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Re: Zimmerman v. Braddock, et al.
C.A. No. 18473-NC
Date Submitted: May 9, 2005

Dear Counsel:

Plaintiff Mark Zimmerman (the "Plaintiff") alleges, in this derivative action, that Defendants Richard S. Braddock, Jay S. Walker, and N.J. Nicholas, Jr. (collectively, the "Selling Defendants"), all directors of the Nominal Defendant

priceline.com, Inc. ("Priceline" or the "Company"), engaged in insider trading of the Company's stock and misappropriated the Company's confidential information. The other defendants, who with the Selling Defendants constituted Priceline's board of directors, are: Daniel H. Schulman, Paul A. Allaire, Ralph M. Bahna, Paul J. Blackney, William E. Ford, Marshall Loeb, Nancy B. Peretsman, and Heidi G. Miller (collectively, the "Individual Defendants").

Before the Court is the Plaintiff's Motion for Leave to File a Second Amended Derivative Complaint (the "Second Amended Complaint"). The only issue that remains for the Court to decide is whether amendment of the Amended Derivative Complaint (the "Amended Complaint") would be futile because (1) the Plaintiff's claim against the Selling Defendants in the Second Amended Complaint for breach of their fiduciary duties by engaging in insider trading and misappropriating confidential information fails to state a claim as a matter of law, and (2) the Plaintiff's Second Amended Complaint fails to assert well-pled allegations to show that demand upon the Priceline Board would have been futile. For the reasons set forth below, the Plaintiff will be allowed to file his Second Amended Complaint to assert this fiduciary duty claim.

I. PROCEDURAL HISTORY

The Court dismissed the Amended Complaint under Court of Chancery Rule 23.1 for failure to plead facts that would sustain a finding of demand futility.[1] Specifically, the Plaintiff did not sufficiently plead particularized facts showing that the Selling Defendants controlled Priceline and the various entities associated with Priceline and that Priceline's other directors, several of whom were involved with those associated entities, were beholden to the Selling Defendants. The Amended Complaint was dismissed without prejudice.[2]

Thereafter, the Plaintiff sought leave to file a Second Amended Complaint. The Second Amended Complaint attempted to cure the deficiencies of the Amended Complaint by further elaborating on the relationships among the Individual Defendants, the Selling Defendants, and the various entities associated with Priceline. In the Amended Complaint the Plaintiff had presented three counts. In the Second Amended Complaint, only one of these counts (Count 1: Against the Selling Defendants for Breach of Fiduciary Duty for Insider Selling and

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[1] *Zimmerman v. Braddock*, 2002 WL 31926608 (Del. Ch. Dec. 31, 2002) [hereinafter "*Zimmerman I*"].

[2] *Id.*, at *12 n.76 ("I conclude that dismissal with prejudice would not 'be just under the circumstances' . . . .") (quoting Ct. Ch. R. 15(aaa)).

Misappropriation of Information) continued to be asserted.[3] The Second Amended Complaint, however, included three additional counts, all involving the forgiveness of a loan that Priceline had made to Miller (the "Miller loan"), one of the Individual Defendants.[4]

The Court, by bench ruling, denied the Plaintiff leave to amend in order to present Counts II-IV proposed in the Second Amended Complaint. Amendment to assert those claims would have been futile because the Miller loan (the basis of these counts), in the context of the allegedly actionable forgiveness of the loan, was not at issue in the Amended (or the initial) Complaint and, thus, the Second

[3] Count II of the Amended Complaint had alleged that the Defendants had breached their obligation to act loyally and in good faith by allowing Priceline to engage in certain questionable activities that exposed it to substantial liability and expenses, including securities fraud litigation, the repricing of certain warrants, and the loss of goodwill. Count III had charged the Defendants with waste of corporate assets, alleging the free use by the Selling Defendants of Priceline's confidential information in their insider trading activities.

[4] In the Amended Complaint, the Miller loan was mentioned twice. First, in Paragraph 17, in the context of explaining why Director Miller was not independent, the Amended Complaint asserted that Miller "was loaned $3 million by the Company. In November of 2000, Priceline forgave repayment of Miller's loan in its entirety, in violation of the terms of the Miller agreement." Secondly, in Paragraph 100(d), again in the context of Director Miller's independence, the Amended Complaint alleged that Miller was not independent, in part, because of "the forgiveness of a $3 million loan which she was required to repay based upon the circumstances of her departure, according to the terms of the Miller Agreement. Furthermore, at the time this action was initiated, defendant Miller was preparing to leave her employment with Priceline and was beholden to defendants Braddock and Walker to approve the terms of her departure, including substantial severance benefits, loan forgiveness, and other remuneration."

Amended Complaint did not "elaborate[ ] upon facts relating to acts or transactions alleged in the original pleading, or assert[ ] new legal theories of recovery based upon the acts or transactions that formed the substance of the original pleading . . . ."[5] Therefore, demand futility with regard to Counts II-IV was to be assessed at the time the Second Amended Complaint was filed and not as of the time of the initial complaint. By the time the Second Amended Complaint was filed, the composition of Priceline's Board had changed substantially, and the Plaintiff did not attempt to argue that demand upon that board would have been futile. As a result, the futility of the proposed amendment precluded granting leave to amend to add claims relating to the Miller loan.

Thus, the Court turns to the following questions: (1) whether the Second Amended Complaint would adequately allege futility of demand on Priceline's Board as of November 1, 2000, when the initial complaint was filed,[6] and (2) whether it would state a claim for insider trading (and use of confidential Company information) by the Selling Defendants.[7]

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[5] *Harris v. Carter*, 582 A.2d 222, 231 (Del. Ch. 1990).
[6] References to Priceline's Board are to the Board as comprised on November 1, 2000.
[7] More precisely, although the Court's analysis will be under Court of Chancery Rules 23.1 and 12(b)(6), the issues are actually framed by Court of Chancery Rule 15.

