IN THE COURT OF CHANCERY FOR THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

FREDERICK WEISS,
Plaintiff,
v.

ROBERT H. SWANSON, JR., DAVID S. LEE, RICHARD M. MOLEY, THOMAS S. VOLPE, LEO T. McCARTHY, LOTHAR MAIER, PAUL COGHLAN, DAVID B. BELL, ROBERT C. DOBKIN, DONALD PAULUS, ALEXANDER McCANN,
Defendants,

and

LINEAR TECHNOLOGY CORPORATION,
Nominal Defendant.

C.A. No. 2828-VCL

DEFENDANTS' OPENING BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS

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INTRODUCTION

Plaintiff Frederick Weiss ("plaintiff") purports to assert derivative claims against current and former officers and directors of Linear Technology Corporation ("Linear") in connection with stock options granted before or after the Company's routine quarterly earnings announcements. Although the instant case involves the granting of stock options, it is in stark contrast to the recent spate of shareholder derivative cases concerning stock option practices. This case does not involve "backdating" of options in which the company issues stock options on one date while the documentation states that options were issued on a different date.[1] There are no allegations here of accounting violations or restated financials.[2] There are no allegations that the fair market value restrictions in Linear's stock option plans were violated by the issuance of stock options with strike prices below the fair market value of the stock, or that there were falsely stated strike prices or dates in Form 4s or proxy statements.[3]

Instead, the First Amended Complaint ("FAC") alleges that unidentified members of Linear's Board granted options that were "bullet dodged" (options granted after a negative announcement in the expectation of a price drop) or "spring loaded" (options granted before a positive announcement in the anticipation that the share price will increase in response to the news). Granting stock options that are bullet dodged or spring loaded has never been declared unlawful, either eleven years ago when the stock options

[1] *See Ryan v. Gifford*, 918 A.2d 341, 345 (Del. Ch. 2007) (discussing backdating controversy).

[2] *Compare Desimone v. Barrows*, 924 A.2d 908, 913, 923-24 (Del. Ch. 2007) (backdated options resulted in restatement with non-cash charges to the balance sheet and resultant reduction of earnings); *In re CNET Networks, Inc. S'holder Derivative Litig.*, 483 F. Supp. 2d 947, 950-51 (N.D. Cal. 2007) (restated financials with additional stock compensation expenses of $105 million); *In re Openwave Sys., Inc. S'holder Derivative Litig.*, No. C 06-03468 SI, 2007 WL 1456039, at *1 (N.D. Cal. May 17, 2007) (restatements with $182 million charge for stock based compensation).

[3] *Openwave*, 2007 WL 1456039, at *1 (measurement dates and strike prices differed from dates in public filings).

at issue were first granted or under the SEC's rules. The SEC to this day has never prohibited bullet dodging or spring loading options.

On May 25, 2007, defendants moved to dismiss the complaint as originally filed. Since the filing of Defendants' Opening Brief ("DOB"), Vice Chancellor Strine issued his decision in *Desimone*, 924 A.2d 908, on June 7, 2007. *Desimone* is the first case in Delaware to address bullet dodging. Following an extensive analysis of both bullet dodging and spring loading, the Court dismissed all claims based on these practices. Notwithstanding the absence of any SEC rule prohibiting these practices and the dismissal decision in *Desimone*, plaintiff persists in his quest to impose liability for breach of fiduciary duty against eleven individual defendants.

There are several key facts that make dismissal here even more compelling than in *Desimone* and materially distinguish this case from *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563 (Del. Ch. 2007), which declined to dismiss spring loading allegations.[4] In contrast to the allegations in *Tyson*, plaintiff here admits that the options practices did not violate "*the strict letter* – of Linear's applicable stock option plans." FAC ¶ 5 (emphasis added). Indeed, Linear's stock option plans authorized the granting of options "to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to Employees, Directors and Consultants, and to promote the success of the Company's business." This broad discretion allowed grants that were not limited to creating incentives for future performance, notwithstanding plaintiff's unsubstantiated complaints that defendants granted stock options "to compensate for past performance rather than solely as an incentive for future performance." FAC ¶¶ 145, 202. There is no issue here, as there was in *Tyson*, whether the shareholders who approved Linear's stock option plans were misled to believe that

[4] More recently, Vice Chancellor Chandler denied the defendants' motion for judgment on the pleadings. *In re Tyson Foods, Inc. Consol. S'holder Litig*., No. 1106-CC, 2007 WL 2351071 (Del. Ch. Aug. 15, 2007).

options would only be granted to create incentives for future performance. Plaintiff's attempt to make this case into *Tyson* fails utterly.

The *Desimone* Court made clear that the "recipient of a bullet-dodging option takes the option with an exercise price equal to the current value of the stock." 924 A.2d at 944. "Even when an option plan requires fair-market-value grants, such grants fully comply with that restriction." *Id.* at 948. Spring loaded options also "do not clearly violate the literal terms of a fair-market value restriction because such options are issued at the fair market value prevailing in public markets on the date of issuance." *Id.* at 937 n.98. None of the challenged grants violated the fair market value restrictions in Linear's stock option plans. The options were not "hidden bonuses." And, the Board could grant options for reasons other than to create incentives for future performance. Accordingly, there was no violation of the plans and no basis for imposing liability.

The claims fail to state a cause of action under Rule 12(b)(6). *See* Sections II-IV, VI-VIII, *infra*. In addition, the statute of limitations bars claims based on sixteen of the twenty-two sets of grants at issue. *See* Section V, *infra*. Claims against individuals who had no defined role in the grants must be dismissed. *See* Section IX, *infra*. Finally, demand on the Board is not excused as to the officer grants. *See* Section -X, *infra*. Thus, the First Amended Complaint must be dismissed.

STATEMENT OF FACTS

The Company. Linear is a Delaware corporation that was founded in 1981. Today, Linear employs over 3,700 people, in the United States and elsewhere. It is a leading producer of integrated circuits that support the communications, computing, industrial, and automotive markets. Linear's analog chips in particular are vital to many versatile products and systems, helping to guard against voltage surges. They are used in

such varied devices as medical ultrasound machines, military and space systems, and hybrid car batteries. The success of the Company is nothing short of phenomenal.[5]

Linear's fiscal year 2006 revenues were over $1 billion, and its net income was over $428 million. DiTomo Aff., Ex. 4 at 11. In the period since 1995, Linear's revenues have totaled over $7.8 billion, and the Company has reported net income of over $2.6 billion. The Company's current market capitalization is approximately $7.6 billion. According to a recent Wall Street Journal article, in 2006, Linear's percent of profit on sales was "more than five times the average for U.S. industrial companies," and "outpaced . . . profit powerhouses" including Microsoft and Google.[6]

Procedural History. Plaintiff first filed his complaint on March 23, 2007, asserting that twenty sets of option grants had been spring loaded or bullet dodged between July 1996 and 2005. Plaintiff asserted two counts, one for breach of fiduciary duty against all defendants, and one for unjust enrichment against those defendants who had received the supposedly tainted options.

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[5] *See* FAC ¶¶ 31; Affidavit of John P. DiTomo ("DiTomo Aff.") Ex. 4, Linear's Form 10-K for year ended July 2, 2006, at 2, 8 (cited at FAC, e.g., ¶¶ 35, 133, 150).

Defendants request that the Court review all exhibits attached to the DiTomo Aff. Certain of the exhibits, as shown therein, are referenced and cited directly in the First Amended Complaint. *See id*. Accordingly, they are incorporated by reference, as this Court has held. *President & Fellows of Harvard College v. Glancy*, No. 18790, 2003 WL 21026784, at *12 (Del. Ch. Mar. 21, 2003) (reviewing voting trust agreement and shareholder agreement). *See In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 169 (Del. 2005) (court may consider documents referenced in complaint without converting dismissal into motion for summary judgment); *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001).

Other exhibits may be judicially noticed under D.U.R.E. 201 as facts "not subject to reasonable dispute" that are "capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." *Malpiede*, 780 A.2d at 1090 (Del. 2001) (taking notice of defendant's certificate of charter); *Hughes*, 897 A.2d 170 (affirming court's taking judicial notice of how stockholders voted as set forth in SEC filings); *Weiss v. Samsonite Corp*., 741 A.2d 366, 375 (Del. Ch. 1999) (taking judicial notice of company's closing stock prices), *aff'd*, 746 A.2d 277 (Del. 1999).

[6] DiTomo Aff., Ex. 17 at 2, G. Anders, *Pricing Power: In a Tech Backwater, A Profit Fortress Rises—Maker of Arcane Chips Earns Better Margins Than Google, Microsoft*, Wall St. J., July 10, 2007.

On May 25, 2007, defendants filed their Motion to Dismiss the Complaint, arguing that plaintiff failed to state a claim pursuant to Chancery Court Rule 12(b)(6) and failed to plead facts establishing that demand would have been futile under Chancery Court Rule 23.1. Two weeks after defendants filed their motion to Dismiss, Vice Chancellor Strine issued his decision in *Desimone*, dismissing all claims based on bullet dodged and spring loaded option grants. Plaintiff's Opposition in this case was scheduled to be filed on August 17. Instead, plaintiff chose to file an amended complaint.

The First Amended Complaint. The First Amended Complaint has deleted certain previously challenged grants and added others.[7] The FAC challenges a total of twenty-two sets of grants, starting on July 23, 1996 and ending on July 27, 2005. Of the twenty-two sets, thirteen are allegedly spring loaded and nine are allegedly bullet dodged. Plaintiff now asserts four counts. Count I (FAC ¶¶ 182-87) continues to assert a claim for breach of fiduciary duty against all defendants. Count II (*id.* ¶¶ 188-91) continues to assert a claim for unjust enrichment against the defendants who received the challenged grants. Count III (*id.* ¶¶ 192-200) asserts a claim against the director defendants for a breach of fiduciary duty arising from an alleged failure to disclose material information in certain of Linear's Proxy Statements. Count IV (*id.* ¶¶ 201-04) alleges a claim for waste against the director defendants.

The Director Defendants. Six of the eleven defendants are current or former directors. Mr. McCarthy, who died on February 5, 2007, served twelve years as Lieutenant Governor of the State of California and retired from elective office in 1994. He was an outside director and served on the Compensation Committee from 1995 until November 2006. FAC ¶ 16. Mr. Lee is a former Regent of the University of California and served as an advisor to Presidents George Bush and Bill Clinton on the Advisory

[7] The FAC deletes the allegedly spring loaded grants made on April 19, 2000. It now includes allegedly spring loaded grants made on January 12, 1999 and January 16, 2001 and allegedly bullet dodged grants made on October 16, 1996.

Committee on Trade Policy and Negotiation. He is an outside director and has been a member of the Compensation Committee since 1995. *See id.* ¶ 13. Mr. Moley, a former director of Cisco Systems, is an outside director, and has been a member of the Compensation Committee since 1995. *Id.* ¶ 14. Mr. Volpe, who has managed private risk capital or investment banking firms for over twenty years, is an outside director and has been a member of the Compensation Committee since 1995. *Id.* ¶ 15. Mr. Swanson is a founder of Linear. He served as CEO from Linear's inception until 2005. He has served as a director since 1981, was Chairman of the Board from 1999 to January 2005, and has been Executive Chairman of the Board since January 2005. *Id.* ¶ 12. Mr. Maier is Linear's current CEO. He did not join the Board until September 2005, after the last of the challenged options was granted. *Id.* ¶ 17.

Management Defendants. The remaining five defendants are current or former executives. They include Mr. Coghlan, VP and CFO since late 1986; Mr. Bell, President from 2003 until January 2007; Mr. Dobkin, VP of Engineering and CTO since April 1999; Mr. Paulus, General Manager of Linear's Power Products since 2003; and Mr. McCann, COO since 2005. FAC ¶¶ 23-27.

