DELAWARE BUSINESS COURT INSIDER

June 4, 2014

An ALM Website

A Second Look at the Decision in *Chen v. Howard-Anderson*

By Paul J. Collins

The Court of Chancery's Opinion

The Court of Chancery addressed the plaintiffs' Revlon claims in the context of defendants' motion for summary judgment, holding, in the context of an enhanced scrutiny standard, that "the record supports an inference that certain [of the board's] decisions fell outside the range of reasonableness." The court quickly dispatched defendants' arguments, finding that reasonable inferences existed that many of the board's decisions during the sale process were not reasonable, including the purported favoritism shown to Calix over Adtran, the unnecessarily short 24-hour deadline given to Adtran to submit a bid, and the truncated market check.

The court then discussed whether the directors were entitled to summary judgment on the grounds that Occam's certificate of incorporation barred plaintiffs' *Revlon* claims. The court noted that the issue was not, as defendants claimed, whether they "knowingly and completely failed to undertake their responsibilities" (the standard applied in *Lyondell*), but "whether the directors allowed interests other than obtaining the best value reasonably available for Occam's stockholders to influence their decisions during the sale process, given that they made decisions falling outside the range of reasonableness" (as suggested by *In re Dollar Thrifty Shareholder Litigation*, 14 A.3d 573, 599 n.181 (Del. Ch. 2010)). "The metric of reasonableness employed in the intermediate standard of review enables a reviewing court to 'smoke out mere pretextual justifications for improperly motivated decisions,'" citing *Dollar Thrifty*. In so holding, Laster suggested that *Lyondell* "does not speak to th[e] theory" asserted by the Occam plaintiffs that "the directors acted for reasons unrelated to the pursuit of the highest value reasonably available." Instead, the court suggested that *Lyondell* addressed "only one type of bad faith": allegations that defendants had consciously disregarded their fiduciary duties—a standard derived from the courts' duty of oversight cases under Stone and *In re Caremark International Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

Whether or not *Lyondell* can be confined in the manner Laster proposes, the *Chen* opinion does not suggest what conduct might meet the "improper motive" standard that would not also constitute either a conflict of interest or bad-faith conduct, exculpation for which is expressly not permitted by Section 102(b)(7). Although the court found that the actions of Occam's board did not fall within the range of reasonableness, the plaintiffs were not able to point to any evidence that the outside directors acted with any improper motive. For that reason, the court granted the outside directors' motion with respect to the Revlon claim (but not for a separate disclosure claim). Thus, even in a case in which the court had no difficulty finding directors' actions unreasonable, it did not find that disinterested directors acted pursuant to an improper motive. This suggests that, even if upheld on appeal, *Chen* may not be as far-reaching as some commentators have suggested.

Chen also has been cited for the proposition that management compensation decisions taken in the context of a change of control transaction demonstrate a conflict of interest, at least to management (who were not in any event protected under the exculpatory clause).

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That argument overstates the holding in *Chen*. The officer defendant in *Chen* was alleged to have been conflicted, despite the prospect of losing his job, by virtue of his enhanced change of control agreement, which was approved by the board at the same time as the merger—not because all compensation decisions create management conflicts. Likewise, the court in *Chen* did not purport to address the materiality of either the enhancement to the agreement or the total amount to be paid under the agreement compared to the officer defendant's overall compensation or wealth.

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