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

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

Andre G. Bouchard (# 2504)
BOUCHARD MARGULES & FRIEDLANDER, P.A.
222 Delaware Avenue, Suite 1400
Wilmington, DE 19801
(302) 573-3500
(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.

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

Dated: February 21, 2012

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes and Regulations

Other Authorities

INTRODUCTION

Plaintiff begins his opposition to defendants' motions to dismiss with a three-page screed against compensation decisions and practices that he does not challenge or even bother to mention anywhere in his Amended Complaint. Apparently intent on slinging as much mud as possible at Republic's directors and officers, plaintiff goes so far as to cite (and attach) a 2009 article by a self-appointed "industry watchdog" that warned that Republic shared certain "governance characteristics" with a company that had recently committed accounting fraud. Pl. Br. at 3. Tellingly, plaintiff does not claim that Republic ever engaged in accounting fraud, nor does he cite any allegations in his complaint that support his hyperbolic rhetoric about Republic's claimed "tradition of misfeasance." Pl. Br. at 3. Under these circumstances, plaintiffs' opening broadside against Republic and its directors and officers is entirely irrelevant and should be disregarded in ruling on defendants' motions to dismiss.[1]

When plaintiff finally gets around to addressing the claims actually alleged in his Amended Complaint, his arguments fare no better. Plaintiff has structured his brief so that he argues first that he has properly alleged waste under Rule 12(b)(6); it is not until page 43 that he finally addresses defendants' demand futility arguments, claiming that because he has (supposedly) met the notice pleading requirements for waste, he has also met his obligation to plead demand futility under Rule 23.1. But the "pleading burden imposed by Rule 23.1 . . . is

1 Because his assertions are irrelevant, defendants will not respond to them point by point. Nevertheless, it is worth noting that if the Court were to consider the size of Mr. O'Connor's compensation over the course of his twelve years as Republic's CEO as "background" information, it would also be obliged to consider his accomplishments. Those include growing the company from $800 million in annual revenue to more than $8 billion, making Republic the second largest waste and recycling company in the United States. *See* Def. Ex. A, at 2. Investors greatly benefited from Mr. O'Connor's stewardship. Although an investor who invested in the S&P 500 during Mr. O'Connor's tenure at Republic would have seen his investment increase by only 8.08%, an investor who put his money in Republic stock would have enjoyed an increase of 178.67%. *See* Ex. 1 hereto.

more onerous than that demanded by Rule 12(b)(6)." *McPadden v. Sidhu*, 964 A.2d 1262, 1269 (Del. Ch. 2008). For the reasons outlined in defendants' opening brief and below, plaintiff has not come close to meeting his burden of pleading "particularized allegations that 'overcome the general presumption of good faith by showing that the board's decision[s] [were] so egregious or irrational that [they] could not have been based on a valid assessment of the corporation's best interests.'" *In re The Goldman Sachs Group, Inc. S'holder Litig.*, 2011 Del. Ch. LEXIS 151, at *51 (Oct. 12, 2011) (quoting *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 136 (Del. Ch. 2009), in explaining the standard that applies to "excuse demand on a waste claim").

ARGUMENT

I. Plaintiff Has Failed To Meet His Burden Of Pleading Demand Futility With Respect To Three Of His Four Claims.

The only theory alleged in plaintiff's Amended Complaint is waste. Am. Compl. ¶¶ 6, 45, 47, 49. However, plaintiff's brief suggests that he may be attempting to argue some species of breach of fiduciary duty other than waste. For example, he argues that the directors acted beyond their authority by supposedly violating the terms of Republic's incentive compensation plans. He also argues that the directors had a fiduciary duty to minimize taxes and accuses them of "gambl[ing]" with the Company's tax deductions by structuring Mr. O'Connor's retirement package in reliance on guidance from the IRS. Pl. Br. at 22, 32; *see also* Pl. Br. at 16. To the extent that plaintiff is attempting to claim a breach of fiduciary duty based on a theory other than waste, the Court should take judicial notice of the fact that Republic has a § 102(b)(7) provision in its charter limiting the directors' liability. *See* Ex. 2 hereto. As this Court explained in *Goldman Sachs*, to meet his burden of pleading demand futility in the face of such a charter provision, plaintiff would have to "plead particularized facts that demonstrate that the directors acted with scienter: i.e., there was an 'intentional dereliction of duty' or 'a conscious disregard' for their responsibilities, amounting to bad faith." *Goldman Sachs*, 2011 Del. Ch. LEXIS 151 at *41. Plaintiff has not even attempted to meet that burden.[2]

A. Plaintiff's Failure to Make A Demand Is Not Justified By His Theory That The Directors Violated The Terms Of Republic's Incentive Compensation Plans.

In *Ryan v. Gifford*, Chancellor Chandler held that demand was excused in an options backdating case because the plaintiffs had alleged facts showing that the directors had knowingly and intentionally violated the "express" provisions of a shareholder-approved incentive compensation plan, which prohibited backdating. 918 A.2d 341, 354 (Del. Ch. 2007) (citing *Sanders v. Wong*, 1999 Del. Ch. LEXIS 203 (Del. Ch. Nov. 10, 1999). He concluded that a board's 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" under *Aronson's* second prong. 918 A.2d at 354. Plaintiff argues that he fits within the rationale articulated in *Ryan* because he has supposedly shown that the Republic directors violated the express terms of the Synergy Plan and the Stock Plan when they awarded synergy bonuses and restricted stock awards. Pl. Br. at 15. As demonstrated below, plaintiffs' argument rests on a misinterpretation of the relevant Plan documents. Moreover, plaintiff has at best raised issues of interpretation, which the Plans give the Compensation Committee full and complete discretion to resolve. Thus, unlike the plaintiffs in *Ryan*, plaintiff here has not alleged particularized facts showing that the directors knowingly and intentionally exceeded the Republic shareholders' grant of express authority.