ARGUMENT

I. THE STANDARDS APPLICABLE TO THIS MOTION

Rule 12(b)(6). Court of Chancery Rule 12(b)(6) requires dismissal when the complaint fails to allege facts that entitle plaintiff to relief. The Court must assume as true all well-pleaded allegations of fact and all reasonable inferences to be drawn from those facts. *White v. Panic*, 793 A.2d 356, 363 (Del. Ch. 2000), *aff'd*, 783 A.2d 543 (Del. 2001). However, "'neither inferences nor conclusions of fact unsupported by allegations of specific facts . . . are accepted as true.' . . . . This court 'need not blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences.'" *Id.* (citation omitted); *Albert v. Alex. Brown Mgmt. Servs., Inc.*, No. 762-N, 2005 WL 1594085, at *12 (Del. Ch. June 29, 2005) (citations omitted); *In re 3Com Corp. S'holders Litig.*, No. 16721, 1999 WL 1009210, at *2 (Del. Ch. Oct. 25, 1999) (allegations "which are merely conclusory and lacking factual basis in the complaint will not survive a motion to dismiss"). A "claim may be dismissed if allegations in the complaint or in the exhibits incorporated into the complaint effectively negate the claim as a matter of law." *Malpiede*, 780 A.2d at 1083 (citations omitted).

Demand Futility. Plaintiff concedes that he has have never made demand on Linear's Board. FAC ¶ 175. To show futility under Delaware law, plaintiff must allege particularized facts creating a reasonable doubt that 1) the directors are disinterested and independent, or 2) the challenged transaction was otherwise the product of a valid exercise of business judgment. *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). The business judgment rule "is a presumption that in making a business decision the directors of a corporation 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." *Aronson*, 473 A.2d at 812 (citations omitted). The burden is on the party challenging the decision to establish facts rebutting the presumption. *Id.* (citations omitted). The "mere threat of personal liability

for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors." *Id.* at 815. In "rare cases a transaction may be so egregious on its face that board approval cannot meet the test of business judgment, and a substantial likelihood of director liability therefore exists." *Id.* at 815 (citations omitted).

In the demand context, plaintiffs' pleading burden is "more onerous than that required to withstand [an ordinary] motion to dismiss." *Levine v. Smith*, 591 A.2d 194, 207 (Del. 1991), *overruled in part on other grounds by Brehm*, 746 A.2d 244 (Del. 2000). A complaint must comply with "stringent requirements of factual particularity;" conclusory statements are not considered as "expressly pleaded facts." *Brehm*, 746 A.2d at 254-55. If a derivative plaintiff fails to allege particular facts sufficient to excuse demand, his complaint must be dismissed even if the claim is otherwise meritorious. *Haber v. Bell*, 465 A.2d 353, 357 (Del. Ch. 1983).

II. PLAINTIFF DOES NOT PROVIDE PARTICULARS FOR ANY ALLEGED WRONGFUL CONDUCT

A. Plaintiff Does Not Plead The Circumstances Of The Allegedly Spring Loaded Or Bullet Dodged Grants

Plaintiff alleges that thirteen sets of grants were spring loaded. These include grants on July 23, 1996; January 14 and July 22, 1997; January 12, 1998; January 12, April 13 and July 20, 1999; January 16 and April 17, 2001; July 22, 2003; April 13 and July 20, 2004; and January 18, 2005. FAC ¶¶ 39, 48, 52, 56, 65, 69, 73, 77, 79, 101, 105, 109, 118. Of these, the options granted on January 14, 1997, January 12, 1999, January 16, 2001 and April 13, 2004 were not granted to any named defendants. *Id.* ¶¶ 48, 65, 77, 105. Of the thirteen sets of allegedly spring loaded option grants, members of the Compensation Committee allegedly received grants on four occasions: July 22, 1997; July 20, 1999; July 22, 2003; and July 20, 2004. *Id.* ¶¶ 52, 73, 101, 109.

Plaintiff alleges that nine sets of grants were bullet dodged. These include grants on October 16, 1996; January 22, 1998, July 25 and October 17, 2001; July 26, 2002;

January 15, 2003; October 14, 2004, April 20 and July 27, 2005. *Id.* ¶¶ 44, 60, 84, 89, 93, 97, 114, 122, 127. Of these, the options granted on October 16, 1996 were not granted to any defendant. *Id.* ¶ 44. Of the nine sets of allegedly bullet dodged grants, plaintiff alleges that members of the Compensation Committee received options on four occasions: July 22, 1998; July 25, 2001; July 26, 2002; and July 27, 2005. *Id.* ¶¶ 60, 84, 93, 127.[8]

Of the twenty-two sets of grants, half are underwater, as of the filing date of this action. Allegedly spring loaded options granted on January 16, 2001; April 17, 2001; July 22, 2003; April 13, 2004; July 20, 2004; and January 18, 2005, are underwater. Allegedly bullet dodged options granted on July 25, 2001; October 17, 2001; October 14, 2004; April 20, 2005; and July 27, 2005 are underwater. All of the foregoing options granted to the named defendants remain unexercised.

1. Plaintiff Does Not Plead The Specific Roles Of The Management Defendants

Plaintiff does not allege any specific conduct by any management defendant other than receipt of supposedly tainted options. Plaintiff never explains why he chose to name as defendants non-director executives who merely received allegedly spring loaded option grants, or how, for example, their mere receipt distinguishes them from non-defendant recipients identified, including Louis Dinardo, Robert Reay, Robert Swartz, Richard Nickson or David Quarles. *See, e.g.*, FAC ¶¶ 48, 65, 77, 105. Similarly, plaintiff does not explain why the "management defendants" are named as defendants for their mere receipt of allegedly bullet dodged option grants, whereas Mr. Dinardo, a recipient who is a former vice president, is not. *Id.* ¶ 44.

[8] Linear's fiscal year ends in early July. Outside directors are regularly granted options at Linear's July board meeting after the new fiscal year begins.

2. Plaintiff Does Not Plead The Specific Roles Of The Director Defendants

Plaintiff does not allege a single fact to describe how any grants were made. Instead, plaintiff alleges generally for all grants that the "Director Defendants, other than Maier, (a) authorized and approved one or more of the spring-loaded and the bullet-dodged options described herein at a time when they possessed material non-public information, soon to be released by Linear that would impact the Company's share price." FAC ¶ 155. Plaintiff makes a different allegation elsewhere that defendants "authoriz[ed], *or through abdication of duty* permit[ted]" the grants. *Id.* ¶¶ 1, 167, 185 (emphasis added).

For both types of option grants, the FAC does not describe who in fact authorized the grants or the circumstances, or any defendant's knowledge of or role in the timing of the grants. This is true also with respect to the Compensation Committee allegations. The FAC alleges that "Linear's public documents make clear that the Compensation Committee (or the Board as a whole) is directly responsible for approving and administering all of the option grants at issue." *Id.* ¶ 156. Plaintiff identifies Lee, McCarthy, Moley and Volpe as having served on the Compensation Committee "when the spring-loaded and/or bullet-dodged options described herein were issued." *Id.* ¶ 155. But plaintiff makes the same charges even against directors *who were not members* of the Compensation Committee, including Swanson. *Compare id.* ¶¶ 13-16 *with* ¶ 12. The FAC alleges that "Any delegation if this authority beyond the Compensation Committee would have been strictly impermissible and a clear breach of fiduciary duty." *Id.* ¶ 156; *see id*. ¶¶ 134, 137. Plaintiff *does not allege that there was delegation* beyond the Compensation Committee. *Id.* ¶¶ 156, 134, 137. It is not clear what purpose these assertions serve.

B. Plaintiff Does Not Plead Specific Violations Of Linear's Stock Option Plans

The Stock Option Plans. Preliminarily, plaintiff cites to three pertinent stock option plans, the "1988 Plan," the "1996 Plan," and the "2005 Plan." FAC ¶ 132. These plans provided for the granting of both Incentive Stock Options ("ISOs") and nonqualified or nonstatutory stock options ("NSOs").[9] Although the FAC cites to language included in Linear's stock option plans that pertain to Incentive Stock Options ("ISOs"), the FAC does not assert that any of the twenty-two sets of option grants were ISOs, and indeed they were not. FAC ¶¶ 135, 138, 142, 147. The option grants were NSOs.

No Violation Of Fair Market Value. Plaintiff cites language from the stock option plans requiring that the strike price of ISOs "'shall in no event be less than the fair market value per Share on the date of grant of the Option.'" FAC ¶ 135 (emphasis omitted); *see id.* ¶¶ 138, 142, 147. *There is not a single allegation that the strike prices of the grants were other than the fair market value on the grant dates.* Instead, plaintiff alleges the options were "favorably timed in conjunction with quarterly earnings releases." *Id.* ¶ 158.

Linear's Stock Option Plans Provide Extremely Broad Discretion To The Board And Do Not Require Grants To Be Incentive-Based For Future Performance. Plaintiff alleges that defendants used "stock options to compensate for past performance rather than solely as an incentive *for future performance*." FAC ¶ 202 (emphasis added); *see id.* ¶ 146 (defendants "deceptively conveyed the impression . . . that stock options had been granted in a manner consistent with the purposes, spirit, intent, and objectives of the plans (*including awarding future rather than past performance*)" (emphasis added).

[9] *See* DiTomo Aff., Ex. 3 at ¶ 1, Linear's 1996 Incentive Stock Option Plan, attached to Form 10-Q, filed February 7, 1997 (cited at FAC, e.g., ¶ 132) ("Options granted under the Plan may be Incentive Stock Options or Non-statutory Stock Options, as determined by the Administrator at the time of grant.").

Plaintiff continues to ignore the terms of Linear's stock option plans. Linear's stock option plans were not limited in the way plaintiff alleges. On the contrary, Linear defines "incentives" broadly. The plans authorize the granting of options "to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to Employees, Directors and Consultants, and to promote the success of the Company's business."[10] Although the FAC now cites to Compensation Committee Reports which accompanied certain proxy statements, FAC ¶ 151, those citations *undermine* plaintiff's allegations. The Reports describe the "compensation philosophy" as aligning "executive compensation with the Company's business objectives and performance and to attract, retain and reward executives who contribute both to the short-term and long-term success of the Company."[11]

Linear's 1996 Stock Option Plan provides among other things that the Board has the authority in its discretion:

> (i) to determine the Fair Market value;
>
> * * * *
>
> (v) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any Option granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Options may be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions . . .based in each case on such factors as the Administrator, in its sole discretion, shall determine;
>
> (vi) to reduce the exercise price of any Option to the then current Fair Market Value if the Fair Market Value of the Common Stock . . . shall have declined . . . ;
>
> * * * *
>
> (viii) to construe and interpret the terms of the Plan and awards granted pursuant to the Plan;
>
> * * * *

[10] *See* DiTomo Aff., Ex. 3 at 1.

[11] *See* DiTomo Aff., Ex. 1 at 15, Compensation Committee Report, attached to Linear's Form DEF 14A filed with the SEC on October 3, 1996 (cited at FAC, e.g., ¶ 151).

(x) to modify or amend each Option . . . .[12]

Thus, options can be granted to encourage successful future performance where "success of the Company" is not defined or limited by the perspective of a single quarter but rather embraces growth over a much lengthier period. In addition to using options as a recruitment tool, options can be granted to retain personnel as well as to reward them. The Company has made plain to its investors that it views "incentives" to executives broadly and that compensation would be used to meet the broad goals of the Company. Notably, plaintiff does not allege that Linear has not been successful during the relevant time, and given its phenomenal growth and revenues of $7.8 billion since 1995, cannot make such an assertion.

