EFiled: Mar 30 2012 5:49PM EDT
Transaction ID 43405067
Case No. 4199-VCN

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SUSAN FREEDMAN,	:	
	:	
Plaintiff,	:	
	:	
v.	:	**C.A. No. 4199-VCN**
	:	
WILLIAM H. ADAMS, III, KEITH A. HUTTON, JACK P. RANDALL, PHILLIP R. KEVIL, HERBERT D. SIMONS, VAUGHN O. VENNERBERG, II, LANE G. COLLINS, SCOTT G. SHERMAN, BOB R. SIMPSON and XTO ENERGY INC.,	:	
	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: December 14, 2011
Date Decided: March 30, 2012

Robert D. Goldberg, Esquire of Biggs and Battaglia, Wilmington, Delaware; Alexander Arnold Gershon, Esquire and Michael A. Toomey, Esquire of Barrack, Rodos & Bacine, New York, New York; and Daniel E. Bacine, Esquire and Robert A. Hoffman, Esquire of Barrack, Rodos & Bacine, Philadelphia, Pennsylvania, Attorneys for Plaintiff.

Raymond J. DiCamillo, Esquire and Margot F. Alicks, Esquire of Richards, Layton & Finger, P.A., Wilmington, Delaware, Attorneys for Defendants.

NOBLE, Vice Chancellor

I. INTRODUCTION

Plaintiff Susan Freedman (the "Plaintiff"), a former shareholder of Nominal Defendant XTO Energy Inc. ("XTO"), moves for an award of attorneys' fees and expenses following the stipulated dismissal of her derivative action, which was largely mooted by measures taken by XTO's board of directors (the "Board") shortly after the Plaintiff's Complaint was served. In addition to XTO, the former members of XTO's Board were named as defendants: William H. Adams ("Adams"), Keith A. Hutton ("Hutton"), Jack P. Randall ("Randall"), Phillip R. Kevil ("Kevil"), Herbert D. Simons ("Simons"), Vaughn O. Vennerberg, II ("Vennerberg"), Lane G. Collins ("Collins"), Scott G. Sherman ("Sherman"), Bob R. Simpson ("Simpson" and, together with the other director-defendants, the "Board Defendants"). XTO and the Board Defendants (together, the "Defendants") oppose this motion on several grounds.

The Complaint, consisting of eight pages and filed on November 26, 2008, related to XTO's Board-approved executive compensation plan. Specifically, the Plaintiff objected to the fact that the cash bonuses paid to XTO's Chief Executive Officer ("CEO"), Simpson, and four other officers were not tax-deductible because they did not meet the requirements of § 162(m) of the Internal Revenue Code ("§ 162(m)").[1] Importantly, the cash bonuses did not meet the § 162(m) definition

[1] 26 U.S.C. § 162(m) (2011).

of "[o]ther performance-based compensation," which must be contingent upon achieving performance goals meeting certain statutory requirements.[2] As a result, the Plaintiff claimed that XTO forwent approximately $75 million in tax deductions from 2005 through 2007.[3]

The Plaintiff asserted that, by failing to structure the cash bonuses as tax-deductible compensation, the Board Defendants had breached their fiduciary duties and committed waste. She also claimed that the Board Defendants caused XTO's proxy statements to contain material misstatements or omissions related to the deductibility of these bonuses. The Plaintiff sought relief in the form of an accounting for the losses sustained by XTO, a mandatory injunction requiring the Board Defendants to formulate a tax-deductible bonus plan, an injunction against further payment of non-tax-deductible compensation, and an award of attorneys' fees and expenses. Shortly after being served with the Complaint, the Board adopted a tax-deductible cash bonus plan,[4] thus mooting most of the Plaintiff's claims. Between the time that most of the Plaintiff's claims were mooted and the Complaint's eventual dismissal, the Defendants filed two motions to dismiss. Also

---

[2] *See id.* at § 162(m)(4)(C).
[3] Compl. ¶ 5.
[4] Answering Br. in Opp'n to Pl.'s Mot. for Att'ys' Fees & Reimbursement of Expenses ("Answering Br."), Ex. 1 (XTO Energy Inc., Definitive Proxy Statement (Schedule 14A) (Apr. 17, 2009) ("2009 Proxy")) C-2.

during this period, the Plaintiff sold all of her XTO stock,[5] and, later, XTO was acquired by ExxonMobil Corporation ("Exxon") and merged with and into a wholly owned subsidiary of Exxon.[6] Eventually, the parties agreed to a stipulated order of dismissal, which was granted by this Court on April 6, 2011. The Plaintiff's motion for an award of attorneys' fees and expenses followed shortly thereafter.

In this Memorandum Opinion, the Court denies the motion, ultimately, for reasons that can best be summarized thusly: an arguably poor business judgment, without more, does not excuse demand on the board of directors in a derivative action.

II. BACKGROUND[7]

Simpson was one of the founders of XTO, its CEO from 1986 until at least 2008, and a longtime Board member. He was also "one of the most highly respected executives in the world."[8] In the years 2005 through 2007, XTO paid Simpson $97.5 million in non-tax-deductible cash bonus compensation. During

---

[5] Mot. to Dismiss (filed Aug. 31, 2010) ("Second Mot. to Dismiss"), Ex. A (Email from Robert D. Goldberg, Esq. to Raymond J. DiCamillo, Esq. (July 21, 2010)).
[6] Second Mot. to Dismiss, Ex. B (Exxon press release). XTO had been a Delaware corporation. Compl. ¶ 3.
[7] Because the motion to dismiss standard is applied throughout this opinion, the facts are drawn from the Complaint and the documents incorporated into it, unless otherwise noted. XTO's proxy statements for the years 2004 through 2008 are considered to have been incorporated into the Complaint because they were expressly referred to and heavily relied upon in the Complaint. *See infra* Part IV.A. Facts drawn from sources other than the Complaint and the documents incorporated into it are included only to provide the reader with a better understanding of the overall factual background of this action and are not utilized in this Court's analysis.
[8] Compl. ¶ 5.

the years 2004 through 2007, XTO paid other officers approximately $23.5 million in non-tax-deductible cash bonus compensation. Assuming a corporate tax rate of 35%, the non-tax-deductible bonuses paid to Simpson and the other officers resulted in lost tax benefits of approximately $40 million.

Generally, under § 162(m), compensation in excess of $1 million paid to the CEO and the other four highest-paid officers of a public company (together with the CEO, the "Covered Officers") is not tax-deductible.[9] But, § 162(m) includes an exception for "[o]ther performance-based compensation."[10] To be eligible for this exception, compensation must be: (1) paid solely on account of the attainment of one or more performance goals determined by a compensation committee comprised solely of two or more outside directors; (2) the material terms of the plan must be disclosed to shareholders and approved by a majority in a separate shareholder vote before the payment of such compensation; and (3) before payment, the compensation committee must certify that the performance goals were satisfied (a "§ 162(m) plan").[11] Cash bonuses paid to XTO's Covered Officers were not tax-deductible because they were not paid under a § 162(m) plan. When the Complaint was filed, XTO had not proposed a § 162(m) plan to its shareholders.

[9] 26 U.S.C. § 162(m)(1).
[10] *Id.* at § 162(m)(4)(C).
[11] *Id.*

The Board was aware that the cash bonuses paid to the Covered Officers were not tax-deductible. In fact, XTO's proxy statements for the years 2004 through 2008 (the "contested proxy statements") each included a disclosure substantially similar to the following:

> Section 162(m) of the Internal Revenue Code generally limits the corporate tax deduction for annual compensation paid to certain of our executive officers named in the summary compensation table to $1,000,000, unless the compensation satisfies the requirements for performance-based compensation. Stock options granted under the company's [1998 or 2004] stock incentive plan have generally been entitled to the full tax deductions available because the compensation has qualified as performance-based and, therefore, not applied against the $1,000,000 limit. Base salary and cash bonuses have not been performance-based for purposes of Section 162(m) and, therefore, were not fully deductible by the company. While the compensation committee monitors compensation paid to our named executive officers in light of the provisions of Section 162(m), the committee does not believe that compensation decisions should be constrained necessarily by how much compensation is deductible for federal income tax purposes, and the committee is not limited to paying compensation under plans that are qualified under Section 162(m). During [the year in question], compensation paid to covered named executive officers exceeded the maximum deductible amount.[12]

[12] XTO Energy Inc., Definitive Proxy Statement (Schedule 14A) 26 (Apr. 21, 2008) ("2008 Proxy"); *See* XTO Energy Inc., Definitive Proxy Statement (Schedule 14A) 23 (Apr. 13, 2007) ("2007 Proxy"); XTO Energy Inc., Definitive Proxy Statement (Schedule 14A) 13 (Apr. 13, 2006) ("2006 Proxy"); XTO Energy Inc., Definitive Proxy Statement (Schedule 14A) 12 (Apr. 15, 2005) ("2005 Proxy"); XTO Energy Inc., Definitive Proxy Statement (Schedule 14A) 11 (Apr. 21, 2004) ("2004 Proxy").

Although the contested proxy statements never quantified the forgone tax deductions, each contested proxy statement included a table disclosing the salaries and cash bonuses received by Simpson and the other Covered Officers.[13]

In the contested proxy statements, XTO reported that five of its nine directors were independent: Adams, Collins, Kevil, Sherman, and Simons (together, the "Outside Directors"). Although not an employee of XTO, Randall was not reported as an independent director in the contested proxy statements; his employer provided services to XTO.[14] In addition to serving as directors, Simpson, Hutton, and Vennerberg were Covered Officers, and each was paid non-deductible bonuses. The Plaintiff contends that the Outside Directors were "paid too much to be independent," and their compensation "increased steadily over the years."[15] According to the Plaintiff, XTO's reported "basis for this large compensation [was] the significant time commitment for extensive involvement in extra work at [B]oard and committee meetings, attendance at two management conferences each year, and frequent informal discussions with management."[16] The Plaintiff further alleged that the Outside Directors were in fact employees because work was assigned to them by Simpson, Hutton, Vennerberg, or people

[13] *See* 2008 Proxy at 27, 2007 Proxy at 24, 2006 Proxy at 16, 2005 Proxy at 15, 2004 Proxy at 14.
[14] *See* 2007 Proxy Statement at 39.
[15] Compl. ¶ 18.
[16] *Id.*

under their control, and they received health benefits, retirement plans, and severance pay.

