IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE PAXSON COMMUNICATION CORPORATION SHAREHOLDERS LITIGATION	)	CONSOLIDATED CIVIL ACTION NO. 17568

MEMORANDUM OPINION

Date Submitted: April 25, 2001
Date Decided: July 10, 2001

Joseph A. Rosenthal, Jr., of ROSENTHAL, MONHAIT, GROSS & GODDESS, P.A., Wilmington, Delaware; OF COUNSEL: Kenneth J. Vianale and Robert R. Adler, of MILBERG WEISS BERSHAD HYNES & LERACH LLP, Boca Raton, Florida; MILBERG WEISS BERSHAD HYNES & LERACH LLP, New York, New York; STULL, STULL & BRODY, New York, New York; LAW OFFICES OF CURTIS V. TRINKO, LLP, New York, New York; WEISS & YOURMAN, New York, New York; Attorneys for Plaintiffs.

Kenneth J. Nachbar and James G. McMillan, III, of MORRIS, NICHOLS, ARSHT & TUNNELL, Wilmington, Delaware; OF COUNSEL: Tracy Nichols, of HOLLAND & KNIGHT LLP, Miami, Florida; Attorneys for Defendants.

CHANDLER, Chancellor

This action arises out of the alleged rejection of a cash offer for Paxson Communications Corporation (“Pax” or the “Company”) from Fox Network (“Fox”) and the later acceptance by Pax of a series of agreements (the “NBC Transactions”) with the National Broadcasting Company, Inc. (“NBC”). The plaintiffs allege that Fox made an all cash offer of $20 per share for Pax common stock (the “Fox Offer”) that was summarily rejected by the directors and/or senior officers of Pax.* Shortly after the alleged Fox Offer, NBC invested $415 million in Pax in exchange for convertible preferred stock, certain warrants, and the right to purchase certain shares owned by Pax’s controlling stockholder, Lowell W. Paxson.

Based on these events, the plaintiffs make two claims, each premised on the Individual Defendants’ alleged violations of their fiduciary duties of loyalty and care. Plaintiffs first assert a direct claim, arguing that the defendants abdicated their duty to evaluate and fairly respond to the Fox Offer with a view towards maximizing shareholder value and thereby depriving the Company’s shareholders of a substantial premium that Fox (or perhaps another potential bidder) might have been willing to provide (“Claim I”). They also present a derivative claim on behalf of Pax to redress

[1] These directors and/or officers of Pax are Lowell W. Paxson, the Chief Executive Officer (“CEO”) and Chairman of the Pax Board of Directors (the “Pax Board”), William E. Simon Jr., Jeffrey Sagansky, James Bocock, Bruce Burnharn, and James Greenwald (collectively, the “Individual Defendants”).

injuries suffered (and to be suffered) by the Company as a result of the Individual Defendants' purported violations of their fiduciary duties ("Claim II"). This is the Court's decision on the defendants' motion to dismiss these two claims.

I. FACTUAL BACKGROUND

Defendant Pax is a Delaware corporation with its headquarters in West Palm Beach, Florida. Pax is a network television broadcasting company that owns and operates the largest group of broadcast television stations in the United States. Pax is a publicly traded company whose Class A cornmon stock trades on the American Stock Exchange. Pax's capital structure also includes Class B common stock. The Class B stock, beneficially owned entirely by Pax Chairman Lowell Paxson, is identical to the Class A stock except that each Class B share possesses ten votes per share. Class A shares possess one vote per share.

The Individual Defendants were the six members of the Pax Board at the time of the challenged NBC Transactions. Lowell Paxson, Jeffrey Sagansky, and James Bocock were also officers of the Company during the period in question. Through his ownership of 39.2% of the Pax Class A stock and 100% of the Pax Class B stock, Mr. Paxson controls approximately 75% of Pax's voting power.

On or about August 9, 1999, Pax issued a press release announcing that it had formally retained Salomon Smith Barney ("Salomon") to explore potential strategic alternatives for the Company. In this press release, Pax stated that the Pax Board had decided to pursue this course of action in anticipation that the Federal Communications Commission would loosen ownership restrictions affecting the broadcasting industry.

The plaintiffs contend that shortly after issuing this press release, Pax received an unsolicited offer from Fox to acquire Pax for approximately $20.00 per share. They further allege that Pax responded to the Fox Offer with a counter-offer of $26.00 per share, but failed to enter into a genuine negotiating process with Fox aimed at selling the Company. As Pax common stock had traded between $6.00 and $17.4375 over the preceding twelve months, the plaintiffs conclude that this aborted attempt to sell Pax deprived them as Pax shareholders of a substantial premium.

