

United States District Court
For the Northern District of California

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

)	Case No.: 5:10-cv-3608 EJD
IN RE HP DERIVATIVE LITIGATION)	ORDER GRANTING MOTIONS TO DISMISS
)	(Re: Docket Nos. 99, 102, 103)
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Presently before the court are three motions filed by Defendants to dismiss Plaintiffs Louis Levine, Teamster Union Local # 142 Pension Trust, Key West Police & Fire Pension Fund, and Louisiana Municipal Police Employees Retirement System’s (collectively, “Plaintiffs”) complaint. Defendants are Marc L. Andreessen, Lawrence T. Babbio (“Babbio”), Sari M. Bauldauf (“Bauldauf”), Rajiv L. Gupta (“Gupta”), John H. Hammergren (“Hammergren”), Mark V. Hurd (“Hurd”), Joel Z. Hyatt (“Hyatt”), John R. Joyce (“Joyce”), Robert L. Ryan (“Ryan”), Lucille S. Salhany (“Salhany”), G. Kennedy Thompson (“Thompson”), and Nominal Defendant Hewlett-Packard Company (“HP”).

For the reasons discussed below, Defendants' motions to dismiss will be granted with leave to amend.

I. BACKGROUND

1
2 This is a shareholders' derivative action suit brought for the benefit of HP against Hurd,
3 HP's former Chief Executive Officer ("CEO"), and the members of HP's Board of Directors (the
4 "Board" or the "Directors"). See Consolidated Verified Shareholder Derivative Complaint
5 ("Consolidated Complaint"), Docket No. 60. According to the Consolidated Complaint, Plaintiffs
6 are shareholders of HP and were shareholders at the time of the alleged wrongdoing. *Id.* ¶¶ 8-11.
7 HP is a Delaware corporation, headquartered in Palo Alto, California, which provides technology
8 solutions to consumers, businesses, and institutions globally. *Id.* ¶ 12. Hurd, a citizen of California,
9 served as HP's Chairman of the Board and CEO until his resignation on August 6, 2010. *Id.* ¶ 13.
10 The ten individually named defendants are directors of HP. *Id.* ¶¶ 14-23. The Consolidated
11 Complaint alleges the following facts:

12 Hurd and the other members of the Board, particularly the members of the HR and
13 Compensation Committee (Babbio, Gupta, Hammergren, Hyatt, and Salhany) knew that Hurd's
14 Employment Agreement had expired on March 29, 2009 and had not been renewed or extended. *Id.*
15 ¶ 39. Nevertheless, on January 27, 2010, the Board filed with the SEC and disseminated to HP
16 shareholders the 2010 Proxy Statement, which falsely represented several times that Hurd's
17 Employment Agreement was still valid and in effect. *Id.* ¶ 39-40. These misstatements were
18 material to shareholders' votes on, among other things, the election of Hurd for another term as
19 HP's director and the approval of the Stock Incentive Plan, pursuant to which the Board sought and
20 received authority to issue additional shares of stock for use in compensating HP's officers,
21 directors, and employees, including Hurd. *Id.* ¶ 41.

22 In May 2010, HP received allegations that Hurd engaged in misconduct. *Id.* ¶ 48. Jodie
23 Fisher, a former independent contractor at HP, claimed through her attorney that Hurd had sexually
24 harassed her and which exposed Hurd and HP to liability. *Id.* ¶ 48. HP's Board initiated and
25 oversaw a formal investigation upon learning of the charges. *Id.* ¶ 49. The investigation concluded
26 that Hurd had violated HP's Standards of Business Conduct. *Id.* ¶ 51. Specifically, the investigation
27 found that Hurd had a close personal relationship with Ms. Fisher; that Hurd failed to disclose that
28 relationship to the Board of Directors; and that there were numerous instances where Hurd

1 submitted inaccurate expense reports that were intended to conceal or had the effect of concealing
2 Hurd's personal relationship with Ms. Fisher. Id. ¶ 50.

3 On August 6, 2010, HP announced that Hurd had resigned his positions as HP's Chairman,
4 CEO, and President, and that Hurd and HP had entered into a Separation Agreement and Release
5 (the "Separation Agreement"). Id. ¶ 54; Decl. of Brian Danitz Ex. H, Docket No. 100-8. Under the
6 terms of the Separation Agreement, Hurd was entitled to receive a cash severance payment and
7 non-severance elements consisting of certain limited rights to previously granted equity awards.
8 Consol Compl. ¶ 54. The Separation Agreement granted Hurd:

- 9 • a "Separation Amount" of \$12,224,693 in cash;
- 10 • the right to exercise each of the outstanding stock options to acquire Company common
11 stock that is vested and exercisable by Hurd during the Company's next open trading
12 window, tentatively scheduled to commence August 23, 2010 and end September 7, 2010,
13 in accordance with the terms of the Company's 2004 Stock Incentive Plan;
- 14 • the right to pro-rata vesting and settlement, at the same time and on the same terms as other
15 HP employees, of 330,177 performance-based restricted stock units granted to Hurd on
16 January 17, 2008 based on actual HP performance during the three-year performance period
17 ending on October 31, 2010;
- 18 • the right to settlement on December 11, 2010 of 15,853 time-based restricted stock units
19 granted to Hurd on December 11, 2009 at a price equal to the lesser of (a) the closing price
20 of HP's common stock on August 6, 2010 or (b) the per share closing trading price of HP
21 common stock on December 11, 2010;
- 22 • Hurd's unpaid base salary accrued up to the Separation Date; and
- 23 • vested amounts payable to Hurd under the Company's 401K plan.

