Unreported Cases

INTRODUCTION

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IN RE THE DOW CHEMICAL COMPANY DERIVATIVE LITIGATION

No. 4349-CC

Court of Chancery of the State of Delaware, New Castle

January 11, 2010

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CHANDLER, *Vice Chancellor*

This is a shareholder derivative action brought on behalf of the Dow Chemical Company ("Dow" or the "Company"), seeking to recover for the Company its losses arising from the difficulties with the Rohm & Haas Company ("R&H") transaction. Plaintiffs, stockholders of Dow, brought this action against current directors and officers of the Company, alleging that the defendants breached their fiduciary duties to the company by (1) approving the R&H transaction, (2) misrepresenting the relationship between the R&H transaction and a joint venture with a Kuwaiti company, and (3) failing to detect and prevent a variety of alleged wrongs, including bribery, misrepresentation, insider trading, and wasteful compensation.

Pending before the Court is defendants' motion to dismiss the complaint for failure to properly plead demand futility under Chancery Court Rule 23.1.[1] For the reasons set forth below, the motion to dismiss is granted

[1]Plaintiffs argue that the broader pleading requirements of Rule 12(b)(6) should govern the majority of the claims, but all claims are derivative; there are no direct claims. *See* Compl. ¶ 119. Defendants correctly note, however, that demand futility under Rule 23.1 is "logically the first issue [for all derivative claims] and if plaintiffs cannot succeed under the heightened pleading requirements of Rule 23.1 . . . there is no need to proceed to an analysis of the merits of the claim" under Rule 12(b)(6). Defs.' Reply Br. at 3, n.4; *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 139 (Del. Ch. 2009) (citing *McPadden v. Sidhu*, No. 3310-CC, 2008 WL 4017052, at *7

as to all claims. Pursuant to Chancery Court Rule 15(aaa), the primary breach of fiduciary duties claims are dismissed with prejudice as to the named plaintiffs, and all remaining claims—insider trading, waste, and contribution and indemnification—are dismissed without prejudice.[2]

I. BACKGROUND

A. The Parties

Dow is a large, historically lucrative American chemical company. For years, Dow focused on the commodities side of the chemical business. More recently the Company decided to embark on a "transformative strategy" by diversifying into the specialty chemicals business. Dow is a corporation organized and existing under the laws of Delaware; its principal place of business is Midland, Michigan.

Defendants in this action are current directors and officers of Dow. The complaint names twelve directors as of February 9, 2009, the date the first of the now-consolidated actions was filed. Dow's board of directors consists of Andrew N. Liveris, Geoffry E. Merszei, Arnold A. Allemang,[3] Jacqueline K. Barton, James A. Bell, Jeff M. Fettig, Barbara Hackman Franklin, John B. Hess, Dennis H. Reilley, James M. Ringler, Ruth G. Shaw, and Paul G. Stern (collectively, the "director defendants"). Liveris and Merszei are also current officers of the Company. Liveris serves many roles as the President, Chief Executive Officer, Chairman of the Board, and de facto Chief Operating Officer; Merszei is Dow's Chief Financial Officer.

(Del. Ch. Aug. 29, 2008) ("The standard for pleading demand futility under Rule 23.1 is more stringent than the standard under Rule 12(b)(6), and 'a complaint that survives a motion to dismiss pursuant to Rule 23.1 will also survive a 12(b)(6) motion to dismiss, assuming that it otherwise contains sufficient facts to state a cognizable claim.'")). Therefore, the Court begins its analysis of the derivative claims under Rule 23.1, and does not continue to Rule 12(b)(6) for the individual defendants because plaintiffs fail to adequately plead demand futility as to the entire derivative complaint.

[2]Ch. Ct. R. 15(aaa). With regard to plaintiffs' primary breach of fiduciary duty claims, I find no good cause to depart from the default pleading rule of Rule 15(aaa) which dictates dismissal with prejudice when a defendant succeeds on a motion to dismiss for failure to plead demand futility. I do find good cause, however, to dismiss all insider trading and waste claims without prejudice because plaintiffs voluntarily abandoned these claims. *See* discussion *infra* Part II.B.I. Good cause also exists to dismiss the contribution and indemnification claims without prejudice because those claims are unripe. *See* discussion *infra* Part II.C. Additionally, plaintiffs' request to replead in the event I grant defendants' motion to dismiss—in clear contravention of Rule 15(aaa)—is also denied. A plaintiff must amend his complaint before standing on it in opposition to a motion to dismiss.

[3]The complaint is unclear as to whether Allemang also held an executive or employee position at Dow during the relevant time period of this litigation. *Compare* Compl. ¶ 28 ("Allemang was an officer or employee of Dow for 43 years"), *with id.* at ¶ 125(c) ("Allemang [is a] high-level, highly-compensated executive officer[]"). In any event, defendants concede that Allemang "does not qualify as 'independent' under the standards Dow has adopted because of his former service as a Dow officer." Defs.' Supp. Br. at 9, n.9. Whether Allemang was only a director during the Rohm & Haas deliberations or was also an officer or employee does not affect my analysis.

The complaint also names three officers, alleged to have committed insider trading under Count I. The three officers are: Michael Gambrell, William Banholzer, and David E. Kepler.

Plaintiffs Michael D. Blum and Norman R. Meier are owners of shares of Dow stock.

B. K-Dow Joint Venture with Kuwait

In December 2007, Dow's board of directors caused the Company to enter a Memorandum of Understanding ("MOU") with Kuwait's Petrochemicals Industries Company ("PIC").[4] The MOU, which was subject to the execution of a definitive agreement, customary conditions, and regulatory approvals, provided for $9 billion in cash payments to Dow upon the transfer of a 50% interest in five global Dow commodities chemical businesses into a joint venture with Kuwait.[5] The joint venture was known as "K-Dow," and each company was to take a 50% equity interest in the new company. At the time, Dow expected the K-Dow transaction to close in late 2008.

C. The R&H Merger Agreement

In July 2008, following an intense auction and six months after the K-Dow MOU, the Dow board unanimously approved and caused Dow to enter into a strategic merger agreement with R&H (the "R&H Transaction" or the "Merger Agreement"), pursuant to which Dow agreed to acquire all of R&H's stock for $78 per share, or roughly $18.8 billion.[6] Recognizing that uncertainty was a deal-breaker for R&H—and that there were many competitors standing ready to provide the certainty R&H sought—Dow did not condition the transaction's close on financing.[7] The transaction was slated to close within two business days of receiving all the required regulatory approvals.

The Merger Agreement provided no traditional "outs" from completing the transaction with R&H but provided traditional penalties for any delay or failure to close, including specific performance. Section 5.1(b)(i) of the Merger Agreement required Dow to "take all action necessary to ensure that as of the Closing Date, [Dow] will obtain the Financing." Moreover, under

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[4]The facts are drawn from the complaint except where noted otherwise, and taken as true for purposes of the motion to dismiss.

[5]This amount consists of approximately $9 billion in pre-tax cash proceeds and an additional $500 million through the joint venture's proposed assumption of existing debt.

[6]Similar to the K-Dow deal, this amount consists of $15.6 billion in cash and a proposed assumption of approximately $3 billion of R&H's debt.

[7]The bidding contest was quite spirited among the major chemical players. In addition to Dow, DuPont and BASF also participated. Defs.' Supp. Br. at 7, n.6.

Section 4.6 Dow expressly represented that it would have the funds necessary to close by the closing date. Dow also agreed to assume all risk regarding negative developments affecting the chemical industry or financial markets, in the form of a "Material Adverse Effect" clause. Pursuant to this provision Dow assumed the risk that the chemical industry or the financial markets would be negatively affected between signing and closing. The Merger Agreement also included a "force majeure" clause which only would provide Dow an out if R&H performed worse than all its peers.

Furthermore, the Merger Agreement provided for additional consideration—but not liquidated damages—to R&H in the event that the Transaction was delayed or did not close. In particular, Section 2.1(a) provided for "ticking fees" for a period up to six months. The per-day ticking fee amounted to approximately $3.3 million, minus any dividend that R&H paid to its shareholders during that period. These payments were clearly not liquidated damages because the Merger Agreement contained a specific performance provision in Section 8.5(a).

Though the markets may have been tightening during the summer of 2008, funding remained available and Dow had a variety of potential sources of financing. In addition to its available cash balances, Dow anticipated $9 billion in pre-tax cash proceeds from the K-Dow joint venture, $4 billion from investments by Berkshire Hathaway Inc. and the Kuwait Investment Authority, and a syndicated bridge loan for $13 billion of debt financing led by Citibank, N.A. if the R&H transaction closed before the K-Dow venture.[8]

Although proceeds from K-Dow were one source of financing, the R&H deal was not conditioned nor did it depend on the K-Dow deal closing. Accordingly, the Dow board informed stockholders that the financing for the Merger did not depend on Dow entering into a binding contract with Kuwait. Specifically, Liveris and Merszei disclaimed any temporal connection at a July 10, 2008 press conference. Liveris told an analyst: "we are not counting on [the K-Dow deal]. We can do [the R&H] deal without the Kuwait money, and we will stay at investment grade." Merszei expanded, stating: "[t]his deal is certainly not contingent on the closing of our Kuwait joint venture." Throughout the fall of 2008 defendants remained confident that the R&H Transaction would close "early next year."

At the time Dow entered the Merger Agreement with R&H, its earnings and stock price were strong. Two weeks after signing the Agreement, Liveris announced favorable second quarter results on behalf of Dow. Although oil prices surged from the first to second quarter of 2008, Dow "reacted quickly...enabl[ing Dow] to weather unparalleled increases in hydrocarbons, supply chain and other costs." All signs still indicated Dow

[8]The terms of the bridge loan provided $13 billion in debt financing for 12 months from the closing of the R&H Transaction, or April 14, 2010, whichever came first.

would be able to arrange the financing necessary to close the R&H Transaction.

D. Tightening of Credit Markets & K-Dow's Disintegration

Unfortunately, a series of unforeseeable economic events unfolded over the next six months, which led to a drastic change in circumstances. As with other companies and the commodities and specialty chemicals industries, Dow's earnings and share price declined precipitously. Concurrently, Dow's cash reserves plummeted, and when coupled with the Company's general financial health decline, Dow's ability to tap alternative lines of credit, including the $13 billion bridge loan, quickly changed. Dow, along with many other companies, experienced multiple credit rating agency downgrades. In the span of five days, from December 29, 2008 to January 2, 2009, all three of the rating agencies—S&P, Moody's, and Fitch—lowered Dow's credit ratings to just a few notches above junk. Plaintiffs allege that the Dow board was faced with two problems in late 2008: (1) Dow did not have sufficient cash reserves to complete the R&H Transaction, and (2) if Dow closed the R&H Transaction without K-Dow's proceeds, a series of credit defaults would be triggered, causing insolvency.

Despite these challenges the Dow board remained committed to its transformative strategy and worked diligently to keep the R&H Transaction and K-Dow deals on track. For the R&H Transaction, the board worked to secure the required regulatory approvals, and remained on schedule by late December 2008. At that point the only remaining conditions on Dow's obligation to close were antitrust approvals by the FTC and the European Commission, which were anticipated to be obtained within the first two weeks of January.

Regarding the K-Dow deal, Dow received approval on November 24, 2008 from the Supreme Petroleum Council ("SPC") of Kuwait. Within days Dow executed the K-Dow Petrochemicals joint venture agreement with Kuwait, setting a closing date of January 2, 2009. Dow announced the execution of the K-Dow joint venture agreement on December 8, 2008. Unfortunately, yet another set back occurred on December 28, 2008. The Kuwaiti Petrochemicals Corporation and Petrochemicals Industries Company informed Dow that the Kuwait Supreme Petroleum Council had rescinded its approval of the joint venture. No reason was given for the rescission. Dow received written notice of the rescission on December 31, 2008, and promptly issued a press release restating that the R&H Transaction was not contingent on K-Dow and reiterating its intent to keep the R&H Transaction on track.

It took nearly a month after Kuwait's withdrawal of its regulatory approval, before it publicly announced the bribery allegations through a report published by the *Kuwait Times*. Up until that report, vague allegations of the SPC's justifications trickled from the media stream. For instance, on December 29, 2008, the *Kuwait Times* reported that SPC's reversal was a

reaction to believing that many senior oil sector officials had complained of "external interference" and "politicizing" of the country's vital oil industry. These vague terms were left undefined in the December 29th article. That same article stated that:

> The [K-Dow] deal came under the spotlight early this month when the Popular Action Bloc threatened it would grill the prime minister if the government *did not cancel the deal before the start of the New Year*. The Bloc described the deal as a sellout and that its value was highly exaggerated, citing the fact that Dow Chemical's value had fallen from $51 billion last year to $17 billion now because of the global financial crisis. The call was supported by many other MPs who also *questioned the benefits of the deal in the wake of the global financial crisis*.[9]

The same article disclosed that had Kuwait waited until the New Year to cancel its agreement it would be "liable to pay a penalty of up to $2.5 billion."

It was not until January 28, 2009, in another report published by the *Kuwait Times*, that the alleged reason for Kuwait's backing out of the deal came to light. According to the article, the National Assembly had voted overwhelmingly to investigate "suspicions of profiteering and accepting all forms of commissions by oil executives" involved in several deals, including K-Dow. Not only does this report still not mention "bribery"—though that allegation flows more reasonably than from the "external interference" and "politicizing" allegations—the same article stated that MP Mohammad Al-Mutair "said the government should tell Dow Chemical that if it initiated legal action against Kuwait on the deal, it risks losing its strategic projects in the country."

E. Dow's Attempt to Extend R&H Closing

Contemporaneously, the Dow board proceeded ahead with the R&H Transaction, but allegedly attempted to delay the closing. By January 9, 2009, only one hurdle remained before the Transaction could close: FTC regulatory approval. Plaintiffs allege that the Dow board lobbied the FTC to delay its approval and asked R&H to consider extending the deadline, but both routes were unsuccessful. The FTC granted final antitrust clearance for the R&H Transaction on January 23, 2009, which triggered a closing date of no later than January 27, 2009.