On September 15, 1999, Pax entered into the NBC Transactions. These three agreements included an investment agreement (the "Investment Agreement"), a call option agreement (the "Call Agreement"), and a stockholder agreement (the "Stockholder Agreement"). In the aggregate, NBC and its affiliates paid approximately $415 million for the rights they received in the NBC transactions.

In the first of these transactions, the Investment Agreement, Pax agreed to: (i) sell 41,500 shares of newly created preferred stock in Pax to a wholly owned subsidiary of NBC ("NBC Sub I"), convertible at any time into 3 1,896,032 shares of Pax Class A common stock for an initial conversion price of $13.0 1 per share; (ii) issue a warrant ("Warrant A") to another wholly owned subsidiary of NBC ("NBC Sub II") to purchase up to 13,065,507 shares of Pax common stock at an exercise price of $12.60 per share; and, (iii) issue a warrant ("Warrant B") to NBC Sub II to purchase another 18,966,620 shares of Pax common stock at an exercise price equal to the average closing prices of the Class A common stock for the 45 consecutive trading days before the warrant exercise date, subject to a minimum exercise price of $22.50 per share during the three years after September 15, 1999. Subject to certain conditions and limitations, Warrants A and B are exercisable for ten years from September 15, 1999.

Concurrently with the Investment Agreement, a wholly owned subsidiary of NBC entered into the Call Agreement with Lowell Paxson, personally, and certain entities controlled by him. By the terms of the Call Agreement, the NBC subsidiary was granted the right (the "Call Right") to purchase all, but not less than all, of Mr. Paxson's 8,3 11,639 shares of Pax's Class B common stock (the "Call Shares"). Under the Call Agreement, the

NBC subsidiary may purchase the Call Shares at a price equal to the greater of(i) the average of the closing sale prices of the Class A common stock for the 45 consecutive trading days ending on the trading date immediately preceding the date of exercise of the Call Right; and (ii) $22.50 per share for any exercise of the Call Right within three years of September 15, 1999, or $20.00 per share if the Call Right is exercised thereafter.

The third of the NBC transactions, the Stockholder Agreement, provided, among other things, for NBC to have representation on the Pax Board if permitted by applicable law. The Stockholder Agreement also requires NBC's consent for Pax to take certain actions, including the adoption of a shareholder's rights plan, amendments to Pax's organizational documents, and issuances of stock or other securities.

If NBC converts the newly created preferred shares, exercises both warrants, and purchases Lowell Paxson's Class B shares, NBC would own approximately 49% of the equity in Pax and control almost 70% of its voting power.

II. ANALYSIS

A. *Standard on a Motion to Dismiss*

A motion to dismiss under Court of Chancery Rule 12(b)(6) will be granted where it appears with "reasonable certainty" that the plaintiff could

not prevail on any set of facts that can be inferred from the pleadings.[2] The plaintiff, however, is entitled to all reasonable inferences that can be drawn from the complaint.[3] With this standard in mind, I turn to my analysis of the two claims pending before me.

B. Claim I

Claim I purports to be a class action claim for breach of fiduciary duty. The defendants insist that Claim I is in fact a derivative claim that can be brought only on the Company's behalf and, therefore, must be dismissed for failure to state a direct claim.

The Delaware courts are often faced with the complex task of distinguishing derivative claims from individual claims.[4] The distinction between the rights of the corporation as opposed to the individual rights of shareholders is often "a narrow one" that can have extremely important consequences for litigation.' Among these consequences are:

> the possible dismissal for an unjustified failure to demand that the board institute litigation; the general inability of a derivative plaintiff to engage in discovery relevant to the demand issue when dismissal on such grounds is sought; [and,] the ability of a special litigation committee of the board to terminate even a

---

[2] *Solomon v. Path Communications Corp.,* Del. Supr., 672 A.2d 35, 38 (1996) (citing *In re USACafes, L.P. Litig.,* Del. Ch., 600 A.2d 43, 47 (1991).
[3] Id. (citing *In re USACafes, 600* A.2d at 47).
[4] *See generally* Donald J. Wolfe. Jr. and Michael A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery,* § 9-2(a), 5 16-26 (1998). .
[5] *Kramer* v. *Western Pacific Indus., Inc.,* Del. Supr., 546 A.2d 348, 351-52 (1988).

properly instituted derivative action as to which demand has been shown to be futile.[6]

In determining whether a given claim is derivative or direct in nature. this Court must look to "'the nature of the wrong alleged' and the relief, if any, which could result if plaintiff were to prevail."' In determining the nature of the wrong alleged, the Court will not be bound by the plaintiffs characterization of the claim in the complaint, but rather must look to "the body of the complaint."*

