UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

PENNSYLVANIA AVENUE FUNDS,

Plaintiff,

v.

EDWARD J. BOREY, et al.,

Defendants.

CASE NO. C06-1737RAJ

ORDER

I. INTRODUCTION

This matter comes before the court on a motion to dismiss (Dkt. # 71) from Defendants Edward Borey, Steven Moore, Michael Kourey, Michael Hallman, Richard LeFaivre, and William Schroeder. Each of these six Defendants is a former member of the board of directors of WatchGuard Technologies Incorporated ("WatchGuard"). The court will refer to them collectively as "the Directors." The court has reviewed the Directors' motion together with all documents filed in support and in opposition, and has heard oral argument. For the reasons set forth herein, the court GRANTS the motion.

II. BACKGROUND

This action arises from a merger that extinguished WatchGuard as a publicly traded corporation. Plaintiff Pennsylvania Avenue Funds owned WatchGuard stock, and seeks to represent all persons who owned WatchGuard stock at the time of the merger.

According to Plaintiff's operative complaint[1] ("Complaint"), the Directors' actions and omissions led to a merger in which WatchGuard's shareholders received too low a price for their stock. As this is a motion to dismiss the Complaint, there are no facts supporting Plaintiff's claims, only allegations, which the court summarizes below.

A. The WatchGuard Acquisition Process

In 2005, after a long period in which WatchGuard's financial results disappointed the investing public, speculators began to express interest in acquiring the company. ¶¶ 30-32. In May 2005, the Directors adopted a "poison pill" shareholder rights plan to protect the company from any acquisition proposal that the Directors had not blessed. ¶ 33. They disclosed the poison pill in a May 5, 2005 regulatory filing, of which the court takes judicial notice. Defs.' Req. for Jud. Notice ("RJN"), Ex. D. At least one suitor expressed interest in acquiring WatchGuard in August 2005, ¶ 34, but there is no allegation that any suitor approached WatchGuard with a formal bid while the poison pill was in effect. By September 2005, the Directors began consulting with investment banks, who advised them to pursue a sale or merger of the company. ¶ 35. That advice led the Directors to initiate an acquisition process in which, by Plaintiff's admission at oral argument, as many as 50 suitors expressed interest in WatchGuard. Of those suitors, only two, a consortium led by Vector Capital Corporation ("Vector") and another led by Francisco Partners ("FP"), offered a price for WatchGuard. In February 2006, Vector sent a letter to WatchGuard declaring its interest in an acquisition without stating a price. ¶ 36. By March 23, 2006, Vector had acquired nearly 10% of WatchGuard's stock on the open market, and had disclosed as much in a regulatory filing. ¶ 37.

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[1]Plaintiff relies upon its first amended complaint (Dkt. # 52). The court will use bare "¶" symbols when citing this pleading.

In May 2006, after WatchGuard shareholders declined to ratify the poison pill (¶ 44), FP and Vector submitted conditional bids of $5.00 and $5.10 per share, respectively. ¶¶ 46-47. On June 26, 2006, they revised their bids downward to $4.65 and $4.60 per share. ¶ 50. By late July, FP had lowered its bid to $4.25 per share. ¶ 56. The Complaint is silent as to whether Vector withdrew its $4.60 bid, or whether the bid was ever formalized. In any event, the Directors accepted FP's $4.25 per share bid in a public announcement on July 25, 2006. ¶ 56. There is no allegation that any suitor made, or attempted to make, a better offer for WatchGuard after July 25, 2006. Indeed, there is no allegation that any suitor other than Vector or FP ever stated, at any point in the acquisition process, even a conditional price that it would pay for WatchGuard.

The Directors publicly declared their support for the merger. ¶ 57. They also entered into support agreements with FP wherein they pledged, in their capacity as shareholders only, to vote their stock in favor of the merger with FP, and pledged not to solicit or encourage competing offers. ¶¶ 58-60. In addition, they agreed that WatchGuard would pay a $6 million termination fee, which was 4% of the total merger consideration, if the parties could not complete the merger. ¶ 63.

In August 2006, Vector announced its agreement to fund half of FP's acquisition of WatchGuard in exchange for an equal share of WatchGuard after the merger. ¶ 65.

