

Randall v Pattiz

2007 NY Slip Op 32447(U)

August 3, 2007

Supreme Court, New York County

Docket Number: 0603161/2006

Judge: Karla Moskowitz

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: Hon. KARLA MOSKOWITZ PART 03
Justice

MARK RANDALL, Derivatively on Behalf of Nominal
Defendant WESTWOOD ONE, INC.,
Plaintiff,
- against -

INDEX NO. 603191/2006

MOTION DATE _____

NORMAN J. PATTIZ, FARID SULEMAN, GREGORY P.
BATUSIC, JOEL HOLLANDER, GERALD GREENBERG,
JOSEPH B. SMITH, STEVEN A. LERMAN, DAVID L. DENNIS,
GARY J. YUSKO, MICHAEL D'AMBROSE
and PAUL G. KRASNOW,

MOTION SEQ. NO. 001

MOTION CAL. NO. _____

Defendants,
and,
WESTWOOD ONE, INC.,
Nominal Defendant.

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits	_____
Answering Affidavits — Exhibits	_____
Replying Affidavits	_____

Cross-Motion: Yes No

FILED
AUG 08 2007
NEW YORK
COUNTY CLERK'S OFFICE

Upon the foregoing papers, it is

ORDERED that this motion is decided in accordance with the accompanying Decision and Order.

Dated: August 02, 2007

Kay

KARLA MOSKOWITZ J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

DO NOT POST REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 3

-----X
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Plaintiff,

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- against -

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GARY J. YUSKO, MICHAEL D'AMBROSE
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DECISION and ORDER

Defendants,

and

WESTWOOD ONE, INC.,

Nominal Defendant.

-----X

MOSKOWITZ, J.:

Plaintiff Mark Randall, a shareholder of nominal defendant Westwood One, Inc. (“Westwood”), brought this shareholder derivative action against Westwood and members of Westwood’s board of directors, that includes defendants Norman J. Pattiz, Farid Suleman, Gregory P. Batusic, Joel Hollander, Gerald Greenberg, Joseph B. Smith, Steven A. Lerman, David L. Dennis, Gary J. Yusko, Michael D’Ambrose and Paul G. Krasnow (“director defendants”). In the amended derivative complaint, dated December 15, 2006 and verified December 11, 2006 (“Complaint”), plaintiff purports to assert claims on behalf of Westwood in connection with alleged “backdating” of stock options and alleged ultra vires stock option grants.

Westwood and the director defendants move, pursuant to CPLR 3211, for an order dismissing the Complaint on the grounds that, inter alia: (1) plaintiff failed to make a pre-suit demand on Westwood’s board of directors to prosecute his claims or to demonstrate that

a demand would be futile, as the governing Delaware law requires; (2) the Complaint fails to adequately allege options backdating or ultra vires grants; and (3) the applicable statute of limitations bars all of the claims.

For the reasons discussed infra, the courts grants defendants' motion to dismiss.

BACKDATING of STOCK OPTIONS

“On March 18, 2006, *The Wall Street Journal* sparked controversy throughout the investment community by publishing a one-page article, based on an academic's statistical analysis of option grants, which revealed an arguably questionable compensation practice. Commonly known as backdating, this practice involves a company issuing stock options to an executive on one date while providing fraudulent documentation asserting that the options were actually issued earlier. These options may provide a windfall for executives because the falsely dated stock option grants often coincide with market lows. Such timing reduces the strike prices and inflates the value of stock options, thereby increasing management compensation. This practice allegedly violates any stock option plan that requires strike prices to be no less than the fair market value on the date on which the option is granted by the board. Further, this practice runs afoul of many state and federal common and statutory laws that prohibit dissemination of false and misleading information.”

(Ryan v Gifford, 918 A2d 341, 345 [Del Ch 2007]).

