IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

RUTH ABRAMS,	:	
Plaintiff,	:	
v.	:	Civil Action No. 11-297-RGA
JAMES L. WAINSCOTT, et al.,	:	
Defendants.	:	

ORDER

Before the Court is the Motion to Dismiss filed by Defendants Richard A. Abdoo, John S. Brinzo, Dennis C. Cuneo, Albert E. Ferrara, Jr, Douglas W. Gant, William K. Gerber, Bonnie G. Hill, David C. Horn, Robert H. Jenkins, John F. Kaloski, Ralph S. Michael, III, Shirley D. Peterson, James A. Thomson, and James L. Wainscott (D.I. 20) and joined in part by Defendant AK Steel Holding Corp. (D.I. 19), and related briefing (D.I. 21, 22, 23, 24, 25). The Court has the benefit of oral argument. For the reasons that follow, the Motion is **GRANTED**.

1. In the Verified Amended Complaint (D.I. 15), Plaintiff alleged that the 2010 Proxy Statement of April 12, 2010, instructed stockholders that if they voted to reapprove the performance goals of the Long-Term Performance Plan ("LTPP"), performance goals of the Stock Incentive Plan ("SIP"), and the amendment and restatement of the SIP, performance-based compensation under these plans would be tax-deductible under I.R.C. § 162(m) (2006). (D.I. 15, ¶¶ 11, 14, 23). Plaintiff alleged that the plans do not actually allow for such tax deductions, so the proxy statement disclosures regarding the LTPP and SIP, including the SIP amendment, were false and misleading. Plaintiff alleged four derivative claims: for Breach of Duties under § 14(a) of the Securities and Exchange Act, for Breach of the Duty of Loyalty, for Waste (based on the payment of non-deductible compensation), and for Unjust Enrichment. (D.I. 15, ¶¶ 76-91).

2. Pursuant to FED.R.CIV.P. 23.1(b) (3), a shareholder bringing a derivative action must file a verified complaint that states with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and (B) the reasons for not obtaining the action or not making the effort. "Although Rule 23.1 provides the pleading standard for derivative actions in federal court, the substantive rules for determining whether a plaintiff has satisfied that standard are a matter of state law." *King v. Baldino*, 409 F. App'x 535, 537 (3d Cir. 2010). "Thus, federal courts hearing shareholders' derivative actions involving state law claims apply the federal procedural requirement of particularized pleading, but apply state substantive law to determine whether the facts demonstrate [that] demand would have been futile and can be excused." *Kantor v. Barella*, 489 F.3d 170, 176 (3d Cir. 2007). The Delaware Supreme Court has characterized the exercise of determining demand futility as deciding "whether, under the particularized facts alleged, a reasonable doubt is created that (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson v. Lewis*, 473 A.2d 805, 814 (Del.1984).

3. In moving to dismiss, Defendants first argue that Plaintiff failed to plead particularized facts demonstrating demand was excused. (D.I. 21, pp. 18-32). Under the first *Aronson* prong, Plaintiff alleged Defendant Wainscott, as CEO, is interested in the payments under the LTPP, SIP, and SIP Amendment. (D.I. 15, ¶ 71). Plaintiff alleged the nine remaining outside members of the Board (the Director Defendants) are interested in SIP payments, and are "therefore interested in the transactions and events alleged herein." (*Id.* ¶¶ 25, 71; D.I. 22 at 39-40). These Director Defendants are not participants in the LTPP plan and their retainer under the SIP is not

performance-based. (D.I. 15, ¶¶ 25, 71; D.I. 21, Ex. 1 at 27). Plaintiff alleged the Director Defendants were interested in the proxy's SIP amendments that asked shareholders to extend the expiration period during which restricted stock could be granted, and to increase the number of shares available for the grant of restricted stock awards, because the Director Defendants receive at least half of their annual retainer in the form of restricted stock units. (*Id.* ¶ 71).

4. Defendants argue that director compensation under the SIP does not make the directors "interested" in the result of the 2010 proxy, as the SIP would have continued to exist and provide that compensation regardless of the result of the 2010 vote and the tax consequences thereof. (D.I. 21 at 21). The issue here is whether pleading that the outside directors were interested in the proxy statements' representations about restricted stock creates reasonable doubt as to whether the outside directors were interested in the proxy statement's representations about performance-based compensation under the SIP and LTPP - the heart of Plaintiff's claim. The performance-based compensation representations appear in Proposals 3 and 4 in the Proxy Statement, and the restricted stock representations appear in Proposal 5. (D.I. 21, Ex. 1 at 71-81).

