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Case No. 9425-VCN

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

GARY LIVINGSTON, derivatively on behalf of CABLEVISION SYSTEMS CORPORATION, Plaintiff, v. CHARLES F. DOLAN, JAMES L. DOLAN, KATHLEEN M. DOLAN, DEBORAH DOLAN-SWEENEY, MARIANNE DOLAN WEBER, THOMAS V. REIFENHEISER, JOHN R. RYAN, and VINCENT TESE, Defendants, -and- CABLEVISION SYSTEMS CORPORATION, a Delaware Corporation, Nominal Defendant.	C.A. No. 9425-VCN

REPLY BRIEF IN SUPPORT OF THE DOLAN DEFENDANTS' MOTION TO DISMISS THE COMPLAINT PURSUANT TO COURT OF CHANCERY RULE 12(b)(6)

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PRELIMINARY STATEMENT

Plaintiff's Opposition Brief appears to propose that the Court adopt a black-line rule in which any award of compensation to an executive who is a member of an alleged controlling group would be subject to entire fairness review—even if the award were made by an independent compensation committee. Plaintiff hints that business judgment review might be available, if at all, if such an award were made by an independent compensation committee *and* subject to the majority vote of minority stockholders. Plaintiff cites no case in which a court has applied this unnecessarily cumbersome approach to an executive compensation decision, and for good reason: a decision regarding whether a particular executive warrants large sums of money is "the essence of business judgment." *Brehm v. Eisner*, 746 A.2d 244, 260 (Del. 2000).

Delaware law consistently applies the business judgment rule where an independent committee has determined an executive's compensation—even an executive who is also a controller. This legal framework enables boards to make compensation decisions efficiently and objectively, and encourages and rewards the use of independent compensation committees to determine executive compensation at controlled companies. Plaintiff has presented no compelling reason to disrupt this sound approach, and his attempt to analogize executive compensation decisions to going private mergers, in which the potential for a

controlling stockholder to exploit his influence at the expense of the minority is at its height, is unpersuasive. Plaintiff's argument that entire fairness review should apply to Charles and James Dolan's compensation should be rejected.

Plaintiff barely addresses the Dolan Defendants' remaining arguments. Lacking any factual or legal basis to state a claim against the Dolan Defendants for merely accepting compensation awarded by the Compensation Committee, Plaintiff simply reasserts the unsubstantiated personal views on which his claims are based. While Plaintiff concedes with respect to his waste claim against Charles and James Dolan that "a recipient's retention can serve as adequate consideration for a grant of stock options," he claims that this does not apply here because, according to Plaintiff, "[n]either James nor Charles plan to ever leave Cablevision." Plaintiff's Corrected Answering Brief in Opposition to Defendants' Motions to Dismiss the Complaint ("Pl. Br.") at 56. Likewise, having conceded that he largely miscalculated the Board attendance records of Kathleen Dolan, Deborah Dolan-Sweeney, and Marianne Dolan Weber, Plaintiff now bases his breach of fiduciary duty claims against these directors on his belief that they "lack the necessary qualifications to serve on Cablevision's Board." Pl. Br. 5. The Court should decline Plaintiff's invitation to engage in a substantive evaluation of director qualification. Plaintiff's claims against the Dolan Defendants should be dismissed.

ARGUMENT

I. The Business Judgment Rule Applies to Charles and James Dolan's Compensation

Unable to cite a single executive compensation case applying the entire fairness standard, Plaintiff argues that executive compensation awards to controlling stockholders by independent compensation committees raise the same risks and require the same procedural protections as self-dealing merger transactions in which a controlling stockholder that stands on both sides of the transaction negotiates against and buys out the minority. But the rationale for those protections simply does not apply to awards of executive compensation.

Delaware law recognizes that executive compensation determinations are quintessentially within the judgment of a corporation's directors and fundamentally different from corporate transactions. *See, e.g.*, *Brehm*, 746 A.2d at 260 n.49, 262. As discussed in depth in the Compensation Committee Defendants' Reply Brief, which the Dolan Defendants adopt and incorporate by reference to the extent relevant to their claims, cases involving merger transactions with controlling stockholders are inapplicable here because:

- Compensation awards, unlike mergers or acquisitions, do not pose "an extraordinary potential for the exploitation by powerful insiders of their informational advantages and their voting clout" at the expense of the minority. *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 617 (Del. Ch. 2005);

- When an independent committee determines the executive compensation of a controlling stockholder, the controller is not engaging in a negotiation or exercising his or her powers to effect a self-interested transaction. *See, e.g.*, *Odyssey Partners, L.P. v. Fleming Cos., Inc.*, 735 A.2d 386, 412 (Del. Ch. 1999); and

- Executive compensation payments have minimal impact on a company's finances and share price, especially compared to the great impact that a merger or acquisition can have on a company's finances, share price, and minority stockholders' rights. *See Brehm*, 746 A.2d at 260 n.49.

