# IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

## IN AND FOR NEW CASTLE COUNTY

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, an agency and instrumentality of the State of California,

Plaintiff,

v. C.A. No. 19191

JAMIE B. COULTER, JOHN D. WHITE, FRED B. CHANEY, WILLIAM B. GREENE, JR., MICHAEL J. ARCHER, CLARK R. MANDIGO, WILLIAM H. TILLEY, and DENNIS L. THOMPSON,

Defendants,

and

LONE STAR STEAKHOUSE & SALOON, INC.,

Nominal Defendant.

## MEMORANDUM OPINION

Date Submitted: May 28, 2002
Date Decided: December 18, 2002

Jay W. Eisenhofer, Esquire, Cynthia A. Calder, Esquire and Sidney S. Liebesman, Esquire of Grant & Eisenhofer, P.A., Wilmington, Delaware, Attorneys for Plaintiff.

Bruce L. Silverstein, Esquire, Martin S. Lessner, Esquire, Danielle Gibbs, Esquire and Adam W. Poff, Esquire of Young Conaway Stargatt & Taylor LLP, Wilmington, Delaware, Attorneys for Defendants Fred B. Chaney, William B. Greene, Jr., Clark R. Mandigo, and John D. White.

A. Gilchrist Sparks, III, Esquire and S. Mark Hurd, Esquire of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, Attorneys for Defendants Michael J. Archer, William H. Tilley and Dennis L. Thompson.

Steven J. Rothschild, Esquire and Martina Bernstein, Esquire of Skadden, Arps, Slate, Meagher & Flom **LLP,** Wilmington, Delaware, Attorneys for Defendant Jamie B. Coulter.

NOBLE, Vice Chancellor

## I. INTRODUCTION

Plaintiff California Public Employees' Retirement System ("CalPERS") brings this action, both derivatively and as a purported class action, against Nominal Defendant Lone Star Steakhouse & Saloon, Inc. ("Lone Star"), a Delaware corporation, and several of its current and former officers and directors. CalPERS, through its amended complaint, derivatively attacks the "repricing" of options owned by executives and board members, certain related transactions between Lone Star and Lone Star's largest stockholder, who, at the time, was also its chairman, and the severance packages granted key executives which are alleged to have served as entrenchment devices. CalPERS, through its direct claims, challenges certain actions of Lone Star's board as an unlawful impairment of the shareholders' voting rights and as an illegal classification of directors.

CalPERS made no pre-suit demand upon the Lone Star board. Accordingly, the Defendants have moved to dismiss the derivative claims under Court of Chancery Rule 23.1 for failure to make demand upon the board or, in the alternative, for failure to plead adequately that demand on the board was excused. The Defendants have also moved to dismiss all claims under Court of Chancery Rule 12(b)(6) for failure to state a claim and under various theories that certain claims are time-barred, moot, or precluded by the exculpatory provision in Lone Star's certificate of incorporation authorized by 8 ***Del. C.*** § 102(b)(7). For the

reasons set forth below, the motions to dismiss are granted in ‘part and denied in part.

## II. THE PARTIES[1]

CalPERS owns approximately 293,000 of the roughly 24 million outstanding shares of Lone Star.

Defendants are current and former officers and directors of Lone Star. Defendant Jarnie B. Coulter (“Coulter”) is the current Chief Executive Officer and a former director and Chairman of the Board of Lone Star. Coulter is also the largest single shareholder of Lone Star, owning 2.4 million shares and 2.6 million currently exercisable options. Defendant John D. White (“White”) is a director, Executive Vice President, and Treasurer of Lone Star. He is the former Chief Financial Officer of Lone Star. Prior to joining Lone Star, White was the Senior Vice President of Finance for Coulter Enterprises, Inc. (“CEI”), a company then owned by Coulter. White has been a shareholder of Total Entertainment Restaurant Corp. (“TENT”), another Coulter-affiliated business, since before its initial public offering (“IPO”)—shares “given” to him by Coulter according to the amended complaint. Defendants Fred B. Chaney (“Chaney”), William B. Greene

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[1] The factual context for consideration of the pending motions is drawn from the well-pled allegations of the amended complaint. *See infra* notes 5-8, 42-44 & accompanying text.

("Greene"), and Clark R. Mandigo ("Mandigo") are members of Lone Star's board of directors. Mandigo is also a shareholder of TENT. Defendant Michael J. Archer ("Archer")- is a former director and Senior Vice President of Operations of Lone Star and is now Chief Operating Officer of Lone Star's Del Frisco/Sullivan unit. Archer is also a TENT shareholder. Defendant William H. Tilley ("Tilley") is a former director of Lone Star. Tilley is also the majority shareholder of Pacific Ventures, Ltd., which in turn owns 50% of Restaurants of Micronesia. Restaurants of Micronesia is a Lone Star licensee and operates a Lone Star restaurant in Guam. He is also the principal shareholder of California Star Restaurants, a Lone Star licensee that operates Lone Star restaurants in California. Finally, Tilley is a shareholder of TENT. Defendant Dennis L. Thompson ("Thompson") was previously a director (1992-98) and Senior Vice President (1992-97) of Lone Star. Thompson was also an officer, director, and shareholder of a corporate franchisee of Lone Star from 1985-95 and has served on the board of directors of TENT since 1997.

## III. FACTUAL BACKGROUND

Lone Star, founded by Coulter, owns and operates a number of restaurants, including Lone Star Steakhouse & Saloon, Del Frisco's Double Eagle Steak House, and Sullivan's Steakhouse. Lone Star went public in 1992. Coulter then became Lone Star's CEO and Chairman of the Board.

Lone Star has a history of dealing with other Coulter businesses. A separate entity, CEI, which was owned solely by Coulter until it was purchased by Lone Star in October 1998, has provided accounting and administrative services under an annual contract with Lone Star since at least 1993. In addition, Lone Star reimbursed CEI for Coulter's use of aircraft and pilot services in 1996-98. These reimbursed amounts had been paid by CEI to another wholly-Coulter-owned entity and amounted to approximately $2.2 million over a thirty-three month period. There were also several short-term loan transactions between Lone Star and CEI.

In October 1998, Lone Star purchased CEI for almost $11.5 million which consisted of a $10.5 million sale price plus Lone Star's assumption of nearly $1 million of CEI's liabilities. The transaction was approved by a three-member special committee of the board of directors. Tilley was the chairman of the committee and the two other members were Chaney and Mandigo. Steven Wolosky, Esquire ("Wolosky") of the law firm Olshan, Grundman, Frome & Rosenzweig ("Olshan") informed the committee that no independent counsel would be necessary because Olshan had already drafted a purchase agreement. Wolosky and his firm had acted as legal counsel for many of Coulter's businesses, including CEI, TENT, and Lone Star, and Wolosky had been a shareholder and director of TENT. Upon his advice, the committee did not seek the services of independent legal counsel to represent Lone Star in the transaction. The committee

did employ the services of investment bankers, Houlihan Lokey Howard & Zukin ("Houlihan"), to prepare a valuation report. Houlihan's report valued CEI between $1 O-l 1 million, but the valuation disclosed that it was based, in part, on unverified information provided by CEI and Lone Star management. This undocumented and unverified information included a recent offer to purchase CEI for $20 million, an estimate of the costs of replacing the services that CEI provided to Lone Star, and cash flow and revenue forecasts that exceeded CEI's historical performance. CalPERS contends that the $20 million offer was fabricated; no one ever investigated the costs of replacing CEI's services; and the cash flow and revenue forecasts failed to reflect either the recent loss of service contracts with Pizza Hut and KFC franchises[2] or the impending loss of TENT's service contract. White, not a member of the special committee, was assigned the task of representing Lone Star for the purpose of negotiating the acquisition. Less than one week later, White and Coulter (CEI's owner) agreed to the nearly $11.5 million transaction and the special committee approved it.