On February 17, 2009, the Board approved a § 162(m) plan for cash bonuses,[17] and it was submitted to XTO's shareholders for a vote on April 17, 2009.[18] The XTO shareholders approved the plan at the annual stockholders meeting in May 2009.[19] In early 2010, the Plaintiff sold her XTO stock.[20] On June 25, 2010, XTO was merged with and into a subsidiary of Exxon.[21]

Due to the merger with Exxon, XTO never received any tax deductions as a result of the § 162(m) plan it adopted. After the merger in 2010, XTO could not benefit from the § 162(m) plan because it was not a public company, and, therefore, the deductibility limitations of § 162(m) did not apply to it.[22] In 2009, the § 162(m) plan would have allowed XTO to receive a tax deduction, but, due to agreements among Exxon, XTO, and the Covered Officers, the Covered Officers' 2009 bonuses were paid before the end of 2009, rendering them non-deductible under the § 162(m) plan.[23] The Plaintiff alleged that XTO still received a benefit from the § 162(m) plan, however, in the form of reduced bonus payments to the

---

[17] 2009 Proxy at C-2.
[18] 2009 Proxy at Appendix C.
[19] Answering Br., Ex. 3 (Form 8-K) 2.
[20] Second Mot. to Dismiss, Ex. A (Email from Robert D. Goldberg, Esq. to Raymond J. DiCamillo, Esq. (July 21, 2010)).
[21] Second Mot. to Dismiss, Ex. B (Exxon press release).
[22] Br. in Supp. of Pl.'s Mot. for Att'ys' Fees & Reimbursement of Expenses ("Br. in Supp.") 11.
[23] *Id.* at 9-10.

Covered Officers in 2009.[24] The 2009 bonuses received by the Covered Officers were $6.575 million less than the bonuses that would have been under the § 162(m) plan.[25] Had XTO paid 2009 bonuses under the § 162(m) plan, it would have received an $8.12 million tax benefit.[26] According to the Plaintiff, the Covered Officers accepted lower 2009 bonuses because XTO forfeited the § 162(m) tax deduction in order to pay the bonuses in 2009.[27] Finally, the Plaintiff alleged that the § 162(m) plan created prospective tax savings of $56 million for the years 2010 through 2013 measured at the date of its approval (before the Exxon merger).[28]

III. CONTENTIONS

The Plaintiff contends that she is entitled to receive payment of attorneys' fees and expenses by the Defendants under the corporate benefit doctrine[29] because the Board Defendants mooted the bulk of her claims when they approved a § 162(m) plan shortly after the Complaint was served. According to the Plaintiff, the Complaint properly pled claims of waste and a bad faith breach of the duty of

---

[24] *Id.*
[25] *Id.* at 10.
[26] *Id.* at 9.
[27] *Id.* at 10. Receiving their 2009 bonuses in 2009, as opposed to 2010, benefitted the Covered Officers because it allowed them to receive larger consulting and retention payments from Exxon without paying an excise tax, and it allowed Exxon to deduct more of the consulting and retention payments. *Id.* at 9-10 n.10.
[28] *Id.* at 11.
[29] The Plaintiff refers to this as the "common benefit" doctrine, *but see Dover Historical Soc'y, Inc. v. City of Dover Planning Comm'n*, 902 A.2d 1084, 1090 n.11 (Del. 2006).

loyalty. She also contends that demand would have been excused because she sufficiently pled all or any of the following: (1) that a majority of the Board was interested or lacking independence; (2) that the Board's decision to not have a § 162(m) plan for cash bonuses was not protected by the business judgment rule because it constituted waste; or (3) that the contested proxy statements contained material misstatements or omissions. The Plaintiff argues that her Complaint caused the Board to adopt a § 162(m) plan and that adoption of the § 162(m) plan provided a benefit to XTO in the form of prospective tax savings, some of which were realized when XTO paid reduced bonuses to the Covered Officers in late 2009. The Plaintiff seeks $1 million in attorneys' fees and reimbursement of approximately $5,000 in expenses. The amount of fees requested is justified, the Plaintiff claims, by the large benefit conferred by this litigation. By the Plaintiff's reckoning, the § 162(m) plan conferred a benefit upon XTO of $6.575 million in 2009 and a prospective benefit of $56 million for the years 2010 through 2013.

The Defendants contend that the Plaintiff is not entitled to attorneys' fees and expenses. The Defendants first argue that the Plaintiff's action was not meritorious when filed because the Complaint did not allege sufficient facts to excuse demand or to state a claim. The Defendants also contend that the Plaintiff lacked standing to assert certain claims that arose before she became an XTO shareholder and that other claims were barred by a laches-borrowed statute of limitations. Next, the Defendants argue that, even if the Court finds that the Plaintiff's action was meritorious when filed, it did not cause XTO to adopt the § 162(m) plan and, regardless, the § 162(m) plan conferred no benefit upon XTO. In support of their argument that the § 162(m) plan created no benefit, the Defendants point to the fact that, as a result of XTO's sale to Exxon and the early payment of the 2009 bonuses, XTO never received any tax benefits from compensation paid under the plan. The Defendants also contend that the Plaintiff's counsel's efforts further undercut her claim for fees, noting that a short complaint was the only substantial filing made by the Plaintiff before her application for fees. Finally, the Defendants argue that a percentage-of-benefit analysis is inappropriate in this case, and fees should be awarded under a *quantum meruit* standard, if at all. Based on the Plaintiff's counsel's hourly rate, the maximum fee award under this method would be $91,800, as calculated by the Defendants, although, the Defendant argues, because no benefit was achieved, it would be inappropriate to award the Plaintiff any fees under the *quantum meruit* standard.

In response, the Plaintiff repeats her arguments in favor of demand excusal, the sufficiency of her pleadings, and the use of "benefit conferred" as the primary factor for determining attorneys' fees.

IV. ANALYSIS

A plaintiff is entitled to an award of attorneys' fees and expenses under the corporate benefit doctrine when her claims were mooted, if she can show that: (1) the suit was meritorious when filed; (2) the action that provided a benefit to the corporation was taken by the defendant before a judicial resolution was achieved; and (3) the resulting corporate benefit was causally related to the lawsuit.[30] "[A] claim is meritorious within the meaning of [the corporate benefit doctrine] if it can withstand a motion to dismiss on the pleadings."[31] The Defendants argue that the Plaintiff's suit was not meritorious when filed because her Complaint failed to plead facts sufficient to excuse demand or to state a claim for relief. Because the futility of demand issue is dispositive, it is the only issue reached by the Court.

A. *Court of Chancery Rule 23.1 Standard*

Under Court of Chancery Rule 23.1, 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."[32] Under the familiar test set forth in *Aronson v. Lewis,*[33] to establish demand futility, a plaintiff must plead particularized factual allegations that raise a reasonable doubt that: (1) the directors

[30] *Allied Artists Pictures Corp. v. Baron*, 413 A.2d 876, 878 (Del. 1980).
[31] *Id.* at 879 (internal quotation and citation omitted).
[32] Ct. Ch. R. 23.1.
[33] 473 A.2d 805 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

are disinterested and independent; or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.[34] A plaintiff's burden under Rule 23.1 is more onerous than that required to withstand a motion to dismiss for failure to state a claim under Court of Chancery Rule 12(b)(6).[35] While "[i]n both cases this Court must make all inferences in favor of plaintiffs, . . . in the Rule 23.1 context such inferences may only be drawn from particularized facts."[36]

"A motion under Rule 23.1 requires the court to limit its inquiry to the well-pled allegations of the complaint, documents incorporated into the complaint by reference, and judicially-noticed facts."[37] These allegations are accepted as true in deciding a motion to dismiss, although the Court need not accept conclusory allegations not supported by allegations of particularized facts.[38] When a plaintiff expressly refers to and heavily relies upon documents in her complaint, these documents are considered to be incorporated by reference into the complaint;[39] this is true even where the documents are not expressly incorporated into or attached to the complaint.[40] Because the contested proxy statements were expressly referred to

---

[34] *Id.* at 818.
[35] *In re Tyson Foods, Inc.*, 919 A.2d 563, 582 (Del. Ch. 2007).
[36] *Id.*
[37] *Breedy-Fryson v. Towne Estates Condominium Owners Ass'n, Inc.*, 2010 WL 718619, at *9 (Del. Ch. Feb. 25, 2010).
[38] *In re Nat'l Auto Credit, Inc. S'holders Litig.*, 2003 WL 139768, at *8 (Del. Ch. Jan. 10, 2003).
[39] *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 1594085, at *12 (Del. Ch. June 29, 2005).
[40] *e4e, Inc. v. Sircar*, 2003 WL 22455847, at *3 (Del. Ch. Oct. 9, 2003).

and heavily relied upon in the Complaint, they are considered to be incorporated by reference into the Complaint.

