IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

NELSON LEUNG, individually and on behalf of all others similarly situated, and derivatively on behalf of VENTANA MEDICAL SYSTEMS, INC., a Delaware corporation,

Plaintiff,

v. C.A. No. 17089

JACK W. SCHULER, JOHN PATIENCE, R. JAMES DANEHY, EDWARD GILES, THOMAS M. GROGAN, M.D., JAMES M. STICKLAND, JAMES WEERSING, VENTANA MEDICAL SYSTEMS INC., a Delaware corporation, MARQUETTE VENTURE PARTNERS, L.P., a Delaware limited partnership and MVP II AFFILIATES FUND, L.P., a Delaware limited partnership.,

Defendants,

MEMORANDUM OPINION

Date Submitted: July 12, 1999
Date Decided. September 29, 2000

Craig B. Smith, David A. Jenkins and Michele C. Gott, Esquires, of SMITH, KATZENSTEIN & FURLOW LLP, Wilmington, Delaware; Attorneys for Plaintiff

Jesse A. Finkelstein and Raymond J. DiCamillo, Esquires, of' RICHARDS, LAYTON & FINGER, Wilmington, Delaware; and Steven M. Schatz, David J. Berger and Elizabeth M. Saunders, Esquires, of WILSON SONSINI GOODRICH & ROSATI, Palo Alto, California; and Michele E. Rose, Esquire, of WILSON SONSINI GOODRICH & ROSATI, McLean, Virginia; Attorneys for Defendants

JACOBS;, VICE CHANCELLOR

Pending is the defendants renewed motion under Court of Chancery Rules 12(b)(6) and 23.1' to dismiss the amended complaint in this stockholder derivative action. This action challenges the sale, in January 1996 by Ventana Medical Systems, Inc. ("Ventana"), of 646,734 shares of Ventana common stock to certain of its inside directors. It is claimed that those Ventana shares were issued at a price far below their fair market value, which violated the duties of care and loyalty owed by the Ventana directors who authorized the transaction.

For the reasons set forth below, I conclude that the motion to dismiss must be granted.

I. FACTUAL BACKGROUND

The plaintiff, Nelson Leung ("Leung" or "plaintiff') is and at all relevant tirnes has been a holder of Ventana common stock. Leung obtained his stock in exchange for his Investor Notes in BioTek Investor Solutions, Inc. ("BioTek"), in the February 1996 Ventana-BioTek merger that is more fully described below.

The named defendants are (i) Ventana, which is a Delaware corporation headquartered in Tucson, Arizona, that develops, manufactures and markets various tests used in treating, cancer; and (ii) the "Director Defendants," who were

[1]The Court dismissed the original complaint in this matter with leave to replead. Leung v. Schuler, Del. Ch., C.A. No. 17089, Jacobs, V.C. (Feb. 29, 2000) ("Leung I").

Ventana directors at all times relevant to this action.[2]

In February 1996, BioTek, a California corporation that developed, manufactured, and distributed systems used to diagnose diseases, entered into an agreement to merge with Ventana, which would be the surviving corporation (the "Merger"), In early February 1996, BioTek and Ventana mailed an Information Statement to the BioTek stockholders -- who by virtue of an earlier transaction were also BioTek Noteholders -- soliciting their approval of the Merger. The Information Statement disclosed that (i) there was a "substantial likelihood" that the BioTek stockholders would receive no consideration in the Merger, and (ii) the only value the BioTek Noteholders would likely realize would be Ventana convertible subordinated notes (the "Exchange Notes") that the Noteholders would receive in exchange for their BioTek Investor Notes. Those Exchange Notes would entitle the holders, at any time before the 30th day after the closing of the Merger, to convert any or al.1 of their Exchange Notes into Ventana common stock at a conversion price of $13.53 per share. On February 23, 1996, the BioTek Noteholders approved the: Merger, which became effective three days later.

[2]The "Director Defendants" are Jack W. Schuler, John Patience, R. James Danehy, Edward Giles, Thomas M. Grogan, M.D., James M. Strickland, and James Weersing.

The circumstance that gives rise to this controversy is that when the plaintiff and the other Noteholder class members approved the transaction, they did not know that -in January 1996 (one month before the Merger closed), Ventana's board had authorized the issuance of 554,343 shares of Ventana common stock at $1.62 per share (the "Insider Sale"] to Crabtree Partners and to director defendants Jack Schuler and John Patience (the "Insiders"). The purpose of the Insider Sale was to provide the Insiders with an incentive to continue their efforts on behalf of Ventana.[3] The shares to be issued to the Insiders, which were increased to 646,734 shares at the February 23, 1996 board meeting, would constitute 26.5% of Ventaria's equity.