To have standing to sue directly rather than derivatively on behalf of the corporation, the plaintiff must have been injured "*directly* or *independently* of the corporation."[9] In other words, the plaintiff needs to have sustained a "special injury," defined as "a wrong inflicted upon [a shareholder] alone or a wrong affecting any particular right which [that shareholder] is asserting, -- such as his preemptive rights as a stockholder, rights involving the control of the corporation, or a wrong affecting the stockholders and not the corporation."[10]

---

[6] Wolfe and Pittenger, $9-2(a) at 5 16.
[7] *Kramer, 546* A.2d at 352 (quoting *Elster v. American Airlines, Inc.,* Del. Ch., 100 A.2d 219, 221-23 (1953)).
[8] *Kramer,* 546 A.2d at 352 (quoting *Lipton v. News Int 'l PLC,* Del. Supr., 5 14 A.2d 1075, 1078 (1986).
[9] *Kramer, 546* A.2d at 352.
[10] *Lipton,* 514 A.2d at 1079 (citing *Elster v. American Airlines, Inc.,* Del. Ch., 100 A.2d 219,222 (1953)).

Although there is no standard test that shall be mechanistically applied in all cases to determine whether a given claim is derivative or direct, probably the most-cited formulation is that of former Chancellor Brown in *Moran v. Household International Inc.* :

> To set out an individual action, the plaintiff must allege either 'an injury which is separate and distinct from that suffered by other shareholders,' . . . or a wrong involving a contractual right of a shareholder, such as the right to vote, or to assert majority control, which exists independently of any right of the corporation.[11]

The Supreme Court has made clear that although Chancellor Brown's *Moran* forrnulation may serve as "a quite useful guide," that test is not conclusive.[12] Rather, Delaware courts must ultimately look "to whether the plaintiff has alleged 'special' injury, in whatever form."[13]

In this case, the plaintiffs assert that they have suffered two distinct, direct injuries that each bestow standing on the plaintiffs to bring direct claims against the defendants. Plaintiffs point to the dilution of their ownership interest, earnings per share and voting power due to the effect of the NBC Transactions. Additionally, plaintiffs argue that the Pax Board's failure to pursue the Fox Offer in favor of the NBC Transactions resulted in

---

[11] 490 A.2d 1059, 1070 (1985), *aff'd,* Del. Supr., 500 A.2d 1346 (1986) (quoting 12b Fletcher Cyclopedia of Corps, § 5921, at 452 (perm. ed., rev. vol. 1984)).
[12] ***Lipton,*** 514 A.2d at 1078.
[13] ***Id.***

the loss of the opportunity for the shareholders to receive optimum value for their investment in Pax. I address each of these contentions in turn.

First, the plaintiffs argue that "it is well-settled that equity dilution and diminution of one's voting power constitutes a direct injury to the shareholders and not the corporation."[14] They contend that the NBC Transactions will dilute the equity and voting power of the plaintiff shareholders should NBC Sub I convert its 41,500 shares of preferred stock into 3 1896,032 shares of common stock and NBC Sub II exercise its warrants to purchase a total of 32,032,127 shares of Pax common stock.

Plaintiffs point to two cases, *In re Tri-Star Pictures, Inc. Litigation*[15] and *Oliver, et al. v. Boston University, et al.*[16] to support the proposition that their dilution claim is direct rather than derivative. Their reliance on these two cases, however, is misplaced. In *Tri-Star,* the plaintiffs, former stockholders of Tri-Star Pictures, Inc. ("Tri-Star"), challenged an assets for stock transaction between Tri-Star and Coca-Cola Company ("Coca-Cola"), a 36.8% stockholder of Tri-Star before the transaction.[17] The complaint alleged that Coca-Cola had wrongfully manipulated the transaction to receive an excessive amount of Tri-Star shares in exchange for assets having

---

[14] Pls.' Answering Br. in Opp'n to Defs.' Mot. to Dismiss, at 9.
[15] Del. Supr., 634 A.2d 319 (1993).
[16] Del. Ch., C.A. No. 16570, mem. op., Steele, V.C. (July 18, 2000).
[17] *Tri-Star, 634* A.2d at 321.

a lower value. As a result of the transaction, Coca-Cola obtained an 80% stock interest in Tri-Star and the public shareholders, who had formerly owned 43.4% of the common equity, now owned only 20% of Tri-Star's equity.[18] Because Coca-Cola, a significant stockholder of Tri-Star before the transaction, did not suffer a similar dilution of their percentage ownership or their voting power as compared to the plaintiffs, the Supreme Court held that the plaintiffs had suffered a special injury not shared equally by all shareholders.[19] This rendered the plaintiffs' claims direct and not derivative in nature.[20]