BACKGROUND

Mark Randall, a Florida resident, is a shareholder of Westwood. Westwood is a leading supplier of information services and programming to radio and television stations. It is the largest domestic provider of traffic reporting services and the nation's largest radio network, producing and distributing national news, sports, talk, music and special event programs.

The Complaint asserts six causes of action for accounting, breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, common law restitution/unjust enrichment, and rescission and bases these claims primarily on the contention that six stock option grants to

certain director defendants over a period of time were allegedly backdated (“Backdating Transactions”). Essentially, plaintiff claims that the director defendants breached their fiduciary duties by (1) improperly authorizing backdated option grants to five directors on six isolated occasions between March 1997 and September 2001, and (2) directing or permitting Westwood to engage in improper activities to conceal their scheme. At the time plaintiff filed the initial complaint, Westwood’s board consisted of 11 inside and outside directors. Plaintiff alleges that Westwood’s Compensation Committee, that is comprised of three board members (rather than the full board), made and approved these option grants. Distinct from the alleged Backdating Transactions, the Complaint also asserts that certain grants of stock options to various director defendants were issued on dates that Westwood’s 1989 and 1999 Stock Incentive Plans did not authorize and were therefore ultra vires (“Ultra Vires Transactions”).

Plaintiff did not make a demand on the board prior to instituting this action. In paragraphs 61 to 64 of the Complaint, plaintiff explains why he concluded a demand on the board was futile and therefore excused:

61. . . . Plaintiff has not made any demand on the Westwood Board of Directors to institute this action against the [director] Defendants. Such demand would be a futile and useless act because the Board is incapable of making an independent and disinterested decision to institute and vigorously prosecute this action.

62. At the time this action was commenced, the Board consisted of eleven directors: defendants Greenberg, Smith, Dennis, Pattiz, Hollander, and Lerman, and directors H. Melvin Ming, Albert Carnesale, Grant F. Little, III, Walter Berger, and Peter Kosann. The following directors are incapable of independently and disinterestedly considering a demand to commence and vigorously prosecute this action:

a. Pattiz, Greenberg, Smith, Lerman, and Hollander, because they are directly interested in the improperly backdated

stock option grants complained of herein as recipients of such improperly backdated stock option grants. Accordingly, Pattiz, Greenberg, Smith, Lerman, and Hollander are incapable of independently and disinterestedly considering a demand to commence and vigorously prosecute this action against the [director] Defendants;

b. Greenberg, Smith, and Dennis because as members of the Compensation Committee, they directly participated in and approved the misconduct alleged herein, and therefore are substantially likely to be held liable for breaching their fiduciary duties, as alleged herein. Moreover, by colluding with the Option Recipient Defendants, as alleged herein, Greenberg, Smith and Dennis have demonstrated that they are unable or unwilling to act independently of the Option Recipient Defendants;

c. Lerman and Dennis, because as members of the Audit Committee they directly participated in and approved the misconduct alleged herein and are substantially likely to be held liable for breaching their fiduciary duties, as alleged herein. Moreover, by colluding with the Option Recipient Defendants, as alleged herein, Lerman and Dennis have demonstrated that they are unable or unwilling to act independently of the Option Recipient Defendants;

d. Greenberg, Hollander, Pattiz, Smith, Lerman, and Dennis, because as directors of [Westwood] they directly participated in and approved [Westwood's] filing of false financial statements and other SEC filings, as alleged herein. Moreover, by colluding with the Option Recipient Defendants, as alleged herein, Greenberg, Hollander, Pattiz, Smith, Lerman, and Dennis have demonstrated that they are unable or unwilling to act independently of the Option Recipient Defendants.

63. Furthermore, demand is excused because the misconduct complained of herein was not, and could not have been, an exercise of good faith business judgment. . . . [B]y granting options with backdated exercise prices, the [director] Defendants undermined the purpose of [Westwood's] compensation policies by awarding employees compensation that had intrinsic value regardless of Westwood's performance. In effect, this practice was nothing more than secret handouts to executives at the expense of unsuspecting shareholders.

