IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

ROBERT FREEDMAN,

Plaintiff,

v.

SUMNER M. REDSTONE, PHILIPPE P. DAUMAN, THOMAS E. DOOLEY, GEORGE S. ABRAMS, ALAN C. GREENBERG, SHARI REDSTONE, FREDERIC V. SALERNO, BLYTHE J. MCGARVIE, CHARLES E. PHILLIPS, JR., WILLIAM SCHWARTZ, ROBERT K. KRAFT, and VIACOM INC.,

Defendants.

C.A. No. 1:12-cv-01052 SLR

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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE COMPLAINT

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Dated: October 22, 2012

CORPORATE DISCLOSURE STATEMENT

Nominal Defendant Viacom Inc. has Class A and Class B publicly-traded common stock. Affiliates of GAMCO Investors, Inc. are beneficial owners of 11.2% of Viacom Inc.'s Class A common stock.

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NATURE AND STAGE OF THE PROCEEDINGS

This is a putative derivative and direct shareholder action against the members of the Board of Directors of Viacom Inc., a Delaware corporation ("Viacom" or the "Company"). Plaintiff Robert Freedman ("Plaintiff") purports to be a shareholder of Viacom, and Viacom is named as a nominal defendant with respect to his derivative claim. The derivative claim alleges breach of fiduciary duty, waste, and unjust enrichment and seeks damages and an injunction against the members of the Board of Directors (the "Director Defendants" or the "Board") arising out of Viacom's alleged non-compliance with the terms of Viacom's 2007 Senior Executive Short-Term Incentive Plan (the "Plan") in awarding compensation to three senior executives of Viacom for the years 2008 through 2011. The direct claim seeks a shareholder re-vote with respect to Viacom's 2012 Senior Executive Short-Term Incentive Plan (the "2012 Plan") in which the Class B shareholders will be permitted to vote – a claim invalid at the threshold since Viacom's certificate of incorporation provides that the Class B shares are non-voting shares.

Viacom and the Director Defendants (together, the "Defendants") bring this motion (the "Motion") to dismiss the Complaint for failure to state a claim pursuant to Federal Rules of Civil Procedure 12(b)(6) and 23.1, on the grounds that no demand was made on the Board to bring suit and the Complaint does not adequately allege demand on the Board would be futile and hence excused. The Director Defendants also move to dismiss the Complaint for failure to state a valid substantive claim for relief.

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SUMMARY OF ARGUMENT

Plaintiff objects to the manner in which Viacom's Board of Directors, through its admittedly independent Compensation Committee, determined short-term incentive compensation for three of its senior executives (the "Senior Executives") pursuant to the Plan.

The Complaint purports to bring a derivative claim on behalf of the Company based on this objection, but it does not adequately plead that demand on the Board is excused (as required for a derivative action to proceed) or even state a cause of action on behalf of the Company.

In order to plead demand futility in a shareholder derivative action involving a Delaware corporation, a plaintiff must allege *particular facts* showing that (i) a majority of the board of directors is not independent and disinterested as of the date the Complaint was filed, or (ii) the challenged transaction was not the product of a valid exercise of business judgment, such that a majority of the directors face a substantial likelihood of liability as a result. The Complaint fails to do either.

First, the Complaint does not allege with particularity that a majority of the Board (that is, six of the eleven directors) were not independent or disinterested. Plaintiff in fact does not even dispute the independence of five of the directors, and then makes only inadequate, conclusory allegations of non-independence with respect to the sixth director.

Second, there is no colorable basis for director liability, for several reasons. The Complaint's *only* challenge to the compensation received by the Senior Executives in 2008 – 2011 is that it was not awarded in accordance with the terms of the Plan and thus, allegedly, would not be tax-deductible under Section 162(m) of the Internal Revenue Code ("IRC"). Specifically, the Complaint alleges that the independent Compensation Committee of the Board (the "Compensation Committee" or the "Committee") acted contrary to the terms of the Plan by including subjective criteria in the many factors that it ultimately used to *reduce* the Senior Executives' short-term incentive compensation.

On its very face, the terms of the Plan itself demonstrate that Plaintiff's claim is mistaken. Pursuant to the Plan, the Compensation Committee set the maximum amount of the Senior Executives' short-term incentive compensation using targets set by indisputably objective

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criteria. If those targets were not met, then the Senior Executives would not be entitled to any award. If the objective targets were met, as here, then "the Awards for such Performance Period shall have been earned except that the Committee may, in its sole discretion, reduce the amount of any Award to reflect the Committee's assessment of the Participant's individual performance or for any other reason." Plan § 2.4 (Ex. A).[1] That the Compensation Committee exercised its authority to *reduce* the maximum earned award authorized by the Plan, and did so in part using subjective factors, was perfectly consistent with the Plan and IRC Section 162(m).

