IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

| | | |
|---|---|---|
| IN RE: AFFILIATED COMPUTER SERVICES, INC. SHAREHOLDERS LITIGATION. | ) ) ) | Consolidated C.A. No. 2821-VCL |

***MEMORANDUM OPINION AND ORDER***

**Submitted: October 23, 2008**
**Decided: February 6, 2009**

Pamela S. Tikellis, Esquire, Robert J. Kriner, Jr., Esquire, A. Zachary Naylor, Esquire, Scott M. Tucker, Esquire, Tiffany J. Cramer, Esquire, CHIMICLES & TIKELLIS LLP, Wilmington, Delaware; Jeffrey C. Block, Esquire, Patrick T. Egan, Esquire, Autumn Smith, Esquire, BERMAN DEVALERIO PEASE TABACCO BURT & PUCILLO, Boston, Massachusetts; Peter D. Bull, Esquire, Joshua M. Lifshitz, Esquire, BULL & LIFSHITZ, LLP, New York, New York; E. Powell Miller, Esquire, THE MILLER LAW FIRM, P.C., Rochester, Michigan; Lionel Z. Glancy, Esquire, Peter A. Binkow, Esquire, GLANCY BINKOW & GOLDBERG LLP, Los Angeles, California, *Attorneys for the Plaintiffs.*

David C. McBride, Esquire, Bruce L. Silverstein, Esquire, Martin S. Lessner, Esquire, Tammy L. Mercer, Esquire, YOUNG CONAWAY STARGATT & TAYLOR, LLP, Wilmington, Delaware; Robert H. Baron, Esquire, Gary A. Bornstein, Esquire, CRAVATH SWAINE & MOORE LLP, New York, New York; Paul E. Coggins, Esquire, FISH & RICHARDSON, Dallas, Texas; C. W. Flynn, Esquire, LOCKE LORD BISSELL & LIDDELL LLP, Dallas, Texas, *Attorneys for Defendants Darwin Deason, Lynn Blodgett, and John Rexford.*

Kevin G. Abrams, Esquire, A. Thompson Bayliss, Esquire, ABRAMS & LASTER LLP, Wilmington, Delaware; Greg A. Danilow, Esquire, John A. Neuwirth, Esquire, Stacy Nettleton, Esquire, Caroline Hickey Zalka, Esquire, WEIL GOTSHAL & MANGES LLP, New York, New York, *Attorneys for Defendants Frank A. Rossi, J. Livingston Kosberg, and Robert B. Holland.*

Kenneth J. Nachbar, Esquire, Susan W. Waesco, Esquire, John P. DiTomo, Esquire, MORRIS NICHOLS ARSHT & TUNNELL LLP, Wilmington, Delaware; Bruce W. Collins, Esquire, Ken Carroll, Esquire, C. Shawn Cleveland, Esquire, CARRINGTON COLEMAN SLOMAN & BLUMENTHAL, LLP, Dallas, Texas, *Attorneys for Defendants Joseph P. O'Neill and Dennis McCuistion*.

Donald J. Wolfe, Jr., Esquire, Kevin R. Shannon, Esquire, Berton W. Ashman, Jr., Esquire, Ryan W. Browning, Esquire, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; Howard O. Godnick, Esquire, Gregory A. Kasper, Esquire, SCHULTE ROTH & ZABEL LLP, New York, New York, *Attorneys for Defendant Cerberus Capital Management, L.P.*

Vernon R. Proctor, Esquire, Kurt M. Heyman, Esquire, Patricia L. Enerio, Esquire, Jill K. Agro, Esquire, PROCTOR HEYMAN LLP, Wilmington, Delaware; Orrin L. Harrison III, ,Esquire, David R. McAtte, Esquire, Lisa S. Gallerano, Esquire, M. Scott Barnard, Esquire, AKIN GUMP STRAUSS HAUER & FELD LLP, Dallas, Texas, *Attorneys for Nominal Defendant Affiliated Computer Services, Inc.*

LAMB, Vice Chancellor.

The founder, chairman, and significant stockholder of a public company made an offer in conjunction with a private equity firm to take the company private. The terms of the founder's lock up arrangements made it difficult for the special committee of the board to act to induce any competing bids, leaving the board resistant to the offer after months of efforts. During this time, stockholders filed a class action complaint attacking the proposal.

After the credit crisis hit late in the summer of 2007, the deal fell apart and the private equity firm withdrew its offer. Thereafter, angry at the collapse of the deal, the founder demanded the immediate resignation of all of the outside directors, publicly accusing them of breach of fiduciary duty in their dealings with him. The outside directors, in response, sued the founder, seeking a declaratory judgment affirming their actions and stating they would resign office once they reviewed the credentials of candidates to replace them and would not stand for reelection. The stockholders then filed an amended complaint, for the first time bringing derivative claims alleging various breaches of fiduciary duty against the entire board and asserting grounds to excuse demand.