On September 1, 2006, WatchGuard issued a proxy statement to its shareholders in which the Directors recommended voting in favor of the merger. By virtue of its repeated citation to the proxy statement, the Complaint incorporates the proxy statement by reference.[2] The proxy statement discloses information on the terms of the merger, bids and other expressions of interest that preceded the merger, the ultimate decision to

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[2]Plaintiff admits that the court may rely on the proxy statement as evidence of what was disclosed to shareholders, but not for the truth of those disclosures. Pltf.'s Opp'n at 7 n.3.

enter the merger agreement with FP, and the support agreements and other deal protections that the Directors executed in conjunction with the merger agreement. RJN, Ex. B.

By October 4, 2006, WatchGuard's shareholders had approved the merger on the terms of FP's $4.25 offer. Plaintiff admits that 72.64% of WatchGuard's shareholders voted for the merger, more than the two-thirds majority that WatchGuard's articles of incorporation required. Pltf.'s Opp'n at 17-18 & n.14.

B. Plaintiff's Claims for Breach of Fiduciary Duty

Plaintiff alleges that, in their conduct leading up to FP's successful bid and in their actions taken to protect FP's bid, the Directors breached their fiduciary duties. Some allegations describe the Directors' failure to encourage or pursue acquisition possibilities. *E.g.*, ¶ 40 (describing failure to engage Vector in negotiations after its initial expression of interest in February 2006); ¶ 45 (describing failure to engage in "competent, responsible, fair and open negotiations to sell the Company"); ¶¶ 47-49 (alleging failure to use Vector's May 2006 $5.10 per share bid to ensure higher acquisition price); ¶ 56 (alleging that Directors encouraged or failed to prevent Vector and FP's lower bids). Some allegations focus on the Directors' conflicts of interest. *E.g.*, ¶ 33 (stating that Directors enacted the poison pill to protect their positions at WatchGuard); Pltf.'s Opp'n at 8 (describing benefits including accelerated stock option vesting, severance pay agreements, and insurance coverage accruing to Directors in merger). There are allegations that the Directors failed to disclose material information to shareholders. *E.g.*, ¶ 38 (criticizing Directors for not immediately disclosing Vector's February 2006 expression of interest); ¶ 50 (alleging a failure to disclose why Vector and FP reduced their bids); ¶¶ 57-60 (claiming that Directors lied about support agreements executed to protect FP's bid). Other allegations sound in bad faith or fraud. *E.g.*, ¶ 38 (claiming that

Directors hid the Vector offer from the public to help ensure shareholder ratification of the poison pill); ¶ 61 (alleging that Directors accepted FP offer to hide non-public information that would make them personally liable).

III. DISCUSSION

The Directors seek to dispose of Plaintiff's fiduciary duty claims on a motion to dismiss under Fed. R. Civ. P. 12(b)(6).

A. Standard of Review on a Motion to Dismiss

Where a defendant contends that a claim's factual allegations are insufficient to state a claim, the court's review varies depending on which pleading standard applies. Ordinarily, the court reviews factual allegations under the liberal pleading standard of Fed. R. Civ. P. 8(a), construing all allegations in the light most favorable to the non-moving party. *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005). The court must accept all well-pleaded facts as true and draw all reasonable inferences in favor of the plaintiff. *Wyler Summit P'ship v. Turner Broad. Sys., Inc.*, 135 F.3d 658, 661 (9th Cir. 1998). A complaint need not contain detailed factual allegations, but it must provide the grounds for entitlement to relief and not merely a "formulaic recitation" of the elements of a cause of action. *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955, 1964-65 (2007). Plaintiffs must allege "enough facts to state a claim to relief that is plausible on its face." *Id.* at 1974.

The court's review of the record on a Rule 12(b)(6) motion is generally limited to the complaint itself. *Marder v. Lopez*, 450 F.3d 445, 448 (9th Cir. 2006). The court may, however, consider evidence on which the complaint necessarily relies as long as "(1) the complaint refers to the document; (2) the document is central to the plaintiff's claim; and (3) no party questions the authenticity of the copy attached to the 12(b)(6) motion." *Id.* The court may also rely on facts subject to judicial notice. *United States v.*

Ritchie, 342 F.3d 903, 908 (9th Cir. 2003). Finally, the court may consider a plaintiff's clarifications in briefing and at oral argument. *Pegram v. Herdrich*, 530 U.S. 211, 230 n.10 ("[A court] may use [plaintiff's] brief to clarify allegations in [the] complaint whose meaning is unclear."); *see id.* (citing *Alicke v. MCI Commc'ns Corp.*, 111 F.3d 909, 911 (D.C. Cir. 1997), in which court relied on statements in oral argument to clarify complaint).