II. BACKGROUND

A. *Priceline and WebHouse*

The alleged circumstances which motivated the Plaintiff to bring this action have been set forth in *Zimmerman I*.[8] Briefly, Priceline is a "Name Your Own Price" internet retailer of airline tickets, hotel reservations, and home finance and telecommunications products. This format allows customers to save money on products and services while increasing incremental revenue to the companies which sell their goods and services through Priceline. Priceline was founded by Walker, who also "founded and . . . controlled" Walker Digital Corporation, the company which licensed its "demand collection system" technology to Priceline.[9]

Following Priceline's March 1999 initial public offering and during the internet "bubble," Priceline's pricing system was perceived to have the potential to "reinvent the environmental DNA of global business."[10] In an effort to expand and

[8] *See Zimmerman I*, at *1-6.
[9] Second Amended Complaint, at ¶¶ 8, 28. "Using Walker Digital's 'Name Your Own Price' technology, Priceline collects consumer demand, in the form of individual customer offers guaranteed by a credit card, for a particular product or service at prices set by the customer. Priceline then either communicates that demand directly to participating sellers or accesses participating sellers' private databases to determine whether Priceline can fulfill the customer's offer. Consumers agree to hold their offers open for a specified period of time and, once fulfilled, offers cannot be cancelled." *Id.*, at ¶ 30.
[10] *Id.*, at ¶ 34.

diversify away from the travel industry (the industry that Priceline serviced most successfully), Priceline launched WebHouse Club, Inc., which used Walker Digital's "Name Your Own Price" technology to sell groceries and gasoline to the public.[11] "WebHouse was established as an 'independent licensee' of Priceline to which Priceline licensed its name and business model in return for a royalty arrangement and a fully-vested, non-forfeitable warrant to acquire a majority of the equity of WebHouse that was exercisable under certain conditions."[12] Since it was a private company, WebHouse's operating results were neither included in Priceline's financial statement nor known to the public.[13]

WebHouse was an important experiment for Priceline; the market viewed WebHouse as an important test of Priceline's ability to expand its technology beyond its core industries.[14] Diversifying beyond the travel industry was important to Priceline because the discount and online travel services industry was becoming more competitive.

[11] *Id*., at ¶ 40.
[12] *Id*., at ¶ 42.
[13] *Id*., at ¶ 44.
[14] *Id*., at ¶ 45.

Problems arose at WebHouse. Priceline management internally expressed doubt as to whether the "Name Your Own Price" system would work with groceries because, "[u]nlike consumer demands with respect to air travel, WebHouse executives feared that consumers were much more 'brand loyal' when they shopped for groceries . . . ."[15] Additionally, producers were unwilling to discount their grocery products which forced WebHouse to subsidize the discount that its customers were receiving.[16] Further complicating matters were WebHouse's technical problems that caused its website to crash frequently.[17] It is alleged that Priceline's senior management knew about the problems at WebHouse—including its $5 million-dollar-a-week "burn rate."[18]

Although WebHouse was having difficulties, which in turn brought into question the scalability of the Priceline "Name Your Own Price" system, Priceline continued publicly to tout the technology's prospects, while minimizing the

[15] *Id*., at ¶ 49.
[16] *Id*. ("Essentially, due to the dearth of willing suppliers, WebHouse was forced to sell a $1.00 product for $0.80 and WebHouse was funding the difference.").
[17] *Id*., at ¶ 52.
[18] *Id*., at ¶¶ 51-52, 82 (referring to the "Pricing Reports," "Demographic Analyses," "Network Operations Center Reports," and "Promotion Reconciliation Reports" that Priceline management would receive).

problems that both Priceline and WebHouse were facing.[19] However, Priceline's SEC filings did contain some cautionary warnings of risks that Priceline faced.[20]

In August and September of 2001, during this period of uncertainty regarding WebHouse, the Selling Defendants sold shares of Priceline stock, which forms the basis of this action.[21]

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[19] *See Zimmerman I*, at *5 ("The Plaintiff contends that from March 1999 through September 2000, the Individual Defendants [defined there to include the Selling Defendants] made a series of inaccurate and misleading public statements regarding Priceline's financial condition, business, and future growth prospects, allegedly in the face of the known reality that the Company could not match the hyper-aggressive public guidance . . . provided to Wall Street. Walker is alleged to have minimized the threat of the increased competition from Hotwire and other travel websites. Plaintiff contends that, while stating publicly that Priceline would achieve profitability imminently or in the near future, the Individual Defendants knew that Priceline's revenues and earnings were under tremendous pressure due to, *inter alia,* increased competition and loss of customers. Also regarding Priceline's business condition, the Plaintiff alleges that the Individual Defendants portrayed the Company's customer base as satisfied and growing, when in fact the Individual Defendants knew of increasing customer dissatisfaction and a shrinking customer base. Moreover, the Individual Defendants allegedly made misleading public misstatements regarding the prospects of the critical WebHouse venture; the Individual Defendants publicly stated that WebHouse had been successful, thereby demonstrating the scalability of the Priceline business model. In fact, the Individual Defendants were aware of technological, financial and conceptual problems experienced by WebHouse. Thus, the Plaintiff complains that numerous misleading statements were made to the public regarding the business condition and prospects of Priceline." (footnotes and internal quotations omitted)).

[20] *See, e.g.*, Second Amended Complaint, at ¶ 77.

[21] Specifically, on August 1, 2000, Walker sold 8 million shares of Priceline stock at $23.75 per share. *Id*., at ¶ 70. Also on August 1, 2000, Nicholas exercised 200,000 Priceline options at $0.80 per shares and sold 100,000 shares of Priceline stock at $25.19 per share. *Id*., at ¶ 72. That next day, Nicholas (as trustee of a family trust) sold 100,000 Priceline shares for $25.32 per share. *Id*., On August 15, 2000, Braddock exercised an unspecified number of Priceline options and sold 72,000 shares of Priceline stock at $25.31 per share. *Id*., at ¶ 79. The next day, Braddock exercised more options and sold 28,000 shares of Priceline stock at $25.52 per share.

B. *Entities Associated with Priceline*[22]

In *Zimmerman I*, the Court concluded that the Plaintiff had alleged "insufficient particularized facts from which a reasonable inference may be drawn that the interests and positions of the interested directors, whether individually or collectively, empowered them with the means to dominate and control the Board and affairs of [Priceline and the other entities associated with Priceline and its directors]."[23] The members of Priceline's Board were involved with various entities having multiple ties with each other. In order to appreciate why the Plaintiff questions the independence of various directors, a brief review of these entities is required.