The complaint alleges that the Ventana board determined that the "fair market value" of the to-be-issued Ventana common stock was the $1.62 per share price to the Insiders, but that the board did not value the services that the Insiders would be performing in exchange. The complaint also charges that in determining the price at which the stock would be sold to the Insiders, the Ventana board did not take into account the value that they knew the BioTek acquisition would add to the Ventana stock.

---

[3]Amended Complaint at ¶¶14 & 15.

Lastly, the plaintiff claims that although the Insider Sale transaction was authorized in January 1996, the board did not determine the $1.62 per share price until at least February 22, 1996. Leung alleges (to reiterate) that at the time he and the other Noteholders converted their Ventana Notes, they did not know that the $1.62 per share Insider Sale had been authorized several weeks before. That undisclosed fact was significant, Leung claims, because had he and the other class members known that fact, they would not have converted any of their Exchange Notes, since the Insider Sale had diluted Ventana's shares by over 25%. Instead, in ignorance of the Insider Salle, Leung and the other Noteholders made no election. As a result, one-half of the face amount of Leung's Exchange Notes ($31,041.36) were automatically converted into 2,295 shares of Ventana common stock on March 26, 1996.

In April and May 1996, the Insider Sale was consummated, with Ventana issuing 646,734 shares of its stock to the Insiders at $1.62 per share. The plaintiff alleges that the first time he and the other Noteholders learned of the Insider Sale was when it was disclosed three months later, in the July 3, 1996 Ventana Preliminary Prospectus issued in connection with the initial public offering of Ventana stock. That Prospectus also disclosed (again, for the first time) that in connection with the Insider Sale, the Director Defendants had determined that the

fair market value of Ventana's common stock as of January 1996 was $1.62 per share.

This action was commenced on April 1, 1999. On May 6, 1999, all defendants tiled motions to dismiss, and on February 29, 2000 this Court handed down its Opinion granting those dismissal motions ("Bench Opinion").[4] Order dated March 30, 2000, the plaintiff was permitted to, and later did, file an amended complaint, which the defendants moved to dismiss on April 19, 2000.

The amended complaint pleads the same core facts as the original complaint, plus several new facts. The newly-alleged facts include:

(1) a January 23, 1996 statement by director Edward Giles that the merger with BioTek "is a watershed event in terms of the valuation of [Ventana];"

(2) a January 23, 1996 memorandum from director (and Insider) John Patience to Mr. Giles, acknowledging that "[o]n completion of the BioTek merger, Ventana is in a position to go public, is worth significantly more due to market leadership position and enhanced revenue base, and once public, the preferred liquidation preferences disappear. In short, the consummation of the BioTek transaction is a very significant value creating event;"

---

[4]See note 1, supra.

(3) a February 21, 1996 communication from Michael Rodgers, Ventana's Chief Financial Officer, to directors Giles, Strickland and Weersing that the "acquisition of BioTek is a defining moment from both a strategic and economic perspective;" and

(4) advice from BearStearns, Ventana's investment bankers, that Ventana's value in a future initial public offering (which Ventana was then contemplating) would nearly double after the acquisition of BioTek.[5]

'The issues presented on this motion come down to whether those newly-pled facts are sufficient to defeat this renewed motion to dismiss.

II,, TWE CONTENTIONS

The amended complaint alleges only derivative claims, which the defendants seek to have dismissed under Court of Chancery Rules 12(b)(6) and 23.1. 'The defendants argue that both counts of the amended complaint must be dismissed, first, because the plaintiff failed to make a demand on the Ventana Board or show that demand is excused; second, because the complaint fails to state legally cognizable claims; and third, because the requested relief is barred by the exculpatory clause of Ventana's Certificate of Incorporation. The plaintiff

[5]Amended Complaint at ¶18.

responds that this action should be allowed to proceed, because the particularized allegations of the amended complaint are sufficient to excuse demand. Specifically, Leung argues that the pleaded facts show that: (1) the Insider Sale was not a valid exercise of the Director Defendants' business judgment because the Director Defendants' did not determine Ventana's fair market value in good faith; and (2) the Directors' issuance of Ventana stock at a price they knew was not its fair market value, constituted a waste of Ventana's assets. Lastly, the plaintiff argues that (3) Ventana's Certificate of Incorporation does not exculpate the directors from monetary liability for the derivative claims here asserted.

