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UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON AT SEATTLE  
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In re F5 NETWORKS, INC. DERIVATIVE ACTION LITIGATION

GLENN HUTTON, et al.,  
*Plaintiffs,*

vs.

JOHN McADAM, et al.,  
*Defendants.*

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**PLAINTIFFS' ANSWER TO AMICUS CURIAE BRIEF  
OF ASSOCIATION OF WASHINGTON BUSINESS**

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COUGHLIN STOIA GELLER  
RUDMAN & ROBBINS LLP  
TRAVIS E. DOWNS III (*pro hac vice*)  
KEVIN K. GREEN (*pro hac vice*)  
BENNY C. GOODMAN III (*pro hac vice*)  
655 West Broadway, Suite 1900  
San Diego, CA 92101  
Telephone: 619/231-1058  
Fax: 619/231-7423

LAW OFFICES OF  
TAMARA J. DRISCOLL  
TAMARA J. DRISCOLL  
WSBA NO. 29212  
321 North 80th Street  
Seattle, WA 98103  
Telephone: 206/286-1821

PROFESSOR DANIEL J. MORRISSEY (*pro hac vice*)  
GONZAGA UNIVERSITY SCHOOL OF LAW  
721 North Cincinnati Street, Box 3528  
Spokane, WA 99220  
Telephone: 509/313-3693  
Fax: 509/313-5840

Counsel for Plaintiffs

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## I. INTRODUCTION

According to the Association of Washington Business (“AWB”), its recent brief explores points “not otherwise addressed by the parties” and “every effort has been made to avoid unnecessary duplication of arguments.”<sup>1</sup> To the contrary, AWB disregards that *amicus curiae* means “friend of the court, not friend of a party.” *Ryan v. CFTC*, 125 F.3d 1062, 1063 (7th Cir. 1997). AWB’s submission is the quintessential “me too” effort providing no real assistance in deciding this case. AWB piles on the already-extensive arguments of nominal defendant F5 Networks, Inc. (“F5”), whose capable counsel filed two briefs spanning 75 pages. Just as F5 did, AWB expounds on what the law governing shareholder derivative actions *should* be – at least in AWB’s partisan opinion. Citing liberally to secondary sources, AWB admits its preferences are based on “public policy” concerns. Even AWB would concede, however, that this Court must apply the sources of Washington law actually at issue. When these sources are restored to their rightful place in the foreground, AWB’s policy-based theories fall apart.

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<sup>1</sup> Motion for Leave to Submit Brief of *Amicus Curiae* Association of Washington Business 2.

## II. ARGUMENT

### A. All Relevant Sources of Washington Law Point to a Demand Futility Standard

The first part of the certified question raises an issue of statutory interpretation:

“What test does Washington apply to determine whether allegations made pursuant to RCW 23B.07.400(2) by a shareholder seeking to initiate derivative litigation on behalf of a Washington corporation excuse that shareholder from first making demand on the board of directors to bring that litigation on behalf of the corporation?”

Certification Order 2 (Record No. 98). As AWB recognizes, this Court is confronted with a binary choice. Does the Washington statute provide for demand futility (the traditional standard) or universal demand (a recent phenomenon)? All pertinent sources of Washington law dictate the former.

In response to AWB’s view of the matter, the crucial consideration is that every state to adopt universal demand (save one, Pennsylvania, which is *sui generis*) has gone this route by statute. Notably, these jurisdictions have done so by enacting *new* legislation very different from RCW 23B.07.400(2). No court has announced universal demand as the governing standard in the face of legal sources like those summarized below.

The text the Legislature enacted is utterly inconsistent with universal demand. It presupposes cases where there is no demand. A derivative complaint must “allege with particularity the demand made, *if any*, to obtain

action by the board of directors and either that the demand was refused or ignored or *why a demand was not made.*” RCW 23B.07.400(2) (emphasis added). To highlight the difference, it is useful to compare this language to a typical universal demand statute. The textual contrast is stark. Enacted in 1993, Mississippi’s law is illustrative:

No shareholder may commence a derivative proceeding until:

- (1) A written demand has been made upon the corporation to take suitable action; and
- (2) Ninety (90) days have expired from the date the demand was made unless the shareholder has earlier been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result by waiting for the expiration of the ninety-day period.

Miss. Code Ann. §79-4-7.42. If Washington law is to be rewritten to this effect, plaintiffs believe the change should come from the Legislature.