1. Walker Digital Corporation

Walker Digital is a privately-held "think tank" founded by Walker. Walker Digital owns 4.25 percent of Priceline's common stock and licenses Priceline its technology.[24] Walker owns 49 percent of Walker Digital and is the Chairman of

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Id. On September 11, 2000, Walker sold 2 million shares of Priceline stock at $25 per share. *Id*., at ¶ 80. All in all, the proceeds from these sales approached $250 million.

[22] Unless the context indicates otherwise, the descriptions of Priceline's directors and the entities associated with Priceline are as of the filing of the initial complaint in this action.

[23] *Zimmerman I*, at *9.

[24] *Id*., at ¶¶ 7, 28. Additionally, Walker Digital owns approximately 34% of WebHouse's privately held stock. *Id*., at ¶ 7.

its board.[25] Braddock owns 4 percent of Walker Digital.[26] Nicholas is an equity holder of Walker Digital as well.[27] Ford, through his position as Managing Member of General Atlantic Partners, LLC, controls 25 percent of Walker Digital.[28]

2. Synapse Group, Inc.

Synapse is a privately-held direct marketing firm that Walker co-founded with Individual Defendant Loeb's son.[29] Many of the directors of Priceline were also involved with Synapse. Walker served as the non-executive chairman and owned 11.5 percent of Synapse which was described in Priceline's March 27, 2000 Proxy Statement as "an affiliate of Mr. Walker."[30] Loeb, through a family investment vehicle, owns 8.23 percent of Synapse.[31] Furthermore, Braddock and Nicholas are "substantial equity holder[s] of Synapse."[32] Ford and Peretsman have ties to Synapse as well.[33]

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[25] *Id*., at ¶ 8.
[26] *Id*., at ¶ 7.
[27] *Id*., at ¶ 9. Nicholas's equity ownership in Walker Digital is not provided in any more detail.
[28] *Id*., at ¶ 13.
[29] *Id*., at ¶ 7.
[30] *Id*., at ¶ 8.
[31] *Id*., at ¶ 14.
[32] *Id*., at ¶¶ 7, 9.
[33] *Id*., at ¶¶ 13, 15.

3. Worldspan L.P.

Worldspan is a global travel distribution system that, in 1998, had $637.3 million in revenue.[34] Between 1998 and 2000, Priceline sold more than 6 million airline tickets through Worldspan.[35] Priceline is one of Worldspan's two largest clients.[36] In January of 2000, Priceline and Worldspan entered into a five-year agreement under which Worldspan paid Priceline $3 million in exchange for Priceline's committing to a certain minimum volume of bookings.[37] Blackney is the Chief Executive Officer and President of Worldspan.

4. Allen & Company, Inc.

Allen & Company is an investment banking firm. Allen & Company acquired 275,000 shares of Priceline's third round of financing in 1998. It received $850,000 in consulting fees from Priceline in 1999.[38] In 2000, Allen & Company

[34] *Id*., at ¶ 12.
[35] *Id*.
[36] *Id*., at ¶ 121(b)(3).
[37] *Id*., at ¶ 12. In 1998 Worldspan had $637.3 million in revenue and from 1998 through 2000 Priceline sold more than six million airline tickets through Worldspan. *Id*.
[38] *Id*., at ¶ 15.

received $750,000 in fees from Synapse.[39] Peretsman is a Managing Director and Executive Vice President of Allen & Company[40]

5. General Atlantic Partners, LLC

General Atlantic is a venture capital firm with extensive holdings, sometimes through affiliates, in Priceline, Synapse, priceline.com Europe, and Walker Digital.[41] In early 2000, General Atlantic sold 6,567,130 shares of Priceline common stock. Ford is the Managing Member of General Atlantic.

C. *Priceline's Board of Directors*

When this action was initiated, the Priceline Board consisted of 11 members. A brief summary of the Second Amended Complaint's allegations regarding those directors is presented below.[42]

1. Walker

Walker is the founder of Priceline and served on its Board from August 1998 until January 2001. Until August of 1998, he also served as Priceline's Chief

[39] *Id*.
[40] *Id*.
[41] *Id*., at 13.
[42] *Zimmerman I* reviewed the allegations in the Amended Complaint concerning each Board member, s*ee id*., at *2-4. With regard to some directors, additional well-pled allegations have been made in the Second Amended Complaint.

Executive Officer. Walker owns 32 percent of Priceline stock.[43] Additionally, according to Priceline's 2002 Proxy Statement, Walker Digital was "founded and is controlled by Walker." Walker is a 49 percent equity owner in Walker Digital.[44] Priceline's 2000 Proxy Statement reports that Synapse "was an affiliate of Mr. Walker" and that he owned approximately 11.5 percent of Synapse.[45]

2. Braddock

Braddock, one of the original investors in Priceline, has served on the Priceline Board since its inception (and as Chairman from August of 1998). Braddock owns approximately 10 percent of Priceline's common stock.[46] Additionally, Braddock owns approximately 4 percent of the equity in Walker Digital and is a "substantial equity holder" of Synapse.[47] Finally, Braddock serves as a "special advisor" to General Atlantic—a private-equity firm in which Ford is

[43] Second Amended Complaint, at ¶ 8.
[44] *Id.* As discussed above, Walker Digital owns 4.25% of Priceline. *Id.*, at ¶ 7. I note that the Plaintiff's allegation regarding Walker Digital's ownership in Priceline has changed since the Amended Complaint (from 35% to 4.25%, *see* Amended Complaint, at ¶ 6).
[45] Second Amended Complaint, at ¶ 8.
[46] *Id.*, at ¶ 7.
[47] *Id.*

both a partner and Managing Member—and has made "several material investments in General Atlantic partnerships as a limited partner."[48]

3. Nicholas

Nicholas, along with Braddock and Walker, is one of the three Selling Defendants. He has been a director of Priceline since July of 1998 and owns approximately 2 percent of Priceline's common stock. Additionally, he is a "substantial equity holder of Synapse" and "an equity owner in Walker Digital."[49]

4. Schulman

Schulman served as President, Chief Executive Officer, and as a director of Priceline from July 1999 until May of 2001.[50] In the course of his employment with Priceline, Schulman (1) reported directly to Braddock; (2) received a base salary of $300,000 per year; (3) was granted 3 million options to purchase Priceline common stock; and (iv) was loaned $6 million by Priceline ($4.5 million of which was forgiven by the Company in late 2000).[51]

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[48] *Id.*
[49] *Id.*, at ¶ 9.
[50] *Id.*, at ¶ 11.
[51] *Id.*

5. Blackney

Blackney has been a director of Priceline since July of 1998. He has also served as the President and Chief Executive Officer of Worldspan since 1999.