For allegations that sound in fraud, a plaintiff must meet the heightened pleading standard of Fed. R. Civ. P. 9(b).[3] *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1104-05 (9th Cir. 2003). The plaintiff must provide allegations that are specific enough to explain what about the defendant's conduct is false or misleading such that the defendant can formulate a specific denial. *Id.* at 1106.

Alternatively, where a defendant successfully challenges a plaintiff's legal theory, rather than the sufficiency of the plaintiff's allegations, the court must also dismiss the complaint. *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1990) ("Dismissal can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory.").

B. Plaintiff Fails to State a Claim for Breach of Fiduciary Duty.

The allegations in Plaintiff's complaint are intended to state a claim for breach of the Directors' fiduciary duties. Because WatchGuard was incorporated in Delaware, Delaware law defines the Directors' duties. *Davis & Cox v. Summa Corp.*, 751 F.2d 1507, 1527 (9th Cir. 1985). Delaware imposes three fiduciary duties on corporate directors: the duty of loyalty, the duty of good faith, and the duty of care. *In re Lukens,*

[3]The Directors urge the court to broadly construe all of Plaintiff's breach-of-duty allegations as sounding in fraud. Most of the allegations however, are equally consistent with negligence or gross negligence. Rule 9(b) therefore has limited application to this motion.

Inc. S'holders Litig., 757 A.2d 720, 731 (Del. Ch. 1999); *Malpiede v. Townson*, 780 A.2d 1075, 1083-84 (Del. 2001). The duty of loyalty is a mandate "that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally." *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993). A breach of the duty of good faith is either action taken with subjective intent to harm the corporation, or action akin to an intentional dereliction of duty or a conscious disregard for a director's responsibilities. *See Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 62-67 (Del. 2006) (affirming trial court's definition of good faith). Negligent actions, even grossly negligent actions, do not implicate the duty of good faith, but rather the duty of care. *Id.* at 64-65.

The court's analysis of the sufficiency of Plaintiff's breach-of-duty allegations will consist primarily of determining the effect of two legal protections on which the Directors rely: the liability-limiting clause in WatchGuard's articles of incorporation authorized under 8 Del. C. ¶102(b)(7), and the doctrine of shareholder ratification. Three preliminary observations give context to this analysis.

First, Plaintiff does not question that it was appropriate for the Directors to put WatchGuard up for sale. This case, therefore, is not about whether WatchGuard should have been sold; it is about whether it was sold too cheaply. For that reason, Plaintiff's allegations regarding the poison pill that was in effect from May 2005 to May 2006 are difficult to bind in a cohesive legal theory. Plaintiff admits that despite the poison pill, "by the end of 2005, the Directors came to believe that it was an opportune time to sell WatchGuard and solicit offers . . . ." ¶ 32. There is no allegation that the poison pill deterred any suitor while it was in effect. The poison pill would only have affected potential acquirors who came forward with proposals that the Directors then rejected.

There is no allegation that the Directors received, much less rejected, any proposal. There is therefore no basis to infer that adopting the poison pill breached any fiduciary duty.

Second, the claim that the Directors had a pecuniary interest in failing to obtain the highest acquisition price for WatchGuard is without merit. As Plaintiff admits, the Directors collectively owned 5.8% of WatchGuard's stock, and stood to own more after accounting for stock options and other interests. Pltf.'s Opp'n at 18 n.14. Any increase in acquisition price would benefit the Directors, thus aligning their interests with all shareholders. *In re LNR Prop. Corp. S'holders Litig.*, 896 A.2d 169, 175 n.36 (Del. Ch. 2005) (noting that improper interest arises only where director stands to gain a benefit not accruing to all shareholders). By contrast, every financial benefit accruing to the Directors in the merger was either unaffected by the merger price, or increased as the merger price increased. One Director allegedly had an employment contract that paid him 200% of his salary on termination, but that benefit would have accrued to him in any merger. Pltf.'s Opp'n at 5 (citing proxy statement); RJN, Ex. B at 40-41 (stating that severance accrued in any change-of-control transaction).[4] Every Director had stock options and other stock interests in WatchGuard that vested immediately upon consummation of the merger, but again, any merger would have conferred that benefit.

[4]The employment contract and its severance provisions are not before the court. There is no allegation, however, that the proxy statement's description of the severance benefits as accruing in any change-of-control transaction is inaccurate.