The two principal issues raised at this juncture are identical to those presented on the earlier dismissal motions, namely: (1) is the plaintiff excused from making a demand on the Board on the ground that the Insider Sale was not a. valid exercise of business judgment, (2) has the plaintiff stated cognizable claims for relief, and (3) if so, are his claims nonetheless barred by the exculpatory clause of Ventana's Articles of Incorporation? The plaintiff argues that the amended complaint states cognizable claims and that his newly-pled facts satisfy the standards for demand excusal. I disagree, and conclude that Counts I and II of the amended complaint must be dismissed on both Rule 23.1 and Rule 12(b)(6) grounds. It is therefore unnecessary to reach the contention that the exculpatory

provision in Ventana's Articles of Incorporation bars the plaintiff's money damage claims.[6]

III. ANALYSIS

A. The Standards for Rule :112(b)(6) and Rule 23.1 Dismissal

It is well established under Delaware law that **a** complaint will be dismissed under Rule 12(b)(6) if its alleged facts, taken as true, would not constitute a ground for relief.[7] Moreover, under Rule 23.1, demand is excused where the plaintiff pleads particularized facts that satisfy one or both of the two prongs of the test articulated in Aronson v. Lewis[8]. The plaintiff must plead facts creating a reasonable doubt that (1) the directors are disinterested and independent or that (2) the challenged transaction was otherwise the product of valid business judgment. Here, the plaintiff attempts to plead facts that would excuse demand under Aronson's second pro-ng. The resulting issues are whether the complaint states cognizable grounds for relief and whether the particularized factual allegations of the amended complaint create a reasonable doubt that the sale of Ventana stock to

---

[6]For the same reason, it is unnecessary to address the sufficiency of Count III of the amended complaint.

[7]In re Tri-Star Pictures, Inc., Lit., Del. Supr., 634 A.2d 319, 326 (1993).

[8]Aronson v. Lewis, Del. Supr., 473 A.2d 805, 814 (1984).

the Insiders at $1.62 per share was the product of a valid business judgment.

In Leung I, this Court answered that question in the negative. Plaintiff argues that that question must now be answered in the affirmative, because the amended complaint alleges with the requisite factual particularity that the Insider sale was (1) a waste of assets', and (2) not approved in good faith. These claims are next analyzed.

B. The Waste Claim (Count II)

I first address the waste claim. The Delaware law standard for pleading waste is stringent. "Directors are only liable for waste when they 'authorize an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.'"[9] In addition, "[a]bsent fraud [8 Del. C.] Sections 1.52 and 153 give a board considerable latitude in evaluating the kind and amount of consideration to be received for newly-issued. stock."[10] The plaintiff contends that his allegations that (a) the board issued approximately 26.5% of Ventana's equity to the Insiders at $1.62 per share, and (b) that $1.62 price was far below the true market value of the

[9] In re Walt Disney Co. Deriv. Litig., Del. Ch., 731 A.2d 342, 362 (1998) (citations omitted), aff'd in part and Brehm in part on other grounds Eisner v. Del. Supr., 746 A.2d 244 (2000).

[10] Leung I, Mem. Op. at 24.

stock, satisfy that test. More specifically, he predicates his waste claim on the alleged fact that at the same time that the Director Defendants sold the Ventana Stock to the Insiders at $1.62 per share, they fixed the price to convert the Exchange Notes into Ventana Common Stock at $13.53 per share. Leung contends that no person of ordinary, sound business judgment could conclude in these circumstances that the -fair market value of Ventana's stock was $1.62 per share. Therefore, the sale of Ventana stock to the Insiders at that price constituted waste.

