

E-Filed 3/17/2010

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

ANDREW KNOPF,

Plaintiff,

v.

TERRY SEMEL, MICHAEL J. CALLAHAN,
JERRY YANG, ROY J. BOSTOCK, RONALD W.
BURKLE, ERIC HIPPEAU, VYOMESH JOSHI,
ARTHUR H. KERN, ROBERT A. KOTICK,
EDWARD R. KOZEL, GARY L. WILSON, and
MAGGIE WILDEROTTER,

Defendants.

v.

YAHOO! INC., a Delaware corporation,

Nominal Defendant.

Case Number C 08-3658 JF (PVT)

**ORDER GRANTING
DEFENDANTS' MOTION TO
DISMISS WITH LEAVE TO
AMEND**

Re: Docket No. 49

Defendants Terry Semel, Michael J. Callahan, Jerry Yang, Roy J. Bostock, Ronald W. Burkle, Eric Hippeau, Vyomesh Joshi, Arthur H. Kern, Robert A. Kotick, Edward R. Kozel, Gary L. Wilson, and Maggie Wilderotter (collectively, "Defendants"), past and present members of the Board of Directors of nominal defendant Yahoo! Inc. (Yahoo!), move to dismiss the First Amended Shareholder Derivative Complaint ("FAC") of Plaintiff Andrew Knopf ("Plaintiff") pursuant to Fed. R. Civ. P. 23.1 and Fed. R. Civ. P. 12(b)(6). The Court has considered the moving and responding papers and the oral arguments of counsel presented at the hearing on March 12, 2010. For the reasons discussed below, the motion will be granted, with leave to

1 amend.

2 I. BACKGROUND

3 A. Yahoo! Inc.'s operations in China

4 Yahoo! is an internet service company that operates web-based personal email accounts,
5 news portals and a search engine. FAC ¶ 8. Yahoo! is the parent company and owner of the
6 entire issued share capital of Yahoo! Hong Kong Limited (“Yahoo! Hong Kong”). *Id.* ¶ 9.

7 Yahoo! Hong Kong operated business in China through its wholly-owned subsidiary Yahoo!
8 China (“Yahoo! China”). *Id.* “Yahoo! exercised significant control over Yahoo! China via its
9 organizational relationship with Yahoo! Hong Kong” during the relevant time period, including
10 “supervision and control of policy and legal decisions made by Yahoo! China’s legal team.” *Id.*

11 Plaintiff alleges that in 2002, Yahoo! signed an official, voluntary agreement with the
12 People’s Republic of China (“PRC”), known as the “Public Pledge on Self-Discipline for the
13 Chinese Internet Industry” (“the Public Pledge”). *Id.* ¶ 28. Plaintiff claims that by signing the
14 Public Pledge, “Yahoo! voluntarily agreed to help monitor and censor electronic communication
15 use involving information that, according to the Internet Society of China, could ‘jeopardize state
16 security’ or ‘disrupt social stability,’ and to report any offending on-line expression or
17 communication to [government] authorities.” *Id.* Plaintiff asserts further that the Public Pledge
18 “effectively enabled the PRC to identify and target dissidents, through the Internet monitoring
19 and censorship program, who faced a well documented pattern of systematic arbitrary arrest and
20 prolonged detention, incommunicado detention, extrajudicial killings, torture, cruel, inhuman or
21 degrading treatment and punishment, and forced labor.” *Id.* ¶ 29.

