5-13-2008

Order on Defendants' Motion to Dismiss (JEFF MICHELSON)

Elizabeth E. Long
Superior Court of Fulton County

COPY

IN THE SUPERIOR COURT OF FULTON COUNTY
STATE OF GEORGIA

JEFF MICHELSON, on behalf of himself and all others similarly situated, Plaintiffs, v. CUMULUS MEDIA INC., LEWIS W. DICKEY JR., HOLCOMBE T. GREEN, JR ERIC ROBISON, RALPH B. EVERETT, ROBERT H. SHERIDAN, III and MERRILL LYNCH GLOBAL PRIVATE EQUITY, Defendants.	)(	**Civil Action File No. 2007CV137612** **BC2**
PAUL COWLES, on behalf of himself and all others similarly situated, Plaintiffs, v. CUMULUS MEDIA INC., LEWIS W. DICKEY JR., HOLCOMBE T. GREEN, JR ERIC ROBISON, RALPH B. EVERETT, ROBERT H. SHERIDAN, III and MERRILL LYNCH GLOBAL PRIVATE EQUITY, Defendants.	)(	**Civil Action File No. 2007CV139383** **BC2**

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ORDER ON DEFENDANTS' MOTION TO DISMISS

On April 28, 2009, counsel appeared before this Court to present oral argument on Defendants' Motion to Dismiss. After reviewing the briefs filed on the Motion, the pleadings, and the arguments presented by counsel, the Court hereby finds as follows:

I. FACTS

This case was filed in Fulton County Superior Court during the summer of 2007, and removed to Federal District Court in July, 2008. In Federal Court, Defendants filed Motions to Dismiss. On February 12, 2009, Judge Evans of the Northern District of Georgia issued two separate opinions denying Defendants' Motions to Dismiss under SLUSA and remanding the remaining issues to Fulton County Superior Court. Thereafter, the case was transferred to the Business Court and scheduled for hearing on the remaining issues in Defendants' Motions to Dismiss.[1]

This case arises out of a proposed management-led buyout of Cumulus headed by Defendant Lewis W. Dickey, Jr., CEO and Chairman of the Cumulus Board ("Dickey"). In July, 2007, Cumulus announced a merger (the "Proposed Merger"), between it and the buyout group which consisted of Dickey, his family, and Merrill Lynch (the "Buyout Group").

Cumulus has a five member Board of Directors, four of whom are outside directors who were not interested in the Proposed Merger: Holcombe T. Green, Jr., Eric Robison, Ralph B. Everett, and Robert H. Sheridan III (collectively the "Outside Directors"). The fifth member is Dickey, who, together with his family, controls between 35-50% of the voting shares depending upon whether outstanding stock options are counted in the total or not.

Plaintiffs filed their respective suits to enjoin the Proposed Merger. In May, 2008, Cumulus announced that the Proposed Merger was terminated. Cumulus then entered into a termination agreement with the Buyout Group that resulted in a $15 million payment to Cumulus and a release of all claims against the members of the Buyout Group.

Plaintiffs amended and restated their Complaints to include allegations of waste, failure of oversight, and self-dealing transactions. Plaintiffs have identified the Amended Complaint in the Michelson matter, *Civil Action No.* 2007CV137612, to serve as the operative pleading for both cases (the "Operative Complaint"). Plaintiffs' Operative Complaint no longer seeks to enjoin the Proposed Merger, but alleges that the Director Defendants, under the direction of Dickey, took measures to artificially decrease the price of the stock in order to facilitate the Proposed Merger, and then after the Proposed Merger was terminated, to facilitate a potential future merger,

[1] Defendant Merrill Lynch Global Private Equity had filed a Motion to Dismiss, but withdrew its Motion on April 21, 2009. This Court's order will therefore focus solely on the Director Defendants.

possibly with the same buyer. Plaintiffs allege that the Outside Directors are controlled by Dickey because he hand-selected them and controls a significant block of the Company. Plaintiffs allege that the Outside Directors' approval of transactions that benefited Dickey, but harmed shareholders, is evidence of Dickey's control over them.