The Complaint does not even come close to alleging particularized facts demonstrating that the awards of compensation pursuant to the Plan were not the products of valid exercises of business judgment such that a majority of directors face a substantial likelihood of liability. Demand may be excused based on allegations of wrongdoing by directors only in the "rare" case where the complaint alleges with particularity facts showing that a majority of directors engaged in such "egregious" misconduct that they face not simply a "mere threat" but a "substantial likelihood of director liability." *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984). Even if Plaintiff had adequately alleged that the compensation decisions were not in accordance with the Plan (and the opposite is in fact true), the Complaint still does not allege particular facts to show that the compensation decisions are unprotected by the business judgment rule. Plaintiff alleges no particularized facts raising a reasonable doubt that the Director Defendants acted without due care and on an informed basis, or that they acted disloyally or in bad faith. And pleading a substantial likelihood of liability is effectively impossible here as to Plaintiff's claim for damages because Viacom's shareholders have adopted a charter provision pursuant to Delaware General Corporation Law Section 102(b)(7) that exculpates directors from liability for damages for breaches of duty not based on bad faith or disloyalty.

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[1] The attached copy of the Plan was filed as Ex. 10.11 to Viacom's February 12, 2009 Form 10-K.

For much the same reasons, Plaintiff's derivative claim also should be dismissed because it fails to state a cause of action. The Complaint fails to allege facts that the compensation decisions ran contrary to the terms of the Plan, that the decisions are not protected by the business judgment rule, or that the Director Defendants' actions were disloyal or in bad faith.

Plaintiff's direct claim, which contends that Viacom Class B shareholders were improperly denied a vote on the 2012 Plan, is simply wrong. Under Viacom's charter, the Class B shares are non-voting shares. Contrary to the premise of Plaintiff's claim, the federal law on which Plaintiff relies (IRC Section 162(m)) does not override a corporation's charter and state law and grant voting rights to non-voting shares. In addition, Plaintiff fails to allege that he is a Class B shareholder and therefore that he has standing to pursue this claim.

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STATEMENT OF FACTS

A. The Parties

Nominal Defendant Viacom is a worldwide entertainment company, incorporated in Delaware, with its principal executive offices located in New York. Complaint ¶ 4 (paragraphs in the Complaint are cited in the form "¶ _"). Plaintiff alleges that he has owned Viacom shares continuously from December 31, 2005 to the date of the Complaint (although he notably does not allege whether he owns Class A or Class B shares). ¶ 5.

The Director Defendants are the eleven current members of the Board of Directors of Viacom. Three of the Director Defendants (Sumner Redstone, Philippe P. Dauman, and Thomas E. Dooley) are the Senior Executives whose short-term incentive compensation is challenged in this action. ¶¶ 7, 49. The Complaint alleges that two of the Director Defendants (Shari Redstone and George S. Abrams) are not independent because they are described in Viacom's 2012 proxy statement as "Not Independent" under Viacom's Corporate Governance Guidelines and the listing standards of the NASDAQ Global Select Market (the "NASDAQ Standards"). ¶ 49;

Viacom's Notice of 2012 Annual Meeting of Stockholders and Proxy Statement ("2012 Proxy Statement") at 6-9 (Ex. B). Five of the Director Defendants (Frederic V. Salerno, Blythe J. McGarvie, Charles E. Phillips, William Schwartz, and Robert K. Kraft) are past or current members of the Compensation Committee of the Board. ¶ 8. All five of these directors are designated as "Independent" directors under Viacom's Corporate Governance Guidelines and the NASDAQ Standards, and the Complaint does not even challenge their independence. 2012 Proxy Statement at 6-9 (Ex. B). The Complaint alleges, however, that the eleventh Director Defendant (Alan C. Greenberg) is not independent, even though Mr. Greenberg is designated in the 2012 Proxy Statement as "Independent" under Viacom's Corporate Governance Guidelines and the NASDAQ Standards. *Id.*; ¶ 49.

B. <u>The Plan and Short-Term Incentive Compensation Awarded Pursuant to the Plan</u>

Beginning in 2008, Viacom awarded annual incentive compensation to the Senior Executives pursuant to the Plan, the terms of which were fully disclosed. ¶ 16. The Plan provided that the Compensation Committee would select, for a specific "Performance Period," one or more "Performance Goals" from a list of objective measures set forth in the Plan and "establish specific performance targets related to such Performance Goals." ¶¶ 16, 49; Plan § 2.2(a), (b) (Ex. A); *see* 2012 Proxy Statement at 34 (stating that 2011 performance target set for the Plan was operating income of $2.791 billion) (Ex. B). The Committee is required to determine following each Performance Period whether these entirely objective "performance targets have been achieved." Plan § 2.4 (Ex. A). If the performance targets were not achieved, then no Award is authorized; if the performance targets were achieved, then the Award is deemed earned, in the maximum amount of the lesser of either (i) eight times the Senior Executive's annual base salary or (ii) $51.2 million. *Id.* §§ 2.3, 2.4. Once the Senior Executive

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qualified for the maximum award, however, the Committee is still conferred discretion to adjust the amount of the Award downward "for any [] reason":

> If the performance targets have been achieved, the Awards for such Performance Period shall have been earned except that the Committee may, in its sole discretion, reduce the amount of any Award to reflect the Committee's assessment of the Participant's individual performance or for any other reason.

