Unreported Cases

INTRODUCTION

UNREPORTED CASES is a continuing feature of THE DELAWARE JOURNAL OF CORPORATE LAW. All unreported cases of a corporate nature that have not been published by a reporter system will be included. The court's opinions are printed in their entirety, exactly as received.

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BIG LOTS STORES, INC. v. BAIN CAPITAL FUND VII, LLC

No. 1081-N

Court of Chancery of the State of Delaware, New Castle

March 28, 2006

Norman M. Monhait, Esquire, of Rosenthal Monhait & Goddess, P.A., Wilmington, Delaware; and Jeff J. Marwil, Esquire, Barry Sullivan, Esquire, James A. Mckenna, Esquire, and Anders C. Wick, Esquire, of Jenner & Block LLP, Chicago, Illinois, of counsel, for the plaintiff.

Robert K. Payson, Esquire, Kevin R. Shannon, Esquire, and Bradley W. Voss, Esquire, of Potter Anderson & Corroon LLP, Wilmington, Delaware; and John K. Villa, Esquire, and Steven M. Farina, Esquire, of Williams & Connolly LLP, Washington, D.C., of counsel, for the Bain defendants and the Bain director defendants.

Lewis H. Lazarus, Esquire, and Thomas E. Hanson, Jr., Esquire, of Morris, James, Hitchens & Williams LLP, Wilmington, Delaware; and Thomas O. Kuhns, Esquire, Thomas L. Campbell, Esquire, and Benjamin W. Hulse, Esquire, of Kirkland & Ellis LLP, Chicago, Illinois, of counsel, for defendant Michael Glazer.

Barry M. Klayman, Esquire, of Wolf, Block, Schorr and Solis-Cohen LLP, Wilmington, Delaware; and Mitchell H. Kaplan, Esquire, and Wendy S. Plotkin, Esquire, of Choate, Hall & Stewart LLP, Boston, Massachusetts, of counsel, for defendant Robert J. Feldman.

LAMB, *Vice Chancellor*

In December 2000, in a sponsored management buyout transaction, a corporation sold a subsidiary business that operated a chain of toy stores. It received in exchange $257.1 million in cash and a deeply subordinated $45 million pay-in-kind note due in 2010. In 2002, the new owners refinanced the business and distributed approximately $120 million to the buyout sponsor, certain of its affiliates, two officers and directors of the subsidiary who invested in the buyout, and others. In 2004, the toy business filed a bankruptcy petition under Chapter 11 of the U.S. Bankruptcy Code.

As the holder of the $45 million note, the selling corporation is the largest unsecured creditor in the bankruptcy proceeding. Purporting to assert direct claims arising out of both the 2000 sale and 2002 refinancing, the seller brings this action asserting claims based on a variety of legal theories including breach of fiduciary duties, fraud, and civil conspiracy. The complaint seeks recovery for the amount due on the note and restitution for the alleged unjust enrichment of certain of the individual defendants.

In this opinion, the court concludes that it must grant the defendants' motions to dismiss. In sum, most of the plaintiff's claims are barred as a matter of law because they are derivative in nature, not direct, and thus belong to the bankruptcy estate. In more general terms, the underlying infirmity of the complaint is that the unavoidable effect of granting relief would be to unfairly advantage the plaintiff, an unsecured creditor, over any number of other unsecured creditors having claims in the bankruptcy. Simply put, this case stands for the well-established proposition that derivative claims cannot be used by a single creditor to upset the structured bankruptcy process. That principle equally applies when a plaintiff has erroneously characterized various derivative claims as direct, in the hope of escaping the broad jurisdiction of the bankruptcy court and the proceedings therein.

I.

A. The Parties

The plaintiff in this case is Big Lots, Inc., a Ohio corporation with its principal place of business in Columbus, Ohio. Until December 2000, through its wholly owned subsidiary, KB Consolidated, Inc., Big Lots owned and operated more than 1,300 retail toy stores across the United States, Puerto Rico, and Guam under the names K*B Toys, K*B Toy Works, and K*B Toy Outlet. In addition, KB Consolidated conducted online sales of children's products under the name Kbkids.com.

The complaint identifies three discrete sets of defendants. First, Big Lots seeks recovery against Michael L. Glazer, a long-time manager and executive of the KB Toys companies. At all relevant times, Glazer was a director of Havens Corners Corporation ("HCC") and KB Holdings (now KB Toys, Inc.), as well as a chief executive officer of various of the KB

companies, including HCC and KB Holdings.[1] Additionally, Glazer was a director of Big Lots at all times through May 20, 2003.[2]

Second, Big Lots brings claims against Robert J. Feldman, who, during the challenged events, was a manager and executive of the KB Toys companies. Further, Feldman was at all relevant times a director of HCC and KB Holdings, as well as chief financial officer of various of the KB companies, including HCC and KB Holdings.

Finally, the complaint sets out certain allegations against a group of individuals and entities affiliated with Bain Capital, LLC (together known in this opinion as the Bain defendants), a private equity investment firm.[3] The Bain director defendants include Joshua Beckenstein, Matthew Levin, and Robert White, who are alleged in some combination to have constituted the board of directors of KB Holdings, the ultimate parent of HCC and its affiliates.[4]

B. The Facts

During 2000, Big Lots received various indications of interest or offers for the KB Toys businesses, including an offer from one of its own directors, Glazer, to purchase KB Toys in a leveraged buyout transaction. Glazer ultimately withdrew his offer. But in December 2000, Big Lots entered into a stock purchase agreement to sell KB Consolidated and its operating subsidiaries to the Bain defendants, Glazer, Feldman, and other members of their management group. The transactional structure of this deal is complex, but is briefly summarized below.

1. The 2000 Sale Of The KB Toys Businesses To Bain Capital

Before 2000, the KB Toys businesses were wholly owned by Big Lots, then known as Consolidated Stores, Inc. The KB Toys structure at that point consisted of a holding company called KB Consolidated, which was directly owned by Consolidated Stores, and various operating companies positioned as subsidiaries of KB Consolidated.

The sale of KB Consolidated to the defendants took the form of a complicated multi-step transaction. First, Big Lots formed HCC, to which it transferred 100% of KB Consolidated's stock in exchange for all of the

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[1] Am. Compl. ¶ 11.

[2] *Id.* at ¶ 105.

[3] Claims have also been filed against various Bain Capital affiliates, each of which is a private equity investment fund or other investment vehicle. *Id.* at ¶ 16.

[4] *Id.* at ¶ 7.

stock of HCC. This left the entire KB Toys structure described above as a subsidiary of HCC. The defendants created KB Holdings and its wholly owned subsidiary, KB Acquisition Corporation. The parties then consummated the transaction by transferring all of the stock of HCC to KB Acquisition for $257.1 million in cash and a $45 million pay-in-kind note issued by HCC and due in December 2010 (the "PIK Note").

At the conclusion of all related transactions, KB Holdings owned HCC, which held all the stock of KB Consolidated, which, in turn, wholly owned the various subsidiaries that operated the KB Toys businesses. In essence, the PIK Note became the obligation of a company (HCC) with no assets other than the stock of another holding company. From its inception and by its terms, therefore, the PIK Note was subordinated to the rights and claims of creditors of the operating companies held by KB Consolidated in any Chapter 11 proceeding.[5]

2. The 2002 Transaction

On April 23, 2002, KB Toys undertook a series of transactions which included the redemption and repurchase of shares of the KB Toys businesses, the restructuring of equity, and the payment of bonuses to more than 50 managers and senior executives of the KB companies.[6] Briefly, KB Toys was able to do this by causing the operating subsidiaries to raise debt, part of which was paid immediately to executives as bonuses. The remaining additional funds were paid upstream to HCC, and then eventually to KB Holdings at the top of the corporate structure. KB Holdings then used these funds to repurchase 65% of its own outstanding stock from the Bain defendants, Glazer, Feldman, and other KB insiders. However the parties characterize these events, the fundamental purpose is clear—the 2002 transaction constituted a liquidity event which allowed Bain and its affiliates, as private equity investors, to withdraw certain sums of money from the KB Toys businesses.

Big Lots had no contractual rights in any capacity to block the 2002

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[5]Scaggs Aff., Ex. B § 5.

[6]The parties quibble as to what to call the set of transactions that occurred in 2002. The defendants prefer the label "recapitalization transactions." At oral argument, the plaintiff argued that this designation was misleadingly benign, masking the defendants' purported misconduct. The plaintiff's papers therefore refer to the 2002 transaction as the "equity distribution transaction." The court will avoid this tangential dispute over labeling by simply referring to these events as the "2002 transaction."

transaction.[7] Nonetheless, on April 23, 2002, Feldman wrote to Charles Haubiel, General Counsel of Big Lots, certifying that following the repurchase agreement which constituted part of the 2002 transaction KB Holdings would continue to have a consolidated net worth of "not less than $20,000,000."[8] The complaint alleges that the purpose of this certification, although not required for any reason, was to induce Big Lots to "generally cooperate with and not object to or seek legal relief with respect to the [2002 transaction]."[9]

3. The KB Toys Bankruptcy

The complaint goes on to allege that the 2002 transaction left HCC and the operating subsidiaries on the brink of bankruptcy, insolvent, and unable to pay their obligations as they matured. In the words of the complaint:

> [t]he effect [of] the [2002 transaction] was to encumber substantially all of HCC's assets and to strip all of the value from HCC and the Operating Subsidiaries. The [2002 transaction] resulted in an enormous and unjustified return on the Defendants' investment in excess of . . . 900% in a mere 16 months, and ultimately resulted in HCC's default on Big Lots' $45 million HCC Note.[10]

Although it is conceded that KB Toys survived through the entire holiday season of 2002, and then the entirety of 2003, the complaint alleges that the 2002 transaction led directly to a Chapter 11 bankruptcy filing on January 14, 2004, some 22 months after the 2002 transaction. As a result of the bankruptcy,[11] the PIK Note became due and payable in the amount of approximately $57 million, consisting of $45 million in principal plus accrued interest.[12]

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[7] Big Lots received $1.95 million in the 2002 transaction in exchange for certain warrants it had been issued in connection with the 2000 transaction, and which it was obligated to surrender under the drag along provision in its warrant holder agreement. Am. Compl. ¶ 35.

