EFiled: Mar 11 2010 1:26PM EST
Transaction ID 30006463
Case No. 3321-CC

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

CRAIG LONDON and JAMES HUNT, individually and derivatively on behalf of MA FEDERAL, INC., d/b/a iGov, a Delaware corporation,	)	
Plaintiffs,	)	
v.	)	Civil Action No. 3321-CC
MICHAEL TYRRELL, PATRICK NEVEN, and WALTER HUPALO,	)	
Defendants,	)	
and	)	
MA FEDERAL, INC., d/b/a iGov, a Delaware corporation,	)	
Nominal Defendant.	)	

MEMORANDUM OPINION

Date Submitted: December 18, 2009
Date Decided: March 11, 2010

David A. Jenkins, Michele C. Gott, and Kathleen M. Miller, of SMITH, KATZENSTEIN & FURLOW LLP, Wilmington, Delaware, Attorneys for Plaintiffs.

Elizabeth M. McGeever and J. Clayton Athey, of PRICKETT, JONES & ELLIOTT, P.A., Wilmington, Delaware; OF COUNSEL: John C. Hayes, Jr. and Kimberly J. Jandrain, of NIXON PEABODY LLP, Washington, District of Columbia, Attorneys for Defendants.

Art C. Aranilla, of MARSHALL, DENNEHEY, WARNER, COLEMAN & GOGGIN, Wilmington, Delaware, Attorneys for Nominal Defendant.

CHANDLER, Chancellor

After a four-month investigation of plaintiffs' claims in this derivative action, a special litigation committee (the "SLC") formed by nominal defendant iGov has recommended dismissal of plaintiffs' suit. I deny the SLC's motion to dismiss because there are material questions of fact regarding (1) the SLC's independence, (2) the good faith of its investigation, and (3) whether the grounds upon which it recommended dismissal of this lawsuit are reasonable. Accordingly, plaintiffs may continue to pursue this action.

I. FACTS

This dispute springs from the approval and implementation of an equity incentive plan on January 30, 2007 (the "2007 Plan") by defendants in their role as iGov directors. To better understand the context of that approval, I begin our review of the facts at an earlier date and tell the story chronologically.

A. iGov Begins to Reinvent Itself and Wins the TACLAN Contract

In 1996, plaintiffs Craig London and James Hunt, defendants Patrick Neven and Walter Hupalo, and others founded MA Federal, Inc., which does business as iGov ("iGov" or the "Company"). iGov is a government contracting firm that initially focused on the reseller market for information technology hardware, primarily selling to federal military and civilian agencies. After nine years in the low margin, highly competitive reseller market, however, the Company decided to change its focus from product sales to the higher-margin government services

market. This shift in focus, which occurred in 2005, was driven by management's view that iGov could not sustain itself over the long term in the reseller business because of increasing competition from larger players.

In October 2005, iGov won its first government services contract with the United States Special Operations Command. iGov refers to this agreement as the TACLAN contract, which stands for Tactical Local Area Network Production. TACLAN units are portable centers capable of coordinating communications for special operations forces all over the world. Under the TACLAN contract, iGov was to engineer, manufacture, test, train, and support TACLAN units, something it had little to no previous experience doing. Plaintiffs' complaint alleges that the TACLAN contract was a 5-year, $300 million competitive contract that would likely provide iGov with a substantial stream of high-margin services revenue. The $300 million figure in the TACLAN contract was an expenditure ceiling that could not be exceeded without government authorization, not a guarantee that the government would actually spend $300 million. iGov's ongoing performance under the TACLAN contract would largely determine how much the government spent. iGov's gross profit margins on the TACLAN contract would, of course, depend on how well iGov managed its costs. Thus, profitability under the TACLAN contract was driven by the volume of government orders and iGov's cost management.

B. Tyrrell is Hired to Help Solve iGov's Financial Difficulties

iGov incurred substantial non-recurring expenses when it began to reinvent itself as a service provider in 2005. These expenses placed iGov in a financially precarious position. In an effort to lift the Company out of its fiscal doldrums, iGov's CEO, Neven, sought help from a professional "turn-around expert" called Tatum LLC. Tatum provided Michael Tyrrell for the job and Tyrrell began to work for iGov as a consultant in September 2005.

As a result of the financial difficulties iGov experienced in 2005, its relationship with its primary lender soured. By May 2006, iGov was searching for a new lender to supply it with an operating line of credit. Textron Financial ("Textron") emerged as a promising source of credit. To induce Textron to extend the needed credit, Tyrrell kept Textron apprised of iGov's financial condition on an ongoing basis. Tyrrell created and approved the financial information transmitted to Textron, which included monthly income statements, balance sheets, and forecasts for fiscal years 2006 and 2007.

C. The First Textron Forecast and the DHS Contract

On May 4, 2006, Tyrrell sent Textron an email with a fiscal year 2007 ("FY07") forecast reflecting an EBITDA of approximately $3.5 million (the "First Textron Forecast"). In the email Tyrrell explained that the First Textron Forecast assumed iGov "will be successful in winning the Department of Homeland

Security (DHS) contract."[1] The DHS contract is a competitive contract under which multiple vendors compete to provide information technology hardware to the various agencies directed by the DHS. Tyrrell included $10 million in DHS contract revenue in the First Textron Forecast. Tyrrell explained to Textron that he was normally "very hesitant to put unawarded contracts into [iGov] forecasts" but nevertheless included $10 million in DHS contract revenue because he had "been pretty conservative in other areas" of the First Textron Forecast and felt that $10 million was "a reasonable figure."[2] He further noted that if iGov was awarded the DHS contract it would probably yield $30 – 50 million in first year business. Other important line items in the First Textron Forecast included $6 million in revenue for iGov's Air Force unit, $35 million in revenue for GCG (an iGov subsidiary), and $195 million in revenue for the TACLAN contract.

D. Tyrrell Becomes CFO after Textron Financing is Obtained

By July 2006 negotiations with Textron were nearing completion. To finalize a $12 million line of credit, London was asked to execute a personal guarantee required by Textron's lending guidelines. Defendants allege that on the due date of the guarantee, London demanded an employment contract in exchange for signing. Apparently Neven did not look favorably on this demand and decided to remove London from his position as CFO in response. Shortly thereafter, Neven

---

[1] Pls.' Answer Ex. 12.
[2] *Id.*

asked Tyrrell to become iGov's full-time CFO. Neven signed the personal guarantee and the $12 million line of credit was obtained.

E. The Second Textron Forecast

On August 15, 2006, Tyrrell sent Textron an updated FY07 forecast showing an EBITDA of roughly $3 million (the "Second Textron Forecast"). The major differences between the Second Textron Forecast and the First Textron Forecast were that projected revenues for the GCG subsidiary were lowered to $25 million and projected revenues from the TACLAN contract were lowered to $183 million.[3]

F. The Original Chessiecap Forecast

At some point in 2006 defendants decided that it would be advisable to implement the 2007 Plan for the benefit of key members of management. Defendants caused iGov to retain Chessiecap Securities, Inc. ("Chessiecap") to value iGov stock for purposes of setting the exercise price of options under the 2007 Plan. Plaintiffs complaint alleges that defendants "secretly decided to implement [the 2007 Plan] at an unfair price to benefit themselves at the expense of the other stockholders."[4]

Chessiecap was to perform a valuation of iGov as of July 31, 2006. To support the valuation, Tyrrell sent Chessiecap a FY07 forecast on August 23, 2006 that showed an EBITDA of roughly $3 million (the "Original Chessiecap

---

[3] Associated expenses were also lowered.
[4] Compl. ¶ 26.

Forecast"). The Original Chessiecap Forecast was identical to the Second Textron Forecast.[5]

G. The Revised Chessiecap Forecast and the Final Valuation

On October 2, 2006, Chessiecap completed its Draft Valuation, concluding that iGov equity was worth $5.5 million. After reviewing the Draft Valuation, Tyrrell sent an email to Chessiecap expressing his view that it was "probably on the high side."[6] Tyrrell gave various reasons for this view. Three of these reasons are of note. First, Tyrrell asserted that the projected $10 million in revenue (and associated costs) for FY07 from the DHS contract should not be considered in the valuation because the DHS contract had not been formally awarded. Second, Tyrrell asserted that the projected $25 million in revenues (and associated costs) from the GCG subsidiary for FY07 should be removed because GCG would be closed before year-end. Third, Tyrrell asserted that most of the projected $6 million in revenues and associated costs from the Air Force unit for FY07 should be removed because iGov was also likely to close down that unit before year-end. On October 18, 2006, Tyrrell sent Chessiecap a revised forecast that eliminated the revenues and expenses from these three line items.[7] This updated FY07 forecast

---

[5] The Second Textron Forecast and the Original Chessiecap Forecast are important to our story because, as will be discussed, plaintiffs' valuation expert, the McLean Group, relied on these identical forecasts in conducting a separate valuation of iGov.

[6] SLC Report Ex. L-8.

[7] Revenues from the Air Force unit were not completely eliminated. They were revised downward from $6 million to $900,000.

showed an EBITDA of $1.8 million (the "Revised Chessiecap Forecast"), 40% less than the $3 million EBITDA reflected in the Original Chessiecap Forecast.

Plaintiffs' complaint asserts that in preparing the Revised Chessiecap Forecast, Tyrrell made material changes based on developments that had occurred after the July 31, 2006 valuation date. For example, iGov did not announce that it was going to close down GCG until October 4, 2006, but Tyrrell incorporated this development into the Revised Chessiecap Forecast. Thus, Chessiecap's Final Valuation, of which more will be said momentarily, was not strictly an evaluation based on what was known or anticipated as of July 31, 2006. According to plaintiffs, this is problematic because, although the Revised Chessiecap Forecast accounted for negative developments that occurred after July 31, 2006, it did not reflect positive developments that occurred after the valuation date. Specifically, plaintiffs allege that iGov had been awarded a $7 million contract with the U.S. Patent and Trademark Office ("PTO") in September 2006, but this was not reflected in the Revised Chessiecap Forecast. Also, plaintiffs allege that by October 2006 the TACLAN contract was generating higher profits than management had originally expected but this was ignored when preparing the Revised Chessiecap Forecast.[8]

[8] As will be discussed, plaintiffs also allege that when the 2007 Plan was approved on January 30, 2007, defendants were certain the TACLAN contract was performing better than anticipated but made no efforts to have Chessiecap update the Final Valuation to reflect this.

Plaintiffs contend that the Revised Chessiecap Forecast was never disclosed to Textron. Plaintiffs also allege that the Revised Chessiecap Forecast was never used by the Company in managing its business. Rather, the Revised Chessiecap Forecast was purposely designed to suppress the value of the Company and was only used by Chessiecap.

On October 31, 2006, Chessiecap certified its Final Valuation of iGov, which was partially based on the Revised Chessiecap Forecast. The Final Valuation placed the value of iGov equity at $4.7 million, approximately 15% lower than Chessiecap's Draft Valuation of $5.5 million. At the time the Final Valuation was issued, Chessiecap did not calculate the fair market value per share of iGov equity. This was done later to support approval of the 2007 Plan on January 30, 2007.