Similarly, in *Boston University,* plaintiffs, investors in Seragen, Inc. ("Seragen"), argued that the defendants, controlling shareholders, directors, and officers of Seragen, unfairly took advantage of their controlling position to dilute the minority's interests, engage in self-dealing, and effect a merger that resulted in a disproportionate amount of consideration to be paid to the controlling shareholders.[21] The Court held that for the purposes of a motion to dismiss, the plaintiffs had adequately alleged a direct claim, noting that

---

[18] Id. at 330-31.
[19] ***Id.*** at 330.
[20] ***Id.***
[21] Boston University, mem. op. at 1-2.

"the defendants engaged in self-dealing that resulted in reduced voting power and stock dilution."[22]

Together, *Tri-Star* and *Boston University* stand for the proposition that dilution claims are individual in nature where a significant stockholder's interest is increased "at the sole expense of the minority."[23] *Tri-Star* and *Boston University* have no application, in my opinion, where the entity benefiting from the allegedly diluting transaction, NBC, is a third party rather than an existing significant or controlling stockholder. This identical distinction was also made by Vice Chancellor Jacobs in *Turner v. Bernstein*.[24] In that case, Vice Chancellor Jacobs noted that a claim of stock dilution and a corresponding reduction in a stockholder's voting power states a direct claim

> only in transactions where a significant stockholder sells its assets to the corporation in exchange for the corporation's stock, and influences the transaction terms so that the result is (i) a decrease (or 'dilution') of the asset value and voting power of the stock held by the public stockholders and (ii) a corresponding increase (or benefit) to the shares held by the significant stockholder.[25]

---

[22] *Id.* at 6.
[23] *Tri-Star,* 624 A.2d at 330.
[24] Del. Ch., C.A. No. 16190, slip op. at 44-45, Jacobs, V.C. (Feb. 9, 1999). See *also In re Ply Gem Indus., Inc. Shareholders Litig.,* Del. Ch., Consol. C.A. No. 15779-NC, Noble, V.C. (June 26, 2001).
[25] *Id.*

Under this principle, to the extent that any alleged decrease in the asset value and voting power of plaintiffs' shares of Pax results from the issuance of new equity to a third party (NBC), plaintiff's dilution theory as a basis for a direct claim fails and any individual claim for dilution must be dismissed.

Plaintiffs also argue that the Call Agreement between NBC and Lowell Paxson confers a benefit on him, namely, "the potential sale of his Class B stock for prices unavailable to the public shareholders at the time (or, indeed, thereafter up to the present)."[26] Thus, plaintiffs assert that the overall injury to Pax's shareholders is not shared equally by all shareholders, Lowell Paxson is engaging in self-dealing, and Claim I is therefore direct. This argument also fails, as it fundamentally misunderstands the nature of a call option.

As explained above, the Call Agreement entered into by a wholly owned subsidiary of NBC with Lowell Paxson, personally, and certain entities controlled by him, grants the NBC subsidiary the right to purchase all, but not less than all, of Mr. Paxson's Class B Shares of Pax at a price specified by the agreement for a period of ten years. The Call Agreement does not necessarily confer on Mr. Paxson "the opportunity to sell [his]

---

[26] Pls.' Answering Br. in Opp'n to Defs.' Mot. to Dismiss, at 10.

shares to NBC for between $20.00 and $22.00 per share."[27] Rather, the Call Agreement grants NBC the right, for a specified period, to purchase Mr. Paxson's shares only *if* NBC ***should*** so ***desire.*** Thus, Mr. Paxson has obligated himself to sell his Pax shares to NBC at a fixed price or if higher, the market price, but only if NBC chooses to exercise its Call Right. As stockholders are assumed to act in their own economic self-interest, NBC will exercise its Call Right only if it believes it is in its own best interests to do so.[28] That is, NBC will exercise should it believe that the value of Mr. Paxson's stock exceeds the call price.

As the defendants point out, the Call Agreement actually places several very important burdens on Mr. Paxson's ownership of the Class B stock. First, Mr. Paxson has precluded himself from selling his shares to any other person or entity besides NBC for the duration of the Call Right. No other Pax stockholder has similarly had his liquidity taken away in this manner. Second, Mr. Paxson has agreed to relinquish a portion of any possible appreciation in his Pax stock above $20.00 or $22.50 per share. No other Pax shareholder has similarly relinquished his right to equity appreciation by having to sell at a defined or average price. Third, Mr.