CalPERS also alleges that, during 1996 and 1997, Coulter was not attentive to his duties at Lone Star because his focus was on the completion of an initial

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[2] These franchises had once been owned by Coulter but were awarded to Coulter's ex-wife in a divorce settlement.

public offering of TENT, another Coulter entity. At this time Lone Star's board of directors was comprised of Coulter, White, Mandigo, Chaney, Tilley, Nickel, Thompson, and Archer. All of the directors, except Nickel and Chaney, were TENT shareholders and Thompson was appointed to TENT's board after the public offering in 1997. Coulter's subsequent relationship with TENT is unclear from the amended complaint. After the IPO, in March 1997, Coulter was the Chairman of TENT's board of directors. By October 1998, however, there may have been some friction because shortly after Lone Star purchased CEI, Coulter was removed as TENT's Chairman and the CEI service contract was discontinued.

A few months later, in January 1999, the Lone Star board amended Coulter's employment contract with Lone Star. Coulter's previous contract contained non-competition and non-solicitation provisions both of which applied in the event that Coulter elected to terminate his employment in response to a change of control at Lone Star. Coulter's contract had included these provisions since 1992, the year Lone Star became a public company. The new contract waived the non-compete and non-solicitation provisions if Coulter, upon ten-days notice to Lone Star, elected to leave the company within three years following any change of control. CalPERS alleges that Lone Star received no offsetting benefit in exchange for this change to Coulter's contract.

Between April 1996 and December 1998, Lone Star's share price declined from $44.00 per share to $7.88. Beginning in 1998 the board of directors began aggressively repurchasing company stock, authorizing the repurchase of 2.6, 8.75, and 5.6 million shares in 1998, 1999, and 2000 respectively. These repurchases reduced the number of outstanding shares by 4 1%.

CalPERS also challenges the "repricing" of employees' and outside directors' stock options on five occasions. In April 1997, 8.1 million employees' options with original exercise prices ranging from roughly $1 9–$40 per share were repriced to $18.25 per share. Of these repriced options, Coulter owned 2.6 million and White owned 1 million. In September 1997, outside directors' options were repriced. The amended complaint does not specify many of the details, but it does note that 52,000 of Chaney's and 42,800 of Mandigo's options, with original strike prices between approximately $19 and $40 per share were repriced to $18.8 1. Employees' options were again repriced in December 1998. At that time, 768,000 options with a weighted average exercise price of $16.91 per share were repriced to $8.00. Archer owned 646,000, or slightly more than 84%, of those shares. Outside directors' options were repriced again in September 1999. Of the 148,400 options repriced, 40,000 belonged to Greene, 42,800 to Mandigo, and 65,600 to Chaney. Except for some having lower original exercise prices, these options were repriced from $18.25 to $7.94 per share. In January 2000, employees' options

were repriced a third time. The repricing affected almost 4.6 million options, with an average exercise price of $18.25, repricing them to $8.46875 per share. Coulter still owned 2.6 million of these options and White still owned 1 million.

The amended complaint does not set forth whether a committee or the full board approved either the employees' or outside directors' options repricings in 1997. The employees' options repricings in 1998 and 2000 were approved by the Stock Options Committee, which was comprised of Mandigo, Chaney, and Tilley in 1998 and of Mandigo, Chaney, and Greene in 2000. The 1999 repricing of outside directors' options was approved by Coulter and White.

At least as early as February 2000, CalPERS voiced dissatisfaction with the management of Lone Star. On February 22, 2000, CalPERS listed Lone Star on its Corporate Governance Focus List of under-performing stocks for the year. On May 1, 2000, CalPERS filed proxy materials to initiate a shareholder resolution seeking to amend the bylaws to require that the board consist of a majority of outside, independent directors. This was followed by a letter to other shareholders urging support for the resolution. The resolution was adopted over the opposition of Coulter and the other directors at the 2000 annual shareholders' meeting. At that meeting, shareholder Guy Adams ("Adams") sharply questioned compensation increases to Coulter and White of 241% and 190% respectively during a period of declining profits and share price for Lone Star. Adams also questioned the wisdom

of repricing millions of predominantly incentive options belonging to White and Coulter given the company's weak performance under their leadership. The Council of Institutional Investors ("CII") sent a letter to Lone Star's board of directors on July 14, 2000. In that letter, CII requested a board resolution requiring a majority of independent directors and sought to have Lone Star declassify the board.

CalPERS served demand to inspect Lone Star's books and records, pursuant to 8 *Del. C.* § 220, on November 9, 2000. The demand letter requested documents related to stock options repricings, the acquisition of CEI, and Lone Star's dealings with Coulter. The board and CalPERS disagreed regarding the scope and propriety of the demand. Litigation on that issue was ultimately avoided through negotiation and subsequent production, which was completed by August 200 1.

On January 3, 200 1, the Lone Star board adopted change of control agreements for senior management, including Coulter and White. The agreements, which would provide compensation to departing managers, were designed to be activated by any change of control at Lone Star. As originally adopted, it is alleged, the agreements would have obligated Lone Star to pay departing executives an amount that would have exceeded one-third of the company's market capitalization if Lone Star were to be purchased for as little as $12 per share. Later clarification of the how the agreements would operate reduced that amount to

approximately one-eighth of Lone Star's market capitalization—still a significant potion of the company's value. In addition, these agreements define "change of control" to include the "failure of the stockholders to re-elect a majority of the currently sitting directors (the "Existing Directors") *unless the new candidates are approved by a majority of the Existing Directors*[.]"[3] The adoption of these agreements was disclosed publicly on March 26,200 1, when Lone Star's 1 O-K was filed with the Securities Exchange Commission.

Shareholder response was not enthusiastic. CalPERS met with Mandigo, Chaney, and Greene on April 17,200 1. CalPERS expressed its concerns about the golden parachutes and requested a reduction in the benefits provided. CalPERS' pointed out that under the agreements departing managers would be entitled to receive, *inter alia*, the exchange of any vested or non-vested stock options for a cash payment equal to the transaction price. It appeared that there would be no offset for the strike price of the exchanged options. Mandigo, Chaney, and Greene disagreed with that interpretation, but they did agree to consider including a clarification that there would be an offset of the strike price in later public filings of Lone Star. Ultimately, CalPERS requested that the agreements be rescinded. The agreements were not rescinded, but Lone Star filed an amended 10-K on

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[3] Pl.'s Am. Compl., ¶ 87 (emphasis added).

April 25, 2001, clarifying that the payment for options exchanged under the agreements would include an offset for the strike price.

On March 26, 200 1, Adams filed proxy materials challenging Coulter's seat on Lone Star's board and sent a proposed shareholder letter to the board on April 6. In that letter, Adams criticized the directors' lack of independence, Lone Star's stock performance, the options repricings, and the golden parachutes. The Lone Star board vigorously opposed Adams' proxy challenge for Coulter's board seat. Nonetheless, Adams was elected to the board, unseating Coulter, on July 6, 2001.