Indeed, the timing of universal demand in legal jurisprudence further supports plaintiffs’ position. RCW 23B.07.400(2) was enacted in 1989 as part of the revamp of the Washington Business Corporation Act (“WBCA”). The WBCA was based, in turn, on the 1984 national Model Business Corporations Act. *See Ballard Square Condo. Owners Ass’n v. Dynasty Constr. Co.*, 158 Wn.2d 603, 620-21, 146 P.3d 914 (2006) (J.M. Johnson, J., concurring) (discussing this history). The 1984 Model Act did not recognize

universal demand because, among other things, this doctrine did not exist. In 1989, when the Legislature passed RCW 23B.07.400(2), universal demand was followed in just one state. *See* Ga. Code Ann. §14-2-742.

The Legislature could not have meant to endorse a new legal doctrine not reflected in the statutory language. More than this, the enacting body affirmatively conveyed its preference for demand futility in the 1989 official commentary to RCW 23B.07.400(2). According to the Senate Journal, shareholders seeking to protect the company's rights should make a presuit demand "in most circumstances." Appendix in Support of Plaintiffs' Brief on Certified Question ("PA"):120. As used here, "most circumstances" reflects the "general rule" at common law that the derivative plaintiff should make a presuit demand *unless* the gesture would be "useless" (or, as put more often today, futile). *Elliott v. Puget Sound Wood Prods. Co.*, 52 Wash. 637, 641, 101 P. 228 (1909). This exception is key. It was expressly recognized in the commentary. As the Legislature emphasized, "there may be circumstances showing that a demand on the board of directors would be useless, and in those circumstances it should be sufficient to allege the reasons why the plaintiff did not make the demand." PA:120.

AWB's strategy is to ignore this comment. In a diversionary move, AWB urges the Court to divine a wholly different legislative intent from a letter drafted recently by Professor Richard Kummert. Brief of *Amicus*

*Curiae* Association of Washington Business (“AWB Br.”) 5-7. Without requesting judicial notice or subjecting Professor Kummert to cross-examination as an expert, AWB seeks to displace what the Legislature actually said in favor of what he now wishes it had said. But, Professor Kummert does not claim to speak for the Legislature and his letter, too, ignores the official commentary. His choice to evade the legislative history is ironic given Professor Kummert’s self-described role in approving the 1984 Model Act comments as authoritative guidance.

At any rate, the post hoc personal views expressed in Professor Kummert’s letter (suspiciously aligned in “me too” fashion with F5’s arguments) are irrelevant to any issue here. Such letters have bearing, if at all, only to fill gaps, and only when “drafted prior to, or contemporaneously with, the passage of an act.” *Seattle Times Co. v. County of Benton*, 99 Wn.2d 251, 255 n.1, 661 P.2d 964 (1983). Correspondence drafted for this litigation – two decades after the statute was passed – does not qualify. As for the future, Professor Kummert advises in his letter that he will “personally advocate” a universal demand standard to the Corporate Act Revision Commission. He thereby acknowledges that this doctrinal shift, and the policy considerations it presents, are for the legislative branch.

Like F5, AWB contends that RCW 23B.07.400(2) is a “merely procedural statute.” AWB Br. 5. This preoccupation with labels is another

red herring. AWB does not dispute that the official comment to RCW 23B.07.400(2) is “indicative of legislative intent.” *Equipto Div. Aurora Equip. Co. v. Yarmouth*, 134 Wn.2d 356, 366, 950 P.2d 451 (1998). The Legislature’s express instruction to excuse demand when it would be “useless” (PA:120) amply conveys the approach the drafters of RCW 23B.07.400(2) had in mind. *See In re Guidant S’holders Derivative Litig.*, 841 N.E.2d 571, 573 (Ind. 2006) (citing same official comment as supporting demand futility standard).

Even if RCW 23B.07.400(2) could be simplistically characterized as “procedural,” it would not follow, as AWB assumes, that courts have leeway to gloss the statute with any standard a litigant might desire. When applying a legislative enactment, courts usually presume there was no intent to change the common law unless this appears “with clarity.” *McNeal v. Allen*, 95 Wn.2d 265, 269, 621 P.2d 1285 (1980). No such intent is present here. The common law, in fact, points the same direction as the official commentary.

