IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

FRANK DAVID SEINFELD, Plaintiff, v. DONALD W. SLAGER, JAMES E. O'CONNOR, JOHN W. CROGHAN, TOD C. HOLMES, DAVID I. FOLEY, RAMON A. RODRIGUEZ, MICHAEL W. WICKHAM, JAMES W. CROWNOVER, NOLAN LEHMANN, ALLAN C. SORENSEN, WILLIAM J. FLYNN, W. LEE NUTTER, JOHN M. TRANI, MICHAEL LARSON, and REPUBLIC SERVICES, INC., Defendants.	C.A. No. 6462-VCG

OPENING BRIEF IN SUPPORT OF DEFENDANTS' MOTIONS TO DISMISS THE AMENDED DERIVATIVE COMPLAINT

Andre G. Bouchard (# 2504)
Sean M. Brennecke (#4686)
BOUCHARD MARGULES & FRIEDLANDER, P.A.
222 Delaware Avenue, Suite 1400
Wilmington, DE 19801
(302) 573-3510
(302) 573-3501 (fax)

Allen M. Terrell, Jr. (#709)
Daniel A. Dreisbach (#2583)
Susan Hannigan (#5342)
RICHARDS, LAYTON & FINGER, P.A.
One Rodney Square
920 North King Street
Wilmington, DE 19801
(302) 651-7500
(302) 651-7701 (fax)

Attorneys for the Individual Defendants

OF COUNSEL:

Michele Odorizzi
MAYER BROWN LLP
71 S. Wacker Drive
Chicago, IL 60606
(312) 782-0600
Attorneys for Republic Services, Inc.

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This memorandum is submitted by nominal defendant Republic Services, Inc. ("Republic" or the "Company") and the fourteen individual defendants (the "Individual Defendants") in support of (i) their motion to dismiss under Rule 23.1 for failure to properly plead demand futility and (ii) the Individual Defendants' motion to dismiss under Rule 12(b)(6) for failure to state a claim.

NATURE AND STAGE OF PROCEEDINGS

This is the second lawsuit that plaintiff Frank Seinfeld has brought against Republic and its officers and directors within the last two years. In *Seinfeld v. O'Connor*, No. 09-887-LPS (D. Del.), plaintiff accused the defendants of materially misleading Republic shareholders in its 2009 Proxy Statement with respect to the deductibility of payments made to "Covered Employees" under the Employee Incentive Plan ("EIP") that Republic's shareholders approved in 2009. The district court dismissed that complaint with prejudice on March 30, 2011, rejecting all of plaintiff's various arguments as to why the 2009 Proxy Statement was supposedly misleading. *See Seinfeld v. O'Connor*, 774 F.Supp.2d 660 (D. Del. 2011). Plaintiff chose not to appeal that decision. Instead, he filed this purported derivative action, bringing an entirely new series of equally meritless challenges to certain compensation decisions made by the Republic Board.[1]

[1] In ¶ 50 of his amended complaint, plaintiff alleges that the federal court "held" based on "substantially similar allegations" that he had raised "arguable theories of waste and unjust enrichment" in the pendent derivative count of his federal complaint. He then states that because the defendants were parties to the prior case "they are precluded from denying it." But the federal court never decided the merits of the derivative claim Seinfeld had asserted in the earlier action because it concluded that it lacked jurisdiction to consider those state law claims after the federal claims had been dismissed and therefore dismissed the state law claims without prejudice. 774 F.Supp.2d at 673, n.12; *see also* Am. Compl. ¶ 7 (acknowledging that Judge Stark dismissed plaintiff's state law claims for lack of federal jurisdiction). Accordingly, the only decision by the district court that is preclusive is the court's ruling that Seinfeld's claims challenging the disclosures in Republic's 2009 Proxy Statement were without merit.

In his amended complaint in this Court, plaintiff challenges four compensation decisions. ***First***, he argues that the Board committed waste by entering into a retirement agreement in June 2010 with the Company's then-CEO, Jim O'Connor, under which Mr. O'Connor agreed to retire effective January 1, 2011, and the Company agreed to make certain payments to Mr. O'Connor. Plaintiff does not complain about most of those payments, which were required by the terms of Mr. O'Connor's May 2009 employment agreement. He argues, however, that two payments, totaling $3.05 million, either are not tax deductible or are unsupported by consideration. Plaintiff contends that the Board committed waste by agreeing to make these two payments. Compl. ¶¶ 14-18.

Second, plaintiff challenges one aspect of Republic's overall executive compensation plan, arguing that the Board committed waste by the way in which it awarded restricted stock units to a handful of senior executives who he characterizes as "Covered Employees." As plaintiff acknowledges, the shareholder-approved 2007 Stock Incentive Plan (the "2007 Stock Plan") expressly authorized the Board to decide whether restricted stock or stock units awarded pursuant to that Plan should vest based on the achievement of preset performance goals or based on the passage of time. The Board chose to make time-vested awards to Covered Employees, which precluded the Company from taking a tax deduction for those particular awards. Plaintiff contends that the Board's decision to forego any deduction with respect to restricted stock awards to Covered Employees constituted waste. Am. Compl. ¶¶ 30-32, 37.[2]

Third, plaintiff asserts that the Board overpaid itself by awarding directors too many restricted stock units in 2009 and 2010. Plaintiff claims that the annual compensation of the

[2] Under the Plan, the Board's Compensation Committee, rather than the Board itself, was required to make this decision. *See* Ex. D hereto at A-3, § 3(h). Since plaintiff appears to allege that the decision was made by the Board, however, *see* Am. Compl. ¶ 34, defendants have treated it as a Board decision throughout this brief.

Republic directors "far exceeds" the compensation paid to directors of Republic's largest competitor, Waste Management, and contends that the payments therefore constitute waste. Am. Compl. ¶ 35. Because he claims that the compensation paid to directors was unreasonable, plaintiff also argues that it is not deductible under the Internal Revenue Code. *Id.*

Fourth, in a new claim added for the first time in his Amended Complaint, plaintiff contends that the Board may decide to improperly pay "synergy bonuses" to employees under the Company's Synergy Incentive Plan, which was approved by the shareholders at the 2009 meeting. The Synergy Plan was designed to create incentives for Republic's employees to maximize the cost savings resulting from Republic's December 2008 merger with Allied Waste Industries. Bonuses are payable under that plan if certain levels of cost improvements are achieved as a result of specific synergy initiatives. Plaintiff alleges that the earnings of the combined companies have not increased and that, under the Synergy Plan, no bonus should therefore be payable. Am. Compl. ¶ 40.

For the reasons outlined below, all of plaintiff's claims should be dismissed. All of the defendants seek dismissal of plaintiff's first, second and fourth claims because he did not make a demand on the Board and has not properly pleaded demand futility under Rule 23.1. Plaintiff does not allege that any Board members other than Mr. O'Connor were interested in either Mr. O'Connor's retirement agreement or the decisions the Board has made in the past or may make in the future with respect to awards under the 2007 Stock Plan or the Synergy Plan. Nor does he claim that any of the eleven outside directors on the Board were dominated or controlled by either Mr. O'Connor or any other employee. Thus, to properly plead demand futility under *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984), plaintiff bears the burden of alleging particularized facts that raise a reasonable doubt that the Board decisions he challenges were the product of a valid exercise of business judgment. As demonstrated below, plaintiff has not come close to meeting that very heavy burden.

The Individual Defendants also seek dismissal of all of plaintiff's claims, including his claim that the directors overpaid themselves, for failure to state a claim under Rule 12(b)(6). Plaintiff characterizes every compensation decision he disagrees with as waste. But he has failed to offer any conceivable basis for believing that he can meet the stringent standard for proving waste. This is not a situation where the facts alleged suggest that the exchanges were "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." *Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000). On the contrary, plaintiff has not pleaded ***any*** facts showing that the Board decisions he challenges fell outside the bounds of a valid business judgment.