## IV. SYNOPSIS OF CLAIMS

Plaintiffs amended complaint consists of the following fourteen claims:

- *Count* I is a derivative claim for breach of fiduciary duty based on the repricing of employees' and directors' options.
- *Count* II is a derivative claim that seeks to void the repricing of employees' options as interested transactions that were not properly ratified.
- *Count III* is a derivative claim that seeks to void the repricing of outside directors' options as an *ultra vires* act and a breach of fiduciary duty.
- *Count IV* is a derivative claim for breach of fiduciary duty based on the board's having permitted Coulter to shirk his duties as CEO and Chairrnan while preparing TENT for its initial public offering.
- *Count V* is a derivative claim for breach of fiduciary duty with regard to the acquisition of CEI by Lone Star.
- *Count VI* is a derivative claim that seeks to void the acquisition of CEI as an improperly ratified interested transaction.
- *Count VII* is a derivative claim that seeks to void payments made to CEI by Lone Star under the 1997 and 1998 service agreements as

improperly ratified interested transactions.

- *Count VIII* is a derivative claim for breach of fiduciary duty in relation to the payments made to CEI in 1997 and 1998.
- *Count* IX is a derivative claim for breach of fiduciary duty based on allegations of entrenchment.
- *Count X* is a derivative claim that seeks to void the amendment to Coulter's employment contract—suspending application of the contract's non-compete and non-solicitation clauses in the event of a change of control-as waste and as an improperly ratified interested transaction.
- *Count XI* is a derivative claim for breach of fiduciary duty in adopting the amendment to Coulter's employment contract.
- *Count XII* seems to be a "catch-all" derivative claim for breach of fiduciary duty apparently on the basis of the combined weight of all the suggestions of wrongdoing contained in the amended complaint.
- *Count XIII* is a class action direct claim for breach of fiduciary duty based on the existing director provisions contained in the change of control agreements or golden parachutes for management because it is claimed that these provisions constitute an unlawful impediment to the shareholders' exercise of voting rights.
- *Count XIV* is a class action direct claim for breach of fiduciary duty alleging that the existing director provisions create an illegal classification of directors.

## V. ANALYSIS

### *A. Demand Requirement*

Defendants have moved to dismiss all derivative claims (Counts I-XII) for failure to allege with particularity facts demonstrating that demand, as required under Rule 23.1, would be futile. Demand futility is determined by application of

the two-pronged *Aronson* test.[4] Under *Aronson,* demand will be excused as futile where the “particularized facts alleged in the complaint create a reasonable doubt *(i.e.,* reason to doubt) that (1) the directors upon whom demand would be made were disinterested and independent or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.“’ Thus, the inquiry of the Court is whether the plaintiff has “alleged particularized facts creating a reasonable doubt that the actions of the defendants were protected by the business judgment rule.”[6] Where the amended complaint alleges particularized facts, the plaintiff is entitled to the reasonable inferences flowing from those facts.[7] The plaintiff is not entitled to rely upon conclusory allegations.’

The original complaint was filed on October 16, 2001. At that time the board members were defendants White, Mandigo, Chaney, and Greene, and non-defendant Adams. While the composition of Lone Star’s board changed before the filing of the amended complaint on January 9, 2002, the amended complaint did not add any derivative claims that were not included in the original complaint.

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[4] *Aronson v. Lewis, 473* A.2d 805, 814 (Del. 1984). See *Brehm v. Eisner, 746* A.2d 244, 256 (Del. 2000).
[5] ***Zupnick*** *v. Goizueta, 698* A.2d *384, 386* (Del. Ch. 1997). *See also Aronson, 473* A.2d at 814.
[6] *Brehm, 746* A.2d at 255.
[7] Id.
[8] Id.

Thus, the board as constituted on October 16, 2001, is the board for purposes of evaluating whether demand is required or excused.[9]

1. Disinterest and Independence: First Prong of the *Aronson* Test

A plaintiffs burden in seeking to justify a failure to make demand on the board under *Aronson* has been described as follows:

> *The Aronson Court*.. . defined interest as "mean[ing] that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." . . . [I]n the absence of self-dealing, it is not enough to establish the interest of a director by alleging that he received *any* benefit not equally shared by the stockholders. Such benefit must be alleged to be ***material*** to that director. Materiality means that the alleged benefit was significant enough *"in the context of the director's economic circumstances,* as to have made it improbable that the director could perform her fiduciary duties to the. . . shareholders without being influenced by her overriding personal interest."
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> On the separate question of independence, the *Aronson Court* stated that "[i]ndependence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." Such extraneous considerations or influences may exist when the challenged director is controlled by another. To raise a question concerning the independence of a particular board member, a plaintiff asserting the "control of one or more directors must allege particularized facts manifesting 'a direction of corporate conduct in such a way as to

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[9] ***See, e.g., Haseotes*** v. ***Bentas,*** 2002 Del. Ch. LEXIS ***106,*** at * 14 (Del. Ch.); ***Needham v. Cruver,*** 1993 Del. Ch. LEXIS ***76,*** at *8-9 (Del. Ch.); ***Harris v. Carter, 582*** A.2d 222, 229-32 (Del. Ch. 1990).

comport with the wishes or interests of the corporation '(or persons) doing the controlling. The shorthand shibboleth of 'dominated and controlled directors' is insufficient." This lack of independence can be shown when a plaintiff pleads facts that establish "that the directors are 'beholden' to [the controlling person] or so under [his] influence that their discretion would be sterilized."[10]

a. Guy Adams

All parties agree that Adams, who unseated Coulter from Lone Star's board, is disinterested and independent.

b. William B. Greene

Greene became a director of Lone Star in August of 1999, after many of the disputed transactions had already occurred. The only allegations that are remotely related to the domination of Greene by Coulter are repeated references to Greene's having once said, "Those that got most of the gold make most of the rules."[11] CalPERS would have the Court presume that Greene would defer to Coulter on business decisions because as the largest single shareholder, Coulter has "most of the gold." This is simply inadequate to raise a reasonable doubt regarding Greene's ability to exercise independent business judgment.

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[10] *Orman v. Cullman*, 794 A.2d 5, 23–24 (Del. Ch. 2002) (citations omitted).
[11] I do not understand CalPERS to dispute the historical accuracy of this pithy observation attributed to Greene.

The one factual allegation of financial interest on the part of Greene is that he owned 40,000 options that were repriced in September 1999. This repricing of outside directors' options was approved by the inside directors Coulter and White. The award of options is a form of director compensation and 8 *Del. C.* § 14 1 (h) provides that "the board of directors shall have the authority to fix the compensation of directors" absent contrary provisions in the bylaws or certificate of incorporation. Furthermore, when a director's compensation is established by a majority of disinterested directors, the business judgment rule applies to the decision.[12] The amended complaint alleges variously that this repricing of options was (1) a repayment to the outside directors who "had approved everything Coulter and White wanted" and (2) a *quid pro quo* for the employees' options repricing that took place four months later in January 2000. Both assertions are conclusory

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[12] *See Lewis v. Hirsch,* 1994 Del. Ch. LEXIS 68, at *10-1 1 (Del. Ch.) (stating that executive compensation is "ordinarily left to the business judgment of a company's board of directors"); *Tate & Lyle PLC* v. *Staley Cont 'l,* Inc., 1988 Del. Ch. LEXIS 61, at *19-22 (Del. Ch.) (finding business judgment rule afforded no protection where outside directors recommended their own retirement plan and where all directors approved creation of trust benefiting both inside and outside directors, but business judgment rule did protect disinterested directors' approval of compensation packages for other directors). *Cf. Telxon Corp. v. Meyerson, 802* A.2d 257, 265-66 (Del. 2002) (noting that director self-compensation "where properly challenged" would be evaluated under an entire fairness standard like any other interested transaction); *Steiner v. Meyerson*, 1995 Del. Ch. LEXIS 95 at *32-33 (Del. Ch.) (excusing demand where challenged transaction affected compensation of outside directors, comprising a majority of the board, and where the complaint alleged that directors had *"appropriated for themselves* excessive fees and stock options") (emphasis added).

and the amended complaint offers no factual basis for either. The repayment allegation has little force, particularly as against Greene who had become a director only a month before the repricing and was not involved in approving any of the alleged self-dealing transactions. As discussed in greater detail below, the factual allegations of the amended complaint do not provide a basis to support an inference that there was a repricing scheme or conspiracy in which employee directors repriced the options of outside directors as a *quid pro quo* for prior or subsequent repricing of their own options.