Less than a month after the derivative complaint was filed, the outside directors resigned and new independent directors took their places constituting a majority of the board. Later, in response to a motion to dismiss, the stockholders filed a second amended complaint, raising substantially similar claims, but

supplementing the complaint's factual allegations. In response, a renewed motion to dismiss was filed, based on a variety of grounds, including failure to make demand.

There is no question that the second amended complaint does not adequately allege grounds to excuse demand on the newly constituted board. Thus, it can survive the motion to dismiss only if the claims asserted therein were validly in litigation at the time the first amended complaint was filed, i.e., during the interval between the founder's demand that the outside directors resign and their eventual departure. In this case, the defendants concede that the first amended complaint alleges a derivative claim and that the second amended complaint is based on the same operative facts. Thus, the outcome of the motion depends entirely on whether or not the first amended complaint satisfied the standard for demand excusal at the time it was filed.

Even considering the unusual circumstances that existed when the first amended complaint was filed, there are no well pleaded allegations of fact from which the court could infer that a majority of the directors then in office could not have validly considered a demand, had one been made. Thus, the court concludes that demand was not excused at the time the first amended complaint was filed. This conclusion requires that the second amended complaint be dismissed in accordance with Court of Chancery Rule 23.1.

## I.

A. The Parties[1]

The plaintiffs are owners of common stock of Affiliated Computer Services, Inc. ("ACS"), suing derivatively on behalf of ACS.

ACS, the nominal defendant, is a Delaware corporation with its principal place of business in Dallas, Texas. ACS's business is to provide "business process outsourcing and information technology services to commercial and government clients."[2] ACS has two classes of common stock. As of February 8, 2007, ACS had 92,314,491 shares of Class A common stock outstanding, and 6,599,372 shares of Class B common stock outstanding. The Class A shares are entitled to one vote for every share of common stock. The Class B shares have an equivalent economic interest to the Class A shares, but are entitled to 10 votes per share.

The second amended complaint names the following defendants:

Darwin Deason has been the Chairman of the board of directors of ACS since the company's founding in 1988. Deason owns 100% of ACS's Class B common stock and approximately 2% of the Class A common stock. Because of

---

[1] The following descriptions of the defendants are drawn from the complaint, and are taken to be true as of the time of the filing of the second amended complaint. Though there has been some turnover in the board, such that some of the defendants are no longer directors, those changes are not relevant for the purposes of deciding this motion.

[2] Second Am. Compl. ("SAC") ¶ 5.

the Class B shares' 10-to-1 voting preference, Deason controls approximately 67.8 million votes or 42% of the total voting power of the company's stock.

Lynn Blodgett is a director and the President and Chief Executive Officer of ACS.

John Rexford is a director and the Executive Vice President and Chief Financial Officer of the company.

Joseph P. O'Neill has been a director of ACS since November 1994, prior to ACS's initial public offering. He serves as President and Chief Executive Officer of Public Strategies Washington, Inc., a public affairs and consulting firm.

Frank A. Rossi has been a director of ACS since November 1994, prior to ACS's initial public offering. Rossi is also the Chairman of FAR Holdings Company, L.L.C., a private investment firm, a position he has held since February 1994.

J. Livingston Kosberg has been a director of ACS since September 2003. Kosberg had previously served on the ACS board, but had been removed as part of a settlement with banking regulators arising from the collapse of a savings and loan of which Kosberg was chairman. Kosberg currently serves as an advisor to several investment funds.

Dennis McCuistion has been a director of ACS since September 2003 and has been designated as the company's lead independent director. McCuistion

currently serves as, and for more than 25 years has been, President of McCuistion & Associates, a firm providing consulting services to banks and other businesses.

Robert B. Holland has been a director of ACS since 2007. He was appointed to that position by action of the ACS board, without a stockholder vote.

Cerberus is a Delaware limited partnership with its principal office in New York City. Cerberus is the manager of a number of private equity funds.

B. Facts

The following facts are drawn from the well pleaded particularized factual allegations in the operative complaint, along with any exhibits attached thereto, as well as certain public securities filings referenced in the complaint.[3]

---

[3] Pleadings in derivative suits are governed by Court of Chancery Rule 23.1, which provides, in pertinent part, that "[t]he complaint shall . . . allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors . . . and the reasons for the plaintiff's failure to obtain the action or for not making the effort." In the case of a motion to dismiss under Rule 23.1, as in the case of a motion to dismiss for failure to state a claim, the court assumes all well pleaded facts to be true. *See, e.g.*, *Malpiede v. Towson*, 780 A.2d 1075, 1082 (Del. 2001)). "Of course, the trial court is not required to accept every strained interpretation of the allegations proposed by the plaintiff, but the plaintiff is entitled to all reasonable inferences that logically flow from the face of the complaint." *Id.* at 1083. However, "conclusory allegations of law or fact that are not supported by specific allegations of fact will not be taken as true for purposes of a motion to dismiss under Rule 23.1." DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY (hereinafter "WOLFE & PITTENGER") § 9.02[b][3][iii], at 9-67 (2008) (citing *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000). Rather, "the pleader must set forth . . . particularized factual statements that are essential to the claim." *Brehm*, 746 A.2d at 254. The derivative plaintiff's burden under Rule 23.1 is thus more onerous than a normal defendant's burden under Rule 12(b)(6). WOLFE & PITTENGER, § 9.02[b][3][iii], at 9-67.