RJN (filed Mar. 15, 2007), Exs. C-E.[5] Moreover, the Directors' profit from exercising stock options would increase with the acquisition price. *See Krim v. Pronet, Inc.*, 744 A.2d 523, 528 n.16 (noting that directors' stock options create no conflict of interest). Every Director received ongoing insurance coverage for their acts on behalf of WatchGuard, but Plaintiff does not allege that this benefit was unique to the FP merger. *See Grover v. Simmons (In re Sea-Land Corp. Shareholders Litig.)*, 642 A.2d 792, 804-805 (noting that director indemnification is ordinary incident of corporate transaction). As previously noted, Plaintiff does not allege that it was inappropriate to put WatchGuard up for sale. It thus cannot allege a conflict of interest by relying solely upon benefits that would have accrued to the Directors in any acquisition. The court finds no basis for a reasonable inference that financial considerations gave any Director a conflict of interest.[6]

These first two observations – that the Directors appropriately wanted to sell WatchGuard and that their pecuniary interest was in obtaining the highest price – lead to a third observation: if the Directors did not obtain the best price, it was either because they were incompetent, acting in bad faith, or motivated by the desire to protect interests that were not pecuniary, even at great expense to themselves. Any other inference is not consistent with the Complaint.

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[5]By virtue of its repeated reliance on the portions of the proxy statement providing for accelerated stock option vesting, the Complaint incorporates the stock agreements on which those statements are based. There is no allegation that the stock agreements are not authentic, or that they misstate the terms of the Directors' stock option grants.

[6]Plaintiff also raises a cursory challenge to the Directors' collective independence. Pltf.'s Opp'n at 13. Independence questions arise where one director's self-interest infects the entire board's decisions. *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 363-366 (Del. 1993) (differentiating independence from disloyalty generally). Plaintiff's allegations give rise to no inference that the Directors lacked independence, because there is no allegation that any single Director had self-interest materially different than all other Directors.

1. The Statutory Liability Limitation in WatchGuard's Articles of Incorporation Is Fatal to Plaintiff's Duty-of-Care Claims.

To the extent that Plaintiff has pleaded breaches of the Directors' duty of care, a claim that would encompass negligence and gross negligence, the Directors are not liable. WatchGuard's articles of incorporation contain a measure eliminating, to the extent that Delaware law permits, the Directors' liability for any breach of fiduciary duty. RJN, Ex. J. at Art. 10. Delaware law, in turn, permits a corporation to bar directorial liability for breaches of the duty of care, but not other fiduciary duties. 8 Del. Code § 102(b)(7); *Malpeide v. Townson*, 780 A.2d 1075, 1095 (Del. 2001). The effect of the § 102(b)(7) bar is to eliminate liability for all breaches of the duty of care, including negligence and gross negligence. *Brehm*, 906 A.2d at 64-65 (holding that gross negligence is a breach of duty of care, not duty of good faith).

Plaintiff's effort to prevent the court from applying the § 102(b)(7) bar is unavailing. First, contrary to Plaintiff's assertion, the Directors may invoke the § 102(b)(7) bar on a motion to dismiss. *See Malpeide*, 780 A.2d at 1091-92; *Lukens*, 757 A.2d at 732-34; *In re Sagent Tech., Inc. Deriv. Litig.*, 278 F. Supp. 2d 1079, 1095 n.9 (N.D. Cal. 2003) ("Contrary to plaintiffs' argument, it is not improper for the court to consider the effect of a § 102(b)(7) exculpatory provision on a 12(b)(6) motion to dismiss."); *Continuing Creditors' Comm. of Star Telecommc'ns. Inc. v. Edgecomb*, 385 F. Supp. 2d 449, 466 n.14 (D. Del. 2004). Second, the court finds no merit in Plaintiff's allegation that Defendant Borey remains liable because he was WatchGuard's chief executive officer as well as a Director. Although a § 102(b)(7) bar does not extend to the acts of corporate officers, the actions at issue in this case, negotiating and consummating a sale of the company, are within the sole authority of the board of directors. *See* 8 Del. C. §§ 251-258. Plaintiff states no claim against Mr. Borey in his capacity as an officer.