---

[2] Plaintiff notes at pages 14-15 of his brief that shareholders often decide not to make a demand because doing so would weaken their ability to prevail if the demand was denied. While that is undoubtedly true, it is hardly a reason for excusing demand where, as in this case, plaintiff has not met his burden of pleading particularized facts showing that demand is excused.

1. Plaintiff Has Not Shown That The Directors Knowingly And Intentionally Exceeded Their Authority Under The Synergy Plan.

Plaintiff argues that under the Synergy Plan, the Compensation Committee could award Synergy bonuses only if Republic's post-merger earnings before interest and taxes ("EBIT") exceeded the combined EBIT of Allied and Republic before the merger. Pl. Br. at 16. Because Republic's 2010 and 2011 EBIT did not exceed those pre-merger levels, plaintiff argues that there were no Synergies and hence no basis for awarding any Synergy bonuses. This argument misreads Republic's description of the Synergy Plan in its 2009 Proxy Statement as well as in the Plan documents themselves.

In its Proxy Statement, Republic explained that under the Synergy Plan participants would be "entitled to receive cash bonus payments based upon the degree to which the company achieves specified cost reductions following the merger with Allied." Def. Ex. F at 49. Those "specified cost reductions" were defined as "Synergies." *Id.* The Proxy Statement further explained that "Synergies generally include those initiatives that provide an ongoing benefit to our stockholders as a result of the integration of Allied and Republic and will be measured based upon the incremental and ongoing annual impact to earnings before interest and taxes ("EBIT") attributable to the combination of the two companies." *Id*. The Synergy Plan, which was attached as an exhibit to the Proxy Statement, included the identical definition. *See* Def. Ex. G, § IV-A. That definition went on to state that "Synergies include cost improvements and are more fully described in Exhibit II attached hereto." *Id*. Plaintiff focuses on one sentence that appears in Ex. II, which states that "EBIT impact will be measured over the baseline which includes the operations of the two businesses standalone." *Id*. at B-6. Plaintiff assumes that the "baseline" means the ***total*** EBIT of each separate company before the combination and thus argues that the only measure of Synergies is an absolute increase in the earnings before interest and taxes that the combined companies generate. Pl. Br. at 16.

This argument is wrong and contrary to common sense. If the Plan had been intended to condition bonuses on an increase in overall EBIT, it would have said so. Instead, the Plan carefully defined Synergies as cost improvements that (i) provide a net ongoing benefit to stockholders and (ii) resulted from the integration of Allied and Republic. Thus, it provided that cost improvements would be measured based on "the net impact of incremental positive and negative impacts to EBIT ***associated with company integration***" arising out of specific synergy initiatives, examples of which were provided in Ex. II. Def. Ex. G at B-6 (emphasis added). So if there was a net cost savings because of headcount reductions or route optimization (two examples of synergy initiatives given in Ex. II), those would be counted toward the $150 million Synergy target. On the other hand, cost savings that were neither ongoing nor due to synergy initiatives would ***not*** be taken into account. For example, if costs went down because the market price of fuel decreased, that reduction would not count as a "Synergy." Changes in revenue, whether up or down, would also not be taken into account in calculating "Synergies" because "Synergies" were limited to "cost improvements."

Within this context, it becomes clear that the "baseline" was not the total EBIT of the two companies before the merger, but rather that portion of each company's pre-merger EBIT that was impacted by the synergy initiatives. That baseline was used to determine whether the synergy initiatives had increased EBIT over ***what it would have been*** absent the Plan participants' integration efforts. But there was no requirement that there be an increase in the absolute amount of EBIT. To put it another way: cost savings that qualified as Synergies could still be achieved through integration even though Republic's top line revenues (and therefore its

{BMF-W0285386.}

earnings) fell as the nation coped with the worst recession since the Great Depression.[3] Plaintiff notes that Republic has announced that it beat its $150 million target for Synergies. Pl. Br. at 7; Pl. Ex. 13 at 25. Plaintiff cites no basis — other than his own misunderstanding of the Synergy Plan — for challenging the accuracy of that statement.

Plaintiff has not pleaded any particularized facts showing that the directors violated the ***express*** terms of the Synergy Plan by concluding that the Synergy target had been met and that Synergy bonuses should be paid. Nor has he pleaded particularized facts showing that the directors ***knowingly*** and ***intentionally*** exceeded the authority the shareholders had given them. In fact, as noted above, the shareholder-approved EIP specifically gave the Compensation Committee "full and complete authority, in its sole and absolute discretion . . . to construe, interpret and implement the Plan and any related document." Def. Ex. I, § 6.1. Thus, far from exceeding clear limits on their authority, as the directors did in *Ryan*, the Republic directors acted well within their discretion in interpreting the Synergy Plan as they did.

Plaintiff has also failed to allege any particularized facts to support the assertion in his Amended Complaint that the payment of Synergy bonuses will constitute waste. As this Court recognized in *Goldman Sachs*, plaintiff is not entitled to pursue a claim of waste arising out of the payment of bonuses unless he can plead particularized facts showing that the work done by those eligible for such bonuses was "of such limited value to the corporation that no reasonable person in the directors' position would have approved their levels of compensation." 2011 Del. Ch. LEXIS 151, at *55. Plaintiff has not even attempted to meet that burden with respect to the Synergy bonuses. Nor can he, given Republic's announcement that the integration efforts of the

3 Plaintiff also relies on Republic's characterization of the goal of the Synergy Plan in briefs filed in the federal *Seinfeld* case as "measurable earnings improvement over baseline." Pl. Br. at 5. This characterization was entirely accurate. The Plan does require measurable earnings improvement due to cost savings over what earnings would have been without those savings.

participants in the Synergy Plan have yielded and will continue to yield well over the target of $150 million a year in cost savings. *See* Pl. Ex. 13 at 25.