H. The Third Textron Forecast

After the Final Valuation was issued, Tyrrell continued to update Textron on iGov's finances. Tyrrell's updates portrayed a brighter outlook on the EBITDA front than had been communicated to Chessiecap in the Revised Chessiecap Forecast. For example, on December 1, 2006, Tyrrell resent the Second Textron Forecast to a different Textron employee. In the accompanying email Tyrrell

explained that iGov was in the process of further updating its FY07 forecast and that he expected the revised forecast to be "just as good, if not better."[9]

On December 8, 2006, as promised, Tyrrell sent Textron an updated FY07 forecast that showed an EBITDA of approximately $3.1 million (the "Third Textron Forecast"). The individual line items in the Third Textron Forecast differed in many respects from the Second Textron Forecast, though the overall EBITDA was substantially the same.[10] The important factual consideration for present purposes is the many respects in which the Third Textron Forecast differed from the Revised Chessiecap Forecast. For instance, the Third Textron Forecast included approximately $1.9 million in revenue for the Air Force unit (as opposed to $900,000), $950,000 in revenue for GCG (as opposed to $0), and $15 million in revenue for the DHS contract (as opposed to $0).[11] The Third Textron Forecast also reflected $7 million higher projected revenues for the Navy unit. Although TACLAN revenues were projected to be roughly $8 million lower, the projected gross profit from the TACLAN contract was $2 million higher. The net result of all these changes was a stark difference in EBITDA between the Third Textron Forecast and the Revised Chessiecap Forecast: $3.1 million versus $1.8 million.

---

[9] SLC Report Ex. L-16.

[10] Some of the individual line items in the forecast were markedly more positive and others were more negative. The net difference in EBITDA between the forecasts, however, was not especially pronounced: $3.1 million in the Third Textron Forecast versus $3 million in the Second Textron Forecast.

[11] Projected costs for these units were also higher.

I. The Tyrrell Baseline Forecast

Defendants allege that in December 2006 Tyrrell developed three additional forecasts, presumably for internal purposes. Each forecast was based on different assumptions about the future and accordingly yielded different results. The "Baseline Forecast" showed an EBITDA of $2.1 million (the "Tyrrell Baseline Forecast"). It was nearly identical to the Third Textron Forecast. The one major difference was that the $15 million in revenue from the DHS contract and associated expenses were eliminated from the Tyrrell Baseline Forecast. The gross profit margin on the DHS contract accounted for most of the $1 million difference in EBITDA between the two projections.[12] In addition to the Tyrrell Baseline Forecast, Tyrrell allegedly developed a $4.3 million EBITDA forecast which he dubbed the "Better Forecast" and a $6.1 million EBITDA forecast which he dubbed the "Stretch Forecast." From the record, it is not entirely clear what, if anything, these latter two forecasts were used for.

J. iGov's Internal Forecasts Remain Higher than the Revised Chessiecap Forecast

In addition to showing that the First, Second, and Third Textron Forecasts were decidedly more positive than the Revised Chessiecap Forecast, plaintiffs proffered evidence that iGov continued to project a FY07 EBITDA of

[12] The Tyrrell Baseline Forecast is important to our story because, as will be discussed, this forecast was relied upon by the SLC's independent valuation firm, Stout Risius Ross, in conducting its valuation of iGov.

approximately $3-4 million internally *after* Chessiecap had been given the Revised Chessiecap Forecast showing an EBITDA of only $1.8 million. For example, in December 2006, a strategic management plan prepared by Hupalo included a goal to "exceed $3 million in EBITDA by year-end FY'07."[13] On December 15, 2006, Neven represented in an email to a stockholder that "iGov is financially healthy again, . . . we expect to be at $150 million this coming year with an EBITAD [sic] of $3 million **. . .**"[14] On January 7, 2007, Tyrrell sent the Third Textron Forecast to the incoming CFO Rich Marksberry[15] and informed him that it was "the baseline case forecast for iGov for FY07" and that iGov was "currently updating a version that shows EBITDA of over $4 million, which we think is possibly achievable this year."[16] On January 12, 2007, Tyrrell made a presentation at a business development strategy meeting that projected FY07 EBITDA at over $4 million.[17] And on February 10, 2007, Tyrrell sent an email to a strategic consultant representing that "our working internal forecast shows EBITDA of $3MM."[18]

---

[13] SLC Report Ex. L-20.
[14] Pls.' Answer Ex. 33.
[15] Marksberry was brought over from the same consulting firm as Tyrrell, Tatum LLC.
[16] SLC Report Ex. L-23. It is worth noting here that Tyrrell's characterization of the Third Textron Forecast (sent to Textron and Marksberry) as the "baseline case" contradicts defendants' characterization of the Tyrrell Baseline Forecast (sent to SRR) as the "baseline forecast."
[17] SLC Report Ex. L-26.
[18] SLC Report Ex. L-29.

K. Plaintiffs Object to the Final Valuation

On December 22, 2006, Tyrrell became concerned that nearly half a year had passed since the July 31, 2006 valuation date on Chessiecap's Final Valuation. The 2007 Plan was taking longer to implement than defendants had anticipated. Tyrrell contacted Chessiecap and asked them if the Final Valuation needed to be updated "since our 2006 valuation is dated July 31, 2006 and the stock options will not be given until the end of next month . . .?"[19] Chessiecap replied that the Final Valuation was good for one year, unless significant events had occurred that would materially change the financial prospects of the Company.[20]

On December 29, 2006, plaintiffs were provided a copy of Chessiecap's Final Valuation placing iGov's equity value at $4.7 million. After reviewing the Final Valuation plaintiffs requested copies of the information Chessiecap had relied on. Among other things, they were given the Revised Chessiecap Forecast. In the meantime, on January 7, 2007, Tyrrell sent an email to iGov management regarding a proposal to purchase London's shares for $4 per share, plus a "kicker" down the road if iGov was sold. In the email, Tyrrell expressed the view that "since [iGov's] valuation is a few months old, [iGov] will probably have to have it

---

[19] SLC Report Ex. L-21.
[20] *Id.*

updated and the valuation will likely be higher than $4.7 million . . . ."[21] Tyrrell concluded that the $4 per share figure would still be fair to London because the number of iGov's issued shares was soon to be increased by the 2007 Plan. On January 16, 2007, however, after reviewing the Revised Chessiecap Forecast, London objected to iGov relying on Chessiecap's Final Valuation for purposes of the 2007 Plan because he felt the information upon which the Final Valuation was based was stale and inaccurate. The next day, Hunt, who also believed the Final Valuation was unreliable, made an offer to buy all of Neven's stock at $28 per share. Hunt later made the same offer to other shareholders, apparently with the design of purchasing enough shares to gain voting control of iGov.

L. Plaintiffs are Removed from the Board

At this point, in a narrative much belabored with disorienting descriptions of multiple financial forecasts, the human controversy begins. Plaintiffs London and Hunt comprised half of the iGov board on January 16 and 17, when it became clear that they disagreed with using Chessiecap's Final Valuation in its then-current form. The other half of the iGov board consisted of defendants Neven and Hupalo. Collectively, Neven and Hupalo owned 42.5% of iGov's voting stock. On January 19, 2007, Neven and Hupalo teamed up with iGov officer and shareholder Jack Pooley, the three of them collectively owning 50.1% of iGov's voting stock, and

[21] SLC Report Ex. L-22.

executed written stockholder consents removing plaintiffs from the board. At the same time, they elected Tyrrell to the board. Thus, after January 19, 2007, defendants made up the entire iGov board.

M. The 2007 Plan is Adopted

On January 30, 2007, the core series of events occurred that gave rise to this litigation. To address Hunt's $28 per share offer, defendants engaged Chessiecap to prepare an addendum to its Final Valuation. In the addendum, dated January 30, 2007, Chessiecap opined that Hunt's offer did not affect or change Chessiecap's opinion that iGov's equity value was $4.7 million. The addendum stated that Hunt's offer was conditioned on his receiving enough shares to own a majority of iGov's voting stock and that this excluded Hunt's offer "from any consideration in Chessiecap's valuation of the Company, which was premised upon privately-held, minority discounted stock."[22] The addendum then determined for the first time the share price of iGov stock, concluding that the fair market value per share as of July 31, 2006 was $4.92. In calculating this per-share price, the addendum incorrectly included 65,000 shares and 300,000 options that were not outstanding as of the July 31, 2006 valuation date. These shares and options were not approved until January 30, 2007 (the day the addendum was issued) as part of the 2007 Plan, which I will describe in detail momentarily. Plaintiffs assert that defendants knew

[22] SLC Report Ex. M.

these shares and options were inappropriately included in Chessiecap's per share calculation, but ignored the purported error as it resulted in a lower value that benefitted defendants.

Defendants also held a special meeting of the iGov board on January 30, 2007. As Hunt, the former chairman, had just been removed as a director, the first order of business was appointing a new chairman. Neven was appointed by unanimous consent and he then called the meeting to order. During the meeting Tyrrell was named President, Chief Operating Officer, and Treasurer of iGov and Marksberry was named CFO.

The primary purpose of the meeting was to consider the 2007 Plan. Under the 2007 Plan, 300,000 stock options were to be issued to various directors and senior executives. Of the 300,000 options, Tyrrell was to receive 80,000, Neven 50,000, and Hupalo 50,000. Thus, collectively, defendants were to be given 60% of the options granted under the 2007 Plan. In addition, the 2007 Plan contemplated the sale of 65,000 shares of stock to Tyrrell. In contrast, plaintiffs were not to be given any options or shares under the 2007 Plan, presumably because they had been removed from their director and management positions.

The 2007 Plan provided that the exercise price of the options could not be less than 100% of the fair market value of iGov common stock *on the date the options were granted* and that the sale of shares to Tyrrell would be at their fair

market value *on the date of sale*. Defendants unanimously voted as directors to approve the 2007 Plan. Defendants simultaneously adopted $4.92 per share as the fair market value of iGov shares on January 30, 2007 based on Chessiecap's Final Valuation, dated July 31, 2006, and the associated addendum. Before approving the 2007 Plan, Tyrrell represented to Chessiecap that no material change had occurred and so it was still appropriate, in his view, to rely on the Final Valuation.[23] All defendants then implicitly accepted that no material change had occurred by approving $4.92 per share as the fair market value. Tyrrell purchased his 65,000 shares the next day.