The amended complaint does allege with particularity certain facts that provide a reason to doubt that Greene could disinterestedly consider demand as to Count IX, the claim of entrenchment. Greene was a director throughout 2000 and 2001 when CalPERS' and other shareholders' criticism of management became quite serious. Such criticism-including CalPERS' § 220 demand and shareholder resolution, Adams' questions at Lone Star's 2000 annual meeting, and CII's letter to the board-would most likely have been perceived as a threat to the incumbent management and directors of Lone Star. Subsequently, the board approved generous golden parachute agreements for White, Coulter, and others that would be triggered by any change in control at Lone Star. Under those agreements, failure to reelect a majority of the then-incumbent directors or their designated successors would constitute a change in control. The amended complaint alleges

that this and other board actions were taken in response to the 'perceived threat to the incumbent directors' positions and were intended to entrench the incumbent directors (or their designees) in office. These facts state a claim for entrenchment. Directors are presumptively "interested" in such actions taken for entrenchment purposes.[13] This raises a reasonable doubt about the ability of Greene to consider disinterestedly demand on Count IX for entrenchment.

c. Fred B. Chaney

Chaney became a director of Lone Star in May 1995. Therefore, he participated in a number of the decisions regarding the alleged self-interested transactions. He was a director when Coulter was allegedly permitted to shirk his duties at Lone Star in order to work on preparations for TENT's IPO. It is not, however, alleged that Chaney had any personal financial interest in the success of TENT. He was a member of the Lone Star board that approved changes to Coulter's non-competition agreement in 1998 and was a member of the Stock Option Committees that approved the employees' stock options repricings in 1998 and 2000. Chaney was a member of the special committee that approved the

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[13] See *Carmody v. Toll Bros., Inc.,* 723 A.2d 1180, 1189 (Del. Ch. 1998) (stating that there were particularized allegations that "the Toll Brothers directors acted for entrenchment purposes [and under Delaware law] that is sufficient to excuse the requirement of a demand").

purchase of CEI from Coulter. Mere approval of, or acquiescence in, a challenged decision of the board, without more, is insufficient to raise a reasonable doubt as to a director's independence or disinterest.[14]

Like Greene, the only factual allegation of financial interest on the part of Chaney is that he owned options that were repriced-52,000 options in 1997 and 65,600 in 1999. Certainly the argument has somewhat more force against Chaney, who was at least on the board when the approvals took place. Nonetheless, I am not persuaded that the facts alleged raise a reasonable doubt about Chaney's disinterest. First, this represents a fairly long wait for repayment. Some of the challenged approvals occurred as far back as 1996 (e.g., payments to CEI for Coulter's use of private aircraft). Second, there are no, allegations of intermediate facts to link the approval of any of these transactions with the stock option repricing. Third, the several transactions were approved by various groups of directors while the repricing of outside directors' options benefited only Mandigo and Chaney (and in '99, Greene, who had not approved anything).

[14] *See, e.g., Aronson,* 473 A.2d at 817; *Stein v. Orloff,* 1985 Del. Ch. LEXIS 418, at *9 (Del. Ch.); *Kaufman v. Belmont, 479* A.2d 282, 287 (Del. Ch. 1984); *Lewis v. Daum,* 1984 Del. Ch. LEXIS 602, at *7 (Del. Ch.). The amended complaint also asserts that Chaney is beholden to Coulter but fails to provide a factual basis for this conclusory statement. Consequently, Chaney must be considered independent of Coulter for demand requirement analysis.

For the same reasons I determined that Greene could 'not be considered disinterested for purposes of demand on the entrenchment claim in Count IX, I also have a reasonable doubt of Chaney's ability to consider disinterestedly demand on that count.

d. Clark R. Mandigo

Mandigo has been a member of Lone Star's board since March 1992. He was elected Chairman of the Board when Coulter was unseated by Adams in July 2001. Mandigo is alleged to be under the control of Coulter and interested in a number of the disputed transactions for the following reasons:

- Mandigo and Coulter are lifelong friends.
- Mandigo's son's livelihood is dependent on Coulter because Coulter is the CEO of Lone Star and Mandigo's son is the general manager of a Lone Star-owned restaurant in Denver.
- Mandigo was a director and approved or acquiesced in all of Coulter's alleged self-dealing transactions. This includes serving on the Stock Option Committee that approved all the repricings of employee options and on the special committee that approved the CEI purchase.
- Mandigo was a director during the time Coulter was permitted to shirk his duties at Lone Star in preparation for the IPO of TENT. During that time Mandigo owned TENT stock, from before the IPO, and had a financial interest in the success of TENT.
- Mandigo owned 42,800 options that were repriced in 1997 and again in 1999.[15]

[15] I include here CalPERS' allegation that Mandigo owned options that were repriced. I do not, however, consider that this makes Mandigo "interested," any more than owning options made Greene or Chaney "interested" for purposes of excusing demand.

- Mandigo was a director during the period when the alleged acts of entrenchment occurred.

If taken separately, none of the individual allegations would be adequate to raise a reasonable doubt as to Mandigo's disinterest or independence. Our cases have determined that personal friendships,[16] without more; outside business relationships,[17] without more; and approving of or acquiescing in the challenged transactions,[18] without more, are each insufficient to raise a reasonable doubt of a director's ability to exercise independent business judgment. On these facts, however, none of the allegations stands alone "without more." Taken together, they give this Court reason to doubt that Mandigo is disinterested and independent. Furthermore, it is a reasonable inference from the alleged particularized facts that the combination of relationships between Coulter and Mandigo, along with Coulter's position as CEO of the company that employs Mandigo's son, would be

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[16] *See, e.g., Crescent/Mach I Partners, L.P. v. Turner, 2000* Del. Ch. LEXIS 145, at *40-41 (Del. Ch.).

[17] *See, e.g., Goldman v. Pogo.com,* Inc., 2002 Del. Ch. LEXIS 71, at *14 (Del. Ch.); *Orman, 794* A.2d at *26-27; Crescent/Mach I Partners, L.P.,* 2000 Del. Ch. LEXIS 145, at *40-41.

