private equity route over the strategic route. Members of management desired to continue as executives and they desired more equity. A larger strategic buyer would likely have had less interest in retaining all of them and would not have presented them with the potential for the same kind of second bite. The private equity route ***199** was therefore a clearly attractive one for management, all things considered.

William Blair had its own incentive to favor that route, too. Although William Blair had a right to 1.7% of any deal, its aging contract undoubtedly gave it a strong incentive to bring about conditions that would facilitate a deal that would close. The path of dealing with a discrete set of private equity players was attractive to its primary client contact-management-and the quickest (and lowest cost) route to a definitive sales agreement.

By acknowledging these incentives, I do not mean to imply in any way that **Netsmart** management or William Blair consciously pursued objectives at odds with getting the best price. Rather, I simply point out the reality that the **Netsmart** board rapidly narrowed its options to a channel consistent with those incentives. By the time the Special Committee began its work, the inertial energy of the sales process was already clearly directed at a private equity deal. The record evidence regarding the consideration of an active search for a strategic buyer is more indicative of an after-the-fact justification for a decision already made, than of a genuine and reasonably-informed evaluation of whether a targeted search might bear fruit. For all these reasons, I believe the plaintiffs have demonstrated a reasonable probability that they will later prove that the board's failure to engage in any logical efforts to examine the universe of possible strategic buyers and to identify a select group for targeted sales overtures was unreasonable and a breach of their *Revlon* duties.

2. *The Plaintiffs' Disclosure Claims*

The plaintiffs allege that the Proxy Statement is deficient because it omits material facts and presents other issues in a materially misleading manner. Specifically, the plaintiffs complain about the following aspects of the Proxy: (i) the failure of the Proxy to include the Scalia "Stay the Course" projections presented to the board on May 11, 2006; (ii) the failure of the Proxy to provide a complete set of the projections used by William Blair in preparing its discounted cash flow valuation, which was presented to the board and used in connection with its issuance of a fairness opinion concerning the Merger; and (iii) the failure of the Proxy to identify certain instances in which members of the Special Committee had served on other boards with Conway.

[9][10][11][12] The basic standards applicable to the consideration of these arguments are well settled. Directors of Delaware corporations must "disclose fully and fairly all material information within the board's control when they seek shareholder action." FN83 An omitted fact is only material if there is a substantial likelihood that it would be considered important in a reasonable shareholder's deliberation and decision making process before casting his or her vote.FN84 "Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." FN85 To this end, disclosures must provide a "balanced," "truthful," and "materially complete"***200** account of all matters they address.FN86

FN83. *Arnold v. Society for Savings Bancorp., Inc.,* 650 A.2d 1270, 1277 (Del.1994) (quoting *Stroud v. Grace,* 606 A.2d 75, 84 (Del.1992)).

FN84. *Zirn v. VLI Corp.,* 621 A.2d 773, 778-79 (Del.1993).

FN85. *Id.* (quoting *TSC Industries, Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976)).

FN86. *E.g., Malone v. Brincat,* 722 A.2d 5, 12 (Del.1998) (requiring disclosures to "provide a balanced, truthful account of all matters"); *In re Pure Resources, Inc. S'holders Litig.,* 808 A.2d 421, 448 (Del.Ch.2002) ("When a document ventures into certain subjects, it must do so in a manner that is materially complete and unbiased by the omission of material facts.") (citing Arnold, 650 A.2d at 1280-82).

[13] When stockholders must vote on a transaction in which they would receive cash for their shares, information regarding the financial attractiveness of the deal is of particular importance.FN87 This is because the stockholders must measure the relative attractiveness of retaining their shares versus receiving a cash payment, a calculus heavily dependent on the stockholders' assessment of the company's future cash flows.

FN87. *Pure Resources,* 808 A.2d at 447-48.

a. *The Proxy Is Not Deficient Because It Omitted The May 11 Scalia Projections*

[14] The figures at issue are the "Stay the Course" projections included in Scalia's presentation to the **Netsmart** board on May 11, 2006. In that model, Scalia projected revenues and profits based on organic growth and presented company valuations based on a price-to-earnings multiple of 25-a figure materially higher than **Netsmart's** trading multiple at the time.FN88 The relevant portion of these projections reads as follows: FN89

FN88. According to Griffin's June 5, 2006 research report, **Netsmart** had a trailing P/E multiple of 20.2 and a forward P/E multiple of 15.2. *See* King Ex. 2 at SC-YS 000582.

FN89. *Id.* at NET 00009.

I conclude that the disclosure of these projections would not have a material effect on a rational shareholder's impression of the proposed Merger. Admittedly, the Proxy omitted the Scalia May 11 projections and presented different ones. But this discrepancy is entirely non-insidious because the later disclosed projections, which were relied upon by William Blair and shaped by management input, including from Scalia himself, were more current and more bullish. That is, the plaintiffs are arguing for the disclosure of a set of projections that are more pessimistic than those disclosed in the Proxy.[FN90] Using the dated Scalia projections as a basis for an independent valuation of **Netsmart's** future earnings would demonstrate only that the Merger consideration offered was "fairer" to the selling shareholders than the projections presented in the Proxy imply. As such, that portion of the Scalia model would not materially influence any rational ***201** shareholder's vote, and no duty was breached by its omission.

> FN90. *Compare* Naylor Aff., Ex. 2 at NET-00009 (listing Scalia's May 11 projections, which include 2009 revenues of $89.579 million and EBITDA of $14.812 million) *with* Proxy at 79 (listing William Blair's November 18 projections, which include 2009 revenues of $100.041 million and EBITDA of $24.367 million).

The oddment of the plaintiffs' pressing of this point was clarified at oral argument. At that time, it became clear that the plaintiffs were mostly interested in disclosure of Scalia's prior work because of its estimates of share prices of $18 in 2007, $22 in 2008, $26 in 2009, and $30 in 2010.[FN91] The plaintiffs say those estimates are material. The problem with that argument is that there has been no demonstration that this part of Scalia's estimate was at all reliable. The chart produced above clearly illustrates that Scalia got to his share price estimate by multiplying the projected earnings per share value by a constant price-to-earnings multiple of 25. That high multiple is what the plaintiffs want disclosed and multiplied by projections; indeed, for their purpose the later projections are even better, because when multiplied by 25 they yield an even higher per share value than Scalia's earlier May 11 projections.

> FN91. *See* Transcript of Oral Argument on Motion for Preliminary Injunction (Feb. 27, 2007) at 50 (stating that the "critical fact" contained in the Scalia model was that the company was projecting its share price to rise).

But, the market, not **Netsmart** or Scalia, determines the price-to-earnings multiple. Unlike managerial projections of revenues, costs, and profits, factors over which management can exercise some control and provide a greater level of insight than independent investors, there is no basis to believe that someone like Scalia would have a reliable basis to estimate future trading multiples of his particular firm.[FN92] Even more importantly, the plaintiffs have failed to demonstrate that Scalia's constant use of a P/E multiple of 25 reflected his best estimate of the multiple **Netsmart** shares would attain in the market. The plaintiffs never took Scalia's deposition. Absent testimony to the contrary, the use of such a constant high number seems more likely to have been an optimistic "plug figure" than a reasoned estimate. That is especially the case when **Netsmart's** historically much lower multiples-only 20.2 as of June 2006 [FN93]-are considered. Although the past is not an indicator of future performance (as any mutual fund manager will tell you), on what reasonable basis could Scalia have predicted a huge increase in **Netsmart's** multiple to 25 and the constant maintenance of that multiple for the succeeding years? What is far more likely is that Scalia intended to make no such prediction but simply wished to give the board a generous illustration of what attainment of his projections might yield in terms of the company's market price. Given this record, the Proxy's failure to disclose Scalia's earlier analysis is not troubling.

> FN92. *See* *In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *16 (Del.Ch.2006) ("[O]ur law has refused to deem projections material unless the circumstances of their preparation support the conclusion that they are reliable enough to aid the stockholders in making an informed judgment."); *Loudon v. Archer-Daniels Midland Co.*, 700 A.2d 135, 145 (Del.1997) ("Speculation is not an appropriate subject for a proxy disclosure.").

> FN93. *See* King Ex. 2 at SC-YS 000582 (presenting Griffin's P/E multiple calculations).

b. *The Proxy's Failure To Disclose All The Projections Used By William Blair In Preparing Its DCF Valuation Renders It Materially Incomplete*

[15] In the Proxy, William Blair's various valuation analyses are disclosed. One of those analyses was a DCF valuation founded on a set of projections running until 2011. Those projections were generated by William Blair based on input from ***202 Netsmart** management, and evolved out of the earlier, less optimistic, Scalia projections. Versions of those figures were distributed to interested parties throughout the bidding process, and one such chart is reproduced in part in the Proxy. The final projections utilized by William Blair in connection with the fairness opinion, however, have not been disclosed to shareholders. Those final projections, which were presented to the **Netsmart** board on November 18, 2006 in support of William Blair's final fairness opinion, take into account **Netsmart's** acquisition of CMHC and management's best estimate of the company's future cash flows.[FN94]

> FN94. *See* King Aff., Ex. 21 at SC 000264.