In late 2005, ACS received an unsolicited buyout offer of $65 per share, totaling $8 billion, from a consortium of large private equity firms, including Texas Pacific Group, Bain Capital LLC, and Blackstone Group LP.[4] After engaging in discussions with the offering group, ACS ended talks with the potential buyers in early 2006 and indicated that it was no longer considering a sale transaction. In a contemporaneous press release, ACS stated that it was "continuing to consider additional alternatives for enhancement of shareholder value, but [those] alternatives do not include a sale of the Company."[5] According to a *Wall Street Journal* article dated March 21, 2007, Deason had used his 42% voting power to block the deal at the last moment.

On November 7, 2006, Deason forwarded a buyout proposal to the ACS board of directors. The proposal involved a going private transaction to be led by Deason working with an unnamed private equity sponsor, paying in the range of $60 to $62 per share. The proposal also informed the board that Deason did not intend to vote his shares in favor of or otherwise participate in any transaction with a party other than his group. Attached to the proposal was a "highly confident"

---

[4] Contemporaneous newspaper articles referenced in the complaint suggested that industry insiders expected a steeper deal premium, closer to $70 to $75 per share. On March 20, 2006, both Jefferies & Company, Inc. and Bear Stearns issued reports indicating that $65 per share would be inadequate, and stating that they maintained a $70 per share price target for ACS. They further stated that the price target based on the 2007 earnings per share estimates was $75 per share. SAC ¶ 50.

[5] Affiliated Computer Servs., Inc., Current Report (Form 8-K), Ex. 99.1, at 1 (Jan. 17, 2006).

letter from Citigroup, indicating its expected ability to provide the debt financing for the proposal on the basis of certain public financial reports and other due diligence materials it had examined.[6]

A special meeting of the ACS board was held on November 9, 2006. After discussing the status of the ongoing internal investigation relating to stock option backdating and certain remedial actions that might be needed as a result, the board moved on to a discussion of Deason's November 7 proposal. Deason recommended that the board form a special committee to consider the proposed transaction, and that the committee retain an investment banker and legal counsel to advise it and aid in negotiating the proposed transaction. He also requested that the two potential private equity sponsors he had enlisted be permitted to engage in a two- to three-week due diligence process with the company, and that two officers who had been recommended for termination as a result of the options backdating investigation (Mark King and Warren Edwards, at that time the CEO and CFO, respectively) be allowed to aid in that due diligence process. Deason indicated to the board his belief that there was a high probability that the proposed transaction could be achieved. The board discussed the propriety of allowing King and Edwards to remain as officers during the due diligence period, and some of the

[6] The due diligence materials had apparently been given to the potential sponsors and Citigroup pursuant to a confidentiality agreement Deason had entered into with Cerberus (and presumably the other parties) on November 1, 2006.

independent directors expressed concern regarding the risks of King and Edwards remaining. Ultimately, the board unanimously resolved that it was in the best interests of ACS and its stockholders that the company engage in a three-week due diligence process with Deason's potential private equity sponsors, and authorized and directed the management, including King and Edwards, to proceed with the process.

According to the minutes of the board meetings attached to the complaint,[7] no further board discussions of the proposed transaction took place until February 22, 2007, nor was authorization for an extension of the due diligence period given. The February 22, 2007 board meeting minutes indicate that Cerberus was the only private equity player still expressing interest in ACS. Deason explained that the other buyout shops had decided to wait to see the performance of the new management team, following the resignation of King and Edwards as a result of the options backdating investigation. Deason further indicated that he expected to partner with Cerberus to make a buyout offer, and that such offer would be forthcoming in the following two to three weeks.

---

[7] SAC Ex. 3. Certain redacted portions of the board minutes were initially produced as attachments to Deason's February 11, 2008, motion for partial summary judgment. Because Deason had gone outside the record in his motion, the plaintiffs filed a motion to lift the stay of discovery on February 19, 2008. At oral argument on the motion to lift the stay of discovery, on March 19, 2008, the court ordered ACS to produce the minutes for all board meetings between November 9, 2006 and March 20, 2007. As a result of the receipt of those board minutes, the plaintiffs filed their second amended complaint.

On March 20, 2007, Deason and Cerberus (the "Buyout Group") publicly announced a proposal to acquire all of the outstanding stock of ACS (except for those shares owned by Deason and the company's management team) for $59.25 per share in cash. The March 20 proposal letter did not mention that Deason had expressed interest at a price of $60 to $62 per share in November 2006, nor that both Cerberus and the former potential financial sponsor had given written expressions of interest at that time of more than $60 per share. The letter stated that Cerberus would need 45 days for "confirmatory" due diligence.[8] Attached to the proposal letter was a second "highly confident" letter from Citigroup, in similar form to the previous one, this time dated March 19, 2007. The March 20 proposal letter further reiterated the November 2006 proposal's expectation that the ACS board would form a special committee with independent advisors to consider and negotiate the proposal on behalf of the company's public stockholders.