[18] *See, e.g., Aronson, 473* A.2d at 817; *Stein,* 1985 Del. Ch. LEXIS 418, at *9; *Kaufman, 479* A.2d at 287; *Lewis,* 1984 Del. Ch. LEXIS 602, at *7.

sufficiently material to preclude Mandigo from being able to consider demand without improper considerations intervening.[19]

e. John D. White

White has been a director of Lone Star since 1992 and serves as its Executive Vice President and Treasurer. He was formerly the Chief Financial Officer of Lone Star. In both positions Coulter, as CEO, was and is White's superior at Lone Star. Prior to joining Lone Star, White was the Senior Vice President of Finance for CEI. At that time Coulter was the sole owner of CEI and, again, White's superior. Thus, the amended complaint alleges that Coulter has been White's superior with regard to White's primary employment through White's last three positions and two employers. He has been a shareholder of TENT since before its IPO. The amended complaint alleges that Coulter "gave" shares of TENT to White. White is alleged to have provided false information to Lone Star and its advisors in conjunction with the purchase of CEI from Coulter. Specifically, he told the special committee members that it would be very costly to replace the services provided by CEI even though he had no basis for this assertion

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[19] *See In re New Valley Corp. Derivative Litig.,* 2001 Del. Ch. LEXIS 13, at *23-27 (Del. Ch.) (holding that plaintiffs satisfied pleading burden where "the actual extent of these relationships is not altogether clear at this point" and excusing demand on a motion to dismiss under Rule 23.1).

since he had not researched replacement costs. In addition, he failed to provide Houlihan with information, which he possessed, that CEI would be losing the contract with TENT. That information would most likely have reduced CEI's cash flow projections and ultimately the value placed on CEI. White struck the deal with Coulter regarding the purchase of CEI without any negotiation and at a price that was approximately $0.5–1.5 million (roughly 5-1 5%) more than the Houlihan valuation of the company. The contested change of control provisions, if triggered, could result in millions of dollars of payment to White. White has benefited from options repricings in 1997 and 2000.[20]

Coulter's position as White's superior alone would be sufficiently material to give reason to doubt White's independence from Coulter.[21] Certainly, taken together with all the facts alleged, the amended complaint raises a reasonable doubt regarding White's interest in a number of the challenged transactions, his independence from Coulter more generally, and his ability to exercise independent business judgment in evaluating demand as to each derivative claim.

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[20] As with Mandigo, I mention the allegation that White benefited from options repricing. Still, as with Greene, Chaney, and Mandigo, I note that repriced options do not alone form a sufficient basis for finding White "interested."

[21] See *Mizel v. Connelly*, 1999 Del. Ch. LEXIS 157, at *8–9 (Del. Ch.); ***Steiner,*** 1995 Del. Ch. LEXIS 95, at * 27-30.

For the reasons stated above, I find that demand is excused under the first prong of *Aronson* on Count IX (entrenchment) because the particularized allegations in the amended complaint raise a reasonable doubt about the disinterest and independence of a majority of the directors-White, Mandigo, Chaney and Greene. Because the amended complaint fails, based on its allegations of particularized fact, to raise a reasonable doubt about the disinterest or independence of three (Adams, Greene, and Chaney) of the five directors, demand is not excused. under the first prong of *Aronson* as to the remaining derivative claims.

2. Valid Exercise of Business Judgment: Second Prong of the *Aronson* Test

The determination of whether the amended complaint raises a reasonable doubt as to the disinterest or independence of a majority of Lone Star's directors at the time this action was filed, however, does not end the inquiry under *Aronson.* Even if a majority of the directors is found to be disinterested and independent, demand may be excused under the second prong of *Aronson* if the allegations of the complaint raise a reasonable doubt whether the challenged decision was the

product of the valid exercise of business judgment." Under the business judgment rule, it is presumed that the board acted on an informed basis and that the directors honestly and in good faith believed that the action was in the best interests of the corporation.[23] Thus, in order "to invoke the rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them."[24] In addition, the business judgment rule may not be invoked to shelter unauthorized actions of a board of directors.[25]

a. Repricing of Directors' and Employees' Options

The allegations supporting Counts I-III raise issues that call into question whether some of the options repricings were the product of the exercise of valid business judgment.[26] Count I alleges breaches of fiduciary duty with respect to all

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[22] *See Aronson, 473* A.2d at 814.
[23] *Id.* at 812
[24] Id.
[25] See *Lewis* ***v. Hett,*** 1984 Del. Ch. LEXIS 546, at *9-11 (Del. Ch.) (denying motion to dismiss under Rule 23.1 where complaint alleged adoption of severance package *was* ***ultra*** *vires* and could not be the product of valid business judgment).
[26] It is not alleged that any director approved or participated in the repricing of his own options and was therefore "interested" as analyzed under the first prong of *Aronson.* The complaint does allege, at least indirectly, that there was some sort of repricing scheme whereby employee directors could assure the repricing of their own options by approving the repricing of outside directors' options and vice-versa. The factual allegations about these repricings are sparse and do not reasonably support the inferences that CalPERS asks the Court to draw. The individual repricing actions were not contemporaneous. They span a thirty-three-month period with at least four months between one repricing and the next. The mix of directors changed several times during the "scheme" and the benefits accrued in varying amounts to different configurations of directors, in no ascertainable proportion between the benefits received and the benefits bestowed.

of the options repricings undertaken between 1997 and 2000. Count II seeks to void the repricing of employees' options as interested transactions. Count III seeks to have the repricing of outside directors' options declared void as *ultra vires* transactions. The following repricings are alleged in the amended complaint.

- *April 1997—Employees' Options.* Coulter and White respectively owned 32% and 19.8% of the options repriced. At the time the options were repriced, the board consisted of White, Coulter, Mandigo, Chaney, Nickel, Archer, and Thompson.
- *September 1997—Directors' Options.* There are few details given other than that Chaney had 52,000 options repriced and Mandigo had 42,800 options repriced.
- *December 1998—Employees' Options.* The benefits of this repricing went chiefly to Archer who held 84% of the options that were repriced. The Stock Option Committee was composed of Mandigo, Chaney, and Tilley. The board was composed of White, Coulter, Mandigo, Chaney, Tilley, and Archer.
- *September 1999—Directors' Options.* The benefits accrued to Chaney, Mandigo, and Greene who respectively owned 44%, 29%, and 27% of the options repriced at this time. The transaction was approved by White and Coulter, who along with Chaney, Mandigo, and Greene were Lone Star's directors at this time.
- *January 2000—Employees' Options.* The benefits accrued to White (22%), Coulter (57%), and other employees (22%).[27] The Stock Option Committee consisted of Mandigo, Chaney, and Greene. The board was composed of White, Coulter, Mandigo Chaney, and Greene.

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For example, although White and Coulter had relatively large blocks of options repriced in '97 and '00, virtually all (84%) of the employee options repriced in '98 belonged to Archer, and none is alleged to have belonged to either White or Coulter who then approved the repricing of directors' options in '99. CalPERS' allegations do not offer a plausible theory to support the notion of an options repricing conspiracy.

[27] Totals 101% due to rounding.

The amended complaint alleges that the repricing of employees' options was undertaken without the exercise of ***any*** business judgment. CalPERS first asserts that the justifications given for the repricings-to retain and attract key employees-were false because there was no risk that Coulter, White, or Archer might leave and that they were seeking instead to entrench themselves in office. There are insufficient factual allegations to support such a conclusion. CalPERS next contends that the 2000 repricing was conducted without any "analysis, evaluation, independent review, investment banking opinion, or advice from a compensation consultant or legal advisor."[28] The amended complaint affirmatively alleges that the only document in Lone Star's corporate records related to the transaction is the signed resolution of the Stock Option Committee implementing the repricing.[29] If this is true, and the Court must accept that it is for the limited purpose of ruling on a motion to dismiss, this could indicate that the Stock Option Committee failed to exercise business judgment when repricing employee options

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[28] Pl.'s Am. Compl., ¶ 70.

[29] In their respective briefs, the parties dispute whether the failure of Lone Star to produce any documents evidencing such analysis in response to CalPERS' § 220 request to inspect books and records gives rise to an inference that such records do not exist because they dispute whether such records were within the scope of the records that Lone Star agreed to produce. For the purposes of this motion to dismiss, the Court declines to make any inference. Instead, the amended complaint's factual allegation that no such records exist is accepted.

in January 2000. Such a failure excuses demand under the second prong of the *Aronson* test.[30] Importantly though, the amended complaint fails to make any such particularized allegation as to the repricing of employees' options in either 1997 or 1998. For that reason, I find that demand was required and defendants' motion to dismiss is granted as to Counts I and II insofar as they relate to the repricing of employees' options in 1997 and 1998. Demand is excused, however, as to Counts I and II with respect to the 2000 repricing of employees' options and to that extent the motion to dismiss under Rule 23.1 is denied.