5. Plaintiff's allegations that the outside directors were interested in the outcome of Proposal 5 do not plead particularized facts creating a reasonable doubt that the outside directors (*i.e.*, a majority of the board) are interested as to Proposals 3 and 4. Plaintiff does not allege any basis to believe that the directors would not continue to receive their stock compensation under the SIP regardless of whether the SIP performance goals in Proposal 4 passed, nor does Plaintiff allege any connection between the SIP amendment in Proposal 5, and the performance goals in Proposals 3 and 4. The demand futility analysis proceeds transaction-by-transaction. *Khanna v.*

McMinn, 2006 WL 1388744, *14 (Del. Ch. May 9, 2006). The transactions here - the proxy proposals - split the Director Defendants' interest off from the claims, distinguishing this case from *Hoch v. Alexander*, 2011 WL 2633722 (D.Del. July 1, 2011) and *Resnik v. Woertz*, 774 F.Supp.2d 614 (D. Del. 2011). Plaintiff has failed to plead that demand is excused under *Aronson*'s first prong.

6. This brings the inquiry to *Aronson*'s second prong - whether Plaintiff has alleged particularized facts to create a reasonable doubt as to whether the protections of the business judgment rule are available to the Board. Plaintiff alleged demand is excused because: a) the issue here is one of disclosure; b) at least half the board cannot claim protection of the business judgment rule because they are members of the Compensation Committee that developed, approved, recommended, and implemented the LTPP and SIP, and had at various earlier times[1] allegedly violated the express terms of then-existing LTPP; c) a majority of the board violated United States public policy; and d) the compensation at issue comprises waste, which is not protected by the business judgment rule. (D.I. 15 ¶¶ 72-73; D.I. 22 at 36-38; 40-42).

7. Defendants argue that Plaintiff's disclosure allegations fail because they do not plead bad faith, specifically "what the directors knew and when" or that the Directors knew the 2010 Proxy Statement contained false or misleading statements. (D.I. 21 at 24-25, 30-31; D.I. 23 at 17). In response, Plaintiffs argue that disclosure claims are not protected by the business judgment rule as a matter of law. (D.I. 22 at 40-41) (citing *In re Anderson, Clayton Shareholder Litig.*, 519 A.2d 669 (Del.Ch. 1986); *In re Tri-Star Pictures, Inc. Litig.*, 1990 WL 82734

[1] *See* D.I. 22, p. 38 (referring to *id.*, p. 17); *see id.*, p. 18 (referring to actions in January 2008).

(Del.Ch. June 14, 1990); *Lewis v. Leaseway Transp. Corp.*, 1990 WL 67383 (Del.Ch. May 16, 1990)).

8. Plaintiff's cited cases do not support the proposition that derivative claims based on a proxy statement nondisclosure do not need to meet the second *Aronson* prong in the context of a Rule 23.1 motion. *See Bader v. Blankfein*, 2008 WL 5274442, *6 (E.D.N.Y. Dec. 19, 2008) ("If shareholders could elect to sue on behalf of a corporation without consulting the board of directors whenever they deemed a proxy statement to contain materially false information, shareholders could effectively usurp the board's decision as to whether litigation was merited."); *Freedman v. Adams*, 2012 WL 1099893, *16 n.155 (Del. Ch. Mar. 30, 2012) "[T]he Plaintiff appears to conflate the fact that disclosure claims are generally not subject to the demand requirement (because they are usually direct claims) with the idea that a properly pled disclosure claim excuses demand under *Aronson*'s second prong.") (emphases omitted).

9. Plaintiff also pled that demand is excused under *Aronson*'s second prong because at least half the board sits on the Compensation Committee that violated the LTPP. (D.I. 15, ¶ 73). Defendant argues that Plaintiff failed to plead that the violation was knowing and intentional. (D.I. 21 at 30, D.I. 23 at 15-16). Plaintiff responds that awarding compensation in violation of an approved compensation plan is not protected by the business judgment rule. (D.I. 22 at 38) (citing *Weiss v. Swanson*, 948 A.2d 433, 441-42 (Del. Ch. 2008); *Ryan v. Gifford*, 918 A.2d 341, 357-58 (Del. Ch. 2007); *Sanders v. Wang*, 1999 WL 1044880, *4-5 (Del. Ch. Nov. 8, 1999)).