22 Plaintiff alleges that human rights organizations such as Human Rights Watch
23 discouraged Yahoo! from signing the Public Pledge because “there is a strong likelihood that
24 Yahoo! will assist in furthering...human rights violations.” SAC ¶ 31. Plaintiff claims that on
25 November 26, 2002, Amnesty International published a report documenting the Chinese
26 government’s use of electronic evidence to prosecute political dissidents. *Id.* ¶ 32. According to
27 Plaintiff, “numerous press releases and news articles publicizing it, noted that Yahoo! had signed
28 the Public Pledge and pointed out that compliance with this pledge could lead to violations of

1 international human rights norms.” *Id.* Plaintiff alleges that “in light of these notifications, along
2 with general and well-publicized documentation of Chinese human rights abuses...defendants
3 had every reason to know and understand that the electronic communication user information
4 they possessed, if provided to the Chinese authorities, could be used to assist in the infliction of
5 such abuses...” *Id.* ¶ 33.

6 In 2005, Yahoo! sold Yahoo! China to a Chinese company, Alibaba.com Corporation
7 (“Alibaba”), and invested \$1 billion in Alibaba in exchange for a forty percent stake in the
8 company. *Id.* ¶ 9, 11. Defendant Yang, who is a co-founder, director, and former Chief
9 Executive Officer of Yahoo!, became a director of Alibaba’s parent company, Alibaba Group
10 Holding Limited. Accordingly, during the relevant time period, Yahoo! was effectively a forty
11 percent owner of Yahoo! China, through its minority stake in Alibaba. *Id.* ¶ 9.

12 **B. Prosecution and imprisonment of Shi Tao**

13 In April 2004, Shi Tao, a reporter and head of the Editorial Department of *Contemporary*
14 *Business News (Dangdai Shangbao)* in Changsha, Hunan Province, published an essay, “The
15 Most Disgusting Day.” *Id.* ¶ 34, 36. The essay criticized the Chinese government for detaining
16 an activist member of the Tiananmen Mothers, an organization of mothers whose children were
17 killed by the Chinese government in 1989. *Id.* ¶ 36. Shi Tao published the essay under a
18 pseudonym on an internet forum. *Id.* On April 20, 2004, at a staff meeting, Shi Tao was advised
19 of a document from the Chinese Communist Party’s Central Propaganda Bureau alerting
20 journalists to security concerns and government preparations in anticipation of the upcoming
21 fifteenth anniversary of the 1989 Tiananmen Square massacre. *Id.* ¶ 37. Using an alias, Shi Tao
22 sent notes from the staff meeting to the New York-based Web site *Democracy Forum, (Minzhu*
23 *Tongxun)* using his personal Yahoo! email account. *Id.*

24 Plaintiff alleges that between April and November 2004, Yahoo! Hong Kong provided
25 Chinese government officials and investigators with information linking Shi Tao to the
26 anonymous email sent to *Democracy Forum.* *Id.* ¶ 38. The information included Shi Tao’s
27 email address, the IP address and physical address of the computer from which the email was
28 sent, the date and time the email was sent, and the content of the email. *Id.* Plaintiff claims that

1 Yahoo! Hong Kong also provided prosecuting officials with the physical address of the office
2 from which the electronic communication took place, thus linking the anonymous email to Shi
3 Tao. *Id.* On November 23, 2004, Shi Tao was detained near his home in Taiyuan, Shanxi
4 Province. ¶ 39. His home was searched and police seized his computer, papers, and other
5 property without a warrant. *Id.* After twenty-one days of detention, Shi Tao was arrested and
6 charged. *Id.* ¶ 40. On March 11, 2004, Shi Tao was tried in a closed hearing, and his court-
7 appointed attorney entered a guilty plea on his behalf. *Id.* ¶ 42. On April 30, 2005, the court
8 sentenced Shi Tao to ten years of imprisonment for “illegally providing state secrets overseas.”
9 *Id.* ¶43. Plaintiff alleges that the Chinese court specifically cited information provided by
10 Yahoo! in its verdict. *Id.* ¶ 43 (“Account holder information furnished by Yahoo! Holdings
11 (Hong Kong) Ltd., which confirms that for IP address 218.76.8.201 at 11:32:17 p.m. on April 20,
12 2004, the corresponding user information was as follows: user telephone number 0731-4376362
13 located at the Contemporary Business News office in Hunan.”).