II. CUMULUS MOTION TO DISMISS

The parties agree that Delaware law applies to this Motion. O.C.G.A. § 14-2-747 ("[A]ny derivative proceeding in the right of a foreign corporation...shall be governed by the laws of the jurisdiction of incorporation of the foreign corporation."); Kamen v. Kemper Fin. Servs., 500 U.S. 90, 98-99 (1991); Diedrich v. Miller & Meier & Assoc., Architects & Planners, Inc., 254 Ga. 734, 735-736 (1985).

A party seeking a motion to dismiss brought under OCGA § 9-11-12(b)(6) for failure to state a claim upon which relief can be granted must demonstrate that plaintiff's allegations in the complaint disclose with certainty that the claimant would not be entitled to relief under any state of provable facts asserted in support thereof. Common Cause/Georgia v. City of Atlanta, 279 Ga. 480, 481 (2005). "On a motion to dismiss pursuant to [a plea of demand futility], the Court considers the same documents, similarly accepts well-pled allegations as true, and makes reasonable inferences in favor of the plaintiffs—all as it does in considering a motion to dismiss under Rule 12(b)(6)." Beam v. Stewart, 833 A.2d 961, 976 (Del. Ch. 2003) *aff'd* 845 A.2d 1040 (Del. 2004).

Defendants assert that the Operative Complaint should be dismissed for failure to make first a demand upon the Cumulus Board or to demonstrate demand futility as required under Delaware law. Aronson v. Lewis, 473 A.2d 805, 806 (Del. 1984). "The purpose of the demand requirement is not to insulate defendants from liability; rather, the demand requirement and the strict requirements of factual particularity under Rule 23.1 exist to preserve the primacy of board decisionmaking regarding legal claims belonging to the corporation." In re Citigroup, 964 A.2d 106, 120 (Del. Ch. 2009).

Plaintiffs concede that demand was not made, but assert that they have sufficiently alleged demand futility by pleading particularized facts demonstrating that a majority of the Board at the time the Operative Complaint was filed could not have fairly and impartially evaluated a demand. Wood v. Baum, 953 A.2d 136 (Del. 2008). The Delaware Supreme Court instructs trial courts to view the alleged demand futility facts in a light favorable to plaintiffs. Beam v. Stewart, 845 A.2d 1040, 1049 (Del. 2004). Directors, however, are entitled to a presumption that they would have acted faithful to their fiduciary duties if presented with a demand. Aronson v. Lewis, 473 A.2d 806, 812 (Del. 1984).

Demand futility is evaluated under two standards: the Aronson and Rales tests. "The Aronson test applies to claims involving a contested transaction *i.e.*, where it is alleged that the directors made a conscious business decision in breach of their fiduciary duties. Aronson, 473 A.2d 806. That test requires that the plaintiff allege particularized facts creating a reason to doubt that (1) the directors are disinterested and independent, or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. Wood v. Baum, 953 A.2d136, 140 (Del. 2008) (citing Aronson). Rales, on the other hand, applies where the subject of the derivative suit is not a decision of the Board of Directors, but rather a violation of their oversight duties. Rales v. Blasband, 634 A.2d 927 (Del. 1993). The Rales test requires that the plaintiff allege particularized facts establishing a reason to doubt that "the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." Wood v. Baum, 953 A.2d 136, 140 (Del. 2008). The Aronson test applies to Plaintiffs' allegations that the Director Defendants took certain corporate actions (*i.e.*, approval of executive compensation plan, approval of the stock repurchase plan) and the Rales test applies to Plaintiffs' oversight claims. "To satisfy either test, a plaintiff must comply with stringent requirements of factual particularity" as is required under Delaware law. Wood v. Baum, 953 A.2d at 141.

A. Lack of Disinterest and Independence to Establish Demand Futility

Plaintiffs allege that demand would have been futile because under a totality of circumstances it is apparent that Dickey exercised dominion and control over the Outside Directors in such a manner as to negate their independence, and satisfy demand futility under both Aronson and Rales. They argue that the only reasonable conclusion based upon all of the challenged transactions is for the Court to find demand futility. See Harris v. Carter, 582 A.2d 222, 229 (Del.Ch. 1990) ("[T]he question is whether the accumulation of all factors creates the reasonable doubt to which Aronson refers."); cf. Khanna v. McMinn, 2006 WL 1388744, *14 (Del. Ch. 2006) ("Demand futility [analysis] ... is fact-intensive and proceeds director-by-director and transaction-by-transaction.").