Id. § 2.4. The Plan further provides that "[a]ll questions of interpretation, administration and application of the Plan shall be determined by the Committee." *Id.* § 1.3.

The Complaint does not allege that from 2008 to 2011 the objective performance targets established pursuant to the Plan were not met. Nor does the Complaint allege that the Senior Executives were awarded more than the maximum award allowable under the Plan. Instead, the Complaint focuses on the factors applied by the Committee in adjusting the awards downward from the maximum amount permitted under the Plan, including objective criteria (*e.g.*, operating income and free cash flow) and subjective criteria (*e.g.*, leadership, vision, continuing to navigate economic challenges). ¶¶ 19-46.

C. <u>The 2012 Plan</u>

On March 8, 2012, Viacom submitted the 2012 Plan to a shareholder vote. ¶ 10. Holders of Class B non-voting shares were not permitted to vote for or against the 2012 Plan. ¶ 56. Plaintiff contends that the Court should order a new vote allowing holders of the non-voting Class B shares to vote on the 2012 Plan. ¶ 59. Viacom's certificate of incorporation provides that the Class B shares are non-voting. *See* Viacom's March 13, 2006 Form 10-K at Ex-3.1 ("Viacom's certificate of incorporation") at 2 (Ex. C).

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ARGUMENT

I. THE DERIVATIVE CLAIM SHOULD BE DISMISSED BECAUSE THE COMPLAINT FAILS TO ALLEGE WITH PARTICULARITY THAT DEMAND ON THE BOARD WOULD BE FUTILE AND IS THEREFORE EXCUSED

Under both federal and Delaware law, before asserting a derivative claim on behalf of a corporation, a shareholder plaintiff must demand that the corporation's board of directors take action or, alternatively, plead with particularity that demand is excused. *See* Fed. R. Civ. P. 23.1(b)(3) ("The complaint must . . . state with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors . . . and (B) the reasons for not obtaining the action or not making the effort."); *accord* Del. Ch. Ct. R. 23.1. The Complaint alleges neither.[2]

The demand requirement is grounded in the principle that the "business and affairs of every corporation . . . shall be managed by or under the board of directors." 8 Del. C. § 141(a); *see also Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) ("A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation."). This authority of the board of directors encompasses the power to decide whether "to bring a law suit or to refrain from litigating a claim on behalf of a corporation." *Spiegel v. Buntrock*, 571 A.2d 767, 773 (Del. 1990); *see also White v. Panic*, 793 A.2d 356, 363 (Del. Ch. 2000), *aff'd,* 783 A.2d 543 (Del. 2001).

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Shareholders cannot divest directors of their authority to control a corporation's legal claims without first pleading with particularity why demand would be futile as to at least half of the corporation's directors. *See Beam v. Stewart*, 845 A.2d 1040, 1046 n.8 (Del. 2004).

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[2] Because Viacom is a Delaware corporation, Delaware law determines whether Plaintiff's allegations demonstrate that demand would be futile. *See Iron Workers Dist. Council v. Elliott*, C.A. No. 10-699-SLR, 2011 WL 4632872, at *1 (D. Del. Oct. 4, 2011) ("[F]ederal courts hearing shareholders' derivative actions involving state law claims apply the federal procedural requirement of particularized pleading, but apply state substantive law to determine whether the facts demonstrate that demand would have been futile and can be excused.") (quoting *Kanter v. Barella*, 489 F.3d 170, 176 (3d Cir. 2007)).

Accordingly, Delaware law imposes an "onerous" burden on plaintiffs who allege that a pre-suit demand would have been futile. *Levine v. Smith*, 591 A.2d 194, 207 (Del. 1991), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

A shareholder who fails to make a demand on the board must overcome the powerful presumptions of the business judgment rule before being permitted to pursue the derivative claim. *See White*, 793 A.2d at 552. To plead demand futility, a complaint "must comply with stringent requirements of factual particularity that differ substantially from the permissive notice pleading" standard. *Brehm*, 746 A.2d at 254. It must set forth particularized facts creating a reasonable doubt that: (i) a majority of directors are disinterested and independent; or (ii) the challenged transaction was the product of a valid exercise of business judgment, such that a majority of the directors face a substantial likelihood of liability. *See Aronson*, 473 A.2d at 814-15. "The 'heavy burden' of pleading demand futility is a substantive component of a plaintiff's case and, as such, the failure to meet either of the two showings prescribed by [the Delaware] Supreme Court in *Aronson v. Lewis*, ends a court's inquiry before it can even address the merits of the challenged transaction." *In re The Limited, Inc*., C.A. No. 17148, 2002 WL 537692, at *3 (Del. Ch. Mar. 27, 2002). The Complaint fails to meet this burden.