24 Id. ¶ 54; Danitz Decl. Ex. H, Docket No. 100-8.

25 On September 6, 2010, Oracle announced that Hurd had joined Oracle as President and was
26 to be named to Oracle's Board of Directors. Consol. Compl. ¶ 58. On September 7, 2010, HP filed
27 an action against Hurd asserting claims for breach of contract and threatened misappropriation of
28 trade secrets in connection with Hurd's employment at Oracle. Id. ¶ 61. On September 20, 2010, HP
announced that it had resolved the HP/Hurd Action. As part of that resolution, Hurd agreed to
forfeit his right to the 346,030 shares of HP stock that were included in the separation package. Id.

Plaintiffs allege that the Board had committed waste or otherwise breached its duties to HP by
approving the Separation Agreement. Count I alleges that the Directors wasted corporate assets by

1 approving the Separation Agreement. *Id.* ¶¶ 80-82. Count II alleges that the Directors “breached
2 their fiduciary duties of loyalty and good faith by awarding [Hurd] excessive and unwarranted
3 severance payments and benefits, and by knowingly failing to inform themselves regarding all
4 material information in making that decision.” *Id.* ¶¶ 83-86. Count III asserts an unjust enrichment
5 claim against Hurd. *Id.* ¶¶ 87-89. Count IV alleges that all defendants breached their fiduciary
6 duties of loyalty and good faith by filing false and misleading statements regarding Hurd’s
7 Employment Agreement in HP’s 2010 Proxy Statement. *Id.* ¶¶ 90-93. Count V alleges a similar
8 claim under Section 14(a) of the Securities Exchange Act. *Id.* ¶¶ 94-98.

9 **II. LEGAL STANDARD**

10 **A. Motion To Dismiss**

11 Under Federal Rule of Civil Procedure 12(b)(6), a complaint may be dismissed if it fails to
12 state a claim upon which relief can be granted. “To survive a motion to dismiss, a complaint must
13 contain sufficient factual matter, accepted as true, ‘to state a claim to relief that is plausible on its
14 face.’” *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1949 (2009) (internal citations omitted). “A claim has
15 facial plausibility when the plaintiff pleads factual content that allows the court to draw the
16 reasonable inference that the defendant is liable for the misconduct alleged.” *Id.* Recitals of the
17 elements of a cause of action and conclusory allegations are insufficient. *Id.*

18 Federal Rule of Civil Procedure 8(a) requires a plaintiff to plead each claim with sufficient
19 specificity to “give the defendant fair notice of what the . . . claim is and the grounds upon which it
20 rests.” *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (internal quotations omitted).
21 Moreover, the factual allegations “must be enough to raise a right to relief above the speculative
22 level” such that the claim “is plausible on its face.” *Id.* at 555, 570. In considering the sufficiency
23 of a claim, the court must accept as true all of the factual allegations contained in the complaint. *Id.*
24 at 555–56. However, the court is not required to accept as true legal conclusions cast in the form of
25 factual allegations. *Id.* at 555.

26 If dismissal is granted under Rule 12(b)(6), leave to amend should be allowed unless the
27 pleading could not possibly be cured by the allegation of other facts. *Lopez v. Smith*, 203 F.3d
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1 1122, 1130 (9th Cir. 2000). If amendment would be futile, however, a dismissal may be ordered
2 with prejudice. Dumas v. Kipp, 90 F.3d 386, 393 (9th Cir. 1996) (internal quotations omitted).

3 A shareholder derivative suit is a uniquely equitable remedy in which a shareholder asserts
4 on behalf of a corporation a claim belonging not to the shareholder, but to the corporation. Aronson
5 v. Lewis, 473 A.2d 805, 811 (Del. 1984) (overruled on other grounds by Brehm v. Eisner, 746
6 A.2d 244 (Del.2000)). Pursuant to Federal Rule of Civil Procedure 23.1, which governs derivative
7 actions, a shareholder's complaint must state with particularity “any effort by the plaintiff to obtain
8 the desired action from the directors” and “the reasons for not obtaining the action or not making
9 the effort.” Fed. R. Civ. P. 23.1. Rule 23.1 imposes a higher standard of pleading than Rule 8(a).

10 **B. Choice of Law**

11 When a federal court sits in diversity, it looks to the forum state's choice of law rules to
12 determine the controlling substantive law. Patton v. Cox, 276 F.3d 493, 495 (9th Cir. 2002). Here,
13 because HP has its corporate headquarters and main place of business in Palo Alto, California, the
14 court applies California state law.