Third, the Complaint gives the court no basis to question whether WatchGuard's shareholders approved the § 102(b)(7) bar. *See Williams v. Geier*, 671 A.2d 1368, 1381 (Del. 1996) (noting shareholder approval requirement). Absent such an allegation, there is no reasonable inference that WatchGuard's § 102(b)(7) bar is invalid.[7]

Because of the § 102(b)(7) bar, the court dismisses Plaintiff's claims to the extent they state claims for breaches of the duty of care – including negligence and gross negligence. If Plaintiff is to withstand this motion to dismiss, therefore, it must state claims for a breach of the duties of good faith or loyalty. The court has come up emptyhanded in searching the Complaint for allegations supporting an inference of bad faith or disloyalty. The observations of a Delaware court seem particularly apt here.

> [W]hile the complaint is replete with assertions that the defendant directors' actions were unreasonable, imprudent, or inappropriate, it contains precious few allegations bearing on the improper motivations the defendant directors had for intentionally or in bad faith conducting a less than professional search for the best value for [the company].

See McMillan v. Intercargo Corp., 768 A.2d 492, 499 (Del. Ch. 2000) (dismissing complaint). The court need not, however, describe in depth the lack of allegations supporting bad faith or disloyalty, because the doctrine of shareholder ratification provides an independent basis for dismissing Plaintiff's bad faith and disloyalty claims.

2. The Shareholder Vote in Favor of the Merger Requires Dismissal of Plaintiff's Other Breach-of-Duty Claims.

Under Delaware law, WatchGuard's shareholders' vote in favor of the FP merger protects the Directors from claims that they breached their fiduciary duties. *Gottlieb v. Heyden Chem. Corp.*, 91 A.2d 57, 59 (Del. 1952) ("[T]he entire atmosphere is freshened

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[7] If Plaintiff has a good faith belief that WatchGuard's § 102(b)(7) bar is invalid, it should state allegations supporting that belief in an amended complaint. If appropriate, the court would then consider a motion seeking "[v]ery limited discovery" on the adoption of the § 102(b)(7) bar. *See Boeing Co. v. Shrontz*, Civ. No. 11,273, 1992 Del. Ch. LEXIS 84, at *10-11 (Del. Ch. 1992).

and a new set of rules invoked where formal approval has been given by a majority of independent, fully informed stockholders.”). Shareholder ratification of a challenged transaction extinguishes claims against a corporate board for breach of its duty of care.[8] *In re Wheelabrator Techs. S’holders Litig.*, 663 A.2d 1194, 1200 (Del. Ch. 1995). As for claims of breach of the duties of loyalty and good faith, ratification cloaks a transaction in the protection of the business judgment rule. *Wheelabrator*, 663 A.2d at 1205; *Gottlieb*, 91 A.2d at 58 (discussing duty of good faith); *Marciano v. Nakash*, 535 A.2d 400, 405 n.3 (Del. 1987). The business judgment rule is a presumption of propriety that a plaintiff can overcome, in the context of a merger, only by pleading waste of corporate assets. *Solomon v. Armstrong*, 747 A.2d 1098, 1117 (Del. Ch. 1999), *In re Gen. Motors Class H S’holders Litig.*, 734 A.2d 611, 616 (Del. Ch. 1999); *Marciano*, 535 A.2d at 405 n.3.

Depending on the circumstances, invoking the ratification doctrine requires various preliminary showings. Where directors face a claim that some shareholders voting in favor of the merger had a conflict of interest, then the directors must show that a majority of disinterested shareholders approved the transaction. *Solomon*, 747 A.2d at 1115; *Wheelabrator*, 663 A.2d at 1203 (citing 8 Del. C. § 144(a)(2)). Where a plaintiff alleges that incomplete or misleading disclosures tainted the shareholder vote, the directors must show that the vote was fully informed and not coercive. *Solomon*, 747 A.2d at 1127. Practically speaking, a plaintiff must identify omissions or misrepresentations that tainted the shareholder vote. *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 890 n.36 (Del. Ch. 1999); *Solomon*, 747 A.2d at 1127 (“[P]laintiffs may

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[8]In light of the § 102(b)(7) bar applicable in this action, the court need not consider the effect of shareholder ratification on Plaintiff’s claim that the Directors breached their duty of care. The court notes, however, that ratification likely provides an independent basis for dismissing Plaintiff’s duty of care claims.

defeat the business judgment rule's presumptions . . . by alleging materially false or misleading statements in the disclosure statements on which the vote was predicated.").

a. A Two-Thirds Supermajority of Disinterested Shareholders Approved the Merger.