2. Plaintiff Has Not Shown That The Directors Knowingly And Intentionally Exceeded Their Authority Under The Stock Plan.

Plaintiff argues that the Compensation Committee also violated the terms of the separate shareholder-approved Stock Plan by issuing restricted stock to executives that vested over time rather than based on the achievement of preset performance objectives. In so arguing, plaintiff ignores the unambiguous terms of the Stock Plan, which gives the Compensation Committee broad discretion to grant "Restricted Stock, in such amounts and on such terms and conditions as the Committee shall determine in its sole and absolute discretion." Def. Ex. D, § 9(a). Section 9(b) of the Stock Plan then goes on to provide that "[t]he Committee shall impose such restrictions on any Restricted Stock granted pursuant to the Plan as it may deem advisable including, without limitation; time based vesting restrictions, or the attainment of Performance Goals." Thus, far from knowingly and intentionally violating the ***express*** terms of the Stock Plan, the Compensation Committee's decision to issue restricted stock that vested over time was ***expressly authorized*** by the terms of the Stock Plan that Republic's shareholders approved.

Plaintiff tries to avoid this conclusion by ignoring § 9(b)'s reference to time-based vesting and concentrating instead on the Plan's general statement of purpose. Plaintiff quotes the Stock Plan's statement that its purpose is to "enable the Company to attract, retain, reward and motivate [e]ligible [i]ndividuals by providing them with an opportunity to acquire or increase a proprietary interest in Republic and to incentivize them to expend maximum effort for the growth and success of the Company." Pl. Br. at 10. He ***assumes*** that this purpose can be achieved only by granting restricted stock based on the achievement of preset performance goals and then leaps to the conclusion that — despite the Plan's plain language to the contrary — the

Compensation Committee was ***required*** by the Plan's terms to award restricted stock based ***only*** on the achievement of performance goals.[4]

Plaintiff's interpretation of the Stock Plan would nullify the broad discretion granted to the Compensation Committee in § 9(b) to grant restricted stock that vests based on time. As such, plaintiff's interpretation violates one of the cardinal rules of contract construction — that "a contract should be interpreted in such a way as to not render any of its provisions illusory or meaningless." *See Sonitrol Holding Co. v. Marceau Investissements*, 607 A.2d 1177, 1183 (Del. 1992). More importantly, for purposes of a demand futility analysis, plaintiff has failed to allege any particularized facts to show that the Compensation Committee knowingly and intentionally violated an express provision of the Plan and therefore exceeded the authority granted to it by Republic's shareholders. Like the EIP, the Stock Plan gives the Compensation Committee "the full power and authority to take all actions, and to make all determinations not inconsistent with the specific terms and provisions of the Plan." Def. Ex. D, § 5(a). Section 5(a) also provides that "[t]he decisions by the Committee shall be final, conclusive and binding with respect to the interpretation and administration of the Plan." These provisions, along with § 9, make it clear beyond dispute that the shareholders entrusted the Compensation Committee with the power and the discretion to make a business judgment as to whether restricted stock should vest based on time or based on the achievement of performance goals. Plaintiff cannot second-guess that judgment on the theory that it somehow exceeded the Committee's authority.

---

4 Plaintiff's initial assumption — that the only way to incentivize executives to expend maximum effort is to grant restricted stock based on achievement of performance goals — is untenable. Compensating executives with an equity interest in the company by its very nature provides such an incentive. Even if an executive knows that he or she will be receiving a certain amount of stock every year regardless of the stock's or company's performance, the incentive to maximize the value of that stock will remain.

That time-based awards of restricted stock to Covered Employees may not be tax deductible under section 162(m) also does not provide a basis for claiming that the directors committed waste or otherwise breached their fiduciary duties.[5] As this Court explained in *Goldman Sachs*,

> "[W]aste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." Accordingly, if "there is any *substantial* consideration received by the corporation, and if there is a *good faith judgment* that in the circumstances the transaction is worthwhile, there should be no finding of waste." The reason being, "[c]ourts are ill-fitted to attempt to weigh the 'adequacy' of consideration under the waste standard or, *ex post*, to judge appropriate degrees of business risk." Because of this, "[i]t is the essence of business judgment for a board to determine if a particular individual warrant[s] large amounts of money.

2011 Del. Ch. LEXIS 151, at *51-52 (citations omitted). Here, plaintiff has not alleged any particularized facts to suggest that the Compensation Committee acted in bad faith in deciding to award restricted stock grants over time. Nor has he alleged any particularized facts showing that Republic failed to receive any "substantial consideration" from the executives who received restricted stock awards as part of their compensation.

Plaintiff cites a handful of mostly very old cases (at 22) for the proposition that directors have a fiduciary duty to minimize the company's tax burden.[6] We would agree that, all things

---

[5] Such awards are not deductible to the extent that the Covered Employee's non-performance based compensation exceeds $1 million.

[6] The only recent case plaintiff cites, *Resnik v. Woertz*, 774 F.Supp.2d 614 (D. Del. 2011), is off point. Like Seinfeld's federal case, *Resnik* involved allegations that the defendants had misrepresented that payments made to Covered Employees under the plan would be deductible even though the plan would not in fact qualify as performance-based under section 162(m). *Id.* at 628. *Resnik* did not involve a situation like that here, where the directors made an affirmative and fully disclosed decision to select one method of compensating Covered Employees (time-based restricted stock awards) that would not be deductible to the extent their total compensation exceeded $1 million. Indeed, even the older cases plaintiff cites do not help his cause. In *Dodge v. Woolsey*, 59 U.S. 331, 345 (1856), the Court found a breach of duty because the directors themselves firmly believed that the state tax in question was invalid, yet refused to take action to avoid paying it; in *Spirt v. Bechtel*, 232 F.2d 241, 247 (2d Cir. 1956), the court held that directors

being equal, directors should ordinarily seek to minimize taxes to the extent they can, just as they should seek to minimize any other cost of doing business. But when it comes to executive compensation, all things are not equal. Directors have a variety of competing concerns to consider in deciding how to structure an executive's compensation package. Deductibility is only one of those concerns. If directors decide that one component (here, restricted stock) should be fixed, rather than based on achievement of performance goals, and therefore not deductible when paid to a Covered Employee making more than $1 million, a court cannot second-guess that decision unless the directors were acting in bad faith.