15 Pursuant to the “internal affairs” doctrine, which is generally followed by courts in
16 California, “the law of the state of incorporation governs liabilities of officers or directors to the
17 corporation or its shareholders.” In re Sagent Tech., Inc., Derivative Litig., 278 F. Supp. 2d 1079,
18 1086 (N.D. Cal. 2003); see Cal. Corp. Code § 2116. Additionally, the demand requirements for a
19 shareholder derivative suit are determined by the law of the state of incorporation. Kamen v.
20 Kemper Financial Services, Inc., 500 U.S. 90, 96 (1991) (“the function of the demand doctrine . . .
21 is a matter of ‘substance’ not ‘procedure’ . . . [Courts] must apply the demand futility exception as
22 it is defined by the law of the state of incorporation”); Potter v. Hughes, 546 F.3d 1051, 1054 n. 1
23 (9th Cir. 2008) (“the substantive demand requirement is an issue of state law”). Accordingly,
24 because HP is incorporated in Delaware, the court applies Delaware law to determine whether
25 demand is excused.

26 **C. Demand Futility**

27 Under Delaware law, “directors of a corporation and not its shareholders manage the
28 business and affairs of the corporation, and accordingly, the directors are responsible for deciding

1 whether to engage in derivative litigation.” Levine v. Smith, 591 A.2d 194, 200 (Del. Ch. 1991)
2 (internal citation omitted) (overruled on other grounds by Brehm, 746 A.2d 244). Because directors
3 are empowered to manage or direct the business affairs of the corporation, a shareholder seeking to
4 bring a derivative action must first make a demand on that corporation's board of directors, giving
5 the board an opportunity to examine the alleged grievance to determine whether pursuing the
6 action is in the best interest of the corporation. Aronson, 473 A.2d at 812. The right of a
7 shareholder to prosecute a derivative suit is limited to situations where the shareholder has
8 demanded that the directors pursue the claim and they have wrongfully refused to do so or where
9 demand is excused because the directors are incapable of making impartial decisions regarding
10 such litigation. Rales v. Blasband, 634 A.2d 927, 932 (Del. 1993) (quoting Levine, 591 A.2d at
11 200).

12 To prove that demand is excused, a shareholder must plead with particularity the reasons
13 why such demand would have been futile. Fed. R. Civ. P. 23.1. In general, Delaware law provides
14 two demand-futility tests, as set forth in Aronson, 473 A.2d 805, and Rales, 634 A.2d 927. When
15 the alleged wrong is the result of a business decision by the whole board of directors, a court
16 should employ the Aronson test, which evaluates whether, under the particularized facts alleged, a
17 reasonable doubt is created (1) that the directors are disinterested and independent, or (2) that the
18 challenged transaction was otherwise the product of a valid exercise of business judgment.

19 Aronson, 473 A.2d at 812. When, however, the board members who approved the challenged act
20 have since changed, or when the challenged act does not constitute a business decision by the
21 board, a court should employ the Rales test, which determines whether the particularized factual
22 allegations create a reasonable doubt that, as of the time the complaint was filed, a majority of the
23 board as constituted at that time could have properly exercised its independent and disinterested
24 business judgment in responding to a demand. See Rales, 634 A.2d at 934.

25 III. DISCUSSION

26 A. Waste Of Corporate Assets Based On the Separation Agreement (Count I)

27 Count I alleges that the Directors committed waste of corporate assets by approving the
28 Separation Agreement because the amount given to Hurd was excessive and one-sided. Id. ¶¶ 81-

1 82. Where a plaintiff challenges an affirmative board decision, demand is excused only if the
 2 plaintiff pleads particularized facts (1) creating a reasonable doubt that at least half the directors are
 3 disinterested and independent, or (2) creating a reasonable doubt that the transaction was the
 4 product of a valid exercise of business judgment. Aronson, 473 A.2d at 814.

5 **1. First Prong of the Aronson Test**

6 Plaintiffs allege that each Director is “incapable of independently and disinterestedly
 7 considering a demand to commence and vigorously prosecute this action because he wasted
 8 corporate assets by approving the terms of the Separation Agreement, a transaction which was so
 9 one-sided that no business person of ordinary, sound judgment could conclude that the Company
 10 received adequate consideration.” See, e.g., Consol. Compl. ¶ 70. This conclusory allegation
 11 appears to allege that the Separation Agreement was not the result of a valid business decision and
 12 therefore the Directors are interested or lack independence. Plaintiffs, however, have made no
 13 allegation that any of the Directors had any personal interest in or derived any personal benefit
 14 from approval of Hurd’s Separation Agreement.¹ The Consolidated Complaint also does not allege
 15 that any Director was beholden to Hurd such that he would have considered anything other than the
 16 Company’s best interests in awarding a separation package.² Aronson, 473 A.2d at 816. Thus,
 17 Plaintiffs do not attack the disinterest or independence of the Directors, except to say that the
 18 Directors failed to exercise their business judgment in awarding the Separation Agreement to Hurd.
 19 Thus, the court finds that Plaintiffs have not met their burden under the first prong of the Aronson
 20 test.