In its disclosures concerning William Blair's fairness opinion, the Proxy does not contain any charts of revenue or earnings projections. In a separate section, though, the Proxy presents two sets of projections. Neither is identical to the set of projections used in the fairness opinion. The first set, titled "Sell Side Projections," uses the same revenue estimates as William Blair's final model but differs in its projection of EBITDA.[FN95] It was apparently used "as part of the formal process of soliciting interest in the acquisition of the company." [FN96] The second, captioned "Financing Projections," is

completely distinct from the final figures used by William Blair because it served a different purpose-that set was apparently given by Insight to prospective lenders in its effort to finance its acquisition of **Netsmart**.FN97 Neither set of projections included in the Proxy includes any revenue, cost, or earnings estimates for **Netsmart's** performance in years 2010 and 2011. A likely explanation for that omission is that the projections for those years were not given to any of the bidders.

FN95. *Compare* King Aff., Ex. 21 at SC 000264 (showing William Blair's revenue projections of $67.641, $80.253, and $100.041 million and EBITDA projections of $13.941, $18.422, and $24.9 million for 2007 through 2009) *with* Proxy at 79 (Table 1) (listing identical revenue projections but projecting EBITDA to be $13.737 million in 2007, $17.89 million in 2008, and $24.367 million in 2009).

FN96. Proxy at 79.

FN97. *Id.*

The parties' original briefs missed the fact that the disclosed Sell Side Projections were not the ones ultimately utilized in connection with William Blair's fairness opinion. They therefore dueled over the materiality of the failure to disclose the Sell Side Projections for 2010 and 2011. The defendants took the position that they were not material because, among other reasons, they were not given to buyers and, as the most distant projections, they were too speculative to require disclosure.

But, that was thin gruel to sustain the omission. Even if it is true that bidders never received 2010 and 2011 projections, that explanation does not undercut the materiality of those forecasts to **Netsmart's** stockholders. They, unlike the bidders, have been presented with William Blair's fairness opinion and are being asked to make an important voting decision to which **Netsmart's** future prospects are directly relevant. Further, the Proxy clearly states that the discounted cash flow analysis conducted by William Blair covered the "period commencing January 1, 2007 and ending December 31, 2011" and that "approximately 82% to 86% of the present value of **Netsmart's** calculated enterprise value was attributable to the terminal value calculated from the 2011 projected EBITDA." FN98 Yet, nowhere in the Proxy is there any financial information ***203** covering that critical, terminal year (or the prior year for that matter).

FN98. Proxy at 40.

Making the defendants' position even weaker is the reality that emerged after argument. At that time, it became clear that the Proxy did not contain the *final* William Blair projections underlying its ultimate DCF model and fairness opinion. Thus, the Proxy now fails to give the stockholders the best estimate of the company's future cash flows as of the time the board approved the Merger. Because of this, it is crucial that the entire William Blair model from November 18, 2006-not just a two year addendum-be disclosed in order for shareholders to be fully informed.

Faced with the question of whether to accept cash now in exchange for forsaking an interest in **Netsmart's** future cash flows, **Netsmart** stockholders would obviously find it important to know what management and the company's financial advisor's best estimate of those future cash flows would be. In other of our state's jurisprudence, we have given credence to the notion that managers had meaningful insight into their firms' futures that the market did not.FN99 Likewise, weight has been given to the fairness-enforcing utility of investment banker opinions. It would therefore seem to be a genuinely foolish (and arguably unprincipled and unfair) inconsistency to hold that the best estimate of the company's future returns, as generated by management and the Special Committee's investment bank, need not be disclosed when stockholders are being advised to cash out. That is especially the case when most of the key managers seek to remain as executives and will receive options in the company once it goes private. Indeed, projections of this sort are probably among the most highly-prized disclosures by investors. Investors can come up with their own estimates of discount rates or (as already discussed) market multiples. What they cannot hope to do is replicate management's inside view of the company's prospects.

FN99. *See* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value,* 96 NW. U.L.REV. 521 (2002) (presenting an amusing and incisive critique of this aspect of our law).

In concluding that this omission is material, I also take into account that stockholders might place greater value on company-specific estimates of future performance in this situation than on inferences based on supposedly comparable companies. The defendants themselves have stressed **Netsmart's** unique market niche and its dominant position in a niche market. Therefore, the materiality of a direct evaluation of the value of the company's expected future cash flows might rationally take on more importance in this instance than comparisons to other firms or transactions several times larger or smaller or in different sectors than **Netsmart**. And the mere fact that William Blair claims to have placed little weight on its DCF analysis seems a poor reason to blind stockholders to their management's best estimates of the company's future profits.

[16][17] The conclusion that this omission is material should not be surprising. Once a board broaches a topic in its disclosures, a duty attaches to provide information that is "materially complete and unbiased by the omission of material facts." FN100 For this reason, when a banker's endorsement***204** of the fairness of a transaction is touted to shareholders, the valuation methods used to arrive at that opinion as well as the key inputs and range of ultimate values generated by those analyses must also be fairly disclosed.FN101 Only providing some of that information is insufficient to fulfill the duty of providing a "fair summary of the substantive work performed by the investment bankers upon whose advice the recommendations of the [] board as to how to vote ... rely." FN102

FN100. *Pure Resources,* 808 A.2d at 448; *see also Frank v. Arnelle,* 1998 WL 668649, at *3 (Del.Ch.1998) (citing *Lynch v. Vickers Energy Corp.,* 383 A.2d 278, 281 (Del.1977), and explaining that when directors communicate with their company's shareholders, "[c]ompleteness, not adequacy, is the mandate").

FN101. *Pure Resources,* 808 A.2d at 449 ("The real informative value of the banker's work is not in its bottom-line conclusion, but in the valuation analysis that buttresses that result.... Like a court would in making an after-the-fact fairness determination, a Pure minority stockholder engaging in the before-the-fact decision whether to tender would find it material to know the basic valuation exercises that First Boston and Petrie Parkman undertook, the key assumptions that they used in performing them, and the range of values that were thereby generated.").

FN102. *Id.* at 449.

Aside from the omission of the projections underlying the Blair fairness opinion, the plaintiffs have failed to persuade me that the Proxy does not fairly describe William Blair's work. Several of the items that plaintiffs find objectionable amount to mere nit-picking. For example, the fact that the Proxy states that "minor decreases" in the company's growth rate or margins would have a material negative impact on valuation while omitting the inverse of that proportional relationship is not a material omission. Likewise, I reject the plaintiffs' demand that the directors and William Blair engage in self-flagellation over the fact that the $16.50 Insight price comes in at the low range of William Blair's valuation analyses.FN103 Like the plaintiffs, other stockholders can discern that reality from the Proxy itself, which describes the mean and medians of those analyses. Requiring disclosure of the reason why William Blair still gave a fairness opinion in these circumstances would require disclosure of information that the record suggests does not exist. In prior decisions, this court has noted that so long as what the investment banker did is fairly disclosed, there is no obligation to disclose what the investment banker did not do.FN104

FN103. *In re JCC Holding Co., Inc.,* 843 A.2d 713, 721 (Del.Ch.2003) ("This kind of quibble with the substance of a banker's opinion does not constitute a disclosure claim.")

FN104. *E.g., id.* at 721 ("Under Delaware law, there is no obligation on the part of a board to disclose information that simply does not exist."); *see also In re Dataproducts Corp. S'holders Litig.,* 1991 WL 165301, at *8 (Del.Ch.1991) (refusing to affirmatively oblige directors to create and then disclose valuations that had not been previously prepared).

Here, there is no evidence in the record indicating that William Blair ever explained its decision to issue a fairness opinion when the Merger price was at a level that was in the lower part of its analytical ranges of fairness. The relevant board minutes simply state:

In response to Mr. Conway's question of whether William Blair's analysis shows that the proposed transaction is the best possible deal for the Corporation or a deal that is within the range of a fair deal for the Corporation's shareholders, Mr. Palasz answered that the proposed deal is within the range of fairness.FN105

FN105. King Aff., Ex. 17 at 3.

From this "range of fairness" justification, one can guess that William Blair believed that, given the limited auction it had conducted and the price competition it generated, a price in the lower range was "fair," especially given William Blair's apparent assumption that an implicit, post-signing market check would be meaningful. I say ***205** guess because these reasons are not developed in the record. The one reason in the record is simply that the price fell within, even if at the lower end, of William Blair's fairness ranges. William Blair's bare bones fairness opinion is typical of such opinions, in that it simply states a conclusion that the offered Merger consideration was "fair, from a financial point of view, to the shareholders" [FN106] but plainly does not opine whether the proposed deal is either advisable or the best deal reasonably available. Also in keeping with the industry norm, William Blair's fairness opinion devotes most of its text to emphasizing the limitations on the bank's liability and the extent to which the bank was relying on representations of management.[FN107] Logically, the cursory nature of such an "opinion" is a reason why the disclosure of the bank's actual analyses is important to stockholders; otherwise, they can make no sense of what the bank's opinion conveys, other than as a stamp of approval that the transaction meets the minimal test of falling within some broad range of fairness.

FN106. Proxy at B-2.

FN107. Proxy at B-1, B-2.

c. *The Proxy Did Not Omit Any Material Information Regarding The Special Committee's Independence*

The plaintiffs have also alleged that the Proxy omits information regarding the contemporaneous service of Conway and two members of the Special Committee on other boards of directors.

First, plaintiffs say that **Netsmart** should have disclosed the simultaneous service of Conway and Special Committee member Shamash on the board of the Long Island Software Technology Network Association ("LISTnet"). This claim is frivolous because that information is, in fact, fully disclosed in the Proxy, which states, "Conway was recently elected to the board of LISTnet" and that Shamash "is a member of the board of directors of LISTnet." [FN108] Furthermore, LISTnet is a trade group promoting the software industry in Long Island, New York. Simultaneous service on LISTnet's 30 to 35 member board by Conway, a CEO of a Long Island-based software firm, and Shamash, the Vice President of Economic Development and the Dean of the College of Engineering and Applied Sciences at Stony Brook University in New York, hardly seems confidence-eroding.