14 On May 4, 2005, Shi Tao appealed the judgment to the Hunan Province High People’s
15 Court. The appeal was unsuccessful. *Id.* ¶ 44. Plaintiff alleges that since June 2005, Shi Tao
16 has been incarcerated at Chishan Prison, a high-security facility known for holding political
17 prisoners and violent criminals serving long sentences. *Id.* ¶ 46 (stating that the “prison uses a
18 severe system of forced labor, in which prisoners work in dark, dust-filled factories, starting
19 before dawn and working for sixteen hours or more, in conditions intended to destroy their
20 physical and mental capacities.”). Shi Tao’s status as a political prisoner has been recognized by
21 the Committee to Protect Journalists, Amnesty International, and the United States Department
22 of State Country Report on Human Rights. *Id.* ¶ 48.

23 **C. Defendants’ alleged breach of fiduciary duty**

24 **1. Callahan’s February 2006 Congressional Testimony**

25 In February 2006, Defendant Callahan, then General Counsel and now Executive Vice
26 President of Yahoo!, testified before a subcommittee of the International Relations Committee of
27 the United States House of Representatives (“the House”). *Id.* ¶¶ 10, 49. Callahan was prepared
28 for his testimony by the law firm of Covington & Burling and “a team of nearly a dozen Yahoo!

1 lawyers as well as other advisors from both inside and outside the Company.” *Id.* ¶ 50. The
2 preparation team “anticipated possible lines of questioning by the subcommittee and prepared
3 draft testimony for Callahan.” *Id.*

4 During the hearing, members of the Subcommittee asked Callahan about Shi Tao. *Id.* ¶
5 51. Callahan testified that, “[w]hen Yahoo! China in Beijing was required to provide
6 information about a user, who we later learned was Shi Tao, we had no information about the
7 identity of the user or the nature of the investigation. Indeed we were unaware of the particular
8 facts surrounding this case until the news story emerged...” *Id.* ¶ 52. Callahan further explained,
9 “[I]aw enforcement agencies in China, in the United States, and elsewhere typically do not
10 explain to information technology companies or other businesses why they demand specific
11 information regarding certain individuals.” *Id.* Callahan submitted a written statement
12 consistent with his oral testimony. *Id.*

13 Plaintiff alleges that in fact Yahoo! was aware of the nature of the investigation both at
14 the time of the Chinese government’s request and afterwards. *Id.* ¶ 54. Plaintiff claims that on
15 April 24, 2004, the Beijing State Security Bureau provided a document (“the Beijing Document”)
16 to Yahoo! China stating in part, “Your office is in possession of the following items relating to a
17 case of suspected illegal provisions of state secrets to foreign entities...” *Id.* Plaintiff alleges that
18 the phrase “‘state secrets’ is commonly used by Chinese officials to denote impermissible
19 speech.” *Id.* Plaintiff claims that while the Beijing Document was not translated from Chinese
20 to English or provided to Callahan, a “key member of the Yahoo! team that prepared Callahan
21 for his appearance...had a copy of [it].” *Id.*

22 **2. Callahan’s 2007 Congressional testimony**

23 In 2007, after an investigation by the House Foreign Affairs Committee revealed that
24 Yahoo! did have information regarding the nature of the investigation when it provided
25 information about Shi Tao to the Chinese authorities in 2004, the Committee held a second
26 hearing on Yahoo!’s role. *Id.* ¶ 58. Callahan testified that during the 2006 hearing it had been
27 his understanding that the Beijing Document “contained no information about the name,
28 profession, activities, or even charges under investigation, and that is how [he] testified.” *Id.* ¶

1 61. He also stated that in October 2006, he learned for the first time that the Beijing Document
2 “did contain additional information – that the investigation related to disclosure of state secrets.”
3 *Id.* He apologized to the Committee “for not coming back to the Committee once [he]
4 realized...that the demand contained additional information.” *Id.* Finally, Callahan clarified that
5 if he “had had this additional information [at the 2006 hearing, he] would have made it clear that
6 we were aware of the general law in question though not the specific nature of the case and not
7 the political nature of the case.” *Id.* Plaintiff alleges that no one else at Yahoo! contacted the
8 Subcommittee either orally or in writing to correct Callahan’s previous false testimony. *Id.* ¶ 69.