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A. The Complaint Fails to Allege with Particularity Facts Raising a Reasonable Doubt That a Majority of the Directors Are Independent and Disinterested

The Complaint fails to allege with particularity facts showing that a majority of the eleven Board members are not independent and disinterested. Plaintiff does not even allege that the five independent directors who served on the Compensation Committee (Messrs. Salerno, Phillips, Schwartz, and Kraft and Ms. McGarvie) are interested in the challenged compensation decisions or lack independence. They are, therefore, presumptively disinterested and

independent. *See In re W. Nat'l Corp. S'holders' Litig.*, C.A. No. 15927, 2000 WL 710192, at *15 (Del. Ch. May 22, 2000).

As to the remaining six directors, the Complaint alleges that the three Senior Executives whose compensation is challenged are interested, an assertion the Defendants do not dispute for purposes of this Motion. Nor do Defendants dispute, for purposes of this Motion only, that the two directors designated as "Not Independent" under Viacom's Corporate Governance Guidelines and the NASDAQ Standards (Shari Redstone and George S. Abrams) are not independent. ¶ 49; 2012 Proxy Statement at 6-9 (Ex. B).

That leaves the eleventh director, Alan C. Greenberg, as determinative for purposes of this Motion. Mr. Greenberg is "Independent" under Viacom's Corporate Governance Guidelines and the NASDAQ Standards (*see* 2012 Proxy Statement at 6-9), but Plaintiff alleges that Mr. Greenberg is not independent because he is a "long-time close personal friend and adviser to Sumner Redstone" and in 2006 a lower court state judge in New York concluded that a complaint filed in 2005 challenging Mr. Redstone's compensation adequately alleged that Mr. Greenberg was not independent. ¶ 49.

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These allegations of Mr. Greenberg's non-independence are insufficient. To show a lack of independence for demand excusal purposes, a complaint must plead particularized facts "demonstrating that through personal or other relationships the directors are beholden to the controlling person or so under their influence that their discretion would be sterilized." *Zimmerman v. Crothall*, C.A. No. 6001-VCP, WL 707238, at *41 (Del. Ch. Mar. 5, 2012) (internal quotations and citations omitted). The facts pleaded must "support the inference that because of the nature of a relationship or additional circumstances…the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director." *Beam*, 845 A.2d at 1052. The Complaint's superficial allegation that Mr. Greenberg

was not independent because he and Mr. Redstone were "close friends" is exactly the sort of conclusory allegation that the Delaware Supreme Court has held to be insufficient: "[M]ere allegations that [directors] move in the same business and social circles, or a characterization that they are close friends, [are] not enough to negate independence for demand excusal purposes." *Beam*, 845 A.2d at 1051-52. Here, nothing else is pled.

Plaintiff's challenge to Mr. Greenberg's independence is not saved by the Complaint's citation to the six-year-old decision of a New York state court. ¶ 49 (citing *In re Viacom Inc. S'holder Deriv. Litig.*, 2006 N.Y. Misc. LEXIS 2891, at *10-12 (N.Y. Sup. June 26, 2006)). Independence must be assessed as of the date of the filing of this Complaint, *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984), not as of a date seven years in the past (when the New York complaint was filed). Notably, Plaintiff does not set forth in his Complaint any of the specifics or reasoning underlying that 2006 decision, which related to Mr. Greenberg's involvement in work done by Bear Stearns (a firm no longer in existence) for Viacom's predecessor company in the 1990s and early 2000s. Moreover, the decision plainly misapplied Delaware law, including by failing to take into account the straightforward Delaware authorities holding that business dealings do not evidence a lack of independence absent particularized facts demonstrating the materiality of such dealings to the director personally. As the Delaware Supreme Court has instructed, a director is not beholden to an interested director unless the interested director has direct or unilateral power to decide whether the director continues to receive a benefit upon which the director is so dependent or is of such subjective material importance that its threatened loss might create a reason to question whether he could properly exercise independent business judgment. *See Telxon v. Meyerson*, 802 A.2d 257 (Del. 2002). The 2006 New York decision

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contained no facts that would support such a finding of materiality even as of that date; it certainly provides no support for a claim that Mr. Greenberg is not independent in 2012.[3]

B. Plaintiff Has Failed to Plead with Particularity That the Challenged Compensation Decisions Were Not the Product of a Valid Exercise of Business Judgment

Because a majority of the Board is independent and disinterested under the first prong of *Aronson*, Plaintiff has a "heavy burden" to satisfy the second prong – to show the challenged transaction was not the product of a valid exercise of business judgment, such that a majority of the directors face a substantial likelihood of liability. *Aronson*, 473 A.2d at 814-15. "The Court begins its analysis presuming that the business judgment rule applies, and the plaintiff must establish facts rebutting this presumption. To do so, [Plaintiff] must plead particularized facts to create a reasonable doubt that either (i) the action was taken honestly and in good faith or (ii) the board was adequately informed in making the decision." *Freedman v. Adams*, C.A. No. 4199-VCN, 2012 WL 1099893, at *10 (Del. Ch. Mar. 30, 2012) (internal quotations and citations omitted). Again, the Complaint fails to plead facts to carry either burden. [4]