The offered $59.25 per share proposal represented a 15.5% premium over ACS's closing price on March 19, 2007, and was approximately 10% below ACS's 52-week high share price of $63.61.

---

[8] *Id.* ¶ 42 (quoting Affiliated Computer Servs., Inc., Current Report (Form 8-K), Ex. 99.1, at 3 (Mar. 20, 2007)).

Also on March 20, 2007, Deason signed (as a stockholder) an exclusivity agreement with Cerberus in which he pledged not to support or participate in any alternative transaction that did not involve the Buyout Group.[9]

The market reacted to the Buyout Group's offer by surging ahead of the proposed transaction price in early trading on March 20, 2007. The ACS board held a special meeting that day to discuss the proposal. After a brief discussion, Deason recused himself from the remainder of the meeting. The board's outside counsel then briefed the board on the ongoing responsibilities of the management and outside directors and the anticipated special committee. The remaining management directors then recused themselves from the meeting. After discussing their concerns with the "exclusivity and process" proposed by Deason and Cerberus, the board formed a special committee consisting of Holland, Kosberg, and Rossi.[10] The special committee subsequently retained Weil, Gotshal & Manges LLP as its independent legal advisor and Lazard Freres & Co. as its independent financial advisor.

---

[9] All details of the substantive content of the exclusivity agreement are taken from the factual allegations in the SAC. Under the terms of the exclusivity agreement, Deason was precluded from engaging as a stockholder in any discussions or negotiations regarding any alternative transaction. It also required, should a stockholder vote on the proposed transaction occur, that Deason vote his shares in favor of the transaction. SAC ¶ 45.

[10] Based on the minutes of that meeting and the resolutions contained therein, the special committee appears to have been granted the powers customary in such situations.

On April 21, 2007, the Buyout Group raised its offer to $62 per share, representing a 21% premium over the pre-announcement closing price.[11] The new offer also included provision for a 40-day "go shop" period following the signing of a definitive merger agreement between ACS and the Buyout Group.[12] The proposed break-up fee associated with the go shop would be 1.5% of the equity value of ACS.

On April 23, 2007, the special committee responded in a letter to Deason. In the letter, the special committee expressed its misgivings and "serious concerns" with regard to the company's ability to attract other bidders during a go shop period given Deason's five-year employment agreement, exclusivity agreement with Cerberus, and the head start that Cerberus had with respect to due diligence.

In an attempt to mitigate the chilling effects of the exclusivity agreement between Deason and Ceberus, the special committee negotiated a temporary waiver of that agreement by Cerberus. On June 10, 2007, ACS and Cerberus executed a

---

[11] A February 14, 2007 AG Edwards report "conservative[ly]" valued ACS's common stock at $68 per share. SAC ¶ 50. The $62 per share price was also less than the $63 offered by ACS in a Dutch self tender completed in March 2006. *Id.* ¶ 51. The company engaged in the self tender at the time because management believed the company's stock was substantially undervalued. ACS had offered to purchase as many as 55,500,000 shares at that price, but just 7,365,100 Class A common shares (6%) were tendered and not withdrawn.

[12] In his April 21, 2007 letter to the ACS board, Deason further stated that he would agree to a provision, with respect to a vote of ACS's stockholders on the Buyout Group's offer (and only with respect to such a vote), that would treat his Class B shares as one-share one-vote, instead of the 10-to-1 voting preference they normally enjoyed. This would decrease his voting power with respect to the approval of the Cerberus transaction to approximately 9%. Deason's voting power would remain at approximately 42% with respect to his ability to block any alternative transaction.

waiver pursuant to which Deason would be permitted to engage in discussions with potential bidding parties other than Cerberus. In exchange for this waiver, ACS agreed to pay Cerberus $7.5 million in compensation for its expenses incurred in connection with the buyout proposal.[13] On August 10, 2007, ACS publicly announced the expiration of the waiver, although it also expressed its intent to extend the waiver to a later date.

On October 30, 2007, in a letter to the special committee, Cerberus withdrew its buyout offer. That same day, Deason (by letter from a New York lawyer purporting to act as counsel to ACS, but delivered through Deason's personal counsel) demanded the immediate resignation of all of the outside directors of ACS, whom the letter accused of various breaches of fiduciary duty, and named four candidates to replace them. The outside directors responded by filing suit against Deason, the management directors, and ACS in this court on November 1,

---

[13] In addition, ACS would pay Cerberus another $15 million if ACS entered into a transaction with another party and Cerberus had not withdrawn its proposal, reduced its offer price below $62 per share, or otherwise modified the proposal in a manner materially adverse to ACS. Deason's obligation to disgorge to Cerberus his excess gain on any alternative transaction would be reduced as well. If ACS were to consummate a superior transaction, Deason would only be required to pay Cerberus 40% of his excess gain. The waiver agreement also superseded Deason's right to receive 20% of any termination, break-up, topping, bid protection, or similar fee, but only until August 19, 2007, or the date an alternative superior proposal ceased being superior, whichever occurred first. Because the court does not have before it a copy of the waiver agreement, it is unclear why the expiration date of this provision appears to be nine days after the expiration of the agreement as a whole. *See* SAC ¶ 59.