Plaintiffs bear the burden of pleading facts sufficient to form a "reasonable doubt" as to the independence or lack of interest of a majority of the Outside Directors. Beam v. Stewart, 845 A.2d 1040, 1050 (Del. 2004). Interest and independence are two separate bases upon which to review a director's bias. Interest "requires an analysis of whether the director is disinterested in the underlying transaction ..." Id. at 1049. The independence analysis is a fact-specific inquiry to determine whether the directors were capable of independently making a business decision with regard to the demand. Id. at 1049-1050.

Plaintiffs' allegations of demand futility specific to the Outside Directors and the challenged transactions are discussed below.

1. Plaintiffs' Allegations Regarding the Independence of the Outside Directors

Plaintiffs assert that the Board of Directors is dominated and controlled by Dickey (and his family), and that the Board approved transactions in breach of their fiduciary duties as a result of this control. Plaintiffs dispute the independence of the Outside Directors because Dickey "hand picked" them. Additionally, Plaintiffs highlight the Outside Director's long record of service with the Board as evidence that the Outside Directors are beholden to Dickey (Everett and Sheridan since 1998, Robison since 1999, and Green since 2001). Plaintiffs also allege that the Outside Directors could not have properly considered a demand that would have resulted in their own personal liability. Finally, Plaintiffs argue that the Outside Directors' approval of the challenged transactions, as described below, is evidence of Dickey's control over them.

In addition to these allegations against all of the Outside Directors, Plaintiffs allege that Defendant Robison lacked independence because he received additional compensation (up to $59,000 per year) pursuant to a separate consulting contract with Cumulus.

2. Plaintiffs' Allegations Regarding the Challenged Transactions

a. Cumulus Media Partners Transfer

Plaintiffs point to the 2006 transfer of certain Houston and Kansas City radio stations to Cumulus Media Partners LLC ("CMP"), a company of which Dickey was later named CEO, as evidence of a interested transaction (for Dickey) that was approved by the Outside Directors. Plaintiffs allege that this transaction drove down Cumulus' stock price and set the stage for the low-bid merger offer from the Buyout Group led by Dickey.

b. Proposed Merger

Plaintiffs also point to the Proposed Merger with the Buyout Group as another example of an interested transaction (for Dickey) that was approved by the Outside Directors. Plaintiffs allege that the stock price was artificially deflated, and therefore, the "premium" per-share price offered was no bargain for Cumulus shareholders. Additionally, Plaintiffs argue that the termination fee of $15 million set in the Proposed Merger agreement was too high and deterred other offers.

In response to the Buyout Group merger offer, the Cumulus Board formed a special committee comprised of three of the Outside Directors (the "Special Committee"), which retained independent counsel, obtained an independent expert valuation report, negotiated for an increased per-share offer price generating a net increase of $42 million to the purchase price, and negotiated a 45-day go-shop provision to test the offer price on the market.

When the Proposed Merger was terminated, the Buyout Group paid the $15 million termination fee to Cumulus and entered into a termination agreement with Cumulus, which included a release of liability of the Buyout Group. In addition, the members of the Buyout Group entered into a separate termination agreement to which Cumulus was not a party. The second termination agreement essentially granted the parties a right of first refusal in future merger attempts with Cumulus. Plaintiffs complain that the release of liability obtained by the Buyout Group in the termination agreement is evidence of Dickey's control over the Outside Directors. Additionally, Plaintiffs assert that Cumulus is a de facto party to the second termination agreement as a result of the Dickey family's control over the company.

c. Amendments to Credit Facility Agreement

Plaintiffs allege that certain Cumulus credit agreements were amended with unfavorable terms in order to facilitate the Proposed Merger. Defendants respond that such amendments were only effective, however, if the Proposed Merger was completed, which it was not.

d. Cumulus Stock Repurchase Plan

Plaintiffs allege that the Board's decision to undertake a campaign to buy-back up to $75 million of the company's stock resulted in increasing Dickey's control over Cumulus, and therefore, the Board as a whole. Defendants point to the absence of particularized allegations that the Outside Directors acted with such a motive.[2]