21 **2. Second Prong of the Aronson Test**

22 Under the second prong of the Aronson test, Plaintiff must raise a reasonable doubt that the
 23 transaction is entitled to the protection of the business judgment rule. In re Walt Disney Co.
 24 Derivative Litig., 825 A.2d 275, 286 (Del. Ch. 2003). The business judgment rule is “a

25 _____
 26 ¹ A director is interested ““whenever divided loyalties are present, or a director has received, or is
 27 entitled to receive, a personal financial benefit from the challenged transaction which is not equally
 shared by the stockholders.”” Rales, 634 A.2d 927, 933, 936 (Del. 1993) (citation omitted).

28 ² A director lacks independence when he is “so under [another party’s] influence that [his]
 discretion would be sterilized.” Rales, 634 A.2d at 936; see Dunn, 2008 WL 878424, at *6.

1 presumption that in making a business decision the directors of a corporation acted on an informed
2 basis, in good faith and in the honest belief that the action taken was in the best interest of the
3 company.” Aronson, 473 A.2d at 812. Under the business judgment rule, “directors are entitled to a
4 presumption that they were faithful to their fiduciary duties [and] the burden is upon the
5 plaintiff in a derivative action to overcome that presumption.” Beam v. Stewart, 845 A.2d 1040,
6 1048–49 (Del. 2004). To rebut the business judgment rule presumption, “plaintiffs must plead
7 particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in
8 good faith or (2) a reason to doubt that the board was adequately informed in making the decision.”
9 In re J.P. Morgan Chase & Co. S'holder Litig., 906 A.2d 808, 824 (Del. Ch. 2005) (quoting In re
10 Walt Disney Co., 825 A.2d at 286). “[A] decision made by a loyal and informed board will not be
11 overturned by the courts unless it ‘cannot be attributed to any rational business purpose.’” Cede &
12 Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (quoting Sinclair Oil Corp. v. Levien, 280
13 A.2d 717, 720 (Del. 1971)). In Delaware, corporations are empowered to “[a]ppoint such officers
14 and agents as the business of the corporation requires and to pay or otherwise provide for them
15 suitable compensation.” 8 Del. C. § 122(5). A board's decision on executive compensation is
16 “entitled to great deference.” Brehm, 746 A.2d at 263.

17 **a. Honest Belief And Good Faith**

18 Plaintiffs insist that the complaint creates a reasonable doubt as to whether approving the
19 Separation Agreement was the product of a valid exercise of business judgment because it pleads
20 allegations showing waste.

21 “The standard for waste under the second prong of Aronson may be expressed as akin to res
22 ipsa loquitur, and is difficult to meet” Protas v. Cavanagh, No. 6555–VCG, 2012 WL
23 1580969, at *9 (Del. Ch. May 4, 2012) (footnote omitted). Pleading waste requires a “showing that
24 the board’s decision was so egregious or irrational that it could not have been based on a valid
25 assessment of the corporation’s best interests.” White v. Panic, 783 A.2d 543, 554 n.36 (Del.
26 2001); accord Sample v. Morgan, 914 A.2d 647, 669-70 (Del. Ch. 2007) (Waste entails “a
27 transaction that is on terms so disparate that no reasonable person acting in good faith could
28 conclude the transaction as in the corporation’s best interest.”). Indeed, the challenged transaction

1 must reflect “an exchange of corporate assets for consideration so disproportionately small” that it
2 effectively could be characterized as a mere gift serving no corporate purpose. Lewis v. Vogelstein,
3 699 A.2d 327, 336 (Del. Ch. 1997). “Where, however, the corporation has received ‘any
4 substantial consideration’ and where the board has made ‘a good faith judgment that in the
5 circumstances the transaction was worthwhile,’ a finding of waste is inappropriate, even if
6 hindsight proves that the transaction may have been ill-advised.” Protas, 2012 WL 1580969, at *9
7 (quoting Vogelstein, 699 A.2d at 336). “This is obviously an extreme test, very rarely satisfied by a
8 shareholder plaintiff.” Steiner v. Meyerson, Civ. A. No. 13139, 1995 WL 441999, at *1 (Del. Ch.
9 July 19, 1995).

10 Defendants argue that HP received valuable consideration in the Separation Agreement
11 referenced in the Consolidated Complaint in form of (1) a full release of claims against HP
12 (“Release”); (2) an extension of certain protective covenants, including those concerning the use or
13 disclosure of HP’s trade secrets and those prohibiting solicitation of HP’s customers, employees
14 and suppliers; (3) Hurd’s cooperation post-employment with respect to transition matters, requests
15 for information, and in any investigation or review; and (4) Hurd’s agreement to refrain from
16 disparaging HP, its affiliates, subsidiaries, officers or directors. See HP Motion at 5-7; Opp’n at 17,
17 Docket No. 109. Additionally, Defendants argue that Hurd’s compensation was not excessive
18 because the amount of Hurd’s cash payment was determined by a formula set out in HP’s
19 Severance Plan and the remainder of the benefits consisted only of limited extensions of time to
20 exercise previously earned equity awards.