It is ironic that plaintiff argues that ***all*** of the executive compensation at issue here should have been performance-based, while in *Goldman Sachs* the complaint was that too much of the compensation was performance-based, giving employees an incentive to take undue risks. 2011 Del. Ch. LEXIS 151, at *3-4. As the Court recognized in *Goldman Sachs*, it is up to a company's directors to strike what they believe to be a proper balance. *Id.* at *45-46. Their business judgment as to what is appropriate is simply not subject to judicial second-guessing through a shareholder derivative action.

In this case, as in *Goldman Sachs*, plaintiff cites compensation policies adopted by other companies in arguing that the decisions the Republic directors made were so far off the mark that they face a substantial likelihood of liability. Plaintiff points to three of the ten companies that Republic considers part of its peer group for executive compensation purposes and claims that they award most or all of their restricted stock based on performance. He claims that Republic's decision to award all of its restricted stock based on the passage of time is so "unusual" that he should be allowed to pursue his claim of waste and breach of fiduciary duty. Pl. Br. at 11. But a

---

did not have a duty to pursue a tax deduction that was "very doubtful" in light of what they knew at the time.

three-company, cherry-picked sample[7] does not provide any factual basis for concluding that there is such a "shocking disparity" between Republic's compensation practices and the practices followed by other companies that Republic's grants of restricted stock should be deemed "legally excessive." *Goldman Sachs*, 2011 Del. Ch. LEXIS 151, at *54; *see also id.* at *52-55 (finding plaintiffs' conclusory allegations that Goldman's compensation system was significantly out of line with its "peers" insufficient to show that demand was futile on the plaintiffs' allegations of waste).

Finally, in a last-ditch effort to avoid dismissal of his restricted stock claim, plaintiff argues that demand would be futile because the directors should be deemed "interested" in the decision whether to grant restricted stock to executives subject to time- or performance-based vesting. Plaintiff does not claim that the directors themselves had any personal interest in that decision.[8] Nevertheless, he argues that the directors should be deemed "interested" under the first *Aronson* prong simply because they themselves were eligible to participate in awards under the Stock Plan. Pl. Br. at 46. The two federal cases plaintiff cites for that proposition, *Resnik*, 774 F.Supp.2d at 633, and *Hoch v. Alexander*, 2011 U.S. Dist. LEXIS 71716, at *15 (D. Del. July 1, 2011), do not support plaintiff's argument. In those cases, the plaintiffs challenged the validity of the ***entire plan***, which covered both executives and directors. The directors had a personal interest in getting the plans approved because, without shareholder approval, they

---

7 At page 10 of his brief, plaintiff says that it is "odd" that Republic does not "follow the lead of these peer companies" because "its proxy statements claim it uses the above ***three*** companies' 'compensation programs . . . as context in establishing the structure and levels of compensation of our named executive officers.'" (Emphasis added). This statement is misleading because the Proxy Statement actually lists ***twelve*** companies as "peer group companies" that its Compensation Committee "considered as context" for its own compensation decisions and not just the ***three*** companies plaintiff picked. *See* Pl. Ex. 13, at 33-34.

8 Plaintiff does, of course, contend that the directors overpaid themselves. But that is an entirely separate claim as to which no argument is being made that demand was required.

would lose the right to payments under the plan. Here, by contrast, plaintiff is challenging the validity of ***particular awards to executives*** on the ground that the directors should have chosen a tax-deductible type of compensation. Plaintiff has not even attempted to explain how or why Republic's directors would have had any personal interest in that issue, since non-management directors are not subject to the deductibility restrictions in section 162(m). Accordingly, plaintiff has not carried his burden of showing that the directors are "interested" under the first *Aronson* prong.

But even if demand were excused with respect to this particular claim (which it is not), it would still be subject to dismissal under Rule 12(b)(6) because plaintiff has not pleaded ***any*** basis for his conclusory assertion that the directors committed waste by deciding to grant restricted stock that vested based on time rather than performance. Indeed, if this claim were to withstand a motion to dismiss, the courthouse doors would be flung wide open to second-guessing of director decisions, based solely on the assertion that the decision was "unusual" and that a few other companies had made different choices.

B. Plaintiff Has Not Demonstrated That Demand Is Excused On His Claim Regarding Mr. O'Connor's LTIP Award.

Plaintiff does not contend that the directors had any personal interest in the decisions they made with respect to Mr. O'Connor's Retirement Agreement. Thus, to plead demand futility, he would have to allege particularized facts raising a reasonable doubt whether the Board made a valid business judgment by agreeing to pay Mr. O'Connor the full target amount of his long-term incentive award for 2009-2011 ($1.25 million), in accordance with the terms of his 2009 Employment Agreement. Plaintiff acknowledges that in negotiating the terms of the Employment Agreement and the subsequent Retirement Agreement the Board was following the guidance promulgated by the IRS in Revenue Ruling 2008-13. As demonstrated below, that admitted fact is dispositive of plaintiff's argument that demand is excused.