B. *Director Disinterestedness and Independence*

When assessing the independence and disinterestedness of directors under Rule 23.1, the Court considers the board's composition at the time the plaintiff brought the complaint, not when the alleged wrong occurred;[41] here, apparently, the same directors were on the Board at both times. "Directors are deemed disinterested when they '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.'"[42] "Directoral interest also exists where a corporate decision will have a materially detrimental impact on a director, but not on the corporation or stockholders."[43] Generally, the interest at issue must be material to the director, and materiality is assessed based upon the individual director's economic circumstances.[44]

"Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or

---

[41] *Tyson Foods*, 919 A.2d at 582.
[42] *Nat'l Auto Credit*, 2003 WL 139768, at *8 (quoting *Aronson*, 473 A.2d at 812).
[43] *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).
[44] *Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. Mar. 1, 2002).

influences,"[45] such as may exist when the challenged director is controlled by another.[46] The plaintiff may show control by pleading facts that establish that "the directors are 'beholden' [to the controlling person] or so under their influence that their discretion would be sterilized."[47] Simply reciting "[t]he shorthand shibboleth of 'dominated and controlled directors' is insufficient."[48]

The Plaintiff argues that the entire Board[49] lacked either disinterestedness or independence with regard to the decision not to implement a § 162(m) plan. Simpson, Hutton, and Vennerberg (the "Officer Directors") were interested, the

---

[45] *Aronson*, 473 A.2d at 816.
[46] *Orman*, 794 A.2d at 24.
[47] *Rales*, 634 A.2d at 936.
[48] *Aronson*, 473 A.2d at 816.
[49] Although the contested proxy statements explain that XTO's "executive compensation program is under the direction and control of the compensation committee," and "[e]xecutive compensation is determined by the [compensation] committee in executive session, with the other non-employee directors of the company present," the Plaintiff never explained the role of the compensation committee in the Complaint, and, in her briefs, she did not address the impact of this committee on which directors' independence and disinterestedness is truly relevant. 2007 Proxy at 12. According to the contested proxy statements, the compensation committee was composed entirely of Outside Directors. *See* 2008 Proxy at 6, 2007 Proxy at 6, 2006 Proxy at 11, 2005 Proxy at 10, 2004 Proxy at 10 (In each of the cited proxy statements the compensation committee was reported to consist of some combination of the following directors: Adams, Collins, Sherman, Kevil, and Simons.). Because the Plaintiff failed to challenge successfully the Outside Directors' independence and disinterestedness, as explained in this Part of the Memorandum Opinion, the Court need not address whether the compensation committee, and not the entire Board, is the appropriate population of directors to inspect for loyalty issues in the demand excusal context, since both would have had majorities of directors whose independence and disinterestedness have not been successfully challenged. Furthermore, throughout this Memorandum Opinion, when discussing certain challenged actions, the Court will refer to the entire Board in instances where the Plaintiff did so in her Complaint, even if the contested proxy statements would suggest that the actions were taken by the compensation committee. At all relevant times majorities of both the compensation committee and the Board were composed of directors whose independence and disinterestedness have not been successfully challenged, as explained above; therefore, whether or not a challenged action was taken by the entire Board or the compensation committee would not affect the Court's analysis of the challenged action.

Plaintiff contends, because each received bonuses that would have been subject to a § 162(m) plan, and such a plan could have been detrimental to them, if they did not meet the plan's performance goals. The Plaintiff argues that Randall should not be considered independent because he was not reported as such in the contested proxy statements. The Defendants contest the Plaintiff's assertions that these directors were not disinterested and independent. The Court need not assess the independence and disinterestedness of these four directors—who did not constitute a majority or half of the Board—because the arguments challenging the independence and disinterestedness of the remaining Board Defendants (the Outside Directors)—who, together, did constitute a majority of the Board—are based upon facts and legal theories common to all of the Outside Directors. As a result, whether or not the Plaintiff has successfully challenged the independence and disinterestedness of a majority of the Board turns on whether she has successfully challenged the independence and disinterestedness of the Outside Directors.

1. <u>Board Compensation Exceeding What is Usual and Customary</u>

The Plaintiff advances three arguments challenging the Outside Directors' independence and disinterestedness. First, she argues that they were "paid too much by XTO to be actually independent."[50] Generally, the fact that directors

[50] Compl. ¶ 18.

receive customary compensation for their service on the Board does not lead to an inference of a material conflict.[51] It has been suggested, however, that director fees could have a disqualifying effect if they "exceed[ed] materially what [was] commonly understood and accepted to be a usual and customary director's fee."[52] The Plaintiff did not allege sufficient particularized facts in the Complaint to show or to allow the Court reasonably to infer that the Outside Directors' compensation met this standard. In her Complaint, the Plaintiff provided the Outside Directors' total annual compensation for 2006 and 2007; she also provided the amount of their cash retainers for 2004 and 2005 and alleged that they received stock options in each of those years.[53] Additionally, she alleged that their compensation increased each year and that they received health benefits, retirement plans, and severance.[54]

Although the Plaintiff has alleged that the Outside Directors received substantial compensation, she simply has not alleged any particularized facts from which this Court could infer that this compensation materially exceeded what is

---

[51] Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 9.02[b][3], at 9–75 n.327 (2011).

[52] *Orman*, 794 A.2d at 29 n.62. *See also Nat'l Auto Credit*, 2003 WL 139768, at *11.

[53] Compl. ¶ 18. In 2006, Outside Director compensation ranged from $459,676 to $516,860. *Id.* In 2007, Outside Director compensation ranged from $678,555 to $792,198. In 2004, each Outside Director received a cash retainer of $100,000, and this amount increased to $180,000 in 2005. The Plaintiff included compensation amounts for Randall, too, although the Court is not addressing the question of Randall's independence and disinterestedness because he was also alleged to have lacked independence under another theory.

[54] *Id.*

commonly understood and accepted to be a usual and customary director's fee.[55] Perhaps if the circumstances of XTO's business were different—for instance, if it was a small, private company that underperformed the market, as opposed to a relatively large, public company that outperformed the market (at least in the years 2004 through 2008)[56]—the Court could draw a reasonable inference that these compensation amounts, on their faces, materially exceeded what was usual and customary. But, with the facts as they are, the Plaintiff simply leaves the Court to speculate as to whether the Outside Directors' compensation so far exceeded what was customary that it was disabling. This argument fails.

2. <u>Board Compensation Received in Exchange for Not Pursuing a § 162(m) Plan</u>

Second, the Plaintiff makes a related argument that the Outside Directors were paid generous compensation as part of a *quid pro quo* understanding with the Officer Directors. Under this theory, the Outside Directors received allegedly high compensation in exchange for not seeking to implement a § 162(m) plan. In support of this theory, the Plaintiff relies on *In re National Auto Credit, Inc.*

[55] In her Brief in Support, the Plaintiff cites a short news article in support of the proposition that "[the Outside Directors] were paid far too much by XTO to be actually independent." Br. in Supp. 26. This article was not quoted in, cited in, or attached to the Complaint. Therefore, the Court will not consider this article in its assessment of whether or not the suit was meritorious when filed, for which it must utilize the motion to dismiss standard.

[56] *See* 2008 Proxy at 25 (chart showing that from 2004 through 2008 XTO's total return significantly exceeded the Standard and Poor's 500 Index and the Dow Jones U.S. Exploration and Production Index).

Shareholders Litigation,[57] but that case highlights why the Plaintiff did not plead sufficient particularized facts to allow the Court to infer a *quid pro quo* arrangement.

National Auto Credit involved a claim that seven members of its board (the "Interested Directors") breached their fiduciary duty of loyalty by engaging in *quid pro quo* conduct with National Auto Credit, Inc.'s ("NAC") Chairman and Chief Executive Officer, James J. McNamara ("McNamara").[58] In exchange for a massive increase in director compensation, stock options, and compensation for past services, the Interested Directors allegedly voted in favor of two resolutions that granted McNamara a hefty raise and other compensation and served to solidify his control over the company.[59]

In *National Auto Credit*, the plaintiff pled many particularized facts that allowed the Court to infer that a *quid pro quo* exchange had taken place. There, the plaintiff showed that McNamara took actions to entrench himself before the board meeting where the alleged *quid pro quo* votes occurred (the "Meeting").[60] Under McNamara's leadership, the Board entered into settlements with two major shareholders by which those shareholders sold all or most of their holdings and

[57] 2003 WL 139768 (Del. Ch. Jan. 10, 2003).
[58] *See id.*
[59] *Id.* at *11.
[60] *Id.* at *3.

entered into standstill agreements.[61] Also, under pressure from McNamara, the then-Chairman and CEO and another Director resigned; McNamara was named interim Chairman and CEO.[62]

Three resolutions were adopted at the Meeting. First, McNamara was named permanent Chairman and CEO and granted a generous compensation package for heading what was, essentially, a passive corporation.[63] Second, the Board approved a resolution that increased the Interested Directors' remuneration, including a massive increase in Director's fees from $1,000 per meeting to $55,000 per year, significant compensation for past services rendered, and stock options.[64] Third, the board approved a transaction in which NAC acquired ZoomLot, an unprofitable internet company, in exchange for consideration valued between $27.5 million and $36.5 million that included NAC common shares equal to 23.5% of NAC's outstanding common shares.[65] The common shares and other consideration were issued to Ernest C. Garcia, Jr. ("Garcia") and his affiliates.[66] In the past, as an NAC shareholder, Garcia had supported McNamara in his battles for control of NAC after engaging in potential *quid pro quo* transactions with NAC.[67] The common shares issued to Garcia and his affiliates were sufficient to enable

---

[61] *Id.*
[62] *Id.*
[63] *Id.* at *5, *14.
[64] *Id.* at *6.
[65] *Id.* at *5.
[66] *Id.*
[67] *Id.* at *2.

them to block any attempt to repeal NAC's bylaws, which included a staggered Board provision.[68]

Before these resolutions were adopted, however, an unusual event occurred at the Meeting. While deliberations regarding the resolutions were ongoing, the Board took a break, during which a representative of NAC approached two directors appointed by Reading Entertainment, Inc. ("Reading") and proposed a buyout of the NAC stock owned by Reading.[69] One of these directors had previously circulated a memo asserting that McNamara was unqualified to serve as Chairman and CEO.[70] NAC's repurchase offer was conditioned upon the immediate resignation of Reading's directors; Reading agreed to the buyout and its Directors immediately tendered their resignations.[71]

In *National Auto Credit*, the Court ultimately concluded that the particularized facts of the complaint and the reasonable inferences drawn from them created reasonable doubt as to the disinterestedness of the board regarding its adoption of the three resolutions.[72] The directors' potential interest stemmed from the fact that their votes in favor of McNamara's compensation and the ZoomLot agreement appeared to be the products of a *quid pro quo* exchange for the large

[68] *Id.* at *5.
[69] *Id.* at *4.
[70] *Id.*
[71] *Id.*
[72] *Id.* at *11.

increase in their own compensation.[73] In support of this conclusion, the Court noted not only the large increase in the directors' annual compensation, but also the fact that they received compensation for past services and, crucially, the timing of the votes.[74] Indeed, the Court stated that "[t]he timing of the transactions factors significantly into the Court's decision."[75] Timing issues relevant to the Court's decision included: (1) the resolutions were adopted within minutes of each other; (2) their adoption immediately followed the proposed buyback of the Reading stock; and (3) their adoption occurred less than a month and a half after a bitter contest for control of NAC.[76] "Thus, the [Interested Directors] voted on the Resolutions authorizing both the McNamara Employment Agreement and the ZoomLot Agreement with a known causal link to their remuneration."[77] Therefore, the problem was "not that the Directors' Fees [were] large amounts paid on a regular basis; rather, the Directors' Fees were the product of massive increases which reasonably [could] be inferred to have been granted in return for the [Interested Directors'] support of the McNamara Employment Agreement and the ZoomLot Agreement."[78]

[73] *Id.*
[74] *Id.*
[75] *Id.* at *10.
[76] *Id.*
[77] *Id.* at *11.
[78] *Id.*

Here, the Plaintiff has not approached pleading sufficient particularized facts to allow the Court to infer that a *quid pro quo* trade took place. The only relevant non-conclusory facts pled in her Complaint were the amounts of the Outside Directors' compensation, which also supported the Plaintiff's allegation that this compensation had "increased steadily over the years."[79] While the Plaintiff correctly points out that the total compensation and increases in compensation (measured in dollar terms) received by the Outside Directors were significantly larger than those received by the Interested Directors in *National Auto Credit*,[80] she presented no factual allegations from which the Court could reasonably infer that the increases in the Outside Directors' compensation were related to the Board's decision to not adopt a § 162(m) plan. The Complaint contains no factual allegations related to the timing of the votes to increase the Outside Directors' compensation, let alone how the timing of these votes related to the Board's decisions to not implement a § 162(m) plan. The Plaintiff's broad allegations that the Outside Directors' compensation has grown over a period of time during which the Board has taken (or not taken) certain actions are simply insufficient for this

---

[79] Compl. ¶ 18.