This claim was previously made and rejected in Leung I. Plaintiff contends, nonetheless, that the claim should now survive by virtue of two newly-pled facts. The first is the alleged "acknowledgment of Mr. Giles that the directors knew $1.62 . . . was not the fair market value of Ventana's stock, but rather was . . . a deliberately low price so that the Insiders could benefit from the difference between $1.62 per share and the real fair market value" and (2) "the directors' 'knowledge that the imm.ediately impending merger with BioTek would enormously increase the value of Ventana's stock and increase the likelihood that Ventana would be able to go public, probably at a price far in excess of $1.62 per

share,“”

In Lewis v. Vogelstein, this Court stated:

> .A waste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade. Most often the claim is associated with a transfer of corporate assets that serves no corporate -purpose; or for which no consideration at all is received. Such a transfer is in effect a gift. If, however, there is any *substantial* good faith *judgment* that in the: circumstances the transaction is worthwhile, there should be no finding of waste, even if the fact tinder would conclude *ex post* that the transaction was unreasonably risky. Any other rule would deter corporate boards from the optimal rational acceptance of risk, for reasons explained elsewhere. Courts are ill-fitted to attempt to weigh the “adequacy” of consideration under the waste standard or, *ex-post,* to judge appropriate degrees of business risk.[12]

Measured against this standard, the thrust of Leung’s two new allegations -- that the Ventana directors knew that the $1.62 per share price in the Insider Sale did not represent Ventana’s fair market value -- does not remedy the adjudicated deficiencies of the original complaint. For the waste claim to survive “[t]he particularized pleaded facts must show that the consideration received for the stock was so minimal that issuing the Ventana stock was the functional equivalent

---

[11]Amended Complaint at ¶26.

[12]Lewis v. Vogelstein, Del. Ch., 699 A.2d 327, 336 (1997) (italics added, citations omitted).

of making a gift to the insiders."[13] Leung has not alleged facts showing the board "gave away" the Ventana stock to the Insiders for essentially no consideration. At most, the new allegations, when viewed in the light most favorable to the plaintiff; permit the inference that the Insider Stock was issued to the Insiders at a price deliberately set below fair market value. But, at the same: time the complaint also alleges that that was done to provide the Insiders an incentive to continue working for Ventana.[14] The implicit premise of the waste claim is that stock compensation must always be priced at a m.i:nimum or "floor" equal to the stock's fair market value.[15] Delaware law does not so require. Rather, as this Court has stated:

> [S]o long as there is *any* consideration for the issuance of shares or options, the sufficiency of the consideration fixed by the directors cannot be challenged in the absence of actual fraud. Only where it is claimed that the issuance of shares or options was entirely *without consideration* will § 1 57[16] not operate as "a legal barrier to any claim for relief as to an illegal gift or waste of corporate assets in the issuance of stock options."[17]

---

[13]Leung I, Mem. Op. at 28.

[14]Amended Complaint at ¶¶1 4 & 15.

[15]Leung I at 23-24, citing, 8 Del. C. § 152 & 153(a).

[16]8 Del. C. § 157 provides in relevant part that "[i]n the absence of actual fraud in the transaction, the judgment of the directors as to the consideration for the issuance of such rights or options and the sufficiency thereof shall be conclusive."

[17]Zupnick v. Goizueta, Del. Ch., 698 A.2d 384, 387 (1997) (quoting Michelson v. Duncan, Del. Supr., 407 A.2d 211, 224 (1979) (italics added).

Leung does not claim that there was actual fraud in the transaction or that the stock was issued to the Insiders for less than its par value.[18] Indeed, the consideration that Ventana allegedly would receive in exchange for the Insider shares was disclosed in the Ventana IPO prospectus.[19] From this it must be inferred from the complaint itself that Ventana's disinterested directors had determined that the value of the Insiders' future services represented a fair exchange for their right to purchase the Insiders' shares identified in the Compensation Package for $1.62 per share. Accordingly, the newly-pled facts do not alter my earlier conclusion that the plaintiff has failed to state a claim of waste capable of surviving dismissal under Rule 12(b)(6) or Rule 23.1.

C. Lack of Good Faith (Count I)

In. Count I, the plai-ntiff claims that the Director Defendants could not have

---

[18] 8 Del. C. § 153(a) provides in relevant part: "[s]hares of stock with par value may be issued for . . . not less than the par value."

[19] The Ventana IPO Prospectus, which is incorporated by reference into the Amended Complaint, details the consideration exchanged for the Insider Shares at page 58, note 1:

> Messrs. Schuler and Patience were provided with the opportunity to purchase these shares in connection with (i) their efforts and assistance in completing the BioTek acquisition and assisting management with the integration of the companies, (ii) Mr. Schuler's decision to serve as Chairman of the Board of Directors and (iii) Mr. Schuler's and Mr. Patience's devotion of a significant portion of their work time to the Company's business.

acted in good faith when they approved the issuance of stock to the Insiders at $1.62 per share, because i:n setting that price they purposefully failed to take into account material information relating to Ventana's value.