[2] Defendants urge the Court to consider a January, 2009 Voting Agreement entered into between the Dickey family and Cumulus which, retroactive to June, 2008, prevents the Dickey family from voting any increase in their control as a result of the buy-back program. Because this agreement was not in place at the time of the filing of the Operative Complaint, the Court will not consider this point. Similarly, the Court will not consider Plaintiffs' allegations related to the October, 2008 Cumulus Equity Incentive Plan.

e. Open Market Stock Repurchase

Plaintiffs also complain that the Dickey family's purchase of Cumulus stock on the open market at a depressed stock price, increased the Dickey family's voting control over Cumulus and is further evidence that they shaped company policy for their own benefit. Defendants call the Court's attention to the fact that the Cumulus Board took no action with regard to the Dickey family's purchase of stock on the open market, nor could they have prevented the purchases.

f. Executive Compensation

Plaintiffs assert that Dickey and his brother, John Dickey, Co-Chief Operating Officer, received excessive compensation as set by the Compensation Committee composed of Robison, Green, and Sheridan. Plaintiffs argue that the inequity between John Dickey's compensation and that received by the other Co-Chief Operating Officer demonstrates the control that the Dickey family exerts over the Board.[3] Additionally, Plaintiffs characterize Dickey's compensation package as "excessive."[4] Defendants countered that Plaintiffs failed to plead particularized facts establishing that the compensation paid to the Dickey brothers was so excessive that it was beyond the scope of the business judgment rule presumption that the Directors acted reasonably.

3. Analysis of Independence and Disinterest for Demand Futility

Plaintiffs have failed to plead particularized facts sufficient to demonstrate that a majority of the Outside Directors lacked independence or were interested in the transactions in order to excuse demand under either the Aronson or Rales tests. The Operative Complaint is devoid of allegations that the Outside Directors were "interested" in any of the complained of transactions. Similarly, there is insufficient evidence of bias-producing relationships between Dickey and the

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[3] John Dickey, Co-Chief Operating Officer was awarded 60,000 common shares (value of $590,400), which was four times what Mr. Pinch, the other Co-Chief Operating Officer, was awarded (value of $196,800). During this time, Mr. Dickey received a salary of $570,000 and Mr. Pinch received a salary of $505,000.

[4] In 2006, Lewis Dickey received $825,000 in salary and $3.4 million in stock awards. In 2007, Lewis Dickey received $901,250 in salary, $8.5 million in stock awards, and $185,000 in non-equity incentive plan.

Outside Directors so that Dickey's interest in the Proposed Merger (and the other complained of transactions) taints the four Outside Directors. Beam v. Stewart, 845 A.2d 1040, 1050 (Del. 2004) ("[T]o render a director unable to consider a demand, a relationship must be of a bias producing nature. Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director's independence.").

In Beam v. Stewart, the Delaware Supreme Court evaluated demand futility where the company founder, CEO, and Board Chairwoman—Martha Stewart—controlled over 94% of the company. 845 A.2d 1040 (Del. 2004). The plaintiffs in Beam alleged demand futility because of Stewart's control over the company and her close business and personal relationship with the other directors. Despite Stewart's ability to "remove or replace any or all of the Directors" at will, news articles confirming personal friendships between Stewart and certain Board members, and acknowledgment that Stewart traveled in the same social circles as the directors, the Delaware Supreme Court affirmed the trial court's finding that a majority of the Board was uninterested and independent for purposes of considering demand. Id. at 1047-1051.

In this case, the Dickey family controls a majority of the voting interests in Cumulus, but much less than that held by Martha Stewart. Additionally, while Plaintiffs allege that the Outside Directors were beholden to Dickey, there are no particularized allegations to support such a conclusion other than the argument that they approved transactions which benefited Dickey and his family. Additionally, a mere threat of personal liability in a derivative suit is insufficient to render a Director interested for purposes of demand futility as Plaintiffs allege. In re Citigroup Inc., 964 A.2d 106 (Del. Ch. 2009); Desimone v. Barrows, 924 A.2d 908, 943 (Del. Ch. 2007). Plaintiffs' general allegations against the Outside Directors do not provide particularized facts sufficient to infer interest or lack of independence necessary to excuse demand. Beam, 845 A.2d 1040.