1. Plaintiff Cannot Sue The Directors For Following The Guidance In Revenue Ruling 2008-13.

Plaintiff recounts at length the history behind Revenue Ruling 2008-13, 2008 WL 451876 (IRS Feb. 21, 2008). He argues that the IRS was right in concluding in 2008 that any incentive award that is payable at target upon retirement is not performance-based. But he vehemently challenges the IRS's decision to promulgate transition rules that not only grandfathered existing agreements but also allowed companies to enter into new agreements providing for payment at target upon retirement for performance periods beginning on or before January 1, 2009. Pl. Br. at 29-30. Plaintiff even goes so far as to ask this Court to "void" the IRS's Revenue Ruling, while keeping in effect the part he thinks is right. *Id*. at 31. Even more remarkably, plaintiff argues that the "whole world" should have realized that the IRS' transition rules were "void" as soon as they were promulgated and that it was therefore a breach of fiduciary duty for the directors to "gamble" by following the IRS's guidance. *Id*. at 32. Plaintiff predicts that the IRS will "correct[] its mistake" at some point in the future, *id.*, resulting in the loss of tax deductions not only for the $1.25 million payment to Mr. O'Connor but for ***all*** payments made to Covered Employees under the EIP, including payments under the Synergy Plan.

All of these arguments should be rejected. There was nothing irrational about the Republic Board's decision to rely on the transition rules promulgated by the IRS in Revenue Ruling 2008-13. Revenue rulings are published for the express purpose of giving taxpayers guidance. The IRS's Revenue Procedures explain that "[t]axpayers generally may rely upon revenue rulings" like Revenue Ruling 2008-13 that are "published in the Bulletin in determining the tax treatment of their own transactions." Rev. Proc. 89-14, 1989 IRB LEXIS 93 (Jan. 1989),

§ 7(5). The IRS can revoke or modify Revenue Rulings, but when it does so "the authority of section 7805(b) ordinarily is invoked to provide that the new rulings will not be applied retroactively to the extent that the new rulings have adverse tax consequences to taxpayers." *Id*., § 7(3). It seems highly unlikely that the IRS would suddenly decide that it had made a mistake and would revoke the transition rules that it promulgated in Revenue Ruling 2008-13 after taxpayers had relied on them in entering into employment agreements. That is particularly true since it is now four years since the IRS issued Revenue Ruling 2008-13. Plaintiff cites nothing to suggest that the IRS believes it made a "mistake," let alone has done anything to "correct" it.

Furthermore, although plaintiff says that the "whole world" knows that the IRS overstepped its boundaries in issuing the transition rules, he does not cite anything to suggest a groundswell of support for that proposition. He cites no contemporaneous commentary on the IRS's exercise of its power or any advice from the many tax practitioners whose white papers are available on the internet warning companies that they would be "gambling" to rely on the IRS's transition rules. Nor does plaintiff offer any explanation as to why he himself missed this issue not only in his first lawsuit, but also when he filed his initial complaint in this action challenging the LTIP provision. If, as he now claims, it was obvious that a company could not reasonably rely on the transition rules in Revenue Ruling 2008-13, plaintiff should have recognized the problem immediately. That he came up with this novel argument only after defendants cited Revenue Ruling 2008-13 in their motion to dismiss his initial complaint demonstrates that plaintiff is grasping at straws.[9]

[9] Plaintiff is also grasping at straws by asking this Court to decide the limits of the IRS's authority and actually reach out and declare a portion of an IRS Revenue Ruling "void." It is remarkable that plaintiff should make such an outlandish request in a case where he purports to be acting on behalf of Republic.

In any event, for demand futility purposes, plaintiff has to plead particularized facts showing that the directors either acted in bad faith or committed waste. Whether or not the IRS had the power to provide the guidance it did to corporate America is beside the point; the directors' decision to follow that guidance cannot possibly be deemed an act of bad faith or waste.

2. The LTIP Payment Did Not Destroy The Deductibility Of The EIP.

Plaintiff's assertion that the LTIP payment to Mr. O'Connor was the proverbial nail that ultimately caused the kingdom to be lost should also be rejected. Plaintiff appears to acknowledge that whether an award is deemed performance-based is determined on a grant-by-grant basis. So even if the payment to Mr. O'Connor somehow turned out not to be deductible, there is no reason to think that it would infect any other grants to him or any other Covered Employee. *See* Def. Opening Br. at 20 n.15. Plaintiff, however, offers a brand new and extraordinarily convoluted theory in his brief as to why the LTIP payment will supposedly result in the destruction of any and all deductions. In a nutshell, his argument is that the retirement provisions in Mr. O'Connor's 2009 Employment Agreement somehow vitiated the shareholder approval of the 2009 EIP (including the Synergy Plan), rendering all payments made to Covered Employees under the EIP non-deductible because the exception in section 162(m) applies only to compensation paid under an incentive plan that was properly approved by the shareholders.[10] *See* Pl. Br. at 35.

---

[10] Plaintiff also complains that Republic improperly obtained shareholder approval of the EIP in 2009 because it supposedly "buried" the terms of Mr. O'Connor's Employment Agreement. *See* Pl. Br. at 36. Any argument attacking the sufficiency of the disclosures in the 2009 Proxy Statement is barred by principles of *res judicata*, however. *See* Def. Opening Br. at 21-22. In any event, the Proxy Statement summarized the terms of Mr. O'Connor's employment agreement and specifically noted that his 2009-2011 LTIP would be paid at target if he retired before the measurement period ended. *See* Def. Ex. F, at 36. That this issue was not specifically

Plaintiff's new argument should be rejected. It hinges on the notion that the Compensation Committee somehow modified the terms of the EIP when it interpreted the EIP as permitting it to enter into individual employment agreements that deviated from the default rule in § 5.1, which requires awards to retiring employees to be paid on a pro rata basis and then only if the award would have been fully earned had the employee not retired. Plaintiff acknowledges that § 5.3 of the EIP expressly allows the Compensation Committee to depart from that ordinary rule when it negotiates individual employment agreements. Pl. Br. at 34; Am. Compl. ¶¶ 14-15. He argues, however, that § 5.3 "says nothing about § 4.2" which he reads as imposing a blanket prohibition on paying "Awards" unless performance goals have been achieved. Thus, although § 5.3 specifically ***allows*** different retirement and termination provisions in separate employment agreements, plaintiff contends that § 4.2 effectively ***prohibits*** such agreements.