To support this claim Leung relies upon newly-pled facts, namely (in his words), that the Director Defendants deliberately failed "to include in their decision-making process extremely material information pertaining to the value of Ventana's stock, knowing that their resulting determination of fair market value was inaccurate."[20] Moreover, the plaintiff asserts, that the Board did not value the stock at the January 19, 1996 board meeting, because the valuation could not have occurred before February 22, 1996. Thus, the claim is that the Insiders' stock should have been priced at its actual fair market value as of the date the parties reached agreement on the Ins-iders' Sale.[21]

The defendants respond that this newly-alleged fact adds nothing of substance. The reason, defendants urge, is that whether the valuation was announced on January 16 or on February 22, the price was set "as of' January 16, 1996, the date that the board decided to sell the stock to the Insiders. Thus, the defendants argue, the proper inquiry is whether that value, determined as of that

---

[20]Plaintiff's Answering Brief at 18.

[21]Complaint at ¶32

date, fell outside the bounds of reasonable judgment.

In my view the plaintiff's newly-pled facts fall short of meeting the standard. As this Court stated in Leung I:

> Under the business judgment rule a board's good faith in making a decision is presumed. That presumption is heightened where, as here, the -majority of the directors making the decision are independent or outside directors. To overcome that presumption and to survive a motion to dismiss under Rule 12(b)(6) or Rule 23.1, the complaint must plead specific facts from which it can be inferred that 'the decision [by the board] is so beyond the bounds of reasonable judgment that it seems essentially inexplicable on any other grounds. '[22]

Leung claims that the amended complaint satisfies that standard, pointing to the testimony of Mr. Giles as support for his allegation that the directors knew that $1.62 was not the fair market value of the stock.[23] But that fact alone would not establish that the board's decision to sell stock to the Insiders at $1.62 per share went beyond the bounds of reasonable judgment. This claim, like the waste claim, appears to rest upon the unstated assumption that a board was legally required to issue stock intended as compensation for no less than its fair market

---

[22]Leung I, Mem. Op. at 30, quoting In re Rexene Corp. Shareholder Litig., Del. Ch., C.A. Nos. 10897 & 11300, Mem. Op. At 8, Berger, V.C. (May 8, 1991); aff'd sub nom. Eichorn v. Rexene Corp., Del. Supr., 604 A.2d 416 (1991) (TABLE).

[23]Complaint at ¶¶15 & 26

value -- an assumption that is legally incorrect.[24]

The plaintiff also claims that the defendants acted in bad faith because at the time they set the Insider Sale price at $1.62 per share they knew that the BioTek merger would increase Ventana's value.[25] But that argument does little to further the analysis. To begin with, even if that were true, this claim, if validated, would require the board to have speculatively determined the incremental value of a transaction that had not occurred. The plaintiff cites no case that would require a board to engage in this exercise. In addition, the conceded purpose of the Insider Sale negates the claim that the Ventana stock was priced in bad faith. In his Answering Brief the plaintiff acknowledges (by citing Mr. Giles' testimony) that the Insider Sale was intended as incentive compensation to the Insiders.[26] That purpose is inconsistent with a claim that the directors set a value of the Insiders' Stock in bad faith. To put it differently, the fact that the 'Ventana board determined to award stock to the Insiders, as incentive compensation, at a price

---

[24]As previously discussed, see note 14, supra, Delaware law does not require that stock be issued at its fair market value.

[25]Amended Complaint at ¶26(b) states: the directors' knew "that the immediately impending merger with BioTek would enormously increase the value of Ventana's stock and increase the likelihood that Ventana would be able to go public, probably at a price far in excess of $1.62 per share."

[26]Plaintiff's Answering Brief at 9.

lower than what they believed the stock would be worth after the BioTek merger, does not, without more, give rise to a reasonable inference that the board acted in bad faith.

For these reasons, I conclude that the amended complaint fails to state a cognizable claim, under either Rule 12(b)(6) or Rule 23.1, that in approving the Sale to the Insiders the Ventana Board acted in bad faith and thereby breached its duty of loyalty.

V. CONCLUSION

For the above reasons, -the defendants' motion to dismiss the amended complaint under Rules 12(b)(6) and 23.1 is granted. IT IS SO ORDERED.

Jack B. Jacobs
Vice Chancellor