[8] *Id.* at ¶ 36.

[9] *Id.*

[10] *Id.* at ¶ 40.

[11] *Id.* at ¶ 47.

[12] *Id.* at ¶ 42.

II.

The amended complaint originally set out nine counts alleged against various of the defendants. Count VI, a claim of unjust enrichment against the Bain defendants, Glazer, and Feldman, has now been voluntarily dismissed. As to those counts still at issue, Count I alleges that the Bain defendants and the Bain director defendants committed fraud by making false representations in the 2000 stock purchase agreement, and in various personal representations immediately thereafter. Count II alleges that Feldman's representation on or about April 23, 2002, certifying that KB Holdings would have a consolidated net worth of not less than $20 million, was false, and that all the defendants committed fraud by allowing Big Lots to rely to its detriment on Feldman's representation in acquiescing to the 2002 transaction, which purportedly resulted in KB Holdings being rendered insolvent. Count III alleges that Glazer and Feldman, as directors of HCC and various HCC subsidiaries, acquired fiduciary duties to Big Lots as a result of HCC's insolvency, and breached those duties by approving the 2002 transaction. Count IV makes similar allegations against the Bain director defendants. Count V alleges that the Bain defendants and the Bain director defendants aided and abetted Glazer's and Feldman's breaches of fiduciary duty as alleged in Count III. Count VII alleges that Glazer breached his fiduciary duties under Ohio law, as a director of Big Lots, in failing to inform Big Lots of HCC's pending insolvency as a result of the 2000 and 2002 transactions. Count VIII alleges that the 2002 transaction, by rendering HCC's performance of its obligations under the PIK Note impossible, constituted tortious interference with contractual relations. Finally, Count IX alleges that all the defendants engaged in a civil conspiracy when they agreed and conspired with each other to commit the acts alleged in Counts I through VIII.

The defendants move to dismiss the amended complaint on a number of grounds.[13] First, the defendants claim that Counts II through IX are derivative and belong to the bankruptcy estate. Therefore, they argue, Big Lots has no standing to bring those claims. Second, the defendants claim that Counts I and II are barred by the statute of limitations. Third, the defendants maintain that all counts fail to state a proper claim for relief. Finally, the defendants raise a number of miscellaneous challenges to the complaint, arguing that Count I should independently be dismissed because

[13]The defendants have submitted three sets of briefs; one set for both the Bain defendants and the Bain director defendants, one set on behalf of Glazer, and one set on behalf of Feldman.

it is contradicted by the stock purchase agreement on which it is based, and that Count II fails to allege causation.

The plaintiff argues that the complaint alleges sufficient facts to survive the defendants' motions to dismiss.

III.

In order to dismiss a claim under Court of Chancery Rule 12(b)(6), a court "must determine with reasonable certainty that, under any set of facts that could be proven to support the claims asserted, the plaintiffs would not be entitled to relief."[14] A court must accept as true all well pleaded factual allegations in the complaint and all reasonable inferences to be drawn from those facts. But a court need not "blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences."[15]

A. Derivative And Direct Claims

The defendants' primary defense to Counts II, III, IV, V, VII, VIII, and IX is that, under Delaware law, those counts set out derivative claims, belonging to the bankruptcy estate, and that Big Lots lacks standing to advance these claims. Specifically, the defendants argue, the common element to these counts is that the fundamental injury alleged is the insolvency of HCC, and that this insolvency injured Big Lots. Thus, they argue, under the relevant Delaware precedent, these claims must all be derivative. The court agrees with the defendants as to Counts III, IV, V, VIII, and IX. However, the court finds Count VII to set out a direct claim, and dismisses Count II on other grounds.

1. Count II

Count II alleges that the defendants fraudulently induced Big Lots to refrain from interfering in the 2002 transaction by issuing the April 23, 2002 Feldman letter assuring Big Lots that KB Holdings would continue to have a consolidated net worth of above $20 million after that transaction closed. Although the court notes that, under the relevant precedent, similar claims have been found to be derivative (and would therefore be barred under the facts in this case), the court dismisses Count II on the alternative ground that it fails to state a cognizable legal claim.

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[14] *Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988).
[15] *Id.* at 187.

As a threshold matter, the plaintiff is correct to note that, in the bankruptcy context, some courts have permitted individual creditors to maintain direct actions for fraudulent inducement, even when those claims, in some way, implicate injury to the corporation. In *BRS Associates v. Dansker*,[16] for example, the court was faced with a fraudulent inducement claim by a creditor against a defendant in bankruptcy. Addressing itself to the difference between derivative claims and direct claims, the court ruled that certain RICO claims with regard to fraudulently induced investments were direct claims,[17] especially where the defendants' misconduct concealed the fact that a loan was in default.[18] As the court wrote in that case, this doctrine represented a "narrow exception" to the general rule that a shareholder lacks standing to bring an individual action under RICO to redress injuries to the corporation in which he owns stock.[19] Similarly, in *In Re Granite Partners*,[20] the court held that a complaint alleging that the plaintiffs were fraudulently induced to invest in a company was a direct claim, even when the plaintiffs had also made allegations, such as corporate waste, mismanagement, and breach of fiduciary duty,[21] that the court dismissed as plainly derivative.[22] The fraudulent inducement claim, in that case, was not premised on the corporation's eventual bankruptcy.

The bankruptcy cases, in other words, hold that claims somewhat akin to those brought here in Count I can be brought directly. But the bankruptcy cases also make clear that fraudulent inducement claims where the only alleged injury is inextricably linked to a corporate injury are derivative claims. In *In re Swallen's, Inc.*,[23] for example, the court dismissed as derivative a claim by a creditor that the failure to maintain a sufficient collateral base led to the debtor's failure to repay certain debentures.[24] And in *In re WorldCom*,[25] the court held that the shareholders' claim that they were fraudulently induced not to sell their shares was derivative because they had failed to allege any distinct injury to themselves.[26] The main dividing line between direct and derivative claims styled as "fraudulent inducement," therefore, has been whether the plaintiff has alleged some injury other than that to the corporation. As

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[16] 246 B.R. 755 (Bankr. S.D.N.Y 2000).
[17] *Id.* at 769.
[18] *Id.* at 761-62.
[19] *Id.* at 769.
[20] 194 B.R. 318 (Bankr. S.D.N.Y. 1996).
[21] *Id.* at 327.
[22] *Id.*
[23] 205 B.R. 879 (Bankr. S.D. Ohio 1997).
[24] *Id.* at 883.
[25] 323 B.R. 844 (Bankr. S.D.N.Y. 2005).
[26] *Id.* at 855.

such, these cases are entirely consistent with the Delaware Supreme Court's recent reformulation of the law on direct versus derivative claims in *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*[27]

Strictly speaking, a claim for fraudulent inducement in the context of a credit agreement usually requires that the plaintiff be fraudulently induced to extend credit. On occasion, however, plaintiffs have raised a substantially different claim under the same rubric; namely, that they were fraudulently induced to *refrain* from acting to collect their debt. Courts have been extremely reluctant to grant relief in those cases.

In the admittedly early case of *Evans v. Burson*,[28] the Supreme Court of Oklahoma refused to grant relief where a seller claimed to have eschewed filing suit against a debtor on the basis of potentially fraudulent representations by the clerk overseeing a public sale. The court observed that the reason it dismissed the claim was that the "damages sought to be recovered are too remote and contingent to admit of a judgment at law therefor."[29] The plaintiff might never have had an action; the suit might never have been brought; the court might have decided that the action did not belong to the plaintiff. As the *Evans* court noted, the plaintiff's possible recovery depended on "numberless unknown contingencies, and can be nothing more than conjecture."[30]

The Oklahoma Supreme Court's decision in *Evans* has been recognized as the general rule by more recent case law as well as by treatise authority.[31] Other courts, while not citing *Evans*, have identified the wildly contingent nature of the requested recovery as a bar to this kind of fraudulent inducement claim.[32] On those occasions where *Evans* has been

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[27] 845 A.2d 1031 (Del. 2004). Certain of these bankruptcy court cases were apparently decided on the basis of the "special injury" test rejected in *Tooley*. *See, e.g.*, *In Re Granite Partners*, 194 B.R. at 333 ("the contract claims belong to the trustee, and Primavera has not alleged a special injury."). These cases have continuing relevance, a conclusion reinforced by the Supreme Court's observation in *Tooley*, discussing *Lipton v. News International*, 514 A.2d 1075 (Del. 1985), that the *Lipton* court "could have reached the same correct result by simply concluding that the manipulation directly and individually harmed the stockholders, without injuring the corporation." *Tooley*, 845 A.2d at 1038.

[28] 164 P. 471, 472 (Okla. 1917).

[29] *Id.*

[30] *Id.*

[31] *Sade v. Northern Natural Gas*, 483 F.2d 230, 233 (10th Cir. 1973); *Wilkenson v. Linnecke*, 251 Cal. App.2d 291, 293 (Cal. Ct. App. 1967); *Miller v. Bank of Commerce*, 387 S.W.2d 691, 692 (Tex. App. 1965); 37 AM. JUR. 2D *Fraud and Deceit* § 50 (2001) (noting that "a creditor cannot maintain an action against a third party for fraudulent representations inducing the creditor merely to refrain from taking steps to collect the debt until collection has become impossible"); 37 C.J.S. *Fraud* § 53 (1997) (noting that "recovery . . . cannot be had for fraudulent representation inducing a creditor merely to refrain from taking steps to collect a debt until collection has become impossible . . . ").