Dow thereafter refused to close the Merger and informed R&H on January 25, 2009, citing economic concerns and viability of the combined

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[9]Compl. ¶ 77 (emphasis added).

entities. On January 26, 2009, R&H filed suit against Dow in this Court seeking specific performance of the Merger Agreement.

F. Plaintiffs' Claims

Plaintiffs primarily allege that director defendants breached their fiduciary duties by entering a merger agreement with the specialty chemical maker Rohm & Haas for $18.8 billion that unconditionally obligated Dow to consummate the merger. Plaintiffs challenge the wisdom of the board's July 2008 decision, focusing on the substantive provisions of the deal, rather than the procedure employed to make an informed business judgment by a majority of the disinterested and independent board members. In particular, plaintiffs take issue with the board's decision to enter a merger agreement without a financing condition. Repeatedly plaintiffs assert that the director defendants have placed Dow in a precarious position, facing potential financial ruin if this Court forced specific performance of the R&H Transaction.[10] Since plaintiffs in this action challenge a board decision, they must show that demand was futile under the two-pronged *Aronson* test.

Plaintiffs also seek to hold the directors liable under a *Caremark* theory for a variety of alleged monitoring failures. Under this theory, plaintiffs must demonstrate that the defendant directors acted in bad faith and consciously disregarded their fiduciary duties and thus face a "substantial likelihood" of liability for the alleged bribery, misrepresentations, insider trading, and wasteful and excessive compensation.

Plaintiffs attempt to show that the K-Dow deal fell apart because Dow officers bribed certain senior Kuwaiti officials. Plaintiffs argue that the press releases and newspaper articles from Kuwait, described above, support an allegation of bribery. They also assert that the Dow board was aware of or should have been aware of the bribery and failed to do anything. Therefore, plaintiffs conclude that the director defendants breached their fiduciary oversight duties under *Caremark*.

Plaintiffs allege that Liveris' and Merszei's press statements on behalf of Dow, among others, were false and misleading, and made with the direct intent to cover up the conditional nature of the R&H Transaction on K-Dow. Plaintiffs further allege that the director defendants knew the negotiations with Kuwait and PIC were not on track, yet continued to tell the press they were throughout the fall of 2008. Liveris continued to reassure stockholders and the public that Dow was "on track to close the [R&H]

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[10]This assertion is moot as the R&H Transaction was consummated on April 1, 2009 and the combined entity has survived. Additionally, the potential liabilities of billions of dollars in damages to R&H is not only moot, but also unripe at the time the complaint was filed and as this motion is pending before the Court.

acquisition," that Dow "remain[ed] committed to the deal," and that Dow has "plenty of financing resources available" to do so.[11]

To add to their litany of allegations, plaintiffs also allege unlawful insider trading by three directors and three officers: Allemang, Liveris, and Merszei (directors); Banholzer, Gambrell, and Kepler (officers). Here, plaintiffs make attenuated insider trading arguments, insisting that these defendants had "non-public information about the business of Dow, as well as its finances, major contracts, merger plans, and present and future business prospects" through access to internal corporate matters. All but two of the twelve stock sales at issue here were made before the R&H Merger Agreement was executed; the vast majority was sold in April 2008, months before the R&H Transaction. Plaintiffs further assert that at the time of these sales the insiders knew that the R&H Transaction was dependent on the K-Dow deal but failed to disclose that material information to the public. As made clear throughout this Opinion, the statements were not misstatements; they were accurate as to the temporal significance of the two deals.

As for plaintiffs' final substantive allegation, wasteful and excessive compensation, there are no particularized allegations in the complaint. Even in plaintiffs' brief in opposition to defendants' motion, plaintiffs do not allege particularized facts. Rather, plaintiffs merely make broad assertions that the Dow board caused excessive and wasteful compensation to be made to unidentified directors and officers.

G. The Procedural History

On January 26, 2009, R&H filed suit in this Court seeking specific performance of the Merger Agreement. On the eve of trial, the lawsuit settled and the merger closed on April 1, 2009, on substantially altered financial terms.[12]

Shortly after R&H filed suit, on February 9 and 12, 2009, two individual stockholders filed two virtually identical derivate actions that have been consolidated into this action. The actions were consolidated on March 5, 2009. Defendants filed a motion to dismiss on April 15, 2009. Oral argument on this motion to dismiss was held on December 31, 2009.

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[11]Compl. ¶ 63. Plaintiffs assert a corollary argument that the director defendants admitted in the R&H litigation that the R&H Transaction depended on K-Dow all along. Compl. ¶ 88. That a component of the financing for the R&H Transaction was anticipated to come from K-Dow does not mean that statements making clear the R&H Transaction was not dependent on the *closing* of K-Dow were misleading or false. To the contrary, the statements, as described below, were not misstatements at all; they merely relayed the temporal connection between the two deals. *See* discussion *infra* Part II.B.2.b.

[12]All facts within this section come from the Defendants' Memorandum in Support of their Motion to Dismiss. Defs.' Supp. Br. at 2.

II. ANALYSIS

A. Legal Standard for Demand Excusal

In recognition of the "fundamental precept that directors manage the business and affairs of corporations,"[13] Chancery Court Rule 23.1 imposes a demand requirement for derivative actions.[14] The shareholder-plaintiff must either make pre-suit demand on the corporation's board of directors or allege demand futility.[15] Demand is deemed futile, and therefore excused, only if a majority of the directors have such a personal stake in the matter at issue or the proposed litigation that they would not be able to make a proper business judgment in response to a demand.[16] Rule 23.1 places "stringent requirements of factual particularity [on allegations of demand futility] that differ substantially from the permissive notice pleading[]" requirements of Rule 8.[17] The purpose of this heightened standard is to ensure only derivative actions supported by a reasonable factual basis proceed.[18] Plaintiffs need not demonstrate, however, a reasonable probability of success on the merits. Rather, plaintiffs need only make a "threshold showing through the allegation of particular facts, that their claims have some merit."[19]

Upon reviewing a motion to dismiss for failure to demonstrate demand futility pursuant to Rule 23.1, the Court must accept the well-pled factual allegations of the derivative complaint as true and draw all reasonable inferences in favor of plaintiffs.[20] "Conclusory allegations, however, are not accepted as true."[21] Different standards apply to the various decisions or non-decisions a board may make. For conscious board decisions—whether to act or not—the two-pronged *Aronson* test applies.[22] A board's failure to act absent a conscious decision to refrain from acting, such as a failure to supervise,[23] is analyzed under *Rales*.[24]

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[13]*Aronson*, 473 A.2d at 812.

[14]The purpose of this requirement "is not to insulate defendants from liability; rather, the demand requirement and the strict requirements of factual particularity under Rule 23.1 'exist[] to preserve the primacy of board decisionmaking regarding legal claims belonging to the corporation.'" *Citigroup*, 964 A.2d at 120 (citing *Am. Int'l Group, Inc., Consol. Derivative Litig.*, 965 A.2d 763, 807-09, 2009 WL 366613, at *29 (Del. Ch. 2009)).

[15]Ch. Ct. R. 23.1.

[16]*Aronson*, 473 A.2d at 814.

[17]*Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000). *See also Citigroup*, 964 A.2d at 120-21 (citing *Brehm*).

[18]*See Brehm*, 746 A.2d at 266.

[19]*Rales v. Blasband*, 634 A.2d 297, 934 (citing *Aronson*, 473 A.2d at 811-12).

[20]*Rales*, 634 A.2d at 931 (footnotes omitted).

[21]*Id.*

[22]*See Aronson*, 473 A.2d at 813. *See also Citigroup*, 964 A.2d at 121.

[23]*In re Caremark Int'l Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).

[24]*Rales*, 634 A.2d at 930.

The *Aronson* standard clearly applies to plaintiffs' claims arising from the board's approval of the R&H merger. The remaining claims are based on a failure to supervise, and thus are governed by the *Rales* standard.[25]

B. Demand Futility Regarding Plaintiffs' Breach of Fiduciary Duty Claims

Plaintiffs' complaint pleads three derivative claims. Count I pleads a breach of the fiduciary duty of loyalty claim for insider trading by certain director and officer defendants.[26] Count II pleads breaches of fiduciary duty by the director defendants by: (a) approving the R&H Transaction, (b) misrepresenting the relationship between the R&H and K-Dow transactions, (c) failing to detect and prevent alleged bribery in connection with the K-Dow transaction, (d) failing to detect and prevent the alleged misrepresentations, (e) failing to detect and prevent insider trading, and (f) failing to prevent the payment of allegedly excessive and wasteful compensation. Count III asserts claims for contribution and indemnification against the director defendants for unidentified future claims.

1. Insider Trading Claim – Count I

As an initial matter, I deem plaintiffs' insider trading claims in Count I as waived. Plaintiffs quietly abandoned this claim in their brief in opposition to defendants' motion to dismiss, by failing to address or respond to defendants' arguments in their motion to dismiss.[27] As noted above, the complaint is insufficient to satisfy the particularized factual allegations standard relating to insider trading. The complaint fails to identify any specific knowledge of inside material information on the two relevant trade dates.[28] Moreover, the relevance of ten of the alleged twelve insider trades is not pleaded adequately. These ten trades occurred months before the R&H

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[25]Plaintiffs argue that the breach of fiduciary duty claims arising from the R&H Transaction should be analyzed under *Rales* as well as *Aronson*. But defendants correctly note that plaintiffs are not entitled to "two bites at the demand futility apple." Defs. Supp. Br. at 17. As *Citigroup* made clear, *Aronson* applies to board action and *Rales* applies to board inaction. *Citigroup* at 121. The R&H Merger was a transaction and any allegations relating to that decision are analyzed under *Aronson*. Plaintiffs' other claims as to failure to supervise (enabling bribery and insider trading) are not board decisions and, thus, are appropriately analyzed under *Rales*.

[26]Plaintiffs allege that three directors and three officers—Allemang, Banholzer, Gambrell, Kepler, Liveris, and Merszei—sold their Dow shares when "each had access to and knew highly confidential information." Compl. ¶ 137.

[27]The only mention of "insider trading" in plaintiffs' brief is a conclusory allegation contained within a laundry list that the board "fail[ed] to detect and prevent insider trading." Pls.' Opp'n Br. at 25.

[28]Compl. ¶ 109 (the relevant dates are August 29, 2008 and September 12, 2008).

Merger Agreement was executed and no particularized facts are pled that these were based on inside information regarding the R&H deal as of the April trade dates. Therefore, Count I is dismissed without prejudice pursuant to Chancery Court Rule 15(aaa).[29]

2. Approval of R&H Transaction – Count II

To satisfy *Aronson* plaintiffs must plead particularized facts that raise a reasonable doubt either (i) that a majority of the directors who approved the transaction in question were disinterested and independent, or (ii) that the transaction was the product of the board's good faith, informed business judgment.[30]

a. First Prong of *Aronson*

Plaintiffs argue that demand is excused because it would be futile. According to plaintiffs, at least half of the board members, or six of the board's twelve directors, fail the test of being disinterested and independent.[31] Disinterested "means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally."[32] "Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences."[33]One such influence occurs when a director is "dominated and controlled" by someone who is interested;[34] an entrenchment motive can provide another such influence.[35] But where there is no director who is interested in the transaction, there is no need to consider the independence of the remaining directors.[36]

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[29]Because plaintiffs abandon this insider trading claim in their opposition brief, it may be unjust to dismiss with prejudice. Therefore, I dismiss without prejudice. Ch. Ct. R. 15(aaa).

[30]*Aronson*, 473 A.2d at 814.

[31]Plaintiffs must show that at least half of the board is not disinterested and independent. *Beam v. Stewart*, 845 A.2d 1040, 1046 (Del. 2004) ("[D]emand is excused where a board is evenly divided between interested and disinterested directors.").

[32]*Aronson*, 473 A.2d at 812.

[33]*Id.* at 816.

[34]*Brehm*, 746 A.2d at 257. *See also* David A. Skeel, Jr., *The Accidental Elegance of* Aronson v. Lewis, *in* THE ICONIC CASES IN CORPORATE LAW 165, 187 (Jonathan R. Macey ed., 2008) ("Only if a majority of the board is either interested or can be shown to be controlled by the interested director is demand excused under *Aronson*'s first prong.")

[35]*In re The Limited, Inc. S'holders Litig.*, 2002 WL 537692 at *3 (Del. Ch. Mar. 27, 2002).

[36]*Brehm*, 746 A.2d at 258. The situation may be different where a majority or control stockholder exists. There the majority or control stockholder may influence board members even if the controller is not on the board. In that case, independence may be dispositive without any director

Here, none of the outside directors[37] stood on both sides of the transaction; nor are they alleged to have received a personal financial benefit from it other than one devolved on all Dow stockholders alike. Moreover, *no* directors are alleged to have been interested in the deal.[38] Thus, there is no issue regarding any directors' interest. Rather, the thrust of plaintiffs' allegations is that the Dow directors were not independent because of various business or personal relationships with Liveris, which allegedly left at least seven directors beholden to Liveris, and thus unable to act independently of his influence. But plaintiffs do not allege any interest on the part of Liveris.[39] At best plaintiffs point to Liveris' role as a director at Citigroup—the named bank in a consortium of nineteen to provide bridge financing for the R&H Transaction, should Dow need it. That the potential for a conflict of interest may have existed does not reasonably lead to the conclusion that a conflict existed. Defendants correctly note that Liveris may have had a conflict if R&H had succeeded in forcing Dow to draw on its bridge financing to close the deal, and Dow had gone into bankruptcy as a result.[40] Nonetheless, under *JP Morgan*, even directors with "substantial personal wealth invested in their related companies [e.g., Citi], each of which conducts business with [Dow]" were found independent.[41] Without a conflict there is no interest hook for plaintiffs to assert.

Under *Brehm*, without an interested director the independence of the remaining directors need not be examined. Plainly put, the beholdenness or dominance of any director is irrelevant because there is no fear that the

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being interested. That individual will satisfy the interest hook of the *Aronson* test. Here, no control or majority stockholder exists, so the relevant persons to examine for purposes of interest are the directors, and absent an interest hook, the Court need not consider the remaining directors' independence.

[37]Of the twelve directors on Dow's board, nine are outside directors. *See* Compl. ¶ 125(c).