FN108. Proxy at 73-74.

[18] The plaintiffs' second allegation has some more color. More by happenstance than by design, the plaintiffs discovered that Conway had previously been invited by Special Committee member Sicinski to serve on the board of Trans Global Services, Inc. ("TransGlobal"), and had held that position for a couple of years while Sicinski was CEO of that company.[FN109] The Proxy discloses that Sicinski was the CEO of TransGlobal and that he eventually joined the board of **Netsmart** while Conway was CEO.[FN110] But it does not disclose that Conway served on TransGlobal's board.[FN111] Exactly when Conway served on TransGlobal's board and whether that service overlapped with Sicinski's service on **Netsmart's** board while Conway was CEO is unclear. The fault for that rests with the plaintiffs, who failed to follow up.

FN109. Conway Dep. at 28-30.

FN110. Proxy at 74-75.

FN111. *Id.*

[19] The reason that this claim has some color is that it is plausible to think that in circumstances when a busy executive***206** (such as Conway) had agreed to help another CEO (such as Sicinski) by serving on his board (TransGlobal), the CEO in Sicinski's position might bring some feeling of beholdness to his later service once he reciprocates by agreeing to serve on Conway's board. In considering the vigor of a Special Committee, this sort of past interlock might be thought to be relevant to a (cynical?) stockholder, on the theory that Conway and Sicinski were part of an implicit CEOs' club whose members did not as outside directors rock the ships other members captained. That does not in any sense imply that a past interlock of this kind would render someone like Sicinski non-independent; [FN112] rather, it is to admit of the possibility that there are facts that, although not in themselves sufficient to render a committee member non-independent, might be material. Otherwise, there would be no need to disclose anything about independent directors, on the grounds that only the disclosure of facts that were fatal to their independence was required.

FN112. Without more, directors are not deemed to lose their independence merely because they move in the same social circles or hold seats on the same corporate boards. *E.g., Beam v. Stewart,* 845 A.2d 1040, 1051-52 (Del.2004) (holding "mov[ing] in the same business and social circles ... is not enough to negate independence for demand excusal purposes"); *Langner v. Brown,* 913 F.Supp. 260, 266 (S.D.N.Y.1996) ("The fact that several director defendants sat on the same boards of directors of other companies does not in itself establish lack of independence."); *see also* NASD Rule 4200(14)(E) (including only "a director who is employed as an executive of another entity where any of the company's executives serve on that entity's compensation committee" within its examples of non-independence stemming from simultaneous board service).

The plaintiffs bear a special burden in this delicate territory, however. Federal regulations and exchange rules address disclosure of this kind in a detailed manner that balances the costs of disclosing all past relationships against the need to give stockholders information about some prior relationships that, while not rendering directors non-independent of each other, are important enough to warrant disclosure. Those bodies of authority should not be lightly added to by our law. After a consultation of the pertinent provisions of that authority, unaided by the parties themselves, I fail to perceive any requirement for the disclosure the plaintiffs demand.[FN113] In view of the tightened definitions of independence that now prevail, I am chary about adding a judicially-imposed disclosure requirement that past interlocking board service involving a target's CEO and another independent director must always be disclosed. This area of disclosure-i.e., the description of factors bearing on independence-is already well-covered, some might even say smothered. Certainly, I cannot prudently add to those requirements here where the plaintiffs have entirely failed to make a clear record about when Conway and Sicinski served on the two boards in question, how material their service as outside directors was to each other as CEOs, and what remuneration they received for their board service.

FN113. As it appears, on a hasty review, that the SEC's proxy disclosure rules do not establish disclosure requirements regarding special committee members who negotiate and approve going-private transactions like this one, I am guided by the SEC's disclosure rules in other contexts. For example, with respect to matters involving the election of directors, § 229.401(e)(2) of SEC Reg. S-K requires disclosure only of "other [current] directorships held by each director or person nominated or chosen to become a director." *See also* SEC Reg. § 229.407 (requiring registrants to identify directors meeting exchange rule independence standards and to describe the basis on which the director was determined to be independent).

***207** B. *Irreparable Harm And The Balance Of The Equities*

Having concluded my considerations of the merits prong of the preliminary injunction inquiry, I turn now to the other prongs, both of which are designed to help the court determine whether the powerful tool of an injunction should be used or whether the court should stay its hand, let events proceed, and address any harm after a final hearing.

[20] I begin with the question of whether the **Netsmart** stockholders face a possibility of irreparable injury if an injunction does not issue. The defendants say no, because the court, in a later appraisal or equitable action, can always award monetary damages if it believes that the compensation the stockholders stand to receive does not reflect the value of **Netsmart** and if the plaintiffs meet the other requirements for obtaining relief (e.g., in the case of an equitable action, proving a non-exculpated breach of fiduciary duty). Therefore, even if the **Netsmart** stockholders face the possibility of voting on the Insight Merger without access to material facts, the defendants say that the loss of the ability to make an informed decision can be compensated for in cash down the road.

Although not without dissonance, this court's jurisprudence has tended to reject the notion that stockholders do not face a threat of irreparable injury when a board seems to have breached its *Revlon* duties or failed to disclose material facts in advance of a merger vote. No doubt there is the chance to formulate a rational remedy down the line, but that chance involves great cost,

time, and, unavoidably, a large degree of imprecision and speculation. After-the-fact inquiries into what might have been had directors tested the market adequately or stockholders been given all the material information necessarily involve reasoned guesswork. Foundational principles of Delaware law also color the approach our courts take to this issue. Delaware corporate law strives to give effect to business decisions approved by properly motivated directors and by informed, disinterested stockholders. By this means, our law seeks to balance the interest in promoting fair treatment of stockholders and the utility of avoiding judicial inquiries into the wisdom of business decisions. Thus, doctrines like ratification and acquiescence operate to keep the judiciary from second-guessing transactions when disinterested stockholders have had a fair opportunity to protect themselves by voting no.

Because this feature of our law is so centrally important, this court has typically found a threat of irreparable injury to exist when it appears stockholders may make an important voting decision on inadequate disclosures.[FN114] By issuing an injunction requiring additional disclosure, the court gives stockholders the choice to think for themselves on full information, thereby vindicating their rights as stockholders to make important voting and remedial decisions based on their own economic self-interest.[FN115] By this approach, ***208** the court also ensures that greater effect can be given to the resulting vote down the line, reducing future litigation costs and transactional and liability uncertainty.

> FN114. *See, e.g., ODS Technologies, Inc. v. Marshall,* 832 A.2d 1254, 1262 (Del.Ch.2003) ("The threat of an uninformed stockholder vote constitutes irreparable harm."); *Pure Resources,* 808 A.2d at 452 ("[I]rreparable injury is threatened when a stockholder might make a tender or voting decision on the basis of materially misleading or inadequate information."); *see also In re Staples, Inc. S'holders Litig.,* 792 A.2d 934, 960 (Del.Ch.2001) ("[I]t is appropriate for the court to address material disclosure problems through the issuance of a preliminary injunction that persists until the problems are corrected.").

> FN115. *See Staples,* 792 A.2d at 960 ("An injunctive remedy ... specifically vindicates the stockholder right at issue-the right to receive fair disclosure of the material facts necessary to cast a fully informed vote-in a manner that later monetary damages cannot and is therefore the preferred remedy, where practicable.").

In the *Revlon* context, the issue of full disclosure intersects with the broader remedial question. In cases where the refusal to grant an injunction presents the possibility that a higher, pending, rival offer might go away forever, our courts have found a possibility of irreparable harm.[FN116] In other cases when a potential *Revlon* violation occurred but no rival bid is on the table, the denial of injunctive relief is often premised on the imprudence of having the court enjoin the only deal on the table, when the stockholders can make that decision for themselves.[FN117] The difference in these contexts is not really about the irreparability of the harm threatened to the target stockholders as a theoretical matter,[FN118] it is really about the different cost-benefit calculus arising from throwing the injunction flag. When another higher bid has been made, an injunction against the target board's chosen deal has the effect of ensuring a fair auction in which the highest bidder will prevail, at comparatively little risk to target stockholders. Indeed, in most circumstances, this means that the chances for a later damages proceeding are greatly minimized given the competition between rival bidders.

> FN116. *See, e.g., QVC Network, Inc. v. Paramount Communications, Inc.,* 635 A.2d 1245, 1273 n. 50 (Del.Ch.1993) ("Since the opportunity for shareholders to receive a superior control premium would be irrevocably lost if injunctive relief were not granted, that alone would be sufficient to constitute irreparable harm."), *aff'd,*637 A.2d 34 (Del.1994).

> FN117. *See, e.g., Toys "R" Us,* 877 A.2d at 1023 ("[T]he bottom line is that the public shareholders will have an opportunity [] to reject the merger if they do not think the price is high enough in light of the Company's stand-alone value and other options.").

> FN118. In *Revlon* itself, the court actually focused on the harm to the frustrated bidder qua bidder, because it would lose the unique opportunity to acquire Revlon. 506 A.2d at 184-85 (finding that absent an injunction the opportunity for the competing bidder to gain control of Revlon would be lost and "the need for both bidders to compete in the marketplace outweighed any injury to [the defendant]"). As a theoretical matter, the damages inquiry of a *Revlon* case is relatively easy to frame-the difference between what the stockholders received in the deal tainted by *Revlon* violations and what they would have received had the directors complied with their *Revlon* duties. But in a situation when there are no dueling bidders, such as the case here, such an inquiry involves great speculation: Did no one bid because there was no effective sales effort or because the company was not valuable to other buyers?