STATEMENT OF FACTS

Republic is a Delaware corporation whose stock is traded on the New York Stock Exchange. Am. Compl. ¶ 5. In 2008, a Republic subsidiary merged with Allied Waste Industries to form one of the nation's largest non-hazardous waste hauling and disposal companies. *See Seinfeld*, 774 F.Supp.2d at 662. After the merger, in 2009 and 2010, Republic reported annual revenues of $8 billion. *See* Ex. A hereto (Republic's 2010 10-K) at 2.[3]

Republic is subject to section 162(m) of the Internal Revenue Code, which generally prohibits a public company from taking a deduction on its federal income tax return for any compensation in excess of $1 million that is paid to a handful of "Covered Employees,"

[3] In ruling on defendants' motions to dismiss, the Court can take judicial notice of the various publicly available documents that plaintiff himself relies upon, which are integral to his complaint, and other SEC documents that are offered to show what Republic has disclosed, but which are not being relied upon to prove the truth of their contents. *Robotti & Co., LLC v. Liddell*, 2010 WL 157474, at *5-6 (Del. Ch. Jan. 14, 2010).

including the CEO.[4] However, performance-based compensation is excluded from this prohibition. To fall within this exception, performance-based compensation paid to Covered Employees must be payable “solely” on account of the attainment of one or more performance goals established pursuant to a shareholder-approved incentive compensation plan. Compl. ¶ 9; 26 U.S.C. § 162(m)(4)(C).

Republic has two incentive compensation plans that apply to Covered Employees, as well as to directors and other employees who are not subject to section 162(m).[5] The first is the 2009 EIP, which Republic’s shareholders approved in 2009 and which was the subject of Seinfeld’s failed federal lawsuit. The EIP was intended to meet section 162(m)’s requirements for deductibility for three different types of cash incentive awards: (i) annual awards for meeting or exceeding annual targets, (ii) long-term awards for meeting or exceeding goals for a three-year period, and (iii) a one-time synergy bonus for meeting or exceeding goals for cost-savings resulting from the Allied merger. *Seinfeld*, 774 F.Supp.2d 660 at 662. Republic also has a stock incentive plan, which provides for the award of stock options and restricted stock grants. Under the stock plan (as described in greater detail below), the Board can choose performance-based or time-based vesting; awards of restricted stock to Covered Employees are not deductible under section 162(m) when the directors choose time-based vesting. Am. Compl. ¶ 30.

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4 Plaintiff alleges that defendants O’Connor, Slager, and Holmes are all “Covered Employees.” In fact, only Mr. Slager falls into that category. Mr. Holmes has never been a Covered Employee because he is the Chief Financial Officer. *See infra* at 33-34. Mr. O’Connor was a Covered Employee in 2010 and earlier tax years because he was the CEO, but he is not a Covered Employee for the 2011 tax year because he retired before year-end. *See infra* at 17.

5 The compensation paid to non-Covered Employees is deductible regardless of whether the EIP complies with section 162(m), so long as it meets the basic requirement of reasonableness established by section 162(a)(1) of the Internal Revenue Code.

Mr. O'Connor's Retirement Agreement

Jim O'Connor was Republic's Chairman and CEO for nearly a decade before the merger and continued in that role following the merger. Am. Compl. ¶ 25. He entered into a new employment agreement with the Company in May 2009 (the "2009 Employment Agreement"). Am. Compl. ¶ 26. Under that Agreement (attached hereto as Ex. B), Mr. O'Connor had the option to retire at any time, so long as he gave the Company twelve months' advance notice; the Board had the right to terminate him without cause at any time. *See* Ex. B, §§ 1(b), 3(c), 25. In either case, the 2009 Employment Agreement gave him the right to a series of payments when he retired, including payments with respect to "open" awards under the EIP —– that is, awards that had not been fully earned because the performance period had not yet expired. *See* Ex. B at 20, § 25. For award periods beginning on or before January 1, 2009, Mr. O'Connor was entitled to receive the full target amount that was authorized under the EIP.[6] For award periods beginning after January 1, 2009, he was entitled only to a pro rata share of the award (if any) that he would have received had he still been employed as CEO at the end of the performance period. *Id.*

On or about June 25, 2010, the Republic Board entered into a Retirement Agreement with Mr. O'Connor under which Mr. O'Connor agreed to retire as CEO on January 1, 2011, to continue serving as Chairman of the Board until May 2011, and to relinquish his seat as a director at the May 2011 shareholders meeting. Compl. ¶ 13, Ex. C hereto. The Retirement Agreement recites that "[t]o make sure that your retirement occurs on mutually acceptable terms, the Company is prepared to make certain commitments to you in exchange for certain promises

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[6] Under the EIP, certain amounts are paid if the Company achieves a pre-set target; larger bonuses are paid if the target is exceeded by a certain percentage, up to a maximum bonus amount. Am. Compl. ¶ 16. Paying "at target" gives the retiring employee the full amount of the bonus he would have received had he been in the Company's employ for the full length of the performance period and had the Company met (but not exceeded) the target in question.

you will make to the Company." Ex. C at 1. Among other things, the Company agreed to make all of the payments that were required by Mr. O'Connor's 2009 Employment Agreement in the event of his retirement. The Retirement Agreement provides (as the 2009 Employment Agreement did) that the Company will pay Mr. O'Connor the full amount of his target long-term incentive award for 2009-2011 ($1.25 million). *Id*. at 2; Am. Compl. ¶¶ 20-21. The Retirement Agreement also provides for an additional payment of $1.8 million that is not required by Mr. O'Connor's 2009 Employment Agreement. Am. Compl. ¶ 27. This payment is described as being made "to reward you for your long service to the Company." *Id*.

In his original complaint, plaintiff alleged that paying Mr. O'Connor at target for his 2009-2011 long-term incentive award violated both the EIP and a 2008 IRS Revenue Ruling, Revenue Ruling 2008-13, 2008 WL 451876 (IRS Feb. 21, 2008). Plaintiff claimed that under the EIP and the Revenue Ruling all payments to retirees had to be prorated based on the amount the employee would have received had he or she remained in the Company's employ for the full performance period; because the $1.25 million payment was inconsistent with plaintiff's reading of the EIP and the 2008 Revenue Ruling, plaintiff alleged that the payment itself was not tax deductible and that the mere existence of the retirement provision in question rendered ***all*** payments made to Covered Employees under the EIP non-deductible. Compl. ¶¶ 13-15.

In defendants' motion to dismiss the complaint, we pointed out that Mr. O'Connor's employment agreement did not violate the terms of the EIP because the EIP specifically provides in § 5.3 that its provisions with respect to payments upon retirement are trumped by inconsistent provisions in an employment agreement. Moreover, the very IRS Revenue Ruling that plaintiff cited in his original complaint provides for transition rules under which companies were specifically allowed (as Republic did) to provide for payments at target on retirement for performance periods beginning on or before January 1, 2009, without risking the loss of any deductions.

In his amended complaint, plaintiff does not disagree with this analysis and, in fact, affirmatively alleges that Mr. O'Connor's employment agreement did ***not*** violate the EIP and also comported with the transition rules set forth in Revenue Ruling 2008-13. Am. Compl. ¶¶ 14-22. Nevertheless, plaintiff still challenges the $1.25 million payment, on the theory that the IRS exceeded its authority in promulgating the transition rules, rendering those rules void, and that the $1.25 million payment and all payments made to Covered Employees under the EIP therefore should be deemed non-deductible. Am. Compl. ¶¶ 18, 22. Based on this logic, plaintiff contends that the directors committed waste by relying on the Revenue Ruling to structure Mr. O'Connor's contract as they did. Am. Compl. ¶ 23.

Plaintiff also challenges the additional $1.8 million payment provided for in Mr. O'Connor's Retirement Agreement on the theory that there was no consideration for this payment and therefore it constitutes a gift or waste. Compl. ¶ 28.

The 2007 Stock Plan

Under section (b) of the 2007 Stock Plan, the directors can choose to have restricted stock and stock units vest after the passage of time, or on the attainment of pre-set performance goals. Am. Compl. ¶ 30; 2007 Stock Plan, attached hereto as Ex. D. Awards under the Plan to Covered Employees are tax deductible under section 162(m) only if the vesting provisions are performance-based. Am. Compl. ¶ 30. According to the Company's disclosures, the grants to Covered Employees have all been time-based and therefore none are deductible. *Id*. As the Company explained in its 2010 Proxy Statement:

> We do not have a policy that requires all of our compensation to be deductible for purposes of Section 162(m). . . . The options we grant to our executive officers are

> intended to qualify as performance-based compensation that is not subject to deduction limits. The restricted stock and restricted stock units we grant to our executive officers do not so qualify because they vest over time rather than based on performance. Payments under the Executive Incentive Plan approved by stockholders at the May 2009 Annual Meeting, including annual, long-term and synergy payments, are intended to qualify as performance-based compensation that complies with Section 162(m).