[38]Defendants directly challenged plaintiffs' apparent misunderstanding of the relationship between interestedness and independence. Defs. Supp. Br. at 15. In response, plaintiffs consciously chose: (i) to stand on their complaint that contained no interest allegation, and (ii) to answer defendants' brief *still* without addressing the interest issue and instead focusing solely on the independence analysis. *See* Pls. Opp'n Br. at 14-19. Plaintiffs have clearly misunderstood the *Aronson* test and its progeny; under *Brehm*, the independence of directors is only relevant when there exists an interested person.

[39]*See* Compl. ¶ 125 (although plaintiffs allege the directors "are not disinterested and independent," the list of specific allegations (¶¶ (a) – (k)) focuses solely on independence and does not mention interestedness).

[40]But even that conflict is not clear. First, the decisions challenged under the alleged conflict are decisions made after the K-Dow deal—not R&H—did not close. Plaintiffs are solely challenging the R&H deal, not K-Dow. Second, Citigroup was one of *nineteen* banks that agreed to provide bridge financing. The potential conflict here is too attenuated, especially in light of plaintiffs' own argument that Liveris depends on his continued employment with Dow for his livelihood, suggesting he would not place Citigroup's interest above Dow's. Pls.' Opp'n Br. at 14.

[41]*In re J.P. Morgan Chase & Co. S'Holders Litig.*, 906 A.2d 808, 821-22 (Del. Ch. 2005) ("JPMC is a national commercial and investment bank. That it provided financing to large American companies should come as no shock to anyone. Yet this is all that plaintiffs allege.").

dominating director, without a personal or adverse interest, will do anything contrary to the best interest of the company and its stockholders. Thus, plaintiffs' allegations of Liveris' domination over seven directors is irrelevant.[42] Liveris is not interested in the R&H deal and, therefore, his influence is not in question.

Before moving on to the second prong of *Aronson*, I pause to address two of plaintiffs' arguments. First, plaintiffs allege that the three inside directors—Liveris, Merszei, and Allemang—depend for their livelihood on Dow.[43] Under *Rales*, depending on a director office for one's livelihood is evidence of beholdenness.[44] But where a director is beholden to the *company* there is no reason to doubt her loyalty to that company. Her interests are aligned with the company and presumably she is able to make decisions in the best interests of the company. Thus, plaintiffs' allegations of "beholdenness to Dow" are misplaced and inaccurate.

Second, assuming that plaintiffs adequately pleaded interest as to one director—which they have not—a domination and control inquiry still would not establish a lack of independence. Plaintiffs have alleged no more than "mere outside business relationship[s which], standing alone, are insufficient to raise a reasonable doubt about a director's independence."[45] Plaintiffs assert that the defendant directors are beholden to Liveris for numerous reasons, but they fail to demonstrate why that is so.[46]

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[42]The seven directors are Bell, Hess, Merszei, Reilley, Shaw, Stern, and Franklin. Pls.' Opp'n Br. at 16.

[43]The board is dominated by outsiders. Of the twelve directors, only three are insiders. Liveris, Merszei, and Allemang are employed by Dow in various executive capacities. Compl. ¶ 125(c). The remaining nine directors are not employees and, therefore, not insiders. Neither party disputes these three directors' dependence. Both the New York Stock Exchange and Dow's own director independence standards support their dependence. *Id.*; Defs.' Reply Br. at 9.

[44]*Rales*, 634 A.2d at 936. Yet, beholdenness is only relevant where there is an interested person, as there was in *Rales*. *See id.* at 936 (Rales brothers found "interested" because subject to a substantial likelihood of liability); *see also*, *Brehm*, 746 A.2d at 258.

[45]*Beam*, 845 A.2d at 1050. *See also J.P. Morgan*, 906 A.2d at 821 (citing *Beam* at 1051 ("Allegations that Stewart and the other directors moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends,' even when coupled with Stewart's 94% voting power, is insufficient, without more, to rebut the presumption of independence.")).

[46]For example, plaintiffs' argument that Liveris allegedly exercised influence by "order[ing] the Board, overnight, to summarily terminate two dissident officers"—their best argument—falls short. Upon further investigation it is clear that valid business reasons existed to terminate those two officers; they held clandestine meetings and set up a proposed leveraged buyout—all behind the board's back. Not surprisingly, the board may not have wanted them at the company. On the contrary, plaintiffs paint a different picture, suggesting that the two officers were whistleblowers on the bribery charges brought by the SEC against Dow in early 2007. Pls.' Opp'n Br. at 16. The complaint, however, states that the officers were engaged in clandestine meetings without the full board or the CEO's knowledge. *See* Compl. ¶ 125. Thus, it is far from clear that the board acted as Liveris' puppets in deciding to fire them.

Problems also exist with all other allegations of influence. That directors of one company are also colleagues at another institution does not mean that they will not or cannot exercise their own business judgment with regard to the disputed transaction.[47] Furthermore, the mere fact that a director played a role in nominating new directors does not mean that the new director is beholden to the nominating director.[48] It is a business reality that current directors often nominate new directors, and some former relationship usually factors in to the nomination.[49] Finally, allegations of interlocking positions forming a tight "inner circle" between the Audit Committee and Governance Committee and Liveris on the board are, without more, also insufficient. Committees may, and often do, have overlapping members. That sole fact, without some allegation of improper influence, is not enough to establish lack of independence.[50]
Upon review of the plaintiffs' allegations, I find that plaintiffs fail to meet their burden under Rule 23.1 with respect to any of the outside directors. The majority of the Dow board was disinterested and independent.

b. Second Prong of *Aronson*

Plaintiffs argue that demand is also excused under the second prong of the *Aronson* test. In order to succeed, "plaintiffs must allege particularized facts that raise doubt about whether the challenged transaction is entitled to protection of the business judgment rule."[51] Specifically, the "plaintiffs must

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[47]For instance, in addition to co-directorship at Dow, Hess and Franklin also are colleagues at J.P. Morgan Chase. Plaintiffs suggest, as a result of this perceived "structural bias," that "neither would take action to investigate or sue the other with respect to the R&H Merger for fear of jeopardizing his own financial dependence on J.P. Morgan." Pls.' Opp'n Br. at 18. But without more, such as a financial connection between Dow and the other company, this allegation is merely conclusory and insufficient. *See Beam, supra* note 45; *see also J.P. Morgan* at 821-24 (finding that outside directors' ties to organizations that JPMorgan donated to still was not enough to find an improper influence).

[48]Plaintiffs allege that Liveris "hand picked or played a heavy role" in the selection and retention of six of Dow's board members who joined in 2005 or later: Bell, Hess, Merszei, Reilley, Shaw, and Stern. Pls.' Opp'n Br. at 16.

[49]*See* A. Gilchrist Sparks, III, *Corporate Democracy – What It Is, What It Isn't, and What It Should Be* 6 (February 2006), *available at www.mnat.com/attachment/39/Sparks+New+Article.pdf* ("the corporation's slate is nominated by a committee of the incumbent board").

[50]As the Supreme Court observed in *Brehm*, demand futility allegations cannot be based on deviations from "aspirational goals of ideal corporate governance practices." 746 A.2d at 256. Moreover, plaintiffs concede that they did not employ a books and records demand as a tool to flesh out their unparticularized allegations of a "clubby" inner circle on the Dow board. Had they done so (as plaintiffs were admonished in *Beam, supra* note 45) their allegations might have met the requirements of Rule 23.1.

[51]*J.P. Morgan*, 906 A.2d at 824 (citing *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 286 (Del. Ch. 2003)).

plead particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision."[52]

Nothing in the complaint indicates the Dow board was not adequately informed about the transaction with R&H. The complaint is devoid of any allegations that the board failed to put in the time and effort necessary to properly evaluate the risks and benefits of that transaction, or allegations that the board was unaware of any material terms of the transaction or failed to obtain the advice of experts before approving it. On the contrary, plaintiffs unintentionally concede—on more than one occasion—that defendant directors did perform some due diligence.[53] Even accepting all the well-pled allegations as true, plaintiffs do not rebut or address the accepted facts that the board was negotiating in a seller's market and R&H demanded certain deal protections.[54] Fearing that R&H would walk away, Dow made a clear business decision to approve the R&H deal and sign the Merger Agreement without a financing contingency. Plaintiffs' failure to address these facts is highly suggestive that they do not focus on the process but rather on the substantive content of the directors' decision.

Simply put, plaintiffs take issue with the substantive decisions of the R&H Transaction, instead of the process the board followed. This Court made clear in *Citigroup* that substantive second-guessing of the merits of a business decision, like what plaintiffs ask the Court to do here, is precisely the kind of inquiry that the business judgment rule prohibits.[55]

Both of plaintiffs' attempts to distinguish *Citigroup* fail. First, plaintiffs draw a line between a simple exercise of business judgment relating to a transaction or series of transactions, and a "bet the company" transformational transaction.[56] Delaware law simply does not support this distinction. A business decision made by a majority of disinterested, independent board members is entitled to the deferential business judgment rule regardless of whether it is an isolated transaction or part of a larger transformative strategy. The interplay among transactions is a decision

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[52] *Id.*

[53] "Plaintiffs do, indeed, attack the board of directors for the woefully inadequate *process*, and lack of acting properly on *what they must have learned through due diligence*, in connection with the K-Dow and R&H transactions." Pls. Opp'n Br. at 20 (emphasis added). *See also* Compl. ¶ 58 (quoting Liveris stating: "[A] lot of work we've done already on due diligence tells us that we'll make sure that synergies are bankable.").

[54] Both parties acknowledge that R&H was unwilling to enter an agreement without the certainty that an agreement without a financing condition provides. Compl. ¶ 56; Defs.' Supp. Br. at 17.

[55] *Citigroup*, 964 A.2d at 122 ("[S]o long as the court determines that the process employed was either rational or employed in a *good faith* effort to advance corporate interests" the court will not second-guess a board's business decisions.).

[56] Pls.' Opp'n Br. at 33.

vested in the board, not the judiciary.[57]

Second, plaintiffs again attempt to distinguish *Citigroup* on the ground that the Citigroup directors were accused of failing to recognize business risk, rather than failing to uncover fraud or criminal conduct. As described below, I am not persuaded that the directors made any misrepresentations, and plaintiffs' bribery allegations with respect to the board's involvement are wholly unsupported. Nonetheless, as in *Citigroup* I examine plaintiffs' primary claim in evaluating whether plaintiffs properly pleaded demand futility.[58] Here, plaintiffs have failed to adequately plead that the directors are not entitled to business judgment review for decisions made by a disinterested and independent board.

Turning to plaintiffs' allegations of bad faith, I am unconvinced that the directors acted in any way other than honestly and in good faith. To show that a disinterested and independent board acted outside the bounds of business judgment, plaintiffs must show that directors acted in bad faith.[59] Recently, the Supreme Court clarified the concept of bad faith in *Lyondell Chemical Co. v. Ryan*, noting that "[i]n the transactional context, [an] extreme set of facts [is] required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties."[60] Plaintiffs must show that defendants completely and "utterly failed" to even attempt to meet their duties.[61]

Though the complaint does identify specific disclosures alleged to be misleading, plaintiffs do not allege specific facts "that reasonably suggest sufficient board involvement in the preparation of the disclosures,"[62] nor does the complaint sufficiently allege that "the director defendants had knowledge that any disclosures or omissions were false or misleading or that the director defendants acted in bad faith in not adequately informing themselves."[63] To determine "whether the alleged misleading statements were made with knowledge or bad faith requires an analysis of the state of mind of the individual director defendants."[64] Plaintiffs have not made specific factual allegations that allow for such an inquiry.

The gist of plaintiffs' claim is that Liveris and Merszei, with the board's approval, misrepresented the connection between the R&H and K-

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[57]*See, e.g.*, 8 *Del. C.* § 141(a).

[58]The primary claim in *Citigroup* was that the directors failed to recognize the coming subprime business risk. The Court examined this claim under the business judgment rule, even though the plaintiffs also accused management of making misrepresentations and engaging in other misconduct. *See Citigroup*, 964 A.2d at 124.

[59]*Lyondell Chem. Co. v. Ryan*, 2009 WL 1024764 at *7 (Del. 2009).

[60]*Id.* (quoting *In re Lear Corp. S'holder Litig.*, 2008 WL 4053221 at *11 (Del. Ch. 2008)).

[61]*Lyondell* at *7.

[62]*Citigroup*, 964 A.2d at 134.

[63]*Id.* (citing *Pfeffer v. Redstone*, 965 A.2d 676, 687 (Del. 2009)).

[64]*Citigroup*, 964 A.2d at 134.

Dow deals. According to plaintiffs the K-Dow deal was an integral part of the R&H financing, known to the board upon entering the merger agreement in July 2008. The board, therefore, must have concealed and misrepresented this fact when Liveris stated that the R&H deal was not contingent on the closing of the K-Dow deal.

This claim fails for two reasons. First, plaintiffs' own allegations show that Liveris never stated anything that misrepresented the relationship between the R&H and K-Dow transactions; he merely stated that the *order in which the transactions were completed* did not matter.[65] At that time the board believed that the $13 billion bridge loan would enable Dow to maintain its investment grade rating and close the R&H deal in the event that R&H closed *before* K-Dow. Liveris never stated, and there is no allegation to suggest that the board believed, that the R&H deal was contingent on K-Dow. Even in light of the unanticipated financial turmoil, which made it impossible for Dow to take advantage of its back-up financing arrangement when K-Dow did not close, Liveris' earlier statement still was not a misrepresentation because the board only intended to draw on the bridge loan if Dow would remain at investment grade.

Second, plaintiffs accusation as to state of mind is, as defendants correctly note, "utterly circular."[66] For Liveris and Merszei to "feel a need to conceal" they must first have made a misrepresentation, which they did not. The complaint offers no factual basis for plaintiffs' misrepresentation claim and, furthermore, the disputed statements, on their face, do not appear to be misrepresentations. Thus, plaintiffs' allegations are insufficient to support demand futility under the second prong of *Aronson*.