[32] *In re Worldcom*, 323 B.R. at 855 (citing *Crocker v. Fed. Deposit Ins. Co.*, 826 F.2d

distinguished, furthermore, it has been distinguished on the basis of case specific facts. In *O'Gorman v. Haber*,[33] for example, the court allowed a fraudulent inducement claim for inaction where "the plaintiff intended to attach [and thus secure payment] and had the right to attach," noting that the plaintiff in that case actively "g[a]ve up this right in reliance upon the defendant's false representation . . . ."[34]

The facts alleged in the instant complaint set out precisely the kind of "fraudulent inducement" claim that courts have historically rejected. The gravamen of Count II is that Big Lots was injured because it refrained from bringing suit to stop the 2002 transaction as a result of a purportedly fraudulent misrepresentation by Glazer, a third party to the debt between Big Lots and HCC. Nevertheless, the complaint presents no facts to suggest that the plaintiff had any sort of legal right against the defendants, or that it gave up any legal right in reliance on the allegedly fraudulent misrepresentation. In addition, Big Lots does not allege any basis in the PIK Note or the warrants on which it could have objected to the 2002 transaction. Further, there is no reason to believe that Big Lots ever contemplated suit, or that it had even a colorable claim against the defendants at the time of the 2002 transaction. With the benefit of hindsight, Big Lots now claims it could have taken "affirmative action" to block the transaction. But the complaint does not plead any contemporaneous facts suggesting that this was so. Thus, the court will dismiss Count II for failure to adequately allege a claim of fraudulent inducement.[35]

2. Counts III, IV, V, VIII, And IX

The defendants argue that Counts III, IV, V, VIII, and IX, based on allegations of fraud and violations of fiduciary duty in approving the 2002 transaction, are derivative claims and therefore must be dismissed for lack of standing. Big Lots responds that, in the context of this case, the

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347, 351 (5th Cir. 1987) (holding that stockholders' claims of fraudulent inducement were too speculative because there was no contention that any stockholder "desired specifically to sell their stock at a given point, but were deterred from effectuating a sale because of the misrepresentations")).

[33] 147 A. 882 (R.I. 1929).

[34] *Id.* at 883.

[35] Big Lots's claim would have somewhat more force had Big Lots brought a colorable action for injunctive relief before the 2002 transaction, which it had then surrendered on the basis of Feldman's letter. In that circumstance, the court would still be faced with deciding whether the claim would now, after KB Toys's insolvency, be considered direct or derivative.

allegations in these counts set forth direct claims for which it has standing outside the bankruptcy estate.

Any analysis of these claims must start with *Tooley*, the Delaware Supreme Court's foundational opinion on the distinction between direct and derivative claims.[36] Rejecting previous, and sometimes contradictory, reliance on the so-called "special injury" test, which looked to see whether the plaintiff had alleged a "special injury, in whatever form,"[37] the Supreme Court refocused the relevant inquiry onto two broader prongs:

> [t]he analysis must be based solely on the following questions: Who suffered the alleged harm—the corporation or the suing stockholder individually-and who would receive the benefit of the recovery or other remedy?[38]

A direct claim, in other words, is a claim on which the stockholder can prevail without showing an injury or breach of duty to the corporation,[39] and one in which no relief flows to the corporation.[40]

Since *Tooley* was decided, this court has been called upon to differentiate between direct and derivative claims.[41] The most relevant of these post-*Tooley* opinions to the facts of this case is *Production Resources Group v. NCT Group*,[42] a suit brought by a creditor against a debtor, seeking the appointment of a receiver under 8 *Del. C.* § 291, and alleging that the defendants' board and a non-director officer committed various breaches of fiduciary duty.[43] The *Production Resources* court rejected any bright line test for determining whether claims are derivative or direct when brought by the creditor of an insolvent corporation. Although the court recognized that most such claims are likely to be derivative claims, under the standard in *Tooley*, the court acknowledged there might nonetheless be some circumstances in which "directors display such a marked degree of animus towards a particular creditor with a proven entitlement to payment

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[36] 845 A.2d 1031.

[37] *Lipton*, 514 A.2d at 1078.

[38] *Tooley*, 845 A.2d at 1035.

[39] *Id.* at 1038.

[40] Id. at 1039.

[41] *See, e.g., Albert v. Alex. Brown Mgmt. Servs.*, 2005 Del. Ch. LEXIS 133, *43-50 (Del. Ch. Aug. 26, 2005) (holding that a well-pleaded disclosure claim is a direct claim under *Tooley*, while claims for gross negligence, and failure to provide competent and active management are "clearly derivative"); *In re Syncor Int'l Corp. S'holders Litig.*, 857 A.2d 994 (Del. Ch. 2004) (holding that injuries comprising the reduction of consideration paid to shareholders in a merger caused by disclosures of purported misconduct are derivative claims).

[42] 863 A.2d 772 (Del. Ch. 2004).

[43] *Id.* at 772.

that they expose themselves to a direct fiduciary duty claim by that creditor."[44]

The unusual allegations of the plaintiff in *Production Resources* vividly illustrate how such animus could be pleaded. As the court's opinion sets out, the plaintiff had obtained a judgment against the defendant for $2 million in 1999, and had attempted to compel payment since that time. The facts alleged in the complaint established that the defendant had been insolvent for several years and, yet, had gone to extreme lengths both to avoid paying its judgment creditor and to misuse corporate power for the purpose of improperly benefitting itself and others in control.[45] In the face of such extraordinary machinations, the court was unwilling to dismiss the creditor's claims of specific injury as derivative because it seemed possible that the creditor in question was the only one that had been injured, and was thus the only one to which recovery was due. At the same time, certain other claims were dismissed as derivative, including conclusory accusations that "mismanagement and excessive salaries" had caused the company to become insolvent.[46]

Big Lots urges that the facts of this case mirror those of *Production Resources*, noting similar allegations of insider payments in defiance of a "legitimate, undisputed, debt obligation" owed to it, with knowledge that the 2002 transaction would allegedly render HCC insolvent. However, there are fundamental differences between this case and *Production Resources*, a decision which relied heavily on its unique facts. As is clearly evident in *Production Resources*, all the challenged transactions occurred in the context of an already insolvent company. In contrast, the amended complaint in this case only attempts to allege that HCC became insolvent after, and as a result of, the 2002 transaction.

Additionally, the plaintiff in this case had no right to repayment of its debt at the time of the challenged transaction. Unlike the judgment creditor plaintiff in *Production Resources*, Big Lots's entire credit agreement with HCC consisted of the unsecured PIK Note, due eight years after the 2002 transaction was set to close. The immediacy of the *Production Resources* defendant's debt was a necessary underpinning of the court's finding that the debtor's recalcitrance might have been motivated by

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[44] *Id.* at 798.

[45] *Id.* at 778.

[46] *Id.* at 780. The court dismissed these claims in part because they set out no claim, and in part because they were derivative claims. ("Some of PRG's fiduciary duty claims rest largely on generalized and conclusory allegations that NCT's board and officers have mismanaged the firm. Claims of this kind are classically derivative, in the sense that they involve an injury to the corporation as an entity and any harm to the stockholders and creditors is purely derivative of the direct financial harm to the corporation itself."). *Id.* at 776.

targeted animus towards the plaintiff.[47] The PIK Note in this case sat in the distant future, making Big Lots's argument that the defendants acted with the PIK Note in mind entirely incredible.

Indeed, the claims brought by Big Lots in this case, if they resemble those in *Production Resources* at all, resemble the claims that the court dismissed.[48] Shorn of excess verbiage, Big Lots's fundamental complaint in the counts at issue here is that the defendants caused HCC to become insolvent through what amounted to breaches of fiduciary duty. As the court noted in *Production Resources*, however, "claims of this type are classically derivative."[49] They do not become direct simply because they are raised by a creditor, who alleges that the breaches of fiduciary duty caused it specific harm by preventing it from recovering a debt outside of bankruptcy.

That result is directly in line with good corporate policy. As numerous commentators have observed, creditors are usually better able to protect themselves than dispersed shareholders.[50] There is no doubt that Big Lots was a sophisticated creditor which could have negotiated in the 2000 sale for protections against later transactions. However, the PIK Note is not alleged to contain any of the covenants and warranties that often bind debt contracts. Given the facts as pleaded, the absence of these otherwise standard provisions suggests strongly that the PIK Note was designed from the beginning to provide Big Lots some limited upside potential in the event that Bain was able to turn the KB Toys businesses into a profitable enterprise over the medium term. To imply further protections through fiduciary duty law would put the court in the awkward position of renegotiating a deal reached by extremely sophisticated and well represented parties, to the clear detriment of the bankruptcy estate. That

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[47] As the court noted, it was the "odd" circumstances of *Production Resources* in concert that were "suggestive of . . . bad faith on the part of the NCT board members." *Id.* at 797.

[48] *Id.* at 798.

[49] *Id.* at 776.

[50] *See, e.g.*, Stephen M. Bainbridge, *Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency*, J. BUS. & TECH. L. (forthcoming) http://ssrn.com/abstract=832504 at 28 (noting, for example, that "relative to many nonshareholder constituencies, shareholders are poorly positioned to extract contractual protections. Unlike bondholders, for example, whose term-limited relationship to the firm is subject to extensive negotiations and detailed contracts, shareholders have an indefinite relationship that is rarely the product of detailed negotiations"); *But see* Larry E. Ribstein & Kelli A. Alces, *Directors' Duties in Failing Firms*, J. BUS. & TECH. L. (forthcoming) http://ssrn.com/abstract=880074 at 8 (arguing that the greater protection generally due to debt-holders over shareholders is not an inherent characteristic of either instrument, because such distinctions may not apply to closely held corporations, or public corporations held substantially by institutional shareholders who can act collectively or through intermediaries).

kind of *ex post* rationalization has rarely been the practice of the Delaware judiciary, and for good reason.