2007, seeking declaratory judgment that they had not breached their fiduciary duties.[14]

After recounting the long, contentious history of the special committee's dealings with Deason and the Buyout Group, the complaint reported the outside directors' response to Deason's threats and demands, stating as follows:

> 18. On November 1, 2007, at another special meeting of the Board of Directors, the independent directors informed Deason and the management directors that, because of Deason's and management's conduct, they felt compelled to resign from the Board and not to stand for re-election. However, to ensure that their successors were truly independent and to protect the Company's minority shareholders, the independent directors also stated during the November 1 special meeting that they were prepared, prior to their resignation, to immediately begin the process of reviewing Deason's suggested nominees and any additional nominees proposed by the Company's shareholders.[15]

On November 21, 2007, the outside directors dismissed their complaint pursuant to a settlement agreement. Simultaneously, the outside directors resigned from the board and issued a statement that they were satisfied that the replacement director candidates were qualified and independent of Deason and the company's management.[16] The settlement provided that "the outside directors would resign as

---

[14] The outside directors also responded by letter from counsel (Greg Danilow at Weil, Gotshal & Manges LLP), likewise dated November 1, 2007, denying that the outside directors had breached any fiduciary duties.

[15] Outside Directors' Compl. (hereinafter "ODC") ¶ 18.

[16] *See* Affiliated Computer Servs., Inc., Current Report (Form 8-K), Ex. 99.1 (Nov. 21, 2007) (SEC Accession No. 0001299933-07-006811). Rexford also resigned from the board that day, and the remaining directors appointed the four candidates to the board. *Id.*

directors of ACS, voluntarily dismiss their complaint and would release [ACS] and any of [ACS's] current or former officers, directors, stockholders and employees from any and all claims that resulted from or otherwise related to the outside directors' service as a director to [ACS]."[17] The settlement also provided that ACS and Deason grant a general release to the outside directors for any claims that result from or otherwise relate in any way to the outside directors' service as directors of ACS. In addition, the settlement provided that the outside directors would be entitled to indemnification and advancement for fees and expenses resulting from litigation arising out of their service as directors. Lastly, the settlement provided that the outside directors would retain any already vested options in ACS.

C. Procedural History

The original complaint in this case was filed on March 22, 2007 as a purported class action on behalf of the stockholders of ACS and named Deason, Blodgett, Rexford, O'Neill, Rossi, Kosberg, McCuistion, Holland, Cerberus, Citigroup, and ACS as defendants. That complaint challenged the buyout proposal made by Deason on March 20, 2007, and sought injunctive relief to prevent its consummation. Several other similar actions were filed at or around the same

---

[17] SAC ¶ 76.

time. On May 9, 2007, this court consolidated those related actions and appointed lead plaintiff and lead counsel.

When Cerberus withdrew its buyout proposal on October 30, 2007, the claims for injunctive relief in the original complaint were effectively mooted. In response to these changes, the plaintiffs amended the complaint on November 5, 2007 and asserted derivative claims for the first time, while continuing to plead their class claims in the alternative.

On December 19, 2007, various defendants filed motions to dismiss the amended complaint. On February 11, 2008, the defendants filed opening briefs supporting their respective motions to dismiss. On April 8, 2008, in lieu of filing answering briefs to the defendants' motions to dismiss, the plaintiffs filed a consolidated second amended class and derivative action complaint, pursuant to Court of Chancery Rule 15(aaa). The second amended complaint essentially supplemented the fact allegations in the first amended complaint with additional information obtained through discovery granted by this court. No new counts were added however, nor did the fundamental nature of the allegations change.

The claims alleged in the second amended complaint are, like those in the first amended complaint, based on the abandoned buyout process. Count III is styled as a derivative claim against the individual defendants for breach of fiduciary duty. Count IV is styled as a derivative claim against Cerberus (and

formerly Citigroup) for aiding and abetting the individual defendants' alleged breaches of fiduciary duties. Counts I and II alternatively plead the same claims as putative class claims. The plaintiffs have waived the class claims, apparently admitting that the claims are properly derivative in nature.[18]

Following the plaintiffs' filing of the second amended complaint, the defendants renewed their various motions to dismiss for failure to make demand pursuant to Rule 23.1 and failure to state a claim pursuant to Rule 12(b)(6). The defendants filed their various opening briefs on May 23, 2008. On July 10, 2008, the plaintiffs filed a notice and order of dismissal without prejudice of the claims against Citigroup. This court approved the dismissal of the claims against Citigroup on July 14, 2008. The plaintiffs filed an omnibus brief in opposition to the defendants' various motions to dismiss on July 15, 2008, and the defendants filed their reply briefs on August 15, 2008. The court heard oral argument on the defendants' motions on October 22, 2008.