[80] Although the key factor that distinguishes the instant case from *National Auto Credit* is the absence of a causal nexus between the acts that purportedly constitute a *quid pro quo* arrangement, the Court also notes that, in percentage terms, the pay increases received by the Interested Directors in that case dwarf those received by the Outside Directors. Furthermore, here, there are no accusations that the Outside Directors received compensation for past services rendered, which was another factor that seemed to trouble the Court in *National Auto Credit*. *See Nat'l Auto Credit*, 2003 WL 139768, at *11.

Court reasonably to infer a causal connection between these two circumstances. As such, the Court cannot reasonably infer that the Outside Directors engaged in a *quid pro quo* process with the Officer Directors and cannot doubt their disinterestedness under such a theory.

3. Outside Directors Were Really "Employees" of XTO

Third and finally, the Plaintiff argues that the Outside Directors were not independent because, while their titles read "director," they were actually *employees* of XTO working under the direction of the Officer Directors or their subordinates. It is unhelpful to frame this argument in terms of which label (director or employee) should be applied to the Outside Directors for reasons including, but not limited to, the fact that the Plaintiff's explanation of the Outside Directors' status is somewhat contradictory.[81] But, the Court accepts the Plaintiff's broader proposition that if the Outside Directors routinely behaved in the manner of employees—that is to say that their actions demonstrated that an interested director, like an employer, controlled the performance of their duties[82]—the Court could infer that they were not independent. When viewed this way, the employee-

[81] "Although these paid directors [were] assuredly not employees of the Company, they [were] in fact employees . . . ." Compl. ¶ 18.

[82] Control is one of the key factors in determining whether someone is an employee. *See Fisher v. Townsends, Inc.*, 695 A.2d 53, 58 (Del. 1997) (discussing the distinctions between servants (employees) and independent contractors for purposes of determining vicarious liability); *White v. Gulf Oil Corp.,* 406 A.2d 48, 51 (Del. 1979) (listing "power to control the conduct of the employee" as a factor to consider when determining whose employee someone is for purposes of establishing workmen's compensation insurance liability).

employer argument is just a more focused argument that the Outside Directors were controlled by the Officer Directors. Therefore, the Court will assess the particularized facts alleged by the Plaintiff in support of her employee-employer argument to determine whether these facts permit an inference that the Outside Directors were controlled by the Officer Directors; whether or not the facts support an inference that the Outside Directors were acting as "employees" is not determinative, and such a conclusion is not necessary for this Court to determine that the Outside Directors were not independent.

Again, the relevant, particularized facts set forth by the Plaintiff are rather limited. In addition to the amount of the Outside Directors' compensation, the Plaintiff alleged that Board membership required a significant time commitment, including extra work at Board and committee meetings, attendance at two management conferences each year, and frequent informal discussions with management.[83] The Plaintiff also asserted that the Outside Directors had "work assigned to them by defendants Simpson, Hutton, and Vennerberg or persons acting under their direction and control."[84] Moreover, the Plaintiff alleged that the Outside Directors received health benefits, retirement plans, and severance pay.[85]

---

[83] Compl. ¶ 18.
[84] *Id.*
[85] *Id.*

These factual allegations are insufficient to allow this Court to infer that the Outside Directors were controlled by the Officer Directors. As discussed above, generally, "receipt of director's fees alone is insufficient to disqualify any director from considering demand."[86] This Court has already considered and rejected the Plaintiff's arguments regarding the Outside Directors' compensation. The allegations concerning the significant time commitment required of the Outside Directors also do not contribute to an inference that they are somehow controlled by the Officer Directors. The alleged activities may go beyond what is asked of directors of some other corporations, but they do not appear improper or support an inference that the Outside Directors were controlled by the Officer Directors. Indeed, this Court is loath to make a ruling under which a board member's somewhat more active engagement in the management of a corporation's affairs[87] may be seen as casting a shadow over that director's presumed loyalty. Finally, the Plaintiff's allegation that the Outside Directors had "work assigned to them by defendants Simpson, Hutton, and Vennerberg or persons acting under their direction and control"[88] is too vague for the Court to draw an inference of control from it under the heightened pleading standard of Rule 23.1. The Plaintiff did not allege what particular types of work were assigned to the Outside Directors. If this

---

[86] *Nat'l Auto Credit*, 2003 WL 139768, at *10 (internal quotation and citations omitted).
[87] "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." 8 *Del. C.* § 141(a).
[88] *Id.*

work was the type of work normally performed by a director, or if the work was "assigned" as part of a process whereby the directors, in their capacities as directors, divvied up Board work, such "assignments" would not support an inference of control. In short, the Plaintiff did not plead the sort of particularized facts that would allow this Court to draw an inference that these "assignments" are indicative of the Officer Directors' control over the Outside Directors. For the foregoing reasons, this argument fails.

C. *Valid Exercise of Business Judgment*

When a majority of the Board is independent and disinterested under *Aronson*'s first prong, the Plaintiff has a "heavy burden" to satisfy the second prong.[89] The Court begins its analysis presuming that the business judgment rule applies, and the plaintiff must establish facts rebutting this presumption.[90] To do so, she "must plead particularized facts to create a reasonable doubt that either (1) the action was taken honestly and in good faith or (2) the board was adequately informed in making the decision."[91] The Plaintiff contends that *Aronson's* second prong is satisfied because the Board Defendants' decision to not adopt a § 162(m)

---

[89] Wolfe & Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 9.02[b][3], at 9–84 (citing *White v. Panic*, 783 A.2d 543, 551 (Del. 2001)).
[90] *Aronson*, 473 A.2d at 812.
[91] Wolfe & Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 9.02[b][3], at 9–84 (citing *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 286 (Del. Ch. 2003)).

plan was made in bad faith,[92] constituted waste, and was not properly disclosed in the contested proxy statements.

1. Bad Faith

The second prong of *Aronson* may be met by pleading particularized facts that raise a reasonable doubt as to whether the Board's actions were taken in good faith.[93] This Court has stated that the three most salient examples of bad faith are: (1) intentionally acting for a reason other than advancing the best interests of the corporation; (2) acting with the intent of violating applicable positive law; or (3) intentionally failing to act in the face of a known duty to act, demonstrating a conscious disregard of the fiduciary's duties.[94] The Plaintiff argues that the Board Defendants' inaction constitutes bad faith under each of these formulations.

a. *Intentionally Acting for a Reason Other Than Advancing the Best Interests of the Corporation*

The Plaintiff contends that the Board Defendants' decision to not adopt a § 162(m) plan was made to advance the interests of the Officer Defendants,[95] not the best interests of XTO. This decision ran counter to the best interests of XTO,

---

[92] The Plaintiff presented her bad faith arguments in support of the contention that the Complaint stated a claim for relief, but, since a showing that the Board Defendants acted in bad faith could also excuse demand, the Court will consider these arguments in determining whether the Plaintiff met her burden under Rule 23.1.
[93] *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d at 286.
[94] *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 755-56 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).
[95] According to the Plaintiff, the sole basis for the Board's decision to not adopt a § 162(m) plan was "to prevent the compensation of [the Officer Directors] from ever being tied to their actual performance." Br. in Supp. 16.

according to the Plaintiff, because cash bonus compensation paid to XTO's Covered Officers was not awarded on the basis of meeting objective, shareholder-approved performance goals, and it was not tax-deductible. The Plaintiff argues that the Board acted in this manner because the Outside Directors were dominated by the interested Officer Directors and, therefore, were not independent.

This argument is really just a reprise of the Plaintiff's arguments that the Board Defendants breached their duty of loyalty because a majority of the Board was either interested in or not independent with regard to the decision to not adopt a § 162(m) plan. As the Plaintiff stated in her Reply Brief:

> Plaintiff tied her argument that the [B]oard was not working in the best interests of XTO to her allegations that the supposedly "independent" members of the [Board] in fact operated as highly-paid employees of the executives who they compensated . . . [and] that the supposedly "independent" directors' compensation went up tremendously during the time period relevant to this action.[96]

The Court has already addressed the Plaintiff's loyalty arguments and concluded that they do not prevail. The Plaintiff's attempt to recast these arguments as bad faith does not change this conclusion.

---

[96] Reply Br. in Further Supp. of Pl.'s Mot. for Att'ys' Fees & Reimbursement of Expenses ("Reply Br.") 23. In the Plaintiff's Brief in Support, her argument that the Board acted for a reason other than the best interests of XTO largely consisted of a reference to the portion of her brief where she argues that the directors were all either interested or not independent, which further demonstrates that this bad faith argument is really just another formulation of her loyalty arguments. *See* Br. in Supp. 16.

b. *Intentionally Violating Positive Law*

The Plaintiff next contends that the Board Defendants acted in bad faith because they acted with the intent of violating applicable positive law by deciding not to adopt a § 162(m) plan. This Court has recognized that a director acts in bad faith when he acts with the intent of violating applicable positive law.[97] In defining the term "positive law," Black's Law Dictionary states that "[p]ositive law typically consists of enacted law — the codes, statutes, and regulations that are applied and enforced in the courts."[98] But, the Plaintiff does not present a straightforward argument that the Board's decision violated a statutory provision or regulation. Instead, she argues that, when directors intentionally violate public policy, they may be considered to have acted in bad faith.