See also Compensation Committee's Reply Brief ("Comp. Comm. Reply Br.") at 9–12. Plaintiff's inability to cite a single compensation case supporting his argument demonstrates that the business judgment rule, and not entire fairness, is the appropriate standard here.

II. Plaintiff Has Not Pled Facts Sufficient to Overcome the Business Judgment Rule as to Charles and James Dolan's Compensation

Relying entirely on his novel entire-fairness theory, Plaintiff makes no serious attempt to argue that the Complaint is adequately pled to overcome the presumption that the Compensation Committee's determinations as to Charles and James Dolan's executive compensation are protected by the business judgment rule. Although Plaintiff argues that the Compensation Committee's opening brief provides additional facts from Cablevision's Proxy statements respecting the circumstances surrounding the 2012 award of stock options that go beyond what a court should consider on a motion to dismiss, *see* Pl. Br. 44, the Court need not

consider any of those fact assertions to rule in Defendants' favor on this motion because the Complaint's allegations, taken as is, are plainly lacking.

First, it is black-letter Delaware law that allegations concerning longevity of board service, receipt of directors fees, and longstanding relationships among board members are insufficient to demonstrate that the Compensation Committee members lacked independence.[1] *See* Compensation Committee Defendants' Opening Br. at 18–25.

Second, Plaintiff's claim that the Compensation Committee lacked independence just because it accepted input from James Dolan on Cablevision's peer companies lacks merit. Delaware law does not require a compensation committee to hermetically seal itself when making compensation decisions. To the contrary, and consistent with their duty of care, committee members are permitted to consult with management to inform their decision-making. *See In re Goldman Sachs Grp., Inc. S'holder Litig.*, CIV.A. 5215-VCG, 2011 WL 4826104, at *3, *15

[1] Plaintiff states that "Defendants repeatedly rely on cases imposing the admittedly inapplicable heightened Rule 23.1 pleading burden." Pl. Br. 23. Of course Defendants cite these cases: the vast majority of Delaware law evaluating the independence of directors arises in the Rule 23.1 context. Although Rule 23.1 imposes on a plaintiff a heightened pleading burden to allege with particularity the reasons why a majority of the board is not independent or disinterested, Del. Ch. Ct. R. 23.1, the cases cited by the Dolan Defendants did not turn on lack of particularity, and the underlying legal principles apply with equal force in the 12(b)(6) context.

(Del. Ch. Oct. 12, 2011) (dismissing derivative case where compensation committee consulted with management in determining their compensation).

Third, although members of the Compensation Committee were elected to the Board by only a plurality of Class A shareholder votes in certain years, the Complaint does not and cannot allege that this electoral process was not in accordance with Delaware law. *See* 8 *Del. C.* § 216(3) ("Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors[.]"); *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 926 (Del. 1990) ("[T]he rule in corporate elections is that the affirmative vote of a plurality of the shareholders is sufficient to elect directors.").

Nor does Plaintiff allege that the Class A shareholders proposed any alternative Class A director nominees for election to the Board in those years—which they are entitled to do—or that the Class B Directors somehow interfered with the Class A Director nominations and elections. That the Compensation Committee members chose to remain on the Board after being validly elected as Class A directors pursuant to Delaware law does not indicate that they lacked independence from Charles Dolan, James Dolan, or any other Class B Directors. Plaintiff cites no case to the contrary. *Cf. Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984) (to challenge director independence, "it is not enough to charge that a

director was nominated by or elected at the behest of those controlling the outcome of a corporate election . . ."), *overruled on other grounds by Brehm*, 746 A.2d 244.