Finally, plaintiffs have alleged no particularized facts to connect the board to Liveris or Merszei's statements. Without a connection, there is reason to doubt that the board knew that the statements were false or misleading or acted in bad faith by not adequately informing themselves about the statements.

Plaintiffs thus are unable to meet either prong of *Aronson*. They have failed to show that a majority of the board is either interested or lacks independence. They also have failed to establish a reasonable doubt that the board's decision was anything other than a valid business judgment. Plaintiffs' derivative claim for breach of fiduciary duties regarding the R&H Transaction must be dismissed because demand is not excused. Pursuant to Rule 15(aaa), this claim is dismissed with prejudice.

3. *Caremark* Failure to Supervise Claims – Count II

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[65]"[W]e are not counting on [the K-Dow deal]. We can do [the R&H] deal without the Kuwait money, and we will stay at investment grade." Compl. ¶ 57. Furthermore, Merszei stated "[t]his deal is certainly not contingent on the closing of our Kuwait joint venture." *Id.*

[66]Defs.' Reply Br. at 15.

Plaintiffs allege that demand is futile as to their failure to supervise claims because the director defendants are not able to exercise disinterested business judgment in responding to a demand because their failure of oversight subjects them to a substantial likelihood of personal liability. According to plaintiffs, the directors face a substantial threat of liability because their conscious disregard of their duties and lack of proper supervision and oversight caused the Company to be exposed to (1) bribery allegations in relation to the K-Dow transaction, (2) misrepresentation allegations regarding the relationship between the K-Dow and R&H transactions, and (3) insider trading allegations.

A board's unconscious failure to act is governed by *Rales*.[67] Under *Rales*, the only demand futility issue is whether "the board that would be addressing the demand can impartially consider its merits without being influenced by improper considerations."[68] Again, plaintiffs must plead particularized factual allegations that create a reasonable doubt that the board could have, at the time the complaint is filed, validly exercised its independent and disinterested business judgment when responding to a demand.[69] Under *Rales*, defendant directors who face a "substantial likelihood of personal liability" are deemed interested in the transaction and thus cannot make an impartial decision.[70] But "[d]emand is not excused solely because the directors would be deciding to sue themselves."[71] Rather, "demand will be excused based on a possibility of personal director liability only in the rare case when a plaintiff is able to show director conduct that is 'so egregious on its face that board approval cannot meet the test of business judgment, and a substantial likelihood of director liability therefore exists.'"[72]

a. Substantial Likelihood of Personal Directorial Liability

As in *Citigroup*, plaintiffs' arguments are "based on a theory of director liability famously articulated by former-Chancellor Allen in *In re Caremark*."[73] That theory is oversight liability. Under *Citigroup*, "to

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[67] *See Rales*, 634 A.2d at 930.

[68] *Id.* at 934.

[69] *Id.*

[70] *Id.* at 936.

[71] *Citigroup*, 964 A.2d at 121 (citing *Jacobs v. Yand*, 2004 WL 1728521, at *6 n.31 (Del. Ch. Aug. 2, 2004).

[72] *Citigroup*, 964 A.2d at 121 (citing *Aronson*, 473 A.2d at 815).

[73] *Citigroup*, 964 A.2d at 121 (citing *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996)).

establish oversight liability a plaintiff must show that the directors *knew* they were not discharging their fiduciary obligations or that the directors demonstrated a *conscious* disregard for their responsibilities such as by failing to act in the face of a known duty to act."[74] Furthermore, the test is "rooted in concepts of bad faith; indeed, a showing of bad faith is a *necessary condition* to director oversight liability."[75] Only an "utter failure" will satisfy a showing of bad faith.[76] Moreover, because Dow has adopted a Section 102(b)(7) provision in its charter, plaintiffs must plead particularized facts showing bad faith in order to establish a substantial likelihood of personal directorial liability.[77]

i. Bribery Allegations Relating to K-Dow Transaction

Plaintiffs allege that Dow's board failed to detect and prevent bribery in connection with the K-Dow transaction, and though plaintiffs allege that bribery may have occurred, they do not allege that the board knew about, or had reason to suspect, bribery. Plaintiffs do not dispute that no formal charge of bribery has been made. The only proffered support for the bribery allegation is an unsubstantiated charge made by a member of the Kuwaiti Parliament.[78] But even plaintiffs concede that Kuwait is an "unpredictable regime whose adherence to the rule of law [is] doubtful."[79] Moreover, as the complaint admits, Kuwaiti politics have been riddled with "[e]ndemic infighting" for more than a decade.[80] Further, the Kuwait government took nearly a month to formulate its bribery allegations against Dow. Initially, Kuwait cited vague concerns of "external interference" and "politicizing." During the next month these allegations evolved into "suspicions of profiteering and accepting all forms of commissions by oil executives" involved in K-Dow. Concurrently, the *Kuwait Times* reported that the political group, Popular Action Bloc, "threatened it would grill the prime minister if the government *did not cancel the deal before the start of the New Year*." Presumably this was because after the New Year Kuwait would be liable to pay up to a $2.5 billion penalty. Moreover, the political group makes clear its hesitation to enter a deal "in the wake of the global financial crisis." Other politicians did not hesitate to use strong-arm techniques. For

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[74]*Citigroup*, 964 A.2d at 123 (emphasis supplied) (footnotes omitted).

[75]*Id.*

[76]*Lyondell*, 2009 WL 1024764 at *7 (quoting *In re Lear Corp. S'holder Litig.*, 2008 WL 4053221 at *11).

[77]*See Stone v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006); *Citigroup*, 964 A.2d at 125.

[78]Compl. ¶¶ 76-79.

[79]*See* Pls.' Opp'n Br. at 7.

[80]Compl. ¶ 79. According to defendants, this political fighting has been between the National Assembly (the source of the bribery rumors) and the Cabinet (which was blamed by some Parliament members for its involvement in the K-Dow transaction). Defs.' Reply Br. at 20.

instance, MP Mohammad Al-Muair suggested the government threaten to block Dow out of any Kuwait ventures if Dow brought legal action against the country.[81]

Though plaintiffs' bribery allegations are sketchy (at best), plaintiffs have adequately alleged particularized facts that allow a reasonable inference that bribery may have occurred in relation to the joint venture between Dow and the Kuwaiti government. At a motion to dismiss stage, the key inquiry is "do[es the nonmoving party] get . . . access to evidence to go further."[82] Though the particularized factual allegations also support a theory that Kuwait got cold feet in the wake of the global financial meltdown, and used allegations of bribery as the vehicle to back out of the deal, it is not irrational to infer that bribery could have occurred. Accordingly, based on plaintiffs' factual allegations and the low motion to dismiss threshold, I accept for purposes of this motion the inference that Dow officers may have engaged in bribery.

Nonetheless, plaintiffs fail to plead with particularity allegations that, if true, would give the Dow board cause for suspicion. The alleged "red flag" to alert the board that Dow management had engaged in bribery in connection with K-Dow simply is not a "red flag." As a preliminary matter, the only "red flag" plaintiffs mention is not even contained in the complaint. Accordingly, I need not address it.[83] Even had such an allegation been in the complaint, it is still insufficient. Plaintiffs argue that because bribery may have occurred in the past (Dow paid a fine to the SEC in January 2007), by different members of management, in a different country (India), and for a different transaction (pesticide registrations),[84] the board should have suspected similar conduct by different members of management, in a different country, in an unrelated transaction. This argument is simply too attenuated to support a *Caremark* claim.

With neither knowledge of bribery, nor any reason to suspect such conduct, the defendant directors could not "conscious[ly] disregard" their duty to supervise against bribery. Plaintiffs have also failed to allege facts suggesting that the Dow board "utterly fail[ed]" to supervise insiders, or that any director acted with anything other than good faith.[85] Therefore, plaintiffs

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[81]Compl. ¶ 79 (quoting a January 28, 2009 *Kuwait Times* report).

[82]*In re Marsh & McLennan Cos. Inc. Deriv. Litig.*, C.A. No. 753-VCS (Del. Ch. June 17, 2009) (tr., p.107).

[83]Under Rule 15(aaa), a party cannot use its brief as a mechanism to informally amend its complaint. Ch. Ct. R. 15(aaa).

[84]The SEC alleged that Dow officers "paid bribes to government officials in India to secure the marketing of three insecticides in that country" and Dow later agreed to pay a civil penalty to settle the charges. Pls.' Opp'n Br. at 1, n.1.

[85]Plaintiffs cannot meet their burden here for another reason. The Dow board has set up policies to prevent improper dealing with third parties. In particular, Dow's Code of Ethics expressly prohibits any unethical payments to third parties. Moreover, plaintiffs' own complaint once again

have failed to allege facts that establish a substantial likelihood of director liability due to oversight liability under *Citigroup*, and their *Caremark* claims as to bribery in Count II are dismissed with prejudice pursuant to Rule 15(aaa).

ii. Misrepresentation of Relationship between K-Dow and R&H Transactions

Plaintiffs repeat their allegations that the board is responsible—and thus a substantial likelihood of liability must exist—for violations of the duty of disclosure[86] made by Liveris and Merszei regarding the relationship between the K-Dow and R&H transactions. For the same reasons stated above, and based on the complaint's conclusory allegations, I cannot conclude that the director defendants face a substantial likelihood of liability that would prevent them from impartially considering a demand.[87] Accordingly, these *Caremark* claims are dismissed with prejudice.

iii. Insider Trading and Waste Claims

The complaint also alleges that the board failed to (i) detect and prevent insider trading and (ii) prevent the payment of allegedly excessive and wasteful compensation to unidentified officers and directors. Plaintiffs quietly abandoned these arguments when they failed to respond to defendants' arguments regarding the *Caremark*, claims beyond mere reassertions of broad allegations.[88] I, therefore, deem these claims waived or

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belies their argument. Contained within Count II's litany of alleged breaches of fiduciary duty plaintiffs implicitly acknowledge Dow's "corporate governance procedures." *See* Compl. ¶ 144(i) (plaintiffs accuse director defendants of "allowing the corporate governance features of the Company to be fatally compromised by their direct, complicit participation in the wrongs described herein"). Plaintiffs cannot simultaneously argue that the Dow board "utterly failed" to meet its oversight duties yet had "corporate governance procedures" in place without alleging that the board deliberately failed to monitor its ethics policy or its internal procedures.

[86]*Citigroup*, 964 A.2d at 131.

[87]As stated in my analysis of the board's approval of the R&H Transaction, even assuming that the Liveris and Merszei statements were false, plaintiffs have alleged no reason for the board to suspect, let alone condone, that the statements were false or misleading. *See* discussion *supra* Part II.B.2.

[88]Defs.' Reply Br. at 20. With regard to the insider trading claim, plaintiffs do not allege any specific information to suggest that any director is "interested." Plaintiffs allege that directors had non-public information about all aspects of the Dow business. Compl. ¶ 107. Under *Guttman*, a director is not deemed interested "whenever a derivative plaintiff cursorily alleges that he made sales of company stock in the market at a time when he possessed material, non-public information." *Guttman v. Huang*, 823 A.2d 492, 502 (Del. Ch. 2003). Instead, to show interestedness, a plaintiff must allege specific information that gives rise to a reasonable inference that the insiders sold stock "on the basis of and because of" adverse material non-public information. *Id.* at 505. Plaintiffs have failed to meet their burden here. Turning to the waste claim, plaintiffs never explain whose compensation should be deemed excessive and wasteful, let alone attempt to meet the stringent

abandoned, and grant defendants' motion to dismiss without prejudice as to the *Caremark* insider trading and waste claims of Count II.

b. Director(s) Domination or Control of Board

Plaintiffs further argue that even if none of the outside directors face a substantial likelihood of liability for failing to supervise Dow's management, they have shown that Liveris does and that he dominates and controls a majority of the directors. For all the reasons presented above, I likewise conclude that plaintiffs have not alleged facts sufficient to show that Liveris is subject to a substantial likelihood of liability; therefore, whether he dominates and controls at least five other members of the Dow board is irrelevant because he suffers from no disabling or conflicting interest.[89]

Plaintiffs have failed to plead particularized facts sufficient to establish a substantial likelihood of liability for any Dow director, let alone a majority of the board, on the grounds of bribery, misrepresentations, insider trading, excessive or wasteful compensation or any other ground. Without establishing that at least one director faces a substantial likelihood of liability, plaintiffs cannot show that a majority of the board is dominated and controlled and thus improperly influenced by one such director. Plaintiffs have failed, therefore, to establish that demand is excused for their *Caremark* claims under *Rales*. Pursuant to Rule 15(aaa), all the *Caremark* claims in Count II are dismissed with prejudice, except for the insider trading and waste claims which are dismissed without prejudice.

C. Demand Futility Allegations Regarding Plaintiffs' Indemnification and Contribution Claims

Count III of the complaint seeks to assert claims for contribution or indemnity against the director defendants for unidentified claims that might be asserted in the future against Dow. The complaint is devoid of any currently pending claims, let alone actual claims, against Dow. To establish demand futility, plaintiffs must show that the board cannot exercise valid business judgment in deciding whether to pursue the derivative action

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requirements for waste. Waste occurs when there is "an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." *Citigroup*, 964 A.2d at 136 (quoting *Brehm*, 746 A.2d at 263). Clearly, without even bringing a board decision to the analysis table, plaintiffs have failed to overcome the "general presumption of good faith" with regard to their waste claim. *See Citigroup*, 964 A.2d at 136 (quoting *White v. Panic*, 783 A.2d 543, 554 n.36 (Del. 2001)).

[89] In any event, plaintiffs do not meet the heavy burden to establish domination or control established in *Beam*. A plaintiff "must plead facts that would support the inference that because of the nature of the relationship...the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director." 845 A.2d at 1052.

because it is not disinterested and independent.[90] Delaware courts only hear disputes that are ripe for judicial determination.[91] "[A] ripe dispute is one where litigation 'sooner rather than later appears to be unavoidable,' and one in which the 'material facts are static.'"[92]

Plaintiffs' claims for contribution and indemnification are clearly not ripe because no dispute or litigation currently exists or is pending. Therefore, plaintiffs' allegations are insufficient to establish demand futility, and Count III is dismissed without prejudice under Rule 23.1.[93]

VI. CONCLUSION

For the foregoing reasons, defendants' motion to dismiss is GRANTED. All claims in the complaint are dismissed for failure to adequately plead demand futility pursuant to Chancery Court Rule 23.1. Pursuant to Chancery Court Rule 15(aaa), the primary breach of fiduciary duties claims—the *Aronson* and *Caremark* claims—are dismissed with prejudice as to the named plaintiffs; all remaining claims—insider trading, waste, and contribution and indemnification—are dismissed without prejudice.