DISCUSSION

On a motion to dismiss under CPLR 3211 (a) (7), a court affords the pleading a liberal construction, accepts allegations as true and accords the plaintiff the benefit of all favorable inferences that the court may draw from the pleading. (Campaign for Fiscal Equity, Inc. v State of New York, 86 NY2d 307, 318 [1995]; P.T. Bank Central Asia v ABN AMRO Bank, N.V., 301 AD2d 373, 375-76 [1st Dept 2003]). However, conclusory allegations and those that the documentary evidence flatly contradicts do not receive these inferences. (Franklin v Winard, 199 AD2d 220 [1st Dept 1993]; see also Marx v Akers, 88 NY2d 189, 204 [1996]; Wilson v Tully, 243 AD2d 229, 234 [1st Dept 1998]).

Defendants argue for dismissal because plaintiff failed to plead demand futility with sufficient particularity. Delaware law determines whether plaintiff's failure to make a pre-suit demand should be excused because Delaware is Westwood's state of incorporation. (See Wilson v Tully, *supra*, 243 AD2d, at 232; In re Linear Technology Corp., 2006 WL 3533024 [ND CA 2007] [unpublished opinion], citing In re Silicon Graphics Inc., 183 F3d 970, 990 [9th Cir 1999]). Shareholders seeking to bring a derivative action on behalf of the corporation must first make a demand on the board of directors, unless demand would be futile. (*Id.*, quoting Rales v Blasband, 634 A2d 927, 933 [Del Supr 1991]). Delaware Chancery Court Rule 23.1 provides that every shareholder derivative complaint must allege "with particularity the efforts, if any, made by the plaintiff to obtain the action he or she desires from the directors or comparable authority and the reasons for [his or her] failure to obtain the action or for not making the effort." Plaintiff bears the burden of pleading "demand futility." (Rales v Blasband, *supra*, 634 A2d, at 934).

The test, under Delaware law, for determining whether a derivative complaint adequately pleads demand futility is whether the particular facts alleged create a reasonable doubt that: (1) the directors were independent and disinterested; and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. (See Aronson v. Lewis, 473 A2d 805, 814 [Del Supr 1984]; Brehm v Eisner, 746 A2d 244, 256 [Del Supr 2000]). Where the challenged decision is not a decision of the board in place at the time plaintiff files the complaint, the second prong does not apply. (See Ryan v Gifford, *supra*, 918 A2d, at 352-353, citing Rales v Blasband, *supra*). Under these circumstances, “plaintiff must ‘create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.’” (*Id.*).

Recently, in Desimone v Barrow (924 A2d 908, 927-928 [Del Ch 2007]), the Delaware Chancery Court reviewed the application of Delaware Chancery Court Rule 23.1 under circumstances analogous to those here. The court stated:

Because Desimone did not make a demand on Sycamore's board, the complaint must plead particularized factual allegations establishing demand excusal. All of the parties agree that the standard for determining demand excusal in this case is set forth in Rales v. Blasband. Under Rales, demand is excused where the complaint “creates a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand. The Rales test is a two-prong inquiry requiring courts to analyze whether a complaint pleads particularized facts sufficient to demonstrate that either (1) the underlying conduct being challenged renders any of the directors “interested” and, if so, whether any of the other directors are compromised in their ability to act independently of the interested directors; or (2) at least half of the directors face a sufficiently substantial threat of personal liability as to the conduct alleged in the complaint to compromise their ability to act impartially on a demand.”

(Footnotes omitted).

While the Complaint here contains various boilerplate allegations about the futility of a pre-suit demand because of the defendant directors' interest and lack of independence, conclusory boilerplate allegations of director interest do not, without more, provide a basis to excuse demand. (See Desimone v Barrow, *supra*, 924 A2d, at 928 ["In engaging in this inquiry. . . I draw all reasonable inferences from the complaint's non-conclusory factual allegations But I do not accept cursory contentions of wrongdoing as a substitute for the pleading of particularized facts. Mere notice pleading is insufficient to meet the plaintiff's burden to show demand excusal in a derivative case."]; Brehm v Eisner, *supra*, 746 A2d, at 254).