Perhaps most glaringly, AWB ignores this Court’s last decision discussing when demand will be excused. Two years before the 1989 revamp of the WBCA, this Court encapsulated the common law benchmark: “The doctrine of futility excuses demand on directors when the majority of the directors are the alleged wrongdoers.” *Haberman v. Washington Pub. Power Supply Sys.*, 109 Wn.2d 107, 154, 744 P.2d 1032 (1987). AWB’s

belief that Washington courts have applied de facto universal demand (long before this modern doctrine even existed) is wishful thinking. *See also Williams v. Erie Mountain Consol. Mining Co.*, 47 Wash. 360, 91 P. 1091 (1907) (excusing presuit demand as useless).

**B. The Asserted Policy Benefits of Universal Demand Should Be Debated in the Legislature but, in Any Event, Are Not Compelling**

With no support in the pertinent sources of Washington law, AWB lauds the purported “policy advantages” of universal demand. AWB Br. 5. This plea (really a request for a different statute) is for the Legislature.

AWB’s musings on policy call to mind some recognized limits on the role of amici curiae. When the concept first originated, an amicus was “an impartial individual who suggests the interpretation and status of the law, gives information concerning it, and advises the Court in order that justice may be done, rather than to advocate a point of view so that a cause may be won by one party or another.” *Community Ass’n for Restoration of the Env’t v. Deruyter Bros. Dairy*, 54 F. Supp. 2d 974, 975 (E.D. Wash. 1999) (Shea, J.). Although amicus participation is liberally permitted, “[a]n appeal should . . . not resemble a congressional hearing.” *Voices for Choices v. Ill. Bell Tel. Co.*, 339 F.3d 542, 544-45 (7th Cir. 2003). Mounting a soapbox to argue policy “represent an improper attempt to inject interest group politics into the appeals process.” *Kinkel v. Cingular Wireless, L.L.C.*, No. 100925,

2006 Ill. LEXIS 1, at \*3 (Ill. Jan. 11, 2006). In light of the duplicative nature of its contentions, AWB's brief seems designed merely to "flaunt[] the interest of a trade association or other interest group in the outcome of the appeal." *NOW, Inc. v. Scheidler*, 223 F.3d 615, 617 (7th Cir. 2000). But, except for unusual circumstances not present here, "the fact that powerful public officials or business or labor organizations support or oppose an appeal is a datum that is irrelevant to judicial decision making." *Kinkel*, 2006 Ill. LEXIS 1, at \*6 (quoting *Voices for Choices*, 339 F.3d at 545).

Even if these fundamental considerations could be brushed aside, AWB's claim of policy superiority falls short. AWB says universal demand encourages "cost-containment" and is the proverbial "bright-line rule." AWB Br. 7-8. Crisp legal boundaries definitely have benefits, but AWB oversimplifies to the point of distortion. The inquiry is not so easy as "either demand has been made or it hasn't." AWB Br. 9.

The label on the doctrine is, in fact, a misnomer. All 22 universal demand statutes currently recognize an exception allowing the derivative plaintiff to go to court immediately if "irreparable injury to the corporation would result by waiting" for the corporation to respond to the demand. *See, e.g.,* Neb. Rev. Stat. §21-2072 (enacted in 1995). This exception applies, for example, when the derivative action challenges a pending transaction. *See Ebon Found. v. Oatman*, 269 Ga. 340, 342, 498 S.E.2d 728 (1998) ("a sale of

the property was imminent and [defendant] was likely to have retained the profits”). Likewise, at least one jurisdiction excuses a presuit demand if “the statute of limitations will expire” during the waiting period. Ariz. Rev. Stat. §10-742 (enacted in 1994).

Accordingly, AWB is simply wrong that a presuit demand is “always” required under universal demand regimes. AWB Br. 1. The doctrine is not a panacea eliminating collateral litigation. It merely swaps a fight over one issue (whether the futility exception applies) for skirmishes over other issues (such as whether irreparable injury excused demand). Further demonstrating that the benefits of universal demand are exaggerated, several leading states on corporate law (Delaware, New York and California) still follow demand futility.

AWB says that universal demand cuts down on the dreaded “strike suit.” This policy argument is a tired one unsupported by empirical proof. Contrary to AWB’s description, a demand futility standard is not tantamount to “loose or non-existent protections” against abusive litigation. AWB Br. 14. If that were so, then few if any businesses would incorporate in Delaware. As plaintiffs have observed, it is no small matter to establish demand futility. Even when demand is excused, many hurdles must be surmounted to prosecute a derivative action successfully. *See* Plaintiffs’ Brief on Certified Question (“Plaintiffs’ Br.”) 26-27, 32-38.