Counsel shall confer and agree upon a form of implementing Order.

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[90] *See Aronson*, 473 A.2d at 814.

[91] *See Stroud v. Milliken Enters., Inc.*, 552 A.2d 476 (Del. 1989).

[92] *Bebchuck v. CA, Inc.*, 902 A.2d 737, 740 (Del. Ch. 2006) (citing *Stroud*, 552 A.2d at 476).

[93] As stated above, there is no need to proceed to an analysis of the merits of the claim under Rule 12(b)(6) if plaintiffs cannot sufficiently plead the more stringent demand futility requirements of Rule 23.1. *See supra*, note 1. Also, pursuant to Rule 15(aaa), I find good cause to dismiss without prejudice because plaintiffs' claims are unripe; it would be unjust to foreclose these potential claims should that become possible in the future.

ROBOTTI & COMPANY, LLC v. MIKE LIDDELL

No. 3128-VCN

Court of Chancery of the State of Delaware, New Castle

January 14, 2010

R. Bruce McNew, Esquire, of Taylor & McNew LLP, Wilmington, Delaware, Attorney for Plaintiff.

Michael Hanrahan, Esquire, and Laina M. Herbert, Esquire, of Prickett, Jones & Elliott, P.A., Wilmington, Delaware, Attorneys for Defendants.

NOBLE, *Vice Chancellor*

I. INTRODUCTION

This class and derivative action involves a challenged stockholder rights offering. A shareholder plaintiff alleges that the directors set the offering at a deliberately and inadequately low price that would trigger anti-dilution provisions in the agreements governing their stock options and the controlling shareholder's warrants. The shareholder argues that the triggering of these anti-dilution provisions worked the directors a benefit not shared by the remaining shareholders, and it therefore alleges self-dealing by the defendant fiduciaries. The complaint, however, fails to state a claim because the anti-dilution provisions simply maintained unchallenged, pre-existing contractual rights of the defendant directors, which left them in substantially the same position they were in before the rights offering. For this reason and because the shareholder has not otherwise sufficiently alleged that the directors engaged in disloyal conduct, by, for instance, bowing to the will of a controlling shareholder who received a unique benefit because of the rights offering, this action will be dismissed.

II. BACKGROUND

Plaintiff Robotti and Company, LLC ("Robotti") has been a stockholder in Nominal Defendant Gulfport Energy Corporation ("Gulfport"), a Delaware corporation, since July 1, 2003.[1] Gulfport is an

[1]Second Am. Verified Class Action and Deriv. Compl. (the "Complaint") ¶ 1. The Complaint, along with its attachments and incorporated documents, is the source of the background facts.

independent oil and gas exploration and production company.[2] Robotti owned 90,000 Gulfport shares at the time of the rights offering (the "Offering") at issue.[3]

Defendants, Mike Liddell, Dan Noles, David Houston, Mickey Liddell, and Robert Brooks, were the Gulfport directors who approved the Offering.[4] CD Holding, L.L.C. ("CD Holding"), Gulfport's alleged controlling shareholder at that time, is also a named defendant.[5]

The terms of the Offering were set forth and announced in a prospectus (the "Prospectus"), which Gulfport filed with the Securities and Exchange Commission on July 22, 2004.[6] At that time, Gulfport had 10,146,566 shares of common stock outstanding and 396 shareholders of record.[7] Collectively, Gulfport's officers and directors owned 1,269,416 shares of common stock (counting options then currently exercisable or exercisable within sixty days of the filing), which amounted to 12.5% of the company's equity. Of this figure, Gulfport Chairman Mike Liddell alone owned 1,169,416 shares, amounting to 11% of the company's equity.[8] Gulfport listed Charles Davidson as its largest shareholder. Davidson, who is not a party to this action, beneficially owned 8,177,595 Gulfport shares (including those attributable to warrants that would have been converted into 2,022,740 shares), which represented 67.2% of the all the shares outstanding. Much of Davidson's equity was held by CD Holding, of which Davidson was the sole member, or by Wexford Management, L.L.C., of which Davidson was the Chairman and controlling member.[9]

A. *The Offering*

Under the Offering, one transferable subscription right would be granted to Gulfport's common shareholders for every 1.0146 shares of common stock they owned.[10] Each right could then be exercised for $1.20 in

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[2] *Id.* at ¶ 2.

[3] *Id.* at ¶ 36. As part of its investigation of the Offering, Robotti used 8 *Del. C.* § 220 to inspect the Company's books and records. *See Robotti & Co., LLC v. Gulfport Energy Corp.*, 2007 WL 2019796 (Del. Ch. July 3, 2007).

[4] Compl. ¶¶ 3-8. References to the "Defendants" or to the "Board," unless otherwise noted, will be to those directors serving at the time of the Offering.

[5] *Id.* at ¶ 9. CD Holding has not been served.

[6] The Prospectus appears in the record as Exhibit A to the Transmittal Certificate of Laina M. Herbert (Feb. 20, 2009).

[7] Prospectus at 13.

[8] Compl. ¶ 37; Prospectus at 48-49.

[9] *Id.* The Complaint varies between designating Davidson and CD Holding as the controlling Shareholder.

[10] Compl. ¶¶ 33-34. The rights were granted to the stockholders of record as of the close of business on July 16, 2004. The Offering expired on August 17, 2004. Prospectus at 1-2.

return for one share of common stock.[11] Gulfport's common stock closed at $3.10 per share on the OTC (over-the-counter) Bulletin Board on April 21, 2004, the last day before the Board decided upon the rights plan, but closed at $2.19 on July 21, 2004, the day before the Board filed the Prospectus.[12]

Thus, Gulfport intended to raise $12 million from its then-current stockholders in exchange for 10 million shares of common stock.[13] To guarantee this result, Gulfport entered into a back-stop agreement with CD Holding whereby CD Holding would purchase any of the 10 million shares of common stock not subscribed for by the rights holders. Gulfport agreed to pay CD Holding a commitment fee equal to two percent of the Offering's gross proceeds, or $240,000, in return for its back-stop guarantee.[14]

Gulfport claimed that it intended to use the proceeds from the Offering "primarily to fund a portion of [its] proposed seismic and drilling programs."[15] Another identified purpose for the proceeds was the repayment of a line of credit with the Bank of Oklahoma; the balance under that facility was $2.2 million as of March 31, 2004.[16] It disclosed that it had only $580,000 in cash available for investment when it filed the Prospectus, and was therefore in need of capital.[17]

Gulfport also informed its shareholders that it had entered into a $3 million revolving credit facility with CD Holding on April 30, 2004 in connection with the Offering; under this facility, CD Holding could apply any unpaid principal amount and accrued, but unpaid, interest to the subscription price for rights issued to it.[18]

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[11] *Id.*

[12] Prospectus at 2-4. Robotti claims that Gulfport's net asset or "PV-10" value, after adjustment for its oil and gas reserves, was at least $14.00 a share at or around the time of the Offering. Compl. ¶ 35.

[13] Prospectus at 11-12. Although the Offering's gross proceeds would be $12 million, net proceeds would amount to $11,890,000 after accounting for costs and expenses. *Id.*

[14] Compl. ¶ 59; Prospectus at 16. Under the terms of the Offering, the common shareholders could exercise their subscription rights, sell the rights to others, or allow the rights to expire upon the transaction's closing, at which time CD Holding would purchase any outstanding subscription rights pursuant to the back-stop agreement. Prospectus at 15-16.

[15] Compl. ¶ 38. Specifically, Gulfport disclosed that it had budgeted $4.5 million for a 3-D seismic survey at its East Hackberry Field, approximately $9.6 million for drilling twelve wells at its West Cote Blanche Bay Field, and roughly $1 million for "workovers" of ten wells in the West Cote Field. Prospectus at 11.

[16] Compl. ¶ 38; Prospectus at 11.

[17] Compl. ¶ 38; Defs.' Opening Br. at 7. Gulfport additionally disclosed that it had hired Petrie Parkman in 2003 "to assist in the possible sale of its West Cote Blanche Bay Field." No sale of the field was pending as of the date the Prospectus was filed, and the Board determined that it would be in Gulfport's best interests to undertake the Offering if the sale of the oil field was not ultimately consummated. Prospectus at 31.

[18] Compl. ¶ 52(e); Prospectus at 30, 50. As a large shareholder, CD Holding held substantial subscription rights. It ultimately applied $500,000 owed to it under this credit facility

B. *The Options and the Warrants*

Gulfport had warrants exercisable into 2.4 million shares and options exercisable into 627,000 shares at the time of the Offering.[19] Management and the Board owned the options and CD Holding beneficially owned most of the warrants,[20] which could be exercised for $2.00 and $4.00 per share, respectively.[21] The Offering triggered anti-dilution provisions contained in the agreements governing the options and the warrants—these provisions became operative upon a common stock issuance at a price less than the respective option and warrant strike prices.

According to the Prospectus, the number of shares of common stock resulting from exercise of the options "[would] be increased and the exercise price per share [would] be decreased" based upon the Offering's subscription price, the total number of shares offered, and the common stock's current market price; the aggregate exercise price would, however, remain the same. After the Offering, the option holders could acquire 1,245,612 shares of common stock for $1.01 per share.[22] As implemented, the option holders, collectively, could obtain the same percentage of Gulfport's common stock after the Offering as they could have before, and all for substantially the same price.

The anti-dilution provisions applicable to the warrants operated differently from their option counterparts. The Prospectus revealed that the exercise price of the warrants would "be reduced to the subscription price, and the number of shares to be purchased under the warrants [would] be increased by dividing the subscription price into the aggregate exercise amount of the warrant prior to the reduction in the exercise price." Thus, after the Offering, the warrant holders were entitled to acquire 8,105,057 shares of Gulfport common stock for $1.20 a share.[23] In other words, a warrant that allowed for the acquisition of one share of common stock for $4.00 was adjusted after the Offering to allow for the acquisition of more than three shares of Gulfport common stock for $1.20 per share.[24]

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toward its exercise of these rights. Compl. ¶ 38 (citing Gulfport's Form 10-Q from the quarter ending September 30, 2004).

[19] *Id.* at ¶ 39. Specifically, Gulfport had outstanding warrants for the purchase of 2,431,517 shares, and options for the purchase of 627,337 shares. Prospectus at 22.

[20] Compl. ¶ 39. Defendants Brooks, Houston, Mickey Liddell, and Noles each owned 20,000 options while Defendant Mike Liddell owned 467,270 options. *Id.* at ¶ 15.

[21] *Id.* at ¶ 39.

[22] Prospectus at 22.

[23] *Id.* at 22-23. The aggregate exercise price for the warrants was $9,726,068 ($4.00 per share times 2,431,517 shares).

[24] If the Offering price had been, say, $1.80 per subscription right, the exercise price for the warrants would have been adjusted to $1.80, the same price. Moreover, the total number of shares to be acquired through the warrants would have increased to only 5,403,371.

III. CONTENTIONS

Robotti contends that the Offering's low price triggered the anti-dilution provisions, which "greatly increased" the number of shares to be issued to meet Gulfport's obligations to the holders of the warrants and options. Indeed, Robotti asserts that, "in the case of the warrants it increased more than [three] fold and the number of shares issued against the options almost doubled."[25] As a result, Robotti claims that Gulfport issued "approximately 16.2 million shares to raise only approximately $12 million," thereby reducing the average Offering price per share from the $1.20 projected in the Prospectus to a mere $0.70.[26] Robotti argues that both the shareholder class it purports to represent and Gulfport were injured by this result: the public shareholders experienced dilution in the value of their stock to the benefit of "the controlling stockholder and management," while Gulfport failed to raise the full amount of capital it could have raised had the defendants set a higher Offering price.[27] If the rights had been priced "at a more usual discount," Robotti suggests that the "anti-dilutive effects of the options would not have existed and the anti-dilutive effect of the warrants would have been greatly minimized."[28]

In Robotti's view, by pricing the Offering at $1.20 a share and causing the result described above, the Defendants engaged in an "unnecessary self-dealing transaction" with no "indicia of fairness" for the purpose of obtaining a personal financial benefit.[29] In support of this argument, it relies upon a host of circumstantial facts: in particular, it questions whether the Board duly considered the consequences of the low subscription price, and it challenges the truth of certain disclosures made in the Prospectus.

Robotti contends that the Prospectus presented "vague" explanations for why the Offering was priced at $1.20 a share, and it asserts that the Board failed specifically to explain why it priced the subscription rights below the respective strike prices for the warrants and options.[30] Additionally, Robotti criticizes the Defendants' decision to deploy a rights plan as opposed to some alternative financing method that would not have triggered the anti-dilution provisions.[31] It also points out that the Defendants

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[25]Compl. ¶ 55.

[26]*Id.* at ¶ 40.

[27]*Id.* at ¶¶ 61-67.

[28]*Id.* at ¶ 56.

[29]Pl.'s Answering Br. at 21.

[30]Compl. ¶ 41. When setting the price, the Board considered "*such factors as* the current market price of [Gulfport's] common stock, the availability of financing alternatives and the level, volatility of commodity prices and the ability to secure an agreement from CD Holding to back-stop this rights offering." Prospectus at 8 (emphasis added).