9 **3. Harm to Yahoo!**

10 Plaintiff alleges that on November 9, 2007, Yahoo! entered into private settlements with
11 certain Chinese dissidents who had brought legal actions against Yahoo! in the United States. *Id.*
12 ¶ 64. Plaintiff claims that while the terms of the settlements are undisclosed, Yahoo! agreed to
13 pay the dissidents’ attorney’s fees and provide financial, humanitarian, and legal support to their
14 families. *Id.*

15 In addition, Plaintiff alleges that the 2007 hearing was widely publicized and that
16 Callahan’s failure to cure his earlier testimony “caused the Company to suffer a significant
17 tarnish to its reputation within the financial and business communities and among consumers.”
18 *Id.* ¶ 65; *see also id.* ¶ 62 (quoting Representative Tom Lantos’ reprimand of Callahan and Yang
19 at the 2007 hearing, “Yahoo! claims this is just one big misunderstanding. Let me be clear – this
20 was no misunderstanding. This was inexcusably negligent behavior at best, and deliberately
21 deceptive behavior at worst.”); *see also id.* ¶ 63 (quoting Representative Smith urging Yahoo! “to
22 settle [the lawsuit brought by the dissidents] now and settle it generously in their favor.”).
23 Plaintiff also claims that Defendants’ actions and failure to act have left Yahoo! vulnerable to
24 potential civil and/or criminal charges for perjury and contempt for Congress. *Id.* ¶ 65.

25 Finally, Plaintiff alleges that Yahoo!’s stock price dropped following the 2007 hearing.
26 *Id.* ¶ 66. During the two weeks prior to the hearing, Yahoo! stock traded consistently in the low
27 \$30 per share range, but by the end of the day of the 2007 hearing, the price had dropped to
28 \$29.93. Plaintiff claims that the shares were trading at \$25.79 by the end of that week and

1 remained in the mid \$20 range through January 2008. *Id.*

2 **3. Plaintiff's demand and the Board's investigation**

3 On November 14, 2007, counsel for Plaintiff sent a letter (the "Demand") to Yahoo!'s
4 Board of Directors ("the Board") alleging that certain unidentified individuals had breached their
5 fiduciary duties to the company in connection with the disclosure in 2002 and 2004 of internet
6 user information about Shi Tao and another dissident. *Id.* ¶ 72; Declaration of Anna Erickson
7 White ("White Decl."), Ex. A.¹ The letter demanded that the Board institute an independent
8 investigation and bring litigation on behalf of Yahoo! against the "persons who were either
9 actively engaged in improper conduct or failed to adequately oversee the operations and internal
10 controls of the Company such that the improper conduct was able to occur." White Decl., Ex. A
11 at 6. On December 20, 2007, the Board responded to Plaintiff's letter acknowledging receipt of
12 the Demand "and assured Plaintiff's counsel that appropriate consideration of and a response to
13 the demand would be made." FAC ¶ 72.

14 On March 28, 2008, the law firm of Jones Day advised Plaintiff that the Audit Committee
15 was conducting an investigation into the matters described in the Demand and requested that
16 Plaintiff provide the Audit Committee with any additional information he might have relevant to
17 the matters in the Demand. *Id.*; White Decl., Ex. B (stating "Jones Day has been retained to
18 assist the Committee in its investigation."). Plaintiff did not provide additional material, other
19 than a report of his stock holdings. White Decl., Ex. C.