First, the Plaintiff contends that a violation of public policy is essentially equivalent to a violation of positive law and, therefore, is an act committed in bad faith.[99] In support of this argument, the Plaintiff quotes the definition of "illegal act" from a case decided by the Missouri Court of Appeals.[100] Public policy is defined as the "principles and standards regarded by the legislature or by the courts as being of fundamental concern to the state and the whole of society."[101] A

---

[97] *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d at 755-56.
[98] BLACK'S LAW DICTIONARY (9th ed. 2009).
[99] *See* Br. in Supp 16. *See also* Pl.'s Mot. for Att'ys' Fees & Reimbursement of Expenses Hr'g Tr. ("Hr'g Tr.") 9.
[100] Br. in Supp 16 (quoting *McLeese v. J.C. Nichols Co.*, 842 S.W.2d 115, 118 (Mo. App. 1992)).
[101] BLACK'S LAW DICTIONARY (9th ed. 2009).

comparison of the definitions of "positive law" and "public policy" reveals that these phrases are by no means synonymous. Importantly, "positive law" is a much narrower concept, confined to enacted law, which is a well-defined, discrete set. On the other hand, "public policy" is a broader, more nebulous concept. This Court rejects the Plaintiff's argument that a violation of a general public policy is equivalent to a violation of positive law for purposes of determining bad faith, as these terms are not synonyms nor is public policy a subset of positive law.[102]

Second, the Plaintiff seems to advance an argument that violation of public policy constitutes bad faith, without any reference to positive law being necessary.[103] In support of this argument, she cites three cases, only one of which interpreted Delaware law.[104] In *Desimone v. Barrows*,[105] this Court included the following quotation from a law review article parenthetically in a footnote: "Bad

---

[102] At oral argument, in response to a question posed by the Court, the Plaintiff seemingly circumscribed her argument, recasting it as: a violation of public policy is equivalent to a violation of positive law, *if the violation of public policy is easily avoided without much effort or cost*. *See* Hr'g Tr. 9-12. This limitation on the scope of the Plaintiff's proposed rule does not alter the Court's conclusion.

[103] In the Plaintiff's Brief in Support, she appears to present what the Court refers to as the first and second arguments as one argument. Whether the Plaintiff's theories and case citations are viewed as one argument or two has no effect on the Court's ultimate decision.

[104] In addition to an opinion of this Court discussed below, the Plaintiff cites *Abrams v. Allen*, 297 N.Y. 52 (N.Y. 1947), and *Miller v. American Tel. & Tel. Co.*, 507 F.2d 759 (3d Cir. 1974). These cases were not decided by Delaware courts and did not interpret Delaware law. Furthermore, in *Miller*, the court concluded that the plaintiffs alleged that the director-defendants caused the company to violate federal statutory law and engage in criminal activity, not merely violate public policy. *Miller*, 507 F.2d at 761-63. *Abrams* mentions public policy in one, somewhat offhand sentence. *See Abrams*, 297 N.Y. at 56. Even if the Plaintiff's interpretation of this one sentence is correct, *Abrams* does not persuade the Court to endorse the Plaintiff's public policy argument.

[105] 924 A.2d 908 (Del. Ch. 2007).

faith may preclude application of the business judgment defense where directors knowingly violate a statute or comparable expression of public policy, even if such a violation is undertaken in the corporation's best interests."[106]

Desimone does not support the Plaintiff's broad theory that a violation of general public policy constitutes an action taken in bad faith. *Desimone* involved options backdating. The footnote cited by the Plaintiff comes from the Court's discussion of how backdating options could be a bad faith violation of a director's duty of loyalty, even when the shareholder-approved options plan did not preclude backdating and backdating could, otherwise, be within the realm of business judgment. [107] As the Court explained, backdating options under these circumstances could constitute bad faith if they were not accounted for and reported correctly or were not treated properly for tax purposes.[108] Doing so could constitute bad faith because it could "expose the company to the regulatory consequences and civil and criminal liability that stem from knowingly issuing false earnings reports . . . [or expose the company to] additional taxes and penalties."[109] Therefore, the potential bad faith quality of these actions stemmed from intentional violations of statutory laws and regulations (*i.e.*, positive law), not violations of general public policy.

---

[106] *Id.* at 934 n.89 (quoting S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 129-30 (1979)).
[107] *Id.*
[108] *Id.*
[109] *Id.*

Furthermore, the footnote cited by the Plaintiff included three other quotations from other sources, and all of them referred to violations of positive law or "illegal activities."[110] Finally, the quotation itself does not support the Plaintiff's position. It does not say that violating public policy constitutes bad faith; instead, properly read, it states that violating an *expression* of public policy *comparable to a statute* may constitute bad faith.[111] Such *expressions* of public policy might include regulations and other forms of positive law. Indeed, in the law review article, the sentence following the one quoted makes it clear that the Plaintiff's broad reading is unwarranted. It states: "The [business judgment] defense may prevail where directors' actions motivated by the corporate welfare are not clearly *contrary to law* when taken."[112]

The Plaintiff's argument that a violation of general public policy constitutes a bad faith action fails in this context.

c. *Failure to Act Despite a Duty to Act*

In her third and final bad faith argument, the Plaintiff contends that the Board failed to act despite a duty to do so. The Board's "failure to act" resulted from its affirmative decisions in 2004 through 2008 to not adopt a § 162(m) plan, according to the Plaintiff. She contends that the Board had a duty to adopt a

[110] *Id.* n.89.
[111] *See id.*
[112] Arsht, *supra*, at 130 (emphasis added).

§ 162(m) plan under its purported fiduciary duty to minimize taxes.[113] Because the Court concludes that there is no general fiduciary duty to minimize taxes,[114] this argument fails.

The Plaintiff does not cite any case law of this Court or the Delaware Supreme Court directly supporting[115] the purported fiduciary duty to minimize taxes. Furthermore, the case law cited by the Plaintiff does not support such a broadly applicable duty.[116] For reasons that are both numerous and obvious, this

---

[113] The Plaintiff complains in her Reply Brief that the Defendants mischaracterize the proposed duty in their Answering Brief as one that would force directors to "minimize taxes at all costs." Reply Br. 24 (quotation and citation omitted). The Court does not interpret the Plaintiff's argument as suggesting such an extreme duty.

[114] This is not to say that under certain circumstances overpayment of taxes or a poor tax strategy might not result from breaches of the fiduciary duties of care or loyalty or constitute waste. As explained above, the argument advanced by the Plaintiff and rejected by this Court envisions a broader, more generally applicable fiduciary duty to minimize taxes.

[115] The Plaintiff cites to several authorities from other areas of law in which, purportedly, fiduciaries have a duty to minimize taxes. *See* Br. in Supp. 21-22. These authorities concern areas of law such as trusts and estates and guardianships; they are inapposite.

[116] The Plaintiff claims that, "although there is a paucity of case law on the subject, four courts that have addressed derivative suits regarding corporate overpayment of taxes have held corporate boards have a duty to minimize them." Br. in Supp. 22. The cases the Plaintiff cites, however, do not support a broad duty to minimize taxes. In *Dodge v. Woolsey*, 59 U.S. 331 (U.S. 1855), the United States Supreme Court held that a derivative suit could be maintained against a bank's directors for purported breaches of their fiduciary duties arising from their refusal to challenge a tax paid by the bank that they allegedly admittedly believed was unconstitutional and, therefore, the payment of which was a violation of the bank's charter, which was also allegedly admitted by the directors. *See id.* Thus, the key issue was that the directors allegedly caused the bank to violate its charter. In *Truncale v. Universal Pictures Co.*, 76 F. Supp. 465 (S.D.N.Y. 1948), the plaintiff alleged that some of the directors and officers of Universal Pictures Company breached their fiduciary duties by directing the company to forgo a tax deduction related to options issued to an employee, so that the employee would not have to pay federal income taxes on the options. *See id.* But, the court in *Truncale* did not hold that there was a duty to minimize taxes. Instead, on a motion for summary judgment where the defendants argued that the claims were time-barred by the statute of limitations, the defendants conceded for purposes of the motion that there was a good cause of action. *Id.* at 469. In *Resnick v. Woertz*, 774 F. Supp.2d 614 (D. Del. 2011), the Board of Archer-Daniels-Midland

Court is not convinced that it should endorse this proposed new duty. Tax strategy is a complex, dynamic area of corporate decision-making that affects and is affected by many other aspects of a company. A company's tax policy may be implicated in nearly every decision it makes, including decisions about its capital structure, the legal forms of the various entities that comprise the company, which jurisdictions to form these entities in, when to purchase capital goods, whether to rent or purchase real property, where to locate its operations, and so on. Minimizing taxes can also require large expenditures for legal and accounting services and may entail some level of legal risk. As such, decisions regarding a company's tax policy are not well-suited to after-the-fact review by courts and

---

Company distributed a proxy statement that solicited votes for an incentive compensation plan that purported to comply with the requirements of § 162(m) and required a majority vote of the shareholders for approval. *See id.* According to the plaintiff in that action, the proxy statement contained material misrepresentations and omissions regarding the plan, and the plan did not comply with § 162(m), which could have resulted in millions of dollars in additional tax liability. *See id.* With little discussion, the court in *Resnick* concluded that the plaintiff's fiduciary duty claims survived a motion to dismiss. *Id.* at 632-33. The court's conclusion appears to have been based upon the fact that the proxy statement used to solicit shareholder votes in favor of the plan stated that the plan complied with § 162(m), that the proxy statement allegedly contained material misstatements and omissions, and the proxy statement allegedly violated federal securities regulations. *Id.* Thus, the breach of fiduciary duty claims were rooted in alleged violations of the board's duty of disclosure and alleged violations of positive law (federal securities regulations), and not a broad duty to minimize taxes. Notably, as recognized by the Plaintiff in her Complaint, the contested proxy statements did not solicit votes for a § 162(m) plan for the cash bonuses, did not state that cash bonuses were paid under a § 162(m) plan, and, in fact, did state that compensation exceeding the maximum deductible amount was paid to the Covered Officers. *See* Compl. ¶ 7 (quoting the contested proxy statements). Finally, in *Spirt v. Bechtel*, 232 F.2d 241 (2d Cir. 1956), the plaintiff brought fiduciary duty claims against a company's directors for allegedly relinquishing a tax deduction. *See id.* at 245-46. The lower court's grant of a motion to dismiss this claim was affirmed. *Id.* at 247-48. The court's statement that "[a]s directors the defendants did owe the corporation fiduciary duties not to waste or give away its assets" recognizes, perhaps, that a company's tax strategy may form the basis of a waste claim, but it does not establish a fiduciary duty to minimize taxes. *Id.* at 246.

typify an area of corporate decision-making best left to management's business judgment, so long as it is exercised in an appropriate fashion.[117] This Court rejects the notion that there is a broadly applicable fiduciary duty to minimize taxes, and, therefore, the Plaintiff's argument that the Board failed to act despite a duty to minimize taxes is unavailing.

