



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

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IN RE THE DOW CHEMICAL COMPANY : CONSOLIDATED
DERIVATIVE LITIGATION : C.A. No. 4349-CC
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**DEFENDANTS' MEMORANDUM IN
SUPPORT OF THEIR MOTION TO STAY DISCOVERY**

Nominal defendant The Dow Chemical Company ("Dow") and the Dow directors and officers named as defendants (the "Individual Defendants") file this memorandum in support of their motion for a stay of all discovery in the consolidated Derivative Litigation pending the outcome of defendants' planned motion to dismiss for failure to properly plead demand futility under Court of Chancery Rule 23.1.

INTRODUCTION AND NATURE AND STAGE OF PROCEEDINGS

On January 26, 2009, the Rohm & Haas Company ("R&H") sued Dow in this Court, seeking specific performance of a \$19 billion merger agreement that Dow had entered into with R&H in July 2008. Dow argued that the Court, sitting in equity, should deny R&H's request for specific performance. Ultimately, as the Court is aware, the parties resolved the litigation on the eve of trial.

Two weeks after the R&H lawsuit was filed, the first of two derivative actions (the *Blum* action) was filed in this Court against Dow's current directors and Dow as a nominal defendant. With the benefit of 20-20 hindsight, plaintiff alleged that the Dow directors had acted recklessly in approving the R&H merger because they must have known in July 2008 that the size and unconditional nature of that agreement posed too great a risk if (a) Dow's planned joint venture with the Petrochemical Industries Company of the State of Kuwait (the "K-Dow Joint Venture") failed to close and (b) market conditions changed to such an extent that other financing

alternatives would be unavailable. Plaintiff purported to sue the directors on behalf of Dow for billions of dollars in damages and an injunction that would force the Company to make a variety of changes in management and in its corporate governance structure. On February 12, 2009, a second, virtually identical derivative action (the *Meier* action) was filed by another shareholder. Both actions have now been consolidated, the *Meier* complaint has been designated as the operative pleading, and the parties have stipulated to an April 15, 2009 date to answer or otherwise plead to that complaint.

On February 23, 2009, the plaintiff in *Meier* filed and served its First Request for Production of Documents, a copy of which is attached hereto as Ex. A, in which he seeks production of twenty-seven different categories of documents. Among other things, the requests seek discovery of all documents from September 1, 2007 to the present relating in any way to either the R&H merger or the proposed K-Dow Joint Venture, whether in the custody or control of the Company or any of the Individual Defendants. Plaintiff also seeks information about the Individual Defendants' personal finances.

Defendants seek a stay of all discovery because plaintiffs have not shown that they have a right to bring this action on behalf of the Company. Defendants intend to file a motion to dismiss the derivative action on the ground that plaintiffs have failed to plead demand futility with the particularity required by Rule 23.1 of the Court of Chancery Rules. It is well settled that plaintiffs in a derivative action are not entitled to discovery while their right to control the corporation's litigation strategy remains in doubt. Accordingly, all discovery should be stayed until defendants' motion to dismiss is decided.

ARGUMENT

I. Derivative Plaintiffs Are Not Entitled To Discovery Before The Issue Of Demand Futility Is Resolved.

“In general, derivative plaintiffs are not entitled to discovery in order to demonstrate demand futility.” *Beam v. Stewart*, 845 A.2d 1040, 1056 (Del. 2004). *See also Scattered Corp. v. Chicago Stock Exchange*, 701 A.2d 70, 77 (Del. 1997)(same); *White v. Panic*, 2000 Del. Ch. LEXIS 14 at *19 (Del Ch. Jan. 19, 2000) (noting the “unavailability of discovery” in a derivative action “to bolster the facts alleged in the complaint”). In *Brehm v. Eisner*, 746 A.2d 244, 255 (Del. 2000), the Delaware Supreme Court explained that one of the primary reasons for the particularity requirement of Rule 23.1 is to protect the corporation from being subjected to discovery at the whim of a stockholder pursuing claims “based solely on conclusions, opinions or speculation.” That is one reason why “the Court will not permit discovery under Chancery Rules 26-37 to marshal the facts necessary to establish that pre-suit demand is excused.” *Id.* at 266. As the Court observed, there is nothing unfair about this rule: although discovery is barred, plaintiffs may well have utilized the “tools at hand” to develop the facts necessary to support their claim by seeking the right to inspect the Company’s books and records under Section 220 of the Delaware General Corporation Law. *Id.*

Despite “repeated suggestions, encouragement, and downright admonitions over the years both by this Court and the Delaware Supreme Court,” plaintiffs in this case — like the plaintiffs in *Brehm* and *Beam* — failed to make any effort to use the “tools at hand” to conduct a pre-filing investigation of their demand futility allegations. *Beam v. Stewart*, 833 A.2d 961, 981-92 (Del. Ch. 2003). Instead, it is apparent that plaintiffs “plead[ed] demand futility on the basis of precious little investigation beyond perusal of the morning newspapers.” *Id.* Under well-settled Delaware law, plaintiffs cannot use discovery to make up for the defects in their pre-filing

investigation. That is particularly true in light of the obvious weaknesses, detailed below, in plaintiffs' demand futility allegations.

