IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

IN RE TYSON FOODS, INC.	)	
CONSOLIDATED	)	Consolidated C.A. No. 1106-CC
SHAREHOLDER LITIGATION	)	

MEMORANDUM OPINION

Date Submitted: June 29, 2007
Date Decided: August 15, 2007

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CHANDLER, Chancellor

Before me is the outside director defendants' Motion for Judgment on the Pleadings concerning plaintiffs' allegations that defendants "spring-loaded" stock options granted to key Tyson directors and executives. In an Opinion dated February 6, 2007, I refused to dismiss Count III of plaintiffs' consolidated complaint, holding that the authorization of spring-loaded stock options may, in certain limited circumstances, constitute a breach of a director's fiduciary duties.

As part of that Opinion, I also noted that Tyson's public filings provided a more nuanced description of the Tyson Stock Incentive Plan than the consolidated complaint.[1] Plaintiffs alleged that Tyson's shareholder-approved stock option plan required the challenged stock options to be granted at a price no less than the fair market price of Class A Common Stock on the date of the grant. Tyson's proxy statements, however, distinguished between "incentive stock options," to which a fair market value restriction applied, and "nonqualified stock options," which Tyson's Compensation Committee might make exercisable at any price. I refused to dismiss Count III of the complaint based on the premise that the challenged stock options may have been issued "with the intent to circumvent otherwise valid shareholder-approved restrictions upon the exercise price of the options."[2]

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[1] *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 575 n.15 (Del. Ch. 2007).
[2] *Id*. at 593.

Defendants now maintain that the challenged stock options were, in fact, "non-qualified stock options" under Tyson's Stock Incentive Plan and move for judgment on the pleadings as to Count III.

Judicial restraint suggests that a court should limit itself to the case or controversy placed before it and, to the extent practicable, not engage in speculation about phantasmal parties or issues that might one day appear.[3] For this reason, the Opinion ranged very little outside the boundaries of the allegations provided by plaintiffs and, to a lesser degree, challenges raised by defendants. Neither party seriously contested the fact that the options were required to be granted at the market price on the grant date and, although I noted that plaintiffs' allegations and supporting documents were not entirely in accord, I made no assumptions based solely on a few uncited lines scattered throughout multiple proxy statements. Both parties have now directly addressed the issue. With the allegations before the Court more clearly delineated, the holding of the February 6, 2007 Opinion regarding spring-loading can now be considered with greater clarity.

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[3] Justice Holmes aptly described both the responsibility and the limited authority of a common law judge: "I recognize without hesitation that judges do and must legislate, but they can do so only interstitially; they are confined from molar to molecular motions." *S. Pac. Co. v. Jensen*, 244 U.S. 205, 221 (1917) (Holmes, J., dissenting).

I. STATEMENT OF FACTS[4]

Plaintiffs challenge three separate grants of options issued between 2001 and 2003.[5] Each grant was awarded by the Compensation Committee according to the 2000 Stock Incentive Plan approved by shareholders in 2001. The parties disagree, however, as to whether these were grants of incentive or non-qualified stock options.

At a more basic level, the parties disagree as to the materials upon which the Court can base its conclusions at this stage of litigation. Defendants principally rely upon three types of documents: (1) the text of the 2000 Stock Incentive Plan approved by shareholders; (2) proxy statements and other publicly-filed documents issued by Tyson; and (3) minutes of board meetings at which these options were approved. Plaintiffs rightfully object that, not having had the opportunity to complete discovery on this issue, I must limit the range of documents I consider in reaching my conclusions.

On a motion for judgment on the pleadings under Court of Chancery Rule 12(c), the Court is required to take the well-pled facts alleged in the complaint as

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[4] The Court refers to the detailed discussion of plaintiffs' allegations included in the earlier Opinion, and restates here only those allegations necessary to the consideration of the motion for judgment on the pleadings.