2. Waste

A properly pled waste claim may excuse demand may under *Aronson's* second prong.

> To excuse demand on the grounds of waste, the complaint must allege particularized facts sufficient to create a reasonable doubt that the board authorized action on the corporation's behalf on terms that no person of ordinary, sound business judgment could conclude represents a fair exchange. "That extreme test is rarely satisfied, because if a reasonable person could conclude the board's action made business sense, the inquiry ends and the complaint will be dismissed."[118]

Waste entails "an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade," and it is often associated with a transfer of assets that serves no corporate purpose or for which no consideration at all is received,

[117] One of the key rationales underlying the business judgment rule is that it "keeps courts from becoming enmeshed in complex corporate decision-making, a task which courts admittedly are ill-equipped, ill-fitted and neither trained nor competent to perform. Directors are, in most cases, more qualified to make business decisions than are judges." 1 Stephen A. Radin, *The Business Judgment Rule* 35 (6th ed. 2009) (internal quotations and citations omitted).
[118] *Highland Legacy Ltd. v. Singer*, 2006 WL 741939, at *7 (Del. Ch. Mar. 17, 2006) (citing *Brehm*, 746 A.2d at 263) (quoting *Green v. Phillips,* 1996 WL 342093, at *5 (Del. Ch. June 19, 1996)).

essentially a gift.[119] "Courts are ill-fitted to attempt to weigh the adequacy of consideration under the waste standard or, *ex post*, to judge the appropriate degrees of business risk."[120]

The Plaintiff's waste claim is somewhat unusual for an executive compensation-related waste claim. She does not argue that the amount of the cash bonuses paid to the Covered Officers constituted waste, but, rather, she challenges the way in which those bonuses were structured, which she contends was "irrational" and resulted in "tens of millions of dollars" in unnecessary costs to XTO.[121] In fact, the Plaintiff expressly disclaimed any argument that the Board acted "irrational[ly] or disloyal[ly] when it paid [the Covered Officers] $182 million in cash bonuses from 2004-2008,"[122] and she repeatedly extols Simpson's stature as one of America's most admired CEOs.[123]

In short, the Plaintiff contends that by not adopting a § 162(m) plan for cash bonuses and, therefore, not receiving a tax deduction for those bonuses, the Board caused XTO, effectively, to make a gift to the federal government in the amount of the additional taxes paid due to the forgone tax deductions. Crucially, the Plaintiff

---

[119] *Brehm,* 746 A.2d at 263.
[120] *Id.*
[121] Br. in Supp. 29.
[122] Reply Br. 25. *See also* Hr'g Tr. 13 ("[T]here's no objection to the amount of money that the [B]oard was paying these people. . . . We're not questioning the amount they paid the employee."); *id.* at 15 ("Again, Bob Simpson was probably worth the $30 million bonuses they paid him.")
[123] *See* Compl. ¶ 5; Hr'g Tr. 4.

contends that XTO could both have adopted a § 162(m) plan and have adopted a separate discretionary plan that would have given the Board (or the compensation committee) complete flexibility to pay any amount of additional non-tax-deductible bonuses, without these bonuses being tied to pre-established performance goals. In the words of the Plaintiff:

> A § 162(m) plan need not constrain anything. . . . In those years when executive compensation could be legitimately tied to performance, XTO could deduct for these bonuses. When the compensation committee wished to grant more than the year's performance would allow, they could freely do so and forego the deductions.[124]

According to the Plaintiff: "The IRS has explicitly permitted this kind of discretion[.] . . . [It] has told corporations that they can have their cake and eat it to [sic]."[125] Thus, under the Plaintiff's proposed interpretation of § 162(m), when a Covered Officer's bonus cannot be "legitimately" tied to the shareholder-approved § 162(m) plan performance goals, the corporation may simply substitute a non-deductible bonus.[126]

---

[124] Br. in Supp. 30.
[125] Reply Br. 27.
[126] While the Court's ruling on the Plaintiff's waste claim does not turn on the correctness of this proposed tax strategy, there is reason to question whether it would comply with § 162(m) and the related regulations. *See* note 161 *infra*. Additionally, the Plaintiff's argument that the Board committed waste because, essentially, she is aware of a superior tax strategy raises policy concerns. If this Court were to accept that this theory alone, in its general form, enables a claim to survive a motion to dismiss, it could open the door to a deluge of cases where shareholders challenge the tax strategies of corporations. Given the complexity of tax law, presumably many corporations would be vulnerable to an action whereby a plaintiff hires a tax expert to find an arguably superior tax strategy not employed by the company. Such a result would not be in the best interests of corporations, shareholders, or this Court, a core competency of which is not interpreting tax law. The Plaintiff argued that § 162(m) plans are commonly employed and

In the Plaintiff's view, the Board's stated reason for not adopting a § 162(m) plan was that it did not want to be "constrained" in its decision-making regarding cash bonuses.[127] Leaving aside the Plaintiff's argument that a § 162(m) plan would not constrain the Board's discretion at all, if the Board held a good faith belief that adopting a § 162(m) plan would constrain its decision-making, nothing the Plaintiff has alleged raises a reasonable doubt that its decision to not adopt a § 162(m) plan was one that a reasonable person could conclude made business sense.[128] The Plaintiff does not challenge the amount of compensation paid to the

---

would likely argue that this is an extreme case of not employing a well-known tax strategy. Even accepting this limitation would leave this Court with a difficult line-drawing problem, which, again, would largely concern issues (determining the prevalence of certain tax strategies) far removed from its traditional expertise. The Plaintiff, herself, lends credence to this Court's concern regarding the potential ramifications of endorsing her superior tax strategy argument. While arguing in favor of her proposed fee, the Plaintiff states that "approval of the fee demanded here may well set a new trend in corporate compliance by inspiring similar shareholder derivative cases based on § 162(m)." Br. in Supp. 44. As the Court observed before, this is not to say that a company's tax strategy cannot implicate breaches of fiduciary duty and waste, but merely that the traditional tests applied to such claims should be adhered to when tax-related claims are presented and that waste *per se* is not pled by the Plaintiff's pleading that she is aware of a superior tax strategy.

[127] Compl. ¶ 5.

[128] For this same reason, the Plaintiff's conclusory, not-well-developed argument that "no reasonable director would reject millions of dollars in order to prevent the [B]oard from ever tying executive compensation to performance" also fails. Br. in Supp. 31. This argument has at least two other flaws. First, it presumes that the Board acted in the personal interests of the Officer Directors. *See id.* at 30. But, this Court has already considered and rejected the Plaintiff's loyalty arguments and concluded that the Plaintiff has not successfully challenged the Outside Directors' presumed loyalty. Second, another basic premise of this argument is that the Board did not want to adopt a § 162(m) plan because it wanted to prevent "tying executive compensation to performance." Although cash bonuses were not tied to performance measures embodied in a § 162(m) plan, beyond a conclusory allegation, the Plaintiff did not provide any factual allegations to support an inference that cash bonuses were not tied to performance at all. To be clear, the Court is not concluding that cash bonuses were tied to performance. It is merely saying that the Plaintiff did not allege particularized facts necessary to support a basic premise of her argument.

Covered Officers. At least with regard to Simpson, she concedes that he "was probably worth the $30 million bonuses they paid him."[129] She also acknowledges that Simpson was one of the most admired CEOs in America.[130] Therefore, the decision to not adopt a § 162(m) plan could fall within the Board's business judgment, if it believed that it needed to retain the flexibility to pay the Covered Executives whatever reasonable amount was required to retain their services. The lost tax deductions, in essence, would then be just another component of compensation expense,[131] essentially an amount paid so that the Board would not be "constrained" by outside factors when making compensation decisions regarding XTO's key employees. The Plaintiff's primary waste argument is not that the total cost of the Covered Officers' compensation, including forgone tax deductions, constituted waste, but that XTO gave a gift to the federal government for which it received no consideration. As recognized in the Complaint,[132] the Board believed that it received consideration for forgoing the tax deductions, namely, the flexibility to set executive compensation without any constraints imposed by a § 162(m) plan.

---

[129] Hr'g Tr. 15.
[130] *See* Compl. ¶ 5; Hr'g Tr. 4.
[131] This component of compensation expense would have been somewhat unusual in that, while it was an expense to the company, a reciprocal benefit was not *directly* realized by the Covered Officers. Instead, XTO and the Covered Officers benefited from this expense because the Board was free to pay the amount of compensation it believed was necessary to reward or to retain key employees, without risk of running afoul of the tax laws and regulations.
[132] Compl. ¶ 7 (quoting the contested proxy statements).