Regarding the repricing of outside directors' options in 1997 and 1999, the amended complaint alleges that the underlying stock option plan does not permit repricing of options regardless of the technicalities of how repricing is accomplished.[31] The amended complaint incorporates the terms of the Lone Star's Directors' Stock Option Plan. Consequently, the Court may consider this document in ruling on the motion to dismiss.[32] Although Defendants and CalPERS offer, unsurprisingly, different views about the correct construction of the

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[30] *See Aronson, 473* A.2d at 8 14.

[31] The parties dispute whether "repricing" of options consists of changing the price of existing options or canceling existing options and issuing replacement options with a different exercise price. In order to rule on this motion to dismiss, the Court need not, and does not, make a determination about the mechanics of the options repricing.

[32] *See, e.g., In re New Valley Corp. Derivative* Litig., 2001 Del. Ch. LEXIS 13, at *13.

directors' plan, I decline to rule on construction of the agreement on a motion to dismiss. Article X of the agreement addresses the authority of the directors to amend or revise the terms of the plan. Section 10.1 requires shareholder approval of any amendment or revision that would "change the minimum Exercise Price set forth in Article VI[.]" It appears undisputed that the repricings were conducted under the options plan without additional shareholder approval. Quite naturally, the parties disagree whether the repricings constituted a "change" to the exercise price. One plausible answer is that they did. Thus, plaintiff alleges with particularity that repricing of directors' options in 1997 and 1999 was *ultra vires.* Any action of the board that falls outside the rather broad scope of its authority is not entitled to the protection of the business judgment rule[33] and demand is excused. I therefore deny the motion to dismiss Counts I and III for failure to make demand to the extent that these counts relate to the repricing of outside directors' options.

Finally I note that the amended complaint does not make the allegation that the repricing of *employees'* options was *ultra vires.* This argument is made in CalPERS' answering brief in opposition to the motion to dismiss. Arguments in

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[33] See *Lewis,* 1984 Del. Ch. LEXIS 546, at *9–11.

briefs do not serve to amend the pleadings.[34] Nonetheless, CalPERS argues in its answering brief that the directors' options plan and the employees' options plan are substantially identical as to whether repricing of options is permitted. For this reason, to the extent I have dismissed claims regarding the repricing of employees' options, such dismissal is without prejudice. CalPERS may request leave to amend the pleadings to allege that the employees' options repricings were *ultra vires*, if that is its contention.

b. Acquisition of CEI

The facts alleged regarding Lone Star's acquisition of CEI, an entity wholly owned by Coulter, raise a reasonable doubt as to whether the transaction was the product of the board's[35] exercise of business judgment. Thus, demand is excused as to Count V, which alleges breach of fiduciary duty in relation to the purchase, and as to Count VI, which seeks to void the acquisition as an improperly ratified interested transaction.

The Lone Star board obtained a valuation opinion from Houlihan when it considered the purchase of CEI. Where a board has relied on expert opinion and

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[34] *See Oman,* 794 A.2d at 28 n.59.

[35] At the time Lone Star acquired CEI, the board members were Coulter, White, Archer, Chaney, Mandigo, and Tilley.

seeks to support its actions with that opinion, *Brehm v. Eisner* 'has articulated the standard for assessing the allegations in the context of a motion to dismiss under Rule 23.1:

> [W]here an expert has advised the board in its decisionmaking process, the complaint must allege particularized facts (not conclusions) that, if proved, would show, for example, that: (a) the directors did not in fact rely on the expert; (b) their reliance was not in good faith; (c) they did not reasonably believe that the expert's advice was within the expert's professional competence; (d) the expert was not selected with reasonable care by or on behalf of the corporation, and the faulty selection process was attributable to the directors; (e) the subject matter (in this case the cost calculation) that was material and reasonably available was so obvious that the board's failure to consider it was grossly negligent regardless of the expert's advice or lack of advice; or (f) that the decision of the Board was so unconscionable as to constitute waste or fraud.[36]

The allegations of the amended complaint address parts (b) and (e) of the *Brehm* analysis, that is the allegations raise a reasonable doubt as to ( 1) whether

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[36] 746 A.2d at 262. I note that *Brehm* addressed a somewhat different set of issues than those before me based on the allegations of the amended complaint. First, *Brehm* articulates a standard for evaluating the demand requirement when the challenged board decision was based on expert opinion. *Id.* The improprieties alleged in the amended complaint encompass issues of both the price paid and the process utilized for evaluation and negotiation of the deal. Elements of the allegations raise issues related to the board's reliance on the Houlihan valuation, but other alleged improprieties cannot be attributed to reliance on the report. Second, the *Brehm* test is directed toward a due care claim. Id. The amended complaint raises issues associated with the contemplation, valuation, negotiation, and approval of the CEI purchase that encompass breaches of both care and loyalty. Nonetheless, the analytical paradigm stated in *Brehm* is useful for application of the second prong of *Aronson* to Counts V and VI in this case, at least to the extent that the Defendants assert reliance on Houlihan's valuation when evaluating and approving the purchase of CEI.

reliance on the Houlihan valuation was in good faith and (2) whether the directors were not grossly negligent. Taking all well-plead allegations as true, as I must, there are only two possible explanations for the special committee's reliance on the Houlihan valuation report. Either the committee members knew the report was based on grossly inaccurate data that inflated the valuation of CEI or they worked very hard not to know that information—facts which were both material and obvious. If the former is true, the committee's reliance could not have been in good faith. If the latter, the committee was grossly negligent. In either event, based on the amended complaint's allegations of particularized facts, the decision would not be the product of the valid exercise of business judgment, and demand on the board is, thus, excused.

CalPERS alleges that some of the bases of the Houlihan valuation opinion were fabricated and unfounded. Specifically, Houlihan was told that there had been a recent offer to purchase CEI for $20 million. The complaint alleges that this offer never occurred and was fabricated by Coulter and Wolosky (Coulter's attorney who handled the transaction). Also, the estimated costs of replacing CEI's services were provided by Lone Star management. Particularly, White told the board that he had a bid for the payroll services and the cost was substantial. The amended complaint alleges that there was no bid for payroll services and that White had failed to research the replacement costs at all. Finally, Houlihan's

valuation was based on cash flow in excess of CEI's historical. performance even though those revenues had been reduced by the recent loss of service agreements with KFC and Pizza Hut franchises (now owned by Coulter's ex-wife) and did not take into account the anticipated loss of the TENT service agreement. Houlihan did not request or receive any documentation to support any of these figures, nor did the special committee. The valuation report disclosed that it was based on unverified information.

Given the pervasive, complex, and overlapping business and personal relationships alleged among Coulter, White, and the special committee members, it is difficult to imagine that they would not have actual knowledge of CEI's loss of the KFC/Pizza Hut contracts or that they would not have anticipated the pending loss of the TENT contract, as well. At the very least, such knowledge would seem to be more readily accessible than it was avoidable among a group of individuals who had shared long years of an assortment of business and personal relationships that were specifically related to the businesses involved. With knowledge that CEI had lost and stood to lose important service agreements, it is hard to understand how the special committee could have in good faith accepted earnings projections in excess of historical performance, particularly with no explanation or documentation provided either to the committee or to the investment bankers.