[5] *See In re Tyson Foods*, 919 A.2d at 575-576. The consolidated complaint originally challenged four grants of options, but plaintiffs have conceded that the 1999 grant has been rendered moot by a subsequent cancellation.

admitted and to view the allegations and reasonable inferences drawn from them in the light most favorable to the non-moving party.[6] There are a few exceptions to this general rule, however. The Court may take judicial notice of a corporation's public filings,[7] and the Court may rely upon documents integral to or incorporated by reference in the consolidated complaint.[8]

The text of the 2000 Stock Incentive Plan and the various Tyson proxy statements are properly before the Court. The latter are public filings subject to judicial notice and the former is a document integral to the consolidated complaint. A plaintiff may not base a claim upon a contract or similar document, describe that contract in its complaint, but prevent a court from reviewing the plain terms of that agreement by omitting the document from the complaint itself. Such a rule would promote the crafting of misleading complaints containing strategic omissions.[9]

On the other hand, the notes of the Compensation Committee must be excluded from consideration. Defendants suggest that the board resolutions approving the grant of stock options "are essentially contracts that provide the option recipients the right to receive the options set forth therein and form the basis

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[6] *See Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1205 (Del. 1993).
[7] *See In re Gen. Motors (Hughes) S'holder Litig*., 897 A.2d 162, 170-171 (Del. 2006).
[8] *See Midland Food Services, LLC v. Castle Hill Holdings V. LLC*, 792 A.2d 920, 925 n.5 (Del. Ch. 1999).
[9] *Id*.

of Plaintiffs' claims."[10] Whatever the minutes may "essentially" constitute, they are not themselves the relevant agreements between the Company and grantees referenced in the consolidated complaint. It would be fundamentally inequitable for the Court to consider documents cherry-picked from defendants' files on a judgment on the pleadings before plaintiffs have had the benefit of complete discovery.

Considering only the terms of the 2000 Stock Incentive Plan and Tyson's public filings, however, it becomes obvious that the consolidated complaint mischaracterizes the relevant stock option grants. The Plan itself clearly distinguishes between incentive and non-qualified stock option grants and Tyson made this distinction clear to shareholders when it sought approval in 2001. Shareholders had notice of, and approved, a plan that permitted the Compensation Committee the right to distribute options with either a fixed price or a strike price set at the discretion of the Committee.

Although plaintiffs maintain that Tyson's proxy statements do not affirmatively describe the challenged option grants as non-qualified stock options, I find it impossible to reasonably infer that they could be anything else. The Plan defines an Incentive Stock Option as one "contemplated by the provisions of the

[10] Reply Br. in Supp. of Outside Directors' Mot. for J. on the Pleadings at 5.

[Internal Revenue] Code Section 422 or any successor thereto," while non-qualified options are essentially defined as any option that is not an incentive option.[11] The proxy statements do not refer to the status of the options under the Plan, but they explicitly state that the options do not qualify as incentive options under the Code. Given that an option cannot qualify as an incentive stock option under the Plan without first qualifying under the Code, the only reasonable inference is that these were not incentive stock options and, thus, were non-qualified.

Tyson's publicly-filed statements and the shareholder-approved Plan on which plaintiffs rely thus contradict the allegation in the consolidated complaint that "the Plan requires that the price be no lower than the fair market value of the Company's stock on the day of the grant."[12] This conclusion materially alters the appropriate analysis with respect to Count III of the consolidated complaint. The question facing the Court on February 6, 2007, was whether a grant of spring-loaded options could be within the bounds of the Compensation Committee's business judgment in the face of a shareholder-approved agreement explicitly

[11] Opening Br. in Supp. of Outside Directors' Mot. for J. on the Pleadings Ex. A at 3.
[12] Consol. Compl. at ¶ 134.

requiring a market value strike-price. Absent such an agreement, the nature of defendants' alleged deception changes significantly.

Based on the allegations now before the Court, the following circumstances may be reasonably inferred from the consolidated complaint. On three separate occasions between 2001 and 2003, defendants suspected that Tyson's share price would climb once the market learned what the board already knew. Armed with this knowledge, members of the Compensation Committee granted non-qualified stock options to select Tyson employees, ensuring that these options would shortly be in the money. When the option grants were later revealed to shareholders, however, defendants did not straightforwardly describe such strike-price prestidigitation. Rather, they provided minimal assurances to investors that these options rested within the limits of the shareholder-approved plan. The crux of defendants' argument is that a scheme that relies upon bare formalism concealed by a poverty of communication somehow sits within the scope of reasonable, good faith business judgment. At this juncture, and based solely on the pleadings and the public documents, I cannot agree.

II. ANALYSIS

Delaware law sets forth few bright-line rules guiding the relationship between shareholders and directors. Nor does the law require corporations to adopt complex sets of articles and bylaws that govern the method by which

corporate decisions will be made. Instead, shareholders are protected by the assurance that directors will stand as fiduciaries, exercising business judgment in good faith, solely for the benefit of shareholders.