By contrast, when this court is asked to enjoin a transaction and another higher-priced alternative is not immediately available, it has been appropriately modest about playing games with other people's money. But even in that context, this court has not hesitated to use its injunctive powers to address disclosure deficiencies. When stockholders are about to make a decision based on materially misleading or incomplete information, a decision not to issue an injunction maximizes the potential that the crudest of judicial tools (an appraisal or damages award) will be employed down the line, because the stockholders' chance to engage in self-help on the front end would have been vitiated and lost forever.[FN119]

> FN119. *See T. Rowe Price Recovery Fund, L.P. v. Rubin,* 770 A.2d 536, 557-59 (Del.Ch.2000) (recognizing the utility of more tailored relief).

***209** Applied here, the learning from past experience points toward the following result. The **Netsmart** stockholders face a threat of irreparable injury if an injunction does not issue until such time as the **Netsmart** board discloses additional information, to wit, the full November 18, 2006 William Blair revenue and earnings projections including the years 2010 and 2011. Absent such disclosure, the company's shareholders will vote without important information regarding their management's and William Blair's best estimates regarding the future cash flow of the company. In a cash-out transaction, this information is highly material, as the stockholders are being asked to give up the possibility of future gains from the on-going operation of the company in exchange for an immediate cash payment. That is especially so when management is staying in the game, leaving the public stockholders behind with their exit payment as compensation for forsaking any share of future gains.

[21] Likewise, here it also seems to me to be important for **Netsmart** to at least disclose this judicial decision or otherwise provide a fuller, more balanced description of the board's actions with regard to the possibility of finding a strategic buyer. As the Proxy now stands, its description of that issue leads one to the impression that a more reasoned and thorough decision-making process had been used, and that the process was heavily influenced by earlier searches for a strategic buyer that provided a reliable basis for concluding that no strategic buyer interest existed in 2006.[FN120]

> FN120. When directors describe their decision-making process leading up to a merger, they must do so in a fair and balanced way. *E.g., Malone,* 722 A.2d at 12; *Arnold,* 650 A.2d at 1280-82.

Once that information is disclosed, however, the remedial calculus tilts against a more aggressive injunction. If I enjoined the procession of the Merger vote until **Netsmart's** board conducted a search for strategic buyers, I would give Insight the right to walk.[FN121] Insight did not promise to pay $16.50 per share in a deal when **Netsmart** got to actively shop their bid. They promised to pay $16.50 per share based on the opposite: **Netsmart** could only respond to unsolicited superior bids. I perceive no basis where I would have the equitable authority to require Insight to remain bound to complete their purchase of **Netsmart** while simultaneously reforming the Merger Agreement to increase their transactional risk in that endeavor. Certainly, on this record, I could not justify such an unusual exercise of authority on the grounds of any misconduct by Insight. The 3% termination fee in the Merger Agreement is not unreasonable, especially given the size of the transaction and the fact that upon triggering more than a third of the fee would simply go to repay Insight's actual expenses. The granting of a broader injunction would therefore pose a risk that Insight might walk or materially lower its bid. It would be hubristic for me to take a risk of that kind for the **Netsmart** stockholders, and the plaintiffs have not volunteered to back up their demand with a full bond.

> FN121. *See* Proxy at A-44, A-45 & A-47 (setting a termination date of May 15, 2007 and establishing as a condition precedent to closing the absence of any court order or other regulatory action which "prohibits, restricts, or makes illegal consummation of the transactions contemplated").

With full information, **Netsmart** stockholders can decide for themselves whether to accept or reject the Insight deal. If they are confident that the company's prospects are sound and that a search for a strategic buyer or higher-paying financial***210** buyers will bear fruit, they can vote no and take the risk of being wrong. If they would prefer the bird in hand, they can vote yes and accept Insight's cash. Because directors and officers control less than 15% of the vote on the most generous estimate, the disinterested **Netsmart** stockholders are well-positioned to carry the day, and most of them are institutional investors.

In refusing to grant a broader injunction, I am also cognizant of the availability of appraisal rights. In an appraisal, the failure of the **Netsmart** board to test the market for strategic buyers in an active way will have relevance. Unlike past circumstances when the company was fully shopped and the resulting Merger price was deemed the most reliable evidence of fair value in appraisal,[FN122] a future appraisal proceeding involving **Netsmart** will involve more uncertainty given the lack of an active market check and **Netsmart's** micro-cap status. As a result, dissenting **Netsmart** stockholders might have comparatively greater success in relying upon analyses based on discounted cash flows or market comparables in appraisal than stockholders whose boards more aggressively shopped their companies.

FN122. *See Union Illinois 1995 Inv. Ltd. Partnership v. Union Financial Group, Ltd.,* 847 A.2d 340 (Del.Ch.2004).

V. *Conclusion*

For these reasons, I therefore GRANT the motion for a preliminary injunction against the procession of the Merger vote until the **Netsmart** board discloses the information I have described. Otherwise, the motion is DENIED. The parties shall collaborate about an implementing order.

Del.Ch.,2007.
In re Netsmart Technologies, Inc. Shareholders Litigation
924 A.2d 171, 32 Del. J. Corp. L. 941

END OF DOCUMENT

INDEMNIFICATION AGREEMENT

This Indemnification Agreement (the "Agreement") is entered into on ________, 20__, between ____________________, a Washington corporation (the "Company"), and ______________, a director, officer, or both, of the Company and/or one or more of its subsidiaries ("Indemnitee"), for good and valuable consideration as set forth below.

RECITALS

A. The Company recognizes the importance, and increasing difficulty, of obtaining adequate liability insurance coverage for its directors, officers, employees, agents and fiduciaries.

B. The Company further recognizes that, at the same time as the availability and coverage of such insurance has become more limited, litigation against corporate directors, officers, employees, agents and fiduciaries has continued to increase.

C. Article 5 of the Company's Amended and Restated Articles of Incorporation (the "Articles") provides for indemnification of the Company's directors and officers to the full extent authorized by the Washington Business Corporation Act (the "Statute"), and that such provisions are not exclusive and may be supplemented by agreements between the Company and its officers and directors.

D. The Company desires to retain and attract the services of highly qualified individuals, such as Indemnitee, to serve the Company and, in that connection, also desires to provide contractually for indemnification of, and advancement of expenses to, Indemnitee to the full extent authorized by law.

AGREEMENT

1. **Indemnification.**

a. **Scope.** The Company agrees to hold harmless and indemnify Indemnitee against any Damages (as defined in Section 1(c)) incurred by Indemnitee with respect to any Proceeding (as defined in Section 1(d)) to which Indemnitee is or is threatened to be made a party or in which Indemnitee is otherwise involved (including, but not limited to, as a witness), to the full extent authorized by law, without regard to the limitations in RCW 23B.08.510 through 23B.08.550, and 23B.08.560(2), except that Indemnitee shall have no right to indemnification on account of: (i) acts or omissions of Indemnitee that have been finally adjudged (by a court having proper jurisdiction, and after all rights of appeal have been exhausted or lapsed, herein "Finally Adjudged") to be intentional misconduct or a knowing violation of law; (ii) conduct of Indemnitee that has been Finally Adjudged to be in violation of RCW 23B.08.310; (iii) any transaction with respect to which it has been Finally Adjudged that Indemnitee personally received a benefit in money, property or services to which Indemnitee was not legally entitled; or (iv) any suit in which it is Finally Adjudged that Indemnitee is liable for

an accounting of profits made from the purchase or sale by Indemnitee of securities of the Company in violation of the provisions of Section 16(b) of the Securities Exchange Act of 1934 and amendments thereto.

b. **Changes to Indemnification Right.** Indemnitee's right to be indemnified to the full extent authorized by law shall include the benefits of any change, after the date of this Agreement, in the Statute or other applicable law regarding the right of a Washington corporation to indemnify directors or officers, to the extent that it would expand Indemnitee's rights hereunder. Any such change that would narrow or interfere with Indemnitee's rights hereunder shall not apply to, limit, or affect the interpretation of, this Agreement, unless and then only to the extent that it has been Finally Adjudged that its application hereto does not constitute an unconstitutional impairment of Indemnitee's contract rights or otherwise violate applicable law. In the event the Company grants indemnification rights to any other officer or director that are more favorable to the rights granted to Indemnitee hereunder, the Indemnitee will automatically, and without any further action, be entitled to substantially the same benefits set forth in such agreement with such other officer or director.

c. **Indemnified Amounts.** If Indemnitee is or is threatened to be made a party to, or is otherwise involved (including, but not limited to, as a witness) in, any Proceeding, the Company shall hold harmless and indemnify Indemnitee from and against any and all losses, claims, damages, costs, expenses and liabilities incurred in connection with investigating, defending, being a witness in, participating in or otherwise being involved in (including on appeal), or preparing to defend, be a witness in, participate in or otherwise be involved in (including on appeal), such Proceeding, including but not limited to attorneys' fees, judgments, fines, penalties, ERISA excise taxes, amounts paid in settlement, any federal, state, local or foreign taxes imposed on Indemnitee as a result of the actual or deemed receipt of any payments pursuant to this Agreement, and other expenses (collectively, "Damages"), including all interest, assessments or charges paid or payable in connection with or in respect of such Damages.