Tellingly, AWB believes that *all* derivative litigation is a strike suit that “provides no or very little benefit to corporate shareholders.” AWB Br. 9. This disdain overlooks F5’s recent concession that the shareholder derivative action “serves the public interest.” Reply Brief of Nominal Defendant F5 Networks, Inc. 1. If there is public value in such cases, as F5 admits, then this benefit should not be rendered an empty promise to stockholders through a universal demand rule. The demand futility standard soundly takes into account that an obviously compromised board cannot objectively assess the merits of a derivative suit.

As AWB recognizes, it is difficult to consider the certified question without casting an eye on contemporary events. To bolster its grudging assessment of the derivative mechanism, the amicus brief contends that “[c]orporate wrongdoing is actually quite rare.” AWB Br. 11. To the extent AWB believes the current state of business ethics is acceptable, few would agree. Since the high-tech stock bubble burst nearly a decade ago, an ugly cycle of greed, fraud and corruption has unfolded in corporate boardrooms and tainted the integrity of our financial markets. In major accounting scandals such as Enron and WorldCom, and options backdating scandals such as Maxim and Broadcom, shareholders have seen their interests trampled upon. Corporate insiders have broken criminal laws, violated their strict fiduciary duties and, too often, acted to enrich themselves. If this Court

should reaffirm anything here, it is that “equity will permit a suit to be brought by a stockholder or stockholders to enforce a right of action belonging to the corporation” when its managers go astray. *Goodwin v. Castleton*, 19 Wn.2d 748, 761, 144 P.2d 725 (1944); *see generally* Daniel J. Morrissey, *The Path of Corporate Law: Of Options Backdating, Derivative Suits, and the Business Judgment Rule*, 86 ORE. L. REV. 973 (2007).

Seizing on the importance of location, AWB contends that Washington should be an attractive place to incorporate. This is a worthy goal, particularly in tough economic times. But AWB assumes a false choice between stockholder protections (promoting corporate accountability) and a strong business climate (necessarily dependent on clean markets and fair competition). A race to the bottom will not foster the “significant private investment” that AWB seeks to encourage. AWB Br. 15. Instead, Washingtonians will put their money in companies incorporated in jurisdictions striking a fairer balance.

Under AWB’s one-sided view, to whom are corporate directors accountable when they abuse their important positions of trust? Apparently not the shareholders who own our public companies. Management is free to act with impunity, unless caught by prosecuting and regulatory authorities. This should provide scant comfort. Despite good intentions, public prosecutors cannot pursue every act of malfeasance. Moreover, as the recent

scandal involving financier Bernard Madoff illustrates, the regulatory authorities inexplicably miss some big ones. Perhaps now more than ever, public prosecutors hamstrung by lean budgets depend on the companion function long served by private enforcement.

**C. Delaware Law on Demand Futility Is Persuasive for Purposes of Resolving This Case**

Finally, the United States District Court has also sought guidance on the following question:

“If Washington follows Delaware’s demand futility standard, does it also follow the reasoning of *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007) in cases where the improper backdating of stock options has been alleged?”

Certification Order 2 (Record No. 98).

In suggesting an answer here, AWB picks up F5’s theme that Washington is not a copycat of Delaware on corporate law and, in any event, this Court should not follow the demand futility formulation of *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). For their part, plaintiffs have already demonstrated that *Aronson* is a durable legal standard. Since its original formulation, *Aronson*’s two-part test has been refined in subsequent cases to make it an even better tool to assess when demand is futile. *See* Plaintiffs’ Br. 32-38. Indeed, Delaware has followed *Aronson* for a quarter century and is still, by far, the dominant state in luring companies to incorporate.

Although plaintiffs believe Washington would be well advised to develop its law by following *Aronson*, this doctrinal issue ultimately need not be reached. With the benefit of hindsight and, now, full briefing, it seems the second part of the certified question is unnecessarily broad. The overbreadth appears in the federal court's assumption that this Court cannot follow *Ryan* without first deciding to "follow[] Delaware's demand futility standard." Certification Order 2 (Record No. 98).