When viewed in this light, the Board's decision falls within the line of cases dismissing executive compensation-related waste claims and concluding that "the size and structure of executive compensation are inherently matters of judgment."[133] Indeed, "in the absence of fraud, this Court's deference to directors' business judgment is particularly broad in matters of executive compensation."[134] Furthermore, "where, as here, there is no reasonable doubt as to the disinterest of or absence of fraud by the Board, mere disagreement [regarding executive compensation] cannot serve as grounds for imposing liability based on alleged . . . waste."[135]

For example, in *Brehm*, the Supreme Court agreed with this Court's dismissal[136] of waste claims related to the size and structure of executive compensation where this Court inferred, from a reading of the complaint, that the Board had determined that an expensive compensation package was necessary to attract an executive, who, they believed, would be valuable to the company.[137] Leaving aside the Plaintiff's contention that the Board could have had the same flexibility while utilizing a § 162(m) plan, the exact same inferences may be drawn

---

[133] *Brehm*, 746 A.2d at 263.
[134] *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342, 362 (Del. Ch. 1998), *aff'd in part, rev'd in part and remanded sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).
[135] *Brehm*, 746 A.2d at 266 (quoting *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d at 364).
[136] The Supreme Court did hold, contrary to this Court's ruling, that dismissal of the waste claims was without prejudice because it was possible that "a properly framed complaint could pass muster." *Id.* at 263.
[137] *Id.*

from the Plaintiff's Complaint in this case, as explained above. In *Haber v. Bell*,[138] this Court dismissed a waste claim related to the taxation of executive compensation.[139] In *Haber*, the Board altered a stock option plan so that tax deductions formerly received by the company were instead received by the optionees.[140] This Court concluded that the forgone tax deductions were part of the optionees' compensation, and, therefore, the decision to change the tax status of the options fell within the discretion of the Board, as it related to employee compensation.[141] Again, as explained above, the forgone tax deductions, here, may also be viewed as employee compensation expense.

Under this analysis, the crucial question is whether the Complaint has alleged particularized facts sufficient to create a reasonable doubt that the Board, in good faith, believed that implementing a § 162(m) plan would constrain its discretion with regard to cash bonuses.[142] If the Board, in good faith, believed that implementing a § 162(m) plan would constrain its discretion with regard to cash bonuses, then XTO received some substantial consideration (the absence of these

---

[138] 465 A.2d 353 (Del. Ch. 1983).
[139] *Id.*
[140] *Id.* at 356-59.
[141] *Id.* at 359.
[142] "If, however, there is *any substantial* consideration received by the corporation, and if there is a *good faith judgment* that in the circumstances the transaction was worthwhile, there should be no finding of waste, even if the fact finder would conclude *ex post* that the transaction was unreasonably risky." *Brehm*, 746 A.2d at 263 (emphases in original). In this case, flexibility to pay cash bonuses without the constraints imposed by a § 162(m) plan is substantial consideration, assuming that the Board made a good faith judgment that a § 162(m) plan would, indeed, impose constraints on its discretion.

constraints and the ability to pay the Covered Officers as the Board deemed appropriate to retain them) in exchange for forgoing tax deductions related to these bonuses, and this waste claim would not have survived a motion to dismiss. On the other hand, if a § 162(m) plan could have been implemented at little cost and without constraining the Board, and the Board knew this or came to the contrary conclusion in bad faith, then the forgone deductions may have constituted waste. Although the Plaintiff calls the Board's constraint explanation "false"[143] and "disingenuous,"[144] and she quibbles with a statement made in the contested proxy statements regarding the "standards" § 162(m) would require (or not require) XTO to use,[145] she never directly challenges the good faith nature of the Board's judgment that adopting a § 162(m) plan would constrain it. There are no particularized factual allegations in the Complaint from which this Court could reasonably infer that the Board reached its conclusion regarding the constraints of § 162(m) in bad faith. Furthermore, this Court has already addressed and rejected the Plaintiff's more general arguments regarding bad faith.

The Plaintiff argues repeatedly that a § 162(m) plan need not constrain the Board, but, unless the Board reached its contrary conclusion in bad faith, the fact that the Plaintiff has identified a better tax strategy implicates, at best, a breach of

---

[143] Br. in Supp. 30.

[144] *Id.*

[145] *See* Reply Br. 27-28. Notably, the Plaintiff stated that the Board "appear[ed] *confused* by what § 162(m) does require." *Id.* (emphasis added). She did not argue that the Board Defendants truly believed otherwise or came to the relevant conclusion in bad faith.

the duty of care. The Plaintiff did not advance any arguments alleging a breach of the duty of care.[146] The Court concludes that it cannot infer that there was a breach of the duty of care from the particularized factual allegations of the Complaint.[147]

The Plaintiff presents two other arguments in support of its waste claim. First, the Plaintiff invites the Court to follow *Resnick v. Woertz*,[148] as she interprets that case. In *Resnick*, the United States District Court for the District of Delaware, interpreting Delaware law, concluded that a waste claim survived a motion to dismiss.[149] The Plaintiff describes that waste claim as being based upon Archer-Daniels-Midland Company's alleged adoption of a § 162(m) plan that did not comply with the statute, thereby forgoing tax deductions. The court in *Resnick* did mention alleged "substantial and avoidable tax liability" when summarizing the waste allegations, but it also focused on allegations of potentially excessive compensation and the fact that the proxy statements used to solicit shareholder approval of the faulty § 162(m) plan contained material misstatements.[150] The compensation plan at issue in *Resnick* provided for incentive compensation

[146] At oral argument, after the Court asked whether the Plaintiff was not really presenting a duty of care claim, the Plaintiff responded that a defense to such a claim based on an 8 *Del. C.* 102(b)(7) charter provision would fail, as the Complaint sought injunctive relief. Hr'g Tr. 12. The Plaintiff also seemed to suggest that a breach of the duty of care could satisfy the second prong of *Aronson*. *Id.* The Plaintiff did not present an argument that there had been a breach of the duty of care.

[147] The relevant factual allegations, to the extent there are any, suggest that the Board understood the applicable tax law, which, in turn, suggests that the Board exercised at least some level of care in crafting its executive compensation tax strategy. *See* Compl. ¶¶ 6-7.

[148] 774 F. Supp.2d 614 (D. Del. 2011).

[149] *Id.*

[150] *Id.* at 633.

payments of up to $90,250,000 per board member, and the aggregate payments to the board members and executive officers could have potentially reached $1,263,500,000—equivalent to 74% of the previous year's net earnings—for one fiscal year.[151] Not only are the potential lost tax deductions of a completely different magnitude in *Resnick*, but the compensation plan at issue there also introduced elements of excessive compensation, director interestedness, and a lack of candor not present in the instant case. For the foregoing reasons, *Resnick* is distinguishable on its facts.

Second, citing *Telxon Corp. v. Bogomolny*,[152] the Plaintiff contends that, if this Court deems an action of the Board to be "unusual," a waste claim can survive a motion to dismiss. Although the Court in *Telxon* mentioned the unusual nature of the challenged transaction as a reason why the waste claim survived a motion to dismiss, the standard applied by the Court was the normal waste standard, not a separate "unusualness" standard.[153] This Court has already addressed the Board's decision to not adopt a § 162(m) plan under the normal waste standard and rejects the Plaintiff's invitation to apply an "unusualness" standard.

For the foregoing reasons, the Court concludes that the Plaintiff failed to plead a waste claim that would have survived a motion to dismiss.

---

[151] *Id.* at 624, 633.
[152] 792 A.2d 964 (Del. Ch. 2001).
[153] *See id.* at 976.

3. Material Misstatements and Omissions

Finally, the Plaintiff argues that demand was futile because the contested proxy statements contained material misstatements and omissions concerning executive compensation and § 162(m). The Plaintiff claims that disclosure claims are not subject to the demand requirement because the business judgment rule does not apply to the question of whether shareholders have been provided with appropriate information to make a decision.[154] Under the Plaintiff's theory, if she has properly pled a disclosure claim, then demand is excused.[155]

---

[154] *See In re Tri-Star Pictures, Inc. Litig.*, 1990 WL 82734, at *8-9 (Del. Ch. June 14, 1990). *See also Lewis v. Leaseway Transp. Corp.*, 1990 WL 67383, at *6 (Del. Ch. 1990) (stating that the "the business judgment rule has no applicability to the question whether shareholders have been provided with appropriate information to make an informed choice because the underlying duty (candor) does not concern the management of business and the affairs of the corporation"). The Plaintiff does not address the fact that the Court in *Tri-Star* did not hold that the disclosure claims were derivative claims for which demand was excused, but, instead, it held that the disclosure claims were direct claims of the class, since applying the demand requirement of Rule 23.1 would be improper where the business judgment rule was inapplicable. *Tri-Star*, 1990 WL 82734, at *8. Indeed, disclosure claims are generally direct claims of the corporation's shareholders. *See In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 772 (Del. 2006); *Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC*, 2006 WL 4762843 n.41 (Del. Ch. Mar. 28, 2006); *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607 (Del. Ch. Aug. 26, 2005); *Tri-Star*, 1990 WL 82734, at *8. Here the Plaintiff brought her action derivatively, and there might be some question as to whether her disclosure claims are actually direct claims. The Defendants do not challenge her disclosure claims on this ground, though; thus, the Court need not consider whether the disclosure claims should have been brought as direct claims and what impact that conclusion would have on her demand excusal argument.