[31]Compl. ¶ 41.

failed to appoint or obtain an independent representative or advisor to evaluate the transaction's fairness or to issue a fairness opinion. Robotti reports that after reviewing the minutes and documents produced in response to the Court's § 220 order, it found that the Board had neglected to deliberate on the issues it claimed to have considered in its Prospectus disclosures.[32]

Indeed, although emphasizing that it is not bringing disclosure claims, Robotti maintains that the Offering's justifications as set forth in the Prospectus were inconsistent with the Board's own deliberations, as gleaned from minutes produced by, and records put before, the Board at several pre-Offering meetings.[33] Robotti contends that the Prospectus falsely disclosed deliberations by the Board to determine the need for, and the price of, the Offering, which "reveal[ed] an effort by defendants to conceal their improper actions and purpose."[34] It argues that "management and the Company's controlling shareholder" devised the Offering for the purpose of triggering the anti-dilution provisions, and did so not only without genuine Board authorization, but instead with "rubberstamp" approval in the form of the allegedly false Prospectus disclosures regarding Board diligence.[35]

Robotti asserts a claim against the Defendants for breach of the duty of loyalty.[36] It concludes that the Defendants' alleged lack of evaluation of the effect of the anti-dilution provisions, the low price of the Offering, the false disclosures in the Prospectus, and the existence of, but failure to pursue, reasonable alternatives to financing, taken together, indicate that the Defendants knowingly and intentionally used the Offering as a means of working themselves a benefit through operation of the anti-dilution provisions, which harmed both Gulfport and its public stockholders.[37] Robotti also argues in the alternative, albeit less forcefully, that the Defendants triggered the anti-dilution provisions without considering the consequences.[38] Robotti does not, however, make clear whether this alternate allegation rises to the level of conscious disregard of one's fiduciary duties,

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[32]*See id.* at ¶ 52. Robotti and the Defendants, in particular, debate the success of the drilling operation that the Offering was purportedly needed to fund. Robotti argues that the program was complete by the time the Offering closed, and therefore the funds were not needed, or alternatively, funds could have been had by leveraging the successful operation. *Id.* at ¶ 57.

[33]*Id.* at ¶¶ 44, 52.

[34]*Id.* at ¶ 52(c) (arguing that, although the Prospectus disclosed that when determining the subscription price the Board considered the common stock's current market price, alternatives to financing, commodity price volatility and ability to secure the back-stop agreement, "the actual records of the company demonstrate absolutely no validity to [that] assertion").

[35]*Id.* at ¶ 49, 52(c).

[36]Pl.'s Answering Br. at 18 ("The Complaint alleges self-dealing by fiduciaries. The entire Board of Directors at the time of the transaction and the Company's controlling shareholder, all of whom owed fiduciary duties to the other stockholders are alleged to have received financial benefits not available to those other stockholders.").

[37]Compl. ¶ 52.

[38]Compl. ¶ 62.

and thus perhaps represents another claim of disloyalty, or simply constitutes a duty of care claim based upon gross negligence and uninformed decision-making.[39]

The Defendants moved to dismiss, arguing, *inter alia*, that the Offering's trigger of the anti-dilution provisions neither personally benefited the Defendants nor injured the public stockholders or Gulfport itself. In particular, the Defendants maintain that the operation of the anti-dilution provisions upon the options did not dilute the value and positions of the common shareholders but merely maintained the pre-Offering equity position of the option holders.[40] The Defendants argue that application of 8 *Del. C.* § 153 effectively bars Robotti's claims, and that the Court should not disrupt the valid business judgment of the board of directors.

Additionally, the Defendants address allegations that the Board failed to exercise due diligence regarding the Offering; they maintain that the minutes and records upon which Robotti relies tell an altogether different story from the one presented in the Complaint: instead of rubber stamping the transaction, the Defendants maintain that the Board duly considered the need for additional capital, financing alternatives, the subscription price, and the back-stop agreement.[41] Moreover, the Defendants argue that Robotti misinterpreted information concerning the success of the drilling program, which while successful, was not yet complete as of the Offering and therefore in need of additional funds.

Lastly, the Defendants contend that Robotti's claims are derivative and that, at the time Robotti amended its complaint to add the derivative count, a majority of the Board was not interested in the transaction.[42] Further, Defendants claim that the facts as alleged do not create a reasonable doubt that these disinterested directors were under the control of an interested party and thus not independent. They also assert that the Board exercised valid business judgment in approving the Offering. For these reasons, the Defendants conclude that Robotti failed to plead demand excusal as required by Court of Chancery Rule 23.1.

Robotti of course opposes the Defendants' substantive arguments, but also requests that the motion to dismiss be converted into a motion for summary judgment.[43] Robotti complains that the Defendants have relied

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[39]In its answering brief, Robotti explicitly claims that the "Complaint alleges a conscious disregard of the interests of the corporation and the rights of the stockholders." Pl.'s Answering Br. at 20.

[40]Defs.' Opening Br. at 21 ("[B]ecause the Rights Offering doubled the number of outstanding shares, the adjustments cause no dilution. The anti-dilution adjustment simply gave the directors the right after the Rights Offering to purchase the same equity interest for the same amount of money as before the Rights Offering.").

[41]Defs.' Opening Br. at 5-13.

[42]*Id.* at 35.

[43]Pl.'s Answering Br. at 12. *See* Ct. Ch. R. 12(b).

upon extraneous documents to contest the factual basis of its complaint, thereby raising issues of material fact best reserved for summary judgment.

IV. ANALYSIS

Although Robotti alleges dishonest and incomplete disclosures and uninformed Board decisions, this case, by force of the focus of Robotti's contentions, ultimately boils down to an alleged breach of the duty of loyalty and whether or not the Defendants obtained a personal benefit through the Offering.[44] The Court, however, cannot draw a reasonable inference from the facts as alleged that the Offering's trigger of the anti-dilution provisions and their effect upon the options worked a material personal gain to the Defendants at the expense of Gulfport or the public stockholders. Robotti also did not plead sufficient facts to support a claim that the Defendants acted in bad faith by consciously disregarding their fiduciary duties. Because the Court cannot reasonably infer from the facts alleged that the Defendants received a personal gain by way of the collateral consequences of the Offering or consciously disregarded their duties, their decision to consummate the Offering is protected by the business judgment rule. Of equal importance, Robotti has not duly alleged that CD Holding, the controlling shareholder, dominated the Board as it approved the Offering. Lastly, Robotti's derivative claims are barred because it has failed to plead that Gulfport's board of directors was either interested or under the control or domination of an interested party as of the time it asserted the derivative claims.[45]

A. *The Court Declines to Convert Defendants' Motion to Dismiss into One for Summary Judgment*

Robotti requests that the Defendants' Motion to Dismiss be converted into one for summary judgment. It argues that the Defendants have relied upon documents neither integral to, nor incorporated within, the Complaint. These documents include minutes, the Prospectus, the

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[44]Pl.'s Answering Br. at 6-7 ("In short, the Complaint in clear and explicit terms alleges that the Defendants manipulated corporate machinery for personal economic advantage in [a] self- dealing transaction.").

[45]A recurring problem is that Robotti directs a substantial portion of its efforts toward showing that the members of the Board were conflicted—because of their ownership of options—as they approved the Offering. Its other contentions were less developed—some even arguably not fairly presented—such as its argument that the Board failed to exercise due care. Thus, the Court is left with the task of attempting to put flesh on some bare bones arguments that were not presented in any detail.

documents put before the Board during meetings that took place around the time of the Offering, and contemporaneous public disclosures.[46]

If, in considering a motion under Court of Chancery Rule 12(b)(6), matters outside the pleading are "presented to and not excluded by the Court," then the motion must be treated as one for summary judgment under Court of Chancery Rule 56, thereby giving all parties reasonable opportunity to present all material relevant to a summary judgment motion.[47] Thus, matters beyond the complaint may generally not be considered in a ruling on a motion to dismiss.[48] There are exceptions to this principle: 1) when such documents are integral to, and incorporated within, the plaintiff's complaint; or 2) when the documents are not being relied upon for the truth of their contents.[49]

The Prospectus, as used here, comes within the first exception. Robotti expressly incorporates the Prospectus into its complaint,[50] and the Prospectus is integral to its claims. The Prospectus is the factual source for most of Robotti's allegations, including those regarding the Offering's allegedly low price and stated justifications, as well as the respective benefits and injuries the Offering worked for the Defendants and inflicted upon Gulfport and the public shareholders.[51]

The Court, to some extent, may also consider, under both exceptions, the content of the pre-Offering meeting minutes and documents put before the Board during these meetings. Robotti incorporated these documents into its complaint, and such documents are integral to its charge that the Board failed to duly consider the rights offering.[52] Moreover, neither

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[46]Pl.'s Answering Br. at 7, 12.

[47]Ct. Ch. R. 12(b).

[48]*Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 860 A.2d 312, 320 (Del. 2004).

[49]*Vanderbilt Income & Growth Assocs. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996).

[50]*See* Compl. ¶ 33 ("The terms of the Prospectus are incorporated herein by reference . . . .").

[51]*See id.* at ¶¶ 33-34, 38-40. ("By prospectus . . . [Gulfport] first announced a rights offering . . . [that] described a transaction whereby a single transferable subscription right at a price of $1.20 . . . [for] the purpose [of] fund[ing] 'a portion of [its] currently proposed seismic and drilling programs' . . . [D]ue to the low offering price for the subscription rights, anti-dilution provisions protecting the holders of the warrants and options were triggered by the Offering.").

Although Robotti claims that the terms of the Prospectus have not been incorporated "for the truth of the matters asserted herein" and instead only to identify certain company disclosures and admissions, it clearly uses this document as the factual basis for its claims regarding the price of the Offering and effect of the anti-dilution provisions.

[52]*See id.* at ¶ 44 ("The records of [the] Board of Director[s], however, reveal there were no such considerations. The minutes of the meetings and the documents . . . contain absolutely no information . . . regarding current [stock price], the availability of financing alternatives, the level or volatility of commodity prices or the ability to secure a back-stop agreement.").

the Court nor the parties rely upon these documents to prove the truth of their contents, but rather to address whether the Board considered the Offering's effect upon the anti-dilution provisions before moving forward with the transaction.

More importantly, however, the Court ultimately does not rely upon the meeting minutes, or for that matter, any other document outside of the pleadings except for the Prospectus. Because the Court cannot reasonably infer from the facts as alleged that the triggering of the anti-dilution provisions provided the Defendants a material benefit not shared by the remaining shareholders, or that the Defendants consciously disregarded Gulfport's interests, the Court need not review in any great detail what, if any, consideration the Board gave to the subscription price, financing alternatives, or the business justifications underlying the Offering. There is, therefore, no need to rely upon the minutes or other public disclosures.

B. *The Nature of the Claims*

Robotti argues that it has brought both direct and derivative claims. As to the direct claim, Robotti contends that the Offering devalued the public's "shares [to the benefit] of the controlling shareholder and management."[53] Regarding the derivative claim, Robotti argues that the public stockholders experienced value dilution as a result of the Offering, and that Gulfport sustained an injury because the Defendants failed "to raise the full amount of capital which could have been raised through the issuance of the shares issued in the transaction."[54]

When distinguishing between direct and derivative claims, this Court must ask the following questions: (1) who suffered the alleged harm—the corporation or the shareholders individually; and (2) who would receive the benefit of the recovery or other remedy?[55] When a plaintiff asserts a claim against fiduciaries alleging overpayment and subsequent common stock dilution, that claim is typically "regarded as exclusively derivative, irrespective of whether the currency or form of overpayment is cash or the corporation's stock."[56] Dilution in value of corporate stock "is merely the unavoidable result of the reduction in value of the entire corporate entity," and the "equal injury" to the shares that results from an overpayment should not be equated with "harm to specific shareholders individually."[57]

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[53] *Id.* at ¶ 63.

[54] *Id.* at ¶¶ 65-67; *see also* Pl.'s Answering Br. at 25 ("[T]he corporation has suffered injury in that it has issued something valuable, common stock, in exchange for far less than that stock was worth.").

[55] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004).

[56] *Gentile v. Rossette*, 906 A.2d 91, 99 (Del. 2006).

[57] *Id.*

A direct claim results, however, when an overpayment of stock for insufficient consideration (1) goes to, and is caused by, a controlling shareholder and (2) when such overpayment "causes an increase in the percentage of the shares owned by the controlling shareholder, and a corresponding decrease in the share percentage" owned by the minority.[58] In *Gentile*, the corporation's controlling shareholder and chief executive officer caused the company to issue the controlling shareholder stock in return for debt forgiveness. The alleged value of the shares exchanged, however, exceeded the value of the outstanding debt. The transaction not only greatly enhanced the controlling shareholder's equity position at the expense of the minority shareholders, but also injured the corporate entity.[59]

The Supreme Court in *Gentile* held that both the corporation and the shareholders were harmed by the overpayment: the corporation was harmed because it exchanged corporate property for something of a lesser value, and the public shareholders were harmed insofar as economic value and voting power had been "expropriated" by and "redistributed" to the controlling shareholder out of the minority interest.[60] Because of the dual nature of the harm, the Supreme Court considered the claims both direct and derivative.

As in *Gentile*, Robotti brings both direct and derivative claims. Its claims of overpayment to the Defendants are derivative—the directors allegedly were able to purchase stock at a price less than both its trading value and the price paid by the minority shareholders. If true, this overpayment would have diluted the public float and correspondingly injured the corporation. In addition, because Robotti's claims specifically involve a stock overpayment to the controlling shareholder, this case fits within the *Gentile* dual-claim paradigm. Had the anti-dilution provisions allowed CD Holding to purchase more stock than the other shareholders (i.e., other subscription rights holders) and at a price below its worth, CD Holding would have increased its share percentage at the expense of the minority stockholders, thereby giving rise to a direct claim.[61]

C. *Plaintiff's Complaint Fails to State a Cause of Action*

Robotti did not adequately plead both self-dealing by the Defendants and resulting injury to Gulfport and the public shareholders, nor has it sufficiently alleged that the Defendants consciously disregarded Gulfport's interests. For these reasons, the Complaint must be dismissed for failure to state a claim. Although the Board's approval of the $1.20 subscription price did in fact trigger the anti-dilution provisions, the provisions' adjustment of

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[58] *Id.* at 99-100.
[59] *Id.* at 94-96.
[60] *Id.* at 100.
[61] The alleged benefit to CD Holding is discussed in greater detail at note 80 *infra*.

the options did not confer a special benefit upon the Defendants, but instead protected them from the material dilution they would have otherwise suffered through the Offering. It cannot therefore reasonably be inferred from the facts as alleged that the triggering of the anti-dilution provisions, as applied to the options, unfairly diluted the public shareholders or that, by setting the price at $1.20, these provisions harmed Gulfport to the Defendants' personal benefit.