The Complaint challenges the compensation decisions in only one respect: it alleges that the Compensation Committee acted contrary to the Plan in considering subjective factors in awarding short-term incentive compensation. This assertion is demonstrably wrong when the

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[3] The New York case settled after argument before the New York Appellate Division and before the court could rule on whether the lower court had misapplied Delaware law. Notably, on Viacom's application, the appellate court had stayed all discovery in the lower court pending appeal. *See In the Matter of Viacom, Inc*., No. M-6074, 2006 N.Y. App. Div. LEXIS 14718 (N.Y. App. Div. Nov. 30, 2006).

[4] The argument that demand on the board would be futile because the directors would have to sue themselves for making an improper business decision has consistently been rejected by the courts. *See, e.g*., *King v. Baldino*, 648 F. Supp. 2d 609, 619 (D. Del. 2009) ("Were demand to be found futile merely because directors would be suing themselves the demand requirement of Rule 23.1 would be eviscerated.") (internal punctuation and quotations omitted); *Brehm*, 746 A.2d at 257 n.34 ("It is no answer to say that demand is necessarily futile because (a) the directors would have to sue themselves, thereby placing the conduct of the litigation in hostile hands, or (b) that they approved the underlying transaction[.]") (internal quotations omitted).

actual terms of the Plan are taken into account. The Plan provided that objective criteria would be used to establish performance targets under the Plan, which, if achieved, authorize an award of the maximum bonus under the Plan (that is, the lesser of either (i) eight times the Senior Executive's annual base salary or (ii) $51.2 million). Plan §§ 2.2, 2.3, 2.4 (Ex. A). The Complaint does not allege that these performance targets were not met, that the Senior Executives did not earn the maximum bonus under the Plan, or that the Senior Executives were ever awarded more than the maximum amount.[5]

Had the Compensation Committee simply awarded the maximum bonus and stopped there, Plaintiff would have no basis to complain that other than objective criteria were employed. But the Committee went farther – to the benefit of shareholders. Once the objective performance targets were met, the Compensation Committee was explicitly authorized by the Plan to consider "any reason," including both subjective and objective factors, to *reduce* the amount that could be awarded under the Plan. Specifically, the Plan provided that "[i]f the performance targets have been achieved, the Awards for such Performance Period shall have been earned except that the Committee may, in its sole discretion, reduce the amount of any Award to reflect the Committee's assessment of the Participant's individual performance or for any other reason."

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[5]The Complaint appears to confuse the "target bonus" amount with the amount that was deemed earned under the Plan if the objective performance goals established pursuant to the Plan were met. Using information from Viacom's 2012 Proxy Statement, the Complaint alleges that the Compensation Committee used subjective factors to determine how much of a "target bonus" amount would be paid and, in the years 2009 to 2011, did so to increase the actual bonus amount above the target bonus amount. *See* ¶¶ 26-43; Ex. B at 33 (listing the "Actual Bonus" and "Target Bonus" amounts for 2008 – 2011). Even if correct, these allegations are irrelevant to Plaintiff's claim that the Plan terms were violated. As made clear in the Proxy Statement, the target bonus amounts were separate from, and lower than, the maximum allowable bonus amounts under the Plan, and were appropriately considered in revising bonuses downward from the maximum allowable amounts. As disclosed in the Proxy Statement, the Plan "contains a separate, supplemental financial performance goal and is designed to comply with the provisions on performance-based compensation of Section 162(m) . . . . Our fiscal year 2011 operating income for STIP purposes was $3.854 billion . . . which exceeded the fiscal year 2011 performance target set for the Senior Executive STIP [*i.e.*, the Plan] of $2.791 billion. The [Plan] provides for a maximum allowable bonus amount of eight times base salary or $50 million, whichever is lower, subject to downward adjustment." Ex. B at 34.

Plan § 2.4; *see also* ¶ 12 ("the independent compensation committee can exercise negative discretion to reduce the amount or not pay at all").

The IRS regulations relating to IRC Section 162(m) specifically authorize this common-sense approach. They provide that a performance goal that has been determined by objective factors does not thereafter become "discretionary" because the compensation committee reduces the award that would otherwise be earned upon the attainment of that objective:

> The terms of an objective formula or standard must preclude discretion to increase the amount of compensation payable . . . A performance goal is not discretionary for purposes of this paragraph (e)(2)(iii) merely because the compensation committee reduces or eliminates the compensation or other economic benefit that was due upon attainment of the goal.