Although, I believe that the foregoing analysis provides a sufficient basis for excusing demand on Counts V and VI, I now turn to aspects of the CEI purchase that raise wider issues of the operation of the special committee and the process by which the CEI transaction took place-issues that neither implicate the validity or quality of the Houlihan valuation of CEI nor the committee's rationality or good faith in relying on it.

Assuming the truth of the amended complaint's allegations, Lone Star purchased CEI from Coulter, Lone Star's Chairman, CEO, and primary shareholder. In addition to bargaining on behalf of his own company, CEI, Coulter evidently dominated Lone Star's side of the negotiations, as well. Moreover, although a special committee was formed to evaluate and approve the transaction, the amended complaint alleges particularized facts that support the inference that the special committee abdicated its role to Coulter and those controlled by him. The mere approval by a special committee of a self-dealing transaction does not protect the decision from heightened judicial scrutiny or confirm, *ipso facto,* that business judgment was validly exercised.[37] Thus, when it appears that the

[37] "Entire fairness remains applicable even when an independent committee is utilized because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny." *Kahn v. Tremont Corp., 694* A.2d 422, 428 (Del. 1997). See 8 *Del. C.* § 144.

disinterested directors deferred to an interested party in all decisions related to the transaction, demand is appropriately excused under the second prong of *Aronson* because there is a reasonable doubt whether the decision "was the product of considered business judgment of independent directors."[38]

CalPERS makes several factual assertions that indicate that the process implemented by the board and special committee to entertain, to evaluate, and, ultimately, to approve the acquisition of CEI was controlled at every stage by Coulter, obviously a fiduciary of Lone Star, and his associates. Although, he was not a member of the Lone Star special committee that approved the transaction, it is reasonable to infer from the allegations of the amended complaint that Coulter controlled the timing, price, and terms of the transaction. The transaction was pursued, the amended complaint alleges, because Coulter gave Lone Star an ultimatum--either purchase CEI from him or be subjected to a 25%–35% increase in the rates for CEI's services. Coulter was permitted to dictate the terms of the sale through his attorney, Wolosky, whose firm, Olshan, had also done work for Lone Star. Wolosky told the special committee that Lone Star did not need to hire outside counsel because his firm had already drafted the purchase agreement. The

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[38] *Kahn v. Tremont Corp.,* 1994 Del. Ch. LEXIS 41, at * 18 (Del. Ch.) (finding an independent basis, under the second prong of Aronson, for excusing Rule 23.1 demand).

special committee accepted this recommendation and did not hire independent counsel to review the terms of the deal. Furthermore, the board or special committee delegated to White the task of negotiating the price with Coulter. White, as explained above, was not independent of Coulter and thus cannot be viewed as having negotiated with Coulter with the best interests of Lone Star as his motivation. As alleged, no "negotiation" took place. Coulter merely told White how much; White recommended that figure to the committee; and the committee, without any effort to review or to evaluate White's recommendation, approved the transaction. White was appointed to negotiate on Wednesday and the acquisition of CEI was approved the following Monday at a purchase price that was approximately $0.5–1.5 million (roughly 5-l 5%) more than the allegedly inflated Houlihan valuation of the company. In sum, the amended complaint sufficiently alleges that Coulter controlled both sides of the Lone Star-CEI transaction and effectively dictated its terms, including price.

Accordingly, these allegations are sufficient to raise a reasonable doubt as to whether Lone Star's decision to purchase CEI was the "product of a valid exercise of business judgment" and provides an independent basis for excusing demand on Counts V and VI under the second prong of Aronson.

### 3. Counts That Are Dismissed and Those That Survive Defendants' Motion to Dismiss Under Rule 23.1

Defendants' motion to dismiss is granted for failure to comply with Rule 23.1 on the following derivative claims:

- Count IV, which alleges breach of fiduciary duties in relation to allegedly permitting Coulter to shirk his duties at Lone Star while preparing TENT for its IPO;[39]
- Count VII, which seeks to avoid as interested transactions all payments made to CEI under service contracts in 1997 and 1998;
- Count VIII, which alleges breach of fiduciary duty related to the same payments under the 1997 and 1998 CEI service agreements;
- Count X, which alleges that the amendment to Coulter's contract was a voidable interested transaction and waste,[40]
- Count XI, which claims that the amendment to Coulter's contract was a breach of fiduciary duty; and
- Count XII, which alleges that virtually all the actions complained of constituted a breach of fiduciary duty through a systematic and deliberate course of conduct.

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[39] To be precise, the demand requirement as to Count IV could be appropriately evaluated under *Rales v. Blasband*, 634 A.2d 927 (Del. 1993), because permitting Coulter's inattentiveness may not have been based on a "conscious decision of the directors to act or refrain from acting." *Id.* at 933. Thus, under *Rales*, it is appropriate to examine whether the board considering demand could do so based on the merits of the claim, without improper influences holding sway. See *id.* at 934. The outcome is unchanged. Because I find that at least three of five directors (Adams, Greene, and Chaney) would have been able to consider demand impartially, the claim is dismissed.

[40] Although CalPERS asserts that the amendment to Coulter's contract was waste because no benefit accrued to the company, there is an insufficient factual basis asserted for this premise. In the aggregate, the allegations in the amended complaint assert that Coulter received an increase in his compensation. That is not sufficient to support a claim of waste.

Thus, Counts IV, VII, VIII, X, XI, and XII are dismissed in their entirety. I also grant the motion to dismiss under Rule 23.1 in part as to Counts I and II, which are dismissed to the extent that they relate to the repricing of employees' options in 1997 and 1998.

Demand is excused on the following derivative claims:

- Count III, which seeks to have the repricing of directors' options declared void as *ultra vires* transactions;
- Count V, which alleges that the acquisition of CEI constituted a breach of fiduciary duty;
- Count VI, which seeks to avoid the purchase of CEI as an improperly ratified interested transaction; and
- Count IX, which alleges entrenchment.

Demand is partially excused on Counts I and II, to the extent that they relate to the repricing of outside directors' options in 1997 or 1999 or to the repricing of employees' options in 2000.

*B. Failure to State a Claim*

Defendants further argue that the surviving claims, the derivative claims of Counts I-III, V, VI, and IX, and the direct class claims[41] of Counts XIII, and XIV, should be dismissed pursuant to Court of Chancery Rule 12(b)(6) for failure to

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[41] Counts XIII and XIV challenge the existing director provisions in the golden parachute agreements as unlawful infringement of shareholders' voting rights (Count XIII) and as an unlawful classification of directors (Count XIV).

state a claim upon which relief may be granted. In considering a motion to dismiss under Court of Chancery Rule 12(b)(6), the Court must assume the truthfulness of all well-plead facts contained in the complaint and view those facts and all reasonable inferences drawn from them in the light most favorable to the plaintiff.[42] Conclusory allegations unsupported by facts contained in the complaint, however, will not be accepted as true.[43] Dismissal is appropriate under Court of Chancery Rule 12(b)(6) only where it appears with reasonable certainty that the plaintiff would not be entitled to the relief sought under any reasonable set of facts properly supported by the complaint.[44]

For the reasons discussed in relation to the demand requirement, I find that Counts I and II state claims for breaches of fiduciary duty based on allegations that the repricing of employees' options in 2000 was undertaken without the exercise of any business judgment; Counts V and VI state claims for breaches of fiduciary duty based on allegations that the purchase of CEI was an improperly supervised and ratified self-interested transaction; Count IX states a claim for breach of

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[42] See, *e.g.*, *Grobow* v. *Perot*, 539 A.2d 180, 187 (Del. 1988) (stating that "upon a motion to dismiss, only well-pleaded allegations of fact must be accepted as true" and that the 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").