21 Plaintiffs argue that the Board received nothing in exchange for the large amounts given to
22 Hurd in the Separation Agreement. Specifically, Plaintiffs argue that Hurd’s release of claims was
23 worthless because there is no evidence that Hurd even had any claims against HP to release, and
24 that Hurd’s agreement to extend his existing obligations under the Confidentiality Agreement,
25 including non-compete and non-solicitation provisions, is not adequate consideration in exchange
26 for tens millions of dollars in severance. Additionally, Defendants were under no contractual
27 obligations to pay Hurd under the Severance Plan because the Severance Plan applies only when an
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1 employee is involuntarily terminated without cause and does not apply when an employee resigns,
2 as Hurd did.

3 The Consolidated Complaint sufficiently alleges that HP was not required to offer Hurd a
4 severance. For example, it alleges that Hurd resigned, had no employment agreement with HP, and
5 thus no contractual right to severance, when he left. Although the Board could have elected to pay
6 Hurd nothing, determining whether it should have done so, or whether making the deal it did
7 constitutes waste, involves a broader legal analysis. Zucker v. Hewlett, C.A. No. 6014-VCP, 2012
8 WL 2366448, *8 (Del. Ch. June 21, 2012) (evaluating a nearly identical claim regarding Hurd's
9 Separation Agreement and finding that the plaintiff had failed to satisfy his burden under Aronson
10 to show demand futility as to his waste claims).

11 While "the discretion of directors in setting executive compensation is not unlimited," In re
12 Citigroup, 964 A.2d at 138, "[i]t is the essence of business judgment for a board to determine if 'a
13 particular individual warrant[s] large amounts of money, whether in the form of current salary or
14 severance provisions,'" Brehm, 746 A.2d at 263 (second alteration in original) (quoting In re The
15 Walt Disney Co. Deriv. Litig., 731 A.2d at 362). The "outer limit" necessary to sustain a claim of
16 waste is "executive compensation . . . so disproportionately large as to be unconscionable," Id. at
17 262 n.56, but a finding of waste is inappropriate "[s]o long as there is some rational basis for
18 directors to conclude that the amount and form of compensation is appropriate and likely to be
19 beneficial to the corporation," Steiner v. Meyerson, Civ. A. No. 13139, 1995 WL 441999, at *8
20 (July 19, 1995).

21 Plaintiffs' argument that the Release of claims was illusory because there was no indication
22 that Hurd had any claim against HP fails. Plaintiffs' argument ignores that if the Board had not
23 negotiated the terms of Hurd's departure and instead had fired him for cause or denied him
24 severance, Hurd could have sued, bringing a claim for wrongful termination or violation of the
25 Severance Plan. See Zucker, 2012 WL 236648, at *8 (finding Release had some value because had
26 the Board fired Hurd for cause, it may have faced litigation). The Release protected against the
27 expense of litigation and negative publicity resulting from having to defend against such a claim.
28

1 That is, even if the release was worth relatively little, Plaintiff overstates his case to say it was
2 worthless. See id.

3 Plaintiffs' argument that Hurd's agreement to extend his confidentiality, non-compete and
4 non-solicitation covenants was completely hollow also fails. The Separation Agreement included a
5 doubling of the duration of the protective covenants in Section 7 of the Confidentiality Agreement,
6 which included a non-compete and non-solicitation of employees, customers, and suppliers. Danitz
7 Decl. Ex. H at 2. The lawsuit filed by HP after Hurd took a position at Oracle demonstrates the
8 value of this consideration. Although the Confidentiality Agreement was still in force at the time
9 that Hurd joined Oracle, Hurd's decision to accept employment by HP's competitor underscores
10 the value of the extended protections in the Separation Agreement. The Separation Agreement
11 prevents Hurd from engaging in similar conduct after the Confidentiality Agreement ends.

12 Finally, Plaintiffs have failed to demonstrate that the benefits and cash payment in the
13 Separation Agreement were excessive. "[I]n the context of executive compensation, Delaware
14 courts recognize an exception to the general rule barring retroactive consideration. Compensation
15 given in consideration for previously completed performance is not improper '[w]here the amount
16 awarded is not unreasonable in view of the services rendered.'" Underbrink v. Warrior Energy
17 Servs. Corp., 2008 WL 2262316, at *10 n. 92 (Del. Ch. May 30, 2008) (second alteration in
18 original) (quoting Zupnick v. Goizueta, 698 A.2d 384, 388 (Del. Ch. 1997)). Here, Plaintiffs do not
19 allege that HP suffered significant losses during Hurd's tenure as CEO or that he otherwise was an
20 ineffectual executive. Compare In re Citigroup Inc. S'holder Deriv. Litig., 964 A.2d 106, 137–38
21 (Del. Ch. 2009) (challenging \$68 million severance "to a departing CEO whose failures as CEO
22 were allegedly responsible, in part, for billions of dollars of losses") and Brehm, 746 A.2d at 249
23 ("it appears from the Complaint that . . . the compensation and termination payout for Ovitz were
24 exceedingly lucrative, if not luxurious, compared to Ovitz' value to the Company") with Aug. 6
25 Press Release, Danitz Decl. Ex. G. at 1–2, Docket No. 100-7 ("[The Board] recognizes the
26 considerable value that [Hurd] has contributed to HP over the past five years in establishing us as a
27 leader in the industry. . . . The departure was not related in any way to the company's operational
28 performance or financial condition, both of which remain strong."). Under such circumstances, at

1 least some portion of Hurd's severance could represent "reasonable" compensation for his
2 successful past performance. See Zucker, 2012 WL 236648, at *9.