Once again, such a result violates basic rules of contract construction, including the rule that a court should not assume that any provisions are superfluous. Furthermore, even if there were some inconsistency (which there is not), the specific provisions in § 5.3 would control over the general principle set forth in § 4.2. *See Stasch v. Underwater Works, Inc.*, 158 A.2d 809, 812 (Del. Super. 1960) ("Where there is an inconsistency between general provisions and specific provisions, the specific provisions ordinarily qualify the meaning of the general provisions").[11]

---

discussed in the part of the Proxy Statement that was devoted to the proposal to approve the EIP does not affect the validity of the shareholder approval. There was in fact disclosure. Moreover, for the reasons outlined above, plaintiff is wrong in arguing (i) that the LTIP retirement provision in Mr. O'Connor's Employment Agreement affected the deductibility of payments under the EIP and (ii) that it deviated from the terms of the EIP. Under these circumstances, there was no reason to include a discussion of that specific provision in the portion of the Proxy Statement devoted to a description of the EIP that the shareholders were being asked to approve.

[11] Plaintiff's interpretation of § 4.3 is also at odds with § 5.2, which provides for payment of awards, at target, when a participant dies before an award period ends. *See* Def. Ex. I. Under plaintiff's view, that award would also be prohibited under § 4.3 even though it is expressly mandated by § 5.2.

It is particularly appropriate to apply those rules of construction here, where the Compensation Committee had already entered into an employment agreement that contained retirement provisions that deviated from § 5.1, in accordance with the IRS's guidance. That alone demonstrates that the intent of § 5.3 of the EIP was to allow the Compensation Committee to enter into employment agreements with provisions just like the LTIP provision in Mr. O'Connor's Employment Agreement.

In any event, the Compensation Committee's interpretation of the EIP was well within its broad power to "construe, interpret and implement the Plan and any related document" and to "reconcile any inconsistency in the Plan." Def. Ex. I, § 6.1. Contrary to plaintiff's argument, the Committee's common sense interpretation of the EIP does not constitute a decision to "amend" the plan to "giv[e] the [Compensation Committee] power to overrule § 4.2, if not all other provisions of the EIP." Pl. Br. at 35. The Committee did not "overrule" § 4.2 of the EIP, nor has it ever claimed the power to ignore that or any other provision of the EIP. Instead, it merely interpreted § 5.3 in accordance with its plain meaning. Accordingly, there was no "modification" of the EIP and thus no need for a new shareholder vote.

Indeed, that would be true even if the Compensation Committee had erroneously interpreted § 5.3 (which it did not). Plaintiff cites absolutely no authority for his assertion that a failure to properly interpret an incentive plan on a particular point is somehow the equivalent of an unapproved modification of the terms of the plan. Indeed, the plan itself is designed to avoid just such a result by giving the Compensation Committee broad power not only to interpret the plan, but also to resolve any inconsistencies in the Plan. Because the shareholders approved that grant of power to the Compensation Committee, there is no basis for claiming that its exercise of that power somehow constituted an unapproved modification of the Plan.[12] More importantly, for purposes of a demand futility analysis, plaintiff has failed to allege any particularized facts showing that the directors knowingly and intentionally violated the express provisions of the EIP or that they acted in bad faith by interpreting the Plan as they did. Accordingly, demand was not excused as to this claim.

3. The $1.25 Million Payment Was Deductible Because Mr. O'Connor Was Not A "Covered Employee" On The Last Day Of The Tax Year In Which The Payment Was Made.

The $1.25 million LTIP payment Republic made to Mr. O'Connor in 2011 was deductible under the IRS's own transition rules. But it is also deductible for another reason: Mr. O'Connor was ***not*** a "Covered Employee" at the end of 2011, which is the tax year in which the payment was made. Under 26 U.S.C. § 162(m)(3), the term "covered employee" means "any employee of the taxpayer if— (A) ***as of the close of the taxable year***, such employee is the chief executive officer of the taxpayer or is an individual acting in such a capacity" (emphasis added); *see also* Def. Opening Br. at 17. Plaintiff does not dispute that Mr. O'Connor was not a "Covered Employee" at the end of 2011. Instead, he argues (at 27) that Mr. O'Connor was still the CEO when Republic signed his Retirement Agreement in 2010 and that his LTIP compensation should therefore be deemed to have been "awarded" in 2010.

Plaintiff cites no authority supporting his argument that the deductibility of a payment depends on the employee's status at the close of the tax year in which the compensation was "awarded." At page 28 of his brief, he cites regulations that address an entirely different issue —

---

[12] It is unclear why plaintiff, ostensibly acting on behalf of Republic, would take such an extreme position in the apparent hope of depriving the Company of the tax benefits of shareholder approval. He cites nothing to suggest that the IRS would take that view. Thus, the only "threat" to the deductibility of payments under the EIP appears to come from plaintiff himself.