See Ex. E hereto at 33.[7]

Plaintiff asserts that it is "highly unusual" for all grants of restricted stock and stock units to be time-based. Am. Compl. ¶ 32. In support, he cites three other "peer group" companies that he claims award all or a large portion of their stock compensation based on performance, rather than longevity. *Id.* Plaintiff contends that the Board's decision to choose time-based vesting constituted waste because, as a result of that decision, the Company "has faced and will continue to face substantial and avoidable income tax liabilities." Am. Compl. ¶ 36.

Director Compensation

Plaintiff's third claim is that the directors overpaid themselves. He alleges that in 2009 the Board awarded each of the directors $743,700 in restricted stock units, which raised their compensation for 2009 to between $843,000 and $891,000. Am. Compl. ¶ 35. As the 2010 Proxy Statement explained (Ex. E at 17), the Company annually grants each non-employee director 7500 restricted stock units that vest immediately, but are not "settled" until the director leaves the Board, at which time they are settled through the issuance of common stock. In addition, effective January 1, 2009, the directors were given a one-time grant of 22,500 restricted stock units, which vested over three years, and which will also not be settled until each director leaves

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[7] As the disclosure notes, stock options granted pursuant to the Plan are tax deductible. Treasury regulations provide that stock options granted based on the fair market value of the stock are deemed performance-based, even if they vest over time. *See* 26 C.F.R. § 1.162-27(e)(2)(A). The 2007 Stock Plan meets this requirement because it provides that the exercise price of all stock options may not be less than the fair market value of the stock at the grant date. *See* Ex. D, at A-9, § 7(c).

the Board. Director compensation appears to have spiked in 2009 because under SEC reporting requirements Republic was required to report the full value of that one-time grant in 2009.

In 2010, the Board awarded each director 7500 restricted stock units, valued at $215,000, which brought their reported compensation for 2010 to between $320,000 and $345,000 each. Am. Compl. ¶ 35. Plaintiff cites the compensation paid to Waste Management's directors in 2010 in comparison, claiming that they received $205,000 to $240,000, except for the non-executive chairman, who was paid $422,000. *Id*. Based on this comparison, plaintiff alleges that the Republic Board paid itself excess compensation, which constitutes waste and results in unjust enrichment, and which is also supposedly non-deductible under section 162(a)(1) of the Internal Revenue Code because it is unreasonable. *Id*.

Payments Under The Synergy Plan

Plaintiff's final claim, added for the first time in his amended complaint, is that the Company is improperly interpreting the Synergy Plan, leading to the risk that the directors may choose in the future to make payments under that Plan that are unauthorized. As noted above, the Synergy Plan was designed to incentivize Republic's employees to take full advantage of the opportunities for cost improvements created by the Allied merger. A one-time synergy-bonus is payable if Republic realizes cost improvements totaling between $100 million and $150 million annually. Am. Compl. ¶ 38.[8] The measuring period for determining whether those cost improvements have been achieved is calendar year 2011; the Compensation Committee of the Board will then decide whether the target has been achieved. *See* 2009 Proxy Statement (Ex. F) at 49; Synergy Plan (Ex. G) at B-2. The Committee has "negative discretion" and therefore can

[8] The target is $150 million in annual savings. At that level, the Compensation Committee could choose to pay to officers and other employees the maximum amount of the synergy bonus, which would total $69 million. If the synergies achieved were $100 million, the Compensation Committee could pay up to 25% of the maximum bonuses. Am. Compl. ¶ 38.

decrease (but not increase) the award even if the target is met. If the Committee awards bonuses, they will be paid at some point between January 1, 2012 and March 31, 2012. *Id*. at B-3 (Section VII-A).

Plaintiff alleges that the Company has announced its achievement of $190 million in synergies and that it has accrued liabilities totaling $68.1 million under the Synergy Plan in anticipation of a payment of synergy bonuses in the first quarter of 2012. Am. Compl. ¶ 39. Plaintiff contends that this payment would be improper because the goal of the Synergy Plan was supposedly "measurable earnings improvement"; plaintiff contends that there has been no improvement at all in Republic's earnings because Republic's total net earnings in each of 2009 and 2010 were less than the combined earnings of Allied and Republic in 2007. Am. Compl. ¶¶ 38, 40. In fact, however, the Synergy Plan makes clear that the $150 million target has nothing to do with the Company's total earnings. Rather, that target is defined in terms of cost improvements from particular synergy initiatives, which will be "measured based upon the incremental and ongoing impact to EBIT attributable to the combination of Republic and Allied." Synergy Plan at B-1; *see also* 2009 Proxy Statement (Ex. F hereto) at 49.

Allegations Regarding Demand Futility

Until June 2010, the Republic Board consisted of the Chairman and CEO (Mr. O'Connor) and eleven outside directors. Am. Compl. ¶ 3. In June 2010, when Mr. O'Connor's retirement was announced, his successor, defendant Donald W. Slager, was added to the Board as the thirteenth director. This was the composition of the Board at the time plaintiff filed this lawsuit, on May 9, 2011. *Id.*[9]

[9] At the 2011 Annual Meeting, held three days after the complaint was filed, the Board was reduced to eleven directors after Mr. O'Connor and defendant David Foley did not stand for re-election. *See* Republic's 2011 Proxy Statement, Ex. H hereto, at 5.

Plaintiff does not allege that any of the eleven non-management directors who were on the Board when Mr. O'Connor's Retirement Agreement was negotiated had any personal interests that would have interfered with their ability to make a proper business judgment in negotiating Mr. O'Connor's Retirement Agreement. Nor does he allege that Mr. O'Connor dominated or controlled any of those individuals. Similarly, plaintiff does not contend that the outside directors have any conflicting personal interests that affected their business judgment or impaired their independence in deciding how restricted stock units should be awarded to employees or in making decisions under the Synergy Plan. Indeed, in contrast to most derivative complaints, Seinfeld offers no information at all about the non-management directors other than their names. *See* Am. Compl. ¶¶ 2-4.

Rather than challenging the outside directors' ***ability*** to make a proper business judgment, plaintiff alleges demand futility with respect to Mr. O'Connor's retirement agreement, vesting of restricted stock units, and awards under the Synergy Plan on the theory that the directors in fact failed to make proper business judgments.[10] *See* Am. Compl. ¶¶ 45, 47, 48. As demonstrated below, plaintiff has not come close to pleading the kind of particularized facts necessary to demonstrate that a demand would be futile under such a theory.

ARGUMENT

I. Plaintiff Has Failed To Properly Plead Demand Futility With Respect To Three Of His Claims.

The requirement that shareholders make a demand before bringing a lawsuit in the name of the Company "is a recognition of the fundamental precept that directors manage the business

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10 Plaintiff's third claim challenges the directors' decisions with respect to the amount of their own compensation. Plaintiff contends that demand would be futile with respect to this claim because the directors all have a personal interest in their own compensation. Am. Compl. ¶ 43. However, defendants do not seek dismissal of that claim under Rule 23.1.

and affairs of corporations" — including their litigation decisions. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del.1984). Demand is deemed futile and therefore excused only if a majority of the directors at the time the lawsuit was brought had such a personal stake in the proposed litigation that they would have been unable to make a proper business judgment in response to a shareholder demand. *Id.* at 814.

In addressing allegations of demand futility, the critical question is ***not*** whether the directors are likely to agree to the shareholder's demand to file a lawsuit. As the Delaware Supreme Court explained in *Heineman v. Datapoint Corp.*, 611 A.2d 950, 952 (Del. 1992):

> In this context, futility does not mean that there is no likelihood that a board will agree to the demand. Rather, demand is futile where a reasonable doubt exists that the board has the ability to exercise its managerial power, in relation to the decision to prosecute, within the strictures of its fiduciary obligations.

If a majority of the Board is sufficiently independent to make a proper business judgment, then the fact that there may be reasons why the Board might not be willing to authorize the filing of a lawsuit is wholly irrelevant to the demand futility analysis.