Big Lots also relies on what the court may loosely designate as merger cases to bolster its argument that its current allegations represent direct claims. Specifically, it relies on *Parnes v. Bally Entertainment Corp.*,[51] a case which held that a plaintiff that attacks the fairness of a merger alleges a direct injury rather than injury to the corporation.[52] Big Lots argues that because the 2002 transaction in this case was also allegedly "unfair," *Parnes*, as reaffirmed by the Delaware Supreme Court in *Tooley*, controls the result in this case.

Big Lots's argument is based on a gross misreading of *Parnes*. That decision did not establish that every allegation of unfairness, in any transaction whatsoever, raises a direct claim. Rather, the holding in *Parnes* is necessarily premised on the fact that the challenged transaction was a merger, in which the plaintiffs would lose standing to bring derivative claims and the misconduct at issue was intimately bound up with the merger itself. Moreover, the Supreme Court held the claims at issue in *Parnes* to be direct because the purportedly unfair price paid to the shareholders in the merger did not injure the corporation in the way that mismanagement or improper self-dealing does. The facts are quite different here, where the entire injury alleged by Big Lots flows from the fact that KB Toys eventually became insolvent.

In summary, Big Lots has pleaded facts that could support a finding of injury to the corporation alone.[53] Under the test laid out in *Tooley*, therefore, it is clear that the claims asserted in Counts III, IV, V, VIII, and IX are entirely derivative in nature and cannot be maintained by Big Lots in this proceeding.[54]

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[51] 722 A.2d 1243 (Del. 1999).

[52] *Id.* at 1245.

[53] Count VII, which alleges a breach of fiduciary duty against Glazer in his former capacity as a director of Big Lots, is a paradigmatically direct claim brought by an aggrieved corporation (Big Lots) against one of its own directors. That count, as discussed below, is nonetheless dismissed for failure to state a claim.

[54] Big Lots cites two additional lines of authority for its argument that the claims it brings in this case are direct. Both are inapposite. First, Big Lots claims that nondisclosure claims are generally direct claims, citing this courts decision in *Alex. Brown Mgmt. Servs.*, 2005 Del. Ch. LEXIS, at *44. Although the plaintiff is right to note that non-disclosure claims are direct claims where a defendant has "failed to disclose material information when they had a duty to disclose it," the complaint alleges no well-pleaded facts that establish the defendants had any duty to disclose their intention, if any, to conduct the 2002 transaction when they signed the stock purchase agreement in 2000. In the absence of a specific duty to disclose, the plaintiff has only pleaded a set of derivative fiduciary duty claims. Second, Big Lots relies on cases based on the long established and common sense principle that the same set of facts can set out both direct and derivative claims (seeking different forms of relief) to suggest that the same is true in this case.

B. Count I

The plaintiff alleges in Count I that the Bain defendants and the Bain director defendants committed fraud in executing the stock purchase agreement for the 2000 transaction on behalf of KB Acquisition. This allegation is based, purportedly, on the text of Section 4.06 of the stock purchase agreement that formed part of the 2000 transaction, which provides, in pertinent part, that:

> Buyer has received and delivered to Seller a letter from Fleet Retail Finance Inc. and Fleet Securities Inc. . . . with respect to debt financing . . . in an amount sufficient to fund the Company Dividend Amount, and to enable the Buyer or its designee to pay the Share Purchase Price, and *make any other payments to be made by Buyer or its designee under this Agreement or the transactions contemplated hereby.*[55]

According to Big Lots, the italicized language above committed the defendants to ensuring that HCC would remain solvent and able to pay the PIK Note until it became due in 2010. But, Big Lots alleges, the defendants never intended to honor the purported commitment set forth in Section 4.06, and instead meant from the beginning to execute the 2002 transaction and thus render HCC insolvent. Therefore, Big Lots claims, the defendants fraudulently induced it to enter into the 2000 transaction believing that its investment in the PIK Note was secure.[56]

The plaintiff's argument entirely misconstrues Section 4.06 of the stock purchase agreement. The plain language of this provision sets out nothing more than a guarantee that the buyer, defined solely as KB Acquisition Corp.,[57] had obtained a commitment letter from Fleet, that the commitment letter was for sufficient financing to meet the buyer's obligations to close the stock purchase agreement, and that the commitment letter remained in full force and effect as of the closing. Nothing in this

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See, e.g., Grimes v. Donald, 673 A.2d 1207, 1212 (Del. 1996). Had Big Lots pleaded facts which establish a direct claim, such as those in *Production Resources*, both the bankruptcy estate and Big Lots could have brought claims arising out of the same facts. The complaint fails, however, to adequately plead such facts.

[55] Scaggs Aff., Ex. A § 4.06.

[56] The court notes that, by alleging that the defendants committed fraud by inducing Big Lots to enter into a transaction based on a false statement, Big Lots has stated an unambiguously direct claim in the form suggested by *Production Resources*, 863 A.2d at 794. The defendants do not dispute the plaintiff's standing to bring this claim.

[57] Scaggs Aff., Ex. A.

section imposes any obligation on HCC, or even suggests that KB Acquisition undertook therein to ensure the continued solvency of HCC for ten years into the future. Indeed, Section 4.06's emphasis on the defined "Share Purchase Price," which excludes the PIK Note, rather than the "Purchase Price,"[58] which includes that note, makes this conclusion even more clear.[59] In sum, the only reasonable reading of Section 4.06 is that it provides comfort to the seller that the buyer intends to close the transaction, and that the buyer's financial ability to do so will remain uncompromised. To turn that entirely standard promise into an all-encompassing guarantee that KB Acquisition and all its subsidiaries will continue to be solvent for ten years stretches the plain contractual language far beyond the breaking point. Section 4.06, therefore, is unambiguous, and cannot be the basis of an allegation of fraud in the inducement against the defendants.

C. Count VII

Count VII alleges that Glazer violated his fiduciary duties to Big Lots as a Big Lots director on two separate occasions. First, the plaintiff claims that Glazer violated his fiduciary duty of loyalty by approving the 2002 transaction while also serving as a Big Lots director, and by failing to disclose to Big Lots the extent of his interest in that transaction. Second, the plaintiff claims that Glazer violated his fiduciary duty of loyalty to Big Lots because he failed at the time the KB Toys businesses were sold in 2000 to disclose to Big Lots that the defendants intended to execute the 2002 transaction and thus render HCC insolvent. Big Lots claims, in essence, that Glazer's failure to disclose caused Big Lots to approve the 2000 transaction.

Both parties agree that Ohio law applies to Glazer's actions as a director of Big Lots, an Ohio corporation. Fiduciary duty violations under Ohio law are governed by statute, requiring that a director perform his or her duties as a director:

> in good faith, in a manner he reasonably believes to be in or not opposed to the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would use under similar circumstances.[60]

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[58] The "Purchase Price" is defined as the "Share Purchase Price, plus the Company Dividend Amount, plus the HCC note . . . ." *Id.* at § 2.01.

[59] The share purchase price, as defined by the agreement, includes only the "(i) amount in cash equal to the Cash Consideration less the Company Dividend Amount and (ii) the warrants." *Id.*

[60] OHIO REV. CODE § 1701.59(B).

Additional language in the statute provides that a breach of a duty as a director gives rise to an award of money damages only if clear and convincing evidence shows that:

> [the] director's action or failure to act involved an act or omission undertaken with deliberate intent to cause injury to the corporation or undertaken with reckless disregard for the best interests of the corporation.[61]

These two statutory provisions appear to establish a higher pleading standard for claims of monetary damages than claims for injunctive relief. Indeed, as an authority on Ohio corporate law explains:

> [a]pparently, a director can be found, by clear and convincing evidence, to have acted in a manner she does *not* reasonably believe to be in, or not opposed to, the best interests of the corporation . . . i.e., the director may be found to have breached his or her duties under R.C. § 1701.59(B) and still not be held liable in damages for that action or inaction unless it is proved, also by clear and convincing evidence, that the director acted with deliberate intent to injure the corporation, or with a "reckless disregard for the best interests of the corporation."[62]

Essentially, therefore, Ohio law establishes that in cases seeking monetary damages, a plaintiff can only succeed if it proves what, in Delaware, would amount to a lack of good faith. From this statutory foundation, Ohio courts frequently refer to Delaware case law and expertise in determining the contours of fiduciary duty.[63]

Delaware courts have long held that a certain duty to disclose inheres in the duty of loyalty. As this court held in *Hoover Industries v. Chase*,[64] for example, "the intentional failure or refusal of a director to disclose to the board a defalcation or scheme to defraud the corporation of which he

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[61] OHIO REV. CODE §§ 1701.59(C)(1), 1701.59(D); *Frank Lerner & Assoc. v. Vassy*, 599 N.E.2d 734, 738 (Ohio Ct. App. 1991).

[62] JULIE C. SHIFMAN, OHIO CORPORATION LAW § 7.5 (2005).

[63] *See, e.g*, *Abrahamson v. Waddell*, 624 N.E.2d 1118, 1120 (Ohio Com. Pl. 1992) (citing *Paramount Commc'ns v. Time*, 571 A.2d 1140 (Del. 1989); *Kelly v. Wellsville Foundry*, 2000 Ohio App. LEXIS 6287 (Ohio. Ct. App. Dec. 6, 2000) ("Delaware courts are widely renowned and respected for their expertise in the area of business law").