when an award will be deemed "performance based." He then quotes advice provided by the IRS's Chief Counsel, Memo 2009-006, 2009 WL 2138881 (July 17, 2009) (Pl. Ex. 24), on yet another completely different topic that arose when companies that had back-dated options tried to find a way to salvage their deductibility.[13] Some companies argued that repricing the options to fair market value before they were exercised would cure the defect, citing as an analogy the rule that an employee's status as a "Covered Employee" depends on "the facts existing as of the last day of the taxable year for which the employer would claim the deduction." *Id.*; Pl. Ex. 24 at 8. The Chief Counsel did not dispute that this is an accurate summary of the rule that applies in determining who qualifies as a "Covered Employee." Instead, he found the analogy unpersuasive on the issue before him — whether repriced options were "performance-based" — because "the regulations specifically require that the determination whether compensation attributable to stock options is performance-based be made at the time of grant, not at the time of exercise." *Id.* Here, by contrast, the statute specifically requires that the determination whether an employee is a Covered Employee be made at the close of the "taxable year" — that is, the year in which the Company would ordinarily deduct the payment. Plaintiff cites nothing to suggest that the payment would have been deducted in 2010, at a time when Mr. O'Connor was the CEO, as opposed to 2011, when the payment was actually made.[14]

* * * *

For all of the reasons outlined above, Republic's directors had every reason to believe that the $1.25 million payment would be fully deductible. Even if plaintiff's analysis of the tax

---

13 To be deemed performance-based under section 162(m), options must be granted at fair market value on the date of the grant. *See* Def. Opening Br. at 9 n.7. Options that were back-dated to achieve a lower strike price did not meet this requirement.

14 Section 162(a) allows a company to deduct expenses "paid or incurred" during the taxable year. 26 U.S.C. § 162(a). Republic deducts LTIP payments in the year in which they are paid. Thus, the "taxable year" for purposes of the payment to Mr. O'Connor was 2011.

issue were right (which it is not), he alleges no facts to suggest that the directors acted in bad faith. Thus, he has failed to show that demand is excused on any claim he might make that the directors breached a claimed fiduciary duty to "minimize" taxes with respect to the $1.25 million payment.

Nor has plaintiff shown that demand is excused on any waste claim plaintiff might pursue related to the alleged non-deductibility of the $1.25 million payment. Again, there is no reason to believe that Republic will not be able to deduct that payment. Whether it can or cannot do so, however, the payment does not constitute waste, since it was made pursuant to Mr. O'Connor's 2009 Employment Agreement. Notwithstanding plaintiff's apparent disagreement with the compensation decisions the Board made with respect to Mr. O'Connor, he does not and cannot allege that Republic failed to receive any substantial consideration for the promises it made in that Employment Agreement or that the directors acted in bad faith in entering into it.

C. Plaintiff Has Not Met His Burden Of Alleging Demand Futility With Respect To The $1.8 Million Payment To Mr. O'Connor.

Demand is also not excused with respect to plaintiff's claim that the Board committed waste by agreeing to pay Mr. O'Connor $1.8 million more than his Employment Agreement required when he retired. Our opening brief argued (at 22-23) that Mr. O'Connor's agreement to work with the Company to ensure a smooth transition was consideration enough for this relatively modest additional payment. In response, plaintiff argues that Mr. O'Connor was not in control of his retirement, as defendants had argued, because his agreement required him to give 12 months' notice when he decided to retire. Pl. Br. at 18. This argument misses the point. Mr. O'Connor's Employment Agreement had an evergreen provision under which he would continue to be employed indefinitely as CEO unless he decided to retire of his own accord or the Board terminated him. *See* Def. Ex. B, § 1(b). Since a termination would not be conducive to a smooth transition and Mr. O'Connor was under no compulsion to announce his retirement when he did, he had significant leverage in negotiations concerning the date of his departure and the terms of the transition. Whether it was reasonable for the Board to agree to pay Mr. O'Connor $1.8 million more than his Employment Agreement called for in order to secure a smooth transition is a business judgment that this Court should not second-guess.

Plaintiff also argues (at 19) that the fact that the Retirement Agreement describes the payment of $1.8 million as being made "to reward you for your long service to the Company" precludes defendants from claiming that the payment was anything other than a retroactive payment for past service. Def. Ex. C, at 3. But the first paragraph of the Retirement Agreement specifically states 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 you will make to the Company." Def. Ex. C, at 1. One of those "commitments" was the agreement to pay an additional $1.8 million. No matter how the payment was described, it is one aspect of an agreement that was supported by consideration and therefore cannot be deemed waste.[15]

In any event, as plaintiff acknowledges, retroactive compensation is permissible under certain circumstances even without any new consideration. In *Blish v. Thompson Automatic Arms Corp.*, 64 A.2d 581, 588-89 (Del. 1948), the Delaware Supreme Court held that there is an exception to the general rule that retroactive compensation is not permissible "[w]here the amount awarded is not unreasonable in view of the services rendered." *See also Zupnick v.*

---

[15] Plaintiff cites the fact that the Retirement Agreement has a severability clause as support for his position that the $1.8 million must be deemed to be in return *only* for Mr. O'Connor's "long service" to the Company and cannot be viewed as being supported by the other promises made in the Agreement. Pl. Br. at 19. But all the severability clause does is to state the parties' intention of preserving the remainder of the agreement if one provision is held unenforceable. It does not purport to treat every provision as if it were a standalone, individual agreement.

Goizueta, 698 A.2d 384, 388 (Del. Ch. 1997) (quoting *Blish*). Plaintiff argues (at 19) that the exception articulated in *Blish* is limited to situations where the services rendered were "unusual in character and extraordinary." But that confuses the Court's description of the scope of the exception, which is quoted above, with its description of the particular facts in *Blish*. The Court held that the exception applied because the individual in question had rendered services that were "unusual in character and extraordinary, from which [the company] received great gains and profits." *Blish*, 64 A.2d at 607.

