

Legal Updates & News

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Delaware Court Issues Ruling in Backdating Case

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Chancellor Chandler of the Delaware Court of Chancery yesterday issued an opinion denying motions to stay and to dismiss a derivative action involving alleged options backdating at Maxim Integrated Products, Inc. *Ryan v. Gifford*, No. 221-N (Del. Ch. Feb. 6, 2007). The decision addresses many issues likely to recur in other backdating cases, though the Court limited its holding to the “unique facts” of the case.

The case arose shortly after Merrill Lynch published an analysis pointing out the “fortuitously timed stock option grants” made to Maxim executives. Suits on behalf of Maxim were then filed in federal court, California state court, and Delaware Chancery Court. In the Delaware suit filed in 2006, plaintiff named four current and two former members of the board, as defendants, claiming that they had breached their fiduciary duties of due care and loyalty.

The Court first rejected defendants’ motion to stay the Delaware action in favor of the earlier filed federal case. (A California state court had already stayed the California action.) The Court found that “novel and substantial issues of Delaware corporate law are best resolved in Delaware courts.” The Court also found that the existence of the parallel federal action did not justify a stay on forum non conveniens grounds.

The Court also rejected defendants’ motion to dismiss for failure to allege demand futility with particularity. At the time the complaint was filed, Maxim had a six-person board. Three of the six board members were on the Compensation Committee that awarded the alleged backdated options. The Court found that plaintiff had sufficiently alleged that the Compensation Committee’s actions in knowingly approving backdated options did not come within the business judgment rule. In so ruling, the Court took into account statistical data suggesting that the options had been backdated. The Court also presumed that the directors granting the options knew the “actual” date on which the options had been granted.

For similar reasons, the Court rejected the motion to dismiss for failure to state a claim, finding that where a plaintiff “alleges particularized facts sufficient to prove demand futility under the second prong of *Aronson* [that is, where the alleged wrongdoing is not protected by the business judgment rule] that plaintiff *a fortiori* rebuts the business judgment rule for the purpose of surviving a motion to dismiss pursuant to Rule 12(b)(6).”

The Court made two other significant rulings. It rejected defendants’ statute of limitations defense, finding that the running of the statute had been tolled while the company’s disclosures about its options granting practices were inaccurate.

The Court did, however, strictly enforce the rule that a plaintiff must own shares of the company from the time of the transaction in question to the completion of the lawsuit. As plaintiff in this case did not become an owner of Maxim shares until April 11, 2001, all claims based on transactions before that date were dismissed.

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