Case law from the Supreme Court, as well as this Court, is replete with language describing the nature of this relationship. The affairs of Delaware corporations are managed by their board of directors, who owe to shareholders duties of *unremitting* loyalty.[13] This means that their actions must be taken in the good faith belief that they are in the best interests of the corporation and its stockholders, especially where conflicts with the individual interests of directors are concerned.[14] The question whether a corporation should pursue a lawsuit against an errant director belongs to the board, and will not be taken from *disinterested* directors, or those who retain their *independence* from those who might not have shareholder interests firmly at heart.[15] When those same directors communicate with shareholders, they also must do so with *complete candor*.[16]

Loyalty. Good faith. Independence. Candor. These are words pregnant with obligation. The Supreme Court did not adorn them with half-hearted

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[13] *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998).
[14] *Lofland v. Cahall*, 118 A. 1 (Del. 1922).
[15] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).
[16] *Malone*, 722 A.2d at 11.

adjectives. Directors should not take a seat at the board table prepared to offer only conditional loyalty, tolerable good faith, reasonable disinterest or formalistic candor. It is against these standards, and in this spirit, that the alleged actions of spring-loading or backdating should be judged.

Defendants invoke an utterly different vision of Delaware law. Defendants' argument suggests a relationship between director and shareholder that falls beneath any reasonable conception of the fiduciary and into the merely contractual. The 2000 Tyson Stock Incentive Plan clearly stated that non-qualified stock options could be granted at any particular price. All SEC disclosures revealed the stated strike price to be the market price on the day of the grant. A preternaturally-attentive shareholder might have focused in upon the grant dates, matched them to Tyson press releases, and inferred from the relationship between them that the directors intended to issue what amounted to in the money options. All of this is purely to the letter of the agreement (runs defendants' reasoning), and no court should infer from this anything inconsistent with a duty of loyalty.

When directors seek shareholder consent to a stock incentive plan, or any other quasi-contractual arrangement, they do not do so in the manner of a devil in a dime-store novel, hoping to set a trap with a particular pattern of words. Had the 2000 Tyson Stock Incentive Plan never been put to a shareholder vote, the nature of a spring-loading scheme would constitute material information that the Tyson

board of directors was obligated to disclose to investors when they revealed the grant. By agreeing to the Plan, shareholders did not implicitly forfeit their right to the same degree of candor from their fiduciaries.

Defendants protest that deceptive or deficient proxy disclosures cannot form the basis of a derivative claim challenging the grant of these options, asserting that "Tyson's later proxy disclosures concerning the challenged option grants are temporally and analytically distinct from the option grants themselves."[17] At this stage, however, I am bound to give plaintiffs the benefit of every reasonable inference, not to give defendants the benefit of every doubt. Where a board of directors intentionally conceals the nature of its earlier actions, it is reasonable for a court to infer that the act concealed was itself one of disloyalty that could not have arisen from a good faith business judgment. The gravamen of Count III lies in the charge that defendants intentionally and *deceptively* channeled corporate profits to chosen executives (including members of Don Tyson's family). Proxy statements that display an uncanny parsimony with the truth are not "analytically distinct" from a series of improbably fortuitous stock option grants, but rather raise an inference that directors engaged in later dissembling to hide earlier subterfuge.

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[17] Reply Br. in Supp. of Outside Directors' Mot. for J. on the Pleadings at 11, citing *Desimone v. Barrows*, 924 A.2d 908 (Del. Ch. 2007).

The Court may further infer that grants of spring-loaded stock options were both inherently unfair to shareholders and that the long-term nature of the deceit involved suggests a scheme inherently beyond the bounds of business judgment.[18]

In retrospect, the test applied in the February 6, 2007 Opinion was, although appropriate to the allegations before the Court at the time, couched in too limited a manner.[19] Certainly the elements listed describe a claim sufficient to show that spring-loading would be beyond the bounds of business judgment. Given the additional information now presented by the parties, however, I am not convinced that allegations of an implicit violation of a shareholder-approved stock incentive plan are absolutely necessary for the Court to infer that the decision to spring-load

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[18] This is not to say that failure to fully disclose the nature of a transaction in a proxy statement will always lead a court to question the equity of the underlying transaction. For obvious reasons, a company may wish to be less than entirely detailed about trade secrets or other confidential information. Executive compensation, however, is not a realm in which less than forthright disclosure somehow provides a company with an advantage with respect to competitors. Sophism and guile on this subject does not serve shareholder interests. When directors speak out about their own compensation, or that of company managers, shareholders have a right to the full, unvarnished truth.