Turning to the allegation against Robison, individually, the Court finds that the compensation he received for consulting services in 2007 is under the NASDAQ threshold of $100,000 for determining director independence. SEC Release No. 34-58029. Additionally, Robison performed no consulting services for Cumulus in 2008 and, therefore, received no additional compensation in that year. Thus, he was not acting in that capacity at the time that demand could have been made. The Court finds that he was sufficiently disinterested and independent, along with the other Outside Directors to consider properly a demand made by Plaintiffs.

Similarly, the challenged transactions in this case do not demonstrate the lack of independence and disinterest sufficient to excuse demand. The CMP transaction had potential long-term value for the company, which Plaintiffs have conceded. The Outside Directors took appropriate measures with regard to their consideration of the Proposed Merger (*i.e.*, special committee, independent counsel, price negotiations, etc.). Any possible harm to result from the Proposed Merger is mooted by its termination, including the allegedly unfavorable credit agreement amendments. Approval of the stock repurchase plan, without more, is insufficient to raise a reasonable doubt regarding the independence or disinterest of the Outside Directors. See CA Public Employees' Retirement System v. Coulter, 2002 WL 31888343, at *8 (Del. Ch. 2002). Plaintiffs' allegations regarding executive compensation do not exceed the "outer limits" of board discretion and warrant a conclusion of lack of independence. See In re Citigroup, 964 A.2d 106, 138 (Del. Ch. 2009). Finally, Plaintiffs fail to plead specific allegations that the four Outside Directors either had personal interests in the challenged transactions or that they had an improper motive in approving such transactions.

B. Breach of the Duty of Loyalty to Establish Demand Futility

Like many other corporations, Cumulus' Articles of Incorporation contain an exculpatory provision that exculpates any Director from personal liability for violations of fiduciary duties, except for breaches of the duty of loyalty or intentional acts of misconduct. Thus, in order to rebut the business judgment rule for purposes of demand futility, Plaintiffs must demonstrate a breach of the fiduciary duty of loyalty, which requires that the Director Defendants acted with intent to harm, fraud, or a conscious disregard of a known duty to act. Wood v. Baum, 953 A.2d at 141; In re Citigroup, 964 A.2d 106, 125 (Del. Ch. 2009).

Plaintiffs concede that the Operative Complaint is not based upon any allegations of fraud. Plaintiffs allege that the Outside Directors' service on key management committees such as the Audit, Compensation, and Special Committees gave them first-hand knowledge that the challenged transactions were not in the best interest of Cumulus. Plaintiffs have failed, however, to allege particularized facts that the Outside Directors acted with intent to harm or a conscious disregard of their fiduciary duties sufficient for this Court to find a likely breach of the fiduciary duty of loyalty. Wood v. Baum, 953 A.2d at 142-143; *In re* Caremark Int'l Inc., Deriv. Litig., 698 A.23d 959 (Del. Ch. 1996).

C. Corporate Waste to Establish Demand Futility

Plaintiffs allege in the Operative Complaint that the CMP transaction and executive compensation paid to Dickey and his brother, John Dickey, amounted to corporate waste. Proof of corporate waste, under Delaware law, has a very high threshold requiring that a plaintiff demonstrate that a board's actions were egregious or irrational.

> Delaware law provides stringent requirements for a plaintiff to state a claim for corporate waste, and to excuse demand on grounds of waste the Complaint must allege particularized facts that lead to a reasonable inference that the director defendants authorized an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.

In re Citigroup, 964 A.2d 106, 136. Because Plaintiffs conceded that the CMP transaction could lead to substantial revenue increases in the long term, it cannot qualify as waste of corporate assets. Similarly, the allegations regarding executive compensation are insufficient to meet the stringent standard for corporate waste.

III. CONCLUSION

Accordingly, Defendants' Motion to Dismiss is hereby **GRANTED**.

SO ORDERED this 13th day of May, 2009.

Elizabeth E. Long

ELIZABETH E. LONG, SENIOR JUDGE
Superior Court of Fulton County
Atlanta Judicial Circuit

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