This formulation has a sweeping "all or nothing" quality – go with Delaware entirely on demand futility, or not at all. The common law tradition, however, is to decide each case "upon its own peculiar facts and circumstances." *Jennings v. D'Hooghe*, 25 Wn.2d 702, 706, 172 P.2d 189 (1946). The "incremental process of common law development" has an instinct "to avoid overly broad generalizations." *Petition for Promulgation of Rules Regarding Protection of Confidential News Sources, etc.*, 395 Mass. 164, 157-58, 479 N.E.2d 154 (1985) (citation omitted). These principles apply when answering a certified question. In one case, for example, the New York Court of Appeals noted the "breadth of the wording of the certified question," but opted for the "traditionally subtler approach" of common law adjudication "rooted in particular fact patterns." *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 92 N.Y.2d 458, 467, 705 N.E.2d 656 (1998).

This narrower approach presents a viable alternative here. The futility of demand in derivative litigation is fact-specific. This Court's observation a century ago, regarding when demand will be excused, still holds true today: "[I]t is plain that this question must be decided with reference to the facts in each particular case." *Elliott*, 52 Wash. at 641.

By changing just one word, the issue on which the United States District Court seeks guidance could be stated more precisely this way:

"If Washington follows *a* demand futility standard, does it also follow the reasoning of *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007) in cases where the improper backdating of stock options has been alleged?"

This Court, of course, is free to "restate the question somewhat differently." *Maxey v. Dep't of Labor & Indus.*, 114 Wn.2d 542, 544, 789 P.2d 75 (1990); *see also* Certification Order 2-3 (Record No. 98) (acknowledging same). Deeming *Ryan* persuasive, because it is soundly reasoned and factually analogous, does not require wholesale adoption of the *Aronson* test for demand futility, if the Court is not inclined to go that far.

As plaintiffs discussed in their main brief, the Delaware Court of Chancery's opinion in *Ryan* is widely (to plaintiffs' knowledge, universally) followed. It is the seminal decision on pleading demand futility in the options backdating context. *See* Plaintiffs' Br. 38-50. Although more authority should be unnecessary, several additional backdating decisions

have drawn on *Ryan* in just the past few months. See *Indiana State Dist. Council of Laborers v. Brukardt*, \_\_\_ S.W.3d \_\_\_, 2009 WL 426237, at \*10 (Tenn. Ct. App. Feb. 19, 2009); *In re Brocade Commc'ns Sys., Inc. Derivative Litig.*, No. C 05-02233 CRB, 2009 WL 35235, at \*19-\*20 (N.D. Cal. Jan. 6, 2009); *Engel v. Sexton*, No. 06-10447, 2009 WL 361108, at \*7-\*8, \*12 (E.D. La. Feb. 11, 2009). As AWB acknowledges, in filling gaps in Washington law, this Court is usually inclined to "follow the best approach regardless of its state of origin." AWB Br. 12. It is enough to answer the certified question that *Ryan* is persuasive in the particular factual setting here, options backdating.

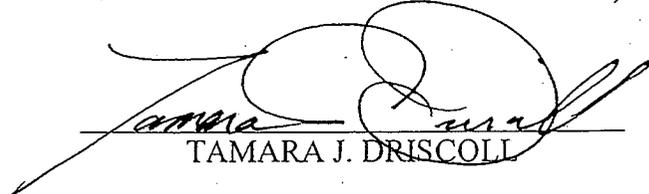
### III. CONCLUSION

The answer to the certified question is that a presuit demand will be excused under RCW 23B.07.400(2) when it would be futile or useless. For purposes of deciding the present case, the United States District Court should be advised that *Ryan*, if not *Aronson* too, is persuasive.

DATED: March 11, 2009

Respectfully submitted,

LAW OFFICES OF TAMARA J.  
DRISCOLL  
TAMARA J. DRISCOLL (WSBA 29212)



TAMARA J. DRISCOLL

321 North 80th Street  
Seattle, WA 98103  
Telephone: 206/286-1821

COUGHLIN STOIA GELLER  
RUDMAN & ROBBINS LLP  
TRAVIS E. DOWNS III (*pro hac vice*)  
KEVIN K. GREEN (*pro hac vice*)  
BENNY C. GOODMAN III (*pro hac vice*)  
655 West Broadway, Suite 1900  
San Diego, CA 92101  
Telephone: 619/231-1058  
619/231-7423 (fax)

DANIEL J. MORRISSEY (*pro hac vice*)  
GONZAGA UNIVERSITY  
SCHOOL OF LAW  
721 North Cincinnati Street, Box 3528  
Spokane, WA 99220  
Telephone: 509/313-3693  
509/313-5840 (fax)

Attorneys for Plaintiffs

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BY RONALD R. CARPENTER

**DECLARATION OF SERVICE BY MAIL**

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a ~~CLERK~~ citizen of the United States and a resident of the County of San Diego, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is 655 West Broadway, Suite 1900, San Diego, California 92101.