[64] 1988 Del. Ch. LEXIS 98 (Del. Ch. July 13, 1988).

has learned, itself constitutes a wrong . . . ."[65] But this duty to disclose is not a general duty to disclose everything the director knows about transactions in which the corporation is involved. Rather, the director disclosure cases decided in Delaware courts have implicated circumstances in which the director is personally engaged in transactions harmful to the corporation, but beneficial to the director.[66] *Hollinger International v. Black*[67] is the paradigmatic example of this claim. In that case, the controlling shareholder and director failed to disclose that he was "shopping" the company in violation of a signed contract that forbade him to do so.[68] The court held this failure to disclose to be a violation of the director's fiduciary duty. But even in that extreme circumstance, the court was careful to note that the duty to disclose this information was based on the specific facts of the case, which featured circumstances "under which . . . full disclosure was obviously expected."[69]

Under this standard, Count VII's allegations concerning the 2002 transaction fail to state a claim for relief. The simple fact is that the extent of Glazer's interest in that transaction, in his capacities as an officer, director, or investor in KB Toys, was completely immaterial to Big Lots, which had no right to approve or disapprove either the transaction or Glazer's participation in it. What was arguably material to Big Lots was the fact of the transaction and its size, and there is no allegation that Big Lots was ignorant of those facts. Nor can it be said that Glazer violated some fiduciary duty owed to Big Lots under Ohio law by approving the 2002 transaction as a director of KB Toys, as his duties in that capacity ran entirely to KB Toys.

Count VII's claim against Glazer with respect to the 2000 transaction is critically dependent on an allegation that Glazer either knew or should have known that the defendants would execute the 2002 transaction within some short time after the sale of the KB Toys businesses and, thus, that Glazer should have warned the other Big Lots directors of that fact. The court must grant the defendants' motion to dismiss this claim because Big Lots has failed to sufficiently allege that Glazer actually knew or actually had reason to know that the 2002 transaction would happen. Instead, just as Big Lots would have the court infer that the proximity of the 2002 transaction and the 2004 bankruptcy means that the two are connected, it

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[65] *Id.* at *7.

[66] *Thorpe v. CERBCO, Inc.*, 676 A.2d 436 (Del. 1996) (finding a duty to disclose where controlling shareholders and directors failed to tell disinterested directors of an offer to buy the company, and instead arranged to sell their own shares only).

[67] 844 A.2d 1022 (Del. Ch. 2004).

[68] *Id.* at 1061.

[69] *Id.* at 1062.

insists that the proximity of the 2000 and 2002 transactions means that Glazer knew or should have known in 2000 that the 2002 transaction was inevitable. Much more than this effort to plead knowledge in the alternative is required where a plaintiff bases a claim on a director's duty to disclose, a duty which our courts have only invoked in cases where the defendant had clear knowledge of the information at issue.[70]

To hold otherwise here would expose participants in leveraged buyout transactions, where directors or officers of the seller often emerge as directors and officers of the surviving corporation, to subsequent litigation based on mere speculation that a defendant should have known of some transaction planned by the new company within a few years after the sale, and that the transaction would turn out badly. That overly broad conception of liability is not what Delaware courts meant in establishing that a director's fiduciary duty of loyalty includes the duty to disclose known facts to his fellow directors.[71]

IV.

For the foregoing reasons, the defendants' motions to dismiss are GRANTED as to all counts. IT IS SO ORDERED.

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[70] *See, e.g., Int'l Equity Capital Growth Fund v. Clegg*, 1997 Del. Ch. LEXIS 59, *19 (Del. Ch. Apr. 21, 1997) (invoking the duty to disclose where a director had induced the board to purchase a manufacturing plant that, at the time of the purchase, was known to manufacture defective products); *Hoover*, 1988 Del. Ch. LEXIS, at *7 (noting that a "director does breach his duty of loyalty if he knows that the company has been defrauded and does not report what he knows to the board . . . at the very least when he is involved in the fraud and keeps silent in order to escape detection"); *Summit Investors II v. Sechrist Indus.*, 2002 Del. Ch. LEXIS 117, *21 (Del. Ch. Sept. 20, 2002) (noting, in the context of the duty to disclose, that a director's "fiduciary duties do not extend to speculation concerning future events").

[71] As one court has held in the context of fraudulent conveyance law, such suits do not "constitute insurance against the ultimate failure of the company." *MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Servs.*, 910 F. Supp. 913, 944 (S.D.N.Y. 1995). *See also, Moody v. Security Pacific Bus. Credit*, 127 B.R. 958, 989 (W.D. Pa. 1991) ("[while there were mistakes made, and while those mistakes arguably exacerbated the difficulties Jeannette began to experience in late 1982, the fraudulent conveyance laws were not designed to insure creditors against all possible consequences of a company's post-leveraged buyout errors in judgment or poor business practices").

CANADIAN COMMERCIAL WORKERS INDUSTRY PENSION PLAN v. ALDEN

No. 1184-N

Court of Chancery of the State of Delaware, New Castle

February 22, 2006

Michael F. Bonkowski, Esquire, and Chad J. Toms, Esquire, of Saul Ewing LLP, Wilmington, Delaware; and Timothy E. Hoeffner, Esquire, and Shiloh D. Napolitan, Esquire, of Saul Ewing LLP, Philadelphia, Pennsylvania, of counsel, for plaintiff.

Albert H. Manwaring, IV, Esquire, of Pepper Hamilton LLP, Wilmington, Delaware, for defendant Eric Alden.

Edward M. McNally, Esquire, and Thomas E. Hanson, Jr., Esquire, of Morris, James, Hitchens & Williams LLP, Wilmington, Delaware; and Robert Weiss, Esquire, of Narvid Scott & Schwartz, LLP, Sherman Oaks, California, of counsel, for defendants Harvey Bibicoff and Gordon Gregory.

William M. Lafferty, Esquire, and Natalie J. Haskins, Esquire, of Morris, Nichols, Arsht & Tunnell, LLP, Wilmington, Delaware; abd Jeffrey I. Shinder, Esquire, and Kerin E. Coughlin, Esquire, of Constantine Cannon, New York, New York, of counsel, for defendant Lorne M. Pollock.

PARSONS, *Vice Chancellor*

Plaintiff Canadian Commercial Workers Industry Pension Plan ("CCWIPP" or "Plaintiff") brought this derivative action on behalf of nominal defendant Case Financial, Inc. ("Case Financial") against four former directors and officers of Case Financial. All four individual defendants moved to dismiss. Two individual defendants—Gordon Gregory ("Gregory") and Lorne Pollock ("Pollock") (collectively, the "Settling Defendants")—settled with CCWIPP just before argument of their motions. This is the Court's decision on the remaining individual defendants' motions to dismiss. For the reasons stated below, the Court denies in part and grants in part defendant Eric Alden's ("Alden") and defendant Harvey Bibicoff's ("Bibicoff") motions to dismiss.

I. BACKGROUND[1]

A. The Parties

CCWIPP is a Canadian pension plan. At all relevant times, it owned Case Financial stock and, as of the filing of the Amended Complaint, owned 1,449,000 shares.

Case Financial is a Delaware corporation with its principal place of business in California. It provides funding to personal injury attorneys to cover the costs of litigation. The current iteration of Case Financial came into existence via an asset purchase agreement between a predecessor entity, also called Case Financial, and Asia Web in or around 2002. Asia Web bought substantially all of the assets of the predecessor entity and then changed the name of the resulting company to Case Financial. The original Case Financial entity continues to exist and is referred to by the parties as Old Case.

Defendant Alden is the former President, CEO and Co-Chairman of Case Financial. He resigned his positions on February 23, 2004.

Defendant Bibicoff is a former director of Case Financial.[2] He resigned as a director on October 7, 2004. From February to June 2004, Bibicoff also served as interim CEO of Case Financial.

B. Plaintiff's Allegations

CCWIPP advances claims against both Alden and Bibicoff for 1) breach of the duty of loyalty and corporate waste, 2) breach of the duty of oversight, *i.e.*, a *Caremark*[3] claim, and 3) common law fraud arising out of the formation of Case Financial.

In support of its duty of loyalty claims, CCWIPP alleges, *inter alia*, that Alden received stock options in contravention of his agreement with the Case Financial board of directors, that Alden used Case Financial property and employees to operate his tax preparation business without reimbursing Case Financial and that Alden used Case Financial capital to further his own private investments. Plaintiff also alleges that, shortly after the creation of Case Financial, Bibicoff improperly transferred accounts receivable from Old Case to an entity in which he had a significant interest,

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[1]The facts set forth herein are taken from the First Amended Derivative Complaint ("Amended Complaint") unless otherwise indicated and accepted as true for purposes of the individual defendants' motions to dismiss.

[2]The Court will refer to Alden and Bibicoff collectively as "Defendants".

[3]*In re Caremark Int'l Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

that Bibicoff improperly authorized the payment of bonuses to management and that Bibicoff usurped corporate opportunities of Case Financial by funding litigation via Bibicoff & Associates, a company he ran out of his office at Case Financial.

In support of its duty of oversight claims, CCWIPP alleges that Alden's and Bibicoff's failure to prevent the various alleged breaches of the duty of loyalty by the other and by the Settling Defendants constitutes a breach of the duty of oversight as defined in *Caremark*. For example, having pled that Alden improperly received stock options, CCWIPP alleges that "[d]espite their knowledge of the premature issuance of stock to [] Alden, Defendants took no action as directors of [Case Financial] to stop the issuance of these shares to [] Alden."[4] In further support of its *Caremark* claim, Plaintiff alleges that Alden and Bibicoff "consistently and continuously" failed to follow Case Financial's internal policies.[5] Finally, CCWIPP alleges that Case Financial personnel other than Defendants failed to follow Case Financial's internal policies, and that Defendants "consciously ignored their duties to [Case Financial] and failed to perform their oversight responsibility to ensure, for example, that borrowers were paying the amounts due to [Case Financial] on time and in full."[6]

In support of its fraud claims, CCWIPP alleges that "certain of the Defendants"[7] provided Asia Web with materially inaccurate financial statements, while "Defendants"[8] failed to disclose to Asia Web a request by one of Old Case's lenders that Old Case perform a fraud audit. Finally, CCWIPP alleges that Defendants allowed Asia Web to purchase worthless notes from a group of investors of which Gregory was a part.