26 C.F.R. § 1.162-27(e)(2)(iii)(A).

The Complaint therefore fails to adequately allege that the Compensation Committee's determinations even violated the terms of the Plan. Because that is the sole aspect of the compensation decisions challenged in the Complaint, the Complaint necessarily fails to allege facts that give rise to a reasonable doubt that the compensation decisions were the exercise of valid business judgment.

Even if the Complaint did properly allege that the Compensation Committee incorrectly interpreted the terms of the Plan, the Complaint would still fail to plead particular facts giving rise to a reasonable doubt whether the challenged transactions were protected by the business judgment rule. Plaintiff pleads no particularized facts creating a reasonable doubt whether the Committee violated its duty of due care in reducing awards pursuant to the Plan. Indeed, the Complaint does not offer even a *conclusory* allegation that that the Director Defendants violated their duty of care.[6]

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[6] Under Delaware law, directors can be held liable for a breach of the fiduciary duty of care only upon a showing of gross negligence. *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006); *In re Citigroup Inc.*

Similarly, the Complaint alleges no specific facts that would give rise to a reasonable doubt that the Director Defendants acted disloyally or in bad faith, or engaged in corporate waste. Even if the Compensation Committee's administration of the Plan resulted in the payment of compensation not deductible under Section 162(m) – and the Complaint does not allege that it has in fact done so – that would not suffice to show that the Committee acted disloyally or wastefully or that its actions go unprotected by the business judgment rule. A company's board of directors has no general fiduciary duty to minimize taxes. *Freedman v. Adams*, 2012 WL 1099893, at *12; *Seinfeld v. Slager*, C.A. No. 6462 VCG, 2012 WL 2501105, at *4 (Del. Ch. Jun. 29, 2012). Companies may choose or not choose to take advantage of tax provisions for any number of reasons, and generally a company's tax policy "typif[ies] an area of corporate decision-making best left to management's business judgment, so long as it is exercised in an appropriate fashion." *Freedman*, 2012 WL 1099893, at *12.

C. The Complaint Fails to Plead with Particularity Facts to Raise a Reasonable Doubt Whether Any Liability for Damages Based on the Challenged Compensation Decisions Would Not Be Exculpated

As demonstrated above, the Complaint fails to set forth any conceivable theory of wrongdoing on the part of the Committee or the Board. However, even if the Compensation Committee's interpretation of the Plan turned out to be incorrect, the Complaint would still fail to meet *Aronson*'s standard for showing a substantial likelihood of liability as to a majority of the Board. As authorized by Section 102(b)(7) of the Delaware General Corporation Law, Viacom's certificate of incorporation includes a provision approved by its shareholders that shields the Board from liability for damages except in certain limited circumstances. This exculpatory

S'holder Deriv. Litig., 964 A.2d 106, 114 n.6 (Del. Ch. 2009). It is a high standard under Delaware law. *See In re Lear Corp. S'holder Litig*., 967 A.2d 640, 652 n.45 (Del. Ch. 2008) ("[T]he definition is so strict that it imports the concept of recklessness into the gross negligence standard, thus conflating two standards that are distinct when used in the criminal law concept.").

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provision must be taken into account in determining whether Plaintiff has adequately pled particularized facts showing that a majority of the directors face a substantial likelihood of liability and that demand is therefore excused. *See In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 647 (Del. Ch. 2008).[7]

In accordance with Section 102(b)(7), Viacom's certificate of incorporation provides that the directors are exculpated for liability for damages, with certain exceptions:

> (1) *Limitation on Liability.* A Director's liability to the Corporation for breach of duty to the Corporation or its stockholders shall be limited to the fullest extent permitted by Delaware law. In particular, no Director of the Corporation shall be liable to the Corporation or any of its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (a) for any breach of the Director's duty of loyalty to the Corporation or its stockholders, (b) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, . . . or (d) for any transaction from which the Director derived an improper personal benefit.

Viacom's certificate of incorporation at 8 (Ex. C).

The Complaint alleges, at most, an erroneous interpretation and application of Plan terms. The Complaint alleges no facts showing that a majority of the Board acted disloyally or in bad faith, engaged in intentional misconduct or a knowing violation of the law, or derived any improper personal benefit from the challenged transactions.

Even if a claim is labeled breach of the duty of loyalty (*see* ¶ 52), the claim will still be exculpated if the plaintiff fails to allege particularized facts in support of that characterization. Delaware courts have consistently held that where a charter limits director liability under Section 102(b)(7), dismissal is required when a complaint fails to adequately allege facts sufficient to

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[7]The policy underlying Section 102(b)(7) was described as follows by the Delaware Court of Chancery in *Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 793 (Del. Ch. 2004):

> Section 102(b)(7) authorizes corporate charter provisions that insulate directors from personal liability to the corporation for breaches of the duty of care. This is an important public policy statement by the General Assembly, which has the intended purpose of encouraging capable persons to serve as directors of corporations by providing them with the freedom to make risky, good faith business decisions without fear of personal liability.