2. That on March 11, 2009, declarant served the **PLAINTIFFS' ANSWER TO AMICUS CURIAE BRIEF OF ASSOCIATION OF WASHINGTON BUSINESS** by depositing a true copy thereof in a United States mailbox at San Diego, California in a sealed envelope with postage thereon fully prepaid and addressed to the parties listed on the attached Service List.

3. That there is a regular communication by mail between the place of mailing and the places so addressed.

I declare under penalty of perjury that the foregoing is true and correct. Executed this eleventh day of March, 2009, at San Diego, California.

  
Terree DeVries

F5 DERIVATIVE (APPEAL)

Service List - 3/11/2009 (06-0168A)

Page 1 of 2

**Counsel For Defendant(s)**

Stellman Keehnel  
Brian D. Buckley  
Kit W. Roth  
DLA Piper LLP (US)  
701 Fifth Avenue, Suite 7000  
Seattle, WA 98104-7044  
206/839-4800  
206/839-4801(Fax)

Hugh Frederick Bangasser  
Philip M. Guess  
K&L Gates LLP  
925 Fourth Avenue, Suite 2900  
Seattle, WA 98104-1158  
206/623-7580  
206/623-7022(Fax)

Richard A. Kirby  
K&L Gates LLP  
1601 K Street, N.W.  
Washington, DC 20006  
202/778-9000  
202/778-9100(Fax)

Robert M. Sulkin  
Gregory J. Hollon  
McNaul Ebel Nawrot & Helgren PLLC  
600 University Street, Suite 2700  
Seattle, WA 98101-3143  
206/467-1816  
206/624-5128(Fax)

George E. Greer  
Lori Lynn Phillips  
Orrick Herrington & Sutcliffe LLP  
719 Second Avenue, Suite 1000  
Seattle, WA 98104  
206/839-4300  
206/839-4301(Fax)

Randy J. Aliment  
John A. Knox  
Williams Kastner & Gibbs PLLC  
Two Union Square  
601 Union Street, Suite 4100  
Seattle, WA 98101-2380  
206/628-6600  
206/628-6611(Fax)

**Counsel For Plaintiff(s)**

Travis E. Downs III  
Kevin K. Green  
Benny C. Goodman III  
Coughlin Stoia Geller Rudman & Robbins LLP  
655 West Broadway, Suite 1900  
San Diego, CA 92101  
619/231-1058  
619/231-7423(Fax)

John K. Grant  
Coughlin Stoia Geller Rudman & Robbins LLP  
100 Pine Street, Suite 2600  
San Francisco, CA 94111-5238  
415/288-4545  
415/288-4534(Fax)

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Page 2 of 2

John G. Emerson  
Emerson Poynter LLP  
830 Apollo Lane  
Houston, TX 77058  
281/488-8854  
281/488-8867(Fax)

William B. Federman  
Sara E. Collier  
Federman & Sherwood  
10205 North Pennsylvania  
Oklahoma City, OK 73120  
405/235-1560  
405/239-2112(Fax)

Professor Daniel J. Morrissey  
Gonzaga University School of Law  
721 North Cincinnati Street  
Spokane, WA 99220-3528  
509/313-3693  
509/313-5840(Fax)

Tamara J. Driscoll  
Law Offices of Tamara J. Driscoll  
321 North 80th Street  
Seattle, WA 98103  
206/286-1821

Kirk Robert Mulfinger  
Mulfinger Law Group  
13555 Bel-Red Road, Suite 111-A  
Bellevue, WA 98005-2324  
425/283-4155  
425/283-4156(Fax)

Kip B. Shuman  
The Shuman Law Firm  
885 Arapahoe Avenue  
Boulder, CO 80302  
303/861-3003  
303/830-6920(Fax)

**Courtesy Copy**

The Honorable Robert S. Lasnik  
United States District Court  
Western District of Washington  
700 Stewart Street  
Seattle, WA 98101  
206/370-8400

The Honorable Janet Thornton  
United States District Court  
Western District of Washington  
1717 Pacific Avenue, No. 3100  
Tacoma, WA 98402  
253/882-3730

**Counsel for Amicus Curiae**

Kristopher I. Tefft  
General Counsel  
Association of Washington Business  
1414 Cherry Street SE  
Post Office Box 658  
Olympia, WA 98507  
360/943-1600  
360/943-5811 (Fax)