21 ¹ On a motion to dismiss, the Court's review is limited to the face of the complaint and
22 matters judicially noticeable. *MGIC Indem. Corp. v. Weisman*, 803 F.2d 500, 504 (9th Cir.
23 1986); *N. Star Int'l v. Ariz. Corp. Comm'n*, 720 F.2d 578, 581 (9th Cir. 1983). However, under
24 the "incorporation by reference" doctrine, the Court also may consider documents which are
25 referenced extensively in the complaint and which are accepted by all parties as authentic. *In re*
26 *Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 986 (9th Cir.1999). The FAC refers specifically
27 to the correspondence between Plaintiff's counsel and Jones Day, as well as the final letter
28 indicating the Board's rejection of the Demand request. FAC ¶ 72. Neither party challenges the
authenticity of the letters reflecting such correspondence, in fact both parties request judicial
notice of the same documents. White Decl., Exs. A, B, C, D; *see also* Declaration of Leigh A.
Parker, Exs. A, B, C, D. The Court finds that these exhibits properly are incorporated by
reference and will take judicial notice of them.

1 On September 29, 2008, Plaintiff was advised by letter that the Board had conducted an
2 independent investigation that included the collection and review of documents, legal research,
3 and interviews of individuals with knowledge of issues raised in the Demand. White Decl., Ex.
4 D. The letter explained that based on the investigation, the Audit Committee had concluded that
5 it was not in the best interest of Yahoo!’s shareholders for the Company to take any further
6 action with respect to Plaintiff’s allegations. *Id.* The Audit Committee reported its investigation
7 and recommendation to the Board, and after considering the recommendation, the Board also
8 determined that further action was not in the best interest of Yahoo!’s shareholders. *Id.*

9 On July 30, 2008, while the Audit Committee’s recommendation still was pending before
10 the Board, Plaintiff filed the original complaint in the instant action. In that pleading, Plaintiff
11 alleged that Defendants breached their fiduciary duties by failing to “exercise oversight” by not
12 preventing the disclosure of electronic information to the Chinese government in 2002 and 2004.
13 Complaint ¶ 75. Defendants then moved to dismiss the original complaint, arguing, among other
14 things, that the claims were barred by the statute of limitations and that Plaintiff lacked standing
15 to bring the litigation because he had failed to meet his burden under Rule 23.1 and Delaware
16 law of showing that the Board wrongfully had refused the Demand. On October 1, 2009, rather
17 than opposing Defendant’s original motion to dismiss, Plaintiff filed the FAC.

18 The FAC does not allege any claims for relief regarding Yahoo!’s disclosure of internet
19 user information in 2002 and 2004, but instead asserts a more limited claim that the Defendants
20 breached their fiduciary duties by failing to ensure the accuracy of Callahan’s testimony at the
21 2006 hearing and by not timely correcting that testimony. FAC ¶¶ 68, 69, 73. Plaintiff also
22 claims that the Board wrongfully refused the Demand. *Id.* ¶ 73.

23 II. LEGAL STANDARD

24 A complaint may be dismissed for failure to state a claim upon which relief may be
25 granted if a plaintiff fails to proffer “enough facts to state a claim to relief that is plausible on its
26 face.” *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). Allegations of material fact must
27 be taken as true and construed in the light most favorable to the nonmoving party. *Pareto v.*
28 *FDIC*, 139 F.3d 696, 699 (9th Cir. 1998), *see also Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336,

1 337-38 (9th Cir. 1997). However, the Court need not accept as true allegations that are
2 conclusory, unwarranted deductions of fact, or unreasonable inferences. *See Sprewell v. Golden*
3 *State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001); *see also Twombly*, 550 U.S. at 561 (“a wholly
4 conclusory statement of [a] claim” will not survive motion to dismiss). Leave to amend should
5 be granted unless it is clear that the complaint’s deficiencies cannot be cured by amendment.
6 *Lucas v. Dep’t of Corr.*, 66 F. 3d 245, 248 (9th Cir. 1995).