give rise to an inference of conduct within one of Section 102(b)(7)'s exceptions. *See Emerald Partners v. Berlin*, 787 A.2d 85, 92 (Del. 2001) ("[I]n actions against the directors of Delaware corporations with a Section 102(b)(7) charter provision, a shareholder's complaint must allege well-pled facts that, if true, implicate breaches of loyalty or good faith."). Even if the Complaint alleged gross negligence (and it plainly does not), that would not constitute bad faith or other non-exculpated conduct. *See Malpiede v. Townson*, 780 A.2d 1075, 1094-95 (Del. 2001) ("[E]ven if the plaintiffs had stated a claim for gross negligence such a well-pleaded claim is unavailing because defendants have brought forth the Section 102(b)(7) charter provision that bars such claims. This is the end of the case."). Similarly, "[a]bsent a breach of loyalty, § 102(b)(7) protects directors and officers from a claim of corporate waste." *Continuing Creditors' Comm. of Star Telecomms. Inc. v. Edgecomb*, 385 F. Supp. 2d 449, 465 (D. Del. 2004) (citing *Green v. Phillips*, C.A. No. 14436, WL 39547 (Del. Ch. June 19, 1996)); *see also Apple Computer, Inc. v. Exponential Tech*., C.A. No. 16315, WL 39547, at *30 (Del. Ch. Jan. 21, 1999) (dismissing waste claims under 102(b)(7) where plaintiff only alleged facts indicating nothing more than "a good faith error").[8]

II. THE COMPLAINT FAILS TO STATE A CAUSE OF ACTION

A. The Derivative Claim Fails to State a Cause of Action

The derivative claim should be dismissed for failure to state a cause of action pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. As discussed above, the Complaint does not adequately plead a violation of the terms of the Plan or non-compliance with IRC Section 162(m). Nor does the Complaint plead specific facts to show that the Board did not act with due

[8] The Plan itself also provides for an exculpation of liability for members of the Committee: "Subject to applicable law: (i) no member of the Committee shall be liable to any Participant or any other person for anything whatsoever in connection with the administration of the Plan except such person's own willful misconduct . . . ." Plan § 1.4 (Ex. A).

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care, or that it engaged in disloyal or bad-faith conduct. Accordingly, no factual basis is alleged to rebut the presumption that the business judgment rule protects the Committee's compensation decisions. *See In re infoUSA, Inc. S'holders Litig*., 953 A.2d 963, 984 (Del. Ch. 2007) ("[A] simple, fundamental truth of institutional competency long understood in Delaware law . . . [is] [t]he value of assets bought and sold in the marketplace, including the personal services of executives and directors, is a matter best determined by the good faith judgments of disinterested and independent directors, men and women with business acumen appointed by shareholders precisely for their skill at making such evaluations."). And the presumption of the business judgment rule is particularly viable where, as here, the compensation decisions are made by a committee of independent and disinterested directors. *See Tate & Lyle PLC v. Staley Cont'l, Inc*., C.A. No. 9813, 1988 WL 46064, at *7 (Del. Ch. May 9, 1988) ("Compensation decisions are generally the sole prerogative of the directors. Even when a compensation decision directly benefits directors, if the decision is approved by a committee of disinterested directors, it is afforded the protection of the business judgment rule") (internal citations omitted); *Nomad Acquisition Corp. v. Damon Corp*., C.A. Nos. 10173,10189, 1988 WL 383667, at *6 (Del. Ch. Sept. 20, 1988) ("The actions of the compensation committee, comprised of Damon's independent directors, are *prima facie* subject to the protections of the business judgment rule"). *See also* 8 Del. C. § 122(5) ("Every corporation created under this chapter shall have power to . . . Appoint such officers . . . and to pay or otherwise provide for them suitable compensation."); 8 Del. C. § 141(c)(1) ("Any . . . committee . . . may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation.").

As discussed above, Delaware also imposes no fiduciary duty to obtain a particular tax treatment or to maximize tax savings. Similarly, a failure to obtain a tax deduction (even had there been such a failure here) does not constitute waste. "A claim of waste will be sustained

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only in the rare, unconscionable case where directors irrationally squander or give away corporate assets." *Kates v. Beard Research, Inc.*, C.A. No. 1480-VCP, 2010 WL 1644176, at *5 (Del. Ch. Apr. 23, 2010). This standard is "obviously an extreme test, very rarely satisfied by a shareholder plaintiff." *Steiner v. Meyerson,* C.A .No. 13139, 1995 WL 441999, at *1 (Del. Ch. July 19, 1995); *see also Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins*, C.A. No. 20228-NC, 2004 WL 1949290, at *17 (Del. Ch. Aug. 24, 2004) (same). Plaintiff's pleading does not come close to this standard.