d. **Definition of Proceeding.** For purposes of this Agreement, "Proceeding" shall mean any actual, pending, threatened or completed action, suit, claim, investigation, hearing or proceeding (whether civil, criminal, administrative or investigative, and whether formal or informal) in which Indemnitee is, has been, or becomes involved, or regarding which Indemnitee is threatened to be made a named defendant or respondent, based in whole or in part on or arising out of the fact that Indemnitee is or was a director, officer, member of a board committee, employee or agent of the Company and/or any of its subsidiaries or that, being or having been such a director, officer, member of a board committee, employee or agent, Indemnitee is or was serving at the request of the Company as a director, officer, partner, employee, trustee or agent of another corporation or of a foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise (each, a "Related Company"), whether the basis of such action, suit, claim, investigation, hearing or proceeding is alleged action or omission by Indemnitee in an official capacity as a director, officer, committee member, partner, employee, trustee or agent or in any other capacity while serving as a director, officer, committee member, partner, employee, trustee or agent. "Proceeding" shall not, however, include any action, suit, claim, investigation, hearing or proceeding instituted by or at the direction of Indemnitee unless pursuant to an Enforcement Action (as defined in Section 3(a)) or its institution has been authorized by the Company's Board of Directors (the "Board").

e. **Notifications.**

i. Promptly after receipt by Indemnitee of notice of the commencement (including a threatened assertion or commencement) of any Proceeding, Indemnitee will, if it is reasonably foreseeable that a claim in respect thereof will be made against the Company under this Agreement, notify the Chair of the Board's Audit Committee of the commencement thereof (which notice shall be in the form of Exhibit A hereto) (the "Indemnification Notice"). A failure to notify the Company in accordance with this subsection (e)(i) will not, however, relieve the Company from any liability to Indemnitee under this Agreement unless (and then only to the extent that) such failure is Finally Adjudged to have materially prejudiced the Company's ability to defend the Proceeding.

ii. At the same time, or from time to time thereafter, Indemnitee may further notify the Chair of the Board's Audit Committee, by delivery of a supplemental Indemnification Notice (or by checking the second box and providing the corresponding information on the initial Indemnification Notice), of any Proceeding for which indemnification is being sought under this Agreement.

f. **Determination of Entitlement.**

i. To the extent Indemnitee has been wholly successful, on the merits or otherwise, in the defense of any Proceeding, the Company shall indemnify Indemnitee against all expenses incurred by Indemnitee in connection with the Proceeding, within ten (10) days after receipt of an Indemnification Notice delivered pursuant to subsection (e)(ii).

ii. In the event that subsection (f)(i) above is inapplicable, or does not apply to the entire Proceeding, the Company shall indemnify Indemnitee within thirty (30) days after receipt of an Indemnification Notice delivered pursuant to subsection (e)(ii) unless during such thirty (30) day period the Audit Committee of the Board delivers to Indemnitee a written notice contesting Indemnitee's indemnification claim (the "Contest Notice"), which Contest Notice shall state with particularity the reasons for the decision to challenge Indemnitee's indemnification claim and the evidence the Company would present in any forum in which Indemnitee might seek review of such decision. The Company's failure to deliver a Contest Notice within thirty (30) days after the Company's receipt of an Indemnification Notice pursuant to subsection (e)(ii) shall obligate the Company unconditionally to indemnify Indemnitee to the extent requested in the Indemnification Notice.

iii. At any time following receipt of a Contest Notice, Indemnitee shall be entitled to select a forum for the review of, and in which the Company will defend, the Contest Notice and the Company's decision to challenge Indemnitee's indemnification claim. Such selection shall be made from among the following alternatives, by delivering a written notice to the Chair of the Board's Audit Committee indicating Indemnitee's selection of forum:

(a) A quorum of the Board consisting of directors who are not parties to the Proceeding for which indemnification is being sought;

(b) Special Legal Counsel (as defined in subsection (f)(vii) below); or

(c) A panel of three independent arbitrators, one of whom is selected by the Company, another of whom is selected by Indemnitee and the last of whom is selected by the first two arbitrators so selected,

provided, that nothing in this Section 1(f) shall prevent Indemnitee at any time from bringing suit against the Company to recover the amount of the indemnification claim (whether or not Indemnitee has otherwise exhausted its contractual remedies hereunder). In addition, any determination by a forum selected by Indemnitee that Indemnitee is not entitled to indemnification, or any failure to make the payments requested in the Indemnification Notice, shall be subject to judicial review by any court of competent jurisdiction, as described in Section 3.

iv. In any forum in which the Company defends its Contest Notice and its decision to challenge Indemnitee's indemnification claim under this Section 1(f), the presumptions, burdens and standard of review set forth in Section 3(c) shall apply and are incorporated into this Section 1(f) by reference, except as otherwise expressly provided in Section 3(c).

v. As soon as practicable, and in no event later than fifteen (15) days after the forum has been selected pursuant to subsection (f)(iii) above, the Company shall, at its own expense, submit the defense of its Contest Notice and the question of Indemnitee's right to indemnification to the selected forum.

vi. The forum selected shall render its decision concerning the validity of the Contest Notice and the Company's decision to deny Indemnitee's indemnification claim within thirty (30) days after the forum has been selected in accordance with subsection (f)(iii).

vii. For the purposes of this Agreement, "Special Legal Counsel" shall mean an attorney or firm of attorneys, selected by Indemnitee and approved by the Company (which approval shall not be unreasonably withheld), who must not have performed other services for the Company or Indemnitee within the last three years.

2. **Expense Advances.**

a. **Generally.** The right to indemnification conferred by Section 1 shall include the right to have the Company pay Indemnitee's attorneys' fees and other expenses, including but not limited to out of pocket costs and disbursements, incurred in connection with any Proceeding, or in connection with bringing, defending and/or pursuing an Enforcement Action (as defined in Section 3(a)), as such expenses are incurred and in advance of the final disposition of such Proceeding or Enforcement Action (such entitlement is referred to hereinafter as an "Expense Advance").

b. **Undertaking.** The Company's obligation to provide an Expense Advance is subject only to the following condition: if the Proceeding arose in connection with Indemnitee's service as a director and/or officer of the Company or member of a committee of the Board (and not in any other capacity in which Indemnitee rendered service, including but not limited to service to any Related Company), then Indemnitee or his or her representative must have executed and delivered to the Chair of the Board's Audit Committee an undertaking (in the form of Exhibit B hereto) (the "Statement of Undertaking") to repay all Expense Advances if and to the extent that it may be Finally Adjudged that Indemnitee is not entitled to be indemnified for such Expense Advance under one or more of clauses (i) through (iv) of the first sentence of Section 1(a). The Statement of Undertaking need not be secured and shall be accepted by the Company without reference to Indemnitee's financial ability to make repayment. No interest shall be charged on any obligation to reimburse the Company for any Expense Advance.

c. **Service as Witness.** Notwithstanding any other provision of this Agreement, the Company's obligation to indemnify, or provide Expense Advances under Section 2, to Indemnitee in connection with Indemnitee's appearance as a witness in a Proceeding at a time when Indemnitee has not been made a named defendant or respondent to the Proceeding shall be absolute and unconditional, and not subject to any of the limitations on, or conditions to, Indemnitee's right to indemnification or to receive an Expense Advance otherwise contained in this Agreement.

3. **Procedures for Enforcement.**

a. **Enforcement.** If a claim for indemnification made by Indemnitee hereunder is not paid in full (whether or not the provisions of Section 1(f) have been complied with, or completed), or a claim for an Expense Advance made by Indemnitee hereunder is not paid in full within twenty (20) days from delivery of a Statement of Undertaking to the Chair of the Board's Audit Committee, Indemnitee may, but need not, at any time thereafter bring suit against the Company to recover the unpaid amount of the claim (an "Enforcement Action").

b. **Required Indemnification.** The court hearing the Enforcement Action shall order the Company to provide indemnification or to advance expenses to Indemnitee to the full extent sought in the Enforcement Action if it determines that (i) the Enforcement Action is brought by Indemnitee to enforce the Company's obligation under Section 1(f)(ii) unconditionally to indemnify Indemnitee to the extent requested in the Indemnification Notice where the Company has failed timely to deliver a Contest Notice, or (ii) the Company failed to prove by clear and convincing evidence that Indemnitee is not entitled to indemnification based on one or more of clauses (i) through (iv) of the first sentence of Section 1(a).