[19] "[The conclusion that spring-loading may not be an exercise of a good faith fiduciary] rests upon at least two premises, each of which should . . . be alleged by a plaintiff in order to show that a spring-loaded option issued by a disinterested and independent board is nevertheless beyond the bounds of business judgment. First, a plaintiff must allege that options were issued according to a shareholder-approved employee compensation plan. Second, a plaintiff must allege that the directors that approved spring-loaded (or bullet-dodging) options (a) possessed material non-public information soon to be released that would impact the company's share price, and (b) issued those options with the intent to circumvent otherwise valid shareholder-approved restrictions upon the exercise price of the options." *In re Tyson Foods*, 919 A.2d at 593.

options lies beyond the bounds of business judgment. Instead, I find that where I may reasonably infer that a board of directors later concealed the true nature of a grant of stock options, I may further conclude that those options were not granted consistent with a fiduciary's duty of utmost loyalty.

Nor are my conclusions, based upon the allegations in this case, inconsistent with two of the multiple scenarios described by Vice Chancellor Strine in *Desimone v. Barrows*.[20] Vice Chancellor Strine imagines a circumstance in which a COO and CFO of a corporation involved in a merger of equals have "missed their summer vacations, their children's baseball games, and every important family occasion for four months" while working on a merger of equals.[21] In recognition of this sacrifice, a hypothetical compensation committee awards each officer a grant of stock options in advance of the merger announcement, knowing that those options will almost immediately increase in value and, indeed, insist that the options may be immediately exercised in the event of the forthcoming merger. Vice Chancellor Strine alternately considers the duties of this fictitious board of

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[20] 924 A.2d 908, 936-37.
[21] *Id*.

directors in the absence, and then in the presence, of a shareholder-approved stock option plan that limits the strike price of the options.[22]

In both cases, however, these hypotheticals *assume that the board of directors has revealed their strategy to shareholders in complete and utter candor*. In the absence of a shareholder-approved plan, the board clearly discloses in the merger proxy that these grants are rewards for exemplary service. Where the board operates under the restrictions of a shareholder-approved plan, it is explicitly assumed that "stockholders were told that the reason for [the requirement to grant stock options at market price] was singular and predicated solely on the desirability of having all grants qualify for favorable tax and accounting treatment. In fact, the disclosures to the stockholders in advance of the approval vote made clear that the stock option plan was, subject to such qualification, intended to permit the corporation to reward outstanding performance *and* to create incentives for superior future efforts."[23] It is fair to say that, based upon the actual allegations before the Court in this case, defendants' disclosures are too sparse to fit into either hypothetical analyzed by Vice Chancellor Strine in *Desimone*.

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[22] *Id*.
[23] *Id*.

As Vice Chancellor Strine thus made clear, if a board of directors candidly discloses why and when it awarded options, and accounted for them in a lawful manner consistent with the actual facts, the board has, absent unusual circumstances, insulated itself from fiduciary liability for misleading investors or regulatory authorities. What the directors would remain subject to was a well-pled claim that the compensation awarded was actionably excessive because, for example, it involved self-dealing and was not fair to the corporation. That is all that the following citation to Tyson was intended to show: "Under the carefully-crafted test articulated by the Chancellor in *Tyson*, these facts would arguably not give rise to anything other than an excess compensation claim, as it would be difficult to find that the defendants acted in a deceptive manner intended to circumvent the purposes of a stockholder-approved stock option plan."[24] What the defendants here fail to confront is that their disclosures regarding the options under attack do nothing to rebut the pleading stage inference that the defendants intended to conceal a pattern of unfairly stocking up insiders' larders with option grants shortly before the announcement of events likely to increase the Company's stock price. In fact, the magnitude and timing of the grants, when accompanied with no disclosure of the reasons motivating the grants, is suggestive, at the pleading stage,

[24] *Id.*

of a purposeful subterfuge. Put simply, the pleadings support an inference not only that the defendants engaged in self-dealing, but that they attempted to hide their conduct from the stockholders.

For all of the above reasons, judgment on the pleadings is inappropriate. Defendants' motion is denied.

IT IS SO ORDERED.