B. The Direct Claim Should Be Dismissed for Failure to State a Cause of Action Because Viacom's Class B Shares Are Non-Voting Shares

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Plaintiff alleges that pursuant to IRC Section 162(m) Class B shareholders were entitled to vote on the adoption of the 2012 Plan, but were not permitted to do so. ¶ 56. Although Plaintiff does not allege that he is a Class B shareholder (and thus that he even has standing to bring this claim), there is simply no basis for the claim in any event. Viacom's charter, as authorized by Delaware law, provides that the Class B shares are non-voting. Section 162(m) does not purport to override state corporate law and disrupt the well-settled expectations and rights of the corporate stakeholders who have relied on it.

Delaware corporate law expressly confers on corporations the flexibility to offer voting and non-voting stock. *See* 8 Del. C. § 151(a) ("Every corporation may issue 1 or more classes of stock . . . which classes or series may have such voting powers, full or limited, or no voting powers[.]"); *Lehrman v. Cohen,* 222 A.2d 800, 807 (Del. 1966) ("Non-voting stock is specifically authorized by § 151(a)[.]"). Viacom has issued Class A shares, with voting rights, and Class B shares, without voting rights, both of which are publicly traded. *See* Viacom's Certificate of Incorporation at 2; 2012 Proxy Statement at 24 (Exs. C and B).

Plaintiff's legal theory essentially contends that this provision of the Delaware General

Corporation Law has been silently or indirectly preempted by Congress through Section 162(m)'s requirement that the 2012 Plan be put to a "vote" because Section 162(m) does not explicitly state that only holders of voting shares may vote. ¶ 56. This logic is backwards. It flies in the face of well-established principle of statutory construction that courts must interpret a federal law as preempting state law only where Congress explicitly makes clear its intent to do so. *See Bates v. Dow Agrosciences LLC*, 544 U.S. 431, 449 (2005) ("[W]e assume that a federal statute has not supplanted state law unless Congress has made such an intention 'clear and manifest.'") (citations omitted); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) ("we have long presumed that Congress does not cavalierly pre-empt state-law") (citations omitted).

This conclusion is strengthened by the fact that the IRS regulations applying Section 162(m) evidence the opposite intent of respecting state law concerning the voting rights of classes of shares. The final IRS regulations adopted pursuant to Section 162(m) provide that "the material terms of a performance goal are approved by shareholders if, in a separate vote, a majority of the *votes* cast on the issue (including abstentions to the extent abstentions are counted as voting under applicable state law) are cast in favor of approval." 26 C.F.R. § 1.162-27(e)(4)(vii) (emphasis added). In the Preamble to the amended proposed regulations, the IRS explained that the text is intended "to reflect the fact that certain shares may have more than one vote, and to properly deal with abstentions." Disallowance of Deductions for Employee Remuneration in Excess of $1,000,000, 59 Fed. Reg. 231 (Dec. 2, 1994) (codified 26 C.F.R. § 1). Thus in the final regulations, the IRS determined to respect the disparate voting rights that a company's charter documents may accord different classes of stock and to refer specifically to a majority of *votes* rather than a majority of *shares*. Not all shares are created equal, and the IRS regulations do not require that they be treated as though they were.

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Failing to find a "clear and manifest" expression for preemption by Congress, the Complaint asserts, based on reference to IRC Section 368(a)(1), that "when Congress intends to limit the meaning of stock to voting stock, it does so." ¶ 56. This argument is contradicted by other provisions of the IRC that set forth a shareholder approval requirement related to compensation. Both IRC Section 422, providing for incentive stock options, and Section 423, setting out the requirements for tax-advantaged employee stock purchase plans, require that plans under which options or rights are granted be "approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted." 26 U.S.C. § 422(b)(1)(2006). Although there is no reference in the statutory text to voting stock, the IRS regulations interpreting these requirements make clear that only voting shares are relevant. The regulations provide that the approval "must comply with all applicable provisions of the corporate charter, bylaws and applicable State law prescribing the method and degree of stockholder approval required" and go on to state that, if state law is silent on the matter, the plan must be approved "by a majority of the votes cast at a duly held stockholders' meeting at which a quorum representing a majority of all outstanding *voting stock* is, either in person or by proxy, present and voting on the plan." 26 C.F.R. § 1.423-2(c) (emphasis added). Unless Plaintiff means to assert that these IRS regulations misconstrue Congressional intent, it is simply not the case that a statutory reference to shareholder approval must be read to override state law and enfranchise otherwise non-voting stock. Even if Plaintiff had pled that he is a Class B shareholder, and thus would have standing to bring this action, he cannot state a substantive claim that the Class B shareholders were improperly excluded from the vote on the 2012 Plan.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Court dismiss the Complaint with prejudice.

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October 22, 2012

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CERTIFICATE OF SERVICE

I hereby certify that on October 22, 2012, I caused the foregoing to be electronically filed with the Clerk of the Court using CM/ECF, which will send notification of such filing to all registered participants.

I further certify that I caused copies of the foregoing document to be served on October 22, 2012, upon the following in the manner indicated:

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