3 This possibility further undermines Plaintiff's waste claim, which effectively requires a
4 showing that the Severance Agreement constitutes an "egregious or irrational" exchange of
5 corporate assets "that could not have been based on a valid assessment of the Corporation's best
6 interests." White, 783 A.2d at 554 n. 36. Additionally, denying Hurd any severance despite issuing
7 a statement recognizing the "considerable value that [he] has contributed to HP" could have
8 undermined HP's efforts to attract outside executive talent. Danitz Decl. Ex. G; see Zucker, 2012
9 WL 236648, at *9.

10 As discussed by the Delaware Court of Chancery in Zucker, having found that the
11 Separation Agreement reflects at least some element of bilateral exchange and that there were
12 rational bases for the Board to agree to it, Plaintiffs' waste claim is reduced to their allegations that
13 the payments and benefits Hurd received, valued at approximately \$53 million (Consol Compl. ¶¶
14 53-54) was just too much. "[T]he size of executive compensation for a large public company in the
15 current environment often involves large numbers," Brehm, 746 A.2d at 259 n. 49, and "amount
16 alone is not the most salient aspect of director compensation" for purposes of a waste analysis,
17 Steiner, 1995 WL 441999, at *8. Without question, the amount of Hurd's severance may appear
18 extremely rich or altogether distasteful to some. But, "[t]he waste doctrine does not . . . make
19 transactions at the fringes of reasonable decision-making its meat." Protas, 2012 WL 1580969, at
20 *10. Rather, "[t]he value of assets bought and sold in the marketplace, including the personal
21 services of executives and directors, is a matter best determined by the good faith judgments of
22 disinterested and independent directors, men and women with business acumen appointed by
23 shareholders precisely for their skill at making such evaluations." In re INFOUSA, Inc.
24 Shareholders Litig., 953 A.2d 963, 984 (Del. Ch. 2007). Thus, allegations that the payments and
25 benefits Hurd received were valued at approximately \$53 million are alone insufficient to
26 demonstrate waste.

27 In sum, because the Consolidated Complaint demonstrates that Hurd provided HP with
28 consideration in the Separation Agreement and fails to plead facts showing that there is no

1 reasonable basis for the amount of benefits provided to Hurd, Plaintiffs have failed to show that
2 approving the Separation Agreement was so egregious or irrational that it could not have been
3 based on a valid assessment of the corporation's best interests. Thus, Plaintiffs have failed to plead
4 particularized facts sufficient to raise a reason to doubt that the approval of the Separation
5 Agreement was taken honestly and in good faith.

6 **b. Informed Basis**

7 Plaintiffs also fail to plead any facts raising a reasonable doubt that the Board acted on an
8 informed basis in deciding to enter into the Separation Agreement. The Consolidated Complaint
9 alleges that the Board acted precipitously and without adequate time because the Separation
10 Agreement was signed in less than 24 hours after Hurd's resignation was announced. *Id.* ¶ 57. Any
11 inference drawn from these allegations, however, is offset by other allegations showing the Board
12 engaged in an investigation and deliberation regarding Hurd's termination. For example, when the
13 Board learned of Ms. Fisher's accusations against Hurd, it initiated and oversaw a formal
14 investigation of the allegations, which outside legal counsel and the General Counsel's office
15 conducted. *Id.* ¶¶ 46, 49. The Board's investigation made a number of factual findings and
16 conclusions. *Id.* ¶¶ 46, 50-51. The investigation concluded that there was no violation of HP's
17 sexual harassment policy, but did find violations of HP's Standards of Business Conduct. *Id.* ¶¶ 46,
18 51. HP announced Hurd's resignation on August 6, 2010, a number of weeks after Ms. Fisher first
19 asserted her accusations. *Id.* ¶ 46.

20 The Consolidated Complaint's assertion that the Board failed to inform itself of relevant
21 facts before entering the Separation Agreement is conclusory and contradicted by the facts set forth
22 in the Consolidated Complaint. Thus, Plaintiffs have not presented facts showing that the Board's
23 investigation and deliberations resulted in an uninformed decision. See Pirelli Armstrong Tire
24 Corp. Retiree Medical Benefits Trust v. Fed. National Mortgage Association, 534 F.3d 779, 792
25 (D.C. Cir. 2008) ("The complaint itself acknowledges that the termination decision was made in a
26 series of board meetings held over several days"); In re Goldman Sachs Group., Inc. Shareholder
27 Litig., No. 5215, 2011 WL 4826104, at *16 (Del. Ch. Oct. 12, 2011) ("[t]he business judgment rule
28 . . . only requires the board to reasonably inform itself; it does not require perfection or the

1 consideration of every conceivable alternative.”). Thus, Plaintiffs have not pleaded particularized
2 facts sufficient to raise a reason to doubt that the board was adequately informed in making the
3 decision.