1. Standard of Review and the Applicable Law

On a motion to dismiss, the Court accepts the truth of all well-pled facts of the Complaint and will draw all reasonable inferences in a light most favorable to the plaintiff.[62] The Court may not, however, assume the accuracy of a plaintiff's factual conclusions unless supported by specific factual allegations.[63] Thus, the Court need not accept as true all allegations without question, nor must it draw unreasonable inferences from these allegations.[64] This Court will only dismiss a complaint under Court of Chancery Rule 12(b)(6) "where it appears with 'reasonable certainty' that the plaintiff could not prevail on any set of facts that can be inferred from the pleadings."[65]

2. Robotti's Mathematical Conclusions

Robotti maintains that, because of its unfairly low pricing, the Offering triggered anti-dilution provisions that caused Gulfport to issue 16.2 million shares of common stock for $12 million, or $0.70 a share.[66] The pleadings adequately allege that the anti-dilution provisions, once triggered, raised the number of shares of common stock into which the options and warrants could be converted from 3,058,854 to 9,350,669 shares, for a total

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[62] *Hillman v. Hillman*, 910 A.2d 262, 269 (Del. Ch. 2006).

[63] *Id.*

[64] *Gloucester Holding Corp. v. U.S. Tape & Sticky Prods.*, 832 A.2d 116, 123 (Del. Ch. 2003) (quoting *Grobow v. Perot*, 539 A.2d 180, 187 & n.6 (Del. 1988)).

[65] *In re Paxson Commc'n Corp. S'holders Litig.*, 2001 WL 812028, at *3 (Del. Ch. July 12, 2001) (quoting *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35, 38 (Del. 1996)).

[66] Compl. ¶ 40. Robotti and the Defendants quarrel over whether and when the options or warrants were in fact exercised. *See* Defs.' Opening Br. at 24. Although the question of whether Robotti's claims are ripe may not be ignored altogether, this debate is of only marginal significance. The Prospectus disclosed the effect of the anti-dilution provisions upon the warrants and options, and thus any injury or loss of value to the common shareholders or Gulfport itself would have been understood by the investing public as of the time of the Offering, even if the effects were formally not recognized until exercise. It may be worth noting that there is evidence of exercise, especially of the warrants, in the record. Trans. Cert. of Laina M. Herbert (Apr. 28, 2008), Ex. 16, at RC0008.

increase of 6,291,815 shares.[67] Robotti's argument seems to assume that these roughly 6.3 million shares would be issued for free, in addition to the 10 million shares issued by exercise of the Offering's subscription rights.

Robotti's argument, however, fails to account for the exercise price of the options and warrants. Those 6.3 million additional shares may only be issued upon the Defendants' payment of the adjusted warrant and option prices: $1.20 per share for the warrants, and $1.01 per share for the options. Thus, Gulfport would not be issuing 6.3 million additional shares for nothing, but would instead issue such shares upon exercise of the options and warrants, and payment of their respective exercise prices.

If the option and warrant holders purchased just the additional shares available under the instruments, they would pay roughly $6.8 million for the additional shares available under the warrants, and about $624,500 for the additional shares available under the options.[68] And of course, if the defendants exercised all of their options and warrants, including the additional shares provided by the anti-dilution provisions, they would pay approximately the original aggregate exercise prices: $9,726,068 for stock issued under the warrants, and $1,258,068 for stock issued under the options.

Viewing the transaction as a whole: if all those entitled to participate in the Offering exercised their subscription rights, Gulfport would in fact receive $12 million in return for an issuance of 10 million shares.[69] This issuance would trigger the anti-dilution provisions, increasing the number of shares into which the warrants and options are convertible. If the adjusted warrants and options were then exercised in full, Gulfport would issue an additional 9,350,669 shares for $10,984,136. Under no circumstance would Gulfport issue 16.3 million shares for only $12 million—the option and warrants holders cannot obtain the additional 6.3 million shares provided by operation of the anti-dilution provisions without first paying their exercise price.

If all the subscription rights were exercised, and then all of the adjusted warrants and options were exercised, Gulfport would ultimately be issuing 19,350,669 shares for $22,984,136, which amounts to an average price of $1.19 per share.[70] While Robotti's argument rightfully points out that

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[67]The number of shares into which the options could be exercised increased by 618,275, while the number of shares into which the warrants could be exercised increased by 5,673,540.

[68]Multiplying $1.01 by 618,275 additional shares under the options equals approximately$624,500; and multiplying $1.20 by 5,673,540 additional shares under the warrants equals roughly $6.8 million. Combined, the aggregate purchase price for additional shares available under both instruments would be roughly $7.4 million.

[69]Even if less than all of the subscription rights were exercised, Gulfport would still receive $12 million in return for 10 million shares by operation of the back-stop agreement.

[70]To arrive at its conclusion that the Offering caused Gulfport to issue stock for $0.70 per

more than six million new shares became available under the options and warrants as a result of the Offering, such shares would not be issued for free, but would be paid for as these instruments are exercised.

3. Robotti Otherwise Fails to Establish Personal Gain for the Defendants

The heart of Robotti's complaint may be summarized as follows: Robotti maintains that the Defendants deliberately set the Offering at $1.20 per share "for the purpose of obtaining personal benefits not available to other shareholder[s]." That price triggered the anti-dilution provisions, and thereby allowed the Defendants to acquire stock on better terms than those under which the holders of the subscription rights participated in the Offering.[71] Robotti essentially "alleges self-dealing by fiduciaries," as to both the Board at the time of the transaction and Gulfport's controlling shareholder, "all of whom owed fiduciary duties to the corporation."[72]

A stockholder seeking to overcome a Rule 12(b)(6) challenge to its claim that a transaction was approved by a board with a majority of its directors interested in a transaction must allege, as to at least half of the board, facts that create a reasonable ground to infer that those directors had a material interest in the transaction and that such interest was inconsistent with that of the corporation. A director will be considered interested if he or she engaged in self-dealing, or otherwise stood on both sides of the transaction.[73] Interest may also be shown when a director authorized a transaction with the expectation of receiving a personal financial benefit not available to the other shareholders generally.[74]

The Prospectus shows that the options held by the directors were originally exercisable into 627,337 shares of Gulfport common stock at a price of $2.00 per share, which amounts to an aggregate $1,254,674 exercise price. After, and as a result of the Offering, the options could be converted into 1,245,612 shares of common stock for $1.01 a share. Thus the number of shares into which the options could be converted increased 98.55% as a result of the anti-dilution provisions. Through the Offering, however,

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share, Robotti added the 6.3 million additional shares made available under the options and warrants by operation of the anti-dilution provisions to the 10 million shares issued pursuant to the Offering. It then divided the $12 million to be raised in the Offering by this 16.2 (16.3) million "new" share figure. Doing so yielded a price per share of around $0.74 . Robotti, however, failed to add the aggregate $7.4 million exercise price of the new shares made available under the options and warrants to the $12 million Offering price. Dividing this $19.4 million figure by 16.3 million shares yields a $1.19 share price.

[71] Pl.'s Answering Br. at 5.

[72] *Id.* at 18.

[73] *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1169 (Del. 1995).

[74] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (*overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)).

Gulfport intended to issue an additional 10 million shares of common stock. As there were 10,146,566 shares outstanding immediately before the Offering, this 10 million share increase represented an identical 98.55% increase in new equity.

Thus, the anti-dilution provisions, once triggered, increased the number of shares that could be purchased under the options by the same percentage as the subscription rights, when exercised, would increase the total number of shares outstanding. The anti-dilution provisions essentially allowed the option holders to stand in the same position as the shareholders in terms of the percentage increase in the number of shares they could each acquire through the Offering. Robotti therefore cannot argue that the anti-dilution provisions caused the Defendants to acquire a greater equity interest under the Offering than the common shareholders: both the option-holders and the common shareholders who exercised their rights increased their respective equity positions in lock-step by the same 98.55%.

Here is the effect of the anti-dilution provisions upon the options from a different perspective: before the Offering, had the options been fully exercised, the resulting shares would have represented 5.822% of all the common stock outstanding. After the Offering, had the options been fully exercised into the now adjusted figure, the resulting shares would still have represented 5.822% of all the common stock outstanding, including of course the new stock issued in the Offering. Thus, the anti-dilution provisions, in regard to the options, preserved the option holders' pre-Offering equity position by allowing them to pay the same aggregate price after the Offering as they would have paid before the Offering, and all for the same Gulfport equity stake.[75] Instead of diluting the other shareholders, the anti-dilution provisions prevented the Defendants from being diluted by those shreholders participating in the Offering.[76]

It is true that the directors (as option holders), after the Offering, could purchase common stock under their options for only $1.01 a share

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[75]Although Gulfport reported that the anti-dilution provisions would adjust the post-Offering option exercise price based on, in part, the "subscription price per share of the rights issued in this rights offering," it appears that the determinative factor in the option adjustment was the number of shares to be issued through the Offering. Prospectus at 22. As explained above, the anti-dilution provisions increased the number of shares to be purchased under the options by the same percentage as the total shares increased pursuant to the Offering. After the Offering, the option holders had the right to purchase 98.55% more shares under their options, or 1,245,612 shares. The exercise price of the options was then adjusted downward by dividing the total number of shares into which the options could be exercised into the pre-Offering aggregate option exercise price ($1,254,674) to arrive at $1.0072 a share, or, when rounded to the nearest cent, $1.01 per share.

[76]In fact, Gulfport warned the shareholders that, by not participating in the Offering, they would face substantial dilution. Prospectus at 9 ("To the extent a stockholder does not exercise its rights in full, such stockholder's voting power and percentage equity interest in the Company, including its percentage interests in any future earnings, will suffer substantial dilution.").

while the shareholders could purchase stock in the Offering for $1.20 a share. Although it may seem as though the directors therefore received a benefit that did not accrue to the shareholders, this is a result of their pre-Offering (and otherwise unchallenged) contractual rights under the option agreements. The directors had the right to purchase 5.822% of Gulfport's equity for $1,254,674. By triggering the antidilution provisions, the Defendants did not confer upon themselves a benefit but instead maintained an interest that they had held since the options were granted.[77] Robotti does not challenge the actual grant of the options and therefore cannot now challenge the directors' right to 5.822% of the Gulfport equity for $1,254,674.

Robotti is unable, from its well-pled factual allegations, to support the inference that the Defendants received a personal benefit from the Offering.[78] The Defendants had pre-existing contractual rights to a percentage of Gulfport's equity at a predetermined price. The anti-dilution provisions preserved these rights and allowed the directors to purchase the same pre-Offering amount of equity for the same aggregate pre-Offering price after the Offering's near doubling of the outstanding common stock at a price below market value.[79] Although the option's price per share was in fact lowered to $1.01, this result was necessary to preserve the value of the directors' options, and in any event, represented a contractually established price for a percentage of equity agreed upon before the Offering. Of further importance, the anti-dilution provisions allowed the Defendants to increase their stock holdings by the same percentage as the Offering permitted the shareholders to increase their shares.[80]

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[77]With the influx of proceeds from the Offering, the value of that same percentage may have increased; that, however, is a contention that Robotti has not advanced.

[78]Even if the Court assumes that some special benefit resulted from the anti-dilution provisions protecting the options, nothing before the Court suggests that such benefits were in any way material to a majority of the Board. *See infra* note 98 & accompanying text.

[79]Because, as even Robotti acknowledges, a successful rights offering will be priced below market value of the underlying shares to assure, to the extent possible, full subscription, Compl. ¶ 56; some loss in value of the shares outstanding before the offering is likely, simply as the result of averaging.

[80]The effect of the anti-dilution provisions upon the warrants merits discussion here. As stated previously, before the Offering, the warrants were exercisable into 2,431,517 shares of common stock at a price of $4.00 per share for an aggregate $9,726,068. After the Offering, those same warrants could be exercised into 8,105,057 shares of common stock at $1.20 per share, and again for the same aggregate $9,726,068. As explained in the Prospectus, the per share price for the shares underlying the warrants was simply ratcheted down to $1.20, and this price was then divided into the original aggregate purchase price to arrive at the total number of shares then available under the warrants after the Offering.

Unlike the options, the anti-dilution provisions did not merely prevent the warrant holders from suffering dilution, but rather allowed them to increase their stake in Gulfport. While the options were adjusted to allow for a 98.55% increase in their underlying shares—an amount commensurate with the percentage increase in the shares issued to the subscription rights holders in

4. Insofar as Robotti Seeks to Allege Bad Faith, That Inference Also Cannot be Drawn from the Facts as Alleged

Although Robotti alleges self-dealing many times throughout the Complaint and its answering brief in response to the Defendants' Motion to Dismiss, it also implies that the Defendants acted in bad faith by consciously disregarding Gulfport's interests.[81] Its Complaint asserts that the Directors

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the Offering—the warrants were adjusted to allow for a 233.33% increase in their underlying shares. And while the options were adjusted based upon the number of shares issued in the Offering, the warrants were simply readjusted based upon the Offering's per share price—the lower the price of the subscription rights, the cheaper the price per share available under the warrants and the more equity the warrant holders could purchase for the same total investment under these instruments.

As an additional matter of contrast, the option holders were entitled to the same amount of equity after the Offering as they were before, and all for the same aggregate purchase price; the warrant holders, on the other hand, could acquire either the same amount of equity after the Offering as they could before but for less consideration, or could acquire a greater total amount of equity but for no more than the original aggregate consideration. Thus, while the option holders could acquire 5.822% of Gulfport's equity both before and after the Offering, and do so at either time for $1.26 million, the warrant holders were entitled to 19.33% of Gulfport's equity before the Offering, and 28.7% after, but for the same $9.73 million in consideration.

This last point regarding transactional arithmetic leads to a final conclusion: although the anti- dilution provisions allowed the option holders to withstand the possible dilution they faced from the participating rights holders, it did not entirely protect them from the dilution they would face from the warrant holders if the warrants were fully exercised after the Offering. On a fully diluted basis that accounts for exercise of the warrants, the option holders were entitled to 4.75% of Gulfport's equity before the Offering, but only 4.22% after. The warrant holders, also on a fully diluted basis that accounts for exercise of the options, were entitled to 18.41% of Gulfport's equity before the Offering and 27.48% after.