Delaware Chancery Court Rule 23.1 requires a plaintiff in a derivative case to allege "with particularity" the "efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors [or] the reasons for the plaintiff's failure to obtain the action or for not making the effort." The requirement that demand futility be pled with particularity is designed to ensure that a derivative action is not allowed to proceed unless there is a reasonable factual basis for questioning the directors' ability to make an independent judgment as to whether litigation is in the best interests of the corporation.[11] *See Brehm v. Eisner*, 746 A.2d at 255, 266 (the

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[11] The fact that plaintiff has sued all of the current directors does not, of course, impair their ability to make a disinterested business judgment in response to a demand. The "mere threat of personal liability" from a shareholder derivative action "is insufficient to challenge either the independence or disinterestedness of the directors." *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993). *See also Gagliardi v. Trifoods Int'l, Inc.*, 683 A.2d 1049, 1055 (Del. Ch. 1996) (demand

particularity requirement prevents a stockholder from "caus[ing] the corporation to expend money and resources in discovery and trial in the stockholder's quixotic pursuit of a purported corporate claim based solely on conclusions, opinions or speculation").

Because plaintiff challenges affirmative decisions made by the Board, the familiar two-part test articulated in *Aronson v. Lewis* applies to his assertion that a demand on the Board was excused because it would have been futile. Under *Aronson*, "plaintiffs must plead particularized facts that raise a reasonable doubt either (i) that a majority of the directors who approved the transaction in question were disinterested and independent, or (ii) that the transaction was the product of the board's good faith, informed business judgment." *In re Dow Chem. Co. Deriv. Litig.*, 2010 WL 66769, at *7 (Del. Ch. Jan. 11, 2010).

Plaintiff contends that he meets the second prong of *Aronson* because the directors' decisions with respect to Mr. O'Connor's retirement, the vesting of restricted stock grants to employees, and awards under the Synergy Plan were all so egregious that they could not have been the product of a good faith business judgment. In evaluating this kind of claim, the Court "does not assume that the [challenged] transaction is a wrong to the corporation requiring corrective steps by the board." *Aronson*, 473 A.2d at 814. Instead, the Court must begin with the presumption that "in making a business decision the directors . . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Id*. at 812. To overcome that presumption and carry his "heavy burden" of satisfying the second *Aronson* prong, *id.* at 814, plaintiff must allege particularized facts showing that there is reason to doubt that the directors' actions were taken "honestly and in good faith" or "reason to doubt

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futility cannot be established by "the simple expedient of naming a majority of otherwise disinterested and well motivated directors as defendants and charging them with laxity or conspiracy etc.").

that the board was adequately informed in making the decision." *In re Dow Chem. Co.,* 2010 WL 66769, at *9.

In this case, plaintiff does not challenge the process by which the Board made its decisions. Thus, for example, he does not claim that the Board failed to properly inform itself before it made the decisions he challenges. Instead, his challenge is to the ***substance*** of those decisions, claiming that they were so irrational that they constituted waste. As Vice Chancellor Parsons observed in *Kates v. Beard Research, Inc.,* 2010 Del. Ch. LEXIS 74, at *15 (Del. Ch. Apr. 23, 2010), "Delaware courts have described the standard for corporate waste as onerous, stringent, extremely high, and very rarely satisfied." "[T]o excuse demand on grounds of waste the Complaint must allege particularized facts that lead to a reasonable inference that the director defendants authorized 'an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.'" *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 136 (Del. Ch. 2009) (quoting *Brehm*, 746 A.2d at 263). "To prevail on a waste claim . . . the plaintiff must overcome the general presumption of good faith by showing the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests." *Id.* (quoting *White v. Panic*, 783 A.2d 543, 554 n.36 (Del. 2001)). Thus, "[a] claim of waste will be sustained only in the rare, 'unconscionable case where directors irrationally squander or give away corporate assets.'" *Kates,* 2010 Del. Ch. LEXIS 74, at *15-16.[12]

For the reasons outlined below, plaintiff has not come close to meeting his burden of pleading particularized facts showing waste with respect to Mr. O'Connor's Retirement

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[12] As the Delaware Supreme Court explained in *In re Walt Disney Co. Deriv. Litig.,* 906 A.2d 27, 74 (Del. 2006), the "onerous standard for waste is a corollary of the proposition that where business judgment presumptions are applicable, the board's decision will be upheld unless it cannot be 'attributed to any rational business purpose.'"

Agreement, the directors' implementation of the 2007 Stock Plan with respect to Covered Employees, or awards under the Synergy Plan. *See Jacobs v. Yang*, 2004 WL 1728521, at *2 (Del. Ch. Aug. 2, 2004) ("Demand futility analysis is conducted on a claim-by-claim basis") (internal quotations omitted).

A. Plaintiff Has Not Pleaded Particularized Facts Showing That The Two Retirement Payments He Challenges Constituted Waste.

In *Brehm v. Eisner*, the Delaware Supreme Court explained that "[i]t is the essence of business judgment for a board to determine if a particular individual warrants large amounts of money, whether in the form of current salary or severance provisions." 746 A.2d at 263 (internal quotations omitted). Although the Court acknowledged that there are "outer limits" beyond which a compensation or severance package may constitute waste, "they are confined to unconscionable cases where directors irrationally squander or give away corporate assets." *Id*. In *Brehm*, the Court held that the plaintiffs had failed to meet their burden of pleading demand futility against the Disney Board based on a theory of waste. The Court reached that conclusion despite the "exceedingly lucrative, if not luxurious" nature of the $140 million severance package the Board had agreed to pay to Michael Ovitz, after his short and unsuccessful tenure as Disney's CEO. *Id*. at 249.

In this case, plaintiff does not challenge the entire package of benefits that the Board agreed to pay Mr. O'Connor on his retirement. Instead, he picks out only two elements of that package — the payment of Mr. O'Connor's long-term award for 2009-2011 at target and the additional $1.8 million payment. Plaintiff has not carried his burden of pleading particularized facts that raise a reasonable doubt that either payment was the product of a valid business judgment.

1. Plaintiff Has Not Raised A Reasonable Doubt Whether The Board's Agreement To Pay Mr. O'Connor His 2009-2011 Award At Target Upon His Retirement Was A Valid Business Judgment.

Plaintiff argues first that the Board committed waste by resolving Mr. O'Connor's "open" award under the 2009-2011 long-term incentive plan (the "LTIP") by agreeing to pay him at target ($1.25 million). Plaintiff contends that the Board should have insisted instead that Mr. O'Connor be paid two-thirds of whatever his award would have been had he remained as CEO through the end of 2011. Am. Compl. ¶¶ 14, 21. Plaintiff does not claim that it was excessive to pay Mr. O'Connor the full amount of his award, at target. Instead, he claims that the Board's agreement to pay the award at target constitutes waste because it supposedly failed to comply with the requirements for deductibility under section 162(m) and thus "renders the entire EIP non-tax deductible." Am. Compl. ¶ 23.

This argument fails as a matter of law. Contrary to plaintiff's allegations, the $1.25 million payment made in 2011 to Republic's retired CEO is fully deductible. Under section 162(m)(3), the company's CEO is deemed a "Covered Employee" in any tax year only if he or she still held that position "as of the close of the taxable year." 26 U.S.C. § 162(m)(3); *see also* 26 CFR § 1.162-27(c)(2) (to be a "Covered Employee," an executive must hold the position in question "on the last day of the taxable year"). Mr. O'Connor retired effective January 1, 2011, and his 2009-2011 LTIP award was paid to him in 2011. *See* Am. Compl. ¶¶ 8, 21; Ex. C at 2. Since Mr. O'Connor will not qualify as a Covered Employee "as of the close of" 2011, that $1.25 million payment need not comply with section 162(m) in order to be deductible on Republic's 2011 federal income tax return.[13]

[13] There are a number of Private Letter Rulings in which the IRS advised that section 162(m)'s deductibility limit did not apply to payments made after an executive retired because he was not a "Covered Employee" on the last day of the tax year in question. *See* Private Letter

Furthermore, under the 2008 Revenue Ruling that plaintiff relies upon, the fact that Mr. O'Connor's 2009-2011 LTIP payment was made at target will not have any impact on the deductibility of ***other*** payments made to Covered Employees under the EIP. The applicable Treasury Regulations provide that, in order to qualify as "performance-based" compensation, all incentive payments must be payable "solely" on account of the attainment of pre-set performance goals. *See* 26 CFR 1.162-27(e)(2)(C)(5). The question the 2008 Revenue Ruling addressed was whether an award meets that standard if the plan or an employment agreement provides that the award would be paid in full, at target, in the event of an employee's retirement.