6. Ford

Ford has served as a director of Priceline since 1998. He is a partner and Managing Member of General Atlantic. Partnerships affiliated with General Atlantic own over 21 million shares of Priceline common stock at a cost basis of approximately $1.28 per share.[52] Additionally, General Atlantic owns approximately 17.5 percent of Synapse and 25 percent of Walker Digital (having invested at least $125 million). It also invested in priceline.com Europe (controlled by Walker Digital).[53]

7. Loeb

Loeb has been a Priceline director since 1998.[54] Loeb's son co-founded with Walker the entity that later became Synapse in 1992, and Loeb has "invested over

[52] *Id*., at ¶ 13.
[53] *Id*.
[54] *Id.*, at ¶ 14. It is unclear from the Second Amended Complaint whether Loeb served on the Compensation Committee at Priceline. Paragraph 14 (which discusses Loeb) provides: "During 2000, Nicholas served as a member of Compensation Committee." Although not material to the Court's decision, the Court is unable to determine whether the sentence regarding Nicholas was

$3 million in Synapse."[55] Additionally, The Loeb Family Limited Partnership owns approximately 8.23 percent of Synapse.[56]

8. Peretsman

Peretsman has been a director of Priceline since 1999. She is a Managing Director and Executive Vice President of Allen & Company, an investment banking firm. Allen & Company is an equity investor in Priceline and received $850,000 in consulting fees from Priceline in 1999 and $750,000 in fees from Synapse in 2000.[57] Moreover, Allen & Company acts as Priceline's financial advisor and has provided investment banking services to Synapse in the past.[58] The firm "is one of the largest equity owners of Synapse" and "was also an investor in Walker Digital."[59] In addition, Peretsman sits on the board of Synapse and was granted options to purchase 35,000 shares of Synapse at $8 per share.

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misplaced or whether the reference to Nicholas was a typographical error and the correct reference should be to Loeb.

[55] *Id*.

[56] *Id*.

[57] *Id.*, at ¶ 15.

[58] *Id*. Allen & Company was "scheduled to be one of the lead underwriters for Synapse's planned initial public offering which was cancelled during December of 2000." *Id*.

[59] *Id*.

9. Miller

Miller was the Chief Financial Officer and a director of Priceline from February 2000 to November 2000. Pursuant to her employment agreement, Miller (1) reported directly to Braddock; (2) received a base salary of at least $300,000 per year; (3) was granted 2.5 million options to purchase Priceline common stock; and (4) was loaned $3 million by Priceline.[60] In November of 2000, the loan to Miller was forgiven.

10. Allaire

Allaire has been a director of Priceline since February of 1999. Allaire also served as the Chief Executive Officer and Chairman of the Board of Xerox, where Nicholas also was a director.[61]

11. Bahna

Bahna has served as a director of Priceline since July of 1999.[62]

III. CONTENTIONS

The Plaintiff brings forth a claim against the Selling Defendants for breach of fiduciary duty for insider trading and misappropriation of the Company's

[60] *Id.*, at ¶ 18.
[61] *Id.*, at ¶ 16.
[62] *Id.*, at ¶ 17.

confidential information. The Plaintiff alleges that the Selling Defendants had material, nonpublic information regarding the state of affairs at WebHouse and Priceline and sold Priceline stock for their personal benefit while they flooded the market with upbeat news and projections to keep Priceline's stock trading at an artificially high price.

The Defendants argue that the Plaintiff should not be permitted to amend his Amended Complaint because doing so would be futile because the Second Amended Complaint fails to plead demand futility and fails to state a claim as a matter of law.

IV. MOTION TO AMEND

Under Court of Chancery Rule 15(a), "leave [to amend] shall be freely given when justice so requires." Factors that support the Court's exercise of its discretion to deny leave to amend have been identified as bad faith, undue delay, dilatory motive, repeated failures to cure by prior amendment, undue prejudice, and futility of amendment.[63] The Defendants oppose the motion to amend Count I of the Amended Complaint only on the ground that it would be futile. The

[63] *Foman v. Davis*, 371 U.S. 178, 182 (1962); *N.S.N. Int'l Indus., N.V. v. E.I. duPont de Nemours & Co.*, 1994 WL 148271, at *8 (Del. Ch. Mar. 31, 1994).

proposed amendment would be futile if Count I of the Second Amended Complaint would not survive a motion to dismiss under either Court of Chancery Rule 23.1 or Court of Chancery Rule 12(b)(6).

V. DEMAND FUTILITY

A. *Applicable Standard*

In performing demand futility analysis under Court of Chancery Rule 23.1, the Court is limited to the allegations in the complaint and the documents which are incorporated into it and must accept as true all particularized, well-pled allegations. The Plaintiff is entitled to all reasonable, logical inferences to be drawn from those particularized facts. Conclusory allegations, however, are not regarded as fact.[64] Furthermore, since the alleged insider trading was not an affirmative action of the Priceline Board, demand futility is evaluated under the *Rales* standard,[65] which centers on whether a majority of the board was

[64] *Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004) ("The Court should draw all *reasonable* inferences in the plaintiff's favor. Such reasonable inferences must logically flow from particularized facts alleged by the plaintiff. Conclusory allegations are not considered as expressly pleaded facts or factual inferences. Likewise, inferences that are not objectively reasonable cannot be drawn in the plaintiff's favor.") (footnotes and internal quotations omitted).
[65] *See, e.g.*, *In re Bally's Grand Deriv. Litig.*, 1997 WL 305803, at *3 (Del. Ch. June 4, 1997) ("Depending on the circumstances, demand futility must be determined under the standards articulated in *Aronson v. Lewis* or *Rales v. Blasband.* Under the two-pronged *Aronson* test, demand will be excused if the derivative complaint pleads particularized facts creating a reasonable doubt that (1) the directors are disinterested and independent [or] (2) the challenged

disinterested and independent when the initial complaint was filed and under which the Court does not inquire into the Board's exercise of its business judgment.[66]