Plaintiffs allege that the 2007 Plan was designed to substantially reduce their ownership interests in iGov and increase defendants' interests to a level that would permit defendants to entrench themselves as iGov directors and managers. In support of this theory, plaintiffs assert that implementation of the 2007 Plan immediately reduced their collective ownership interests from 44% to 40%. On a fully diluted basis, the 2007 Plan allegedly reduced plaintiffs' collective ownership interests from 42.3% to 28.7%. At the same time, the 2007 Plan allegedly increased defendants' collective ownership interests from 50.1% to 54.1% and, on

[23] SLC Report 63.

a fully diluted basis, defendants' collective ownership interests allegedly increased from 48.2% to 54.2%.[24]

As we have discussed, plaintiffs contend that defendants manipulated the Final Valuation by excluding positive developments which occurred after July 31, 2006 from the Revised Chessiecap Forecast. Plaintiffs also contend that defendants wrongfully declined to update either the Revised Chessiecap Forecast or the Final Valuation before approving the 2007 Plan, falsely representing that no material change had occurred between July 31, 2006 and January 30, 2007. Plaintiffs point to three specific developments which were purportedly ignored. First, the $7 million PTO contract had been awarded on September 29, 2006, but was not reflected in the Revised Chessiecap Forecast or the Final Valuation. Second, on December 20, 2006, iGov received a pre-award notice that it had been selected as one of the vendors under the DHS contract, putting the Company one step further towards realizing DHS revenue in 2007, but no such revenues were included in the Revised Chessiecap Forecast or the Final Valuation. And third, by January 30, 2007, iGov was aware that the TACLAN contract was performing

[24] In calculating defendants' collective ownership interests, plaintiffs include shares owned by Pooley, who is not a defendant in this suit. According to plaintiffs, Pooley was controlled by Neven during all relevant periods and should be considered part of defendants' voting block. If Pooley's shares are not included in the calculation, the 2007 Plan increased defendants' collective ownership interests from 42.5% to 47.1%. On a fully diluted basis defendants' collective ownership interests increased from 40.9% to 49.3%.

better than expected but did not have Chessiecap update its Final Valuation to reflect the increased profitability of the TACLAN contract.[25]

Other features of the 2007 Plan should be noted to tell the full story. For starters, the 2007 Plan replaced an existing equity incentive plan at iGov. In February 2001, the iGov board had approved the 2000 Stock Option and Incentive Plan (the "2000 Plan"). The 2000 Plan gave iGov the power to grant stock options to various officers, directors, consultants, and other employees at an exercise price of $5.00 per share. No formal valuation appears to have supported the $5.00 strike price, though options were granted to employees and exercised at this price. A few years later, on February 26, 2003, London proposed that Neven, Hupalo, and London should each be awarded 50,000 options under the 2000 Plan at an exercise price of $1.25 per share as compensation for their services to iGov. The board approved London's proposal, but these options were never exercised. In fact, there is a dispute over whether they were ever actually granted. Evidently, in 2005

[25] In support of this last point about the TACLAN contract plaintiffs proffer an email from Tyrrell to Textron on October 12, 2006 reporting that iGov "now has $39 million in delivery orders for TACLAN. This is huge because it's the first time that our backlog has been so large and predictable." *See* SLC Report Ex. L-9. Plaintiffs also proffer an email from Tyrrell to iGov management on January 17, 2007 reporting on December 2006 income and explaining that "TACLAN led the way with $6.1 million in Revenues and over $655K in Net Income, which covered nearly 90% of our Operating Expenses for the month . . . Overall, TACLAN did much better than expected . . . ." *See* SLC Report Ex. L-27. In addition, the Revised Chessiecap Forecast showed TACLAN's projected gross profit for FY07 at approximately $4.5 million while the Third Textron Forecast showed TACLAN's projected gross profit for FY07 at approximately $6.5 million. Thus, the financials Tyrrell gave Textron on December 8, 2006 projected TACLAN's gross profit to be $2 million higher for FY07 than the financials Tyrrell provided to Chessiecap on October 18, 2006.

iGov's auditors noted that the marked difference between the $5.00 and $1.25 strike prices under the 2000 Plan had not been properly accounted for, and would give rise to a substantial charge on the financial statements if iGov was determined to leave the $1.25 options in place.

Defendants contend that the 2007 Plan was an effort to revamp the 2000 Plan, which was imperfectly structured, and to replace the $1.25 options granted to Neven, Hupalo, and London. Accordingly, defendants assert that in adopting the 2007 Plan Neven and Hupalo gave up options with a strike price of $1.25 for options with a strike price of $4.92, sacrificing personally for the good of the Company. Plaintiffs, on the other hand, contend that the $1.25 options were never actually granted and so Neven and Hupalo gave up nothing. I will explore this dispute later. For now, I simply note that the 2007 Plan as adopted explicitly superseded the 2000 Plan (at least to the extent it was legitimate).

The 2007 Plan also gave Neven and Tyrrell the collective authority to grant up to 25,000 options to the new CFO, Marksberry, at an exercise price equal to the fair market value of the shares *on the date of the grant.* If Neven and Tyrrell both wished to grant Marksberry these options, the 2007 Plan required them to do it by April 15, 2007. Marksberry did not receive a grant of options by that date and the delegated authority to Neven and Tyrrell expired.

Finally, the 2007 Plan provided that stockholder approval would be obtained within twelve months. Plaintiffs, who remained stockholders in iGov after their removal from the board, allege that they never voted on the 2007 Plan.[26]

N. The DHS Contract is Awarded

A few months later, in March 2007, iGov announced that it had formally been awarded the DHS contract. This placed the Company firmly in the position of being able to realize DHS revenues in 2007. The amount of DHS revenues to be realized, of course, would depend on how well iGov performed under the DHS contract relative to the other approved vendors. As we have seen, Tyrrell had excluded DHS revenues from the Revised Chessiecap Forecast because the DHS contract had not been formally awarded.

O. Marksberry is Granted 25,000 Shares

Despite having formally secured the DHS contract, on May 30, 2007, defendants approved the grant of 25,000 options to Marksberry at a strike price of

---

[26] This is significant in part because 8 *Del. C.* § 144 provides that transactions approved by interested directors are not void or voidable if the transaction (1) is also approved by a majority of disinterested directors after disclosure of all the material facts, (2) is approved in good faith by the *disinterested* shareholders after disclosure of all the material facts, or (3) is fair to the corporation at the time it is approved by the board. Defendants were interested in the 2007 Plan and comprised the entire board at the time they approved it, so the 2007 Plan cannot be sustained under the first prong of § 144. After the 2007 Plan was enacted plaintiffs collectively owned a majority of the disinterested shares, so their vote would be necessary to validate the 2007 Plan under the second prong of § 144, but that did not happen. Accordingly, the 2007 Plan can only be upheld if it was fair to iGov when it was enacted. *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 366 n.34 (Del. 1993) ("Under this statute, approval of an interested transaction by either a fully-informed disinterested board of directors . . . or the disinterested shareholders . . . provides business judgment protection.").

$4.92 per share.[27] Apparently cognizant that ten months had passed since the date of Chessiecap's Final Valuation, defendants explicitly stated in the board resolution approving the grants that "there ha[d] been no material changes affecting the Company's financial operations or prospects which would affect [the Final] Valuation since the date of its last determination of Fair Market Value."[28] Thus, in approving the option grants to Marksberry, defendants relied on Chessiecap's advice that the Final Valuation was good for one year absent any material changes and on its own determination that no material changes had occurred between July 31, 2006 and May 30, 2007. Defendants made this determination even though the DHS contract had been formally awarded in the interim.

P. Plaintiffs' Suit

After the 2007 Plan was approved, plaintiffs made a books and records request under 8 *Del. C.* § 220. The ground for the request was plaintiffs' objection to iGov using Chessiecap's Final Valuation as the basis for the $4.92 per share strike price. Plaintiffs also engaged the McLean Group, a valuation firm, to conduct separate valuations of iGov's equity as of October 31, 2006 and December 31, 2006 (the "McLean Valuations"). In performing the McLean Valuations,

[27] Defendants, acting as the entire board, had to approve this grant because the delegated authority to Neven and Tyrrell had expired.
[28] SLC Report Ex. L-30.

McLean used the Second Textron Forecast[29] rather than the Revised Chessiecap Forecast. McLean noted that Chessiecap's Final Valuation incorrectly included in its option-pricing model the 300,000 options and the 65,000 shares approved by the 2007 Plan, rather than the outstanding 745,000 shares that actually existed as of July 31, 2006. The McLean Valuations placed the per share value of iGov equity at $13.32 on October 31, 2006 and $15.45 on December 31, 2006. The McLean Valuations were sent to iGov on September 18, 2007, along with McLean's separate critique of Chessiecap's Final Valuation.

While the McLean Valuations were being conducted, iGov expanded the size of its board from three members to five. In August 2007, Vincent Salvatori and John Vinter became iGov directors. Both men were first approached by Tyrrell and both had connections to him, which I will discuss at some length later. Both men also had extensive experience in government contracting that understandably made them attractive candidates for iGov's board.

On October 31, 2007, after attempts to resolve the dispute failed, plaintiffs filed their complaint. The counts in the complaint are characterized as derivative and individual, alleging harm to iGov as a company and to plaintiffs in their personal capacity. In February 2008, the complaint was amended in response to defendants' motion to dismiss.

[29] The Second Textron Forecast was identical to the Original Chessiecap Forecast.

The amended complaint contains three counts. Count I is a derivative claim for breach of fiduciary duty alleging defendants failed to honor their duties of care and loyalty. With regards to the duty of loyalty, Count I alleges that defendants materially misrepresented iGov's business prospects to Chessiecap in order to ensure a low valuation so that they could personally obtain iGov stock at an artificially low price. Count I also alleges that defendants breached their duty of loyalty by approving the 2007 Plan with the intent that it would firmly entrench them in their positions as directors and managers of iGov. Regarding the duty of care, Count I alleges that defendants failed to consider all material information available to them in determining the value of iGov stock for purposes of the 2007 Plan. In that vein, Count I alleges that defendants knew when they approved the 2007 Plan that Chessiecap's Final Valuation was based on stale and inaccurate information and was therefore an inappropriate tool for determining the fair value of iGov shares as of January 30, 2007. Count I also alleges that defendants had even more reason to believe the Final Valuation was outdated by May 30, 2007 because the DHS contract had been definitively awarded by that date, but defendants still declined to have the Final Valuation updated. Count II is a request for relief rather than a cause of action. It seeks rescission of the option grants to defendants and the stock sale to Tyrrell based on the breaches of fiduciary duty described in Count I. Count III is characterized by plaintiffs as an individual

claim, the personal harm being that defendants improperly diluted plaintiffs' ownership interests by implementing the 2007 Plan, thereby expropriating economic value and voting power from them. For their part, defendants contend that Count III is a derivative claim.

Q. iGov Forms a Special Litigation Committee after its Motion to Dismiss is Denied

After plaintiffs' complaint was amended, defendants again filed a motion to dismiss on several grounds, including plaintiffs' failure to make a demand on the board before filing suit. In my June 24, 2008 Opinion, I found that plaintiffs' complaint "easily survived" defendants' motion to dismiss; demand being excused because a majority of the board was interested in the transaction.[30] Thereafter, on November 21, 2008, the iGov board voted to form a two-member SLC comprised of Salvatori and Vinter to consider whether it was in iGov's best interest to pursue the derivative claims in plaintiffs' complaint.

After its formation, the SLC obtained advisors. In February 2009 the SLC engaged Blank Rome LLC as independent counsel and in March 2009 the SLC engaged Stout Risius Ross ("SRR") as its independent financial advisor.

---

[30] *London v. Tyrrell*, 2008 WL 2505435 (Del. Ch. June 24, 2008).

From April 2009 to July 2009 the SLC conducted its investigation. Discovery was stayed during this time. In conducting the investigation the SLC interviewed twelve witnesses and reviewed relevant documentation produced by the parties, iGov, Textron, Chessiecap, McLean, and others, including the documents provided to plaintiffs in response to their § 220 action. To inform their investigation, the SLC sought counsel's advice as to the legal principles that determine whether defendants complied with their fiduciary duties.