---

[27] *Id.* at 3.
[28] *See Unitrin, Inc. v. American Gen. Corp.,* Del. Supr., 651 A.2d 1361, 1380-81 (1995).

Paxson has agreed to sell his Class B stock, which alone provides control of the Company, to NBC at NBC's sole discretion, without necessarily receiving the control premium his shares would ordinarily command. As the Call Agreement imposes substantial burdens on Mr. Paxson, in contrast to the substantial benefits alleged by plaintiffs, this argument in favor of plaintiffs' standing to bring a direct claim also fails.

In the plaintiffs' second attempt to support a direct claim, they allege that the defendants' failure to properly explore the Fox Offer, and later engage in serious negotiations with Fox, deprived the plaintiffs of the opportunity to realize the optimum value for their Pax stock. This, according to the plaintiffs, caused them to suffer individual injury. In substance, the plaintiffs argue that as soon as the Pax Board announced that Pax had retained Salomon to "explore strategic alternatives," the plaintiffs were entitled to a reasonable inference that the individual defendants had engaged in an active bidding process seeking to sell Pax and were under a fiduciary obligation to maximize value for the Pax shareholders in accordance with *Revlon, Inc. v. McAndrews & Forbes Holdings, Inc.*[29] This argument fails for at least two reasons.

[29] Del. Supr., 506 A.2d 173 (1986); *see also Paramount Communications, Inc. v. QVC Network, Inc.,* Del. Supr., 637 A.2d 34, 47 (1994) ("Under Delaware law there are. generally speaking and without excluding other possibilities, two circumstances which may implicate *Revlon* duties. The first, and clearer one, is when a corporation initiates an

First, the plaintiffs have failed to distinguish these facts from the numerous cases that have previously held that allegations that directors wrongfully failed to pursue business combinations are derivative in nature. Vice Chancellor Hartnett's opinion in *Sumers v. Beneficial Corporation* is representative of this line of authority.[30] In *Sumers,* the plaintiff alleged that directors of Beneficial Corporation announced that the corporation was for sale and then "summarily and arbitrarily rejected, without timely disclosure to the public shareholders," acquisition offers made at substantial premiums over the market price.[31] The Court held that

> [t]he complaint in the present suit . . . does not state any claim of breach of contractual rights, nor any facts which, if true, would constitute a special or individual cause of action. Plaintiffs' injury, if any, is the same as the injury to all other stockholders of [the corporation].[32]

In the present case, the plaintiffs have represented to the Court that "[t]he Class B stock is identical to the Class A stock except for voting power. The

---

active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company.") (quoting *Paramount Communications, Inc. v. Time Inc.,* Del. Supr., 571 A.2d 1140, 1150 (1990).

[30] Del. Ch., C.A. *No. 8788,* mem. op., Hartnett, V.C. *(Mar. 9,* 1988). *See also Bodkin v. Mercantile Stores* Co., Del. Ch., C.A. No. 13770, mem. op., Chandler, V.C. (Nov. 1, 1996); *Lewis v. Spencer,* Del. Ch., C.A. No. 8651, mem. op., Berger, V.C. (Oct. 31, 1989), *aff'd,* Del. Supr., 577 A.2d 753 (1990).

[31] *Sumers,* mem. op. at 2.

[32] *Id.* at 4.

economic attributes are identical."[33] They have failed to identify any significant difference between the facts in this matter and those found in the *Sumers* line of cases.

Second, *Revlon* does not apply where the plaintiffs cannot allege that a sale or change of control has taken place or necessarily will take place such that the public shareholders of a corporation have been or will be deprived of a control premium. To the contrary, it is clear from the complaint that Mr. Paxson controls Pax through his ownership of 39.2% of the Company's Class A stock and 100% of the Company's class B stock. These holdings collectively represent 75% of Pax's voting power. If NBC exercises its Call Right, a possibility that is by no means assured, it will control Pax. If NBC does not exercise, Mr. Paxson will retain control. In either circumstance therefore, the minority public shareholders of Pax will be subject to a controlling shareholder. The only difference would be the identity of that controlling shareholder. In other words, the public shareholders of Pax will never be in the position to collectively control the corporation and therefore receive a control premium for their shares.

[33] Pls.' Answering Br. in Opp'n to Defs.' Mot. to Dismiss, at 10 n.5.