Court of Chancery Rule 23.1 governs a shareholder's efforts "to enforce a right which may properly be asserted by [the corporation]" when the corporation has not undertaken the effort. A derivative complaint must allege "with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors . . . and the reasons for the plaintiff's failure to obtain the action or for not making the effort."[67] In this case, the Plaintiff, a shareholder of Priceline, made no demand upon the Priceline Board because he

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transaction was otherwise the product of a valid exercise of business judgment. As the Supreme Court stated in *Rales v. Blasband*, however, there are three circumstances in which the *Aronson* standard will not be applied: (1) where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced; (2) where the subject of the derivative suit is not a business decision of the board; and (3) where . . . the decision being challenged was made by the board of a different corporation. In those situations, demand is excused only where particularized factual allegations . . . create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand. That is, in those three circumstances described in *Rales*, the Court will apply only the first ('disinterest' and 'independence') prong of *Aronson*.") (footnotes and internal quotations omitted) (alterations in original).

[66] *Rattner v. Bidzos*, 2003 WL 22284323, at *8 (Del. Ch. Sept. 30, 2003) ("[U]nder the *Rales* test, a court must determine whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand. If the derivative plaintiff satisfies this burden, then demand will be excused as futile.").

[67] Ct. Ch. R. 23.1

viewed that as a futile endeavor. Thus, it is his burden to plead, with allegations of particularized fact, why making demand on the Priceline Board would have been futile. This burden is imposed upon shareholder-plaintiffs in derivative actions because "[t]he key principle upon which this area of our jurisdiction is based is that the directors are entitled to a *presumption* that they were faithful in their fiduciary duties."[68] Because our law presumes that directors will act loyally and with due care, the Delaware General Corporation Law prescribes that "[t]he business and affairs of every corporation organized under [Delaware law] shall be managed by or under the direction of a board of directors . . . ."[69]

A director who is interested in the matter to be submitted to the board or who lacks independence from someone who is interested will lose the presumption of faithful compliance with her fiduciary duties. A director may be "interested," in relation to a transaction, if she stands on "both sides of the transaction." In the context of insider trading by fiduciaries, directors will be interested if they face a substantial likelihood of material, personal liability.[70] Analysis of directorial independence necessitates an inquiry into whether a director is controlled by, or

[68] *Beam*, 845 A.2d at 1048 (emphasis in original).
[69] 8 *Del.C.* § 141(a).
[70] *See Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003); *Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002).

otherwise beholden to, another and, thus, whether there is reasonable doubt about that director's ability to address corporate matters on their merits instead of extraneous considerations.[71]

B. *Analysis*

The Priceline Board consisted of eleven members. Therefore, in order for demand to have been futile, a majority of the board of directors—six members—must be shown to have been interested or not independent.

1. The Selling Defendants

In *Zimmerman I*, the Defendants did not debate that Walker, Braddock, and Nicholas were interested.[72] However, their interestedness is now contested.[73] The Defendants rely upon *Guttman v. Huang*, which observed that it would be "unwise to formulate a . . . rule that makes a director 'interested' whenever a derivative plaintiff cursorily alleges that he made sales of company stock in the market at a time when he possessed material, non-public information."[74] *Guttman* recognized that the proper approach "is to focus the impartiality analysis on whether the

[71] *Orman*, 794 A.2d at 23-24.
[72] *Zimmerman I*, at *8 n.64 ("As stated previously, the Defendants do not contest that Walker and Braddock, along with Nicholas, are interested for the purposes of this motion.").
[73] Defs.' Jt. Br. in Opp'n to Pl.'s Mot. for Leave to File a Second Amend. Compl., at 29 n.12.
[74] *Guttman*, 823 A.2d at 502.

plaintiffs have pled particularized facts regarding the directors that create a sufficient likelihood of personal liability because they have engaged in material trading activity at a time when (one can infer from particularized pled facts that) they knew material, non-public information about the company's financial condition."[75]

The Plaintiff joined the "interestedness" debate with vigor. His argument boils down to two separate prongs: (1) that, since in earlier litigation the Defendants did not contest the Selling Defendants' interestedness, the law of the case doctrine prohibits the Defendants from now arguing that the Selling Defendants are disinterested; and (2) that the Selling Defendants are interested due to their receipt of personal financial benefits and the risk of personal liability.

The Court need not resolve the Plaintiff's law of the case argument, because the Second Amended Complaint adequately alleges that the Selling Defendants (Walker, Braddock, and Nicholas) are interested for purposes of demand futility analysis. The Plaintiff has—to use the language of *Guttman*—gone beyond mere cursory allegations of insider trading. The policy rationale behind this Court's interestedness analysis with respect to insider trading by fiduciaries is clear: on the

[75] *Id.*

one hand, the Court must be careful not to put too high a burden on pleaders,[76] but, on the other hand, the Court must be careful not to leave the directors of Delaware corporations at risk of burdensome legal challenges whenever they sell stock in the corporation.[77] There are incentive-based rationales as to why directors should be encouraged to invest in stock of the corporation.[78] Not permitting directors adequate opportunities, however, to liquidate their holdings (or placing potential insider trading liability upon them without sufficient allegations of fault) destroys the very incentive that holding company stock provides directors.

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[76] *See Brehm v. Eisner*, 746 A.2d 244, 268 (Del. 2000) ("Plaintiffs must not be held to a too-high standard of pleading because they face an almost impossible burden when they must plead facts with particularity and the facts are not public knowledge.") (Hartnett, J., concurring).

[77] *See In re Oracle Corp.*, 867 A.2d 904, 930-31 (Del. Ch. 2004) ("To subject corporate insiders to a possible disgorgement remedy under our law whenever a court, in hindsight, concludes that the insiders should, under some type of due care standard, have suspected that their company would later miss the mark, would cabin the breadth of discretion afforded to Delaware companies to design their own compensation systems and—perhaps worse—raise the barriers that already dissuade large, but not controlling, stockholders from serving on company boards."). The Court in *In re Oracle Corp.* was presented with, but did not need to decide, the question of whether insider trading by corporate fiduciaries with the benefit of confidential corporate information remains a viable claim under state law. *Id.*, 867 A.2d at 929. *See also Guttman*, 823 A.2d at 505 n.28. (Delaware's "remedy for insider trading by fiduciaries presents an obvious potential for regulatory conflict between state courts and the federal enforcement regime, which notably includes the potential for criminal penalties.").