The court begins the ratification inquiry by finding that a majority of disinterested shares were voted in favor of the WatchGuard merger. Plaintiff admits that, consistent with the proxy statement, the Directors collectively owned 5.8% of WatchGuard stock, and Vector owned 9.4%. Pltf.'s Opp'n at 18 n.14. The merger required approval by two thirds of voting shares; and it passed with 72.64% of the vote. *Id.* Plaintiff alleges that the Directors and Vector had a conflict of interest, and that their collective 14.2% voting bloc was interested. Even assuming that the allegation of conflicted interest is plausible, more than two thirds of disinterested shares were cast for the merger. Disinterested shareholders held 84.8% of WatchGuard stock. To leap the numerical hurdle for ratification, only two thirds *of those disinterested shares* needed to be cast in favor of the merger.[9] Two thirds of the 84.8% bloc of disinterested shares is 56.0% of all shares. Subtracting the 15.2% of allegedly interested shares from the 72.64% of shares cast for the merger, disinterested owners holding 57.44% of all shares voted for the merger, more than the 56.0% that constitutes a two-thirds majority of disinterested shares in this case.

b. The Proxy Statement Fully Disclosed All Material Information About the Merger, and Was Not Coercive.

The court must now determine whether material nondisclosures or misdisclosures clouded the vote in favor of the merger. To determine what was disclosed to

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[9]Plaintiff errs in calculating the proportion of disinterested shares cast in favor of the merger by subtracting the percentage of allegedly interested shares from the total percentage of votes in favor of the merger. Pltf.'s Opp'n at 18 n.14. There is no requirement that disinterested shares cast in favor of the merger make up a supermajority of all shares cast, only that the disinterested shares make up a supermajority of all *disinterested* shares voting on the merger.

shareholders, the court may properly rely upon WatchGuard's proxy statement. *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 70 (Del. 1995); *Harbor Fin.*, 751 A.2d at 890. A comparison of disclosures in the proxy statement to the alleged misstatements shows that Plaintiff fails to allege facts to create a reasonable inference of a material misstatement or omission.

Plaintiff alleges that Defendant Borey misinformed shareholders when he stated, during a July 25, 2006 public conference call announcing the FP merger, that the Directors would follow their fiduciary duties if WatchGuard received a topping bid. ¶¶ 57-58. Plaintiff claims that Mr. Borey failed to disclose that the support agreements that each Director had signed were inconsistent with his statements. The proxy statement discloses the existence of the support agreements and summarizes their contents. RJN Ex. B at 18, 59-60. Those disclosures are consistent with Mr. Borey's statements. The support agreements themselves, which Plaintiff refers to in the Complaint and whose authenticity is not in dispute, allowed the Directors to consider other offers (RJN, Ex. H at p.3 § 4), and contained a "fiduciary out" clause acknowledging that the Directors retained their fiduciary responsibilities to WatchGuard (RJN, Ex. H at p.5 § 9). The Complaint raises no reasonable inference that the Directors misrepresented their ability to respond to competing offers or misrepresented the contents of the support agreements.

Plaintiff fares no better with allegations that the Directors failed to disclose why the merger price dropped from an initial bid of at least $5.00 per share to the final $4.25 price. *E.g.*, ¶ 50 ("[P]roxy materials provide no explanation as to the Directors [sic] failure to accept the [higher] offer, whether it was withdrawn, or why."); Pltf.'s Opp'n at 11 ("[Directors] have put forth no plausible explanation – or any explanation – as to why the consideration for WatchGuard decreased, or why they chose to accept it."). The proxy statement discloses every bid that the Directors received in the acquisition process.

The Directors have no duty to explain why the bids dropped, or why they chose to accept or reject them. *See Malpeide*, 780 A.2d at 1087 (holding that board's disclosure of bid price "renders immaterial as a matter of law any misstatement about the rationale of [the board] for rejecting the bid"); *Lukens*, 757 A.2d at 736 ("[I]t is not enough simply to pose questions that are not answered in the proxy statement."). The Directors have no obligation to explain the basis for their decisions, they need only disclose what occurred during the acquisition process. *Lukens*, 757 A.2d at 736 (noting that directors need not explain why they "did not take other steps or follow another process"). Moreover, the Complaint provides no basis for the court to infer that the Directors knew why the bid prices dropped as the acquisition process progressed. *See Malpeide*, 780 A.2d at 1088 (rejecting nondisclosure allegation when court could not infer "that the board was aware of the reasons" for an event).