No Alleged Ultra Vires Violations. Plaintiff not only ignores the broad and varied discretionary authority for how and when stock options are granted at Linear, but also fails to cite any authority attacking the scope of this discretion. Indeed, the Board's judgment to determine and define the consideration for the granting of options is "conclusive" in the absence of "actual fraud." 8 *Del. C.* § 157(b); *Zupnick v. Goizueta*, 698 A.2d 384, 387 (Del. Ch. 1997). Delaware law recognizes that stock options are not limited to "motivat[ing] the recipient to continue to perform valuable service for the corporation." *Zupnick*, 698 A.2d at 387. As one Court acknowledged, "Delaware law recognizes that retention of key employees may itself be a benefit to the corporation." *Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins*, No. 20228-NC, 2004 WL 1949290, at *18 (Del. Ch. Aug. 24, 2004) (citing *Beard v. Elster*, 160 A.2d 731, 738 (Del. 1960); *Zupnick*, 698 A.2d at 387-88). The Supreme Court noted in *Beard* that an employee's knowledge of a proposed stock option plan "acted as an inducement to those employees to remain in the corporation's service." 160 A.2d 738. In addition, stock options may be issued as a form of compensation for an employee's

[12] DiTomo Aff., Ex. 3 at ¶ 4(b).

past services in certain circumstances. *Zupnick*, 698 A.2d at 388, n.6 (citations omitted).[13]

Options Were Not Required To Be Granted On Pre-Set Dates Or Periods. Finally, plaintiff asserts that in an SEC filing, Linear "meant to imply that Linear's option grants came on pre-set dates, thus avoiding the possibility of manipulation." FAC ¶ 35. This is false. Plaintiff cites for this proposition a *recent discussion of allegations* made in *pending derivative lawsuits* concerning allegedly backdated grants. *See id.* (citing to Linear's Form 10-K for year ended July 2, 2006 at 10; *see* DiTomo Aff., Ex. 4 at 10).[14] Even so, the discussion there makes clear that the practice is to grant stock options "on a quarterly basis in connection with [the Board's] regularly scheduled board meetings. Board meetings are scheduled far in advance to coincide with the Company's quarterly earnings releases." DiTomo Aff., Ex. 4 at 10. There are no documents that state that grants are restricted to certain dates or are to be issued on pre-set dates. Nothing in Linear's stock option plans requires or sets forth specific dates or periods in which directors grant options. Thus the FAC neither alleges that options were to be granted on

[13] *See also Freedman v. Barrow*, 427 F. Supp. 1129, 1136, 1149 (S.D.N.Y. 1976) ("[k]eeping the high level of motivation of [managers and executives], retaining their loyalty in the future, and protecting their skills, experience and specialized knowledge from raids by competitors or others, is the biggest single responsibility of top management, which naturally is also interested in its own compensation"); DiTomo Aff., Ex. 15 at 4, Paul S. Atkins, Commissioner, United States Sec. & Exch. Comm'n, Washington, D.C., Remarks Before the International Corporate Governance Network 11th Annual Conference (July 6, 2006) (available at http://www.sec.gov/news/speech/2006/spch070606psa.htm) (stating that, *inter alia*, granting options before or after a corporate news disclosure can assist companies to attract and retain talented managers).

[14] Beginning in May 2006, shareholder derivative actions were filed in state and federal courts in California, purporting to assert claims against Linear's directors and certain current or former officers based on the alleged backdating of stock option grants. The federal action was dismissed without prejudice for failure to make a pre-suit demand. *In re Linear Tech. Corp. Derivative Litig.*, No. C-06-3290, 2006 WL 3533024 (N.D. Cal. Dec. 7, 2006). Thereafter, the federal plaintiffs agreed to stay their case in favor of the California state action. On July 13, 2007, the California state court sustained Linear's demurrer for failure to make a pre-suit demand. Those plaintiffs amended their complaint on August 13, 2007, and filed renewed demurrers to that complaint on September 12, 2007.

"pre-set dates" nor alleges that Linear falsely stated that grants would be at a specific time but in actuality granted them at a different time. Moreover, plaintiff fully acknowledges that the timing of grants vis-à-vis the issuance of press releases has always been a matter of public record. *See* FAC ¶ 37, n.1.

C. Plaintiff Does Not Plead A Single Tax Violation Resulting From Any Grant

There are no alleged tax violations in this case. This is not a backdating case with accompanying claims of restated financials or new charges for stock compensation expenses that should have been taken years earlier. *Supra* at 1 n.2. Although the FAC makes reference to 26 U.S.C. § 162(m) of the Internal Revenue Code (*see* FAC ¶¶ 145, 147), which sets forth requirements for performance-based compensation, plaintiff does not allege that section 162(m) was violated. None of the alleged and vague injuries to Linear shareholders includes a suggestion of tax violations. *See id.* ¶ 169.

D. Plaintiff Does Not Plead A Single Violation Of SEC Rules

Significantly, plaintiff does not allege that spring loaded or bullet dodged grants violate any SEC rule, past or present. Until this year, public companies were not required to supply the details of their option grant practices in their public filings: "The existing body of rules regarding disclosure of executive stock option grants, however, has not previously contained a line-item requirement with respect to information regarding programs, plans or practices concerning the selection of stock option grant dates or exercise prices."[15]

In 2006, *after* the alleged conduct here was completed, and as part of a substantial overhaul of its rules in this area, the SEC directed public companies to begin making certain disclosures regarding the compensation of their executives. *See* DiTomo Aff., Ex. 13 at 53, 163-64. Linear, beginning with its fiscal 2007 Form 10-K, along with other

[15] DiTomo Aff., Ex. 13, Final Rule and Proposed Rule ("SEC Rule"), 71 Fed. Reg. 53,158-53,266, at 53,162 (Sept. 8, 2006) (to be codified at 17 C.F.R. pts. 228-29, 232, 239-40, 245, 249, and 274).

public companies, must disclose information concerning any "program, plan or practice to select option grant dates for executive officers in coordination with the release of material non-public information." *Id*. at 53, 163. Such disclosures might include information concerning "grant awards of stock options while [the company] knows of material non-public information that is likely to result in an increase in its stock price, such as immediately prior to a significant positive earnings or product development announcement." *Id*. These new disclosure requirements are prospective.[16]

In sum, despite a few immaterial changes to the Complaint, plaintiff continues to acknowledge that the stock option practices did not violate "the strict letter[] of Linear's applicable stock option plans." FAC ¶ 5. Plaintiff continues to assert only that the practices violate the "purposes, spirit, intent and objectives" of Linear's stock option plans. *Id.* ¶¶ 33, 132, 148, 156. After two attempts, plaintiff has failed to articulate how this is so. As shown above, plaintiff's allegations are belied by the language and provisions of the plans. The grants in question do not violate the plans in letter or in spirit.

III. THE FAC DOES NOT STATE A CLAIM FOR BREACH OF THE DUTY OF DUE CARE FOR THE ALLEGED BULLET DODGED GRANTS

Plaintiff alleges nine purported bullet dodged grants, where stock options were granted shortly *after* supposedly negative announcements. The stock dropped modest amounts following the announcements.[17] As stated above, *Desimone*, 924 A.2d 908, is the first case to have considered bullet dodged grants. The Court dismissed all claims

[16] *See* DiTomo Aff., Ex. 16 at 4, John W. White, Director, Division of Corporation Finance, United States Sec. & Exch. Comm'n: The Principles Matter, at 4 (Sept. 11, 2006) (available at www.sec.gov/news/speech/2006/spch091106jww.htm).

[17] The stock price decreases were: 11.21% (October 16, 1996 grant); 8.88% (July 22, 1998 grants); 4.86% (July 25, 2001 grants); 9.83% (October 17, 2001 grants); 10.43% (July 26, 2002 grants); 4.70% (January 15, 2003 grants); 0.99% (October 14, 2004 grants); 6.58% (April 20, 2005 grants); 3.37% (July 27, 2005 grants). *See* FAC ¶¶ 46, 63, 87, 91, 95, 99, 116, 125, 130; DiTomo Aff., Ex. 18, Linear's historical stock prices. *See* Section IVB2, *infra.*

arising from these grants. There, Sycamore Networks was under investigation by the Securities and Exchange Commission for suspicious stock option grant practices. Ultimately, Sycamore Networks admitted that a large number of options had been granted on different dates than had been reported (backdating). The company improperly accounted for stock option grants, and the improper accounting required restatements of earnings for 2000-2003 and necessitated a $29.9 million non-cash charge. *Id.* at 913, 923-24.

In addition to evaluating the allegations of backdating, Vice Chancellor Strine reviewed claims based on bullet dodging, where options were granted to officers shortly after the announcement that Sycamore had missed its earnings estimate and the stock price fell. The Court also examined options allegedly spring loaded, where options were granted sixteen days before announcing a positive announcement with a resulting increase in the stock price. Plaintiff alleged that both types of grants reflected "hidden bonuses" and breached the duty of loyalty. *Id.* at 915. Plaintiffs argued that the grants did not provide the officers with an incentive to work hard and improve performance; rather, the grants awarded additional compensation for prior work. The Court reviewed the alleged practices, evaluated the arguments under Rule 12(b)(6) and Rule 23.1, acknowledged and distinguished the decision in *Tyson*, 919 A.2d 563, and granted defendants' motion to dismiss the complaint.

A. The Price Of Bullet Dodged Options Reflects The Stock's Fair Market Value And There Is No Concealment

In evaluating the nature of bullet dodged options, the Court in *Desimone* rejected a fundamental proposition that plaintiff makes here, that "the option's market price (and thus its exercise price) is lower than it would have been had the option been granted without delay . . . [and] the employee pays less than he or she should for company stock." FAC ¶ 4. The Court stated:

> The recipient of a bullet-dodging option takes the option with an exercise price equal to the current value of the stock and will realize no value from it, except to the extent the stock price increases from present levels.

Desimone, 924 A.2d at 944. When a "director grants options after a release of negative information, he does so at a time when the market has absorbed all existing information about the company." *Id.* The Court further stated that "*the exercise price of the options is equal to a market price on the date of the grant that incorporates all existing material information. Even when an option plan requires fair-market-value grants, such grants fully comply with that restriction.*" *Id.* at 948 (emphasis added). Thus, "[a]s to the fact that the Officer Grants were made after the issuance of bad news about the preceding quarter's results, nothing was hidden at all." *Id.* at 916. Plaintiff's references here to "secret[] benefit[s]" and a "secretive scheme," FAC ¶¶ 151, 165, as with the allegations referencing fair market value requirements in the stock option plans, *id.* ¶¶ 133, 135, 138, 142, fail.

B. Even If Linear's Stock Option Plans Require That Options Be Granted Only As Incentives For Future Performance, Which They Do Not, Bullet Dodged Options Are Not Inconsistent With Promoting Incentives And Corporate Well Being

The plaintiff in *Desimone* asserted that incentive-based options (which are not at issue here) are inconsistent with the practice of bullet-dodging. Vice Chancellor Strine disagreed, stating that the recipients have the "incentive to perform well in order to help the corporation's stock price improve from its level on the date of issuance, a level that reflects the negative information released." *Desimone*, 924 A.2d at 916. The Court elaborated:

> Even under *Tyson*, there is no obvious reason why a company that wishes to grant its officers and employees stock options as an incentive to align the employee's interests with those of the company, cannot wait until after the company releases negative news to the market to grant the options, so long as it is not in possession of non-public information that will likely cause the stock price to rebound immediately. . . .
>
> The recipient of a bullet-dodging option takes the option with an exercise price equal to the current value of the stock and will realize no value from it, except to the extent the stock price increases from present levels.

