IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

MICHELE S. CRIDEN,	)	
	)	
Plaintiff,	)	
	)	
v.	)	C.A. No. 17082
	)	
JONATHAN L. STEINBERG, BRUCE L. SOKOLOFF, PETER M. ZIEMBA and S. CHRISTOPHER MEIGHER, III,	)	
	)	
Defendants.	)	
	)	
INDIVIDUAL INVESTOR GROUP, INC.,	)	
	)	
Nominal Defendant.	)	

Submitted: February 17, 1999
Decided: March 23, 2000

MEMORANDUMOPINION

Pamela S. Tikellis and James C. Strum of Chimicles & Tikellis, Wilmington, Delaware. Attorneys for Plaintiff.

Barry M. Klayman and Todd C. Schiltz of Wolf, Block, Schorr and Solis-Cohen, Wilmington, Delaware. OF COUNSEL: Richard J. Morvillo, Luther Zeigler and Kenneth F. Rossman of Crowell & Moring, Washington, D.C. Attorneys for Individual Defendants.

Kenneth J. Nachbar of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware. Attorneys for Nominal Defendant.

STEELE, V.C.

Plaintiff files this shareholder derivative action complaining that the board of directors of Individual Investor Group, Inc. improperly re-priced stock options issued under a shareholder approved plan. Plaintiff alleges that the re-pricing constituted corporate waste and that the directors breached their fiduciary duty of loyalty. Defendants move to dismiss plaintiff's claims for: (1) failure to make pre-suit demand under Court of Chancery Rule 23.1; and, (2) failure to state a claim upon which relief can be granted under Court of Chancery Rule 12(b)(6).

I find it unnecessary to determine whether plaintiff failed to make pre-suit demand under Rule 23.1. There is no real need to examine whether demand should have been made on the Board; and, if not, whether the failure to do so can be excused.

Plaintiff's purported claims are for breach of the fiduciary duty of loyalty and corporate waste. Plaintiff's allegations of corporate waste are merely conclusory and lack any factual basis to survive a motion to dismiss. Because the plaintiff has failed to make out a claim of waste and the claim of breach of fiduciary duty rests upon an act of corporate waste, there can be no underlying breach of the fiduciary duty of loyalty. Therefore, I grant defendants' motion to dismiss for failure to state a claim.

I. BACKGROUND

A. The Parties

The plaintiff is a shareholder of Individual Investor Group, Inc., a Delaware corporation that provides financial services information to both individual and professional investors alike. The individual defendants are members of IIG's board of directors'[1] and the nominal defendant is IIG itself.

B. Nature of the Proceedings

Plaintiff filed this shareholder derivative action on March 31, 1999, alleging that IIG's directors committed corporate waste and breached their fiduciary duty of loyalty when they approved the re-pricing of stock options held by both employee and non-employee directors of IIG. Plaintiff amended the complaint on August 4, 1999.

Defendants moved to dismiss plaintiff's claims under Court of Chancery Rules 23.1 and 12(b)(6). The Court held oral argument on the motion on February 23, 2000.

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[1] Defendant, Jonathan L. Steinberg, is both the Chairman and CEO of IIG; the remaining defendants, Sokoloff, Ziemba, and Meigher are all outside non-employee directors of IIG.

C. Stock Option Re-pricing Decisions

On November 19, 1998, the board of directors agreed to a resolution that would substantially reduce the exercise price for stock options held by employees of IIG.[2] Defendant Steinberg, an employee director holding approximately 680,000 stock options, benefited from the directors' decision to re-price.[3] The outside directors received no benefit from this transaction.

Over one month after the board of directors approved a re-pricing decision that significantly impacted options held by Steinberg, the board approved re-pricing options held by non-employee directors. The remaining non-employee directors, Sokoloff, Ziemba, and Meigher received replacement options at a reduced exercise price.[4]

II. CONTENTIONS

A. Plaintiff's Contentions

Plaintiff contends that both the November 19, 1998 and the December 23, 1998 re-pricing decisions should be treated as a singular transaction because of

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[2] Under this re-pricing decision, 1,479,801 options with a weighted average exercise price of $5.34 per share were re-priced at $1.25 per share.

[3] The options defendant Steinberg held had an exercise price ranging from $4.9375 to $7.50. Am. Compl. ¶ 20.