Plaintiff claims that a pre-litigation demand upon the board would have been futile because a majority of the board is "interested." He asserts that six of Westwood's 11 directors could not independently and objectively consider a demand because: (1) five of them actually received backdated stock options and are therefore per se interested; and (2) one additional director, Dennis, together with other Westwood directors, was a member of Westwood's Compensation Committee and its Audit Committee and was thus likely to be liable for breaches of fiduciary duty for having participated in or having approved the challenged transactions. Thus, it is plaintiff's position that the above-mentioned six members of the board were interested directors who were unwilling or unable to act independently.

Plaintiff submits that, consistent with Ryan v Gifford (918 A2d 341, *supra*), this court must necessarily conclude that his pleading of demand futility in the Complaint is satisfactory. In Ryan, however, the plaintiff demonstrated that a majority of the board knowingly approved grants of backdated options and intentionally failed to disclose them in required financial statements. Ryan relied heavily on empirical analysis that compared the annualized returns

calculated from the purported grant dates versus the annualized returns for the stock itself. Plaintiff in this case does not present a similarly detailed and complete analysis but instead cherry-picks data. Further, plaintiff's allegations of demand futility rest upon a generalized assertion that the challenged option transactions were backdated rather than upon particularized facts supporting the conclusion that backdating actually occurred. Thus, unlike the scenario in Ryan, plaintiff here has not met his pleading burden with particularized allegations showing that the dates of the challenged grants were the result of defendants' intentional manipulation. Plaintiff has also not otherwise shown that the directors breached their fiduciary duties or engaged in conduct that would result in a substantial risk of personal liability. (See In re Linear Technology Corp., 2006 WL 3533024 [ND CA 2007] [unpublished opinion]; In re CNET Networks, Inc., 483 F Supp 2d 947 [ND CA 2007]).

Likewise, even assuming arguendo that the five directors who received allegedly backdated stock options were "interested," here, in contrast to Ryan, plaintiff has not alleged sufficient facts to suggest that the sixth, Dennis, was incapable of acting independently of those five directors or that he was otherwise culpable in any respect. Analogous circumstances prompted the court in Desimone v Barrow, *supra*, to reach the conclusion that the particularity of plaintiff's pleading fell far short of that in Ryan, stating, "[i]f Desimone pled facts creating a rational inference that the directors knowingly approved backdated grants of options, realizing that the corporation would deceptively account for them to investors and regulatory authorities as having been made at fair market value on the date of issuance, demand would be excused, consistent with the Ryan decision." (924 A2d, at 915).

With respect to the alleged Ultra Vires Transactions, plaintiff provides even less

specificity and provides no substantiation for excuse of the demand requirement.

Accordingly, the court holds that there is no reason to deprive the board of its “substantive right . . . to the opportunity to rectify an alleged wrong without litigation, and to control any litigation which does arise.” (Braddock v Zimmerman, 906 A2d 776, 784 [Del 2006]). For the foregoing reasons, plaintiff has failed to allege with the necessary particularity facts that would support the futility of a pre-suit demand by him. Thus, the court grants defendants’ motion to dismiss.

The court denies plaintiff’s informal request for leave to replead and file a further amended complaint because plaintiff does not base this request on a showing of merit to the proposed amendment and plaintiff does not submit an amended pleading.

It is unnecessary to discuss defendants’ additional arguments.

CONCLUSION

It is ORDERED that defendants’ motion to dismiss the Complaint is granted, and the Complaint is dismissed with costs and disbursements to defendants, as taxed by the Clerk of the Court upon the submission of an appropriate bill of costs; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: August 03 2007

ENTER:



J.S.C.

FILED
AUG 08 2007
NEW YORK
COUNTY CLERK'S OFFICE