This Court's recent decision in *In re Digex Shareholders Litigation*[34] is directly on point as to *Revlon's* applicability to the facts of this case. There, WorldCom, Inc. ("WorldCom") sought to acquire Digex, Inc. ("Digex"). However, another company, Intermedia Communications, Inc. ("Inter-media"), was the majority shareholder of Digex. Ultimately, Worldcom entered into a merger with Intermedia instead of Digex, a transaction by which it would effectively acquire Intermedia's controlling stake in Digex. During the litigation that ensued, Digex's minority public stockholders sought to assert a *Revlon* claim that they had been deprived of a substantial premium for their shares. The Court rejected this claim, noting that "[t]he Digex minority existed before the proposed merger and it will not change under the proposed transaction. What will change is the ownership of Digex's majority shareholder, Intermedia."[35] Similarly here, even if NBC exercises its Call Right, from the perspective of a Pax minority shareholder, all that will change is the identity of the majority shareholder.[36]

---

[34] Del. Ch., C.A. No. 18336, mem. op., Chandler, C. (Dec. 13, 2000).
[35] *Id.* at 40.
[36] *See also In re Santa Fe Pac. Corp. Shareholders Litig.*, Del. Supr., 669 A.2d 59, 70-71 (1995) ("Plaintiffs appear to rest their claim of a duty to seek the best value reasonably available on allegations that the Board initiated an active bidding process. Plaintiffs do not consider, however, that this method of invoking the duty requires that the Board also seek to sell control of the company or take other actions which would result in a break-up of the company.")

The plaintiffs try to avoid *Digex's* reasoning by asserting that the entire Company was for sale, thus triggering the directors' *Revlon* duties, as soon as Pax announced that it "had formally retained Salomon to explore strategic alternatives."[37] Plaintiffs' contend that they are entitled to the reasonable inference that the announcement of the engagement of an investment bank to "explore strategic alternatives" is well-known industry lexicon for a company that has initiated an active sales process.[38]

This assertion is simply not in accord with Delaware law. The phrase "strategic alternatives" contemplates the possibility of many types of transactions. A sale of the company may be one. It goes without saying, however, that many other types of transactions including special dividend payments, stock repurchases, stock issuances, or recapitalizations are all within the purview of "strategic alternatives." Moreover, numerous cases have held that *Revlon* duties have not applied even where companies have hired investment bankers.[39] This case is no different.

Finally, plaintiffs insist most urgently that this case is controlled by Vice Chancellor Strine's opinion in *In re Gaylord Container Corp.*

---

[37] Pls.' Answering Br. in Opp'n to Defs.' Mot. to Dismiss, at 3, 10-1 1.
[38] *Id.* at 10-11.
[39] *See, e.g., In re Santa Fe Pac. Corp., 669* A.2d at 70-71; *In re Delta & Pineland Co. Shareholders Litig.,* Del. Ch., C.A. No. 17707, mem. op., Chandler, C. (June 21, 2000).

Shareholders Litigation.[40] They invoke ***Gaylord*** to support their argument that they have suffered a direct injury as a result of being "prevented from receiving an adequate offer for their shares."[41] Plaintiffs' reliance on ***Gaylord*** is misplaced. ***Gaylord*** involved *Unocal* claims where a board of directors allegedly enacted defensive measures intended to restrict shareholder action and to make an acquisition virtually impossible without the board's consent. Here, the plaintiffs have alleged no *Unocal* claims, nor are there facts present here which could support such a claim. The arguments made in ***Gaylord*** simply do not apply to the facts present in this case.

For all of the reasons discussed above, the plaintiffs' claims are solely derivative in nature. As such, Claim I must be dismissed for failing to state a direct claim.

C. ***Claim II***

The plaintiffs have asserted a derivative claim on behalf of Pax to redress injuries allegedly suffered and to be suffered by the Company as a direct result of the Individual Defendants' purported fiduciary duty violations. The defendants argue that Claim II must be dismissed because it

[40] Del. Ch., 747 A.2d 71 (1999).
[41] Pl.'s Answering Br. in Opp'n to Defs.' Mot. to Dismiss, at 11.

fails to meet the pleading requirements of Chancery Rule 23.1 to excuse plaintiffs' failure to make pre-suit demand on the Pax Board.[42] Not surprisingly, plaintiffs respond that they are properly excused from making demand because the Pax Board acted for entrenchment purposes, Mr. Paxson dominated and controlled the Pax board, and Mr. Paxson enjoyed a personal financial interest not shared with the other stockholders.