## II.

Unless the plaintiffs can show demand would be futile, they must make a demand on the board of directors of a corporation before a derivative action may be instituted on behalf of the corporation.[19] The threshold question presented here

---

[18] Pls.' Br. in Opp'n 22 n.10.
[19] *See* Ct. Ch. Rule 23.1; *Aronson v. Lewis*, 473 A.2d 805, 811-12 (Del. 1984).

is: against which board is the claim of demand futility to be tested–the old board that was still in office on November 5, 2007, or the new board that was in office at the time of the filing of the second amended complaint? The plaintiffs have made no allegations of demand futility with respect to the newly constituted board. Thus, because the plaintiffs concede that they cannot show demand futility with respect to the new board, the plaintiffs' ability to survive this motion to dismiss hangs on their ability to prove that demand futility should be tested with respect to the old board.

The parties agree that the relevant question under Delaware law is whether the claims presented by the second amended complaint were already validly in litigation. If so, the plaintiffs need not have made demand or otherwise shown demand futility when filing the second amended complaint. If not, the plaintiffs were required to make demand or plead demand futility at the time the second amended complaint was filed (and therefore with respect to the newly constituted board). The parties obviously disagree, however, as to the answer to this question. Thus, it is first necessary to determine what it means for a claim to be "validly in litigation."

The test under Delaware law to determine whether a demand must be made when a derivative complaint is amended is found in *Braddock v. Zimmerman.*[20]

---

[20] 906 A.2d 776 (Del. 2006).

The Delaware Supreme Court, approving the reasoning of Chancellor Allen in *Harris v. Carter*,[21] held that "for purposes of determining whether demand is required before filing an amended derivative complaint, the term 'validly in litigation' means a proceeding that can or has survived a motion to dismiss."[22] Expanding on this, the court explained the three circumstances that must exist to excuse a plaintiff from showing demand futility as of the time of filing the amended complaint: (1) "the original complaint was well pleaded as a derivative action;" (2) "the original complaint satisfied the legal test for demand excusal;" and (3) "the act or transaction complained of is essentially the same as the act or transaction challenged in the original complaint."[23]

The first and third prongs of the test in *Braddock* do not appear to be contested by the parties in connection with the Rule 23.1 motion. The defendants appear to at least tacitly admit, for the purpose of the *Braddock* demand analysis, the first amended complaint contains well pleaded derivative claims. Likewise, there does not seem to be any disagreement that the fundamental acts or

---

[21] 582 A.2d 222 (Del. Ch. 1990). In *Harris*, the Chancellor held that the key question in determining the appropriate time to test demand futility is whether the amended claims were "validly in litigation" prior to the amendment. *Id.* at 230. For the purposes of that analysis, "claim" refers not "simply to legal theories of liability but refers broadly to the acts and transactions alleged in the original complaint. Thus, an amendment or supplement to a complaint that elaborates upon facts relating to acts or transactions alleged in the original pleading . . . would not . . . constitute a matter that would require a derivative plaintiff to bring any part of an amended or supplemental complaint to the board prior to filing." *Id.* at 231.
[22] *Braddock*, 906 A.2d at 779.
[23] *Id.* at 786.

transactions complained of in the first amended complaint are the same as those in the second amended complaint. Rather, the defendants seem to focus on the second prong. ACS argues that only if either (1) the initial complaint survived a motion to dismiss or (2) the defendants had conceded the facial validity of the initial complaint by filing an answer would the complaint be "validly in litigation."[24] But ACS's analysis reads "can" right out of "a proceeding that *can* or has survived a motion to dismiss."[25] In doing so, ACS neglects a third way available to plaintiffs: show that the first amended complaint would have survived a Rule 23.1 motion to dismiss.[26] If the plaintiffs succeed on this, the claims were validly in litigation at the time the complaint was amended, and the second amended complaint will not require a new showing of demand futility (although it would remain subject to the defendants' motion to dismiss for failure to state a claim). If the plaintiffs fail to show that the first amended complaint would have survived a Rule 23.1 motion to dismiss, the plaintiffs' tacit concession that demand is not futile with respect to the second board will be fatal to their case.

---

[24] Def. ACS's Reply Br. 2.
[25] *Braddock*, 906 A.2d at 779.
[26] ACS acknowledges this possibility in its reply brief, but argues against such a test on the grounds that as a policy matter requiring the court to test both complaints would be judicially inefficient. The plain language of *Braddock* nevertheless seems to require this process in this case, ACS's arguments about judicial efficiency notwithstanding.