[4] The committee granted the non-employee directors an opportunity to exercise their options at $2.00 per share. Am. Compl. ¶ 22.

their proximity in time and the circumstances surrounding their approval. Furthermore, plaintiff eschews any need to plead particular facts demonstrating that the two decisions should be treated as one arguing that it is reasonable to infer, based upon the plain allegations in the amended complaint, that the decisions are, in fact, mutually dependent. The directors' decision to separate the two decisions in time in an attempt to make them distinct exhibits a breach of the "duty of good faith."

Moreover, plaintiff claims the decisions to re-price constituted corporate waste because they "resulted in a diversion of corporate assets for improper and unnecessary purposes" without any consideration flowing to IIG.[5] Consistent with her allegations of corporate waste, plaintiff maintains that the defendant directors breached their fiduciary duty of loyalty to IIG because the re-priced options were unauthorized gifts granted only to benefit the defendants.[6]

B. Defendants' Contentions

Defendants move to dismiss this action on all counts for (1) failure to comply with the demand requirements for shareholder derivative actions, under Court of Chancery Rule 23.1; and, (2) failure to state a claim upon which relief

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[5] Am. Compl. ¶¶ 42 – 43.

[6] Am. Compl. ¶ 46.

can be granted, under Court of Chancery Rule 12(b)(6). Defendants maintain that plaintiff offers no specific allegations of fact to support her claim and relies upon nothing more than conclusory allegations.

After contending that the two stock option re-pricing decisions should be treated as independent transactions, defendants maintain that the claims surrounding the November 19, 1998 employee stock option re-pricing decision must be dismissed because plaintiff failed to make pre-suit demand on the board and admittedly failed to plead why demand should be excused. Defendants' assert that the plaintiff fails to plead facts demonstrating that the three non-employee director majority were motivated by self-interest or lacked the independence to evaluate and approve the employee stock option re-pricing objectively.

Finally, while conceding the directors' interest in the December 23, 1998 decision, defendants assert that since plaintiff's amended complaint fails to allege facts establishing claims for corporate waste the directors could not have breached their fiduciary duty of loyalty in re-pricing their own or the employees' stock options.

III. LEGAL STANDARD

The standard for a motion to dismiss is well-established under Delaware law: that under any possible set of facts consistent with the facts alleged in the complaint the plaintiff would still not be entitled to judgment.[7] In reviewing plaintiff's complaint, I am permitted to accept all well-pleaded facts as true and must construe all reasonable inferences from the facts in a light that is most favorable to the non-movant .[8] Allegations that are merely conclusory and lacking factual basis, however, will not survive a motion to dismiss.'

IV. ANALYSIS

A. Demand Analysis Excepted

Whether or not plaintiff's amended complaint alleges sufficient facts to support allegations of director self-interest in the December 23, 1998 transaction, and lack of independence in regard to the November 19 transaction there is no

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'Lewis v. ***Austen***, Del. Ch., C.A. No. 12937, mem. op. at 4, Jacobs, V.C. (June 2, 1999) ("a plaintiff must allege facts that, taken as true, establish each and every element of a claim upon which relief could be granted. ").

[8] ***O'Reilly v. Transworld Healthcare, Inc.,*** Del. Ch., C.A. No. 16507, mem. op. at 11, Steele, V.C. (August 20, 1999).

[9] ***In re Walt Disney Co. Derivative Litig.,*** Del. Ch., 731 A.2d 342, 353 (1998), *aff'd* ***in part, rev'd in part sub nom. Brehm v. Eisner.,*** Del. Supr., No. 469, 1998, 2000 WL 174619 (Feb. 9, 2000).

real need to engage in a demand analysis. The board of directors acted according to a predetermined stock option plan, approved by the shareholders, which included the re-pricing option. The plaintiff raises no issue that the board lacked authority to re-price the options or that they implemented the re-pricing in a manner unintended or unexpected by the shareholders."

Even after drawing every possible inference from the facts supporting plaintiff's contentions, the directors merely implemented a plan presumably entirely consistent with the interests of the corporation and its shareholders because the shareholders knowingly endorsed the parameters of the plan.

The focus of this case should be plaintiff's purported claims for breach of the duty of loyalty arising from acts of corporate waste. The plaintiff alleges that the directors breached their duty of loyalty by re-pricing options in a manner which constituted corporate waste.