7 III. DISCUSSION

8 A. Standing pursuant to Rule 23.1²

9 Defendants contend that Plaintiff lacks standing to bring the instant action because he
10 fails to plead particularized facts establishing that the Board refused his Demand without
11 procedural due care. “The derivative form of action permits an individual shareholder to bring
12 ‘suit to enforce a corporate cause of action against officers, directors, and third parties.’ *Kamen*
13 *v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 95, 111 S.Ct. 1711, 114 L.Ed.2d 152 (1991) (citation
14 omitted) (emphasis in original). A derivative claim belongs to the corporation, “and it is the
15 corporation, acting through its board of directors, which must make the decision whether or not
16 to assert the claim.” *Furman v. Walton*, No. C 06-3532 SBA, 2007 WL 1455904, at *2 (N.D.
17 Cal. May 16, 2007); citing *Grimes v. Donald*, 673 A.2d 1207, 1215 (Del. 1996), *overruled on*
18 *other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

19 In determining whether a complaint alleges, with sufficient particularity, the plaintiff’s

20
21 ² Defendants do contend that the FAC should be dismissed because Plaintiff failed to
22 verify it in accordance with Rule 23.1(b). *Id.* (“the complaint must be verified...”). The purpose
23 of Rule 23.1’s verification requirement is to ensure that a derivative claim has some basis in fact.
24 *See Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363 (1966). Accordingly, “noncompliance with
25 formal verification requirements of the federal rules applicable to stockholder actions will not be
26 grounds for dismissal of the complaint where counsel for plaintiff has diligently investigated the
27 possible charges prior to filing the complaint.” *Weisfeld v. Spartans Industries, Inc.*, 58 F.R.D.
28 570, 577 (S.D.N.Y. 1972). Here, Defendants do not question that Plaintiff’s counsel diligently
investigated the possible charges before filing the complaint. In addition, many of the facts
alleged in the FAC are supported by documents in the public record. Finally, Plaintiff verified
his original complaint and filed verification of the FAC concurrently with his opposition to the
instant motion. Parker Decl., Ex. E. Accordingly, the Court finds that Plaintiff’s failure to verify
the complaint has been remedied sufficiently.

1 efforts to obtain the action he seeks directly from the directors or comparable authority and the
2 reasons for the plaintiff's failure to do so, "the court looks to the law of the state of incorporation
3 of the company." *Furman*, 2007 WL 1455904, at *2, citing *See In re Silicon Graphics Inc. Sec.*
4 *Litig.*, 183 F.3d 970, 990 (9th Cir.1999). The parties agree that because Yahoo! is a Delaware
5 corporation, Delaware law controls as to whether the FAC is factually sufficient. White Decl.,
6 Ex. E.³

7 Under Delaware law, "[a] stockholder filing a derivative suit must allege either that the
8 board of directors rejected her pre-suit demand that the board assert the corporation's claim or
9 allege with particularity why the stockholder was justified in not having made the effort to obtain
10 board action." *Furman*, 2007 WL 1455904, at *2, citing *Grimes*, 673 A.2d at 1216. "[T]he
11 demand requirement is a recognition of the fundamental precept that directors manage the
12 business and affairs of the corporation." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). In
13 this case, Plaintiff made a demand on the board.

14 Because Plaintiff made a demand, the Board is entitled to the presumption of the business
15 judgment rule unless Plaintiff can allege with particularity facts creating a reasonable doubt as to
16 whether the Board is entitled to the benefit of the presumption. *See Grimes*, 673 A.2d at 1220;
17 *see also Levine v. Smith*, 591 A.2d 194, 212 (Del. 1991) (the board's refusal of the demand to
18 pursue the action is subject to judicial review according to the traditional business judgment
19 rule), *overruled on other grounds, Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