## III.

"The test of demand futility is a two-fold test under *Aronson* and its progeny. The first prong of the futility rubric is 'whether, under the particularized facts alleged, a reasonable doubt is created that . . . the directors are disinterested and independent.' The second prong is whether the pleading creates a reasonable doubt that 'the challenged transaction was otherwise the product of a valid exercise of business judgment.' These prongs are in the disjunctive. Therefore, if either prong is satisfied, demand is excused."[27]

Accordingly, the Delaware Supreme Court has observed that the basis for claiming that demand is excused would generally be one of: "(1) a majority of the board has a material financial or familial interest; (2) a majority of the board is incapable of acting independently for some other reason such as domination or control; or (3) the underlying transaction is not the product of a valid exercise of business judgment."[28]

A director is disablingly interested where he or she will receive a greater than pro rata financial benefit or suffer a smaller than pro rata material detriment.[29] In such circumstances, a director cannot be expected to exercise his or her

---

[27] *Brehm*, 746 A.2d at 256 (quoting *Aronson*, 473 A.2d at 814) (internal citations omitted).
[28] *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996) (internal citations omitted).
[29] *See Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993) (citing *Aronson*, 473 A.2d at 812).

independent business judgment.[30] Directors will be deemed interested for demand purposes under *Aronson* where the complaint alleges specific facts establishing that "the potential for liability is not 'a mere threat' but instead may rise to 'a substantial likelihood.'"[31]

"Independence means that a director's decision is based entirely on the merits of the subject before the board rather than extraneous considerations or influence."[32] Obversely, a director lacks independence if he or she is dominated or controlled by an interested party.[33]

> [I]n the demand context even proof of majority ownership of a company [by the allegedly dominating stockholder] does not strip the directors of the presumptions of independence, and that their acts have been taken in good faith and in the best interests of the corporation. There must be coupled with the allegation of control such facts as would demonstrate that through personal or other relationships the directors are beholden to the controlling person . . . . [I]n the demand-futile context a plaintiff charging domination and control of one or more directors must allege particularized facts manifesting a direction of corporate conduct in such a way as to comport with the wishes or interests of the corporation (or persons) doing the controlling. The shorthand shibboleth of "dominated and controlled directors" is insufficient.[34]

Thus, the mere allegation that a director is dominated and controlled does not raise a reasonable doubt as to his or her independence.[35] Rather, the party pleading

---

[30] *Id.*
[31] *Id.* (quoting *Aronson*, 473 A.2d at 815).
[32] *Aronson*, 473 A.2d at 816.
[33] *See* WOLFE & PITTENGER, § 9.02[b][3][iii], at 9-74.
[34] *Aronson*, 473 A.2d at 815-16.
[35] *See* WOLFE & PITTENGER, 9.02[b][3][iii], at 9-75.

demand futility "must advance particularized factual allegations from which the Court of Chancery can infer that the board members who approved the transaction are acting at the direction of the allegedly dominating individual or entity,"[36] such that "their discretion would be sterilized."[37]

The court turns now to analyzing the first amended complaint to determine if it adequately pleads demand futility with respect to the board as it existed at the time it was filed. At that time, there were eight directors on the board of ACS. Of those eight, Deason, Blodgett, and Rexford were management directors and participants in the Buyout Group proposal. As such, those three were clearly interested. Thus, if any one of the five outside directors was interested or lacked independence from the Deason group, demand would be excused since there would not be a majority of disinterested and independent directors.

The plaintiffs, however, offer no well pleaded allegations of either interest or domination or control. There is absolutely nothing in the complaint to suggest that the outside directors had any financial interest in the Buyout Group's proposed transaction beyond their interest as stockholders. Instead, the plaintiffs hang their argument on the "shibboleth of 'dominated and controlled directors.'"[38]

---

[36] *Heineman v. Datapoint Corp.*, 611 A.2d 950, 955 (Del. 1992); *see also Orman v. Cullman*, 794 A.2d 5, 25 n.50 (Del. Ch. 2002) (defining the factors that would potentially make a director not independent).
[37] *Rales*, 634 A.2d at 936.
[38] *Aronson*, 473 A.2d at 815-16; *see* First Am. Compl. ¶ 23.

The only substantive allegation made in the first amended complaint to support the idea that demand would be futile is that days before the complaint was filed the outside directors had stated that their "last duty of business will be to approve a new slate of director nominees."[39] From this, the plaintiffs conclude that the outside directors "[would] not bring suit against the management directors,"[40] and therefore demand would be futile.