4 The Consolidated Complaint therefore fails to raise a reasonable doubt that the Board's
5 decision on the amount of severance it would agree to pay Hurd was the product of a valid exercise
6 of business judgment. Thus, Plaintiffs has failed to satisfy their burden under the second prong
7 Aronson to plead demand futility as to his waste claim. Accordingly, Defendants’ motions to
8 dismiss Count I are GRANTED with leave to amend.

9 **B. Breach Of Fiduciary Duty Based On Separation Agreement (Count II)**

10 The same foregoing analysis under the Aronson test applies to Count II, which asserts a
11 breach of fiduciary duty claim based on the allegedly excessive and unwarranted Separation
12 Agreement. Accordingly, Defendants’ motions to dismiss Count II are GRANTED with leave to
13 amend.

14 **C. Unjust Enrichment (Count III)**

15 Plaintiff also assert a claim for unjust enrichment against Hurd. Plaintiffs claim Hurd was
16 unjustly enriched by his receipt and retention of the excessive and unwarranted benefits pursuant to
17 the Separation Agreement. The same foregoing analysis under the Aronson test applies to Count
18 III. Thus, Defendants' motions to dismiss the Consolidated Complaint for failure to state a claim
19 are GRANTED with leave to amend.

20 **D. Section 14(a) Of The Securities Exchange Act (Count V)**

21 Plaintiffs also assert a federal claim under Section 14(a) of the Securities Exchange Act
22 because HP’s Proxy Statement misstated that Hurd’s employment contract under his Employment
23 Agreement was still in effect, although it had expired in March 2009. Id. ¶¶ 3, 39.

24 Where a plaintiff does not challenge an affirmative board decision, the Aronson test does
25 not apply. Instead, the analysis is whether plaintiff has pleaded “particularized fact[s that] create a
26 reasonable doubt that, as of the time the complaint is filed, the board of directors could have
27 properly exercised its independent and disinterested business judgment in responding to a
28 demand.” Rales, 634 A.2d at 934. Plaintiffs argue they have pleaded demand futility by the

1 assertion that the Directors are interested in that they face a “substantial likelihood of liability” for
2 disclosure violations. Id. ¶¶ 70-79.

3 In order to state a claim under Section 14(a), a plaintiff must allege that (1) defendants
4 made a material misrepresentation or omission in a proxy statement; (2) with the requisite state of
5 mind; and (3) that the proxy statement was the transactional cause of harm of which plaintiff
6 complains. In re Zoran Corp. Derivative Litig., 511 F. Supp. 2d 986 (N.D. Cal. 2007). Plaintiff
7 must also plead that the misstatement or omission was an essential link in the accomplishment of
8 the proposed transaction. Id. “An omitted fact or misrepresentation in a proxy statement is material
9 when there is a substantial likelihood that a reasonable shareholder would consider it important in
10 deciding how to vote.” TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

11 Defendants argue that the Consolidated Complaint fails to plead facts showing that the
12 alleged misrepresentation in the 2010 Proxy Statement that Hurd’s Employment Agreement was
13 still valid and in effect was material to any shareholder vote. Plaintiffs make three arguments
14 regarding whether the Complaint alleges that the misrepresentation was material.

15 First, Plaintiffs claim that the shareholders would have found the statements material in
16 determining whether to reelect the Directors on the Compensation Committee because it would
17 have demonstrated that those members were shirking their duties because Hurd was no longer
18 contractually obligated to serve the Company. Second, Plaintiffs claim that shareholders would
19 have found the statements material in reelecting Hurd as a director because “he no longer needed to
20 comply with the obligations” under the Employment Agreement. Opp’n at 26-27. Both these
21 arguments fail, however, because Plaintiffs have not identified these relevant contractual
22 obligations or otherwise alleged facts indicating these obligations would affect a shareholder’s
23 decision to vote for Hurd as a director. According to the Employment Agreement attached to the
24 Consolidated Complaint, Hurd was an “at will” employee with or without the Employment
25 Agreement. Consol. Compl. Ex. A ¶ 2. There are no allegations showing that the absence of an
26 Employment Agreement had any impact on Hurd’s or the HP’s performance or any other
27 allegations indicating that a reasonable shareholder would have considered the Employment
28 Agreement important in deciding how to vote.

1 Finally, Plaintiffs argue that shareholders would have found it material in approving the
2 stock plan that Hurd was no longer limited by the Employment Agreement with regard to the
3 number of stock options he would receive. Opp'n at 27. Plaintiffs, however, plead no facts
4 demonstrating that shareholders would consider a difference in the amount of options Hurd was
5 entitled to receive in determining whether to vote for the Stock Incentive Plan. Thus, the
6 Consolidated Complaint fails to plead facts showing the misrepresentation in the 2010 Proxy
7 Statement was material.

8 Plaintiffs also fail to plead the misrepresentation was the cause of any harm. Plaintiffs do
9 not cite any allegations in their Consolidated Complaint alleging a link between the
10 misrepresentation and any harm. They argue in their opposition, however, that the Consolidated
11 Complaint indicates (1) that "by falsely reporting that Hurd's Employment Agreement was still
12 valid and in effect, defendants Babbio, Gupta, Hammergren, Hyatt and Salhany, were able to
13 maintain their positions on the Board, which ultimately resulted in the approval of the Severance
14 Agreement which harmed HP by wasting its assets[; and (2) that] HP was also harmed by the
15 approval of the Stock Incentive Plan, which represents a direct and continuing waste of HP's
16 valuable corporate assets." Opp'n at 29:18-23.