Whether CD Holding, which owned most of the warrants, engaged in self-dealing is not directly at issue because it was never served in this action. More importantly, Robotti has not alleged that the Defendants were beholden to the controlling shareholder at the time of the challenged transaction and therefore lacked independence with respect to the Offering. *See In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 363 (Del. Ch. 2008) (holding that a plaintiff may establish disloyalty by showing that a majority of the board suffers either from "a disabling interest or *lack of independence*") (emphasis added). Perhaps it could have been argued that the Defendants were dominated by Davidson or CD Holding, as the controlling shareholder, and, as a consequence, the Offering was carried out. Although Robotti claims that the Defendants and the controlling shareholder worked together, Compl. ¶ 15, it provides no analysis of the directors' independence at the time of the Offering in either the Complaint or its Answering Brief. In fact, Robotti does not even analyze the difference in the application of the anti-dilution provisions to the options and the warrants. Robotti, instead, argues only that the directors themselves had a personal interest in the transaction because of the alleged effect of the anti- dilution provisions upon their options. *See* Compl. ¶¶ 15-16. ("Thus, at the time the transaction was first disclosed and approved each of the directors was interested in the transaction."); *see also* Pl.'s Answering Br. at 31 (arguing that demand was excused as to the Defendants at the time of the Offering because "[t]he Complaint very specifically alleges that they personally benefited from the challenged transaction"). Thus, the Court need only determine whether the Complaint adequately alleges that the Defendants engaged in self-dealing on their own behalf, and not whether they breached the duty of loyalty by being beholden to, and acting for, the controlling shareholder.

[81]Robotti does not formally assert a duty of care claim, nor could it, because Gulfport's

failed to consider the effects of the Offering and its allegedly low price, while its answering brief states that "the Complaint alleges . . . conscious disregard of the interests of the corporation and the rights of the shareholders."[82] Assuming that such a theory has been set forth, it is not supported by the facts as alleged.

The methodology for analyzing allegations of bad faith within the context of a duty of loyalty claim has been set forth in *Lyondell Chemical Co. v. Ryan*.[83] Mere gross negligence, which includes the failure to inform one's self of available material facts, cannot constitute bad faith.[84] Bad faith, and thus a breach of the duty of loyalty, can arise only when a fiduciary consciously disregards his or her responsibilities.[85] The Court in *Lyondell* imposed a high standard on any plaintiff advancing such a claim, and recognized a "vast difference between [an] inadequate or flawed effort to carry out fiduciary duties and a conscious disregard of those duties."[86] It concluded that fiduciaries in this context breach their duty of loyalty only if they "knowingly and completely fail to undertake their responsibilities."[87]

Robotti has never claimed that the Defendants "knowingly and completely" failed to undertake their responsibilities, nor may any such inference be drawn from the Complaint. Instead, Robotti argues that the Defendants failed to consider certain aspects of the Offering, including the effect that the low price would have on the anti-dilution provisions, alternative methods of financing, and even the need for the transaction.[88] Even if the Defendants did not consider these issues as thoroughly as they should or could have, the alleged facts show that the Defendants did not completely abdicate their fiduciary responsibilities: they met several times to discuss the Offering; it is undisputed that Gulfport was short on capital and thus needed to raise funds; and indeed, the Board considered the sale of an oil field as an alternative method of financing.

Thus, although the Defendants may have never fully explained why they chose to price the Offering below the option and warrant strike prices, the Court cannot reasonably infer that the Defendants completely disregarded their responsibilities to the corporation and its shareholders and therefore acted in bad faith.

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charter contains a § 102(b)(7) exculpatory provision.

[82]Pl.'s Answering Br. at 20. The Complaint does not specifically make this allegation.

[83]970 A.2d 235 (Del. 2009).

[84]*Id.* at 240.

[85]*Id.*

[86]*Id.* at 243.

[87]*Id.* at 243-44.

[88]Robotti also alleged that the Prospectus contained inaccurate information, but it made clear that it was not bringing a disclosure claim. Robotti's apparent purpose for this contention is to attempt to show that the Defendants were trying to conceal their self-dealing. The consequences of the Offering for the shareholders generally were disclosed reasonably well. Whether the reasons for (or necessity of) the Offering were disclosed reasonably well might be fairly debated, but it is not a debate framed by the parties for the Court.

5. The Business Judgment Rule Applies

Since Robotti has failed to plead that the Defendants either received a personal benefit or consciously disregarded their duties, the Defendants' decision to initiate the Offering and price it at $1.20 a share is not for the Court to second guess.

The business judgment rule, as a general matter, protects directors from liability for their decisions so long as there exist "a business decision, disinterestedness and independence, due care, good faith and no abuse of discretion and a challenged decision does not constitute fraud, illegality, ultra vires conduct or waste."[89] There is a presumption that directors have acted in accordance with each of these elements, and this presumption cannot be overcome unless the complaint pleads specific facts demonstrating otherwise.[90] Put another way, under the business judgment rule, the Court will not invalidate a board's decision or question its reasonableness, so long as its decision can be attributed to a rational business purpose.[91]

Robotti has been unable to allege that the Defendants were interested in the challenged transaction. Additionally, it has failed to allege bad faith or a conscious disregard of fiduciary duty. Although Robotti may have plead sufficient facts to permit a conclusion that the board failed to act with due care and on an informed basis regarding the transaction, such a conclusion would be unavailing in light of the § 102(b)(7) provision in Gulfport's charter, which precludes a claim for damages on that ground. For these reasons, the Defendants' decision to initiate an offering priced at $1.20 will not be disturbed by the Court.

D. *Demand Excusal*

Because Robotti's claims are largely derivative, it should have made demand on the board before amending its pleadings to sponsor such a claim, or alternatively, pleaded demand excusal with particularity under Court of Chancery Rule 23.1. Under Rule 23.1, when filing a derivative claim, the plaintiff must allege with particularity the efforts made to obtain the action the plaintiff desires from the directors or the reasons for the plaintiff's failure to obtain the action or for not making the effort.[92] Rule 23.1(a) exists to give the directors an opportunity to rectify the alleged wrong without the expense of a lawsuit, or if such lawsuit must be brought, to allow the corporation to

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[89] 1 Stephen A. Radin et al., *The Business Judgment Rule: Fiduciary Duties for Corporate Directors* 110 (6th ed. 2009).

[90] *Id.*

[91] *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 n.17 (Del. 1994).

[92] Ct. Ch. R. 23.1(a).

control the litigation.[93]

The demand requirement also rests upon the presumption that the directors will adhere faithfully to their fiduciary duties.[94] The plaintiff, however, may rebut this presumption, and thus excuse his obligation under Rule 23.1, by creating a reasonable doubt that a majority of the board could have acted independently and without a disabling interest in responding to the demand.[95] A director will be considered incapable of acting objectively to a presuit demand "if he or she is interested in the outcome of the litigation or is otherwise not independent."[96]

Interest can be shown when a director will receive a personal benefit from a transaction not shared equally by the remaining shareholders, and also when a personal benefit or detriment may go to the director as a result of the decision to pursue litigation.[97] In the demand excusal context, this Court has required that the plaintiff do more than allege that the director is interested because he or she received a benefit or detriment not shared or incurred by the stockholders generally; instead, the plaintiff must allege that this interest is material to that director.[98] Thus, the plaintiff must show that the "alleged benefit was significant enough 'in the context of the director's economic circumstances, as to have made it improbable that the director

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[93]*See Ryan v. Gifford*, 918 A.2d 341, 352 (Del. Ch. 2007) (stating that the demand requirement works to curb frivolous lawsuits, which may distract management with litigation and diminish the board's authority to govern corporate affairs).

[94]*Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).

[95]*Id.* at 1049. There is some debate over when this inquiry should have taken place: at the time when this action was filed or at the time Robotti filed the (Second Amended) Complaint to specify that its claims were derivative. The critical time is when Robotti first presented its derivative claim as such, which was December 22, 2008, when the (Second Amended) Complaint was filed. Until then, there was no claim asserting the rights of the corporation for the directors to assess.

[96]*Id.* Robotti argues that the Board's approval of the Offering was not the result of a valid business decision, and that demand should therefore be excused under the second prong of the test articulated in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). Under *Rales v. Blasband*, 634 A.2d 927, 933-34 (Del. 1993), however, the relevant inquiry is only whether the board can exercise its independent and disinterested judgment in responding to a demand, where, as here, the board made a business decision but a majority of the directors responsible for that decision have since been replaced. *See also Ryan*, 918 A.2d at 353 n.29 ("where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced . . . it would be inappropriate to challenge the business judgment of [the] current board under Rule 23.1." (citing *Rales*, 634 A.2d at 932-35)).

[97]*Beam*, 845 A.2d at 1049; *Rales*, 634 A.2d at 936.

[98]*See Transkaryotic*, 954 A.2d at 364 ("Importantly, the mere fact that a director received some benefit that was not shared generally by all shareholders is insufficient; the benefit must be material."); *see also Cinerama*, 663 A.2d at 1169 (distinguishing self-dealing—"when a director deals directly with a corporation, or has a stake in or is an officer or director of a firm that deals with a corporation"—from "incidental director interest," which, to be disqualifying, "must be substantial").

could perform her fiduciary duties to the . . . shareholders without being influenced by her overriding personal interest.'"[99]

Determining whether a director is otherwise not independent involves a contextual inquiry. In making this evaluation, the Court must ask whether the directors are so "beholden" to an interested director or interested controlling shareholder, that their "discretion would be sterilized."[100] Various motivations, "including friendship," may influence this inquiry; "[b]ut, to render a director unable to consider demand, a relationship must be of a bias-producing nature."[101] The Supreme Court has held that mere personal or business friendships will not raise a reasonable inference that a director cannot consider demand without specific factual allegations to support this conclusion.[102] The Court demanded that the complaint identify a relationship between the disinterested director and the interested director or controlling shareholder "that is so close" that one could infer that "the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director."[103]

Robotti has not alleged that it made demand upon Gulfport's board at the time the derivative claim was added, and thus the inquiry turns to whether it adequately pleaded demand excusal. When Robotti's complaint was amended to include its derivative claim, the Gulfport board consisted of Mike Liddell, David L. Houston, James Palm, Scott Streller, and Donald Dillingham (the "Demand Board"). Even assuming for purposes of this section only that the Offering worked the Defendants a personal benefit not shared by the remaining stockholders, Robotti has failed to plead demand excusal with particularly as to a majority of these directors.

1. Mike Liddell

Mike Liddell has served as a Gulfport director since 1997, and has been its Chairman since 1998. In addition, he served as Gulfport's Chief

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[99] *Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002) (quoting *In re Gen. Motors Class H S'holders Litig.*, 734 A.2d 611, 617 (Del. Ch. 1999) (emphasis in original)).

[100] *Rales*, 634 A.2d at 936.

[101] *Beam*, 845 A.2d at 1050.

[102] *Id.*; *see also Cal. Pub. Employees' Ret. Sys. v. Coulter*, 2002 WL 31888343, at *9 (Del. Ch. Dec. 18, 2002) ("Our cases have determined that personal friendships, without more; outside business relationships, without more; and approving of or acquiescing in the challenged transactions, without more, are each insufficient to raise a reasonable doubt of a director's ability to exercise independent business judgment.").

[103] *Beam*, 845 A.2d at 1051-52 (holding that "this doubt might arise either because of financial ties, familial affinity, a particularly close or intimate personal or business affinity or because of evidence that in the past the relationship caused the director to act non-independently vis à vis an interested director."); *see also Rales*, 634 A.2d at 937 (finding reasonable doubt that disinterested directors lacked independence due to their employment with entities affiliated with interested directors).

Executive Officer from 1998 to 2000, and was also its President in 2000. The Complaint alleges that Liddell was interested in the Offering because "he received a personal benefit not available to all stockholders" in that he held options exercisable into 457,720 shares of common stock at the time of the Offering.[104] It also insinuates, but does not state directly, that Liddell cannot exercise independent judgment to evaluate the derivative claim because of his "numerous other relationships" with Charles Davidson. Specifically, the Complaint alleges that Liddell and Charles Davidson "have a long standing history of engaging in business together and acting together as stockholders," and names their joint investment in DLB Oil and Gas in the 1990's as an example.[105]

The Complaint also alleges that Liddell, along with Wexford—a Davidson affiliate—owned the membership interest in Windsor Energy Holdings, L.L.C. and that Gulfport provided managerial and administrative services to this entity from 2003 through the first three months of 2006. In addition, Robotti claims that Mike Liddell has served since either May or December 2005 as the President and Chief Executive Officer of Windsor Energy Group, L.L.C., which is owned 50% by Wexford. Finally, at the time Robotti filed its Second Amended Complaint, Mike Liddell also served as Chairman of the Board and Director of Diamondback Energy Services, Inc., which is 100% owned by Wexford.[106]

Without deciding whether there is reason to doubt Liddell's disinterestedness and independence from CD Holding, the Court will assume, for purposes of the pending motion, that the Complaint successfully alleges that his loyalty was compromised at the time the derivative claims were added.

2. James Palm

Palm has served as Gulfport's Chief Executive Officer since December 2005. The Complaint alleges that he received $585,178 in compensation in 2006 and $590,398 in 2007. In addition, Robotti claims that, "as openly admitted by the Company as late as April 21, 2008," Gulfport's Compensation Committee has not determined the chief executive officer's compensation. For this reason, it concludes that Mike Liddell and the controlling shareholder exercised direct control over Palm's compensation because CD Holding, with Mike Liddell, allegedly "exercised *de facto* control over the Company."[107] Indeed, due to Palm's considerable

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[104] *Id.* at ¶ 15.

[105] *Id.* at ¶ 22.

[106] *Id.*

[107] *Id.* at ¶ 19. As of April 2008 CD Holding owned 35.7% of Gulfport. *Id.* at ¶ 28. It is therefore debatable as to whether CD Holding (or perhaps more accurately,