Id. at 944.

Vice Chancellor Strine rejected the underlying premise of plaintiff's argument that a corporation should issue grants *in advance of the bad news* disclosure. It does not further any corporate purpose to issue under-water options:

> It would be an odd compensation practice indeed to make a discretionary grant of market-price options when the board knows that the stock is actually worth less than the market price. After the bad news is disclosed, the option recipient would be left with underwater options. Corporate morale would likely suffer, rather than improve, by grants of that kind. By waiting until after the negative news is disclosed, the company ensures that the options are granted at a strike price equal to what the stock is actually worth.

Desimone, 924 A.2d at 944-45. The Court noted that the granting of options as a form of compensation are "the kind of situational business judgments, which traditional corporation law principles leave to disinterested directors." *Id.*; *see also id.* at 916 ("Although stockholders might quibble with the decision whether to give large slugs of options to officers after a disappointing quarter, no deception on the stockholders, the market, or regulatory authorities is involved and the officers have the intended incentive to perform well in order to help the corporation's stock price improve from its level on the date of issuance, a level that reflects the negative information released."). Even though Vice Chancellor Strine found that bullet dodged options are not inconsistent with creating incentives, Linear's stock option plans were not so restricted.

The *Desimone* Court dismissed the claims based on both allegedly bullet dodged and spring loaded option grants. The Court questioned whether claims of bullet dodging give rise to any claim whatsoever: "I am skeptical that bare allegations [of bullet dodging] in connection with an option plan that allows for discretionary options grants have any claim-sustaining relevance" because the price of the options reflects the market price on the date of the grant. 924 A.2d at 948.[18] That conclusion applies even more forcefully here. Not only is there no violation of the fair market value requirements, but

[18] The *Desimone* Court discussed in *dicta* two theoretical claims, for waste and self dealing. 924 A.2d at 916, 944. As discussed in Section VIII, *infra*, plaintiff fails to state a claim for waste or self dealing.

the plain language of Linear's stock option plans and Compensation Committee Reports reveals a broad view of incentives and how to achieve success. *See* Section IID, *supra*. There is nothing improper with that approach. *See id*. Because plaintiff does not allege any conceivable violation, the claims must be dismissed.

IV. THE FAC DOES NOT STATE A CLAIM BASED ON SPRING LOADING

The *Desimone* Court also addressed options which were allegedly spring loaded, where plaintiff alleged that the officers received a concealed guaranteed bonus because the grantors "knew the market value of the shares did not reflect positive, non-public information the corporation would soon release." 924 A.2d at 916.

A. This Court Should Dismiss The Claim Outright Where The Stock Option Plans Were Neither Circumvented Nor Violated

The Court in *Desimone* contrasted backdated options with spring loaded options. The former "involve plain lies about the option grant date." 924 A.2d at 937 n.98. Spring loaded options, in comparison, "*do not clearly violate the literal terms of a fair-market value restriction because such options are issued at the fair market value prevailing in public markets on the date of issuance*." *Id.* (emphasis added). Thus, although plaintiff alleges that "[s]pring-loaded options have intrinsic value and are 'in the money' as of the option grant date," FAC ¶ 4, there is no support for that. The options here were issued at the fair market value, are not immediately exercisable, and vest over a lengthy period of one or more years. Many are still currently underwater and not exercised.

The *Desimone* Court considered the practice of spring loading, including a context wherein the stock option plan requires grants to be made at fair market value. The Court assumed further that the stockholders approving the plan were told that the pricing was required to qualify for favorable tax and accounting treatment, and before voting to approve the plan, stockholders were told that the plan is "intended to permit the corporation to reward outstanding performance *and* to create incentives for superior

future efforts." 924 A.2d at 937. The Court concluded that under the analysis in *Tyson*, spring loading in such a context "would arguably not give rise to anything other than an excess compensation claim, as it would be difficult to find that the defendants acted in a deceptive manner intended to circumvent the purposes of a stockholder-approved stock option plan." *Id.*

Although the *Desimone* Court did not dismiss these claims on the basis that spring loading cannot give rise to a breach of fiduciary duty, such a conclusion should be found here. The awarding of option grants at issue closely mirrors the above context. Linear's stock option plans authorized the awarding of grants to attract and retain individuals in "positions of substantial responsibility" (and not simply management), and to promote the success of the business. The Compensation Committee Reports specifically describe the compensation philosophy "to attract, retain and reward executives who contribute both to the short-term and long-term success of the Company." There was no "circumvent[ion of] otherwise valid shareholder-approved restrictions." *Tyson*, 919 A.2d at 593. All of the grant dates and prices were accurately disclosed in Linear's proxies.

The stock option plans at bar are in stark contrast to the one in Tyson. The *Tyson* stockholders had believed the stock option plan on which they would be voting authorized grants only to create incentive for future performance, and not to reward past performance. *Id.* at 575-76 & n.78 ("Performance-based compensation plans must be approved by a majority vote of shareholders"); *id*. at 593 (directors "avoid[ed] shareholder-imposed requirements"). Vice Chancellor Strine observed that this was *the* factor driving the holding in *Tyson. Desimone*, 924 A.2d at 937, n.98 (plans in *Tyson* had supposedly "been sold to stockholders as providing only incentives for future performance, not as a way to reward past performance, and that the spring-loaded issuances essentially breached an implied term of the plan"). Plaintiff concedes there was no literal violation of Linear's plans. FAC ¶ 5. Plaintiff still fails to explain how the "purposes, spirit, intent and objectives" were violated, where the stated purposes and

objectives refute his central thesis that only a narrowly defined interpretation of incentives for future performance can be considered. The claims should be dismissed for failure to state a claim.

B. The FAC Does Not Plead That Each Director Approved The Grants While Knowing Material Non-Public Information And Intended Them To Be Hidden Bonuses

In the alternative, this Court should dismiss the spring loading claims based on the failure to adequately plead the necessary elements. *See Desimone*, 924 A.2d at 945 (dismissing where demand not excused but identifying failures of pleading). The complaint there failed to plead the elements outlined in *Tyson*, which requires specific facts establishing that the options were issued according to a stockholder approved employee compensation plan;[19] that the directors who approved the spring loaded options possessed material non-public information soon to be released that would impact the company's share price; and that they issued those options with the intent to circumvent otherwise valid stockholder-approved restrictions upon the exercise price of options. *Desimone*, 924 A.2d at 930 (citing *Tyson*, 919 A.2d at 575-76); *see Desimone*, 924 A.2d at 916 (failure to plead that each director had "knowledge of corporate information that, if made public on the date of the Grants, would have increased the fair market value of the corporation's stock, turning the Grants into a bonus for past performance, rather than simply an incentive for future performance"). The same pleading defects that the *Desimone* Court recognized are dispositive here.

1. The Vesting And Transferability Restrictions On Options Belie An Intent To Grant A Hidden Bonus

The complaint in *Desimone* did not plead that the directors *who knew of* these grants "*intended*" them to be a "form of hidden bonus to be concealed from regulatory authorities and from Sycamore's stockholders." *Desimone*, 924 A.2d at 916 (emphasis

[19] It appears that *Tyson* based this requirement on the fact that the option plans there seeking to comply with Internal Revenue Code section 162(m) must among other things be approved by a majority of shareholders. 919 A.2d at 593, n.78.

added). One factor that undermined any inference of intent was "the reality that the Grants were subject to a three-year vesting schedule with sharp restrictions on pledging the options received." *Id.*; *see id.* at 919, 945. That vesting schedule "prevented the recipients from realizing any immediate value from the options." *Id.* at 919. The Court held that the positive "announcement would not have been likely to have had a substantial effect on the stock's trading price months later when the first of the options vested, much less on the bulk of the options, the last of which did not vest for three years." *Id.* at 946.

The options at bar were similarly restricted. Linear's stock option plan restricted the transferability of options, including among other things, their sale, pledge, or assignment. DiTomo Aff., Ex. 3 at ¶ 11. And like most options, as well as the options in *Desimone*, the options here vested over a period of time, in some instances many years.[20]

The fact that options could not be exercised immediately is not merely a theoretical argument refuting plaintiff's contention that option grants were in the money. FAC ¶ 4. Of the option grants at issue, half were underwater as of the date plaintiff instituted this action. The options grants received by named defendants for those underwater grants remain unexercised. *See* Section IIA, *supra*. Where, even years after the grants were issued the options have no value to many of the defendants, plaintiff's argument that these grants were a sure bet rings hollow.

2. The FAC Fails To Plead That Defendants Knew The Information Was Favorable, Material And Likely To Increase The Stock Price When Disclosed

The practice of spring loading "involves making market-value option grants at a time when the company possesses, but has not yet released, *favorable*, *material* non-

[20] *See* DiTomo Aff., Ex. 2, Linear's Proxy Statement on Form 14A for period ended June 30, 1996, filed with the SEC on October 3, 1996, at 12 nn.4, 5 (*e.g.*, 10% of certain officer option grants vest every six months for five years). The FAC concedes that vesting did not occur until one year [or more] after the grant issuance date. *See* FAC ¶¶ 47, 55, 88, 113, 131.

public information that will *likely increase* the stock price when disclosed." *Desimone*, 924 A.2d at 918 (emphasis added) (citing *Tyson*, 919 A.2d at 563). The *Desimone* Court found "the nature of the positive information that underlies [the] spring loading allegations" that the plaintiff relied upon undermined any intent to grant a hidden bonus. *Id.* at 945. More particularly, Vice Chancellor Strine contrasted the announcement at issue in *Desimone* (a news release that Sycamore secured the number one position in the European Metro DWDM market) with the announcement in *Tyson* (the decision to cancel a $3.2 billion deal to acquire IBP, Inc.). *Id.* at 945, n.124. The former was a "non-seismic positive announcement that hardly seemed likely to send Sycamore's stock price soaring to historic heights," and while "positive," was not of the type that was "certain to send Sycamore's stock price soaring." *Id.* at 916, 945. In contrast, Tyson's announcement was "clearly market moving." *Id.* at 945.

The *Desimone* Court also examined the stock price's response to announcements. Sycamore's stock price was "fairly volatile" with 10% price swings not uncommon. *Desimone*, 924 A.2d at 945. The Court exclaimed that "Sycamore's stock price traded *downward* during the first two days after the announcement!" *Id.* Even though there was a later upward surge, it was difficult to find a "causal[]" relationship. *Id.* Sycamore's stock price response was in stark contrast to Tyson's announcement; the latter led to a 17% increase in the stock on the day of the announcement. *Id.* at n.124. Thus, the *Desimone* complaint did not allege "facts supporting a rational inference that the announcement of the information in fact had" the effect of sending the "price soaring to historic heights." *Id.* at 916. The *Desimone Court* concluded that even if the announcement had caused some belated spike in stock prices, "given the price swings to which Sycamore's stock was susceptible, the announcement *would not have been likely to have had a substantial effect on the stock's trading price months later when the first of the options vested*, much less on the bulk of the options, the last of which did not vest for

three years." *Id.* at 946 (emphasis added). These facts made the so-called "'positive' announcement . . . even less material." *Id.* at 945.

a. Two grants resulted in stock drops

In the case at bar, it is not clear *what* definition plaintiff is using to allege that defendants granted thirteen sets of "spring loaded" options. The stock *fell* rather than rose two trading days after the allegedly spring loaded grants on July 20, 1999. FAC ¶ 76; *see* DiTomo Aff., Ex. 18. The stock price likewise fell two trading days after the grants on April 13, 2004. The FAC deleted a previously asserted spring loaded grant on April 19, 2000. Orig. Compl. ¶¶ 61-63. That grant also preceded a stock drop (4.42%).

b. Most grants resulted in immaterial increases

In three other instances, the stock response was *miniscule*. The stock rose only 0.17% two days following the grant on July 22, 2003, 4.27% two days following the grant on July 20, 2004 (FAC ¶ 112), and 1.51% two days following the grant on January 18, 2005.[21] Following the grants on January 14, 1997, the stock rose 8.38% (FAC ¶ 50), even though Linear had just reported a 6% *decrease* in net sales and 8% *decrease* in net income for the quarter. *See* DiTomo Aff., Ex. 6, Linear's press release dated January 14, 1997. The stock rose 12.87%[22] following the grant on July 23, 1996, 7.91% following the grant on July 22, 1997 (FAC ¶ 54), 12.88% following the grant on January 12, 1998 (*id.* ¶ 58), 11.91% following the grant on January 12, 1999 (*id.* ¶ 67), and 12.53% following the grant on April 13, 1999 (*id.* ¶ 71). These increases are not noticeably distinguishable from the 10% increase the Court found not remarkable in *Desimone*, 924 A.2d at 945.