The Treasury Regulations do not directly answer this question.[14] In private letter rulings issued in 1999 and 2005, the IRS stated its view that the mere fact that the company had agreed to pay a particular award in full to a "Covered Employee" at retirement did ***not*** mean that such an award lost its character as "qualified performance-based" compensation. *See* Private Letter Ruling 199949014, 1999 PLR LEXIS 1393 (Sept. 9, 1999); Private Letter Ruling 200613012, 2005 PLR LEXIS 1679 (Dec. 5, 2005). On January 25, 2008 however, the IRS released another letter ruling that took the opposite view. *See* Private Letter Ruling 200804004, 2007 PLR LEXIS 2296 (Sept. 21, 2007). In Revenue Ruling 2008-13, the IRS resolved the confusion created by these conflicting private letter rulings by overruling the position it had taken in 1999 and 2005 and holding that the fact that an award would be fully paid on retirement meant that the award in

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Ruling 200836010, 2008 PLR LEXIS 1505 (May 30, 2008); Private Letter Ruling 200547006, 2005 PLR LEXIS 1051 (Aug. 17, 2005); Private Letter Ruling 200042016, 2000 PLR LEXIS 1362 (July 20, 2000); Private Letter Ruling 200039028, 2000 PLR LEXIS 1257 (June 29, 2000); Private Letter Ruling 200019010, 2000 PLR LEXIS 357 (Feb. 8, 2000); Private Letter Ruling 199910011, 1998 PLR LEXIS 2233 (Dec. 4, 1998).

[14] The regulations do address similar circumstances, declaring that "[c]ompensation does not fail to be qualified performance-based compensation merely because the plan allows compensation to be payable upon death, disability, or change in ownership or control." 26 CFR 1.162-27(e)(2)(C)(5). But they are silent as to the effect of a provision allowing full payment on retirement.

question could not be deemed "payable" "solely" on account of the attainment of the performance goal. 2008 WL 451876. As a result, whether or not the employee in question retired, the award would not qualify as a "performance-based award" for purposes of section 162(m).

Because Revenue Ruling 2008-13 represented a drastic change in the IRS' position, the Service provided for transition rules to give companies time to adjust their compensation plans if they chose to do so. The IRS stated that its new position would be applied prospectively only and "will not be applied to disallow a deduction for any compensation that otherwise satisfies the requirements for qualified performance-based compensation" if (among other things) "the performance period for such compensation begins on or before January 1, 2009." 2008 WL 451876. Mr. O'Connor's 2009 Employment Agreement carefully tracked the provisions of Revenue Ruling 2008-13: for performance periods that began on or before January 1, 2009, the Agreement provided that he would be paid the full amount of his potential bonus, at target. For subsequent periods, it provided (as Revenue Ruling 2008-13 requires) that he would receive only his pro rata share of what he would have been paid had the performance goal in question been attained. *See* Ex. B at 20, § 25.

In his amended complaint, plaintiff now acknowledges that Mr. O'Connor's employment and retirement agreements comported with the transition rules announced in Revenue Ruling 2008-13. Am. Compl. ¶¶ 18, 20. He argues, however, that the IRS exceeded its statutory power to "prescribe the extent, if any, to which any ruling . . . shall be applied without retroactive effect." Am. Compl. ¶ 18. Plaintiff concedes that the IRS had the power to provide that its 2008 ruling would not apply to agreements that were already in effect at the time the ruling was issued; but he argues that IRS exceeded its authority by allowing companies to enter into ***new*** agreements after the Ruling was issued providing for payment in full at retirement so long as the performance period began on or before January 1, 2009. *Id.* Plaintiff labels that aspect of the 2008 Ruling "ineffective" and "void" and claims that the directors committed waste by relying on it. *Id*.

Plaintiff's theory is odd, to say the least. Plaintiff does not contend that the IRS has rescinded its guidance or that it has disallowed deductions that were based on the transition rules. Thus, even if he were right in his analysis of the scope of the IRS's authority, his point would be entirely academic. Given the IRS' position, Republic had every right to claim deductions for payments made to Mr. O'Connor under the EIP, and there is no reason to believe those deductions will be disallowed. Thus, plaintiff has offered no basis whatsoever for his assertion that the Board's decision to pay Mr. O'Connor, in accordance with the terms of his employment agreement, at target will somehow affect the deductibility of either the $1.25 million payment or any other payment made to Mr. O'Connor or other Covered Employees under the EIP.[15]

More importantly, for purposes of the demand futility analysis, plaintiff's musings about the limits of the IRS's power to promulgate transition rules cannot possibly sustain a claim that the Board acted so irrationally that it should be deemed to have committed waste. *See Brehm*,

[15] Even absent the transition rules, plaintiff's hyperbolic assertion (in ¶ 23) that having one award to one Covered Employee payable in full at retirement "renders the entire EIP non-tax deductible" is simply wrong. The Treasury Regulations provide that the determination of whether an award "satisfies the [performance goal] requirement of this paragraph (e)(2) generally shall be made on a grant-by-grant basis. . . . without regard to the terms of any other option grant, or other grant of compensation, to the same or another employee." 26 CFR § 1.162-27(e)(2)(C)(4). Here, the retirement provision that plaintiff challenges was limited to Mr. O'Connor's 2009-2011 LTIP award. Thus, even if plaintiff were right (which he is not), only the 2009-2011 LTIP award to Mr. O'Connor would have lost its status as a qualified performance-based award. Ironically, for the reasons outlined above at 17, a determination that Mr. O'Connor's 2009-2011 LTIP award was not performance-based would have affected the deductibility of that award only if he had ***not*** retired and had remained a "Covered Employee" at the close of the 2012 tax year, which is the year in which the award was scheduled to have been paid absent his retirement.

746 A.2d at 266 (plaintiff cannot claim demand futility based on a disagreement with the substance of the Board's judgment on a legal question; "[t]o rule otherwise would invite courts to become super-directors, measuring matters of degree in business decisionmaking and executive compensation"). On the contrary, the very fact that the Board carefully followed the guidance provided by the IRS in negotiating Mr. O'Connor's contracts demonstrates that the Board reasonably attempted to preserve tax deductions for the Company.[16]

Plaintiff also complains that "the language concerning the payment to O'Connor of the 'full target amount' in the 2009 employment contracts was hidden" when Republic sought shareholder approval of its 2009 EIP. Am. Compl. ¶ 24. That is demonstrably untrue. The 2009 Proxy Statement specifically disclosed that, under his February 2009 employment agreement, in the event of retirement, Mr. O'Connor would receive "[f]or all award periods under the annual and long-term cash incentive plans that began on or before January 1, 2009, payments of amounts executive would have received had he remained employed by the company during such periods, as if all performance goals had been met at 100% of target." *See* Ex. F at 36. In any event, the final judgment in the federal *Seinfeld* case precludes plaintiff from bringing any further claims in this or any other court based on alleged material misstatements or omissions in the 2009 Proxy Statement. *See LaPoint v. AmerisourceBergen Corp.*, 970 A.2d 185, 191-92 (Del. 2009) (Delaware applies a "transactional approach" to *res judicata* under which "[t]he procedural bar of *res judicata* extends to all issues which might have been raised and decided in

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16 For the reasons outlined in Part I-B below, a waste claim cannot be predicated on the fact that the Board chose to pay compensation that was not deductible. It necessarily follows that a waste claim also cannot be predicated on the accusation the Board failed to take whatever steps were supposedly necessary to make the deductibility of a payment absolutely bulletproof.

the first suit as well as to all issues that were actually decided") (internal quotations omitted).[17]

2. Plaintiff Has Not Raised A Reasonable Doubt Whether The Board's Agreement To Pay Mr. O'Connor $1.8 Million After He Retired Was A Valid Business Judgment.