17 Plaintiffs' first alleged link fails because the mere fact that but for their reelection the
18 directors could not have approved the Separation Agreement is insufficient to allege transaction
19 causation under Section 14(a). As the Third Circuit noted in rejecting a similar argument:

20 "[T]he mere fact that omissions in proxy materials, by permitting directors to win re-
21 election, indirectly lead to financial loss through mismanagement will not create a
22 sufficient nexus with the alleged monetary loss. Rather, damages are recoverable under
23 Section 14(a) only when the votes for a specific corporate transaction requiring
shareholder authorization, such as a corporate merger, are obtained by a false proxy
statement, and that transaction was the direct cause of the pecuniary injury for which
recovery is sought."

24 Gen. Elec. Co. by Levit v. Cathcart, 980 F.2d 927, 933 (3rd Cir. 1992). Plaintiffs' second alleged
25 link also fails because Plaintiffs have not alleged facts pertaining to the Stock Incentive Plan
26 resulting in waste. Thus, the Consolidated Complaint fails to plead facts showing an essential link
27 between the proxy and any harm alleged.
28

1 Because the Consolidated Complaint lacks facts showing materiality and that the
 2 misrepresentation caused any harm, the Consolidated Complaint fails to plead facts showing that
 3 the Board faces a substantial likelihood of liability, and thus a reasonable doubt that the Directors
 4 could have been independent, that would excuse demand with respect to the Section 14(a) claim.
 5 Accordingly, Defendants' motions to dismiss Count V are GRANTED with leave to amend.

6 **E. Breach of Fiduciary Duty Based On HP'S 2010 Proxy Statement (Count IV)**

7 Finally, Plaintiffs allege that each Defendant breached their fiduciary duties by knowingly
 8 filing and disseminating to HP's shareholders the false 2010 Proxy Statement, which contained
 9 false and misleading statements regarding Hurd's Employment Agreement. Consol. Compl. ¶ 92.
 10 Plaintiffs argue that the pre-suit demand is excused with respect to this claim because five of the
 11 ten directors (Babbio, Gupta, Hammergren, Hyatt, and Salhany) face a substantial likelihood of
 12 liability for breaching their fiduciary duty of candor relating to their violation of Section 14(a).
 13 Opp'n at 30. Because the misrepresentation in the proxy statement does not constitute a business
 14 decision by the board, the court applies again the Rales test rather than the Aronson test.

15 In assessing a duty of disclosure claim, Delaware courts apply the same standard of
 16 materiality used by federal courts for Section 14(a) claims. See Stroud v. Grace, 606 A.2d 75, 84
 17 (Del. 1992) (noting that Delaware law uses the same materiality standard announced in TSC Indus.
 18 for evaluating duty of disclosure claims). Delaware law also requires "the challenged disclosure to
 19 have a connection to the request for shareholder action." Malone v. Brincat, 722 A.2d 5, 12 (Del.
 20 1998). As discussed above, Plaintiffs failed to plead facts showing the materiality of the alleged
 21 misstatements about Hurd's Employment Agreement or a connection between the alleged
 22 misstatement and the shareholder vote. Additionally, although Plaintiffs allege that the Directors
 23 breached their fiduciary duties by filing and disseminating the false and misleading proxy
 24 statement, see, e.g., Consol. Compl. ¶ 71. Plaintiffs do not allege that any Director prepared these
 25 financial statements or that they were directly responsible for the misstatements. See In re Accuray,
 26 Inc. Shareholder Derivative Litigation, 757 F. Supp. 2d 919, 934 (N.D. Cal. 2010) (dismissing
 27 fiduciary duty claim where "Plaintiffs do not allege that any member . . . prepared these financial
 28

1 statements”). Thus, Plaintiffs have not pleaded facts showing that the misrepresentation violated
2 the Directors’ duty of disclosure.

3 Thus, the Consolidated Complaint fails to plead facts showing that the Board faces a
4 substantial likelihood of liability that would excuse demand with respect to the claim for breach of
5 fiduciary duty based on the disclosures in the 2010 Proxy Statement. Accordingly, Defendants’
6 motions to dismiss Count IV are GRANTED with leave to amend.

7 **IV. CONCLUSION**


8 For the foregoing reasons, Defendants' motions to dismiss for failure to state a claim
9 pursuant to Rule 12(b)(6) and Rule 23.1 are GRANTED with leave to amend. Plaintiffs shall file
10 any amended complaint within 30 days of the date of this Order.

11 The court schedules this case for a Case Management Conference on **November 30, 2012.**

12 The parties shall file a Joint Case Management Conference on or before **November 21, 2012.**

13 **IT IS SO ORDERED**

14
15 Dated: September 25, 2012

16 
17 EDWARD J. DAVILA
18 United States District Judge

United States District Court
For the Northern District of California

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