[78] *See, e.g.*, R. Franklin Balotti, et al., *Equity Ownership and the Duty of Care: Convergence, Revolution, or Evolution?*, 55 Bus. Law. 661 (2000); Sanjai Bhagat, et al., *Director Ownership, Corporate Performance, and Management Turnover*, 54 Bus. Law. 885 (1999).

Accepting all the well-pled allegations the Plaintiff has presented as true, the Plaintiff has made out a *prima facie* case that the Selling Defendants sold Priceline stock with the benefit of the Company's adverse material, confidential information. To proceed on an insider selling claim, a plaintiff must shows "that each sale by each individual defendant was entered into and completed on the basis of, and because of, adverse material non-public information."[79] For motion to dismiss purposes, the Plaintiff has met this burden. A reasonable inference from the Plaintiff's allegations is that the Selling Defendants had knowledge—directly[80] and by imputation[81]—of Priceline and WebHouse's problems. In addition, it is a reasonable inference that the public was not aware of Priceline's true predicament because its problems—even if they had been partially disclosed—were likely overshadowed by the public hyperbole of Priceline's executives.[82] While perhaps

[79] *Guttman*, 823 A.2d at 505 (quoting *Stepak v. Ross*, 1985 WL 21137, at *5 (Del. Ch. Sept. 5, 1985)).
[80] *See, e.g.*, Second Amended Complaint, at ¶ 49 (expressing concern regarding the scalability of Priceline's model to groceries); *id*., at ¶ 50 (expressing concern regarding WebHouse's technological capabilities); *id*., at ¶¶ 66-67 (providing an example of how Priceline management would publicly tout its stock only to announce subpar financial results days later).
[81] Paragraph 43 of the Second Amended Complaint alleges that the "defendants" had access to Pricing Reports, Demographic Analyses, Network Operations Center Reports, and Promotion Reconciliation Reports. These reports are detailed enough information to reveal the difficulties Priceline faced.
[82] *See, e.g.*, *id*., at ¶¶ 53, 63, 67, 68 & 69.

the "bespeaks caution" doctrine—to be considered in greater detail later[83]—may provide a defense, it is both context-relative and fact-specific, and, given the Plaintiff's well-pled allegations, needs the benefit of a more developed factual record for assessment.

When the sheer size of the trades (collectively, approximately $248 million dollars) is combined with the Plaintiff's well-pled allegations of insider trading culpability, the Selling Defendants, for motion to dismiss purposes, can be viewed as facing substantial personal liability even though the materiality of the trades (or the consequences of an action challenging them) to the Selling Defendants has not been specifically pled.[84] If the proceeds from the trades were not material to the directors, this would undercut suspicion of their trades and would frustrate the

[83] *See infra* Part VI.

[84] Whether Nicholas should be treated as interested is an interesting question because the size of his trades, somewhat more than $5 million, might not be material. For purposes of measuring compliance with Court of Chancery Rule 23.1, Nicholas's selling at that level puts him in company with Walker and Braddock, even though their sales involved substantially larger amounts. It is a reasonable inference, in this context, that Nicholas would be well beyond reluctant to decide that the Company should sue Braddock and Walker over their sales of Priceline stock if he recognized (as he would) that suit against them would likely lead to a suit against him. Indeed, it may be that the trades were not material to Walker or Braddock. That conclusion, however, would need a more developed factual background. For purposes of a motion to dismiss, that the trades (and the possible consequences of trading on confidential information) were material to each of the directors is a reasonable inference based on the allegations of particularized facts. *See, e.g.*, *Orman*, 794 A.2d at 23 n.44 (allegation is sufficient with respect to materiality if "facts are pled from which a reasonable inference can be drawn that the benefit [or detriment] . . . is material to him").

Plaintiff's efforts to demonstrate that the loyalty of those directors is in doubt.[85] The question with regard to demand futility is whether the trading directors could impartially consider a shareholder's demand upon the corporation to pursue a claim against them based on their trades. In light of the allegations in the Second Amended Complaint and the value of the Selling Defendants' trades, it is a reasonable inference that the Selling Defendants would be personally and significantly concerned about, and opposed to, any such demand and, thus, interested in whether the Priceline Board would pursue a claim based on their trades. Thus, the Second Amended Complaint alleges that the Selling Defendants are interested.

2. The Independence of the Remaining Priceline Directors

The key to the outcome of *Zimmerman I* was the Court's conclusion that the "[Amended] Complaint alledge[d] insufficient particularized facts from which a reasonable inference may be drawn that the interests and positions of the [Selling

[85] *See e.g.*, *In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 927-28 (Del. Ch. 2003) ("Of course, the amount of the proceeds each of the Trading Defendants generated was extremely large. By selling only two percent of his holdings, Ellison generated nearly a billion dollars . . . . But given Oracle's fundamental health as a company and his retention of ninety-eight percent of his shares, Ellison (the SLC found) had no need to take desperate—or, for that matter, even slightly risky—measures.").

Defendants], whether individually or collectively, empowered them with the means to dominate and control the Board and affairs of Priceline, Walker Digital or Synapse."[86]

With his effort to amend, the Plaintiff seeks to cure that pleading shortfall. In the Amended Complaint, the Plaintiff alleged that Walker Digital owned 35% of the common stock of Priceline, but he did not allege with particularity that Walker (even with the other Selling Defendants) controlled Walker Digital. If the Selling Defendants controlled Walker Digital, then with their personal holdings of Priceline, the Selling Defendants would control a majority of Priceline's stock as well. The Second Amended Complaint answers the question of who controls Walker Digital: the Selling Defendants. The Second Amended Complaint, however, has a materially different allegation as to Walker Digital's equity position in Priceline. Instead of a 35% interest, Walker Digital is now alleged to have only a 4.25% interest in Priceline. Thus, when Walker Digital's holdings are added to the personal holdings of Walker (32%), Braddock (10%), and Nicholas (2%),[87] the Selling Defendants only control approximately 48% of the common