During the investigation, the SLC charged SRR with two tasks. First, SRR was instructed to perform independent valuations of iGov as of October 31, 2006 and as of January 30, 2007 (the "SRR Valuations"). The SLC required SRR to complete the SRR Valuations without reviewing the work done by Chessiecap and McLean, presumably to ensure that SRR would not be influenced by any previous valuation work performed. The SLC determined that October 31, 2006 was an appropriate valuation date because it believed that Chessiecap's Final Valuation was essentially current as of October 31, 2006, despite being dated July 31, 2006.[31] The SLC determined that January 30, 2007 was an appropriate date for more obvious reasons; it was the date the challenged 2007 Plan was adopted. I will discuss the SRR Valuations at greater length later but for now I note that the FY07

[31] SLC Report 63 ("The [Final] [V]aluation . . . relied upon iGov financial data for the fiscal year ending October 31, 2006. In the opinion of the [SLC] and SRR, Chessiecap's valuation is more properly viewed as a valuation as of October 31, 2006.").

EBITDA forecast SRR used was the Tyrrell Baseline Forecast. The SRR Valuations concluded that iGov was worth $3.90 - $4.15 per share as of October 31, 2006 and $5.24 - $5.39 per share as of January 30, 2007. The SLC concluded that the $4.92 per share price was "within the range of fair market value" based on the SRR Valuations as well as Salvatori and Vinter's own professional experience in government contracting.[32] Notably, despite the SRR Valuations, the SLC reasoned that $4.92 per share "was likely too high, from a practical, real world perspective, to express the Company's value."[33]

The second task SRR was charged with was to review the Chessiecap Final Valuation and the McLean Valuations and opine on them. SRR did this and helped the SLC prepare a summary comparison between the Chessiecap Valuation and McLean Valuations that was included in the SLC Report. The SLC concluded that both sets of valuations were "tainted" and reasoned that it was not necessary to determine which set of valuations was better.[34] The SLC concluded that it could make a recommendation respecting this suit and iGov's best interests without declaring a winner in the battle between plaintiffs' and defendants' experts.

On August 5, 2009, the SLC Report was filed. The SLC Report concludes that the suit is not in the best interests of the Company and recommends that it be

---

[32] SLC Report 50.
[33] *Id.*
[34] SLC Report 47.

dismissed. The SLC believes that the discovery that will resume if the suit is allowed to continue will be extremely disruptive to iGov's operations. The SLC also believes that negative publicity associated with the suit will immediately damage the Company's goodwill and reputation in the government contracting community.

As to the actual claims asserted in plaintiffs' complaint, the SLC Report concludes as follows. First, as to Count I, the SLC concluded that defendants acted properly in adopting the 2007 Plan and did not breach their duties of care or loyalty. With regards to the duty of care, the SLC found that the 8 *Del. C.* § 102(b)(7) provision in iGov's certificate of incorporation exculpates directors from personal liability not involving intentional misconduct or knowing violations of the law. The SLC concluded that a duty of care claim should not be pursued because defendants breach of care conduct, if it occurred, would be covered by the § 102(b)(7) provision. As to the duty of loyalty, the SLC concluded that defendants' approval of the 2007 Plan and actions leading to that approval would satisfy the entire fairness standard because the process employed was fair and the $4.92 strike price was fair. As to Count II the SLC determined that no rescission of the options granted and shares sold to defendants under the 2007 Plan should occur because $4.92 was in the range of fair market value. Finally, the SLC determined that Count III should be dismissed based on its belief that any dilution

plaintiffs suffered was experienced equally by other shareholders and thus, no individual claim exists. Count III, according to the SLC, is a derivative claim arising out of the conduct alleged in Count I and should be dismissed for the same reasons that Count I should be dismissed.

After reviewing the SLC Report plaintiffs filed an opposition brief arguing that the SLC has not met the standard required by *Zapata Corporation v. Maldonado*[35] and its progeny for dismissal of a claim based on an SLC's recommendation in a demand-excused case. I now consider whether the SLC has met the *Zapata* standard and, consequently, whether the suit should be dismissed or permitted to proceed.

II. STANDARD

The Supreme Court's decision in *Zapata* governs demand-excused derivative cases in which the board sets up an SLC that investigates whether a derivative suit should proceed and recommends dismissal after its investigation.[36] In *Zapata*, the Supreme Court rejected the notion that the SLC's recommendation, made in the form of a motion to dismiss, should be subject to business judgment review.[37] Rather, the Supreme Court established a two-step analysis that must be applied to the SLC's motion to dismiss. The first step of the analysis is mandatory.

---

[35] 430 A.2d 779 (Del. 1981).
[36] *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 (Del. 1981).
[37] *Id.* at 787.

The Court reviews the independence of SLC members and considers whether the SLC conducted a good faith investigation of reasonable scope that yielded reasonable bases supporting its conclusions.[38] The second step of the analysis is discretionary.[39] The Court applies its own business judgment to the facts to determine whether the corporation's best interests would be served by dismissing the suit. The second step is designed for situations in which the technical requirements of step one are met but the result does not appear to satisfy the spirit of the requirements.[40]

An SLC's motion to dismiss is a bit of a curiosity, procedurally speaking. It does not arise directly out of one of our rules of civil procedure. Rather, it is derived by analogy to a motion to dismiss a derivative suit based upon a voluntary settlement between parties and by analogy to a Rule 41(a)(2) motion whereby a plaintiff unilaterally seeks voluntary dismissal of a complaint after the defendant files an answer.[41] The Court treats the SLC's motion in a manner akin to a Rule 56 motion for summary judgment; the SLC bears the burden of demonstrating that there are no genuine issues of material fact as to its independence, the reasonableness and good faith of its investigation, and that there are reasonable

---

[38] *Id.* at 789.
[39] *Id.*; *Kaplan v. Wyatt*, 499 A.2d 1184, 1192 (Del. 1985) (holding that the second step of the *Zapata* analysis is discretionary).
[40] *Zapata*, 430 A.2d at 789.
[41] *Kaplan v. Wyatt*, 484 A.2d 501, 506-07 (Del. Ch. 1984).

bases for its conclusions.[42] If the Court determines that a material fact is in dispute on any of these issues it must deny the SLC's motion.[43] When an SLC's motion to dismiss is denied, control of the litigation is returned to the plaintiff shareholder.[44] With the relevant standard broadly articulated, I now proceed to step one of *Zapata*.

III. ANALYSIS

A. Were the SLC Members Independent?

Whether an SLC member is independent "is a fact-specific determination made in the context of a particular case."[45] When an SLC member has no personal interest in the disputed transactions, the Court scrutinizes the members' relationship with the interested directors, as that would be the source of any independence impairment that might exist.[46] The Court considers the relationship between each SLC member and the interested directors.

An SLC member does not have to be unacquainted or uninvolved with fellow directors to be regarded as independent.[47] But an SLC member is not independent if he or she is incapable, for any substantial reason, of making a

[42] *Id.* at 507.
[43] *Id.* at 508.
[44] *Id.* at 509.
[45] *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004).
[46] *Katell v. Morgan Stanley Group, Inc.*, 1995 WL 376952, at *8 (Del. Ch. June 15, 1995).
[47] *Sutherland v. Sutherland*, 958 A.2d 235, 241 (Del. Ch. 2008).

decision with only the best interests of the corporation in mind.[48] Essentially, this means that the independence inquiry goes beyond determining whether SLC members are under the "domination and control" of an interested director.[49] Independence can be impaired by lesser affiliations, so long as those affiliations are substantial enough to present a material question of fact as to whether the SLC member can make a totally unbiased decision. For example, independence could be impaired if the SLC member senses that he owes something to the interested director based on prior events.[50] This sense of obligation need not be of a financial nature.[51]

The independence inquiry under the *Zapata* standard has often been informed by case law addressing independence in the pre-suit demand context and vice-versa.[52] This is a useful exercise but not one without limits. As the Supreme Court noted in *Beam v. Stewart*:

> Unlike the demand-excusal context, where the board is presumed to be independent, the SLC has the burden of establishing its own independence by a yardstick that must be "like Caesar's wife"-"above

[48] *In re Oracle Derivative Litig.*, 824 A.2d 917, 920 (Del. Ch. 2003).
[49] *Id.* at 937.
[50] *Id.* at 939 n.52.
[51] *Id* at 938-39.
[52] For example, in *Oracle*, a case governed by *Zapata*, after articulating what it means for an SLC member to be independent, the Court noted that "[t]his formulation is wholly consistent with the teaching of *Aronson* [a pre-suit demand case], which defines independence as meaning that 'a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." *Oracle*, 824 A.2d at 938 (citing *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984). Also, in the pre-suit demand case of *Beam v. Stewart*, 833 A.2d 961 (Del. Ch. 2003), the Court's independence analysis was informed by *Oracle*. *Id.* at 979.

> reproach." Moreover, unlike the presuit demand context, the SLC analysis contemplates not only a shift in the burden of persuasion but also the availability of discovery into various issues, including independence.[53]

Unlike a board in the pre-suit demand context, SLC members are not given the benefit of the doubt as to their impartiality and objectivity. They, rather than plaintiffs, bear the burden of proving that there is no material question of fact about their independence. The composition of an SLC must be such that it fully convinces the Court that the SLC can act with integrity and objectivity, because the situation is typically one in which the board as a whole is incapable of impartially considering the merits of the suit.[54] Thus, it is conceivable that a court might find a director to be independent in the pre-suit demand context but not independent in the *Zapata* context based on the same set of factual allegations made by the two parties. This is not because the substantive contours of the independence doctrine are different in these two contexts. Rather, it is primarily a function of the shift in the burden of proof from the plaintiff to the corporation when the suit moves from the pre-suit demand zone to the *Zapata* zone.

It is undisputed that neither SLC member had a personal stake in the challenged transactions. Neither Salvatori nor Vinter received shares of stock or options under the 2007 Plan and neither faces any risk of personal liability in this

---

[53] 845 A.2d 1040, 1055 (Del. 2004) (internal citations omitted).
[54] *Oracle*, 824 A.2d at 940.

suit. Moreover, Salvatori and Vinter were not appointed to the board until after the 2007 Plan was adopted. In addition, plaintiffs do not allege that any of the defendants dominate or control Salvatori or Vinter. Thus, the focus must be on whether the relationships Salvatori and Vinter have with defendants are of such a nature that they might have caused Salvatori and Vinter to consider factors other than the best interests of the corporation in making their decision to move for dismissal. Such a relationship would raise a material question as to the SLC's independence. After carefully reviewing the evidence produced by the limited discovery thus far permitted, I conclude that there is a material question of fact as to the independence of both SLC members based on their relationships to Tyrrell.

I begin by discussing Vinter. Plaintiffs argue that Vinter's independence is impaired by one simple fact; Vinter's wife is Tyrrell's cousin. According to plaintiffs, it was that association that caused Tyrrell to approach Vinter about joining the iGov board.[55] Defendants counter that this familial relationship does not impair Vinter's independence because Tyrrell and Vinter's wife are not close cousins; they only occasionally cross paths at large family functions once or twice each year. Plaintiffs respond that, even though Tyrrell and Vinter's wife may not be particularly close, it would have been impossible for Vinter not to think of

[55] The SLC Report did not reveal that Tyrrell extended the invitation to Vinter to join the iGov board. When Vinter was asked in his deposition how Tyrrell knew to call him, he initially stated "[y]ou'll have to ask [Tyrrell] that. I don't know." Vinter Dep. 20:14-15, Oct. 7, 2009. Plaintiffs' counsel then asked if Vinter knew who Tyrrell was when he called, to which Vinter responded "[w]ell, I mean, he's my wife's cousin" *Id.* at 20:20.