Plaintiff also argues that he has alleged enough under Rule 12(b)(6)'s notice pleading standard to call into question whether the exception applies here and to shift the burden to the defendants to defend the $1.8 million payment. That argument, however, ignores the different standard that applies under Rule 23.1. Again, plaintiff does not allege that the directors had any personal interest in paying Mr. O'Connor an additional $1.8 million. Thus, to excuse demand, he must plead particularized facts showing that the decision to enter into the Retirement Agreement, including the $1.8 million payment, was so "egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests." *Goldman Sachs*, 2011 Del. Ch. LEXIS 151, at *51. Plaintiff has not met that standard. He has not alleged facts to suggest, for example, that Mr. O'Connor would have been willing to enter into the Retirement Agreement absent the additional payment. Nor has he alleged any particularized facts to show that $1.8 million was an unreasonable payment for past services in light of Mr. O'Connor's accomplishments.[16] Under these circumstances, plaintiff has failed to meet his burden of pleading demand futility with respect to the $1.8 million payment.

---

[16] Mr. O'Connor was, after all, Republic's CEO for twelve years; over that time, Republic enjoyed spectacular growth and its stock increased significantly in value, while investments in other companies remained stagnant. *See* note 1, *supra*.

II. Plaintiff Has Failed To State A Claim Under Rule 12(b)(6).

For the reasons outlined above, plaintiff has failed to properly allege demand futility with respect to all but one of his claims and has also failed to state a claim even under the more liberal notice pleading standard in Rule 12(b)(6). The one claim we have not yet addressed in this reply brief is plaintiff's challenge to the directors' own compensation.

Plaintiff begins by arguing that his claim that the directors overpaid themselves must be judged under an "entire fairness" standard under which the burden is on defendants to show that the compensation was entirely fair. Pl. Br. at 40. In so arguing, plaintiff ignores the fact that the award of restricted stock to the directors was made pursuant to the shareholder-approved Stock Plan. The fact that the shareholders approved that plan means that the ordinary waste standard, rather than the "entire fairness" standard, applies. Indeed, one of the primary cases plaintiff relies upon, *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997), makes precisely this point. As the court explained, an "informed, uncoerced, disinterested shareholder ratification of a transaction in which corporate directors have a material conflict of interest has the effect of protecting the transaction from judicial review except on the basis of waste." *Id*. at 336; *accord In re 3Com Corp. S'holders Litig.*, 1999 Del. Ch. LEXIS 215, at *11-12 (Del. Ch. Oct. 25, 1999).

Plaintiff argues that he has alleged sufficient facts to support his claim that the directors committed waste because he claims that the directors' compensation, and particularly the one-time award of restricted stock made in 2009, is "unusual" and exceeds the compensation paid by certain other companies. Pl. Br. at 40. But, as this Court concluded in *Goldman Sachs*, the fact that one company's compensation differs from another's (or even diverges from a claimed peer group) is not enough to state a claim for waste. 2011 Del. Ch. LEXIS 151, at *52-55. So too is the fact that there was a one-time payment to the directors. Once again, to prove waste plaintiff must be able to show that exchange of consideration was "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). Plaintiff has not alleged any basis for believing that he can meet that standard.

III. Defendants Slager And Holmes Should Be Dismissed.

Plaintiff has named defendants Slager (the new CEO) and Holmes (the CFO) on the theory that they were both Covered Employees and were unjustly enriched because the Board awarded them compensation that was supposedly not tax deductible. Plaintiff's unjust enrichment argument fails with respect to Mr. Holmes because, as the CFO, he is ***not*** a Covered Employee under section 162(m). As defendants pointed out in their Opening Brief (at 33-34), the IRS has advised taxpayers that, in light of changes in SEC regulations, the CFO no longer qualifies as a Covered Employee. Plaintiff once again argues that the IRS is wrong. But plaintiff's argument rests on a misreading of the governing statute.

Contrary to plaintiff's truncated quotation of the statute (at 47), section 162(m)(3)(A) does ***not*** define the term "Covered Employee" to mean the CEO and the company's other "four highest compensated officers." Instead, it defines that term to include the CEO and any other employee whose "total compensation . . . for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 ***by reason of*** such employee being among the 4 highest compensated officers for the taxable year (other than the chief executive officer)." (Emphasis added). As plaintiff himself recognizes (at 48), the SEC regulations changed in 2006 so that companies are now required to report the compensation of their CFOs simply because they hold the position as CFO — and ***not*** "by reason of" the fact that they are among the four highest compensated employees other than the CEO. Thus, as the IRS itself has recognized, under the plain language of the statute, the CFO is no longer included within the definition of a "Covered Employee." *See* IRS Notice 2007-49, *Covered Employees Under § 162(m)(3)*, 2007 WL 1586307 (June 18, 2007).

Plaintiff argues that this construction is unreasonable and inconsistent with what he perceives to be the intent of section 162(m). But the IRS has decided to follow the plain language of the statute, rather than trying to divine its intent. That plaintiff does not want to accept the IRS's view is not a reason for suing Mr. Holmes, who is not alleged to have played any role in making the compensation decisions plaintiff complains about.

Another reason why both Mr. Holmes and Mr. Slager should be dismissed from the action is that neither of them would have been unjustly enriched even if plaintiff were right (which he is not) that the Company will not be able to claim tax deductions on their restricted stock awards and Synergy bonuses. Unjust enrichment requires proof not only that the plaintiff has been impoverished, but also that the defendants have been unjustly enriched. Pl. Br. at 49. Even if we assume, for purposes of argument, that the Company has been impoverished because its deductions will be disallowed, the tax impact has not enriched the recipients of the compensation — unjustly or otherwise. Accordingly, since neither Mr. Slager nor Mr. Holmes is alleged to have been responsible for the decisions plaintiff challenges, both of them should be dismissed regardless of how the Court rules on the motion to dismiss.

CONCLUSION

For the foregoing reasons and the reasons set forth in defendants' Opening Brief, 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).

BOUCHARD MARGULES &
FRIEDLANDER, P.A.

/s/ Andre G. Bouchard
Andre G. Bouchard (#2504)
222 Delaware Avenue, Suite 1400
Wilmington, DE 19801
(302) 573-3500
(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

Dated: February 21, 2012