The second payment that plaintiff challenges is the $1.8 million the Company promised to pay Mr. O'Connor in the second half of 2011. Plaintiff alleges that Mr. O'Connor was compensated for his work during his years as CEO and notes that his 2009 Employment Agreement entitled him to $10 million in retirement/severance payments in addition to other benefits. Am. Compl. ¶¶ 25-26. He alleges that the additional $1.8 million that was added by the Retirement Agreement is unsupported by any consideration. Am. Compl. ¶ 28. And because there is "nothing in the expressed purpose of this payment to show that i[t] was based on an implied contract or that the amount is not unreasonable in view of the services rendered," plaintiff contends that the payment constitutes waste. Am Compl. ¶ 27.

Plaintiff's claim that the $1.8 million payment is unsupported by any consideration is refuted by the Retirement Agreement itself. Under the terms of his 2009 Employment Agreement, Mr. O'Connor controlled his retirement date. Although the Board could have

[17] Plaintiff accuses defendants of misleading the federal court, arguing that defendants should have "disclose[d] the 'full target amount' payment" provision found in Mr. O'Connor's employment and retirement agreements in their reply brief in support of their motion to dismiss. Am. Compl. ¶ 24. Defendants did nothing wrong by not discussing this provision since it was not relevant to any issue before the court. Plaintiff challenged only the retirement provision that appears in § 5.2 of the EIP, arguing that it failed to pass muster under section 162(m). Defendants had no obligation to suggest that, rather than pursuing their meritless claims involving the EIP's retirement provisions, plaintiff should make an equally meritless challenge to some of the retirement provisions in Mr. O'Connor's agreements — provisions that precisely tracked the transition rules laid out in Revenue Ruling 2008-13. In any event, if plaintiff was not aware of the provision he now challenges during the federal litigation, he has only himself to blame, since the "full target amount provision" was disclosed long before he filed his federal case, in the 2009 Proxy Statement (*see supra* at 21) and in Republic's Quarterly Report on Form 10-Q for the period ended March 31, 2009 (filed on May 11, 2009), which included Mr. O'Connor's May 2009 employment agreement as Ex. 10.5. *See* Ex. B hereto.

terminated him at any time without cause, an immediate termination would hardly have lent itself to a smooth leadership transition or been viewed favorably by the investment community. Under the Retirement Agreement, Mr. O'Connor agreed to set a retirement date six months in the future and to remain on the board as Chairman until the May 2011 Annual Meeting. As the preamble to the Retirement Agreement recites, in exchange for that and other promises by Mr. O'Connor, which ensured that Mr. O'Connor's retirement would be on "mutually acceptable" terms, the Company agreed to waive the 12-month notice requirement that would ordinarily apply to a retirement, to make all the payments Mr. O'Connor was already entitled to on retirement under his 2009 Employment Agreement, and to pay him an additional $1.8 million in cash in the second half of 2011, after his service as CEO and Chairman had ended.

Plaintiff may disagree with the Board's decision to pay Mr. O'Connor an additional $1.8 million to secure a smooth transition in the leadership of an $8 billion a year business. But the bargain the Board made is hardly "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." *Brehm*, 746 A.2d at 263. That alone is enough to warrant dismissal of plaintiff's waste claim with respect to the additional $1.8 million payment. *See Aronson*, 473 A.2d at 817 (holding that plaintiffs failed to properly allege demand futility based on waste where the board had entered into an employment/consulting agreement with a 75 year-old shareholder and director, under which he was entitled to substantial payments for life regardless of his ability to perform any services).[18]

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[18] We recognize that in the *Citigroup* case the court denied a Rule 23.1 motion to dismiss a waste claim arising out of severance payments made to Citigroup's outgoing CEO. *See* 964 A.2d at 138. But the allegations there were very different from the allegations in this case. In *Citigroup*, the CEO was allegedly responsible for the billions of dollars in subprime losses that Citigroup suffered but nevertheless was paid $68 million when he left the company. All Citigroup received in return was an agreement not to compete with or disparage it and a release. The court found that the plaintiffs had met their burden of pleading waste because the

Another reason for rejecting plaintiff's assertion that the $1.8 million payment constituted waste is that retroactive compensation is permissible even without any new consideration when "the amount awarded is not unreasonable in view of the services rendered." *Blish v. Thompson Automatic Arms Corp.*, 64 A.2d 581, 589 (Del. 1948); *Zupnick v. Goizueta*, 698 A.2d 384, 388 (Del. Ch. 1997). Here, plaintiff alleges that there is nothing in the Retirement Agreement that suggests that this standard was met. But that has the pleading burdens upside down. It is plaintiff who is challenging a decision made by a disinterested and independent Board with respect to a compensation matter, in which the Board has extremely broad discretion. Accordingly, to carry his burden of pleading demand futility, plaintiff would have to affirmatively allege particularized facts showing that (i) there was no consideration for the payment ***and*** (ii) that $1.8 million is an unreasonable amount in view of the past services Mr. O'Connor rendered to the Company. Plaintiff has not even attempted to meet that burden.

B. Plaintiff Has Not Pleaded Particularized Facts Showing That The Award Of Time-Based Restricted Stock Units To Covered Employees Constituted Waste.

As plaintiff himself alleges, the 2007 Stock Plan specifically permits the Board to award restricted stock or stock units to Covered Employees that vest over time rather than based on the achievement of performance goals — even though awards that vest over time are not tax deductible under section 162(m). Am. Compl. ¶ 30. Plaintiff nevertheless argues that the Board had a duty to make some unidentified percentage of the awards to Covered Employees under the

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discrepancy between the amount paid and the consideration received appeared to be so vast that there was a reasonable doubt whether it was beyond the "outer limit" described by the Supreme Court in *Brehm*. The court noted that it could not determine how much additional compensation the CEO had received as a result of the retirement agreement (over and above whatever severance he was entitled to under an employment agreement) or what the value of his promises about his post-employment conduct was. *Id.* Here, by contrast, plaintiff acknowledges that the amount of additional compensation was fixed at $1.8 million and the Retirement Agreement itself makes clear that the Company did receive consideration in return for that payment.

Plan performance-based and hence deductible. According to plaintiff, the Board's failure to structure its incentive program in a way that would enable the Company to take larger deductions constitutes waste.

These allegations are woefully insufficient to state a claim for waste. As the Supreme Court explained in *Brehm*, the "size and structure of executive compensation are inherently matters of judgment." 746 A.2d at 263. There is no requirement that compensation be structured in a way that maximizes the Company's tax deductions. *Haber v. Bell*, 465 A.2d 353 (Del. Ch. 1983), makes precisely this point. In that case, the plaintiff brought a derivative action challenging the Board's decision to forgo a tax deduction by converting "non-qualified options" into qualified options, as certain changes to the tax code permitted it to do. "Non-qualified options" gave rise to tax liability on the part of the recipients and a corresponding deduction by the company. The Board chose to forego the deduction and eliminate the tax liability to the recipients of the options. The court held that the plaintiffs there had failed to properly allege demand futility under a waste theory because "generally directors have the sole authority to determine compensation levels and this determination is protected by the presumption of the business judgment rule." *Id*. at 359. The board's decision to forego tax benefits for the company and instead to benefit the recipients of the stock options was well within the discretion of the board. *Id*. Because the board in that case (as here) was disinterested and independent, the court concluded that the plaintiffs had failed to properly plead demand futility.