20 "Under the business judgment rule, a court will not substitute its judgment for that of the
21 board, and the board's decision will be upheld unless it cannot be attributed to any rational
22 business purpose." *Furman*, 2007 WL 1455904, at *2, citing *In re Walt Disney Co. Derivative*
23 *Litig.*, 906 A.2d 27, 74 (Del.2006) (en banc); *Levine*, 591 A.2d at 207. Accordingly, the Court

24
25 ³ The Court takes judicial notice of Yahoo!'s certificate of incorporation as it is a
26 document that is "not subject to reasonable dispute" and is "capable of accurate and ready
27 determination by resort to sources whose accuracy cannot reasonably be questioned." Fed. R.
28 Evid. 201(b)(2); *Ahcom, Ltd v. Smeding*, No. C-07-1139 SC, 2009 WL 1108658, at *1 n. 1 (N.D.
Cal. Apr. 24, 2009) ("District courts routinely take judicial notice of certificates of
incorporation.")

1 must respect Defendants' decision that litigating the claims identified by Plaintiff was not in the
2 best interest of Yahoo!'s shareholders, "unless [the Plaintiff can plead specific facts alleging that]
3 the directors are interested or lack independence relative to the decision, do not act in good faith,
4 act in a manner that cannot be attributed to a rational business purpose or reach their decision by
5 a grossly negligent process that includes the failure to consider all material facts reasonably
6 available." *Furman*, 2007 WL 1455904, at *2, citing *Brehm v. Eisner*, 746 A.2d 244, 264 n. 66
7 (Del. 2000) (en banc).

8 Plaintiff argues that there is reason to doubt that the investigation at issue here was
9 reasonable and conducted in good faith. First, he contends that the members of the Audit
10 Committee could not conduct an adequate and independent investigation of the Demand because
11 to do so would involve an assessment of their own potential liability. *Id.* ¶ 73. Indeed, Plaintiff
12 asserts that most of the members of the Board who considered the Demand also were Board
13 members at the time of the alleged wrongdoing. *Id.* ¶¶ 11-21, 73. However, under Delaware
14 law, a shareholder who makes a formal demand concedes that a majority of the board is
15 sufficiently disinterested and independent and waives any claim that demand is excused. *See*
16 *Grimes*, 673 A.2d at 1219-20; *Rales v. Blasband*, 634 A.2d 927, 935 n. 12 (Del. 1993) ("Where a
17 demand has actually been made, the stockholder making the demand concedes the independence
18 and disinterestedness of a majority of the board to respond"); *Spiegel v. Buntrock*, 571 A.2d 767,
19 (Del. 1990) ("when a board refuses a demand, the only issues to be examined are the good faith
20 and reasonableness of its investigation."). Accordingly, the only relevant question is whether the
21 directors acted in an informed manner, with due care, and with a good faith belief that their
22 action was in the best interest of the corporation. *Furman*, 2007 WL 1455904, at *3, citing
23 *Levine*, 591 A.2d at 198.

24 Second, Plaintiff argues in his opposition papers that because Defendants have not
25 produced an actual report of the Audit Committee's findings and recommendations, it is
26 impossible to determine whether the Audit Committee's investigation was reasonable and
27 whether the Board's decision to refuse the Demand was made on an informed basis. *Opp.* at 12.
28 Because the FAC itself contains no factual allegations supporting this argument, Plaintiff

1 effectively concedes the deficiencies of his pleading. Defendants also point out that the Audit
2 Committee, with the assistance of independent counsel, conducted an investigation over several
3 months that included collection and review of documents, interviews of individuals, and legal
4 research.. White Decl., Ex. B (Letter from Jones Day to Plaintiff’s counsel stating that “Jones
5 Day has been retained to assist the Committee in its investigation.”)

