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Delaware Court Issues Ruling In Spring-Loading Case

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On Tuesday, Chancellor Chandler of the Delaware Court of Chancery issued his second decision in as many days regarding stock options. *In re Tyson Foods, Inc. Consolidated Shareholders Litigation*, No. 1106-N (Del. Ch. Feb. 6, 2007). His earlier opinion — *Ryan v. Gifford*, No. 221-N (Del. Ch. Feb. 6, 2007) — denied a motion to dismiss allegations regarding stock option backdating. His new decision denies a motion to dismiss claims of alleged option 'spring-loading.' Taken together, these two decisions have important implications for the many option cases now wending their way through the courts.

The new decision arises from several compensation arrangements, including stock options, afforded to senior executives at Tyson Foods. The plaintiffs alleged that four stock option awards made to senior executives were 'spring-loaded' — that is, granted 'days before Tyson would issue press releases that were very likely to drive stock prices higher.' In denying a motion to dismiss these allegations, the court concluded that spring-loading, if done intentionally, 'involves an indirect deception' and constitutes a breach of the duty of good faith: 'A director who intentionally uses inside knowledge not available to shareholders in order to enrich employees while avoiding shareholder-imposed requirements cannot, in my opinion, be said to be acting loyally and in good faith as a fiduciary.'

The court allowed that spring-loading might be appropriate in some circumstances. For example, spring-loaded options might be permitted by a company's stock option plan or otherwise authorized by shareholders. Or an award of spring-loaded options might be “made honestly and disclosed in good faith” and not 'with the intent to circumvent otherwise valid shareholder-approved restrictions upon the exercise price of the options.'

The court also made two other significant rulings. First, the court rejected an argument that claims regarding older option grants are barred by Delaware’s statute of limitations. The court found that representing to shareholders that options are granted 'at market rates,' while they are, as alleged, granted with knowledge 'that those options would quickly be worth much more,' constitutes 'fraudulent concealment' sufficient to toll the statute of limitations. The court observed that reasonable shareholders are not obligated 'to sift through a proxy statement, on the one hand, and a year’s worth of press clippings,” in the other, in order to detect spring-loading.

Second, the court found that plaintiffs were excused from making any pre-suit demand for relief upon Tyson's board of directors. According to the court, plaintiffs adequately alleged a 'conspiracy-style theory' of 'quid pro quo' transactions — spring-loaded options and other perquisites were allegedly awarded to Tyson family members by directors 'in exchange for their own favorable related-party transactions.' The court concluded that these allegations 'raise a reason to doubt the disinterestedness and independence of the board, justifying excusal of demand.'