[21] The FAC asserts an increase of 1.54%. FAC ¶ 120.

[22] The FAC alleges an increase of 11.88%, FAC ¶ 42, but the increase was slightly more.

c. The largest stock increase followed a negative projection

There was one instance where the price increased 30.86% following the grants and press release on April 17, 2001. FAC ¶ 82. The April 17, 2001 announcement that supposedly led to that large increase reported that earnings beat estimates by $0.02 and reported a 52% year over year increase in net sales and a 66% increase in net income. But plaintiff ignores that the Company simultaneously warned *that revenues would decrease by 20%-30% in the subsequent quarter due to diminished demand*. *See id*. ¶ 81; DiTomo Aff., Ex. 12, Linear's press release dated April 17, 2001. The Company stated that it "'was a difficult quarter as *business turned dramatically downward*.'" DiTomo Aff., Ex. 12 (emphasis added). The Company noted that "'as the quarter progressed, cancellations increased and bookings decreased significantly across all business areas.'" *Id.* Business "*now continues to be weak* as customers have been reacting to larger inventories in several channels, shorter supplier lead times and diminished end-user demand.'" *Id.* (emphasis added). Plaintiff does not explain how defendants "knew" that the April 17, 2001 press release in its totality constituted "*favorable*, *material* non-public information that will *likely increase* the stock price when disclosed." *Desimone*, 924 A.2d at 918 (emphasis added).

Plaintiff's characterizations of whether a grant is spring loaded or bullet dodged is result-driven more than anything else. In the case of the April 17, 2001 grants and press release, these are labeled spring loaded even though the Company projected not just unpredictability, but imminent revenue decreases of 20-30%. This press release is not noticeably different from press releases associated with grants labeled bullet dodged. *See* FAC ¶ 45 (press release on October 15, 1996 preceding alleged bullet dodged grant "cautioned about the unpredictable environment in which the company operated"); *id.* ¶ 61 (July 21, 1998 press release preceding alleged bullet dodged grant "predicted significantly lower sales and profits in the next quarter" [declines in sales and profits of 10-15%]); *id.* ¶ 85 (July 24, 2001 press release preceding alleged bullet dodged grant

stating that there were "'continuing weak internal bookings forecasts for the next quarter'") (emphasis omitted). Plaintiff is relying on 20-20 hindsight based on actual stock price movements, rather than what any director believed or knew ahead of time, to arbitrarily characterize the grants as well timed.

d. The stock responded unpredictably to the substance of the announcements

By the same token, there is little rhyme or reason to the stock price movements in response to the announcements that purportedly make the option grants spring loaded. As discussed above, although the April 17, 2001 press release reported some positive news, it also contained extremely negative projections for the future, yet the stock increased 30.86%. A more positive announcement on January 16, 2001 resulted in a substantially smaller increase of 22.89%. FAC ¶ 77. Specifically, options granted on January 16, 2001 to two individuals who are not defendants, *id*., preceded a press release that reported a 59% year over year increase in net sales and 77% increase in net income. *See* DiTomo Aff., Ex. 11, January 16, 2001 press release. Unlike the April 17, 2001 press release, there were no dire projections of sharply lower results for the next quarter but instead reported a "'slowdown in net bookings.'" *Id.* Nonetheless, the more positive announcement resulted in a smaller increase.

Both of these announcements are to be contrasted with the announcement in the prior year. The announcement on April 18, 2000, also reported large increases in net sales and net income, 42% and 52%, respectively, like the other two announcements.[23] But the announcement on April 18, 2000 contained no negative projections for the succeeding quarter or decreases in bookings. On the contrary, the Company reported "'very robust'" demand that the Company expected to continue to the next quarter. Yet, the stock actually fell by 4.42% two days after the April 18, 2000 news release. Plaintiff

[23] *See* DiTomo Aff., Ex. 10, press release dated April 18, 2000 (cited at Orig. Complaint ¶ 62).

has now deleted references to the April 18, 2000 grants. Clearly, the stock responded in unpredictable directions and amounts following these announcements.

The announcement on January 14, 1997, reported *decreases* in net sales and net income; yet the stock rose by 8.38%.[24] For the announcement on July 22, 1997, the stock rose a similar amount, 7.91%, but followed an earnings release reporting that net sales *increased* by 16% and net income increased by 19%.[25] Thus, the stock rose almost identically, even though one announcement was negative and one was positive.

In another instance, the Company reported on April 13, 1999 increases of net sales by 3% and net income by 6%.[26] The stock rose 12.53%. FAC ¶ 71. Yet, the announcement later in the year on July 20, 1999 of even *greater quarterly increases* in net sales and net income (6% and 9% respectively) *preceded a stock drop*.[27] Thus, similar types of earnings reports resulted in inexplicable stock price movements.

Given that one cannot explain the discrepancies in stock price movement *with the benefit of hindsight*, it is impossible for defendants to have known *in advance* that the news disclosures would have a material and positive effect on the price. The FAC fails to adequately plead that recipients received spring loaded grants "at a time when the company possessed, but had not yet released, favorable, material non-public information that will likely increase the stock price when disclosed." *Desimone*, 924 A.2d at 918. The FAC also fails to plead particularized facts showing that *each* defendant who participated in the alleged spring loading of grants had this knowledge.

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[24] *See* DiTomo Aff., Ex. 6, press release dated January 14, 1997 (cited at FAC ¶ 50).

[25] *See* DiTomo Aff., Ex. 7, press release dated July 22, 1997 (cited at FAC ¶¶ 53-54).

[26] *See* DiTomo Aff., Ex. 8, press release dated April 13, 1999 (cited at FAC ¶¶ 70-71).

[27] *See* DiTomo Aff., Ex. 9, press release dated July 20, 1999 (cited at FAC ¶¶ 74).

e. The FAC fails to allege a motive

In *Desimone*, the Court discussed whether there was an apparent motive to grant hidden bonuses. 924 A.2d at 917, 946. It is difficult to fathom how the directors could intend to grant "secret" bonuses where Linear's stock option plans authorized broad means and grounds for compensation, and where the stock prices and dates were accurately reported.

Any inference of motive is further undermined for reasons similar to the findings in *Desimone*. There, two inside directors did not receive any allegedly improper option grants. Thus, it was "difficult to infer any motive on their part to enrich Sycamore's executive officers at the expense of its stockholders." *Desimone*, 924 A.2d at 946; *id.* at 917. Here, the members of the Compensation Committee received four of twenty-two allegedly spring loaded grants. The stock either dropped (July 20, 1999), or rose in modest amounts (July 22, 1997, 7.91%; July 22, 2003, 0.17%; July 20, 2004, 4.27%). They did not receive the options associated with the two largest stock increases (22.89% for grants to non-defendants on January 16, 2001; 30.86% for grants on April 17, 2001; FAC ¶¶ 77-79, 82). This hardly raises an inference that the outside directors on the Compensation Committee sought to make themselves "fat at the expense of the stockholders." *Desimone*, 924 A.2d at 917. Further belying any motivation to grant spring loaded or bullet dodged options is that many of the options have not been exercised. The claims based on spring loading must be dismissed for failure to state a claim.

V. MOST OF THE ALLEGEDLY WRONGFUL GRANTS ARE TIME BARRED

A. Sixteen Grants Are Presumptively Time Barred

The applicable statute of limitations is three years. *See* 10 *Del. C.* § 8106; *In re Dean Witter P'ship Litig.*, No. 14816, 1998 WL 442456, at *4 (Del. Ch. July 17, 1998), *aff'd*, 725 A.2d 441 (Del. 1999). The three year period applies to the claims asserted

here. *Dean Witter*, 1998 WL 442456, at *4 (applying three year period to breach of fiduciary duty).[28] The statute accrues "at the time of the alleged wrongful act, even if the plaintiff is ignorant of the cause of action." *Id*.; *Albert*, 2005 WL 1594085, at *13, 18 (citations omitted). Of the twenty-two grant dates identified in the Complaint, sixteen were between July 1996 and July 22, 2003 (FAC ¶¶ 39-104) – well over three years before the filing of this action on March 23, 2007.[29] Accordingly, all claims based on these grants are "presumptively time-barred." *Albert*, 2005 WL 1594085, at *13.

B. There Is No Fraudulent Concealment Or Tolling

As this Court has made clear, Delaware permits tolling of the limitations period "where the facts underlying a claim were so hidden that a reasonable plaintiff could not timely discover them." *Albert*, 2005 WL 1594085, at *18 (citing *Dean Witter*, 1998 WL 442456, at *5). Plaintiff has the burden of pleading facts to support a conclusion that the statute has been tolled. *Litman v. Prudential-Bache Props., Inc.*, No. 12137, 1994 WL 30529, at *1 (Del. Ch. Jan. 14, 1994), *aff'd*, 642 A.2d 837 (Del. 1994). Such allegations must be set forth with particularity. *Boeing*, 1992 WL 81228, at *3. The vague tolling allegations in the FAC at paragraph 162 are not sufficient. Plaintiff fails to plead adequately concealment or fraud or that the facts underlying the grants were "so hidden" that he could not discover them.

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[28] *See Boeing Co. v. Shrontz*, No. 11273, 1992 WL 81228, at *2 (Del. Ch. Apr. 20, 1992) (applying period under § 8106 to breach of fiduciary duty and waste).

[29] The fact and details of the options granted on July 22, 2003 were publicly filed with the SEC on July 24, 2003. *See* DiTomo Aff., Ex. 5, Form 4s.

Form 4s filed by Linear's directors and those of its officers subject to the Section 16 reporting requirements detail the dates, strike prices, and number of options granted. Since the passage of the Sarbanes-Oxley Act in mid 2002, officers and directors subject to the requirements of Section 16 must electronically disclose any changes in their equity ownership interests, including stock option grants, "before the end of the second business day following the day on which the subject transaction has been executed." 15 U.S.C. §§ 78p(a)(2)(c), 78p(a)(4)(A); *see also* Sarbanes Oxley-Act of 2002, H.R. 3763, 107th Cong. § 403 (2002). Especially for more recent years, those documents are readily available on the SEC's website at www.sec.gov.