c. **Presumptions, Burdens and Standard of Review in Enforcement Action or Company Determination.** In any Enforcement Action (and, except as otherwise expressly provided in this Section 3(c), in any review of a Contest Notice by a forum described in Section 1(f)) the following presumptions (and limitations on presumptions), burdens and standard of review shall apply:

i. The Company shall conclusively be presumed to have entered into this Agreement and assumed the obligations imposed hereunder in order to induce Indemnitee to serve or to continue to serve as an director and/or officer of the Company and/or one or more of its subsidiaries;

ii. This Agreement shall conclusively be presumed to be valid and Article 5 of the Articles shall conclusively be presumed to be effective to waive all of the limitations in RCW 23B.08.510 through RCW 23B.08.550, and RCW 23B.08.560(2);

iii. Submission of an Indemnification Notice in accordance with Section 1(e)(ii) or a Statement of Undertaking to the Company shall create a presumption that Indemnitee is entitled to indemnification or an Expense Advance hereunder, and thereafter the Company shall have the burden of proving by clear and convincing evidence (sufficient to rebut the foregoing presumption) that Indemnitee is not entitled to indemnification based on one or more of clauses (i) through (iv) of the first sentence of Section 1(a);

iv. Indemnitee may establish a conclusive presumption of any objective fact related to an event or occurrence by delivering to the Company a declaration made under penalty of perjury that such fact is true, provided, that no such presumption may be established with respect to the ultimate conclusions set forth in any of clauses (i) through (iv) of the first sentence of Section 1(a);

v. If Indemnitee is or was serving as a director, officer, employee, trustee or agent of a corporation of which a majority of the shares entitled to vote in the election of its directors is held by the Company or in an executive or management capacity in a partnership, joint venture, trust or other enterprise of which the Company or a wholly-owned subsidiary of the Company is a general partner or has a majority ownership, then such corporation, partnership, joint venture, trust or enterprise shall conclusively be deemed a Related Company and Indemnitee shall conclusively be deemed to be serving such Related Company at the request of the Company;

vi. Neither (a) the failure of the Company (including but not limited to the Board, the Company's officers, independent counsel, Special Legal Counsel, any arbitrator or the Company's shareholders) to make a determination prior to the commencement of the Enforcement Action whether indemnification, or payment of an Expense Advance, of Indemnitee is proper in the circumstances, nor (b) an actual determination by the Company, the Board, the Company's officers, independent counsel, Special Legal Counsel, any arbitrator or the Company's shareholders that Indemnitee is not entitled to indemnification or payment of an Expense Advance shall be a defense to the Enforcement Action, create a presumption that Indemnitee is not entitled to indemnification hereunder or be considered by a court in an Enforcement Action, which shall conduct a de novo review of the relevant issues; and

vii. If the court hearing the Enforcement Action is unable to make either of the determinations specified in Sections 3(b)(i) or 3(b)(ii), the court hearing the Enforcement Action shall nonetheless order the Company to provide indemnification or to advance expenses to Indemnitee to the full extent sought in the Enforcement Action if it determines that Indemnitee is fairly and reasonably entitled to such indemnification or Expense Advance in view of all of the relevant circumstances, and without regard to the limitations set forth in clauses (i) through (iii) of the first sentence of Section 1(a). In determining whether Indemnitee is fairly and reasonably entitled to such indemnification or expense advance, the court shall weigh (a) the relative benefits received by the Company and/or any of its subsidiaries or any Related Company, or any of their affiliates other than Indemnitee, on the one hand, and Indemnitee on the other from the transaction from which such Proceeding arose or to which such Proceeding relates, and (b) the relative fault of the Company and/or any of its subsidiaries or any Related Company, or any of their affiliates other than Indemnitee, on the one hand, and of Indemnitee on the other in connection with the transaction that resulted in such Damages, as well as any other relevant equitable considerations. The relative fault of the Company and/or any of its subsidiaries or any Related Company, or any of their affiliates other than Indemnitee, on the one hand, and of Indemnitee on the other shall be determined by reference to, among other things, the parties' relative intent, knowledge, access to information and opportunity to correct or prevent the circumstances resulting in such Damages. If either (Y) the relative benefits received by the Company and/or any of its subsidiaries or any Related Company, or any of their affiliates other than Indemnitee, exceed the relative benefits received by Indemnitee, or (Z) the relative fault of the Company and/or any of its subsidiaries or any Related Company, or any of their affiliates other than Indemnitee, exceeds the relative fault of Indemnitee, then Indemnitee shall be entitled to the full amount of indemnification and/or Expense Advance sought in the Enforcement Proceeding.

d. **Attorneys' Fees and Expenses for Enforcement Action.** In any Enforcement Action, the Company shall hold harmless and indemnify Indemnitee against all of Indemnitee's attorneys' fees and expenses in bringing, defending and/or pursuing the Enforcement Action (including but not limited to attorneys' fees at any stage, and on appeal); provided, however, that the Company shall not be required to provide such indemnification for such fees and expenses if it is Finally Adjudged that Indemnitee knew prior to commencement of the Enforcement Action that Indemnitee was not entitled to indemnification based on any of clauses (i) through (iv) of the first sentence of Section 1(a).

4. **Defense of Claim.**

With respect to any Proceeding as to which Indemnitee has provided notice to the Company pursuant to Section 1(e)(i):

a. The Company may participate therein at its own expense.

b. The Company (jointly with any other indemnifying party similarly notified, if any) may assume the defense thereof, with counsel reasonably satisfactory to Indemnitee. After notice from the Company to Indemnitee of its election to so assume the defense thereof, the Company shall not be liable to Indemnitee under this Agreement for any legal fees or other expenses (other than reasonable costs of investigation) subsequently incurred by Indemnitee in connection with the defense thereof unless (i) the employment of counsel by Indemnitee or the incurring of such expenses has been authorized by the Company, (ii) Indemnitee shall have concluded that there is a reasonable possibility that a conflict of interest could arise between the Company and Indemnitee in the conduct of the defense of such Proceeding, which conflict of interest shall be conclusively presumed to exist upon Indemnitee's delivery to the Company of a written certification of such conclusion, or (iii) the Company shall not in fact have employed counsel to assume the defense of such Proceeding, in each of which cases the legal fees and other expenses of Indemnitee shall be at the expense of the Company. The Company shall not be entitled to assume the defense of a Proceeding brought by or on behalf of the Company or as to which Indemnitee shall have reached the conclusion described in clause (ii) above.

c. The Company shall not be liable for any amounts paid in settlement of any Proceeding effected without its written consent.

d. The Company shall not settle any Proceeding in any manner that would impose any penalty or limitation on Indemnitee without Indemnitee's written consent.

e. Neither the Company nor Indemnitee will unreasonably withhold its or his or her consent to any proposed settlement of any Proceeding.

f. In addition to all the requirements above, if Company has directors and officers liability insurance, or other insurance, with a panel counsel requirement that may be triggered then or at some future point by the matter for which indemnity is owed to Indemnitee, then Indemnitee shall use such panel counsel, unless there is an actual conflict of interest with representation by all such panel counsel, or unless and to the extent Company waives such requirement in writing.

5. **Maintenance of D&O Insurance.**

a. Subject to Section 5(c) below, during the period (the "Coverage Period") beginning on the date of this Agreement and ending at the later of six (6) years following the time Indemnitee is no longer serving as either a director or officer of the Company and/or one or more subsidiaries or any Related Company, or at the end of such longer period during which Indemnitee believes that a reasonable possibility of exposure to a Proceeding or Damages persists (which extended period must be consented to by the Company, such consent not to be unreasonably withheld), the Company shall maintain a directors' and officers' liability insurance policy in full force and effect or shall have purchased or otherwise provided for a run-off or tail policy or endorsement to such existing policy ("D&O Insurance"), providing in all respects coverage at least comparable to and in similar amounts, and with similar exclusions, as that obtained by other similarly situated companies as determined in good faith by any of the parties referenced in Section 1(f)(iii)(a) through (c).

b. Under all policies of D&O Insurance, Indemnitee shall during the Coverage Period be named as an insured in such a manner as to provide Indemnitee the same rights and benefits, subject to the same limitations, as are accorded to the Company's directors or officers most favorably insured by such policy, and each insurer under a policy of D&O Insurance shall be required to provide Indemnitee written notice at least thirty (30) days prior to the effective date of termination of the policy.

c. The Company shall have no obligation to obtain or maintain D&O Insurance to the extent that such insurance is not reasonably available, the premium costs for such insurance are disproportionate to the amount of coverage provided, or the coverage provided by such insurance is so limited by exclusions as to provide an insufficient benefit, such determination to be made by any of the parties referenced in Section 1(f)(iii)(a) through (c).

d. It is the intention of the parties in entering into this Agreement that the insurers under the D&O Insurance, if any, shall be obligated ultimately to pay any claims by Indemnitee which are covered by D&O Insurance, and nothing herein shall be deemed to diminish or otherwise restrict the Company's or Indemnitee's right to proceed or collect against any insurers under D&O Insurance or to give such insurers any rights against the Company or Indemnitee under or with respect to this Agreement, including but not limited to any right to be subrogated to the Company's or Indemnitee's rights hereunder, unless otherwise expressly agreed to by the Company and Indemnitee in writing. The obligation of such insurers to the Company and Indemnitee shall not be deemed reduced or impaired in any respect by virtue of the provisions of this Agreement.

e. No indemnification pursuant to this Agreement shall be provided by the Company for Damages or Expense Advances that have been paid directly to Indemnitee by an insurance carrier under a policy of D&O Insurance or other insurance maintained by the Company.

f. In the event of payment under this Agreement, the Company shall be subrogated to the extent of such payment to all of the rights of Indemnitee to recover the same amounts from any insurer or other third person (other than another person with indemnification rights against the Company substantially similar those of Indemnitee under this Agreement). Indemnitee shall execute all documents required and take all acts necessary to secure such rights and enable the Company effectively to bring suit to enforce such rights.