B. Corporate Waste Claim

I now turn to the standard for corporate waste which is "very rarely satisfied by a shareholder plaintiff. "[11] To support a claim, a shareholder must

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[10] At oral argument, plaintiff conceded that the plan gave the directors the authority to re-price the options and carried out the re-pricing according to the plan.

[11] ***Steiner*** v. ***Meyerson***, Del. Ch., C.A. No. 13139, mem. op., at 2, Allen, C. (July 19, 1995).

demonstrate that the transaction in question either served no purpose or was so completely bereft of consideration that the "transfer is in effect a gift. "[12] In so doing, plaintiff must allege facts that, if true, establish that the defendant directors "authorize[d] an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration. "[13]

Defendants' motion requires that I address the sufficiency of plaintiff's pleading. In order to find that plaintiff has pleaded her claims sufficiently, I must be satisfied that the facts alleged in the amended complaint establish a complete failure of consideration. [14] Insufficient or inadequate consideration is difficult to demonstrate since the alleged acts "have to be so blatant that *no* ordinary business person would ever consider the transaction to be fair to the

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[12] ***Lewis v. Vogelstein,*** Del. Ch., 699 A.2d 327, 336 (1997).

[13] ***Glazer v. Zapata Corp.,*** Del. Ch., ***658*** A.2d 176, ***183 (1993); see also Stein v. Orloff***, Del. Ch., C.A. No. 7276, 11 Del. J. Corp. L. 312, 319, 1985 WL 11561, *3, Hartnett, V.C. (May 30, 1985) ("the test for finding a waste of corporate assets is whether the consideration received by the corporation was so inadequate that no person of ordinary sound business judgment would deem it worth that which the corporation paid"), ***appeal refused by*** Del. Supr., 504 A.2d 572 (1986); ***Saxe*** v. ***Brady,*** Del. Ch., 184 A.2d 602 (1962).

[14] See ***Lewis,*** 699 A.2d at 338 ("The Court of Chancery has interpreted the waste standard in the ratified option context as invoking not a proportionality or reasonableness test a la ***Kerbs*** but the traditional waste standard referred to in ***Michelson.*** ").

corporation."[15] In other words, the company would have to receive virtually nothing for what it gave.

Plaintiff's allegation that the directors wasted corporate assets by authorizing the re-pricing is unaccompanied by any facts demonstrating that the corporation received nothing in kind and is merely conclusory. Plaintiff does not, for example, contend that this plan or any series of earlier plans, prohibited the re-pricing the directors implemented or even that unlike earlier plans, this re-pricing was not specifically authorized.[16] The re-pricing objected to here was a part of an overall plan, approved by the shareholders, to incentivize performance or encourage retention of key employees and non-employee directors. Plaintiff's only factual allegation is that the defendant directors had re-priced a substantial amount of their own options (and of an employee director to whom they were beholden) to purchase common stock without any consideration to IIG. However, their legal allegations, specifically that the re-pricing was "gross, reckless, willful and intentional" and that "no person of ordinary, sound business

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[15] ***In Re 3Com Corp. Shareholders' Litig.,*** Del. Ch., C.A. No. 16721, mem. op., at 11, Steele, V.C. (Oct. 25, 1999).

[16] *Cf.* ***Sanders v. Wang,*** Del. Ch., C.A. No. 16640, mem. op., at 25-27, Steele, V.C. (Nov. 8, 1999) (plaintiffs had sufficiently stated claim for waste to survive a motion to dismiss by pleading particularized facts that the company's board authorized the issuance of shares of Computer Associates International, Inc. common stock under the stock ownership plan ("KESOP") in an amount far exceeding the number authorized by the plan.

judgment would be expected to entertain a view that the consideration or, indeed, lack of consideration was fair, " are wholly conclusory .[17] Here, plaintiff calls into question the defendant directors' "diversion of corporate assets for improper and unnecessary purposes" in the face of a shareholder plan authorizing a re-pricing that was carried out, concededly, according to its terms. Under these circumstances the complaint can not raise a reasonable doubt that any business person of ordinary judgment could conclude that IIG received nothing in exchange for re-pricing the director defendants' options.[18] Is not the only reasonable inference to be drawn from the shareholders' approval of the plan that the shareholders themselves believed the re-pricing to be an appropriate performance incentive for the corporation's managers and directors? Must I infer that the majority of shareholders who approved the plan were persons lacking "ordinary, sound business judgment?"[19]

Plaintiff claims that the defendant directors' grant of stock options amounted to an unwarranted gift unsupported by any valid consideration. Plaintiff requests that this Court infer that the directors' were unjustly enriched

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[17] Am. Compl., ¶42.