The same analysis applies here. Plaintiff does not claim that the compensation provided to Covered Employees under the 2007 Stock Plan was excessive. Instead, he argues that the Board should have structured the grant of restricted stock differently so more payments could have been deducted. But the Board had broad discretion to decide how compensation under the various incentive plans the shareholders approved should be structured, including how much of the Covered Employees' compensation should be fixed (and hence non-deductible to the extent it exceeded $1 million) and how much should be variable, based on the achievement of preset performance goals. The 2007 Stock Plan itself was designed to provide the Board with the flexibility to make such decisions, by expressly authorizing the Board to choose between time- and performance-based vesting. While deductibility is no doubt one consideration any board should take into account in making such decisions, there is no rule under Delaware law that a board must exalt that consideration over all others.[19]

There are benefits and risks to each type of compensation, whether it be performance-based, time-based, or fixed. Compensation that is tied to pre-set performance goals can help to align the goals of executives with the goals of the corporation. But, as recent events suggest, it can also lead to excessive risk-taking and short-term thinking. Time-based vesting requirements for stock grants may lessen, but do not eliminate, the alignment between executive compensation and the financial success of the corporation. Time-based vesting also encourages stability by giving executives a financial incentive to stay with a company in difficult times, when performance goals may not be met. A board is entitled to conclude that guaranteeing compensation over $1 million to Covered Employees will enable the company to secure the

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[19] Nor is there any such federal rule. In ¶ 9 of his amended complaint, plaintiff quotes out of context a snippet from a lengthy report by the Joint Committee on Taxation about lessons to be learned from the Enron debacle. In the final section of the Report, the Joint Committee staff stated its view that the $1 million deduction limitation "reflects corporate governance issues regarding excessive compensation, rather than issues of tax policy." Nothing in the Report, however, even remotely suggests that federal law ***requires*** a Board to take full advantage of the deduction by making all compensation for Covered Employees over $1 million performance-based. On the contrary, the Report recognizes that "[t]axpayers may simply choose to incur the adverse tax consequences rather than change their behavior." Joint Comm. On Taxation, *Report of Investigation of Enron Corp. and Related Entities*, JCS-3-03, Vol. I, Pt. 4, 2003 WL 25599037 at n.2212 (IRS Feb. 2003).

services of the most qualified individuals to run the company. How all of these elements should be weighed and how the entire package of executive compensation should be constructed is a quintessential business judgment, which Delaware courts will not second-guess. *See Dow Chemical*, 2010 WL 66769, at *9 ("substantive second-guessing of the merits of a business judgment . . . is precisely the kind of inquiry that the business judgment rule prohibits").

In this case, plaintiff has not alleged any particularized facts that raise a reasonable doubt about whether the Board was acting within the bounds of the very broad discretion afforded to it when it decided to grant restricted stock units that were not tax deductible. Plaintiff argues (in ¶ 31) that it contravenes the purpose of the Stock Plan to make all restricted stock awards using time-based vesting. But the Stock Plan contains no limitations on the percentage of restricted stock grants that can be non-performance-based. Instead, the Plan leaves it up to the Board's discretion to decide how much of the compensation is performance-based and how much is not.

Plaintiff also alleges that the choices Republic's Board have made are out of line with its peers, citing three other "peer" companies that he says have chosen to give their employees more performance-based than time-vested restricted stock grants. Am. Compl. ¶ 32. But the fact that other boards may have made a different calculus with respect to the proper mix of time- and performance-based restricted stock does not provide a basis for concluding that the Republic Board committed waste.

C. Plaintiff Has Not Properly Pleaded Demand Futility With Respect To His New Claim Concerning Payments Under The Synergy Plan.

Plaintiff's new claim concerning payments that may be made under the Synergy Plan in the first quarter of 2012 should also be dismissed for failure to properly plead demand futility. Under the Synergy Plan, certain executives and managers "will be eligible to receive incentive awards based on the degree to which targeted Synergies (as defined in Section IV [of the Plan]) are generated following the merger of Republic Services and Allied Waste." Ex. G at B-1. Section IV provides that "Synergies" "include those initiatives that provide ongoing benefit to the shareholders of the new Republic Services as a result of the integration of the two predecessor companies and is measured based upon the incremental and ongoing impact to EBIT attributable to the combination of Republic and Allied." *Id.* The target for Synergies "is $150 million, to be achieved on a run rate basis by the end of the implementation period," that is, by December 31, 2010. *Id*. at B-1, B-2. Synergies will be measured over the "measurement period which will consist of the four quarters beginning January 1, 2011." *Id*. at B-2. The Compensation Committee of the Board will decide in the first quarter of 2012 whether any bonuses have been earned under the Synergy Plan and, if so, whether the full amount earned should be paid. *See id.* at B-2; Ex. I at A-4.

Plaintiff argues that no payments can be made under the Synergy Plan because the company's earnings in 2009 and 2010 were smaller than Allied's and Republic's earnings before the combination. That argument completely misconstrues the terms of the Plan. The Plan does not say that *total* earnings growth is the measure of synergy. On the contrary, synergy is defined as "the ***incremental and ongoing*** impact" on earnings that is "attributable to the combination." *See* Ex. G at B-1, and B-6 (emphasis added). *See also id.* at B-6 ("Synergy will be the net impact of ***incremental*** positive and negative impacts to EBIT ***associated with company integration***") (emphasis added). These incremental and ongoing impacts must "only include cost improvements," and could derive, for example, from headcount reduction for duplicate activity, transportation and disposal optimization available from the combination of the two companies and access to a combined set of landfills, and route optimization savings available in overlap markets. *Id*. at B-6.

By definition, these cost improvements will have improved earnings over what they would have been absent the synergy initiatives. But there is nothing in the Synergy Plan that suggests that the cost savings must be accompanied by an increase in total net earnings. As a result, even if the total amount of net earnings decreases because (for example) Republic's revenues or non-synergy-related costs have been adversely affected by the nation's struggling economy, synergy bonuses can still be earned because the hoped-for cost improvements resulting from the merger have in fact been achieved. Plaintiff's suggestion that the synergy bonus depends on an increase in the amount of total earnings, rather than on the level of net savings achieved through the combination, would make no economic sense and, in any event, is contrary to the plain language of the Synergy Plan.

Moreover, even if there were some ambiguity in the Synergy Plan, under the terms of the EIP, it is the Compensation Committee that has "full and complete authority, in its sole and absolute discretion, . . . to construe, interpret and implement the Plan." *See* Ex. I at A-6, Section 6.1.[20] A shareholder cannot use a suit like this to second-guess (in advance) the Committee's interpretation of the Synergy Plan.

Republic's shareholders approved the Synergy Plan. As a result, plaintiff cannot (and does not) argue that making bonus payments pursuant to the terms of that Plan would constitute waste. Plaintiff's amended complaint offers no factual basis for believing that the Compensation Committee intends to deviate from the terms of the Plan or that the circumstances are such that no rational director could approve payments under the Plan. Under those circumstances, plaintiff

[20] The Synergy Plan and the EIP both provide that the Synergy Plan is a subset of the EIP. Therefore, the general provisions of the EIP regarding construction of the Plan apply to the Synergy Plan as well. *See* Ex. G at B-1; Ex. I at A-1.

has failed to meet his heavy burden of pleading demand futility with respect to whatever decision the Compensation Committee may make under the Synergy Plan.

D. Plaintiff's Allegations Concerning Republic's "Say On Pay" Vote Are Irrelevant.

In ¶ 42 of his amended complaint, plaintiff alleges that Republic took an advisory "say on pay" vote at its 2011 meeting and that approximately 63% of the shares voted were cast in favor of the current executive compensation arrangements. Plaintiff quotes a "corporate governance firm" as opining that a vote of 80% or more would be "a positive" and then contends that the fact that less than 80% of Republic's shareholders voiced their support for the Company's executive compensation "should weigh in favor of the relief that plaintiff seeks." Am. Compl. ¶ 42. As plaintiff himself admits, however, "say on pay" votes are merely advisory, *see* Am. Compl. ¶ 41, providing the directors, who must ultimately make compensation decisions, with an indication of the views of the shareholders.[21] Whatever the level of shareholder support may be, it is irrelevant to the legal question of whether plaintiff has met his burden of pleading sufficient facts to support a claim that the directors' decisions with respect to compensation were so irrational that they constituted waste.

As Chancellor Chandler noted in *In re InfoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 984 (Del. Ch. 2007), the Court cannot substitute its judgment about compensation decisions for that of disinterested, independent directors:

> The value of assets bought and sold in the marketplace, including the personal services of executives and directors, is a matter best determined by the good faith judgments of disinterested and independent directors, men and women with business acumen appointed by shareholders precisely for their skill at making such evaluations. The Court of Chancery does not safeguard shareholders by substituting

[21] The Dodd-Frank Wall Street Reform Act requires an advisory shareholder vote on executive compensation every three years, but expressly provides that the shareholder vote is not binding and does not alter the fiduciary duties of directors. 15 U.S.C. § 78n-1(c) (2010).