Tyrrell as "my wife's cousin" when grappling with the difficult decision of recommending whether civil litigation against him should proceed. According to plaintiffs, this is a sufficient connection to create an unacceptable risk of bias in Vinter's mind.[56]

Defendants cite *Beam v. Stewart*, a case in which the Supreme Court stated that "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."[57] Defendants argue that, under *Beam*, the familial connection between Tyrrell and Vinter is simply not enough to raise a material question of fact as to Vinter's independence. I disagree. *Beam* was a pre-suit demand case, and the burden in that case was on the plaintiffs to allege facts sufficient to create a reasonable doubt that the board could not objectively consider a suit against its Chairman, Martha Stewart. In their complaint, the plaintiffs broadly alleged that Stewart had personal friendships or outside business dealings with certain of the directors. This was not enough, standing alone, to create a reasonable doubt about the ability of the directors to objectively consider the merits of a suit against Stewart. In this case, however, the burden is on iGov to show that it has appointed SLC members whose independence cannot seriously be

[56] *Id.* at 947 (holding that independence under *Zapata* is not established where "the connections identified [between the SLC and the interested directors] would be on the mind of the SLC members in a way that generates an unacceptable risk of bias.").
[57] 845 A.2d 1040, 1050 (Del. 2004).

doubted. The Company, not plaintiffs, must do the explaining in the first instance if there are associations that cast a shadow on independence. Frankly, appointing an interested director's family member to an SLC will always position a corporation on the low ground. From there, the corporation must fight an uphill battle to demonstrate that, notwithstanding kinship, there is no material question as to the SLC member's objectivity. Put simply, explaining away a familial association in *Zapata* territory is a more difficult challenge for a corporation than confronting a broad allegation of personal or business relationships in pre-suit demand territory.

I admit that it is not possible, at this stage of the proceedings, to say unequivocally that Vinter's independence is impaired. On the one hand, the relationship between Vinter's wife and Tyrrell does not seem to be particularly close. They do not frequently associate with one another as some cousins are wont to do. On the other hand, they do see each other regularly, albeit infrequently, at family functions. For example, each year Vinter and his wife attend a large family party at Tyrrell's in honor of Tyrrell's mother, who has passed away.[58] Vinter also testified in his deposition that, while he did not see Tyrrell on a regular basis or personally discuss Tyrrell's work with him before joining the iGov board, he "sort

[58] Vinter Aff. ¶¶ 2-3.

of knew where he was at any given time . . . ."[59] Thus, the familial relationship appears to be close enough that Vinter has been kept apprised of Tyrrell's comings and goings through the family grapevine. To my mind, there is a material question of fact as to how much Vinter's family association with Tyrrell may have influenced his objectivity. I cannot say with certainty that Vinter would not have considered the potentially awkward situation of showing up to Tyrrell's annual party after the family rumor mill had spread the word that Vinter had recommended that a lawsuit should proceed against the host.[60] Therefore, I am not convinced, as I must be under *Zapata*, that Vinter's recommendation would have been solely influenced by considerations of iGov's best interests.

Now to Salvatori. Like Vinter, Salvatori's contact with iGov was based on an association with Tyrrell. In 1993, Tyrrell was hired by Salvatori to work as an internal auditor for a company called QuesTech. Salvatori was a QuesTech co-founder and served as its President, CEO, and Chairman while Tyrrell was

[59] Vinter Dep. 21:3-4, Oct. 7, 2009.

[60] Vice Chancellor Strine has made an important holding about the bearing of familial relationships on the independence inquiry. In a pre-suit demand case, plaintiff sought to carry its burden by alleging that a particular director was not independent, and could not impartially consider a demand, because he was the brother-in-law of an interested director. The Vice Chancellor held that "familial relationships between directors can create a reasonable doubt as to impartiality. The plaintiff bears no burden to plead facts demonstrating that directors who are closely related have no history of discord or enmity that renders the natural inference of mutual loyalty and affection unreasonable." *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 889 (Del. Ch. 1999) (internal citations omitted). Thus, in the pre-suit demand context, plaintiffs can often meet their burden of establishing a lack of independence with a simple allegation of a familial relationship. Surely then, in the *Zapata* context, it will be nigh unto impossible for a corporation bearing the burden of proof to demonstrate that an SLC member is independent in the face of plaintiffs' allegation that the SLC member and a director defendant have a family relationship.

employed there for six years. During that time, Salvatori promoted Tyrrell to CFO, in which role he reported directly to Salvatori. Tyrrell worked as QuesTech's CFO until it was sold in 1998. Tyrrell appears to have made a significant and valued contribution to the efforts to sell QuesTech. In his deposition, Salvatori testified that he has "a great respect for [Tyrrell]. And he was very helpful in helping me get a good price for my company. Very helpful."[61] Tyrrell's employment with QuesTech ended when it was sold. After the sale, Tyrrell and Salvatori maintained minimal connections. Their professional association was reinstated when Tyrrell approached Salvatori about joining the iGov board.

As noted, the independence of an SLC member may be impaired if that member feels he owes something to an interested director.[62] That sense of obligation does not have to be financial in nature.[63] In this case, I believe there is a material question of fact as to Salvatori's independence because his earlier associations with Tyrrell may have given rise to a sense of obligation or loyalty to him. Salvatori appears to have been satisfied with the price he received for QuesTech, and he continues to feel that Tyrrell was an important factor in securing that price. In saying this, I do not find that Salvatori in fact does feel a sense of

---

[61] Salvatori Dep. 29:3-5, Oct. 6, 2009.
[62] *Oracle*, 824 A.2d at 938-39.
[63] *Id.*

obligation to Tyrrell, but there is certainly a strong possibility that he does, and that is enough under *Zapata* to preclude dismissal.

Before moving on I note a few pieces of evidence that buttress my conclusion that there is a material question of fact regarding the SLC's independence. First, the SLC members appear to have reviewed the merits of plaintiffs' claims before the SLC was ever formed. In September 2007, plaintiffs' counsel sent a letter to iGov outlining many of the allegations that ultimately appeared in plaintiffs' complaint and requesting a meeting to begin resolving the dispute. The McLean Valuations were attached to the letter. In response, iGov's counsel sent a letter explaining that iGov disagreed with plaintiffs' allegations and would not meet until defendants and "iGov's new board members, John Vinter and Vincent Salvatori, had time to review the McLean Valuations."[64] Vinter and Salvatori both testified that they could not remember reviewing the McLean Valuations, but it is clear that the iGov audit committee, on which both men sit, reviewed the McLean Valuations on October 29, 2007.[65] When SLC members are simply exposed to or become familiar with a derivative suit before the SLC is formed this may not be enough to create a material question of fact as to the SLC's independence. But if evidence suggests that the SLC members prejudged the merits of the suit based on that prior exposure or familiarity, and then conducted

[64] Pls.' Answer Ex. 40.
[65] Pls.' Answer Ex. 41 (audit committee minutes from October 29, 2007 meeting).

the investigation with the object of putting together a report that demonstrates the suit has no merit, this will create a material question of fact as to the SLC's independence. In this case, that is what has occurred.

Two similar pieces of evidence suggest that Vinter and Salvatori may not have conducted their investigation objectively after having considered plaintiffs' claims. First, Salvatori was asked in his deposition about the SLC's efforts to investigate the allegations in plaintiffs' complaint. Salvatori responded "I know we read it all over and I know we *attacked* it all."[66] Plaintiffs' counsel followed up with "[y]ou did what it all?" to which Salvatori answered "*[a]ttacked* it all."[67] Salvatori's counsel then repeated "*[a]ttacked* it all" after which Salvatori changed his answer to "[w]e considered it."[68] To my mind, the word "attack" in this context suggests something other than objectivity. But I readily admit that expressions can be misinterpreted and words can be inadvertently misused. In fact, if this were the only piece of evidence suggesting that the SLC might have engaged in a combative assault rather than an investigation I would be inclined to consider Salvatori's use of the verb "attack" as ambiguous. But the second piece of evidence has Vinter using the same verb—"attack"—in relation to the McLean Valuations.

---

[66] Salvatori Dep. 248:8-9, Oct. 6, 2009.
[67] *Id.* at 248:10-11.
[68] *Id.* at 248:12-13.

Vinter's notes from a June 26, 2009 meeting, at which SRR gave an update of its views of the $4.92 strike price, state as follows:

> McLean *attack*
> -forecast
> -low margin 1.3 → 1.5
> -marketability discount
> -fully diluted approach[69]

As one can see, this appears to be a bullet-point summary of what is purportedly wrong with the McLean Valuations. Some of these criticisms of the McLean Valuations ended up in the SLC Report. In his deposition, Vinter stated his belief that he thought the word "attack" in the notes really said "attach."[70] But "attach" does not make any sense in the context of the note.

Plaintiffs characterize Salvatori and Vinter's uses of the word "attack" as an indication that from the outset of the investigation the SLC was gathering information with the object of putting together a report that cast doubt on the merits of plaintiffs' claims, rather than objectively considering plaintiffs' claims. Given the SLC members' relationships to Tyrrell, their exposure to the merits of plaintiffs' suit well before the SLC was formed,[71] and the unsatisfactory scope of the investigation conducted (of which more will be said below), Salvatori and

[69] Pls.' Answer Ex. 5 at 127.
[70] Vinter Dep. 217:6-17, Oct. 7, 2009.
[71] Salvatori and Vinter had more than an entire year to mull over the merits of plaintiffs' suit before the SLC was formed and they began their investigation.

Vinter's use of the word "attack" does not help to fully convince me that the SLC was independent.

In sum, the independence inquiry under *Zapata* is critically important if the SLC process is to remain a legitimate mechanism in our corporate law.[72] SLC members should be selected with the utmost care to ensure that they can, in both fact and appearance, carry out the extraordinary responsibility placed on them to determine the merits of the suit and the best interests of the corporation, acting as proxy for a disabled board. In this case, I am not satisfied that the independence prong of the *Zapata* standard has been met.

B. Did the SLC Conduct an Investigation of Reasonable Scope in Good Faith and Did the SLC Have Reasonable Bases for its Conclusions?

Because the manner in which the SLC investigated plaintiffs' complaint bears directly on whether it had reasonable bases for its conclusions, I will address both of these aspects of the *Zapata* test together. I begin with an overview of the legal standards for these two components of the test.

To conduct a good faith investigation of reasonable scope, the SLC must investigate all theories of recovery asserted in the plaintiffs' complaint.[73] In doing this, the SLC should explore all relevant facts and sources of information that bear

---

[72] *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 940 (Del. Ch. 2003).

[73] *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985) ("I find that the [SLC] addressed all the issues presented in the complaint and researched an additional issue of whether the Company's directors had a personal interest in the challenged transaction. The investigation spanned four and a half months and was thorough and exhaustive as to all possible claims for recovery. I therefore find that the investigation conducted by the [SLC] was reasonable.").

on the central allegations in the complaint.[74] If the SLC fails to investigate facts or sources of information that cut at the heart of plaintiffs' complaint this will usually give rise to a material question about the reasonableness and good faith of the SLC's investigation.[75] In addition, before an SLC decides not to explore specific acts of alleged misconduct because the costs of a full investigation outweigh any harm that may have been caused by those specific acts, the SLC should carefully analyze whether a summary investigation of those specific acts could shed light on the more serious allegations in the plaintiffs' complaint.[76] A total failure to explore the less serious allegations in plaintiffs' complaint may cast doubt on the reasonableness and good faith of an SLC's investigation when exploring those less serious allegations, at least in summary fashion, would have helped the SLC gain a full understanding of the more serious allegations in plaintiffs' complaint.[77] Finally, an SLC fails to conduct a reasonable investigation if it simply accepts

[74] *See Kaplan v. Wyatt*, 499 A.2d 1184, 1190-91 (Del. 1985).