In its opposition briefing, Plaintiff points to no other misdisclosures or nondisclosures that allegedly tainted the shareholder vote. Nonetheless, the court has reviewed the Complaint, and finds no allegation that raises a reasonable inference that the Directors failed to accurately disclose material information in the proxy statement. For every offer or expression of interest in acquiring WatchGuard that Plaintiff alleges in the Complaint, there is a corresponding disclosure in the proxy statement. *Compare* ¶¶ 34, 36, 46-47, 50 *with* RJN Ex. B at 20-28. Plaintiff's allegation that the Directors failed to disclose that "$60 million of [the merger consideration] would be contributed by WatchGuard," ¶ 62, is baldly false, as the proxy statement reveals. RJN, Ex. B at A-4 ("Immediately prior to the Effective Time, the Company shall deposit $60 million in cash . . . with the Paying Agent."). Plaintiff also alleges that the Directors accepted the FP offer because they wanted to ensure that material, non-public information about WatchGuard remained hidden to avoid personal liability. ¶ 61. This is no mere allegation of nondisclosure; it is an allegation of fraud. As such, it must meet the heightened pleading standards of Fed. R. Civ. P. 9(b). It does not, because Plaintiff's allegations provide no detail regarding what the Directors were hiding.

To conclude its determination that the shareholder ratification doctrine applies, the court finds that the Complaint raises no reasonable inference that the proxy statement or circumstances surrounding the merger vote were coercive. Such an allegation would have to raise a reasonable inference that circumstances "caus[ed] the stockholders to vote in favor of the proposed transaction for some reason other than the merits of that transaction." *Williams*, 671 A.2d at 1382-83. There are no allegations that give rise to an inference of coercion here.

Having established that a majority of WatchGuard's shareholders approved the merger agreement after receiving complete and non-coercive disclosures, the court concludes that the doctrine of shareholder ratification applies. The business judgment rule thus insulates the Directors' conduct in the merger process, and the burden shifts to Plaintiff to allege that the merger constituted a waste of corporate assets.

c. Plaintiff Has Not Pleaded a Claim for Waste.

To plead waste, a plaintiff must "allege facts showing that no person of ordinary sound business judgment could view the benefits received in the transaction as a fair exchange for the consideration paid . . . ." *Harbor Fin.*, 751 A.2d at 892 (Del. Ch. 1999) (internal citations and quotations omitted). If the complaint raises an inference under which "any reasonable person might conclude that the deal made sense, then the judicial inquiry ends." *Id.* (citation omitted); *see also Brehm*, 906 A.2d at 74 ("A claim of waste will arise only in the rare, unconscionable case where directors irrationally squander or give away corporate assets.") (internal quotation omitted).

The court finds no allegations in the Complaint that raise a reasonable inference of waste. Plaintiff points repeatedly to the declining bids for WatchGuard as evidence that WatchGuard was given away on the cheap. These higher bids, however, came from FP and Vector, the same entities who were ultimately unwilling to pay a higher price. There is no allegation that another bidder offered a higher price for WatchGuard, nor that another bidder showed interest after WatchGuard accepted FP's offer.[10] The reasonable inference is that the Directors would have preferred a higher price, but that none was forthcoming. Under these circumstances, the reasonable inference is that the $4.25 per share price was the highest anyone was willing to pay for WatchGuard. There is no reasonable inference that the Directors' acceptance of that price was irrational, and therefore no well-pleaded waste claim.

Plaintiff's waste claim relies largely on the assertion of legal conclusions. Plaintiff cites the decision in *Parnes v. Bally Entm't Corp.*, where the court found that the plaintiff's complaint rebutted the business judgment presumption because it raised the inference that the challenged merger was "so far beyond the bounds of reasonable judgment that it seem[ed] essentially inexplicable on any ground other than bad faith." 722 A.2d 1243, 1246 (Del. 1999). Plaintiff parrots the "essentially inexplicable" language throughout its opposition, but the allegations of its complaint provide no support for this legal conclusion. *Twombly*, 127 S.Ct. at 1965 (pleading "requires more than labels and conclusions" and "courts are not bound to accept as true a legal conclusion