[86] *Zimmerman I*, at *9. The Second Amended Complaint does not demonstrate that the Selling Defendants controlled Synapse.
[87] The Selling Defendants' holding of Priceline were not set forth in the Amended Complaint.

stock of Priceline.[88] Therefore, the Selling Defendants do not have majority control of Priceline's stock.[89]

Accordingly, it is necessary to turn to the question of whether the Selling Defendants, holding a 48% equity position, were able to control the affairs of Priceline. "Stock ownership alone, at least when it amounts to less than a majority, is not sufficient proof of domination of control [of the Board of Directors]."[90]

Evaluation of a board's independence, however, requires a "contextual inquiry."[91] Not only must the Court consider the power and influence of the allegedly dominating person, but it also must assess the susceptibility of the directors to the exercise of that leverage. A large shareholder may be able to

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[88] In *Zimmerman I*, the Court speculated that, if Walker and the other Selling Defendants controlled Walker Digital, then they would be in a position to control Priceline. That speculation, however, was based on the Plaintiff's allegation in the Amended Complaint that Walker Digital owned 35% of Priceline. With the current allegation that Walker Digital holds only 4.5% of Priceline, the foundation for that speculation in *Zimmerman I* has been eroded.

[89] Another allegation first appearing in the Second Amended Complaint is that Priceline is one of Worldspan's two largest clients.

[90] *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984). *See, e.g.*, *In re W. Nat'l Corp. S'holders Litig.*, 2000 WL 710192 (Del. Ch. May 22, 2000) (46% shareholder does not control or dominate the board due to stock ownership alone). In *Western National*, the Court, with the benefit of summary judgment record, carefully assessed both the power and conduct of the large shareholder.

[91] *Beam*, 845 A.2d at 1049. *See also Orman*, 794 A.2d at 23 ("We reach conclusions as to the sufficiency of allegations regarding interest and independence only after considering all the facts alleged on a case-by-case basis.").

control the affairs of a corporation as a matter of voting power even without being able to exercise controlling influence over the company's directors that would raise reasonable doubts about the directors' ability to discharge their fiduciary duties loyally.[92] Under these circumstances, a careful analysis of why the directors, on an individual basis, might need to curry favor with (or otherwise consider their obligations to) the majority shareholder is necessary. For example, the Court must consider what material benefits (or detriments) the majority shareholder can bestow (or impose) upon each of the directors,[93] other than, as a general matter, the majority shareholder's capacity to deny them their continuing status as directors. On the other hand, there are circumstances in which a shareholder with less than a majority of a company's equity can effectively control and dominate a board. Something more than merely owning a sizeable (but less than majority) block of the Company's stock is necessary.[94] This inquiry may involve, for example, the exercise of power by a dominant chief executive.

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[92] *See, e.g.*, *Beam*, 845 A.2d at 1051 (assessing the power and domination of a 94% shareholder).
[93] This, of course, is in addition to other concerns, such as family relationships, that may be present. *See, e.g.*, *Mizel v. Connelly*, 1999 WL 550369 (Del. Ch. July 22, 1999).
[94] *See, e.g.*, *In re Ply Gem Indus., Inc.*, 2001 WL 755133 (Del. Ch. June 26, 2001) (allegedly controlling shareholder with 25% of stock); *Friedman v. Beningson*, 1995 WL 716762 (Del. Ch. Dec. 4, 1995) (allegedly controlling shareholder with 36% of stock), *appeal refused*, 676 A.2d 900 (Del. 1996).

To assess the futility of demand on the Priceline Board, the power of one shareholder is not the measure. Instead, the Court must assess, based on the particularized allegations of the Second Amended Complaint, the collective power and control of the three Selling Defendants. Walker is the founder of Priceline, the owner of 32% of its stock, a former chief executive officer, and a major, if not the major, impetus behind Priceline's efforts to develop WebHouse. The allegations of the Second Amended Complaint, if true, demonstrate that Walker was the driving force behind the Company and was able to prescribe the direction that the Company would take. Braddock, another early participant in the development of Priceline, holds 10% of the stock and, significantly, serves as its chairman. Nicholas, the owner of a small percentage (2%) of Priceline's stock, does not independently have appreciable power, but he does contribute to the collective power of the Selling Defendants. When assessed under a motion to dismiss standard, the Second Amended Complaint sets forth sufficient particularized allegations, which, if true, would support the reasonable inference that the Selling Defendants collectively were in a position to control the affairs of the Company and to impair the objective decision-making capability of the Company's directors if those directors would be beholden to (or under the domination of) persons

holding that type of collective power within Priceline. Accordingly, it is necessary to evaluate whether the Individuals Defendants, as the remaining directors of Priceline, were subject to domination by (or were otherwise "beholden to") the Selling Defendants.

a. *Blackney*

Blackney is the Chief Executive Officer of Worldspan. Priceline is one of Worldspan's two largest clients. Worldspan and Priceline entered into a five-year agreement by which Worldspan paid Priceline $3 million in exchange for Priceline's guarantee of a minimum level of bookings. There is nothing in the Second Amended Complaint that would lead one to conclude that Priceline could not exceed the minimum booking requirements established in its agreement with Worldspan.

Blackney cannot be viewed as independent to those who are alleged to control Priceline. It would be unrealistic for Blackney to assess independently whether to pursue legal action against those who controlled one of his company's two largest clients, as it has been adequately pled that his company's fortunes are contingent on its business with Priceline. The Defendants argue that Priceline and Worldspan are bound together in a long-term relationship and, therefore, whether

Worldspan lost the goodwill of Walker and Braddock was irrelevant. However, this argument fails for two reasons: (1) Walker and Braddock's continued goodwill could be important to Worldspan if it could achieve more than the minimum required level of bookings, and (2) even though the Priceline/Worldspan contract was 5 years in duration, Worldspan would likely benefit from Walker and Braddock's goodwill beyond the life of this initial bargain.[95]

b. *Schulman*

Schulman, when the initial complaint was filed, served as President and Chief Executive Officer of Priceline. In that position, he was handsomely compensated. Significantly, he reported directly to Braddock. In short, these circumstances cast reasonable doubt on Schulman's ability to assess independently