C. Alden's Release

On June 7, 2004, Case Financial entered into an Agreement and Mutual Release (the "Release") with Alden.[9] The Release provided for the "release and discharge" by Case Financial of Alden from

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[4] Am. Compl. ¶ 27.
[5] *Id.* ¶ 60.
[6] *Id.* ¶ 65.
[7] *Id.* ¶ 13.
[8] *Id.* ¶ 17.
[9] *Id.* ¶ 65; Def. Eric Alden's Opening Br. in Support of his Mot. to Dismiss Pl. [CCWIPP's] First Am. Derivative Compl. ("AOB") Ex. B. The Court may consider the Release in deciding a motion to dismiss because the Complaint makes reference to it. *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 872 A.2d 611, 620 n.30 (Del. Ch. 2005).

> any and all debts, claims, demands, liabilities, obligations, contracts, agreements, guarantees, causes of action, known and unknown, against any of them which any of them now owns, holds or has at any time heretofore owned or held by reason of any act, matter, cause or thing whatsoever done prior to the execution of this Agreement.[10]

The Release does not, however, "release or discharge Alden from any act or conduct that constitutes a crime under California and/or federal law" (the "Crime Exception").[11]

The parties to the release waived the protections of Section 1542 of the California Civil Code ("Section 1542")[12] and were represented by counsel.[13]

D. Alden's Motion to Dismiss

Alden moves for dismissal on three grounds. First, he seeks dismissal of the entire Amended Complaint based on an affirmative defense. According to Alden, the Release extinguished any claims Case Financial may have had against him. Second, he moves for dismissal of Plaintiff's *Caremark* claim—Count II of the Amended Complaint—on the grounds that Plaintiff's allegations are not sufficiently egregious to fall outside of the protections of Case Financial's 102(b)(7) exculpatory provision. Finally, Alden moves in the alternative for dismissal of the entire Amended Complaint, arguing that CCWIPP is an inadequate representative of the stockholders of Case Financial under Court of Chancery Rule 23.1.

E. Bibicoff's Motion to Dismiss

Bibicoff also moves for dismissal on three grounds. First, he argues that the Case Financial board of directors improperly abdicated its duties by delegating prosecution of these claims to CCWIPP without an adequate

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[10] AOB Ex. B. ¶ 4.

[11] *Id.*

[12] Cal. Civil Code § 1542 provides: "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor."

[13] The parties argue and the Court agrees that California law governs the Release. It was entered into in California by a California resident and makes explicit reference to California law.

investigation into their merits. He contends that abdication warrants dismissal of the entire Amended Complaint. Second, Bibicoff moves for dismissal of the *Caremark* claim for failure to state a claim upon which the Court can grant relief. Finally, Bibicoff moves for dismissal of the fraud claim for lack of personal jurisdiction over him because, he argues, the claim does not arise out of his conduct as a director of Case Financial. He further argues that this Court should decline to exercise "pendent"[14] jurisdiction over the fraud claim because the facts of the claim are unrelated to CCWIPP's fiduciary duty claims.

II. ANALYSIS

A. Legal Standard

The standard for dismissal pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief can be granted is well established. The motion will be granted if it appears with reasonable certainty that the plaintiff could not prevail on any set of facts that can be inferred from the pleadings. In considering a motion to dismiss under Rule 12(b)(6), the court is required to assume the truthfulness of all well-pleaded allegations of fact in the complaint. All facts of the pleadings and inferences that can reasonably be drawn therefrom are accepted as true. However, neither inferences nor conclusions of fact unsupported by allegations of specific facts are accepted as true. That is, a trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in the plaintiff's favor unless they are reasonable inferences.[15]

B. The Release

Alden argues that the Release extinguished any and all claims Case Financial may have had against him. "When a motion to dismiss relies upon affirmative defenses, such as waiver and release, the Court may dismiss a claim if the plaintiff includes in its pleadings facts that incontrovertibly constitute an affirmative defense to a claim."[16] CCWIPP has not done this with respect to the fraud and duty of loyalty claims, but has done so with respect to the *Caremark* claims against Alden.

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[14] Opening Br. of Defs. [Bibicoff and Gregory] in Support of their Mot. to Dismiss ("BOB") at 16.

[15] *Albert v. Alex Brown Mgmt. Servs.*, 2005 WL 1594085, at *12 (Del. Ch. June 29, 2005) (internal citations omitted).

[16] *Capano v. Capano*, 2003 WL 22843906, at *2 (Del. Ch. Nov. 14, 2003) (internal quotation omitted).

1. The Crime Exception Creates a Factual Issue that Precludes Dismissal of the Fraud and Duty of Loyalty Claims (Counts I and III of the Amended Complaint)

CCWIPP has pled facts in connection with the fraud claim that, if proven, may constitute a violation of the federal securities laws, the California securities laws or both. If such facts are proven true, they would bar application of the Release because of the Crime Exception contained therein.

Section 10 of the Securities Exchange Act of 1934 (the "Exchange Act") provides, in relevant part, that "[i]t shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities & Exchange] Commission ["SEC"] may prescribe . . . ."[17] SEC Rule 10b-5 makes it unlawful for any person

> (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[18]

The federal courts repeatedly have held, although in varying forms, that "[a] violation of Rule 10b-5 comprises four elements: a (1) misleading (2) statement or omission (3) of a 'material' fact (4) made with scienter."[19] A federal jurisdictional means, *e.g.*, the use of the mails or "any facility of any

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[17] 78 U.S.C. § 78j(b).

[18] 17 C.F.R. § 240.10b-5.

[19] *U.S. v. Smith*, 155 F.3d 1051, 1063 (9th Cir. 1998); *see also SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992) ("To establish liability under [section 10 of the Exchange Act and Rule 10b-5], the SEC must establish . . . (1) a misrepresentation, or an omission (where there is a duty to speak), or other fraudulent device; (2) in the offer or sale, or in connection with the purchase or sale, of a security; (3) scienter on the part of the defendant . . . and (4) materiality, in the case of any misrepresentation or omission . . . ."). "Although criminal violations of 10(b) require a showing that the act was done willfully, the elements of [] civil and criminal violations of the statute are otherwise the same, and courts in criminal cases frequently cite civil interpretations of the statute to determine whether there has been a violation." *In re Enron Corp. Secs., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 579 n.18 (S.D. Tex. 2002).

national securities exchange,"[20] is an additional, necessary element of a violation of section 10 of the Exchange Act.[21]

Like section 10, section 25401 of the California Corporate Securities Law of 1968 provides that it is

> unlawful for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.[22]

"[K]nowledge of the falsity or misleading nature of a statement or of the materiality of an omission, or criminal negligence in failing to investigate and discover them" is also an element of a violation of section 25401.[23]

CCWIPP alleges that Defendants misstated Old Case's accounts payable and overhead to Asia Web in connection with the sale of Old Case's assets.[24] Plaintiff further alleges that Defendants failed to disclose significant legal fees owed by Old Case, along with a request for a fraud audit by one of Old Case's creditors.[25] In the aggregate, the allegedly misrepresented and omitted amounts total approximately $1.5 million.[26] These misstatements and omissions, Plaintiff avers, were material and induced Asia Web to issue securities to Defendants. The Amended Complaint also alleges that Defendants were aware of these misstatements and omissions.[27] These allegations, if proven, could give rise to a violation of California or the federal securities laws. To wit, Defendants allegedly 1) offered to buy stock from Asia Web, 2) by means of an oral communication, 3) which included a material untrue statement and 4) knew the statement was untrue. Therefore, contrary to Alden's contention, the

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[20] *Hasho*, 784 F. Supp. at 1106.

[21] *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir. 1993).

[22] Cal. Corp. Code § 25401.

[23] *People v. Simon*, 886 P.2d 1271, 1291 (Cal. 1995).

[24] Am. Compl. ¶ 14.

[25] *Id.* ¶¶ 15-17.

[26] *See id.* ¶¶ 14 (alleging a difference of $136,000 between the amounts disclosed and actually owed), 15 (alleging that $133,714.83 in legal bills were not disclosed), 16 (alleging that a creditor was owed $1.3 million).

[27] *See, e.g., id.* ¶¶ 14 (alleging that Defendants represented that overhead would be approximately $70,000 per month when it was $200,000 per month immediately following the closing of the stock issuance), 17 (alleging that Defendants were aware of a fraud audit request letter but did not disclose it to Asia Web before closing on the asset purchase transaction).

Amended Complaint does not include facts that incontrovertibly support his affirmative defense of release to the fraud claim.

Similarly, the Amended Complaint does not include facts that incontrovertibly constitute an affirmative defense to the duty of loyalty claim because there is a possibility, however remote, that the alleged actions may constitute crimes such as theft or common law fraud under California law. As such, the Crime Exception also precludes dismissal of the duty of loyalty claim pursuant to the Release.[28]

Alden argues that CCWIPP cannot defend against the motions to dismiss by arguing that the Crime Exception bars enforcement of the Release because it did not so argue in its Complaint.[29] Alden misapprehends Delaware law. As he correctly observes, Court of Chancery Rule 15(aaa) requires plaintiffs confronted with a Rule 12(b)(6) motion to dismiss to either stand on the allegations of their complaint or amend their complaint.[30] Rule 15(aaa) does not, however, require a plaintiff to make all of its *arguments* in its complaint. CCWIPP alleged *facts* that may constitute a crime in its Complaint. This is all Rule 15(aaa) requires.[31]

2. The Release extinguished any claims Case Financial may have had against Alden for breaches of the duty of oversight (Count II of the Amended Complaint)

In contrast to the allegations made by CCWIPP in connection with the fraud claim, the allegations made in connection with its *Caremark* claim do not give rise to an inference that the challenged conduct may constitute a crime. At most, the allegations give rise to an inference of poor management of Case Financial.[32] As such, the Crime Exception does not

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[28] This decision on a motion to dismiss does not preclude Alden from arguing at a later stage in this litigation that the Release, in fact, does extinguish the duty of loyalty claim.