6 Finally, Plaintiff asserts that because Callahan conceded that his statements at the 2006
7 hearing were inaccurate and that he failed to correct them in a timely fashion, Callahan’s conduct
8 was “disloyal to the corporation.” Opp. Mot. at 12, citing *Ryan v. Gifford*, 935 A.2d 258, 272
9 (Del. Ch. 2007) (finding that participation in concealment of a prior wrongdoing from a
10 shareholder is “disloyal conduct in breach of [a director’s] duty as a fiduciary.”). Plaintiff argues
11 that the Board’s decision to reject the Demand notwithstanding this concession could not have
12 been made reasonably or in good faith. However, Plaintiff misstates the Board’s legal obligation.
13 Even assuming that Callahan’s action could be characterized as disloyal, it does not follow that
14 the Board’s *evaluation, investigation, and rejection of the Demand* must have been undertaken in
15 bad faith. The Board’s letter rejecting the Demand explains that the Audit Committee simply
16 “concluded that it was not in the best interest of Yahoo!’s shareholders for the company to take
17 any further action with respect to the allegations in the Demand” and that the Board made the
18 same determination. White Decl., Ex. D.

19 The FAC does not allege particularized facts showing that the Board’s decision not to sue
20 is not protected by the business judgment rule. Accordingly, the motion to dismiss, “must be
21 granted.” *Spiegel*, 571 A.2d at 777-78; *Starrels v. First Nat. Bank of Chicago*, 870 F.2d 1168,
22 1174 (7th Cir. 1989) (“If Courts would not respect the directors’ decision not to file suit, then
23 demand would be an empty formality.”).⁴

24
25
26 ⁴ Because it concludes that Plaintiff’s allegations fail to establish that he has standing to
27 bring the instant action, the Court will defer further analysis of Plaintiff’s allegations under the
28 heightened pleading standard articulated in *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d
959, 967 (Del. Ch. 1996).

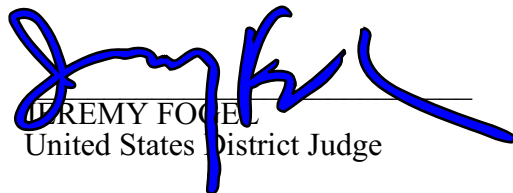
1 **B. Leave to Amend**

2 Under Federal Rule of Civil Procedure 15(a)(2), federal courts are instructed to “freely
3 give leave [to amend] when justice so requires.” The Court may in its discretion deny leave to
4 amend “due to ‘undue delay, bad faith or dilatory motive on the part of the movant, repeated
5 failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing
6 party by virtue of allowance of the amendment, [and] futility of amendment.’ ” *Leadsinger, Inc.*
7 *v. BMG Music Publ'g*, 512 F.3d 522, 532 (9th Cir.2008), quoting *Foman v. Davis*, 371 U.S. 178,
8 182, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962). Defendants contend that the FAC should be dismissed
9 without leave to amend because they clearly identified in their initial motion to dismiss the
10 deficiencies in Plaintiff’s demand refusal allegations and Plaintiff failed to remedy those
11 deficiencies in his amended pleading. MTS at 11, citing *Zucco Partners, LLC v. Digimarc Corp.*,
12 552 F.3d 981, 1008 (9th Cir. 2009). In *Zucco*, however, the district court itself had dismissed a
13 previous complaint and had issued an order identifying specifically the insufficiencies of that
14 pleading. *Id.* at 1007-08. In this case, while the FAC is Plaintiff’s second pleading, the instant
15 order represents the first judicial comment on Plaintiff’s allegations. While the Court has
16 considerable doubt as to whether Plaintiff can allege particularized facts showing that the
17 Board’s decision is not protected by the business judgment rule, leave to amend will be granted.

18 **IV. ORDER**

19 Good cause therefor appearing, the motion to dismiss is GRANTED with leave to amend.
20 Any amended complaint shall be filed within thirty (30) days of the date this order is filed.
21 IT IS SO ORDERED.

22 DATED: March 17, 2010

23 
24 JEREMY FOCHEL
25 United States District Judge
26
27
28