More particularly, the FAC alleges that "Defendants fraudulently concealed the fact that the options granted to numerous officers and directors (including themselves) were spring-loaded and bullet-dodged." FAC ¶ 161. How did defendants do that? The FAC does not say. There is no allegation of false dates or strike prices in Linear's proxies or defendants' Form 4s. The same paragraph alleges a mere failure to disclose the specific stock option practices. *Id.*; *see also id.* ¶¶ 35, 148, 160, 162. As this Court has held, "[m]ere silence is insufficient to establish fraudulent concealment. Rather, the evidence must show that the defendant engaged in some sort of 'actual artifice' to toll the running of the limitations period." *Krahmer v. Christie's Inc*., 911 A.2d 399, 407 (Del. Ch. 2006) (citation omitted).

Plaintiff no doubt will argue that *Tyson* controls here. In *Tyson*, the Court tolled under the doctrine of fraudulent concealment claims based on the spring loading of options where plaintiffs adequately alleged defendants' knowledge and defendants allegedly violated the terms of stock option plans which had authorized options based solely on incentive based future performance. The plaintiffs argued that the spring loading required them to "observe a pattern of opportune distributions." 919 A.2d at 590. The Court agreed and stated it "would be manifest injustice for this Court to conclude . . . that 'reasonable diligence' includes an obligation to sift through a proxy statement . . . and a year's worth of press clippings . . . to establish a pattern." *Id.* at 591.

In contrast, the FAC here concedes that Linear's grants were made in conjunction with quarterly Board meetings and earnings announcements, which occurred at the same time each year. *See* FAC ¶ 35. It is those same occasions upon which plaintiff relies to allege spring loading and bullet dodging. If, at the time the grants were made, stockholders had been concerned that the directors were improperly timing the grants, it would have taken little effort to determine the relative dates of the grants and the earnings announcements and compare them to the Company's stock prices. Indeed, the FAC concedes that plaintiffs used public records to identify grants "that appear to coincide

with Linear's quarterly earnings releases" and ascertain whether they "fit the pattern of spring-loading and bullet-dodging." FAC ¶ 37. The FAC cites to Linear's stock price during the few days before or after the stock option grants, references a contemporaneous press release, and then describes the resultant stock price movement within one to two trading days. *See, e.g.*, *id.* ¶¶ 39-46. The FAC alleges that "Plaintiff and the other Linear shareholders could not have discovered the full truth about the spring-loaded and bullet-dodged options discussed herein through reasonable diligence." *Id.* ¶ 162. But that "diligence" is precisely what resulted in the filing of this FAC. The FAC alleges that it was based on *the* "*investigation of [plaintiff's] counsel*." *Id.* at 1 (emphasis added). Plaintiffs apparently waited until after *Tyson* to perform that diligence. There is no reason why they could not have done so pre-*Tyson*.

Defendants submit that this case is more analogous to *Dean Witter*, 1998 WL 442456, wherein plaintiffs argued that the statute of limitations was tolled until an article in the *Wall Street Journal* alerted them to the possibility that their investment losses were the result of defendants' wrongful conduct rather than a general downturn in the real estate market. Plaintiffs argued that until the publication of the article, they were the victims of defendants' fraudulent concealment, in which defendants had made assurances that the partnerships' properties in which plaintiffs invested were performing better than comparable properties, and that losses were temporary and not caused by defendants' wrongful conduct. Plaintiffs further argued that following the article, they hired experts and thus discovered defendants' wrongful conduct.

The Court rejected plaintiffs' argument. The Court noted that defendants had made "optimistic" and "rosy" comments in their reports to the plaintiffs. However, the Court also found that these optimistic, rosy comments were not enough to support tolling of the statute of limitations where there were also "cold, hard figures" available to the plaintiffs that "should have been a 'red flag'" and thus prompted an inquiry. *Dean Witter*, 1998 WL 442456, at *8. The Court stated that:

> Inquiry notice does *not* require *actual* discovery of the reason for the injury. Nor does it require plaintiffs' awareness of all of the aspects of the alleged wrongful conduct. . . . Although plaintiffs suggest that their claims were 'unknowable' because it required an expert to uncover defendants' alleged wrongdoing, that argument is without merit. It may in fact have taken an expert to unravel the entire scheme alleged by plaintiffs. But having all of the facts necessary to articulate the wrong is *not* required.

Id. at *7 n.49.

The *Dean Witter* Court also rejected the argument that tolling applied because plaintiffs were allowed to rely on defendants as their fiduciaries:

> [T]he trusting plaintiff still must be reasonably attentive to his interests. '[B]eneficiaries should not put on blinders to such obvious signals as publicly filed documents, annual and quarterly reports, proxy statements, and SEC filings.' Thus, even where defendant is a fiduciary, a plaintiff is on inquiry notice when the information underlying plaintiff's claim is readily available.

Id. at *8 (citation and italics omitted).[30] The Court concluded that notwithstanding falsely optimistic statements in the earlier public filings, "the public documents provide the basis for *all* of plaintiffs' claims." *Id.* at *8 n.60 (citing *In re USACAFES, L.P. Litig.*, No. 11146, 1993 WL 18769, at *3-6 (Del. Ch. Jan. 21, 1993)).

As in *Dean Witter*, the "cold, hard figures" from defendants' SEC filings showed the information necessary to prompt inquiry. All of Linear's stock price information and press releases for the grants issued on or before July 22, 2003 were publicly available well before March 23, 2004. Nothing prevented plaintiff from doing the analysis before the statute expired on March 23, 2004, or indeed, years earlier, when the same

[30] *See also Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins*, No. 20228-NC, 2004 WL 1949290, at *8 (Del. Ch. Aug. 24, 2004) (tolling does not apply, notwithstanding allegations of self-dealing where the allegedly wrongful compensation is disclosed in a publicly filed proxy statement); *but see Tyson*, 919 A.2d at 590 (tolling was available there based on defendants' roles as fiduciaries, where they allegedly violated the terms of stock option plans which had authorized options based solely on incentive based future performance).

information was publicly available. Plaintiff thus had the "cold, hard figures" necessary to prompt inquiry well before March 23, 2004.[31]

It is no answer for plaintiff to argue that the concept of spring loading or bullet dodging was not known to him at that earlier time. *See Began v. Dixon*, 547 A.2d 620, 623-24 (Del. 1988) ("If all parties were allowed to toll the statute until they learned the legal theory of a proposed action or so pursued an action, there would be no purpose to the statute of limitations."); *Albert*, 2005 WL 1594085, at *18 n.84 ("'ignorance of a cause of action, absent concealment or fraud, does not stop it'") (citation omitted). Indeed, if it was not known to plaintiff, then why was the impropriety of the practice similarly not known to defendants? Plaintiff cannot simultaneously argue that defendants knew their practices violated their fiduciary duties yet the concept was too new to trigger plaintiff's duty of inquiry. Any tolling argument should be rejected.

VI. THE FAC DOES NOT STATE A CLAIM FOR UNJUST ENRICHMENT

Plaintiff asserts that all recipients of the stock options were unjustly enriched. FAC ¶¶ 165-69, 188-91. A claim for unjust enrichment is an equitable remedy that is *unavailable under Delaware law where there is a governing contract* between the parties. *See ID Biomedical Corp. v. TM Techs. Inc.*, No. 13269, 1995 WL 130743, at *15 (Del.

[31] *See USACAFES*, 1993 WL 18769, at *3-6 (tolling did not apply as a matter of law where plaintiffs alleged that directors awarded themselves excessive fees, salaries and option grants but compensation issues were publicly disclosed in SEC filings, which put plaintiffs on inquiry notice); *United States Cellular Inv. Co. v. Bell Atl. Mobile Sys., Inc.*, 677 A.2d 497, 503 (Del. 1996) (affirming dismissal of claim as time-barred and rejecting equitable tolling where plaintiff had notice from public filing based on defendant's application filed with the Federal Communication Commission; public filing was sufficient to prompt inquiry notice requiring plaintiff to pursue claims); *Official Comm. of Unsecured Creditors*, 2004 WL 1949290, at *8 (dismissing claim as time-barred where allegedly wrongful payment of bonus to CEO was disclosed in proxy statement; court rejected plaintiff's argument that proxy did not alert readers to process defects because disclosure "was enough to alert stockholders reasonably to a possible infringement of their rights"); *Indiana Elec. Workers Pension Trust Fund, IBEW v. Dunn*, No. C-06-01711, 2007 WL 1223220, at *4 (N.D. Cal. Mar. 1, 2007) (holding that derivative claim is time barred where proxy statement alleged to be false and misleading nonetheless contained facts putting plaintiff on notice that company violated compensation program in making payment to former CEO; "all of the facts that form the basis of plaintiffs' argument were disclosed in the 2004 proxy statement").

Ch. Mar. 16, 1995).[32] Here, plaintiff claims that Linear's stock option plans determined the terms under which officers and employees could be granted options, but that the grants violated the purposes, spirit, intent, and objectives of the plans. FAC ¶¶ 132-33, 146. He seeks rescission of the stock options. *Id.* at 51. Recently, in a backdating case, the court granted a demurrer (motion to dismiss) based on Delaware law where similar allegations were made. *See* DiTomo Aff., Ex. 14, *Espinoza v. Wu*, No. RGO6298775, slip op. at 3 (Super. Ct. Alameda County, Aug. 21, 2007). In dismissing the claim of unjust enrichment for failure to state a cause of action under Delaware law, the court stated: "The FAC contains some allegations that suggest that there is a contract between these individual defendants and UTStarcom with respect to the alleged improper stock options. . . . Further, Plaintiff explicitly seeks rescission of contracts concerning stock option grants."). *Id.*

Even if the plaintiff could assert an equitable remedy where the FAC alleges essentially a contractual claim, the pleading elements are not satisfied here. To state a claim for unjust enrichment, a plaintiff must allege that the defendants were enriched, the plaintiff was impoverished, a relationship existed between the enrichment and impoverishment, and there was neither justification nor a remedy provided by law. *See Fleer Corp. v. Topps Chewing Gum, Inc.*, 539 A.2d 1060, 1062 (Del. 1988); *LaSalle Nat'l Bank v. Perelman*, 82 F. Supp. 2d 279, 294 (D. Del. 2000). Plaintiff alleges that had the options not been spring loaded or bullet dodged, the defendants' "profits and/or unrealized gains . . . would have been millions of dollars less." FAC ¶ 167; *see id.* ¶ 168 (Linear "will receive less money . . . when [defendants] exercise their options at prices substantially lower than they should have been"). Plaintiff does not account for the fact that many options remain underwater and have never been exercised. The FAC does not

[32] *See Teachers' Ret. Sys. v. Aidinoff*, 900 A.2d 654, 671 n.24 (Del. Ch. 2006); *McKesson HBOC, Inc. v. N.Y. State Common Ret. Fund, Inc.*, 339 F.3d 1087, 1089, 1091 (9th Cir. 2003) (citing *ID Biomedical*, 1995 WL 130743, at *15).

begin to plead what the true value of the options should have been, much less each of the above requirements.

VII. THE FAC DOES NOT STATE A CLAIM FOR BREACH OF DUTY FOR FALSE OR MISLEADING STATEMENTS IN LINEAR'S PUBLIC FILINGS

Plaintiff alleges that the proxy statements filed on October 3, 1996, September 25, 1998, September 21, 2000, and September 26, 2005 contained material misstatements relating to the manner in which options were granted at Linear and that the director defendants are liable for breach of fiduciary duty. FAC ¶¶ 170-74, 192-200. Plaintiff's allegation is that the proxy statements "conveyed the impression" that stock options were granted consistent with the "purposes, spirit, intent and objectives of the plans," whereas by granting spring loaded and bullet dodged grants, they were not. *Id.* ¶ 146. Plaintiff alleges for example that Linear's policy was to comply with Internal Revenue Code section 162(m), and that options would not be priced at less than 100% of fair market value. *Id.* ¶ 147; *see id.* ¶¶ 148-50. As discussed in Section IIE, *supra*, plaintiff does not allege any violations of Internal Revenue Code section 162(m). Plaintiff does not allege that the options were not granted at the strike prices indicated or that grant dates were misrepresented. Plaintiff's argument is that the stock option plans did not disclose that grants were to be awarded after negative releases and before positive releases. This assumes that the Company engaged in these practices, which the FAC does not adequately plead.