To allege with particularity that a demand upon the board would have been futile, the plaintiffs must establish a reasonable doubt that: (1) a majority of the board of directors is disinterested and independent; and (2) the challenged transaction was a valid exercise of business judgment.[43]

The plaintiffs have attempted to establish reasonable doubt under the first prong of the *Aronson* test by arguing that the directors of Pax were motivated by their desire to remain entrenched. They base this allegation on the argument that had the defendants negotiated a takeover by Fox, the positions of the Individual Defendants may have been in jeopardy. Conversely, the transaction ultimately entered into with NBC did not oust

---

[42] Ct. Ch. R. 23.1. The rule states in pertinent part, "[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 or comparable authority and the reasons for the plaintiffs failure to obtain the action or for not making the effort."
[43] *Aronson* v. *Lewis,* Del. Supr., 473 A.2d 805,814 (1984).

the Individual Defendants from their positions at Pax.[44] Therefore, the plaintiffs contend that it is reasonable to infer that the defendants' alleged rejection of the Fox Offer was motivated by their desire to entrench themselves in office rather than from a desire to engage in an "investment-oriented" transaction as opposed to an outright sale of the Company.

The plaintiffs also contend that because Mr. Paxson has granted NBC the Call Right, he enjoys a unique financial benefit not shared by the other Pax shareholders. As discussed above, the plaintiffs appear to have misunderstood the nature of a call option. There is no assurance that the Call Right will ever be exercised. In fact, as noted above, Mr. Paxson has encumbered ownership of his class B Pax shares in several ways that are unique to him. Additionally, even if NBC exercises the Call Right, the resulting stock sale will merely be because NBC, a third party, has concluded that that decision is in its, not Mr. Paxson's, best interests.

Under the standard to be applied in cases where plaintiffs plead pre-suit demand futility, "the decision to reject a takeover proposal, hostile or friendly, will not excuse demand absent particularized allegations of a breach of fiduciary duty, such as self-dealing, fraud, overreaching, or lack of

---

[44] The plaintiffs seem to disregard the fact that if NBC gains control of Pax pursuant to the NBC Transactions, the Individual Defendants stand a distinct possibility of being ousted from their positions.

good faith."[45] Nothing even close to such an allegation has been made here. Further, the plaintiffs essentially argue that demand must be excused in any case where directors refrain from selling a company. As *Pogostin* makes clear, this is not the law of Delaware.[46]

Moreover, it is well-established that a successful claim of demand futility requires the existence of *an actual threat* to the directors' positions on the board.[47] No such allegation exists here either, as director removal could not occur without the consent of the controlling shareholder, Mr. Paxson. There has been no allegation that Mr. Paxson sought to remove himself or any other Pax director from office.[48]

The plaintiffs also attempt to satisfy *Aronson* by arguing that a majority of Pax's directors were dominated and controlled by Mr. Paxson. Specifically, they contend that directors Sagansky and Bocock are beholden to Lowell Paxson merely because they are officers of Pax. That is, the plaintiffs point out that Mr. Paxson is Mr. Sagansky's and Mr. Bocock's

---

[45] *Pogostin v. Rice,* Del. Supr., 480 A.2d 619, 627 (1984).
[46] *Id.*
[47] *See, e.g., Bodkin,* mem. op. at 8; *Greenwald v. Batterson,* Del. Ch., C.A. No. 16475, mem. op. at 11, Lamb, V.C. (July 26, 1999) ("the mere allegation that directors have taken action to entrench themselves without an allegation that the directors believed themselves vulnerable to removal from office, will not excuse demand."); *Grobow v. Perot,* Del. Ch., 526 A.2d 914, 922-23 (1987), *aff'd,* Del. Supr., 539 A.2d 180 (1988).
[48] *See Bodkin,* at 8.

superior in the Company, he has voting control of Pax, and he has the power to elect all of the Company's directors and appoint its officers.[49]

Nevertheless, under *Aronson,*

> in the demand context even proof of majority ownership 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."

In reviewing whether demand has been satisfied, after "giving little or no weight to vague conclusory statements, . . . [the Court] must evaluate, under the reasonable doubt standard, whether the facts pleaded with particularity are consistent with domination of the independence of the judgment of the remaining board members."[51] Even where the *potential* for domination or control by a controlling shareholder exists, the complaint must allege particularized allegations that would support an inference of domination or control.[52]

---

[49] Pk. Answering Br. in Opp'n to Defs.' Mot. to Dismiss, at 15.
[50] *Aronson, 473* A.2d at 8 15.
[51] *Friedman v. Beningson,* C.A. No. 1223 1, mem. op. at 10, Allen, C. (Dec. 4, 1995).
[52] *See, e.g., Friedman* (noting where the plaintiffs alleged domination of board decision making by a corporation's Chairman, CEO, President, and 36% stockholder, "[f]rom a practical perspective, this confluence of voting control with directorial and official decision making authority, while not itself sufficient under the cases to support a conclusion of reasonable doubt is nevertheless quite consistent with control of the board."); *Heineman v. Datapoint* Corp., Del. Supr., 611 A.2d 950,955 (1992) (holding in a case where a controlling stockholder allegedly dominated and controlled the board through his control of the positions of other directors as well as his control of business