III. Plaintiff Fails to State a Breach of Fiduciary Duty Claim Against Charles and James Dolan for Merely Accepting Compensation Awarded by an Independent Compensation Committee

Having failed to state a claim against the Compensation Committee in connection with Charles and James Dolan's executive compensation, Plaintiff cannot state a breach of fiduciary duty claim against Charles and James Dolan for merely accepting that compensation. Plaintiff cites no case to the contrary.

Instead, Plaintiff points to cases in which executives or board members granted themselves excessive compensation—facts not present here. *See Valeant Pharm. Int'l v. Jerney*, 921 A.2d 732, 736, 746 (Del. Ch. 2007) (case challenging directors' self-payment of "extravagant" cash bonuses without independent committee approval); *Zutrau v. Jansing*, CIV.A. 7457-VCP, 2014 WL 3772859 (Del. Ch. July 31, 2014) (case challenging level of CEO's compensation where CEO was sole decision maker); *Seinfeld v. Slager*, CIV.A. 6462-VCG, 2012 WL 2501105, at *11 (Del. Ch. June 29, 2012) (case involving self-payment of allegedly excessive director compensation). These cases have no bearing on the question of whether executives who merely accept compensation awarded by an independent compensation committee can be held liable for breach of fiduciary

duty for receiving it and cannot salvage Plaintiff's claim against Charles and James Dolan.

IV. Charles and James Dolan's Acceptance of Stock Options Does Not Constitute Waste

Plaintiff's waste claim against Charles and James Dolan arising from their acceptance of a special stock option grant fails for the same reason: Plaintiff has not identified a single case in which an executive who was awarded a special options grant by an independent compensation committee was found to be liable for waste by virtue of having accepted the options. This is unsurprising given Vice Chancellor Glasscock's observation that a plaintiff "alleging waste arising from the decision of an independent board concerning employee compensation has set himself a Herculean, and perhaps Sisyphean, task." *Seinfeld*, 2012 WL 2501105, at *6; *accord In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 74 (Del. 2006) (citing *Brehm*, 746 A.2d at 263) (waste claims only survive in "the rare, unconscionable case" where the plaintiff has "shoulder[ed] the burden of proving that the exchange was 'so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration'").

Plaintiff's Opposition offers little response. Plaintiff concedes that "a recipient's retention can serve as adequate consideration for a grant of stock options," yet insists that this principle does not apply to the special stock options

granted to Charles and James Dolan because "[n]either James nor Charles plan to ever leave Cablevision." Pl. Br. 56. This unsubstantiated assertion (which is at odds with Plaintiff's own claim that Charles and James Dolan were overly focused on outside responsibilities and interests, *see* Compl. ¶ 76) is far too limited and speculative.[2] Nor can Plaintiff rescue his claim by alleging that the Dolan family intends to take the Company private. *See id.* That allegation, if true, merely demonstrates that the Dolan family intends to maintain its financial investment in the Company, not that Charles and James Dolan intend to continue working there.

The three cases cited by Plaintiff as purported examples of the "numerous occasions" on which courts have found that a grant of stock options constituted waste only demonstrate that the facts alleged here do *not* constitute waste. *See* Pl.

[2] *Sample v. Morgan*, 914 A.2d 647, 669 (Del. Ch. 2007), bears no resemblance to the facts at issue and does not support Plaintiff's waste claim. In *Sample*, the plaintiff alleged that the CEO, CFO, and Vice President orchestrated a grant of 200,000 shares to themselves for $200 in total—a tiny fraction of the $5.60 per share estimated value—with the goal of entrenchment, a motive reflected in contemporaneous documents cited in the complaint. In denying a motion to dismiss that he deemed "frivolous," then-Chancellor Strine stated: "If giving away nearly a third of the voting and cash flow rights of a public company for $200 in order to retain managers who ardently desired to be firmly entrenched just where they were does not raise a pleading-stage inference of waste, it is difficult to imagine what would." *Id.* at 652–53. Under the circumstances, then-Chancellor Strine understandably was unwilling to accept an argument that the options were necessary for retention absent an indication that the executive had offers to leave. In this case, by contrast, Plaintiff has alleged no facts to support his assertion that Charles and James are "not going anywhere" and is not entitled to an inference that they are not.