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[10]Although the Complaint is silent as to whether there were any expressions of interest in WatchGuard after the announcement of the proposed FP merger, Plaintiff's briefing contains the allegation that the proxy solicitation reveals that after FP's $4.25 per share bid, "Vector repeatedly requested the Board for an opportunity to make a higher competing bid." Pltf.'s Opp'n at 16 n.13. In actuality, the proxy statement discloses only a single expression of interest, which came just before the announcement of the proposed FP merger. RJN Ex. B. at 31. There is no indication that Vector expressed interest after the announcement.

couched as a factual allegation") (citation omitted). In *Parnes*, the allegations showed that a controlling director demanded bribes for himself before recommending the merger. 722 A.2d at 1246-47. Plaintiff makes no allegations of similarly outrageous conduct, and thus raises no inference of waste.

d. In This Case, Ratification Defeats Plaintiff's Claim for Enhanced Judicial Scrutiny.

Finally, the court rejects Plaintiff's argument that it should apply enhanced judicial scrutiny to the Directors' conduct. Plaintiff invokes the Directors' so-called "*Revlon*" duties. These are not separate duties, but rather an acknowledgment of the need for heightened scrutiny of a board's "performance of [its] duties of care, good faith, and loyalty in the unique factual circumstance of a sale of control over the corporate enterprise." *Lukens*, 757 A.2d at 731.

Under the facts alleged here, the shareholder vote in favor of the FP merger obviates the need for enhanced judicial scrutiny. There are no allegations that the Directors failed to act on a competing acquisition proposal because of protective measures that they took. There is no allegation that the poison pill frustrated any bidder, and there is no allegation that the support agreements or the termination fee prevented any higher bid. Where defensive or protective measures have frustrated a competing proposal, effectively placing the competing proposal beyond a shareholder vote, at least one court has found that shareholder ratification of the board-preferred proposal does not extinguish *Revlon* claims. *Santa Fe*, 669 A.2d 59 at 68. In a case like this one, however, where there is no allegation that the support agreements or any other measure taken to protect the merger kept other offers from being considered, the shareholder vote insulates the defensive measures as well. *Lukens*, 757 A.2d at 737 (extending ratification to defensive measures where "there was an active bidding process [and] no measures precluded any participant from bidding"); *see also Edgecomb*, 385 F. Supp. 2d at 466 n.14 (distinguishing *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1286 (Del. 1989)). The shareholder vote in favor of the FP merger cloaks the Directors' defensive measures in the protection of the business judgment rule, and as the court has already noted, Plaintiff's allegations do not overcome that protection.

Although there is no need for enhanced judicial scrutiny in this case, the court notes that the protective measures in this case differ substantially from those that have been found improper. Most significantly, the support agreements contained a "fiduciary out" clause that permitted the Directors to consider competing acquisition offers to the extent necessary to fulfill their fiduciary duties. *Cf. Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003) (enjoining merger where defensive measures had no fiduciary out clause); *see also H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129, 152 (Del. Ch. 2003) (dismissing complaint, finding "nothing improper" about support agreements requiring directors to cast their shares in favor of merger). The so-called "no-shop" provision protecting the FP merger is also unobjectionable. *McMillan*, 768 A.2d at 506 & n.63 (dismissing complaint, noting that no-shop provision does not breach directors' duties). As to the termination fee, Plaintiff admits that it was equivalent to a mere 4% of the merger consideration. To make an offer more favorable than FP's $4.25 per share offer, a rival bidder would have needed to top it by only 17 cents per share. *See McMillan*, 768 A.2d at 505 (granting motion to dismiss, noting that "it is difficult to see how a 3.5% fee would have deterred a rival bidder"). Termination fees up to 5% are presumptively reasonable, *Kysor Indus. Corp. v. Margaux, Inc.*, 674 A.2d 889, 897 (Del. Super. Ct. 1996), and there are no allegations that warrant a different conclusion here.

IV. CONCLUSION

For the reasons stated above, the court GRANTS the Directors' motions to dismiss Dkt. # 71. The court will grant Plaintiff leave to amend its complaint, but directs that the

Plaintiff prepare no amendment until the court resolves the last of the motions to dismiss pending in this matter. At that time, the court will provide specific instructions on amending the complaint.[11]

Dated this 13th day of February, 2008.

The Honorable Richard A. Jones
United States District Judge

[11]On February 11, 2008, the first court day following oral argument in this matter, Plaintiff submitted a supplemental request for judicial notice (Dkt. # 103). The court denies Plaintiff's request, as the document attached to it, an e-mail purporting to be from a former WatchGuard executive, is not a proper subject for judicial notice.