But even if plaintiff did adequately plead such practices were followed, Linear's stock option plans and the Compensation Committee Reports set forth Linear's compensation policies and authorize broad discretion in meeting them. These documents define incentives broadly, speak of both long term and short term success, and describe the use of options to attract, retain and reward personnel, as well as to provide additional incentives. Plaintiff does not address any of these differing bases for compensation,

much less address how the option grants violated any of these various grounds for compensation. *See* Section IID, *supra*.

Notably, the SEC has declined to take a position regarding when companies may grant stock options. The SEC expressly stated that it "does not express a view as to whether or not a company may or may not have valid and sufficient reasons for such timing of option grants, consistent with a company's own business purposes." DiTomo Aff., Ex. 13 at 53, 163. As discussed in Section IIF, *supra*, the SEC has determined, going forward, to require companies to disclose information concerning any "program, plan or practice to select option grant dates for executive officers in coordination with the release of material non-public information." *Id*. Such disclosures might include information concerning "grant awards of stock options while [the company] knows of material non-public information that is likely to result in an increase in its stock price, such as immediately prior to a significant positive earnings or product development announcement." *Id*. The SEC rule on disclosure is prospective.

Delaware law recognizes that directors cannot be held liable for violating evolving standards of corporate governance that did not exist at the time of a prior Board action. *See In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 698 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006) (directors were not liable for breaching their fiduciary duties in connection with approving president's exceptionally generous employment agreement). The Court noted: "it is perhaps worth pointing out that the actions (and the failures to act) of the Disney board that gave rise to this lawsuit took place ten years ago, and that applying 21st century notions of best practices in analyzing whether those decisions were actionable would be misplaced." *Id*. at 697.[33] In *Lewis v. Vogelstein*, 699

[33] *See, e.g., Colema Realty Corp. v. Bibow*, 555 F. Supp. 1030, 1040 n.13 (D. Conn. 1983) (defendants were not liable for Section 16(b) short swing profits in connection with gains from "pyramiding" option exercises where they reasonably relied on SEC rules and regulations in effect at the time); *Greene v. Dietz*, 247 F.2d 689, 694-95 (2d Cir. 1957) (defendants reasonably relied on SEC rules); *see also Malhotra v. Equitable Life Assurance Soc'y of the United States*, 364 F. Supp. 2d 299, 308 (E.D.N.Y. 2005) (defendant's alleged violation of NASD rule did not support claim for violation of

A.2d 327 (Del. Ch. 1997), the issue was whether the proxy statement that solicited shareholder proxies was materially incomplete and misleading for failure to include an estimated present value of a one-time grant of options immediately exercisable to which directors might become entitled. The Court held that there was no failure of disclosure. In addressing the issue, the Court observed that disclosure of the valuation information plaintiff sought concerned a "'soft information' estimate" which the SEC, rather than the Court, should dictate. *Id.* at 332. There was no such SEC rule requiring disclosure.

Plaintiff cannot state a claim for failure of disclosure where no rules of disclosure existed at the time.[34] Given the recent statutory and judicial pronouncements concerning the timing of option grants, this is hardly "the rare case, envisioned by the Supreme Court in *Aronson*, where defendants' actions were so egregious that a substantial likelihood of director liability exists." *Seminaris v. Landa*, 662 A.2d 1350, 1354 (Del. Ch. 1995) (dismissing for failure to excuse demand where former CEO made false statements about corporation's financial condition).

VIII. THE FAC DOES NOT STATE A CLAIM FOR WASTE, BREACH OF DUTY OF LOYALTY, GOOD FAITH, OR SELF-DEALING

As referenced *supra*, the *Desimone* Court stated in *dicta* that the granting of bullet dodged grants could theoretically give rise to claims for waste and self dealing. *See Desimone*, 924 A.2d at 916 ("[T]he only viable question would seem to be whether the grant of options was somehow inequitable, in the sense that it involved the wasteful enrichment of a recipient at the corporation's expense (when the board or committee awarding the options was independent of the recipient) or unfair self-dealing (when the awarding board or committee was controlled by those receiving the options)."). Apparently prompted by this *dicta*, the FAC now seeks to assert a claim for waste. FAC

Section 10(b) including because rule was issued one month after complained-of transaction).

[34] Even Chancellor Chandler's *Tyson* decision on spring loading, the first in Delaware, was not decided until February 6 of this year.

¶¶ 201-04. Plaintiff also makes vague allegations that all defendants breached fiduciary duties of loyalty and good faith by their grant and receipt of allegedly tainted options. *Id.* ¶¶ 154-64, 183-85. The FAC fails to state a claim for waste or these breaches of duty.

Waste. Vice Chancellor Strine noted in *dicta* that, with respect to independent grantors, the only plausible claim may be one for waste:

> I harbor serious doubt whether any claim, other than a claim for waste, can be lodged against an issuance of options, in conformity with the terms of a stockholder-approved option plan, at a fair market value reflecting negative information previously disclosed to the public markets.

Desimone, 924 A.2d at 916; *see id*. at 944 ("If the grantor board or committee was independent of the recipients, the question would be whether the size or fact of the option grant was so egregious under the circumstances as to constitute a waste of corporate assets."). Bullet dodging claims are limited to potential claims for waste "even when a stockholder-approved option plan requires fair-market-value grants." *Id.*

Plaintiff's claim for waste consists of four paragraphs. FAC ¶¶ 201-04. The allegations do not meet the onerous standard for waste. The Supreme Court of Delaware recently highlighted the difficulty in pleading a claim for waste in the context of a severance payment which exceeded $130 million:

> To recover on a claim of corporate waste, the plaintiffs must shoulder the burden of proving that the exchange was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." A claim of waste will arise only in the rare, "unconscionable case where directors irrationally squander or give away corporate assets." This 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."

In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 74 (Del. 2006) (citations omitted).[35]

Notably, this Court dismissed a waste claim based on an allegedly excessive number of options at substantially undervalued prices, holding that "plaintiffs' allegations

[35] *See Brehm*, 746 A.2d at 263 (a claim based on waste requires "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").

amount to nothing more than a disagreement over what the market value of a share of Unico stock is and how much incentive management should have." *President & Fellows of Harvard College v. Glancy*, No. 18790, 2003 WL 21026784, at *22-23 (Del. Ch. Mar. 21, 2003). Similarly, in *3Com*, the Court dismissed a waste claim asserting that the directors awarded excessive and lavish options. The court found it inappropriate to examine whether the options were "excessive or lopsided . . . proportional or not, or even whether it was a 'bad deal' from a business standpoint." 1999 WL 1009210, at *4. Otherwise, the court would not be "deferring to the board's business judgment." *Id.*

In *Zupnick*, 698 A.2d 384, shareholders alleged that stock options granted to Coca Cola's CEO constituted waste where the options could become exercisable immediately, including on his retirement, for which he was eligible. Plaintiff argued the grant amounted to a reward or bonus for which there was no consideration where the CEO had been compensated already for past services. The Court stated:

> Any analysis of the waste claim must begin with 8 Del. C. § 157. That statute authorizes a Delaware corporation to create and issue (inter alia) options to purchase its shares. It also provides that in the absence of actual fraud, "the judgment of the directors as to the consideration for the issuance of such . . . options and the sufficiency thereof shall be conclusive." That is, so long as there is any consideration for the issuance of shares or options, the sufficiency of the consideration fixed by the directors cannot be challenged in the absence of actual fraud.

Id. at 387. Because the complaint acknowledged the option award was based on the CEO's performance and the success of the company during his stewardship, the complaint failed to state a claim.

Plaintiff fails to adequately allege that any grant to officers or directors was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration" or that there was an absence of consideration. *Disney*, 906 A.2d at 74; *see* FAC ¶ 202. Plaintiff does not allege that the officer-recipients were not entitled to options; plaintiff can hardly do so and does not dispute the service to Linear that any option recipient performed. *See 3Com*, 1999 WL

1009210, at *4 (disputing option recipients' quantum of service does not allege absence of benefit to corporation). Plaintiff only asserts that the amount received was too generous, under plaintiff's view, in that the grants were well timed. Plaintiff does not attempt to quantify the amount of the supposed differential. *See, e.g.*, FAC ¶¶ 167-68; *see 3Com*, 1999 WL 1009210, at *5 ("plaintiff alleges only that certain amounts of compensation were given . . . and then concludes that these amounts are excessive. Plaintiff has not alleged facts . . . to indicated why 3COM did not benefit from these grants.").

Breaches of Duty of Good Faith and Loyalty and Self Dealing. Vice Chancellor Strine also mentioned in *dicta* that *bullet dodged grants* may give rise to a claim based on self-dealing where the grantors are dominated by the options recipients:

> [T]he analysis would turn on whether the transaction involved unfair self dealing and the option recipients would bear the burden of establishing that the options grants were fair to the corporation. In either of those analyses, the fact that negative information was released to the market just before the option grant might or might not be relevant to the court's analysis, but it would not categorically condemn the challenged grant.

Desimone, 924 A.2d at 944.

With respect, this *dicta* should not be viewed as sanctioning such claims, at least in this case. The *Desimon*e Court made clear that bullet dodged grants are at fair market value and there is no concealment. To suggest that there could be claims for self-dealing, based on option grants that do not even vest until well in the future, when Delaware and other jurisdictions *permit stock sales following news disclosures*, is inconsistent and unsupportable. *See Guttman v. Huang*, 823 A.2d 492, 503-04 (Del. Ch. 2003) (directors' stock sales following the filing of a certified financial statement is "consistent with the idea that NVIDIA permitted stock sales in such periods because it diminished the possibility that insiders could exploit outside market buyers"); *Lipton v. Pathogenesis Corp.*, 284 F.3d 1027, 1037 (9th Cir. 2002) ("[o]fficers of publicly traded companies commonly make stock transactions following the public release of quarterly earnings and

related financial disclosures"). If the sale of an insider's stock is permissible after the trading window has opened following the public release of corporate information, it does not advance corporate governance to impose a fairness review on options granted after a public release, particularly where as here there is an intervening vesting period before one can exercise the option and then sell the underlying stock. Directors – even outside directors – will always be privy to some inside information. Thus one could always assert that an option granted prior to a stock price decline was granted at an "artificially low" price, even though the strike price reflected the fair market value.[36]

Although the *Desimone* Court did not address potential self-dealing claims with respect to spring loaded grants, a similar argument can be made here too. Because directors will always be privy to inside information, shareholders will claim that options were artificially inflated, even though they were granted at the market price. That assertion should fail where, as here, none of the challenged grants violated the fair market value restrictions in Linear's stock option plans. The Board could grant options for reasons other than to create incentives for future performance and had substantial authority in setting all terms, all of which the shareholders knew about and approved in advance. Not only were there significant time periods in the vesting of these options, but many of the challenged grants are still under water and have not been exercised, many many years later. Thus, to assert that there were hidden bonuses or even compensation that was guaranteed at the time of the grants flies in the face of the reality of the granting of options at Linear. There was no violation of the plans and no basis for imposing liability.

[36] As SEC Commissioner Atkins has said, "[p]ractically speaking, because corporate boards are almost always in possession of material nonpublic information, it would be difficult (if not impossible) to require them to refrain from making options grants when they are in possession of such information. Along those lines, would we call it insider trading if a board chose not to grant options because it knew of impending bad news?" DiTomo Aff., Ex. 15 at 6.