10. Plaintiff's cited cases do not convince the Court of the blanket proposition that a shareholder need only allege violation of a compensation agreement to excuse demand, without additional allegations of knowledge and intent. *Weiss* specifically provides that "allegations in a

complaint rebut the business judgment rule where they support an inference that the directors intended to violate the terms of stockholder-approved option plans." 948 A.2d at 441. The *Ryan* Court, discussing the allegations before it and *Sanders*, stated that "[a] board's knowing and intentional decision to exceed the shareholders' grant of express (but limited) authority raises doubt regarding whether such decision is a valid exercise of business judgment and is sufficient to excuse a failure to make demand." 918 A.2d at 354. *Sanders* and *Ryan* were also explicitly fact-specific: in *Ryan*, the "unusual facts alleged" of "knowing and intentional violations" of the stock option plans raised reason to doubt that the challenged transactions resulted from a valid exercise of business judgment, while in *Sanders*, demand was excused "[f]or immediate purposes" because the plaintiff had pled violation of an "express," "unambiguous" provision where it was "clear from the uncontroverted facts" that the compensation award exceeded the provision. *Id; see Sanders,* 1999 WL 1044880 at *4-5.

10. Next, Plaintiff pled that demand is excused because "a majority of the Board violated United States public policy." (D.I. 15, ¶ 73). As with Plaintiff's LTPP violation pleading, Defendants argue that demand is not excused for Plaintiff's public policy complaint because Plaintiff does not allege a knowing violation. (D.I. 21 at 31). Plaintiff does not defend its one-sentence public policy allegation in opposing Defendants' motion. (D.I. 22). It appears that Plaintiff's once sentence fails to plead particularized facts under the second *Aronson* prong in any case.

11. Finally, Plaintiff pled that demand is excused because the claim of waste, based on the inability to take tax deductions under the LTPP and SIP, does not invoke the business judgment rule. (D.I. 15, ¶¶ 73-75; D.I. 22 at 37). Defendants argue that a waste claim still

requires pleading particularized facts to create a reasonable doubt that the board's decisions were the product of a valid exercise of business judgment to excuse demand. (D.I. 21 at 26-29 (citing *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006); *White v. Panic*, 783 A.2d 543, 554 n.36 (Del. 2001); D.I. 23 at 11-13). Indeed, the Delaware Supreme Court in *White* affirmed dismissal of a waste claim for failure to show demand was excused under *Aronson*'s second prong. 783 A.2d at 554-55. While Plaintiff's cited case, *Leung v. Schuler*, provides that demand is excused for a "cognizable claim of waste," it proceeded to dismiss a waste claim under Rule 23.1 for failing to state a claim that would excuse demand. 2000 WL 264328, *10 (Del. Ch. Feb. 29, 2000). *Leung* does not support Plaintiff's argument that demand is excused merely because a claim of waste is alleged.

12. Plaintiff has failed to allege particularized facts creating a reasonable doubt that (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. *See Aronson*, 473 A.2d at 814. Plaintiff does not plead particularized facts showing the directors were not interested in the proxy statement proposals underlying Plaintiff's claims. Plaintiff also did not allege any particularized facts creating doubt that the LTPP and SIP proxy proposals were not the product of a valid exercise of business judgment, and the business judgment rule is not rendered moot simply because Plaintiff alleged certain types of claims (*e.g.*, disclosure, a compensation decision, waste). Because Plaintiff has not demonstrated demand futility, the Court need not reach Defendants' other arguments about standing and ripeness under Rule 12(b)(1) and failure to state a claim under Rule 12(b)(6).

13. While Plaintiff does not request in her Brief that she be granted leave to amend, and

Defendants did request dismissal with prejudice, it seems to me the better course is to give Plaintiff the option to amend. If she does not do so within two weeks, the Clerk will be instructed to close the case.

Therefore, it is **ORDERED** that Plaintiff's claims are **DISMISSED WITHOUT PREJUDICE**. Plaintiff is **GRANTED LEAVE TO AMEND** the complaint no later than two weeks from this date. Should the Plaintiff not file an amended complaint by September 5, 2012, the Clerk is directed to close this case.

Entered this 21st day of August, 2012.

Richard G. Andrews
United States District Judge