[18] Am. Compl., ¶43.

[19] I invite the reader to review Vice Chancellor Strine's in depth analysis of the implications of shareholder pre-approval of acts alleged to constitute corporate waste in ***Harbor Finance Partners v. Huizenga***, C.A. No. 14933, Strine, V.C. (Nov. 7, 1999).

by their re-priced options without factual support for the allegation that IIG failed to benefit from the transaction. Plaintiff has failed to allege facts that either directly, or inferentially, indicate why the shareholders, who approved the plan allowing the re-pricing, were so ill informed about the plan they approved that neither they nor any reasonable person could not believe that IIG would benefit from the re-priced options and that the re-priced options they authorized would amount to a gratuity and thus, corporate waste.

There is no legal basis for this Court to question the sufficiency of the consideration for those re-priced options or to second guess the shareholders when they adopted a plan authorizing the stock option re-pricing. To do so would be to frustrate the shareholders' authority to determine the parameters of executive compensation plans and to substitute my judgment for both their and the board's business judgment when it decided to implement the re-pricing. As our Supreme Court recently stated: "To rule otherwise would invite courts to become super-directors, measuring matters of degree in business decision making and executive compensation."[20] Plaintiff's allegations that IIG received no

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[20] ***Brehm v. Eisner.,*** Del. Supr., No. 469, 1998, 2000 WL 174619 at *16 (Feb. 9, 2000), *aff'g* ***in part, rev'g in part sub nom. In re Walt Disney Co. Derivative Litig.,*** Del. Ch., 731 A.2d 342 (1998).

consideration for the director employee and non-employee benefit from the stock option re-pricing, are nothing more than conclusory and are insufficient, as a matter of law, to meet the standard required for a claim of waste. Carrying out a predetermined stock option plan, approved by shareholders, entirely consistently with the plan can hardly be characterized as an act of a "disloyal" fiduciary. Because the plaintiff has failed to make out a claim of waste, there can be no underlying breach of the fiduciary duty of loyalty.

C. **Allegation of Lack of Good Faith Raised at Oral Argument**

Plaintiff's counsel raised for the first time at oral argument the spectre that the defendant directors either breached a fiduciary duty of "good faith" when they implemented the plan or breached an implied contractual duty of good faith which attached to the stock option plan. Quite apart from a failure to support either of these intriguing themes with facts in the pleading, the suggestions came too late for defendants to respond. Plaintiff's complaint, I understand, has already been amended once. Whether there may be a basis to assert differently styled claims now or whether the introduction of a good faith litmus test was merely to question the "good faith" of the directors' decision to separate one transaction into two, I can not tell. Plaintiff presented a copy of our Supreme

Court's decision in ***Brehm v. Eisner ("Disney")***,[21] to me just before oral argument, apparently to suggest that if I granted defendants' motion that I should do so without prejudice and allow plaintiff yet another chance to amend her complaint in the absence of a contention new facts have come to light. I have neither the authority nor the predilection to entertain a practice where I, as a trial judge, develop my own theories of possible recovery for plaintiffs or hear them for the first time from plaintiffs at oral argument, and then allow them to replead until some viable claim hits the wall and sticks. That practice would undermine our adversary system and suggests that practitioners who draft pleadings know less about the facts available to support potential causes of actions than judges who rule on motion practice issues. I resist the temptation to dismiss without prejudice in the hope that a third complaint might finally generate a viable cause of action. Had there been such a possibility, I am sure counsel would have pleaded accordingly in their first or second attempt to state a claim. I do not share plaintiff's counsel's belief that ***Disney*** suggests that trial judges should treat every complaint like a Phoenix ever ready to spring to life from its ashes upon learning of its imminent demise. Motion practice is no place for trial judges to

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[21] ***Brehm,*** supra note 20.

attempt to usurp the Supreme Court's role to make new law or clarify the old in a way which can resuscitate a defective complaint.

V. CONCLUSION

Plaintiff's allegations indicating corporate waste and breach of duty of loyalty are merely conclusory and lack any factual basis to survive a motion to dismiss. Defendants' motion to dismiss for failure to state a claim, under Court of Chancery Rule 12(b)(6) is ***granted.***

IT IS SO ORDERED.

Vice Chancellor