[43] *E.g.*, *id.* (stating that "conclusionary allegations of fact or law not supported by allegations of specific fact may not be taken as true").

[44] *E.g.*, *Rabkin* v. *Philip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1104 (Del. 1985).

fiduciary duty based on allegations that the change of control agreements were adopted in response to a perceived threat to incumbent management and directors and for the purpose of entrenchment; and that Counts I and III state claims that the directors' options repricings were ***ultra*** *vires.* Defendants' motion as to these claims is denied.

The two direct claims, Counts XIII and XIV, allege that the adoption of the existing director provisions in the change of control agreements constituted a breach of fiduciary duty. CalPERS complains that these provisions unlawfully impede shareholder voting rights and that they create an illegal classification of directors. If activation of the change of control agreements is so burdensome as to have the effect of coercing shareholders to vote for incumbent directors or their designees, the provisions may be impermissible.[45] Before the contested provisions

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[45] ***In Sutton Holding Corp.,*** the Court noted:

> Provisions in corporate instruments that are intended principally to restrain or coerce the free exercise of the stockholder franchise are deeply suspect. The shareholder vote is the basis upon which an individual serving as a corporate director must rest his or her claim to legitimacy. Absent quite extraordinary circumstances, in my opinion, it constitutes a fundamental offense to the dignity of this corporate office for a director to use corporate power to seek .to coerce shareholders in the exercise of the vote. It is not surprising that the attempt to do so should be made. As long as there have been elections there have been those who seek to gain unfair advantage in them (and those, who like some lawyers today, can suggest and guide that effort). But courts must remain sensitive to the risk and alert to act when they legitimately can to thwart it. Thus, I suppose (but cannot on this record hold) that adoption of this 1987 provision constituted a breach of the duty of loyalty that the members of the DeSoto board at that time

were fully adopted, the Lone Star board had become aware of the increased concerns of Lone Star's existing shareholders, such as CalPERS, about the management of the company, and it is a fair inference from the allegations of the Complaint that a challenge from existing shareholders (as contrasted with an external third party takeover) was the motivating force behind the board's efforts. Whether these provisions in fact have the effect of hampering the ability of shareholders to replace the existing directors, due to the allegedly outrageous costs to which Lone Star would be subjected as a result,[46] can only be determined by weighing and evaluating the evidence presented by each party. Similarly, it is impossible to determine without the presentation of evidence whether the provisions have the effect of creating an illegal classification of directors-some directors having special status, power, or authority that is not shared by all directors. From the allegations in the amended complaint, it may be inferred that certain directors are empowered to designate authorized replacements, the election of whom would not trigger the change of control provisions, a power not shared

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owed to the company and its shareholders. *Sutton Holding Corp.* v. *DeSoto,* Inc., 1991 Del. Ch. LEXIS 85, at *3–4 (Del. Ch.) (assuming for purposes of ruling on a motion for summary judgment that the adoption of change of control provisions in corporate pension plans amounted to a breach of the directors' duty of loyalty). *See also Carmody, 723* A.2d 1180.

[46] The parties' estimates of the potential costs of these provisions differ greatly.

equally by all directors. Therefore, dismissal of these claims is inappropriate. The motion is denied.

c. *Time-Barred Claims*

Defendants also assert that all claims related to actions taken before October 16, 1998 are time-barred either by a three-year statute of limitations or by laches. Because most of these claims have already been dismissed under Court of Chancery Rule 23.1, I need not address the time bar issue except as to the repricing of directors' options in August 1997. CalPERS asserts that any statute of limitations should be considered tolled on the basis of equitable tolling or fraudulent concealment or should be considered inapplicable as plaintiff seeks only what is essentially equitable relief. As to this transaction, equitable tolling and fraudulent concealment seem to be inapplicable. Still, it is not clear to the Court whether the directors' options repriced in 1997 were the same options repriced in 1999 and whether the repricings in 1997 and 1999 may constitute a single repricing program or merely two distinct "repricing" events.[47]

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[47] **For this reason, and only this reason, Thompson's time-bar defense fails at this time. Thompson's service to Lone Star, both as employee and director, had ended more than three years before commencement of this action.**

I am denying defendants' motion at this time, because the underlying facts are not sufficiently developed to permit a proper determination of whether the claim is time-barred. In addition, the Court notes that allowing the claim to survive does not place an undue burden on the parties because the only issue—whether the directors' option plan permits repricing-is the same for the 1997 repricing as for the 1999 repricing, which is not time-barred.

*D.* ***Mootness***

Defendants assert that certain of the options that were repriced either expired without being exercised or were cancelled in subsequent repricings. Although I agree that the validity of repriced options that ultimately expired without being exercised is a moot question, it is impossible for the Court to determine, absent further development of the record, whether this has, in fact, happened. In addition, the presentation of evidence is required to establish which subset of the repriced options in question would be affected. For this reason, defendants' motion to dismiss for mootness is denied.

*E.* *Breach of Care Claims*

Defendants assert that any claim for breach of the duty of care is precluded, pursuant to 8 *Del. C.* § 102(b)(7), by an exculpatory provision of Lone Star's Certificate of Incorporation. If any surviving claims were based solely upon

breach of the duty of care and sought *solely* monetary damages, this argument might have merit.[48] All surviving breach of fiduciary duty claims may implicate the duty of loyalty for which the directors may not be afforded protection under § 102(b)(7), and, in several instances, the remedy sought is not limited to damages. Defendants' motion to dismiss any claims on the basis of an exculpatory provision in Lone Star's Certificate of Incorporation is denied.

## VI. CONCLUSION

For the foregoing reasons, I grant Defendants' motions to dismiss as to Counts IV, VII, VIII, X, XI, and XII in their entirety for CalPERS' failure to comply with Court of Chancery Rule 23.1. These Counts are dismissed with prejudice pursuant to Court of Chancery Rule 15(aaa). I also grant Defendants' motions to dismiss as to Counts I and II to the extent these claims relate to the repricing of employees' options in 1997 and 1998 for CalPERS' failure to comply with Court of Chancery Rule 23.1. Partial dismissal of Counts I and II is without prejudice. The motions to dismiss are denied as to Counts III, V, VI, IX, XIII, and

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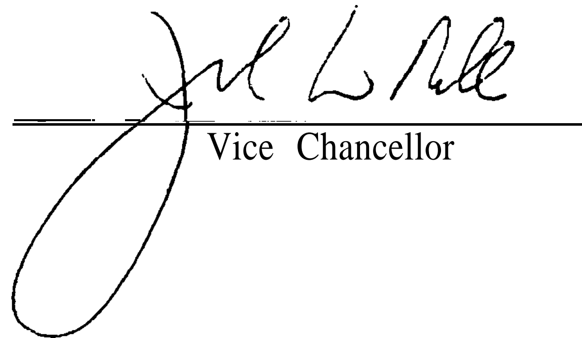
[48] See 8 *Del.* C. § 102(b)(7) (stating that provisions in the certificate of incorporation may limit the liability of directors for money damages for breaches of fiduciary duties, but such provisions may not exculpate a director for the breach of the duty of "loyalty to the corporation or its stockholders"); *Emerald Partners v. Berlin, 787* A.2d *85, 90* (Del. 2001); *Malpiede v. Townson, 780* A.2d 1075, 1095 (Del. 2001).

XIV. The motions to dismiss as to Counts I and II are denied to the extent these claims relate to the repricing of employees' options in 2000 or to the repricing of directors' options.

**IT IS SO ORDERED.**



Vice Chancellor