In the alternative, this claim fails as a matter of pleading. Although plaintiff's claims are asserted against all defendants, plaintiff's claim against the management defendants appears to be based on their mere receipt, rather than any affirmative action in authorizing or approving grants. Plaintiff alleges that the management defendants should have noticed on receipt that the options were well timed. FAC ¶¶ 157-58. Plaintiff does not allege that the management defendants dominated and controlled the members of the Compensation Committee, who were outside directors. Plaintiff does not explain how the management defendants can be liable for self-dealing or breaches of loyalty where they played no role in the grants.

Plaintiff's claim appears to focus instead on the outside directors on the Compensation Committee (and Swanson, who was not a member). *Id.* ¶ 155.[37] The FAC never provides any specifics as to any director or any grant. Plaintiff alleges that it was inconsistent with fiduciary duties "to have asked for shareholder approval of an incentive stock option plans [sic] and then later to distribute shares to themselves and company executives in such a way as to undermine the very objectives approved by shareholders." FAC ¶ 155. But, these allegations are belied by Linear's stock option plans and Compensation Committee Reports, which plaintiff stubbornly ignores and miscites.

The Court in *3Com*, 1999 WL 1009210, is instructive. The Court considered and rejected an analogous allegation. There plaintiff alleged that directors awarded themselves stock options that constituted lavish and excessive compensation, and sought to have his claim reviewed under the entire fairness standard. *Id.* at *1-2. The Court acknowledged that the option grants appeared to be self-interested transactions, but found the entire fairness standard inapplicable. It was evident that the authorization of grants

[37] Committee Members allegedly received four bullet dodged grants, FAC ¶¶ 60, 84, 93, 127. Two of these were simultaneously awarded to many others in the Company including non-defendants. *Id.* ¶¶ 60, 93. Members also allegedly received four spring loaded grants. *Id.* ¶¶ 52, 73, 101, 109. One of these was simultaneously awarded to many others in the Company including non-defendants. *Id.* ¶ 101.

was made within the limitations of the stock option plan previously approved by the shareholders. The Court held that the directors were entitled to the protection of the business judgment rule. *Id.* at *2:

> Precedent in this Court clearly establishes that 'self-interested' director transactions made under a stock option plan approved by the corporation's shareholders are entitled to the benefit of the business judgment rule.

Id. at *3 (citations omitted). Further, having found the plaintiff failed to plead waste, the Court held that "[b]ecause the Board's alleged actions are protected by the business judgment rule and plaintiff has failed to make out a case of waste, there can be no underlying breach of the fiduciary duty of loyalty." *Id.* at *5. Accordingly, these claims should be dismissed.

IX. THE FAC DOES NOT STATE A CLAIM AGAINST THE OFFICER DEFENDANTS AND MAIER

Plaintiff seeks to assert claims against individuals who were never members of the Board or its Compensation Committee, including officers who joined the Company long after many of the challenged grants were made. Even under plaintiff's theory, defendants who were not involved in granting options but are merely grantees cannot be liable.

Defendants Coghlan, Bell, Dobkin, Paulus and McCann are current or former Linear executives who allegedly received spring-loaded or bullet-dodged grants; none were Board members. *See* FAC ¶¶ 23-27. Maier has been an officer since 1999 but has only been a director since September 2005 – months after the last challenged grant was made – and has never been a member of the Compensation Committee. *See id*. ¶ 17. None of these officer defendants is alleged to have been involved in the grant process. *See id*. ¶¶ 155-56 (alleging that the Compensation Committee members and Swanson authorized and approved the grants).

Bell, McCann, and Paulus only joined Linear after many of the grants were made. Specifically, the FAC alleges that Bell joined Linear in 2003 (*see id*. ¶ 24); McCann joined in 2004 (*see id*. ¶ 27); and Paulus joined in 2001 (*see id*. ¶ 26). These defendants

cannot be liable for breaches of duty that allegedly occurred before they joined the Company, or in Maier's case, before he became a Board member. *See Disney*, 906 A.2d at 48-51 (finding that the president could not have breached any fiduciary duty to the company for alleged wrongdoings associated with negotiation of his contract as he was not an officer of the corporation at the time of the negotiation).[38]

Even if allegations of spring loading and bullet dodging can give rise to a claim for breach of duty, and if plaintiff is able to plead such a claim, only those directors who made the decisions to issue favorably timed option grants can be liable for such claims. *See Tyson Foods*, 919 A.2d at 593. There is no basis for asserting such claims against the recipients of the challenged grants, particularly where there are no allegations that they were privy to any non-public information or controlled the timing of the grants. Accordingly, the claims against the officer defendants – Maier, Coghlan, Bell, Dobkin, Paulus and McCann – must be dismissed.

X. THE FAC SHOULD BE DISMISSED FOR FAILURE TO PLEAD DEMAND FUTILITY WITH PARTICULARITY

Plaintiff contends that demand is futile as to every grant and as to every member of the Board, including, apparently Maier, who did not even join the Board until after all the options were granted. FAC ¶¶ 17, 176, 181. Plaintiff's theory is a kitchen-sink approach based on all directors' "participation in and approval of the scheme . . . and/or their receipt of such options." *Id.* ¶ 176. For purposes of this Motion only, defendants assume that the three current members of the Compensation Committee (out of a five

[38] *See In re Guidant S'holders Derivative Litig.*, 841 N.E.2d 571, 573 (Ind. 2006) ("Here, plaintiffs have named directors who did not participate in the challenged actions and indeed some directors who were not even directors at the time of the events at issue."); *CNET*, 483 F. Supp. 2d at 963-64; *In re Sagent Tech., Inc., Derivative Litig.*, 278 F. Supp. 2d 1079, 1094-95 (N.D. Cal. 2003).

person Board) cannot consider demand as to the eight sets of option grants that they received.[39]

With this exclusion, plaintiff does not and cannot plead demand futility as to the other fourteen sets of grants. Plaintiff does not attempt to argue that the members of the Compensation Committee lack independence or that their discretion is sterilized. FAC ¶¶ 175-181; *Aronson*, 473 A.2d at 814. Nor does plaintiff contend, much less plead with particularity, that the members of the Compensation Committee are interested in grants received by other recipients. FAC ¶¶ 175-81. Plaintiff appears to argue instead that the grants the members of the Compensation Committee made to others were not the product of a valid or good faith exercise of business judgment. *Id*. ¶ 175. Plaintiff argues there was no "legitimate basis or justification for granting spring-loaded and bullet-dodged options. Doing so violated the purposes, spirit, intent and objective of Linear's shareholder-approved stock option plans." *Id.*

This boilerplate refrain not only lacks any semblance of particularity, it lacks merit. More than twenty years ago, the Delaware Supreme Court reiterated in *Aronson* that directors "have broad corporate power to fix the compensation of officers." *Aronson*, 473 A.2d at 817 (citing 8 *Del. C.* § 122(5)); *White*, 793 A.2d at 369 ("'this Court's deference to directors' business judgment is particularly broad in matters of executive compensation'") (citation omitted). Linear's stock option plans as discussed throughout sanctioned broad means and grounds for compensation to officers. Even assuming that the FAC pleads adequately that the grants were well timed, the practice was never prohibited by the SEC to this day, and not even arguably prohibited in certain circumstances by Chancellor Chandler until February of this year. This is not a "rare case" where the grants are "so egregious on [their] face that board approval cannot meet

[39] The Court should consider demand futility only after ruling on which grants if any state a claim and are not time-barred. *See CNET Networks*, 483 F. Supp. 2d at 962 (addressing demand futility analysis only after addressing and determining which backdated transactions were adequately pleaded).

the test of business judgment, and a substantial likelihood of director liability therefore exists." *Aronson*, 473 A.2d 815.

The FAC also fails to plead any particularity concerning the actions of the Compensation Committee members. As the Delaware courts have held, "mere directorial approval of a transaction, absent particularized facts supporting a breach of fiduciary duty claim . . . is insufficient to excuse demand." *Aronson*, 473 A.2d at 817. Plaintiff does not even definitively plead affirmative approval: defendants "authoriz[ed], *or through abdication of duty* permit[ted]" the grants. FAC ¶¶ 1, 167, 185 (emphasis added).[40] Further, plaintiff does not plead, for any of the grants covering a nine year period, any facts surrounding the supposed authorization, or how the manipulation was purportedly accomplished. Plaintiff has not alleged facts concerning each director's role in granting options; material non-public information each director supposedly possessed when each grant was made; what each director knew, understood, or believed about the likely effect on Linear's share price of the disclosure of such information; or, how such information affected each director's decision to make the challenged grants.

In *Desimone*, the Court reviewed in addition to allegedly bullet dodged and spring loaded options certain options granted to employees that Sycamore had admitted were backdated. The Court nonetheless dismissed this set of allegations for failure to plead demand futility. *Desimone*, 924 A.2d at 914, 938. The stock option plans contemplated delegation to non-director executive officers. The complaint failed to plead with particularity who approved the grants, and whether any directors or a majority knew the options were being backdated. *Id.* at 914, 938; *see id.* at 943 ("a derivative complaint must plead facts *specific to each director*, demonstrating that at least half of them could not have exercised disinterested business judgment in responding to a demand").

[40] *See Desimone*, 924 A.2d at 939-40 (dismissing allegations that board "abdicated" its role to monitor Sycamore's compliance with applicable laws and regulations based on failure to plead that "'directors knew that they were not discharging their fiduciary duties'") (citing *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006)).

Plaintiff did not plead facts that directors were "involved in the details of the Employee Grants in any way, much less that the board was driving the process by, and dates on, which options were awarded." *Id.* at 938. Although the complaint alleged that the employee stock option plan was administered by the Compensation Committee and specifically, two outside directors, the complaint was "vague and conclusory" because there were no particularized facts to "suggest that the Compensation Committee was involved in or had knowledge of any backdating." *Id.* at 938.

The *Desimone* Court reached similar conclusions with respect to option grants to officers, in which it was less likely that responsibility for such grants was delegated to others by the Compensation Committee. The Court stated: "I can infer nothing from the pled facts about whether and to what extent any director was involved in the mechanics by which the options were issued or the dates on which that administrative task was carried out. *Id.* at 942. The Court concluded: "Desimone has not pled facts suggesting an inference that the Sycamore board knowingly granted Sycamore's officers backdated options. Dismissal is warranted on that basis alone." *Id.* The allegations here are similarly insufficient to excuse demand.[41]

[41] *See CNET*, 483 F. Supp. 2d at 965 (holding that demand is not excused where plaintiffs fail to allege that two members on the compensation committee "chose the date on which the allegedly backdated options were to be granted or that they knew the grant's true date;" "Plaintiff's allegations that because they were on the compensation committee, they must have known, do not constitute particularized facts"); *White*, 783 A.2d at 552 (affirming dismissal based on challenge of business judgment where "factual allegations in the complaint concerning the board's knowledge and conduct are sparse"); *Guttman*, 823 A.2d at 503 ("entirely absent from the complaint are well-plead, particularized allegations of fact detailing the precise roles that these directors played at the company, the information that would have come to their attention in those roles, and any indication as to why they would have perceived the accounting irregularities"); *Seminaris*, 662 A.2d at 1354 (directors' signature on a misleading Form 10-K does not support a substantial likelihood of liability sufficient to excuse demand).

CONCLUSION

For the foregoing reasons, defendants respectfully request this Court to dismiss the FAC in its entirety.

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CERTIFICATE OF SERVICE

I hereby certify that on September 19, 2007, copies of the foregoing were served upon the following counsel in the manner indicated:

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