Br. 57 (citing *Weiss v. Swanson*, 948 A.2d 433, 450 (Del. Ch. 2008); *In re Nat'l Auto Credit, Inc. S'holders Litig.*, CIV.A. 19028, 2003 WL 139768 (Del. Ch. Jan. 10, 2003); and *Halpert v. Zhang*, 966 F. Supp. 2d 406, 416 (D. Del. 2013)). These cases are inapplicable because each involved self-grants of options by executives or directors, rather than grants awarded by an independent committee. In addition, in stark contrast to Plaintiff's unsupported assertion that Charles and James Dolan are "not going anywhere," Compl. ¶ 76, the three cases involved detailed factual allegations indicating that the options at issue were granted in violation of a company's incentive plan (*Weiss* and *In re Nat'l Auto*) or as a quid pro quo between the board and chief executive officer from which the company derived zero benefit (*Halpert*).[3] These detailed factual allegations only highlight the insufficiency of Plaintiff's assertion that Charles and James Dolan committed waste.

[3] *See Weiss*, 948 A.2d at 450 (declining to dismiss waste claim where plaintiff alleged that directors had wrongfully relied on material non-public information to time their options grants so as to maximize personal gain in violation of stockholder approved options plan); *In re Nat'l Auto Credit.*, 2003 WL 139768, at *13 (declining to dismiss waste claim where plaintiff alleged that the company's directors granted themselves stock options in exchange for approving a transaction in which the company acquired a worthless dot com company for millions of dollars in order to benefit the company's controller); *Halpert*, 966 F. Supp. 2d at 416 (declining to dismiss waste claim where directors granted themselves stock options in excess of the 100,000 per recipient per year permitted under the company's stock incentive plan).

V. Plaintiff Fails to State a Breach of Loyalty Claim against Kathleen Dolan, Deborah Dolan-Sweeney, and Marianne Dolan Weber

Plaintiff makes little attempt to defend his claims against Kathleen Dolan, Deborah Dolan-Sweeney, and Marianne Dolan Weber, dedicating a mere three paragraphs of his 60-page brief to the topic. Forced to concede that he largely miscalculated the three directors' board meeting attendance records, Plaintiff backs away from his attack on attendance and focuses instead on the assertion that they are inherently unqualified to serve on Cablevision's Board. *See* Pl. Br. 7 n.3; Compl. ¶ 42; Pl. Br. 5–6. Even if this Court were inclined to take the extraordinary step of engaging in a substantive evaluation of director qualification, however, there is no legal support for the proposition that an individual duly nominated and elected to serve on a board breaches his or her duty of loyalty simply by agreeing to serve.

Unable to salvage his existing claims, Plaintiff asserts for the first time that Kathleen Dolan, Deborah Dolan-Sweeney, and Marianne Dolan Weber's director compensation package—which was identical for all non-employee directors—must be reviewed under the entire fairness standard because the entire Board voted to approve it. As a threshold matter, this argument fails because the Complaint does not allege that the Company's compensation for non-employee directors was excessive. It is nonsensical to suggest that standard non-employee director compensation awarded to numerous directors and not alleged to be excessive

should nonetheless be subject to challenge under the entire fairness standard to the extent that Kathleen Dolan, Deborah Dolan-Sweeney, and Marianne Dolan Weber received it.[4]

To the extent that Plaintiff seeks to hold Kathleen Dolan, Deborah Dolan-Sweeney, and Marianne Dolan Weber liable for breach of the duty of loyalty by virtue of their votes on non-employee board compensation—a claim not asserted in the Complaint—such a claim would fail for the additional reason that Plaintiff does not and cannot allege that the relatively modest director compensation at issue was material to a member of the Dolan family. *In re Gen. Motors (Hughes) S'holder Litig.*, CIV.A. 20269, 2005 WL 1089021, at *1 (Del. Ch. May 4, 2005) *aff'd*, 897 A.2d 162 (Del. 2006) (defendants' standard director compensation did not make them disloyal to spin-off company's shareholders in part because "there are no allegations in the Complaint that any of the compensation paid to the non-employee GM directors is material to them").

[4] The Complaint very clearly challenges only these directors' receipt of non-employee director compensation in light of their purported "non-involvement" with the Cablevision Board, Compl. 43—allegations from which Plaintiff has now retreated, *see* Pl. Br. 7 n.3.

CONCLUSION

For the reasons set forth above, the Dolan Defendants respectfully request that the Court grant their motion dismissing the Complaint pursuant to Rule 12(b)(6).

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CERTIFICATE OF SERVICE

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