6. **Partial Indemnification; Mutual Acknowledgment; Contribution.**

a. **Partial Indemnification.** If Indemnitee is entitled under any provision of this Agreement to indemnification by the Company for some or a portion of any Damages in connection with a Proceeding, but not for the total amount thereof, the Company shall nevertheless indemnify Indemnitee for the portion of such Damages to which Indemnitee is entitled.

b. **Mutual Acknowledgment.** The Company and Indemnitee acknowledge that, in certain instances, federal law or public policy may override applicable state law and prohibit the Company from indemnifying Indemnitee under this Agreement or otherwise. For example, the Company and Indemnitee acknowledge that the Securities and Exchange Commission (the "SEC") has taken the position that indemnification is not permissible for liabilities arising under certain federal securities laws, and federal legislation prohibits indemnification for certain ERISA violations. Furthermore, Indemnitee understands that the Company has undertaken or may be required in the future to undertake with the SEC to submit for judicial determination the issue of the Company's power to indemnify Indemnitee in certain circumstances; all of the Company's obligations under this Agreement will be subject to the requirements of any such undertaking required by the SEC to be made by the Company.

c. **Contribution.** If the indemnification provided under Sections 1, 2 and 6 is unavailable by reason of any of the circumstances specified in one or more of clauses (i) through (iii) of the first sentence of Section 1(a) then, in respect of any Proceeding in which the Company is jointly liable with Indemnitee (or would be if joined in such Proceeding), the Company shall contribute to the amount of Damages (including attorneys' fees) actually and reasonably incurred and paid or payable by Indemnitee in such proportion as is appropriate to reflect (i) the relative benefits received by the Company and/or any of its subsidiaries or any Related Company, or any of their affiliates other than Indemnitee, on the one hand, and Indemnitee on the other from the transaction or events from which such Proceeding arose or to which such Proceeding relates, and (ii) the relative fault of the Company and/or any of its

subsidiaries or any Related Company, or any of their affiliates other than Indemnitee, on the one hand, and of Indemnitee on the other in connection with the transaction or events that resulted in such Damages, as well as any other relevant equitable considerations. The relative fault of the Company and/or any of its subsidiaries or any Related Company, or any of their affiliates other than Indemnitee, on the one hand, and of Indemnitee on the other shall be determined by reference to, among other things, the parties' relative intent, knowledge, access to information and opportunity to correct or prevent the circumstances resulting in such Damages. The Company agrees that it would not be just and equitable if contribution pursuant to this Section 6(c) were determined by pro rata allocation or any other method of allocation that does not take account of the foregoing equitable considerations.

7. **Release of Claims Relating to Officer's Failure to Discharge Duties.** If Indemnitee is an officer of the Company and/or one or more of its subsidiaries, the indemnification and other rights and benefits provided to Indemnitee by this Agreement shall apply fully with respect to any Proceeding in which it is claimed or adjudicated that Indemnitee is liable to the Company and/or one or more of its subsidiaries by reason of having failed to discharge the duties of Indemnitee's office, and the Company hereby irrevocably releases all such claims and liabilities, agrees to cause its subsidiaries to release all such claims, and agrees to hold Indemnitee harmless with respect to any such claims; provided, however, that the foregoing indemnification, release and hold harmless obligations of the Company shall have no application with respect to claims by and liabilities to the Company based upon actions or omissions described in one or more of clauses (i) through (iv) of the first sentence of Section 1(a).

8. **Miscellaneous.**

a. This Agreement shall be interpreted and enforced in accordance with the laws of the State of Washington.

b. This Agreement shall be binding upon Indemnitee and upon the Company, its successors and assigns, and shall inure to the benefit of Indemnitee, Indemnitee's heirs, personal representatives and assigns and to the benefit of the Company, its successors and assigns. The Company shall require any successor to the Company (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business or assets of the Company, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform if no such succession had taken place.

c. Indemnitee's rights to indemnification and advancement of expenses under this Agreement shall not be deemed exclusive of any other or additional rights to which Indemnitee may be entitled under the Articles or the Bylaws of the Company, any vote of shareholders or disinterested directors, the Statute or otherwise, whether as to actions or omissions in Indemnitee's official capacity or otherwise.

d. Nothing in this Agreement shall confer upon Indemnitee the right to continue to serve as a director and\or officer of the Company or any of its subsidiaries or any Related Company. If Indemnitee is an officer of the Company, then, unless otherwise expressly provided in a written employment agreement between the Company and Indemnitee, the employment of Indemnitee with the Company shall be terminable at will by either party. The indemnification and release provided under this Agreement shall apply to any and all Proceedings, notwithstanding that Indemnitee has ceased to be a director, officer, partner, employee, trustee or agent of the Company, any of its subsidiaries or a Related Company, and shall inure to the benefit of the heirs, executors and administrators of Indemnitee.

e. If any provision or provisions of this Agreement shall be held to be invalid, illegal or unenforceable for any reason whatsoever, then: (i) the validity, legality and enforceability of the remaining provisions of this Agreement (including, without limitation, all portions of any paragraphs of this Agreement containing any such invalid, illegal or unenforceable provision that are not themselves invalid, illegal or unenforceable) shall not in any way be affected or impaired thereby; and (ii) to the fullest extent possible, the provisions of this Agreement (including, without limitation, all portions of any paragraphs of this Agreement containing any such invalid, illegal or unenforceable provision, that are not themselves invalid, illegal or unenforceable) shall be construed so as to give effect to the intent manifested by the provision held invalid, illegal or unenforceable.

f. Any notices or communications to be given or required to be given under this Agreement shall be given by personal delivery or registered airmail, overnight courier, telex, facsimile or electronic mail at the following address (or such other address as the relevant party provides the other party in writing and referencing this Section 8(f)):

Company:

Indemnitee:

Notices and communications shall be deemed received by the addressee on the date of delivery if delivered in person, on the third (3rd) day after mailing if delivered by registered airmail, on the next business day after mailing if sent by overnight courier, on the next business day if sent by telex or facsimile, or upon confirmation of delivery when directed to the electronic mail address described above if sent by electronic mail.

g. No amendment, modification, termination or cancellation of this Agreement shall be effective unless in writing signed by both parties hereto.

h. If Indemnitee has previously executed an indemnification agreement with the Company, this Agreement supersedes such prior indemnification agreement in its entirety.

i. This Agreement may be executed in two counterparts, each of which shall be deemed an original, but both of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed and delivered this Agreement effective as of the day and year first set forth above.

"Company" ______________________________________

By: ______________________________________
Name:
Its:

"Indemnitee" ______________________________________

EXHIBIT A

INDEMNIFICATION NOTICE

Check the appropriate space below, and provide a brief description of the Proceeding as requested below:

____ Notice is hereby given by the undersigned, ___________________________, pursuant to Section 1(e)(i) of the Indemnification Agreement (the "Agreement") dated __________ ___, 2007 between _____________________, a Washington corporation (the "Company"), and the undersigned, of the commencement of a Proceeding, as defined in the Agreement. A brief description of the Proceeding is as follows:

____ If indemnification of particular Damages (as defined in the Agreement) is being sought at this time, pursuant to Section 1(e)(ii) of the Agreement, the undersigned hereby requests indemnification by the Company under the terms of the Agreement with respect to the following Damages incurred in connection with the Proceeding:

Dated: _____________________, _________.

____
[Signature of Indemnitee]

[Type name]

EXHIBIT B

STATEMENT OF UNDERTAKING

STATE OF ______________________)
) ss.
COUNTY OF ____________________)

I, _____________________, being first duly sworn, do depose and say as follows:

1. This Statement is submitted pursuant to the Indemnification Agreement (the "Agreement") dated ___________________ between _____________________, a Washington corporation (the "Company"), and me.

2. I am requesting an Expense Advance, as defined in the Agreement.

3. I hereby undertake to repay the Expense Advance if and to the extent it is Finally Adjudged (as defined in the Agreement) that I am not entitled under the Agreement to be indemnified by the Company.

4. The expenses for which advancement is requested, and a brief description of the underlying Proceeding (as defined in the Agreement), are as follows:

[Add brief description of expenses and Proceeding]

DATED: ______________________, _________.

____

SUBSCRIBED AND SWORN TO before me this ____ day of _______________, 20___,

(Seal or stamp)

____
Notary Signature

____
Print/Type Name
Notary Public in and for the State of Washington,
residing at ________________________________
My appointment expires _____________________

Delaware Law Weekly

Court of Chancery Compels Production of Special Panel Communications With Counsel

By: Candice Toll Aaron
Special to the DLW
April 23, 2008

Ryan v. Gifford (the "action"), is a derivative action pending in the Delaware Court of Chancery arising from admitted stock option backdating that occurred at Maxim Integrated Products Inc.

In resolving what would appear to be an ordinary discovery dispute in *Ryan*, the court issued an opinion compelling production of all communications between a special committee and its counsel, arguably rendering a decision with wide-ranging implications. *See Ryan v. Gifford*, C.A. No. 2213-CC, 2007 WL 4259557 (Del. Ch., Nov. 30, 2007).

Background of the Action

After a March 18, 2006, *Wall Street Journal* article sparked controversy throughout the investment community by revealing that the practice of backdating was relatively common, Merrill Lynch issued a report demonstrating that officers of numerous companies, including Maxim, had benefited from so many seemingly well-timed stock option grants that backdating was highly likely to have occurred in connection with the grants.

Plaintiff Walter E. Ryan, in part based on the Merrill Lynch report, filed the action on June 2, 2006, alleging that the defendants, certain officers and directors of Maxim, breached their duties of due care and loyalty by approving or accepting backdated options that violated the clear letter of a shareholder-approved stock option plan and stock incentive plan, and unjustly enriched themselves.

Ryan specifically claims that nine specific grants between 1998 and 2002 were backdated because they seem too fortuitously timed to be coincidence and that the backdating has caused Maxim to, among other things, suffer adverse tax and accounting effects and overstate its profits while at the same time unjustly enriching certain recipients of the grants. Cross motions for summary judgment were pending in the action.