The plaintiffs are putting words into the outside directors' mouths. Examining the letter sent by the outside directors' counsel and the contemporaneously filed complaint seeking declaratory judgment, the only statement of the kind the directors actually made is that:

> [B]ecause of Deason's and management's conduct, they felt compelled to resign from the Board and not to stand for re-election. However, to ensure that their successors were truly independent and to protect the Company's minority shareholders, the independent directors also stated . . . that they were prepared, prior to their resignation, to immediately begin the process of reviewing Deason's nominees and any additional nominees proposed by the Company's shareholders.[41]

The issue raised by the plaintiffs is a novel one in the demand excusal context: can a board in the midst of internal warfare, with the majority of its

---

[39] First Am. Compl. ¶ 23(c). The plaintiffs also make some additional poorly pleaded allegations regarding three of the outside directors, but the plaintiffs' counsel waived these allegations at oral argument. Mot. to Dismiss Tr. 83-86.
[40] First Am. Compl. ¶ 23(c).
[41] ODC ¶ 18.

members preparing to resign, be expected to properly consider a stockholder demand? The answer to this question must come down to whether the majority of the board can fairly be said to have abandoned their duties, such that making a demand upon them would be futile.[42]

The plaintiffs have not sufficiently pleaded facts supporting such a conclusion. Rather, to the contrary, before tendering any resignation, the defendant outside directors first insisted on passing on the qualifications of their replacements, to ensure that the board would remain with a majority of independent directors in order to protect the minority stockholders. Far from showing an abandonment of their fiduciary duties at this time, this shows a continuing focus on those duties so long as they remained directors. It thus cannot be fairly said that, in the absence of well pleaded allegations showing interest or domination, there is any reason to believe that the board of ACS as it existed on November 5, 2007 could not have fairly considered a stockholder demand.[43]

---

[42] Notably, the first prong of *Aronson* usually does not focus on whether each director is disinterested or independent with respect to the decision whether or not to bring suit. Rather, *Aronson* focuses on the sterilization of a director's judgment in considering the underlying challenged business decision. *Rales*, 634 A.2d at 933 ("The question of independence flows from an analysis of the factual allegations pertaining to the influences upon the directors' performance of their duties generally, *and more specifically in respect to the challenged transaction*."). It is only the unusual claim that the directors had abandoned their duties that causes the court to analyze the evident willingness or ability of the directors to consider a demand.

[43] In any event, if, as the plaintiffs suggest, the outside directors would have simply ignored the demand without due consideration, the plaintiffs might then have had a claim for wrongful demand refusal. The plaintiffs' suggestion that merely not having sued Deason for damages in the ODC is evidence of their domination or abandonment of their fiduciary duties is without merit. The ODC was brought by the outside directors in their individual capacities.

The court is left then to the second prong of *Aronson*: whether the pleading creates a reasonable doubt that "the challenged transaction was otherwise the product of a valid exercise of business judgment."[44] The business judgment rule "is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[45]

The plaintiffs have pleaded no facts to undermine the presumption that the outside directors of the board, and in particular the special committee, failed to fully inform itself in deciding how best to proceed to get out from under the exclusivity agreement and attempt to run a robust sale process. To the contrary, the special committee quickly hired Weil Gotshal to provide legal counsel and Lazard & Freres to provide financial advice. Nor does the complaint offer any challenge to the board's or the special committee's good faith in pursuing the course it chose in dealing with Deason. Instead, the complaint essentially states that the plaintiffs would have run things differently. The business judgment rule, however, is not rebutted by Monday morning quarterbacking. In the absence of well pleaded allegations of director interest or self-dealing, failure to inform themselves, or lack of good faith, the business decisions of the board are not

---

[44] *Brehm*, 746 A.2d at 256 (quoting *Aronson*, 473 A.2d at 814) (internal citations omitted).
[45] *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (citing *Aronson*, 473 A.2d at 812).

subject to challenge because in hindsight other choices might have been made instead.[46] For example, there is nothing about the board's conduct in choosing not to form a special committee until it in fact had received a definitive offer from Deason that suggests a breach of duty. Nor does the special committee's choice to negotiate with Cerberus and Deason to obtain a waiver of the exclusivity agreement, rather than suing to nullify the agreement (even assuming that such a suit would have had a reasonable likelihood of success), support any inference of fiduciary misconduct. In short, nothing about the board's or the special committee's conduct creates a reasonable doubt that the choices of the board or the special committee were anything other than a result of their good faith pursuit of the best interests of ACS and its stockholders other than Deason.

Thus, the plaintiffs failed to plead facts in the first amended complaint that raise a reasonable doubt under either prong of *Aronson*. The derivative claims in the first amended complaint were therefore not validly in litigation when the plaintiffs amended their complaint the second time. The plaintiffs were thus required to either make demand at the time they filed their second amended complaint, or to plead that demand would be futile *at that time*, and therefore excused. They have not done so.

---

[46] *See, e.g., Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807, 810 (N.Y. Sup. Ct. 1976 ) ("A complaint which alleges merely that some course of action other than that pursued by the Board of Directors would have been more advantageous gives rise to no cognizable cause of action.").

## IV.

For the foregoing reasons, the court concludes that pre-suit demand on the board of directors of ACS was not excused. The plaintiffs failed to make demand prior to instituting this derivative action. As a result, nominal defendant ACS's motion to dismiss for failure to make demand is GRANTED, and Counts III and IV are therefore DISMISSED WITH PREJUDICE. Because the plaintiffs have abandoned their putative class claims, Counts I and II are DISMISSED WITH PREJUDICE. IT IS SO ORDERED.