Here, paragraph 43 of the Complaint alleges that defendants Sagansky and Bocock enjoy certain "emoluments of office" that they seek to retain.[53] At no point do the plaintiffs describe or list any of these alleged emoluments. The complaint also alleges that defendants Sagansky and Bocock receive "substantial salaries, bonuses, payments, benefits, and/or other emoluments."[54] Again, these generalized allegations do not contain any details that would suggest impropriety specifically on behalf of these two directors/officers of Pax. The complaint contains no information concerning what amounts of stock or cash have been paid either to Sagansky or to Bocock as compensation or as a bonus. There is no information plead regarding the stock ownership positions of either of these directors/officers in the Company that might help to illustrate what the Fox Offer might have meant to them financially. There are no allegations concerning any payments that may have flowed to these two director/officers should they

---

organizations in which the other directors were investors that "an allegation of controlling stock ownership does not raise, ***per se,*** a reasonable doubt as to the board's independence.. . . To raise such a doubt a party attacking a corporate transaction must advance particularized factual allegations from which the Court of Chancery can reasonably infer that the board members who approved the transaction are acting at the direction of the allegedly dominating individual or entity." (citations omitted).)

[53] Compl., ¶ 43 (1).

[54] Compl., ¶ 43 (2).

have been terminated, constructively or otherwise, had the alleged Fox Offer been pursued?

Moreover, the Complaint alleges that "[t]he Board members also have close personal and business ties with each other? This allegation is also hopelessly vague. The plaintiffs have not pled the existence of any particular personal relationship between either Bocock or Sagansky and Paxson. The plaintiffs have pled no facts beyond this very generalized statement that supports this allegation in any way.

In sum, the plaintiffs have not pled, with any particularity, facts that could support an excusal of demand under the reasonable doubt standard. This lack of specificity is simply insufficient to satisfy even the barest requirements set forth by *Aronson* and its progeny.

Finally, I note in passing plaintiffs' allegation that, in rejecting the Fox Offer in favor of the NBC Transactions, Mr. Paxson acted out of a personal desire to remain entrenched and to continue to enjoy the emoluments of office. Quite frankly, I am unable to grasp the distinction (accepting the premise that Mr. Paxson desires to remain in office) between

---

[55] This short list of information the plaintiffs may have pled to support their claims is merely illustrative and is in no way to be construed as exhaustive or as sufficient.
[56] Compl., ¶ 43 (2). For an example where allegations of interestedness were found sufficient to withstand a 12(b)(6) motion, *see In re Ply Gem Indus., Inc. Shareholders Litig.,* Del. Ch., Consol. CA. No. 15779-NC, Noble, V.C. (June 26, 2001).

a cash sale to Fox as opposed to the series of transactions that would lead to NBC being in control of Fox. In either circumstance, Mr. Paxson would seem to have about the same chance of remaining in office. Furthermore, it appears from plaintiffs' allegations that Mr. Paxson must be willing to forego a substantial cash premium on his significant holdings of Pax stock offered by way of the Fox Offer, in order to continue to enjoy certain unspecified "emoluments of his offices" in Pax.[57] This would not have been in Mr. Paxson's economic best interests and thus seems to defy logic?

III. CONCLUSION

Based on all the foregoing reasons, I conclude that the complaint in the present suit alleges claims that are solely derivative in nature. Due to the plaintiffs' failure to comply with the demand requirements of Court of Chancery Rule 23.1, thecomplaint is therefore dismissed.

An Order has been entered consistent with the determination reached in this memorandum opinion.

---

[57] Pls.' Answering Br. in Opp'n to Defs.' Mot. to Dismiss, at 15. Plaintiffs essentially posit that Mr. Paxson declined a premium that totaled over $200 million in order to continue to enjoy the emoluments of his offices. I note that NBC has the right to exercise the Call Option whenever it wishes, removing Mr. Paxson from control of the Company. This fact seems to have been overlooked in the plaintiffs' analysis.

[58] *See Parnes v. Bally Entertainment Corp.,* Del. Ch., C.A. No. 15192, mem. op. at 31-32, Chandler, C. (Feb. 23, 2001).

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE PAXSON COMMUNI- CATION CORPORATION SHAREHOLDERS LITIGATION	CONSOLIDATED CIVIL ACTION NO. 17568

ORDER

For the reasons set forth in this Court's Memorandum Opinion entered in this case on this date, it is

ORDERED that the complaint is dismissed for failure to comply with Court of Chancery Rule 23.1.

Chancellor

Dated: July 10, 2001