> the opinion of a judge for that of a business person merely because a plaintiff shows up at the courthouse asking for relief. Rather, a judge does his duty by ensuring that business decisions, whatever their merit, were undertaken by a director without consideration of his self-interest or for the sake of some third-party. Therefore, a skilled litigant, and particularly a derivative plaintiff, recognizing the institutional advantages and competency of the judiciary, reflected in our law, places before the Court allegations that question not the merits of a director's decision, a matter about which a judge may have little to say, but allegations that call into doubt the motivations or the good faith of those charged with making the decision.

Here, plaintiff has not offered any allegations that "call into doubt the motivations or good faith" of Republic's directors in negotiating a Retirement Agreement with Mr. O'Connor, in making decisions about how the 2007 Stock Plan should be implemented, or with respect to decisions that have not even been made as to whether payments will be made under the Synergy Plan. Accordingly, plaintiff's claims relating to those decisions should be dismissed for failure to properly plead demand futility.

II. All Of Plaintiff's Claims Should Be Dismissed Under Rule 12(b)(6).

For all of the reasons outlined above, plaintiff has failed to state a claim for waste based on Mr. O'Connor's Retirement Agreement, the award of restricted stock or stock units to Covered Employees under the 2007 Stock Plan, or payments made under the Synergy Plan. That is true whether the claims are analyzed under Rule 23.1's heightened pleading requirements or under the ordinary rules applicable to Rule 12(b)(6) motions. Even under Rule 12(b)(6), "[c]onclusions . . . will not be accepted as true without specific allegations of fact to support them." *Solomon v. Pathe Comm'n Corp.*, 672 A.2d 35, 40 (Del. 1996). Here, for the reasons set forth above, plaintiff has alleged only conclusions with respect to his first, second and fourth claims and has failed to plead facts from which the Court could draw a reasonable conclusion that the Board committed waste.

The same is true with respect to plaintiff's third claim — his claim for waste based on the directors' decisions with respect to their own compensation in 2009 and 2010. Plaintiff alleges that the directors awarded themselves restricted stock units under the shareholder-approved 2007 Stock Plan, but does not allege that those awards violated any of the provisions of the Plan. Under these circumstances, the Board's decisions with respect to the directors' own compensation are entitled to the protection of the business judgment rule. *See In re 3Com Corp. S'holders Litig.*, 1999 Del. Ch. LEXIS 215, at *10-11 (Del. Ch. Oct. 25, 1999). As plaintiff himself recognizes (Am. Compl. ¶ 35), that means that plaintiff cannot prevail on an excessive compensation claim unless he is able to prove that the compensation constituted waste of corporate assets. *3-Com*, 1999 Del. Ch. LEXIS 215, at *12.

Under Rule 12(b)(6), to state a claim for waste, it is not enough for plaintiff to assert that the compensation was excessive. Instead, plaintiff must meet the *Brehm* "so one-sided" test. That means that "[t]he transfer must either serve no corporate purpose or be so completely bereft of consideration that such transfer is in effect a gift." *Id*. (internal quotation omitted). Plaintiff has not even attempted to meet that burden here. In *3Com*, the court dismissed a waste claim based on stock options granted to directors, where the only factual allegation was that the options had a value that was "quite large (at least $650,000 per director)." *Id.* at *14. As the court concluded, that allegation was woefully insufficient to meet plaintiff's burden:

> I must be satisfied that the alleged facts establish a complete ***failure*** of consideration, and not merely the insufficiency of the consideration received. A complete failure of consideration is difficult to show since the acts alleged have to be so blatant that ***no*** ordinary business person would ever consider the transaction to be fair to the corporation. The company would literally have to get nothing whatsoever for what it gave. Under this standard I am ***not*** to examine the allegations to see whether consideration, once received, was excessive or lopsided, was proportional or not, or even whether it was a "bad deal" from a business standpoint. If I were to do so I would not be deferring to the board's business judgment, as I am required to do here.

Id. at *13 (emphasis in original).

As in *3Com*, all plaintiff has done here is to allege that in 2009 and 2010, the directors received compensation, including restricted stock units, that he characterizes as very large.[22] Plaintiff compares the Republic directors' compensation to the compensation paid to Waste Management's directors for 2010 and pronounces the difference to be waste. But nowhere does plaintiff even attempt to allege that there was a "complete failure of consideration" for the compensation the directors received. Indeed, plaintiff says nothing at all about the adequacy of the consideration. If the business judgment rule has any meaning at all, the fact that directors of another company were paid less cannot possibly serve as the basis for a claim of waste.

III. Plaintiff Has Failed To State A Claim Against Mr. Holmes Or Mr. Slager.

The entire complaint should be dismissed for all of the reasons outlined above. But plaintiff has also failed to state a claim against either Mr. Holmes, Republic's CFO, or Mr. Slager, its current CEO. It is not entirely clear why plaintiff has sued either one of these defendants. Plaintiff alleges that both are "Covered Employees" and as such both received awards of time-based restricted stock and stock units under the 2007 Stock Plan. Am. Compl. ¶¶ 2, 30. Plaintiff alleges that the "Individual Defendants" as a group "have enjoyed unjust enrichment" because of the Board's decisions and seeks to recover unidentified benefits they received under an unjust enrichment theory. Am. Compl. ¶ 37.

As the defendants pointed out in Seinfeld's federal case, however, Mr. Holmes is ***not*** a "Covered Employee" whose compensation is subject to the limits imposed by Section 162(m). *See* IRS Notice 2007-49, *Covered Employees Under § 162(m)(3)*, 2007 WL 1586307 (IRS June 18, 2007) (explaining that a company's CFO qualifies as a "Named Executive Officer" under

[22] As noted above, the 2009 award was a one-time award that vested over three years.

SEC regulations, which means that the CFO's compensation must be separately described in the company's annual proxy statement, but the CFO is ***not*** a "Covered Employee" for purposes of Section 162(m)). Moreover, nowhere in the complaint is there any allegation that Mr. Holmes ever did anything wrong or that he personally was ever unjustly enriched. Accordingly, he should be dismissed regardless of how the Court rules on the remainder of defendants' motion.

Mr. Slager is a "Covered Employee" and, according to the complaint, received time-based restricted stock units granted to him by the Board of Directors. But Mr. Slager was not a member of the Board when that decision was made, or when any of the other decisions plaintiff complains about were made.[23] Thus, plaintiff has no conceivable basis for claiming that Mr. Slager breached any duty owed to the Company. Instead, he merely accepted compensation that was awarded to him by the Board. Plaintiff does not allege that Mr. Slager failed to provide consideration for that compensation or even that his compensation was excessive. Even if plaintiff could sustain his claim that the Board should have chosen a tax deductible method of compensation, there is thus no basis for any claim that Mr. Slager was unjustly enriched by that decision such that it would be unfair for him to retain the benefits that were provided to him. *See Nemec v. Shrader*, 991 A.2d 1120, 1130 (Del. 2010) (unjust enrichment is "the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience").

CONCLUSION

For the foregoing reasons, plaintiff's complaint should be dismissed with prejudice for failure to properly plead demand futility under Rule 23.1 and failure to state a claim under Rule 12(b)(6).

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[23] Nor is he a member of the Compensation Committee now, which will make the decision as to whether and how much to pay in bonuses under the Synergy Plan.

BOUCHARD MARGULES &
FRIEDLANDER, P.A.

/s/ Andre G. Bouchard
Andre G. Bouchard (#2504)
Sean M. Brennecke (#4686)
222 Delaware Avenue, Suite 1400
Wilmington, DE 19801
(302) 573-3510
(302) 573-3501 (fax)

OF COUNSEL:

Michele Odorizzi
MAYER BROWN LLP
71 S. Wacker Drive
Chicago, IL 60606
(312) 782-0600

Attorneys for Republic Services, Inc.

RICHARDS, LAYTON & FINGER, P.A.

/s/ Daniel A. Dreisbach
Allen M. Terrell, Jr. (#709)
Daniel A. Dreisbach (#2583)
Susan Hannigan (#5342)
One Rodney Square
920 North King Street
Wilmington, DE 19801
(302) 651-7500
(302) 651-7701 (fax)

Attorneys for the Individual Defendants

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