[29] Def. [] Alden's Reply Br. in Support of His Mot. to Dismiss Pl. [CCWIPP's] First Am. Derivative Compl. ("ARB") at 11-13.

[30] *Id.* at 12 (citing *Stern v. LF Capital Partners, LLC*, 820 A.2d 1143 (Del. Ch. 2003)).

[31] *See Stern*, 820 A.2d at 1144 (denying motion to amend complaint where plaintiffs chose to stand on their complaint but then sought to amend to make more detailed allegations of fact based on information known to plaintiffs at time they filed original complaint); *Orman v. Cullman*, 794 A.2d 5, 28 n.59 (Del. Ch. 2002) (refusing to consider additional facts alleged in briefing on a motion to dismiss when facts were offered to substantiate allegations made in complaint).

[32] As explained *infra*, Part II.C.1, there arguably is significant overlap between the underlying wrongs complained of in the breach of loyalty claim and the "self-dealing transactions" involving directors and officers as to which the *Caremark* claim alleges Defendants failed to provide adequate oversight in conscious disregard of their duties to Case Financial. The allegations of the Amended Complaint in this regard are extremely vague and provide no support for inferring some independent form of criminal activity related to the degree of oversight. The

apply to the *Caremark* claim.

CWIPP further argues that Alden procured the Release by fraudulent inducement and thus it is null and void. Alternatively, it argues that Alden's fraudulent nondisclosure of potential claims bars enforcement of the Release. As to the former argument, CCWIPP misapprehends California law; as to the latter, CCWIPP has pled facts that incontrovertibly refute this argument.

General releases of all claims known and unknown are completely enforceable under California law[33] if the release explicitly covers "unknown or unanticipated claims," both parties were represented by counsel and the parties waived the protections of Section 1542.[34] The Release here satisfies these three requirements. Moreover, fraudulent inducement is not a defense to the enforcement of a general release that satisfies these requirements.[35] Fraud in the inception, *i.e.*, one party did not know what it was signing, and a misrepresentation by a fiduciary are defenses to the enforcement of a release,[36] but neither of those exceptions applies here.

In a final attempt to avoid enforcement of the Release, CCWIPP relies upon a dictum from *San Diego Hospice* to the effect that fraudulent nondisclosure bars enforcement of a general release.[37] Even assuming that is a correct statement of California law, it does not bar enforcement of Alden's Release because CCWIPP has pled facts that eliminate any requirement of disclosure on the part of Alden to Plaintiff. A duty to disclose arises when "(1) the material fact is known to (or accessible only to) the defendant and (2) *the defendant knows the plaintiff is unaware of the fact and cannot reasonably discover the undisclosed fact.*"[38] CCWIPP has pled that defendants Bibicoff and Gregory, who were serving as officers and directors of Case Financial when it entered into the Release, were aware of all of the material facts that Alden allegedly did not disclose.[39]

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other alleged misconduct that Defendants allegedly failed to monitor relates to managerial concerns such as the creditworthiness of borrowers and the perfection of security interests. *See* Am. Compl. ¶ 81.

[33] *Winet v. Price*, 4 Cal. App. 4th 1159, 1173 (Cal. Ct. App. 1992).

[34] *San Diego Hospice v. County of San Diego*, 31 Cal. App. 4th 1048, 1053-54 (Cal. Ct. App. 1995) (citing *Winet*, 4 Cal. App. 4th at 1168).

[35] *Id.*

[36] *Id.* at 1054-55.

[37] Pl.'s Am. Mem. of Law in Opposition to Defs.' Mots. to Dismiss ("POB") at 35 (citing *San Diego Hospice*, 31 Cal. App. 4th at 1055).

[38] *San Diego Hospice*, 31 Cal. App. 4th at 1055 (internal citations omitted).

[39] *Compare* Am. Compl. ¶ 67 (listing five facts Alden allegedly did not disclose) *with* Am. Compl. ¶¶ 13-21, 58 (alleging all individual defendants had knowledge of Alden's activities).

Under California law, this knowledge is imputed to Case Financial.[40] Therefore, under the facts alleged by CCWIPP, no duty to disclose by Alden arose.

In sum, Plaintiff has shown no reason to bar enforcement of the Release as to the *Caremark* claim against Alden. Thus, the Court concludes that the Release bars that claim and dismisses it with prejudice.

C. The Complaint Fails to Adequately State a Caremark Claim

To state a claim for breach of the duty of oversight, CCWIPP must allege facts that show "(1) that the directors knew or (2) should have known that violations of law were occurring and, in either event, (3) that the directors took no steps in a good faith effort to prevent or remedy that situation, and (4) that such failure proximately resulted in the losses complained of . . . ."[41] Such a claim is a difficult one to prove.[42]

The duty of oversight implicates both the duty of care and the duty of loyalty:

> Although the *Caremark* decision is rightly seen as a prod towards greater exercise of care by directors in monitoring their corporations' compliance with legal standards, by its plain and intentional terms, the opinion articulates a standard for liability for failures of oversight that requires a showing that the directors breached their duty of loyalty by failing to attend to their duties in good faith. Put otherwise, the decision premises liability on a showing that the directors were conscious of the fact that they were not doing their jobs.[43]

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[40] *Austin v. Hallmark Oil Co.*, 21 Cal. 2d 718, 729 (Cal. 1943) ("[A] corporation is presumed to know what is known to its managing officers and directors.").

[41] *Caremark*, 698 A.2d at 971; *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 833 A.2d 961, 976 (Del. Ch. 2003) ("Two key elements necessary to proving a breach of fiduciary duty claim in this instance would be that (1) the directors knew or should have known that a violation of the law was occurring and, (2) 'the directors took no steps in a good faith effort to prevent or remedy that situation.'") (quoting *Caremark*, 698 A.2d at 971).

[42] *Guttman v. Huang*, 823 A.2d 492, 505-06 (Del. Ch. 2003); *Caremark*, 698 A.2d at 967 ("The theory here advanced is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.").

[43] *Guttman*, 823 A.2d at 506.

Thus, if the Amended Complaint adequately states a *Caremark* claim, the stated claim necessarily falls outside the liability waiver provided by Case Financial's 102(b)(7) exculpatory charter provision.[44]

Plaintiff's *Caremark* allegations fall into two categories. First, CCWIPP alleges that Defendants' failure to stop each other's and the Settling Defendants' alleged self-dealing transactions violated their duty of oversight.[45] Second, CCWIPP alleges that Defendants themselves, along with officers of Case Financial, "failed to follow the policies and procedures or standard industry practices to investigate the creditworthiness of the proposed borrowers."[46] "Thus," CCWIPP argues, "Defendants . . . consciously ignored their duties to [Case Financial] and failed to perform their oversight responsibility to ensure that borrowers were paying the amounts due to [Case Financial] on time and in full."[47] Plaintiff's Amended Complaint avers just a few specific facts coupled with numerous generalizations and conclusory allegations; together, these facts and unsupported legal conclusions fall well short of stating a *Caremark* claim.

1. Failure to stop other Defendants alleged self-dealing transactions

CCWIPP's claim for breach of the fiduciary duty of oversight is exceedingly general. First, they attempt to have most of their breach of loyalty allegations double as *Caremark* claims, as well, by averring that "Defendants breached [this duty of oversight] by continually failing to provide adequate oversight over the underwriting and operations of [Case Financial,] consciously ignoring their duties to [Case Financial.] Specifically, Defendants failed to (a) prevent directors and officers from engaging in self-dealing transactions . . . ."[48] The Amended Complaint, however, lacks the specificity required to support a *Caremark* or conscious

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[44] *See Caremark*, 698 A.2d at 971 ("Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation . . . in my opinion only a sustained or systematic failure of the board to exercise oversight . . . will establish the *lack of good faith* that is a necessary condition to liability.") (emphasis added); *Guttman*, 823 A.2d at 506 ("Functionally, *Caremark* also matches the liability landscape for most corporate directors, who are insulated from monetary damage awards by exculpatory charter provisions."); *cf. In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 290 (Del. Ch. 2003) ("Where a director consciously ignores his or her duties to the corporation, thereby causing economic injury to its stockholders, the director's actions are either 'not in good faith' or 'involve intentional misconduct.'").

[45] Am. Compl. ¶¶ 27, 31, 34, 41, 45, 57, 58.

[46] *Id.* ¶ 63.

[47] *Id.* ¶ 65.

[48] *Id.* ¶ 81(a).

disregard claim, as opposed to a duty of loyalty claim, for the alleged self-dealing transactions.[49] A conclusory allegation at the end of a general description of self-dealing transactions that Defendants were aware of, or consciously ignored, their duties to Case Financial in failing to be aware of the challenged transactions or to stop them is not sufficient to support a separate *Caremark* claim or demonstrate conscious disregard of the directors' duties.

The Amended Complaint identified seven or eight self-dealing transactions. Defendant Alden allegedly participated in and benefited from at least half of those actions.[50] The other individual Defendant, Bibicoff, approved at least two of those transactions. Some or all of these incidents may give rise to liability on the part of Alden or Bibicoff or both under a breach of the duty of loyalty theory. On the facts alleged, however, they fail to support a *Caremark* claim. As an interested party, Alden had loyalty obligations, but neither logic nor precedent suggests he had a separate enforceable duty to oversee his own actions in such circumstances.[51] For example, CCWIPP alleges that Alden failed to prevent Bibicoff from investing his own money in lines of business similar to those pursued by Case Financial and that Alden and Bibicoff failed to stop each other and the Settling Defendants from running other businesses out of their Case Financial offices. But, directors of Delaware corporations generally have no duty to monitor the personal affairs of other directors and officers.[52] In

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[49] *See, e.g.*, *Guttman*, 823 A.2d at 507 ("[Plaintiffs'] conclusory complaint is empty of the kind of fact pleading that is critical to a *Caremark* claim, such as contentions that the company lacked an audit committee, that the company had an audit committee that met only sporadically and devoted patently inadequate time to its work, or that the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation."); *Malpiede v. Townson*, 780 A.2d 1075, 109-294 (Del. 2001) (where, as here, a defendant raises a Section 102(b)(7) provision as a defense, a plaintiff must allege "well-pleaded facts supporting a breach of loyalty or bad faith claim"); *David B. Shaev Profit Sharing Account v. Armstrong*, No. 1449-N, slip op. at 11-12 & n.13 (Del. Ch. Feb. 13, 2006) (listing a variety of ways a plaintiff can plead a *Caremark* claim, but concluding, in the demand excusal context, that plaintiff's bald allegations that defendants should have known about wrongdoing within the company simply because of the financial materiality of the wrongdoing were insufficient).