[95] By pleading that Priceline was one of Worldspan's two largest clients, the Plaintiff has pled the materiality of the relationship. There may be instances where, even if the allegations of the nature asserted by the Plaintiff are true, the relationship may not be material to Worldspan (for example, (a) if Client # 1 accounted for 97% of Worldspan's business and Client #2 accounted for 2%, or (b) if Client # 1 and 2 each accounted for 2% of Worldspan's business and 96 additional customers accounted for 1% each). However, given that the Plaintiff is entitled to all fair and reasonable inferences from the well-pled facts alleged in its Second Amended Complaint, at this stage of the proceedings it would be unreasonable not to infer the materiality of Priceline's business to Worldspan.

demand upon Priceline's Board to file suit against Braddock, his boss; Walker, holder of 32% of the Company's stock; and Nicholas.[96]

c. *Miller*

Because Miller's principal employment was her job as the CFO of Priceline, and because the Plaintiff has successfully pled that Braddock and Walker controlled Priceline, Miller can not have been expected to analyze demand with regard to insider trading allegations against them independently. Even if Miller was planning to leave Priceline when this action was brought, the Selling Defendants could, nonetheless, influence her departing compensation package (including the forgiveness of her loans). Accordingly, it can be reasonably inferred that Miller was beholden to the Selling Defendants at that moment in time and the Plaintiff has adequately alleged that Miller is not independent for demand futility purposes.

* * * *

With the conclusion that six of the eleven directors of Priceline were either interested or not independent, the Court need not consider, and draws no inference

[96] *See, e.g.*, *Telxon Corp. v. Bogomolny*, 792 A.2d 964, 974 (Del. Ch. 2001); *Steiner v. Meyerson*, 1995 WL 441999 (Del. Ch. July 19, 1995).

as to, the independence of the remaining five directors. The Plaintiff has sufficiently alleged that demand upon Priceline's Board would have been futile.

VI. FAILURE TO STATE A CLAIM

A. *Legal Standard*

> On a motion to dismiss under Rule 12(b)(6), I am required to assume the truthfulness of all well-pleaded allegations of the complaint. Although I am required to extend to plaintiffs the benefit of all reasonable inferences that can be drawn from the complaint, conclusory statements without supporting factual averments will not be accepted as true for purposes of a motion to dismiss. Under this analysis, I cannot order dismissal unless it is reasonably certain that plaintiffs could not prevail under any set of facts that can be inferred from the complaint.[97]

B. *Analysis*

The Defendants fail in arguing that amendment of Count I (against the Selling Defendants for breach of fiduciary duty for insider selling and misappropriation of information) would be futile because it fails to state a claim as a matter of law. The Selling Defendants contend that the information they traded upon was disclosed public information and, thus, even assuming that all of the Plaintiff's allegations are true, the Selling Defendants cannot be found liable for trading on inside information. Specifically, the Selling Defendants assert that

[97] *Shamrock Holdings of Cal., Inc. v. Iger*, 2005 WL 1377490, at *4 (Del. Ch. June 6, 2005) (footnote and internal quotation omitted).

Priceline's future profitability, customer satisfaction, competition, third quarter financial guidance, and the future prospects of WebHouse were all publicly disclosed or known to the public. Additionally, the Selling Defendants argue that Priceline's customer dissatisfaction statistics are immaterial.

The Defendants' arguments are unconvincing. The Second Amended Complaint contains allegations that, if true, could lead one to infer that the Selling Defendants, knowing that future prospects did not look promising, gave "kitchen sink warnings" in SEC filings while publicly—and perhaps more visibly—professing the opposite. The "bespeaks caution" doctrine, applied in the context of federal securities law and recently reviewed by this Court in *In re Oracle Corp.*,[98] permits companies to discuss candidly future prospects as long as the risks, assumptions, and factors that form these opinions are adequately disclosed. The doctrine, however, does not allow a party to make overly-optimistic statements while also making blanket cautionary warnings.

> [C]autionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law. . . . Of course, a vague or blanket (boilerplate) disclaimer which merely warns the reader that the investment has risks will ordinarily be inadequate to

[98] 867 A.2d at 935.

> prevent misinformation. To suffice, the cautionary statements must be substantive and tailored to the specific future projections, estimates or opinions in the prospectus which the plaintiffs challenge.[99]

The Plaintiff has recited numerous optimistic statements made by Priceline executives.[100] The Plaintiff has also referenced SEC filings where Priceline issued cautionary remarks,[101] and the Defendants have pointed to cautionary language and negative disclosures as well. Nonetheless, the Second Amended Complaint sets forth allegations supporting the reasonable inference that the "warning" statements were inadequate either on their own or relative to the "optimistic statements." As illustrated in *In re Westinghouse Securities Litigation*, determination of the sufficiency of a disclaimer by itself and in relation to optimistic statements must be done on a case-by-case basis. From the statements, both positive and negative, in the Second Amended Complaint and the incorporated documents, and after drawing all reasonable inferences from these statements in favor of the Plaintiff, it is not appropriate at this stage in the litigation to determine whether the cautionary statements fairly outweighed the positive statements or vice versa. A more

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[99] *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 707 (3d Cir. 1996).
[100] *See, e.g.*, Second Amended Complaint, at ¶¶ 67-69.
[101] *See, e.g., id.*, at ¶ 77.

complete factual record is necessary to perform this inquiry.[102] Thus, the Plaintiff has sufficiently pled allegations that, if proven to be true, could state a viable claim of insider trading and misappropriation of confidential information. Consequently, the Defendants have not demonstrated that amendment of the Amended Complaint would be futile.

VII. CONCLUSION

For the reasons set forth above, the Plaintiff's Motion for Leave to File a Second Amended Derivative Complaint is granted as to Count I. The Defendants have failed to demonstrate that Count I of the Second Amended Complaint would fail when analyzed under Court of Chancery Rule 23.1 or Court of Chancery Rule 12(b)(6). An order will be entered to implement this letter opinion.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC

[102] Similarly, while, as the Defendants point out, some negative information had been released to the public, it is not possible to resolve in the context of a motion under Court of Chancery Rule 12(b)(6) whether those disclosures contributed sufficiently to that mix of public information that would not leave the Selling Defendants with a substantial advantage because of their knowledge of the Company's confidential and adverse information, especially in light of the highly optimistic statements emanating from the Company.