[75] *Sutherland v. Sutherland*, 958 A.2d 235, 242 (holding that there was a material doubt as to the reasonableness and good faith of an SLC's investigation where the SLC's report did not include an analysis of two large payments the corporation had made on the defendants' behalf, even though the complaint alleged that defendants had used corporate funds for personal benefit).

[76] *Electra Inv. Trust PLC v. Crews*, 1999 WL 135239, at *4 (Del. Ch. Feb. 24, 1999).

[77] *Id.* (holding that an SLC's failure to explore a $2,600 secondary dispute on cost-benefit grounds cast doubt on the SLC's investigation because a minimal investigation might have provided the SLC with facts that would have helped it better evaluate the merits of the larger primary dispute).

defendants' version of disputed facts without consulting independent sources to verify defendants' assertions.[78]

To demonstrate that its recommendations are supported by reasonable bases, the SLC must show that it correctly understood the law relevant to the case. If the SLC's recommendation is based on an error of law then the basis for that recommendation is not reasonable.[79] Moreover, if the SLC gets the undisputed facts wrong in its report, and then relies on its erroneous recitation of the undisputed facts in making its dismissal recommendation, it also goes without saying that the basis for the recommendation is not reasonable.[80]

Having articulated the relevant standards I turn to the SLC Report to determine if it demonstrates a reasonable investigation conducted in good faith and reasonable bases for the SLC's recommendation that this case be dismissed. The SLC Report identifies the SLC's recommendations for each of the three counts in plaintiffs' complaint. As we have seen, Count I alleges that defendants breached their fiduciary duties of care and loyalty by adopting the 2007 Plan. The duty of care claims are based on the allegation that defendants approved the 2007 Plan

---

[78] *Id.* at *5.
[79] *Lewis v. Fuqua*, 502 A.2d 962, 968-70 (Del. Ch. 1985) (holding that an SLC did not have a reasonable basis for its dismissal recommendation because it had incorrectly concluded that the business judgment rule applied to the challenged transactions).
[80] *Id.* at 968 (holding that an SLC did not have a reasonable basis for its dismissal recommendation because it had incorrectly assumed in its report that the board had rejected a corporate opportunity when, in fact, it was undisputed that the board had never formally rejected the opportunity).

knowing that Chessiecap's Final Valuation was based on stale and incomplete information in the Revised Chessiecap Forecast. The duty of loyalty claims are based on the allegation that defendants intentionally provided misleading and incomplete information to Chessiecap in order to artificially depress iGov's value so that defendants would receive underpriced options and shares when the 2007 Plan was implemented. Count II seeks rescission of the 2007 Plan and is essentially dependent on the success of Count I. Count III is styled as an individual claim, the personal harm being that defendants improperly diluted plaintiffs' ownership interests, thereby expropriating economic value and voting power from them. I analyze the SLC's recommendation on each count in turn.

1. The Duty of Care Claims in Count I

The SLC first addressed Count I, ultimately concluding that it should be dismissed. As to the duty of care claims in Count I, the SLC found that the 8 *Del. C.* § 102(b)(7) provision in iGov's corporate charter exculpates directors from personal liability for monetary damages so long as the director did not engage in intentional misconduct or knowing violations of the law.[81] The SLC concluded

[81] The full § 102(b)(7) provision reads:

> A director of the corporation shall not be personally liable to the corporation or its stockholders *for monetary damages* for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under Section 174 of the Delaware General Corporation Law; or (iv) *for any transaction*

that a duty of care claim should not be pursued because defendants breach of care conduct, if it occurred, would be covered by the § 102(b)(7) provision.

I take this opportunity to note the first of many concerns I have with the conclusions in the SLC Report. In finding that the action should not be pursued on the basis of duty of care claims, the SLC noted that § 102(b)(7) provisions such as iGov's are routinely upheld by Delaware courts and that such a provision protects defendants from personal liability, in the form of money damages, for gross negligence. *On that basis alone*, the SLC concluded that duty of care claims against defendants should not be pursued. I find this to be an unreasonable conclusion because the SLC failed to consider that the requested relief in plaintiffs' complaint is not limited to money damages; it specifically requests that the 2007 Plan be rescinded. Under Delaware law, exculpatory provisions do not bar duty of care claims "in remedial contexts . . ., such as in injunction or rescission cases."[82] Thus, if I became convinced at the summary judgment stage or after a trial on the merits that defendants breached their duty of care the exculpatory provision in the

---

> *from which the director derived an improper personal benefit.* If the Delaware General Corporation Law is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the corporation shall be eliminated or limited to the fullest extent permitted by the Delaware General Corporation Law, as so amended (emphasis added).

[82] BALOTTI & FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.15[C] (3d. ed. 2009); *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 678 A.2d 533, 542 (Del. 1996).

iGov charter would not preclude me from ordering rescission of the 2007 Plan, even though it might preclude me from entering a judgment for monetary damages against defendants.[83] It was unreasonable, therefore, for the SLC to conclude that the duty of care claims in Count I should not go forward solely on the basis of iGov's § 102(b)(7) provision. The SLC simply fails to understand that Delaware law permits a suit seeking rescission to go forward despite a § 102(b)(7) provision protecting directors against monetary judgments.

2. The Duty of Loyalty Claims in Count I

The SLC's investigation of plaintiffs' duty of loyalty claims, as well as its conclusion that those claims should be dismissed, merits the most discussion in my analysis of the *Zapata* requirements. The SLC concluded that plaintiffs' duty of loyalty claims should be dismissed because it believes the 2007 Plan was entirely fair to iGov. Underlying this conclusion are the SLC's findings that (1) the process defendants' employed to secure approval of the 2007 Plan, particularly the process employed to develop the exercise price, was entirely fair, and (2) $4.92 was a fair exercise price.

---

[83] I also note that iGov's § 102(b)(7) provision might not even protect defendants against liability for monetary damages because the provision makes an exception for "any transaction from which the director derived an improper personal benefit." *See* n.79 above. Plaintiffs' complaint alleges that defendants were able to obtain iGov stock for themselves at an artificially low price as a result of breaching their duty of care. Thus, the exculpatory clause might not apply to adoption of the 2007 Plan. The SLC failed to address this issue in the SLC Report. For the moment, I make no finding on whether the exculpatory clause would or would not apply to adoption of the 2007 Plan. I simply mention this to highlight that it was not considered by the SLC.

a. Fair Process

I begin by analyzing whether the SLC's investigation of defendants' process was reasonable in scope. I also analyze whether the SLC's conclusion that the process was fair is supported by reasonable bases. In conducting this analysis I avoid considering the merits of plaintiffs' claims.[84] My findings here relate only to the SLC's investigation.

In concluding that defendants would be able to show fair dealing, the SLC first determined that plaintiffs' claims can be:

> distilled . . . to *one key issue.* Can a CFO have one forecasting model for the purpose of seeking an increase in the Company's credit availability and for [internal] goal-setting while, at the same time, have a *substantially lower* forecast for the purpose of valuing the Company's equity?[85]

A natural place for me to begin my inquiry is with the SLC's own characterization of the key issue underlying plaintiffs' complaint. Namely, was it acceptable for Tyrrell to provide Chessiecap with the Revised Chessiecap Forecast showing an EBITDA of $1.8 million while simultaneously providing Textron with multiple iterations of EBITDA forecasts, all of which showed an EBITDA of at least $3 million, and using internal EBITDA forecasts that also projected an

[84] *Kaplan v. Wyatt*, 484 A.2d 501, 508 (Del. Ch. 1984).
[85] SLC Report 40-41 (emphasis added); s*ee also id.* 25 ("The [SLC] determined that the crux of the Derivative Complaint goes to the allegation that Tyrrell manipulated the information he was providing to Chessiecap so as to depress the value of the Company"); *id.* 60 ("Plaintiffs' only meaningful attack on the procedural process through which the 2007 Plan was adopted is focused on their belief that Mike Tyrrell deliberately supplied Chessicap (sic) with overly pessimistic financial data for iGov").

EBITDA of at least $3 million? The SLC concluded that this was an acceptable thing for Tyrrell to do. The SLC Report explains this conclusion as follows:

> The existence of multiple forecasts circulated internally and externally during the same time frame, in and of itself, is not indicative of anything nefarious or ill-motivated. It is not unusual for CFOs to analyze and estimate a company's future performance and test their predictions and assumptions. It is also not unusual for CFOs to provide an *optimistic* outlook to its lender when the goal is to instill confidence in the company's ability to comply with its covenant requirements and seek an increase in the availability of the credit line. A forecast that is optimistic is not misleading, it merely reflects the guessing of what the Company *may* accomplish if certain favorable events occur as the management hopes they will. We see no value for a CFO to present a pessimistic case when seeking financing. By the same token, an optimistic forecast is often used by management as a goal setting tool to inspire and incentivize the company's employees who may have incentive based compensation rooted in hitting certain set benchmarks. Setting a high goal is a necessary tool to motivate performance. Such practice is widespread and not misleading, ill-motivated or self-dealing. On the other hand, a CFO can also have a forecast that he believes the company will actually achieve, rather than a wishful "may" achieve. It is that forecast that the Committee believes should be utilized for estimating the value of the Company's equity.[86]

Elsewhere in the SLC Report this conclusion is reemphasized:

> With regard to the forecasts identified by Plaintiff but not provided to Chessiecap, [] Tyrrell stated to the SLC that it was his usual practice regularly to create such varying forecasts for purpose of motivating employees and testing "what if" scenarios. He also created optimistic forecasts showing "*the art of the possible*" to instill confidence in the Company's lender by showing what the Company hoped to achieve, and to illustrate to management how best to position the Company for future growth. The Committee finds that it is not uncommon for CEOs of companies to run varies (sic) scenarios and forecasts particularly

[86] SLC Report 41 (emphasis added).

> for a company like iGov that remained in transition mode through 2006 and 2007. Moreover, the record compiled by the SLC for the period 2006-2007 and the SLC's experience serving on the Board of iGov, corroborate [] Tyrrell's statements and confirm his business practices.[87]

As is evident from the SLC Report, the SLC concluded that the process of adopting the 2007 Plan was fair primarily because the SLC believes it was perfectly normal for Tyrrell to provide "optimistic" and "art of the possible" forecasts to Textron and use those forecasts internally, while at the same time providing a forecast to its valuation expert that was "substantially lower" but something the Company could "actually achieve," rather than being "wishful." To put it mildly, this is an interesting conclusion, especially in light of the current credit environment. One would suspect that lenders would prefer a forecast projecting what management believes is actually achievable as opposed to wishful. In and of itself, this conclusion does not inspire confidence that the SLC conducted a good faith investigation. But I need not rest my decision solely on the merits of this crucial conclusion, because, broadly speaking, I do not believe that the SLC's investigation was sufficient in scope to adequately address plaintiffs' duty of loyalty claims. Nor do I believe the SLC developed reasonable bases for concluding plaintiffs' duty of loyalty claims should be dismissed.

[87] SLC Report 61 (emphasis added).