After reports of stock option backdating scandals at Maxim and other companies were made public, Maxim formed a special committee, comprised of a single disinterested director, empowered to investigate (but not bring claims in connection with the results of any investigation of) the company's stock option grants and practices. The committee engaged counsel and accounting advisers, who conducted extensive interviews and analyzed significant volumes of electronic and paper material. On Jan. 18 and 19, 2007, at meetings attended by the

entire Maxim board and some of the individual directors' personal counsel, the committee and its counsel orally presented its final report to Maxim's full board of directors.

Following this presentation, the board met on several occasions to deliberate and discuss actions in response to the committee's findings and conclusions.

On Feb. 1, 2007, Maxim publicly announced the results of the committee's investigation, noting that there were "deficiencies related to the process for granting stock options to employees and directors" and that, in some instances, the recorded price of those options granted differed from the fair market value on the actual measurement date.

In a non-public report to NASDAQ, the company further reported that the committee found that two employees, John F. Gifford, Maxim's former CEO, and Carl Jasper, Maxim's former CFO, had knowledge of and participated in the selection of grant dates for the disputed options. As a result of the committee's investigation, Maxim terminated Gifford and Jasper's employment, and the company made certain governance changes. Maxim's board, which itself was conflicted, did not take any action to recover the damages Maxim sustained as a result of the backdating scheme.

In addition to providing the results of the committee's work and certain details underlying its findings to the board, Maxim also provided this information to third-parties, including NASDAQ, the SEC, its auditors and the U.S. Attorney's Office. Furthermore, the defendants in the action made use of the committee's findings and conclusions for their own personal benefit, arguing that the committee's exoneration of them should be accorded deference in a number of briefs submitted to the court.

Asserting that the foregoing resulted in a waiver of privilege, the plaintiffs in the action sought discovery of all communication between the committee and its counsel, including counsel's report to the committee, the final report to the full board and counsel's interview notes. The company refused on grounds of privilege and plaintiffs moved to compel.

The Court's Decision

Chancellor William Chandler largely granted plaintiffs' motion, ordering production of all of the requested information except for the interview notes, which the court ordered submitted for an *in camera* inspection, due to the possibility they contained attorney-work product. *Id*. at *4. The court grounded its decision on two independent rationales. First, it held that no privilege applied to prevent discovery under *Garner v. Wolfinbarger*, 430 F.2d 1093, 1103-4 (5th Cir.1970), because plaintiffs pleaded a colorable claim, made specific requests and the information was unavailable from other sources. Thus, plaintiffs had shown good cause for the discovery. *Ryan, 2007 WL 4259557 at *3*.

Second, the court further held that, even if the privilege did apply, the committee had waived it because:

(i) the committee was not a "special litigation committee" under the framework of *Zapata v. Maldonado*,480 A.2d 779 (Del. 1981), because it had not been delegated the power to assert claims on behalf of the company and, therefore, it did not possess a privilege independent of the company;

(ii) it reported its findings to the full board, including directors who had been the target of the investigation and did not have a common interest with the committee;

(iii) the target directors had their personal counsel present at the board meetings where the committee's findings were presented and as a result they were present in their individual, and not fiduciary, capacities; and

(iv) the director defendants and the company relied extensively on the committee's findings as exculpatory evidence in the action and thus attempted to use privileged information as both a sword and a shield.

Denial of Maxim's Appeal

While the court's decision arguably creates a novel doctrine that must be considered any time a committee is investigating potential misconduct by directors or officers, the court in its Jan. 2, 2008, decision denying Maxim's motion for an interlocutory appeal of the Nov. 30 decision suggests that this is not the case. *Ryan v. Gifford*, C.A. No. 2213-CC, 2008 WL 43699 (Del. Ch., Jan. 2, 2008). In this opinion, the court explained that its decision ordering the discovery did not decide an issue of first impression under Delaware law. Rather, as the court explained, its opinion was grounded on a "bedrock principle of waiver" contained in numerous cases and codified in the Delaware Rules of Evidence. *See* D.R.E. 510.

The court also explained that its Nov. 30 decision would not, as Maxim argued, "affect Delaware corporate customs and longstanding principles of good corporate governance," stating that "[n]ot only are such dire consequences exaggerated, but fears thereof are also misplaced." *Id*. at *5.

Rather, the court made clear that "[t]he decision was the result only of the application of well-settled precedent to a set of particular and specific facts" and it "would not apply to a situation ... in which board members are found to be acting in their fiduciary capacity, where their personal lawyers are not present, and where the board members do not use the privileged information to exculpate themselves." *Id*.

Nor would the decision "affect the privileges of a Special Litigation Committee formed under *Zapata* or any other kind of committee that ... has the power to take actions without approval of other board members." *Id*.

Lessons Learned

The court's decision, especially when viewed in light of the limitations expressed in its subsequent denial of Maxim's motion for an interlocutory appeal, provides some practical lessons for future committees and their counsel:

• A committee formed to investigate potential wrongdoing should be delegated power to institute litigation or take actions without the approval of other board members.

• An investigative committee needs to be careful when communicating findings with the board of directors, and focus on communicating findings only to those individuals who genuinely need to know the information and are not implicated in the investigation.

• Counsel for a committee should proactively assess whether the common interest doctrine will apply to each member of the board prior to sharing privileged information with the board.

• Named or targeted individuals, and their counsel, should be excluded from presentation of any investigative committee's report and findings.

• To the extent such individuals are allowed access to that information, it should be provided to them merely in their role as corporate fiduciaries (and access to it by their personal counsel should be restricted or narrowly constrained).

• To the extent privileged company information is shared with defendants or targets, those individuals should sign confidentiality agreements committing not to use the information provided to them for any reason other than in connection with their role as corporate fiduciaries.

• Counsel should document the limitations and conditions placed on the sharing of any privileged company information with defendants or targets, and the fact that such sharing of information is not intended to be a waiver of privilege in board minutes and/or resolutions, where appropriate.

• Because there is always a risk of waiver even if protective measures are taken, counsel conducting an investigation should defensively plan the process and any documents created in the course of the investigation with an eye toward disclosure so that if the privilege is lost, the record revealed is both clean and consistent.

D&O Insurance Checklist

	Yes	No
Is There a Contract?		
➲ Has coverage been unconditionally bound by the beginning of the policy period or are there any outstanding items ("subjectivities") that must be reviewed and accepted by the insurers after the binding?	☐	☐
Rescission:		
➲ Is the policy non-rescindable with respect to Side-A or "non-indemnifiable" claims?	☐	☐
➲ Is there a non-rescindable ABC endorsement that refrains from introducing new exclusions?	☐	☐
➲ If there are bad actors, will the company still be reimbursed for indemnifying good actors?	☐	☐
➲ Can only the knowledge of the CFO and CEO cause the Company to lose its own entity coverage?	☐	☐
Bankruptcy Protection:		
➲ Is "non-indemnifiable" defined to include the situation in which the company is prevented by bankruptcy from indemnifying the directors and officers?	☐	☐
➲ Is there an exception to the insured vs. insured exclusion for claims by bankruptcy trustees?	☐	☐
➲ Does the policy contain an "order of payments" provision giving priority to the directors and officers with respect to the policy proceeds?	☐	☐
➲ Will the policy continue to respond throughout the pendency of the bankruptcy proceedings?	☐	☐
Coverage Breadth:		
➲ Are criminal and administrative proceedings covered?	☐	☐
➲ Are regulatory and derivative suit-related investigations covered?	☐	☐
➲ Is claim defined as a "written" demand?	☐	☐
➲ Can you notice a "circumstance"?	☐	☐
Personal Conduct Exclusions:		
➲ Do they require a "final adjudication" in the underlying case to apply?	☐	☐
➲ Are they "severable" or can one director's or officer's conduct destroy the coverage of the other directors and officers?	☐	☐
➲ Is the "personal profit exclusion" limited to Section 16 claims?	☐	☐
Continuity/Prior Acts:		
➲ Are you covered for all prior acts?	☐	☐
➲ Are pending litigation exclusions narrowly drawn?	☐	☐
Section 11:		
➲ Will the policy pay defense and settlement for Section 11 claims?	☐	☐
Excess Policies:		
➲ Are the excess policies strictly follow-form policies?	☐	☐
Whistleblowers:		
➲ Does the insured vs. insured exclusion contain an exception for whistleblower claims?	☐	☐
Foreign Law Compliance:		
➲ Has the need for locally-admitted policies where required in foreign jurisdictions been addressed?	☐	☐
➲ Has the Master D&O policy been amended accommodate non-US legal issues?	☐	☐
Outside Directors:		
➲ Has a portion of the D&O program been reserved primarily for the outside directors?	☐	☐
ERISA Claims:		
➲ Is the D&O policy shielded from being depleted by payments for ERISA claims under the fiduciary liability insurance policies?	☐	☐
Other Loss Control Issues:		
➲ Are your indemnification agreements state-of-the art?	☐	☐
➲ Have your corporate governance procedures been recently reviewed for best practices?	☐	☐

For questions, please contact:

Priya Cherian Huskins, Esq.
Woodruff-Sawyer & Co.
220 Bush Avenue, 7th Floor, San Francisco, CA 94104
Direct: 415-402-6527 or phuskins@wsandco.com

Copyright © 2008 Timothy Burns and Priya Cherian Huskins
Special thanks to Timothy Burns, the co-author of this checklist.