II. Plaintiffs Face A Heavy Burden To Allege Demand Futility.

Defendants will file their motion to dismiss for failure to comply with Rule 23.1 in due course. However, even a cursory review of the complaint demonstrates that plaintiffs face a steep uphill battle to establish their right to pursue this lawsuit on behalf of the Company. Plaintiffs' theory, in a nutshell, is that the Dow Board's decision to enter into a \$19 billion strategic merger transaction that had no "out" if financing could not be obtained was so "grossly reckless" that it could not have been the product of a good faith, informed business judgment. Compl. ¶¶ 1, 124. Nowhere in the complaint, however, do plaintiffs allege any facts to suggest that *any* of the directors had a personal interest in the outcome of the R&H merger that would call into question their ability to make a disinterested business decision. Nor are there any allegations that the process the Board followed in considering and then unanimously approving the merger was flawed in any respect. Instead, plaintiffs rely on a theory of recklessness by hindsight, arguing that the directors should be deemed to have acted in bad faith because they must have known that they were taking too big a risk by entering into an "ironclad" agreement with R&H.

Plaintiffs apparently contend that this theory satisfies the second prong of *Aronson* by raising a "reasonable doubt" that the "challenged transaction was otherwise the product of business judgment." *Aronson v. Lewis*, 473 A.2d 805, 814 (Del.1984). But that argument cannot be reconciled with this Court's recent decision in *In re Citigroup Inc. Shareholder Derivative Litig.*, 2009 Del. Ch. LEXIS 25, *43 (Del. Ch. Feb. 24, 2009). In *Citigroup*, the Court explained that the protections of the business judgment rule are "designed to allow corporate managers and

directors to pursue risky transactions without the specter of being held personally liable if those decisions turn out poorly.” “Business decision-makers must operate in the real world, with imperfect information, limited resources, and an uncertain future. To impose liability on directors for making a ‘wrong’ business decision would cripple their ability to earn returns for investors by taking business risks. Indeed, this kind of judicial second guessing is what the business judgment rule was designed to prevent. . . .” *Id.* at *46. Thus, plaintiffs cannot meet their burden of alleging facts giving rise to a reasonable doubt that a merger transaction was the product of a valid business judgment by alleging that the decision in fact turned out poorly or that the Board must have known all along that it could turn out that way.¹ Yet that is all plaintiffs have done here.

Plaintiffs also make a half-hearted attempt to challenge the independence of the Dow directors. Nine of those directors are outside directors, who are independent of Dow management. Plaintiffs allege that at least three of the outside directors are dominated and controlled by Dow’s Chairman and CEO, defendant Andrew Liveris. However, the connections plaintiffs invoke challenge the independence of three directors are even more tenuous than those this Court found inadequate in *Beam v. Stewart*, 833 A.2d at 978-981, *aff’d*, 845 A.2d 1040 (Del. 2004). For example, plaintiffs point to the fact that Mr. Liveris serves on two “prominent business councils” with one outside director, on the “prestigious American Chemistry Council” with another, and that he also serves on a “prominent international business council” (the U.S.-China Business Council) with outside director Barbara Hackman Franklin, who served as Secretary of Commerce under President George H.W. Bush. Compl. ¶ 125(j). As the Supreme Court noted in *Beam*, “[m]ere allegations that [directors] move in the same business and social

¹ Of course, it is far too early to tell how the merger will actually turn out over the long-term now that the issues that prevented the closing have been resolved.

circles . . . [are] not enough to negate independence for demand excusal purposes.” 845 A.2d at 1052. Nowhere in plaintiffs’ complaint are there any allegations that come close to the standard the Supreme Court established in *Beam* — allegations that would support the inference that the director in question “would be more willing to risk his or her reputation than risk the relationship with the [allegedly] interested director.” *Id.*

CONCLUSION

For the foregoing reasons, defendants urge the Court to grant their motion and to stay any and all discovery until the Court has ruled on defendants’ motion to dismiss the complaint under Rule 23.1.

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