An obvious first question that was not adequately explored by the SLC is this: why did Tyrrell provide Chessiecap with the Original Chessiecap Forecast (showing an EBITDA of roughly $3 million) if he did not believe that the projections in that forecast were actually achievable? Why put Chessiecap to the time, expense, and effort of developing a valuation based on an overly optimistic projection? The SLC addresses this question, but provides an answer that contradicts the key conclusion of its investigation. Specifically, the SLC Report states that the Original Chessiecap Forecast was the "only operating forecast available" to give to Chessiecap in August 2006.[88] Of course, that is inconsistent with the SLC's finding that it was Tyrrell's "usual practice regularly to create [] varying forecasts . . . ."[89] By August 2006, Tyrrell had worked at iGov for nearly a year, plenty of time to have developed more than one forecast if he actually did that on a regular basis. Moreover, iGov was nearing the end of its fiscal year at that time and so, if it was Tyrrell's usual practice to create varying forecasts, one would assume he would have developed more than one forecast for the next year by then. The SLC does not explain this inconsistency, and it is the only basis on which it attempts to explain away Tyrrell first providing Chessiecap with the Original Chessiecap Forecast, a projection that was identical to the Second Textron

[88] SLC Report 42-43.

[89] SLC Report 61. This inconsistency is problematic for the SLC because its finding that Tyrrell regularly prepared multiple forecasts for different purposes was critical to its conclusion that it was acceptable for him to provide different forecasts to Chessiecap and Textron. The SLC's ultimate conclusion is undermined by this inconsistency.

Forecast that iGov had sent to its lender the same month. The SLC's finding that the Original Chessiecap Forecast was the only one available actually provides evidentiary support for plaintiffs' assertion that Tyrrell began manipulating forecasts to depress iGov's valuation. This cannot be a reasonable basis upon which to conclude that plaintiffs' complaint should be dismissed.

A second question that was not adequately investigated by the SLC is why did Tyrrell provide Textron with the Third Textron Forecast (showing an EBITDA of 3.1 million) *after* he provided Chessiecap with the Revised Chessiecap Forecast (showing an EBITDA of $1.8 million)? The SLC Report explains that the SLC interviewed Tyrrell multiple times and that in those interviews Tyrrell testified that he provided Chessiecap with the Revised Chessiecap Forecast on October 18, 2006 because he believed it was a more realistic projection for FY07. The SLC accepted Tyrrell's testimony on this point as true without adequately exploring contrary evidence. For example, why would Tyrrell have been comfortable continuing to provide Textron with forecasts that were higher than what he believed was realistic?[90] The SLC found that Tyrrell provided Textron with the Third Textron Forecast because he wanted to ensure that financing would be obtained.[91] But the SLC never tested whether Tyrrell genuinely believed he was sending Textron

---

[90] The Third Textron Forecast showed an EBITDA that was 60% higher than the Revised Chessiecap Forecast.

[91] Presumably Textron would have been less willing to lend iGov money if Tyrrell sent them the Revised Chessiecap Forecast.

overly optimistic forecasts by asking him why he was comfortable providing a potential creditor with data he did not believe was realistic. It was not reasonable for the SLC to accept Tyrrell's assertion that the Revised Chessiecap Forecast was the most realistic without exploring Tyrrell's conduct that suggests otherwise.

The SLC also did not adequately address the ample evidence that internal forecasts continued to project EBITDA of roughly $3-4 million, a figure much higher than the Revised Chessiecap Forecast.[92] As we have seen, Tyrrell's own emails suggest that he believed these higher internal forecasts where achievable, in direct contradiction to the testimony he provided the SLC, but the SLC does not appear to have questioned him thoroughly about these emails. Instead, the SLC explains away these internal forecasts with its finding that they were used to motivate and inspire management by demonstrating what *might* be achievable, rather than what Tyrrell actually believed was achievable. The SLC's finding on this point appears to be completely based on Tyrrell's assertions about the purpose of the internal forecasts. Nothing in the SLC Report suggests that management was questioned to see if they understood that the internal projections being circulated were not what the CFO believed was actually achievable. In fact, there

[92] This evidence is outlined in Part I-J of this Opinion.

was evidence that iGov management generally believed that an EBITDA of $3 million or more *was* realistic for FY07.[93]

Based on the SLC's own investigation, it appears that the only character in this story to rely on the relatively lower, but "actually achievable" numbers reflected in the Revised Chessiecap Forecast was Chessiecap—the firm that, according to plaintiffs' complaint, was manipulated to provide a low valuation that directly benefitted defendants. Per the SLC's own findings, then, all other characters were relying on projections that were "art of the possible" but probably not achievable. From the point of view of an objective SLC conducting a good faith investigation, this discovery is clearly problematic. Absent some further explanation, it inferentially supports plaintiffs' allegations that manipulation had occurred. An objective SLC would have been *duty bound* at this point to thoroughly explore why management pervasively used forecasts it did not believe were realistic, but the SLC failed to do this. Rather, it appears to have accepted Tyrrell's representations that the Revised Chessiecap Forecast was the most accurate without pressing him on why he felt the *only* appropriate use of the most accurate forecast was valuing iGov's equity in connection with the 2007 Plan.

A third question the SLC Report did not adequately address was the assertion in plaintiffs' complaint that Tyrrell only considered negative

---

[93] *See* part I-J of this Opinion describing communications from management other than Tyrrell indicating a belief that an EBITDA of $3 million or more was realistic.

developments that had occurred after the July 31, 2006 valuation date when preparing the Revised Chessiecap Forecast. Plaintiffs' complaint provides examples of positive developments that had occurred but were purportedly ignored by Tyrrell; specifically, the $7 million PTO contract that was awarded in September 2006 and the increased profitability in the TACLAN contract that was becoming apparent. Moreover, plaintiffs' complaint alleges that when the 2007 Plan was finally approved on January 31, 2007, defendants were even more aware of the TACLAN contract's better-than-expected performance, as well as the increasing likelihood that the DHS contract would be awarded, but made no efforts to have Chessiecap update its Final Valuation to reflect this.

Nothing in the SLC Report indicates that the SLC seriously investigated plaintiffs' allegations that the Revised Chessiecap Forecast ignored positive developments while incorporating negative developments. Nor does the SLC Report provide me with any comfort that the SLC adequately investigated whether defendants adopted the 2007 Plan despite knowing that the Final Valuation upon which it was based failed to reflect the positive developments that had occurred since July 31, 2006. Tyrrell had specifically stated his belief on January 7, 2007 that the Final Valuation was old and would likely be higher when it was updated and then just a few days later represented to Chessiecap that no material changes had occurred since July 31, 2006. Likewise, Neven and Hupalo implicitly

represented that no material changes had occurred by adopting the 2007 Plan based on the Final Valuation. There is no evidence that the SLC questioned any of defendants as to why they felt the PTO contract, the increased TACLAN profitability, or the increasing likelihood of a DHS contract award were not material developments. Perhaps there would have been defensible reasons for defendants to come to these conclusions, but we are left wondering because the SLC did not investigate it. This was a failure to investigate a fundamental theory of recovery in plaintiffs' complaint that precludes me from granting the SLC's motion to dismiss.[94]

While I am on the subject of the absence of "material changes" I should discuss a fourth question that the SLC did not investigate; namely, the award of 25,000 options to Marksberry in May 2007. These options were awarded at $4.92 per share, the same price as the options under the 2007 Plan. The SLC reasoned that it would not have been useful to explore this grant because Marksberry was no longer employed by iGov at the time of the investigation and could not exercise any of the 25,000 shares he had been granted. The SLC believed that iGov was in

---

[94] *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985). In their depositions, Salvatori and Vinter testified that they did not recall whether they investigated the allegation that the Revised Chessiecap Forecast failed to reflect the increased profitability in the TACLAN contract. Salvatori Dep. 207:19-20, Oct. 6, 2009; Vinter Dep. 95:14, Oct. 7, 2009. Salvatori admitted that knowing whether TACLAN had a large backorder would have been relevant, but he could not say what the SLC did to investigate this allegation. Salvatori Dep. 208:15-16.

no danger of being harmed by this grant and therefore it would not be cost-beneficial to investigate it.

The SLC is undoubtedly correct that the 25,000 option grant to Marksberry does not threaten iGov economically. But that does not mean investigating the option grant would not have shed light on the merits of plaintiffs' complaint. The grant occurred ten months after the Final Valuation upon which the $4.92 per share price was based. Plaintiffs allege that by that time it was abundantly clear that positive, material developments had occurred that made the Final Valuation upon which the $4.92 strike price was based unreliable. Among other things, plaintiffs point out that the DHS contract had been formally awarded in March 2007. Tyrrell's rationale for excluding the DHS contract from the Revised Chessiecap Forecast was that it had not been formally awarded. Thus, it at least seems reasonable that once the DHS contract was formally awarded the Revised Chessiecap Forecast should have been revised again to account for profits from the DHS contract. Nevertheless, defendants did not provide Chessiecap with any revised forecast or ask them to update their Final Valuation. Rather, defendants adopted a formal resolution that specifically stated no material changes had occurred since July 31, 2006 and awarded Marksberry options on that basis.

The SLC declined altogether to investigate this transaction. They did not question defendants about their resolution that no material change had occurred as

of May 2007, despite the DHS contract having been formally awarded. If the SLC had investigated this transaction, it likely would have shed light on the broader allegations in plaintiffs' complaint.[95] Specifically, the SLC could have gained insight into defendants' motivations with respect to the 2007 Plan. By simply asking defendants why they believed no "material change" had occurred for equity valuation purposes since the Final Valuation, the SLC could have determined what sort of change defendants needed to see before they would feel it necessary to update the Final Valuation and could have evaluated whether defendants' assessments were being made in good faith or whether they were ill-motivated. Defendants were willing to award Marksberry options at the $4.92 strike price despite the formal award of the DHS contract. This behavior calls into question the sincerity of Tyrrell's earlier assertion that the DHS contract should not be included in a forecast until it was formally awarded. The SLC should have challenged defendants on this point. It may have taken nothing more than a few questions. But the SLC declined to do so. Seeing this omission, I must conclude that the SLC's investigation into plaintiffs' duty of loyalty claims was not reasonable in scope.

A fifth problem is that the SLC Report fails to investigate the timing of plaintiffs' removal from the board. As we've seen, plaintiffs were removed from

---

[95] *Electra Inv. Trust PLC v. Crews*, 1999 WL 135239, at *4 (Del. Ch. Feb. 24, 1999).

the board just days after they protested the use of the Final Valuation, alleging that it was based on stale and inaccurate information in the Revised Chessiecap Forecast. Plaintiffs' complaint contends that defendants' plan was to procure iGov shares for themselves at artificially low prices and to entrench themselves in management and directorship positions through the increased ownership percentages they would realize under the 2007 Plan. To that end, plaintiffs allege that they did not receive any shares under the 2007 Plan, which was adopted just days after their removal from the board, and that their ownership percentages were decreased by the 2007 Plan while defendants' ownership increased.