[155] The Plaintiff's theory of demand excusal, as it relates to the disclosure claims, is not entirely clear. The Plaintiff argues that *Aronson's* second prong is satisfied because there were material misstatements or omissions in the contested proxy statements, and that "Delaware has established that proxy disclosure violations *excuse* demand" because the business judgment rule is inapplicable. Br. in Supp. 33 (emphasis added) (citing *Tri-Star*, 1990 WL 82734, at *8). The primary case cited by the Plaintiff in support of this argument that disclosure violations *excuse* demand is *Tri-Star*, which actually held that Rule 23.1 was not applicable to the disclosure claims at issue because those claims were direct class claims. *Tri-Star*, 1990 WL 82734, at *8. As such, the Plaintiff appears to conflate the fact that disclosure claims are generally *not subject*

When soliciting shareholder action, the fiduciary duties of care and loyalty require that the directors of a Delaware corporation:

> "disclose fully and fairly all material information within the board's control . . . ." The burden of establishing materiality rests with the plaintiff, who must demonstrate "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[156]

Non-material facts need not be disclosed, although the Board has "an obligation to provide the stockholders with an accurate, full, and fair characterization" of any facts relating to a matter that has been partially disclosed.[157]

The Plaintiff contends that the Board committed three disclosure violations related to XTO's disclosures regarding executive compensation and § 162(m) in

---

to the demand requirement (because they are usually direct claims) with the idea that a properly pled disclosure claim *excuses* demand under *Aronson's* second prong. Furthermore, in the Complaint and in her briefs, the Plaintiff only speaks of disclosure violations in terms of excusing demand; she has not argued that any of the underlying claims for which she sought relief in the Complaint were disclosure claims, but merely that a disclosure violation would excuse demand. *See* Compl. ¶ 20; Br. in Supp. 33-35; Reply Br. 29-30. For ease of reference, the Court will refer to the Plaintiff's allegations of material misstatements and omissions as "disclosure claims." Regardless, the Defendants do not challenge the premise of the Plaintiff's argument that if she properly pled a disclosure claim, then demand would be excused. As such, the Court need not consider whether the Plaintiff's argument is correct. Since there is some uncertainty as to whether the Plaintiff's disclosure claims should have been pled as direct or derivative claims, and, as a result, whether Rule 23.1's pleading requirements are even applicable, the Court will assess these claims under the well-known, more plaintiff-friendly Court of Chancery Rule 12(b)(6) standard. *See Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 535-36 (Del. 2011). Use of this more lenient standard does not alter the Court's ultimate conclusion that the disclosure claims would not have survived a motion to dismiss. In sum, the Court will apply the Rule 12(b)(6) standard when assessing the viability of the disclosure claims, but, for purposes of this motion, will accept the Plaintiff's argument that a properly pled disclosure claim would "excuse demand."

[156] *Gantler v. Stephens*, 965 A.2d 695, 710 (Del. 2009) (quoting *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992)).

[157] *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1280 (Del. 1994).

the contested proxy statements. Two alleged material misstatements relate to the following sentence, which was included in each of the contested proxy statements either verbatim or with minor variations to the quoted sentence:

> While the Committee intends to monitor compensation paid to the Company's executive officers in light of the provisions of Section 162(m), the Committee does not believe that compensation decisions should be constrained necessarily by how much compensation is deductible for federal income tax purposes, and the Committee is not limited to paying compensation under plans that are exempt under Section 162(m).[158]

First, the Plaintiff takes issue with the statement that compensation decisions would be "constrained" by a § 162(m) plan. This argument relates to the Plaintiff's contention, discussed above in the Court's assessment of the waste claim, that implementing a § 162(m) plan would not "constrain" the Board's compensation decisions at all. The Plaintiff apparently wants this disclosure claim to turn on an interpretation of tax law. She contends that she knows of a strategy XTO could have employed in order to "have [its] cake and eat it to [sic]."[159] Understood in simple, straight-forward terms, the constraint statement is undoubtedly true: if XTO had replaced the existing cash bonus plan with a § 162(m) plan, its compensation decisions would have been constrained by the § 162(m) plan, which would have only allowed compensation to be paid under

---

[158] 2008 Proxy at 26 (with minor variations); 2007 Proxy at 23 (with minor variations); 2006 Proxy at 13 (verbatim); 2005 Proxy at 12 (verbatim); 2004 Proxy at 11 (with minor variations).
[159] Reply Br. 27.

certain circumstances.[160] Also, the Plaintiff has presented no factual allegations from which the Court could infer that the Board did not believe that a § 162(m) plan would constrain its compensation decisions. Under these circumstances, the Court cannot conclude that the Plaintiff stated a viable disclosure claim by contending that she has concocted a superior tax strategy.[161]

---

[160] *See* 26 U.S.C. § 162(m)(4)(C) (2011).

[161] This is particularly true where, as here, the effectiveness of the tax strategy proposed by the Plaintiff may be debated. Although this Court's conclusion that this disclosure claim fails does not turn on the validity of the Plaintiff's proposed tax strategy, it appears suspect. The Plaintiff seems to suggest that the Board could have adopted a § 162(m) plan, paid bonuses under that plan whenever possible, and, if the performance goals were ever not met, simply replaced the bonuses that would otherwise be payable under the § 162(m) plan with non-deductible bonuses paid under a discretionary bonus plan. Although "a discretionary bonus, payable whether or not a performance-based bonus is earned, should not cause the performance-based bonus to fail to qualify for the Section 162(m) exemption[,] [c]are should be taken, however, to make sure that the two arrangements are independent of one another and that the *discretionary bonus cannot be considered to be a substitute for performance-based compensation that is not earned*." P. GARTH GARTRELL & STEVEN B. LAPIDUS, EXECUTIVE COMPENSATION FOR EMERGING GROWTH COMPANIES § 2:82 (3d ed. 2011) (emphasis added). A company that creates a § 162(m) plan but intends to pay a substitute bonus whenever the terms of the § 162(m) plan are not met apparently incurs some risk of undermining the tax-deductibility of compensation paid under the § 162(m) plan, even when its terms are met. *See* Rev. Rul. 2008-13, 2008-10 I.R.B. 518, 2008 WL 451876 ("[I]f the facts and circumstances indicate that the employee would receive all or part of the compensation regardless of whether the performance goal is attained . . . none of the compensation payable under the grant or award will be considered performance-based." Compensation not considered performance-based is not deductible under § 162(m)(4)(C), the exception to the $1 million deductibility limit at the heart of a § 162(m) plan.). In fact, the Private Letter Ruling that the Plaintiff contends supports her position only states that having a discretionary bonus plan does not automatically render § 162(m) plan bonuses taxable, but it recites the language from Revenue Ruling 2008-13 quoted above and states that it is a question of fact whether specific discretionary bonuses would render § 162(m) plan bonuses taxable. *See* I.R.S. Priv. Ltr. Rul. 06-17-018, 2006 WL 1126274 (Jan. 18, 2006). The Plaintiff relies on this Private Letter Ruling to support her argument that, with a § 162(m) plan, XTO would be completely unconstrained, even when it could not "legitimately" pay bonuses under the §162(m) plan. *See* Reply Br. 27. Furthermore, that very same Private Letter Ruling was cited by the tax treatise cited above for the proposition that a company should take care *not* to use discretionary bonuses as substitutes for unearned § 162(m) plan bonuses. GARTRELL & LAPIDUS, EXECUTIVE COMPENSATION FOR EMERGING GROWTH COMPANIES § 2:82 n.6.

Second, the Plaintiff contends that the Board's claim that it intended "to monitor compensation paid to the Company's executive officers in light of the provisions of Section 162(m)" [162] was a material misstatement because "that suggest[ed] that the [B]oard had in place a § 162(m) plan, which it could use at any time to deduct amounts tied to compensation. . . . [T]he [B]oard could not truly monitor compensation without a § 162(m) plan already in place."[163] In the context of the contested proxy statements, a reasonable investor would not interpret this statement as the Plaintiff contends. In the contested proxy statements, immediately before the sentence quoted above, XTO explained the tax-deductibility limitations imposed by § 162(m) and that stock options issued under the company's stock option plans qualified as performance-based compensation under § 162(m) and, therefore, did not count against the $1 million limit.[164] Then, immediately following the quoted sentence, XTO explained that compensation paid to executives subject to § 162(m) exceeded the maximum deductible amount.[165] Simply put, in the context described above, a reasonable investor would not interpret XTO's statement that the compensation committee was "monitoring" executive compensation in light of § 162(m) to imply that there was already a

[162] 2008 Proxy at 26 (stating that the Board "monitors," instead of "intends to monitor"); 2007 Proxy at 23 (verbatim); 2006 Proxy at 13 (verbatim); 2005 Proxy at 12 (verbatim); 2004 Proxy at 11 (verbatim).
[163] Br. in Supp. 34.
[164] 2008 Proxy at 26; 2007 Proxy at 23; 2006 Proxy at 13; 2005 Proxy at 12; 2004 Proxy at 11.
[165] 2008 Proxy at 26; 2007 Proxy at 23; 2006 Proxy at 13; 2005 Proxy at 12; 2004 Proxy at 11.

§ 162(m) plan in place for cash bonuses. A reasonable shareholder would not need to "correctly read between the lines"[166] to understand that the "monitoring" statement did not imply that there was a § 162(m) plan in place for cash bonuses. On the contrary, to reach this conclusion, a shareholder would need to read more into the challenged statement than a reasonable shareholder normally would, given the context in which the statement was made.

Third and finally, the Plaintiff argues that the failure to quantify the amount of the potential tax deduction eschewed each year as a result of not paying cash bonuses under a § 162(m) plan was a material omission. This is nothing more than an example of the "tell me more" variety of disclosure claims. The Plaintiff has the burden of establishing that an omission is material, meaning that a reasonable investor would have viewed the information as having significantly altered the "total mix" of information made available. In the contested proxies, XTO disclosed: (1) the $1 million limitation on the tax-deductibility of executive compensation for the Covered Officers, unless such compensation is paid under a qualified plan; (2) that the stock option plan was a qualified plan and option awards did not count towards the $1 million limit; (3) that the compensation committee did not want its compensation decisions to be constrained by limits on its tax-deductibility; (4) that XTO paid executive compensation exceeding the

---

[166] Reply Br. 30 (quoting *O'Malley v. Boris*, 742 A.2d 845, 851 (Del. 1999)).

maximum deductible amount; and (5) a table of the salary, cash bonus, and option and equity awards earned by the officers subject to § 162(m) over the preceding three years.[167] Given this information, the magnitude of the forgone tax deductions is readily apparent.[168] A challenged omission must be material, not just merely helpful.[169] Thus, the Plaintiff has not carried her burden of pleading factual allegations from which the Court can conclude that the omission of a more precise calculation of the forgone tax deduction would be considered material by a reasonable shareholder.

V. CONCLUSION

As set forth above, because the Complaint would not have survived a motion to dismiss, the Plaintiff's motion for an award of attorneys' fees and expenses is denied. An Order will be entered in accordance with this Memorandum Opinion.

---

[167] 2008 Proxy at 26, 27; 2007 Proxy at 23, 24; 2006 Proxy at 13, 16; 2005 Proxy at 12, 15; 2004 Proxy at 11, 14.

[168] A reasonable shareholder can be expected to have a reasonable idea of what the corporation's maximum tax rate could be.

[169] *Gaines v. Narachi*, 2011 WL 4822551, at *2 n.13 (Del. Ch. Oct. 6, 2011).