The SLC Report characterizes plaintiffs' removal from the board as the product of a disagreement between plaintiffs and defendants over the direction that iGov should take. The SLC Report characterizes plaintiffs, specifically Hunt, as wanting iGov to drop all other pursuits so that it could "milk" the TACLAN contract. In contrast, the SLC Report describes defendants, specifically Neven and Hupalo, as wanting to grow iGov and use the TACLAN contract as a stepping stone to reinvent the Company from a low-margin information technology reseller into a higher-margin service provider. The SLC Report states:

> During their interviews, Neven and Hupalo displayed a sense of personal responsibility for the employment of almost one hundred people and felt that the Company had become the home to hardworking individuals who were committed to serving the government and building a great product. It was that sense of long-term commitment to iGov by Neven and Hupalo, in contrast to Hunt's

> short-term objectives, that divided . . . and ultimately shattered the Board.[96]

Conspicuously absent from the SLC Report are any citations to interview notes or other evidence supporting the SLC's finding that this disagreement was the cause of plaintiffs' removal from the board. In fact, there is evidence in the record that shows defendants may have been just as interested in maximizing short-term profits from iGov as plaintiffs' purportedly were, but the SLC Report fails to investigate or explain this.[97] The biggest problem, though, is that the SLC Report wholly fails to analyze or explain why plaintiffs were removed from the board only three days after objecting to the Final Valuation and a little less then two weeks before the 2007 Plan was adopted. There is no indication that the SLC probed defendants on why they felt it was necessary or advisable to remove plaintiffs from the board almost immediately after they objected to the Final Valuation and then shortly thereafter approve the 2007 Plan, which plaintiffs were certain to vote against. In fact, the SLC Report gets the date of plaintiffs' removal from the board wrong. It states: "*By the end of December 2006*, the relationship among the Founders had deteriorated and Neven and Hupalo, acting as majority

---

[96] SLC Report 23.

[97] For example, the SLC's interview notes indicate that Neven and Hupalo both made statements to the SLC that it was their goal to sell or merge the Company. Pls.' Answer Ex. 5 at 38, 47. Similarly, Mr. Tyrrell told Chessiecap in an email dated September 19, 2006 that "[t]here are very few people here with knowledge of our plan to sell in 2 or 3 years . . . ." *Id.* Ex. 55.

shareholders removed London and Hunt from the Board of Directors."[98] Thus, the SLC Report gets a fundamental, undisputed fact from plaintiffs' complaint wrong and then fails to conduct the investigation that would have been necessary if the SLC had the facts right. This does not demonstrate that the SLC conducted an investigation of reasonable scope.[99]

A sixth area of inadequate investigation deserves mention. The SLC Report assumes that defendants Neven and Hupalo gave up options with a $1.25 strike price from the 2000 Plan for options with a strike price of $4.92 in adopting the 2007 Plan. Presumably this finding is included in the SLC Report to demonstrate the good faith of defendants in adopting the 2007 Plan. The SLC concludes that all parties agreed that the 2007 Plan was adopted to replace the 2000 Plan to correct the defects in the 2000 Plan. The SLC fails to acknowledge, however, evidence suggesting that defendants' knew the options under the 2000 Plan were never granted to them. Specifically, in September 2006, Tyrrell told Neven that the options under the 2000 plan were never issued.[100] In addition, on October 26, 2006, iGov's corporate counsel gave the opinion that the options were never granted.[101]

---

[98] SLC Report 24.
[99] *See Lewis v. Fuqua*, 502 A.2d 962, 968 (Del. Ch. 1985).
[100] Pls.' Answer Ex. 56.
[101] *Id.* Exs. 57, 58.

Since the SLC believed that the 2007 Plan was designed to replace the problematic $1.25 options that had been granted under the 2000 Plan, it should have investigated why London did not receive options under the 2007 Plan to replace the options he had purportedly been granted under the 2000 Plan. According to the SLC, London, Neven, and Hupalo had all been given defective options under the 2000 Plan. Yet only Neven and Hupalo had those defective options replaced when they voted to adopt the 2007 Plan. London was not permitted to vote on the 2007 Plan (because he had been removed from the board) and was not given replacement options under the 2007 Plan. Surely this should have suggested something about the fairness of the 2007 Plan adoption process from the SLC's perspective. And yet the SLC did nothing to investigate this.

I could go on, but I decline to.[102] What I have written is sufficient to demonstrate that there is a material question of fact as to whether the SLC conducted a good faith investigation of reasonable scope into the fairness of the 2007 Plan's adoption process.

---

[102] For example, at one point in the SLC Report the SLC speculates that the adoption of the 2007 Plan might actually be subject to business judgment review, rather than entire fairness review. The SLC bases this conclusion on the theory that the option grants and direct share purchases under the 2007 Plan might not have been "material" to defendants. Of course, this speculation is irrelevant because defendants stood on both sides of the transaction in adopting the 2007 Plan and entire fairness review would thus apply regardless of whether the options and direct share purchases were "material" to defendants. *London v. Tyrrell*, 2008 WL 2505435, at *5 (Del. Ch. June 24, 2008) (citing *Orman v. Cullman*, 794 A.2d 2, 25 n.50 (Del. Ch. 2002)). But in speculating as to materiality the SLC failed to conduct any investigation into the net worth or income of defendants so it had no basis in any event upon which to conclude that the options and direct share purchases might not have been "material."

b. Fair Price

Having determined that the SLC did not conduct a reasonably thorough investigation into defendants' process for adopting the 2007 Plan and did not have reasonable bases for concluding that the process was fair, I could dispense with the remainder of the entire fairness inquiry. Nevertheless, to be thorough, I will briefly explore the SLC's investigation of price and whether it had reasonable bases to conclude that $4.92 per share was a fair price.

The SLC ultimately determined that both the Chessiecap Final Valuation and McLean Valuations were "tainted" and did not rely on either valuation in concluding that $4.92 was a fair price.[103] The SLC partially relied on the SRR Valuations in concluding that $4.92 was a fair price. I say "partially" because the SLC Report summarily marginalizes the SRR Valuations, which concluded that iGov equity was worth $3.90 - $4.15 as of October 31, 2006 and $5.24 - $ 5.30 as of January 30, 2007. The SLC Report concludes that $4.92 was in the range of fair market value based on the SRR Valuations, but then states that "$4.92 . . . was likely too high, from a practical, real world perspective . . . ."[104] The SLC Report takes the position that the SRR Valuations $5.24 - $5.30 per share estimate for January 30, 2007 was largely a function of iGov's cash position on that date, and was not an indication of the real value of the Company. This disagreement about

---

[103] SLC Report 47.
[104] SLC Report 50.

the effect of iGov's cash position on value, combined with the SLC's hunches about the Company's value, led the SLC to conclude that even the SRR Valuations missed the mark. Thus, the SLC is left with no professional valuation upon which to hang its hat entirely. That is certainly enough to create a material question of fact about whether the SLC had a reasonable basis to conclude that $4.92 was a fair price.

Compounding this problem though is the fact that SRR utilized the Tyrrell Baseline Forecast (showing an EBITDA of $2.1 million) in preparing its valuation. The SLC Report indicates that SRR was given the Tyrrell Baseline Forecast because:

> . . . Tyrrell testified that he viewed the [Tyrrell Baseline Forecast] as a more realistic projection for FY2007. Tyrrell testified that this forecast was a revision of the [Revised Chessiecap Forecast] previously provided to Chessiecap and did not contain the operational or motivational assumptions found in the [Third Textron Forecast]. The SLC concluded, therefore, that as of December 2006, the [Tyrrell Baseline Forecast] was the most accurate prediction of the Company's likely performance . . . .[105]

There are at least two problems with the SLC's decision to provide SRR with the Tyrrell Baseline Forecast for its analysis. First, as is evident from the language cited, the SLC determined that the Tyrrell Baseline Forecast was the most appropriate forecast for SRR to use solely based on Tyrrell's testimony. This was not a reasonable basis for such a determination. Serious doubts are raised about an

[105] SLC Report 21.

SLC's investigation where it does not consult sources of information other than one of the defendants to make conclusions.[106]

The second problem is related to the first. The SLC does not appear to have actually understood the Tyrrell Baseline Forecast. Tyrrell described the Tyrrell Baseline Forecast as being a revision of the Revised Chessiecap Forecast, but this was inaccurate. The SLC appears to have accepted this characterization, and included it in the SLC Report, without actually testing it. A close comparison reveals that the Tyrrell Baseline Forecast was identical to the Third Textron Forecast with the exception that two line items differed. The principal difference between the Tyrrell Baseline Forecast and the Third Textron Forecast was the revenues and expenses from the DHS contract. As we have seen, the DHS contract was one of the major line items, if not *the* major line item, that plaintiffs accuse Tyrrell of adjusting to manipulate the valuations. If the SLC had compared the Tyrrell Baseline Forecast to the Third Textron Forecast it would have noticed that the two were substantially identical with the exception that DHS contract revenue and expenses were omitted from the Tyrrell Baseline Forecast. This omission largely caused the Tyrrell Baseline Forecast to project an EBITDA of $2.1 million, 32% lower than the Third Textron Forecast's EBITDA projection of $3.1 million. This difference should have been addressed by the SLC because it provides

---

[106] *Electra Inv. Trust PLC v. Crews*, 1999 WL 135239, at *5 (Del. Ch. Feb. 24, 1999).

evidentiary support for plaintiffs' assertion that Tyrrell was manipulating the DHS contract in his projections. But the SLC did not do this because it accepted Tyrrell's inaccurate description of the Tyrrell Baseline Forecast at face value. SRR's consequent reliance on the Tyrrell Baseline Forecast leaves me with a material doubt as to the bases upon which the SLC grounded its conclusion that $4.92 was a fair price. I cannot grant the SLC's motion under the *Zapata* standard where such doubts exist.

Before moving on to Counts II and III I wish to make something clear. I have no opinion at this stage of the proceedings as to the fair market value of iGov shares on January 30, 2007. I have not attempted to determine which valuation is the most accurate. I have simply evaluated the scope of the SLC's investigation into the $4.92 price and the bases of its conclusions regarding the $4.92 price and have found that it leads me to conclude that the SLC's investigation did not meet the *Zapata* requirements.

3. Counts II and III

I briefly address Counts II and III before concluding my *Zapata* step-one analysis. The SLC recommended that Count II be dismissed because it believed adoption of the 2007 Plan was entirely fair to iGov and, therefore, plaintiffs would not prevail on Count I. Because the SLC failed to meet the *Zapata* standard its recommendation to dismiss Count I is denied. Accordingly, Count II, which seeks

rescission of the 2007 Plan, will not be dismissed for the obvious reason that rescission may be the appropriate remedy if plaintiffs ultimately prevail on the merits of Count I.

With respect to Count III, the SLC concluded it was a derivative claim and should be dismissed along with Count I (and for the same reasons). Plaintiffs assert that this is an individual claim over which the SLC has no power. Because I am permitting plaintiffs to continue piloting derivative claims through this litigation, I will not spend time at this juncture attempting to resolve whether Count III alleges individual or derivative claims. Either way the claims survive. We can leave determination of the exact nature of Count III for another day. In fact, a more accurate determination may be made at a later time when the benefits of full discovery have enlarged the record.

C. The Court's Independent Business Judgment

Having determined that I will not grant the SLC's motion to dismiss after fully applying the first step of the *Zapata* standard to the motion, I find it unnecessary to apply the second step of *Zapata*. In my view, this is not a case where application of the second step will add anything of value, and so I exercise my discretion not to apply this step.

IV. CONCLUSION

Because there are material questions of fact as to the SLC's independence, the reasonableness of its investigation, and whether it had reasonable bases for its conclusions, the SLC's motion to dismiss plaintiffs' complaint is DENIED.

IT IS SO ORDERED.