[50] *See* Am. Compl. ¶¶ 23-27, 32-34, 47-49 and 50-53.

[51] Similarly, alleged self-dealing activities of Bibicoff himself, *see id.* ¶¶ 28-31, 35-41, cannot provide the predicate for a claim that Bibicoff breached his duty of oversight. Further, based on the scant facts alleged, the decision by Bibicoff and Gregory, as members of the Compensation Committee of the Case Financial board, to pay Alden and Pollock bonuses to cover taxes related to the receipt of company stock, *see id.* ¶ 32, provides no basis for a duty of oversight claim. Bibicoff conceivably could be liable for a breach of loyalty in that situation, but Defendants' motion does not address that issue. Moreover, the allegations regarding the decision to pay bonuses to cover taxes lack specificity in terms of, for example, whether Bibicoff's approval of that transaction was disinterested, independent and informed, and whether it proximately resulted in any loss to the corporation.

[52] *Beam*, 833 A.2d at 971.

addition, the Amended Complaint fails to allege specific facts showing that the accused directors had knowledge of the alleged wrongdoing or ignored a "red flag" regarding it or that the board exhibited a sustained or systematic failure to exercise oversight.[53]

The remaining self-dealing transactions that CCWIPP alleges Defendants failed to stop do not come close to the level of sustained or systematic failure of oversight necessary to sustain a *Caremark* claim. The Amended Complaint provides few, if any, details regarding the various incidents. No dates are given for some and others appear to have occurred before Case Financial even existed. CCWIPP's pleading also fails to provide much, if any, specific information on any damage that proximately resulted from the alleged failures of oversight.

2. Failure to oversee Case Financial personnel[54]

To reiterate, in order to state a *Caremark* claim adequately, CCWIPP must plead facts that would support a reasonable inference that there was a "sustained or systematic" failure of oversight.[55] "In other words, liability is premised on a showing that the directors were conscious of the fact that they were not doing their jobs."[56]

CCWIPP has not pled such a sustained or systematic failure. At most, Plaintiff has pled facts detailing one concrete incident in which it is

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[53] *See id.* ("In *Graham v. Allis-Chalmers Manufacturing Co.*, the Delaware Supreme Court held that 'absent cause for suspicion there is no duty upon directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists. . . . [T]he quoted statement from *Graham* refers to wrongdoing *by the corporation*."); *Caremark*, 698 A.2d at 971.

[54] Plaintiff's argument that Defendants should be held to a higher standard of care because they are professionals—Alden is a CPA, while Bibicoff is an attorney—isunavailing. First, no Delaware case has held that directors with professional qualifications are held to a higher standard of care in the duty of oversight context. Second, CCWIPP fails to articulate how Defendants' status as professionals provides them greater ability to ferret out wrongdoing or puts them in a "unique position to know" what their fellow directors are doing. *Cf. In re Emerging Commc'ns S'holders Litig.*, 2004 WL 1305745, at *39-40 (Del. Ch. May 3, 2004) (holding after a full trial on the merits that a director with [financial expertise] and "in a unique position to know" should have argued more vociferously that the [$10.25 price] of a proposed transaction was unfair where the court concluded that the price was $27.80/share too low and that the director was not independent); *see also* E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1445-47 (2005) ("It would be a perversity of corporate governance goals, in my view, for the Delaware courts to announce a general rule that a director with special expertise is more exposed to liability than other directors solely because of her status as an expert. Rather, the facts and procedural posture should be key.").

[55] *Caremark*, 698 A.2d at 971.

[56] *Saito v. McCall*, 2004 WL 3029876, at *6 (Del. Ch. Dec. 20, 2004) (internal quotation omitted), *aff'd*, 2005 Del. LEXIS 106 (Del. Mar. 8, 2005); *Guttman*, 823 A.2d at 506.

possible Case Financial's policies were not followed.[57] The few remaining paragraphs of the Amended Complaint addressed to the *Caremark* claim only broadly allege that procedures were not followed.[58] CCWIPP does not describe how Defendants, as directors, interacted with Case Financial personnel, how much time they spent, or did not spend, overseeing the activities of Case Financial personnel, etc. In fact, Plaintiff pleads that Case Financial used both an Underwriting Manual and a Standard Operating Procedures Manual,[59] so it arguably had adequate procedures and safeguards. The *Caremark* section of the Amended Complaint then conclusorily avers that Defendants "ignored their duties to the Company."[60] Absent supporting facts, such bald conclusions need not and will not be accepted as sufficient to survive a motion to dismiss.[61]

CCWIPP also has not pled specific facts supporting a reasonable inference that Defendants were conscious of the fact that they were not doing their jobs. Likewise, the Amended Complaint contains no specific allegations that Defendants ignored red flags that should have alerted them that Case Financial personnel were ignoring company policies.

CCWIPP's allegations, therefore, fail to meet the requirements for pleading a *Caremark* claim. Thus, the Court dismisses Plaintiff's *Caremark* claim as to both Alden and Bibicoff.[62]

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[57] Am. Compl. ¶¶ 61-62. This sole specific example of a violation of Case Financial's policies relates to advances Alden made to an attorney in March and April of 2001, more than a year before the formation of Case Financial. CCWIPP complains that two years later Defendants still had not taken "any affirmative action to recover these fees." *Id.* ¶ 62. Perhaps, CCWIPP could have questioned that inaction as a breach of the duty of care, but, as pled, it does not provide a basis for a breach of the duty of *oversight* claim that would be outside the protections of Case Financial's 102(b)(7) exculpatory provision.

[58] *See id.* ¶¶ 63-64 ("[O]fficers responsible for the underwriting analysis on behalf of [Case Financial] failed to follow the policies and procedures . . . . In addition, for many of these loans, the Company failed to perfect the security interests it received . . . ."). *Cf. Saito*, 2004 WL 3029876, at *7 (concluding that plaintiffs had "barely" stated a *Caremark* claim even though they had pled numerous, specific facts demonstrating that directors should have been aware of accounting irregularities and a $40-$55 million accounting problem in an acquisition target).

[59] Am. Compl. ¶ 59.

[60] *Id.* ¶ 65.

[61] *In re Walt Disney Co.*, 825 A.2d at 285 ("Conclusory statements, without specific allegations to support them, will not suffice [to survive a 12(b)(6) motion to dismiss]."); *UbiquiTel Inc. v. Sprint Corp.*, 2005 WL 3533697, at *2 (Del. Ch. Dec. 14, 2005) ("Neither inferences nor conclusions of fact unsupported by allegations of specific facts are accepted as true.") (internal quotation omitted).

[62] CCWIPP's failure to state a *Caremark* claim provides an independent, alternative ground for dismissal of this claim as to Alden.

D. Adequacy of CCWIPP as a Derivative Plaintiff

To pursue a derivative claim, CCWIPP must satisfy the adequacy requirements of Court of Chancery Rule 23.1.[63] The burden of proof, however, rests with the defendant challenging a plaintiff's adequacy.[64] Alden contends that CCWIPP is not an adequate derivative plaintiff for the Case Financial stockholders because 1) CCWIPP is a creditor of Case Financial as well as a stockholder, 2) CCWIPP is not the driving force behind the litigation and 3) CCWIPP "bears a high degree of vindictiveness toward [him]."[65] To prevail, Alden "must show a *substantial likelihood* that the derivative action is not being maintained for the benefit of the shareholders."[66]

The elements relevant to this inquiry are

> (1) the existence of economic antagonisms between the plaintiff and those he would represent; (2) the nature of the remedy sought; (3) indications that the named plaintiff was not the driving force behind the litigation; (4) plaintiff's unfamiliarity with the litigation; (5) the existence of other litigation pending between plaintiff and defendants; (6) the relative magnitude of plaintiff's personal interests as compared with his interest in the derivative action itself; (7) plaintiff's vindictiveness toward the defendants; and (8) the degree of support plaintiff receives from the stockholders he purports to represent.[67]

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[63] *Emerald Partners v. Berlin*, 564 A.2d 670, 673 (Del. Ch. 1989) ("Although Chancery Rule 23.1 contains no specific requirements as to the competency of a stockholder derivative plaintiff, the analogous adequacy requirements of Chancery Rule 23, which relates to class actions, is applied. . . . Rule 23.1 is intended to make explicit that adequacy of representation is a requirement of derivative as well as class actions.") (internal citations and quotation omitted).

[64] *Id.* at 674.

[65] AOB at 25.

[66] *Emerald Partners*, 564 A.2d at 674 (emphasis added) (citing *Youngman v. Tahmoush*, 457 A.2d 376, 380 (Del. Ch. 1983); *Owen v. Modern Diversified Indus., Inc.*, 643 F.2d 441 (6th Cir. 1981)).

[67] Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate & Commercial Practice in the Delaware Court of Chancery* § 9-2[b] (2005) [hereinafter *Wolfe & Pittenger*] (citing *Katz v. Plant Indus., Inc.*, 1981 WL 15148, at *2 (Del. Ch. Oct. 27, 1981)); *accord Youngman*, 457 A.2d 376.

A combination of these factors often forms the basis of a dismissal of a plaintiff as inadequate, but a strong showing as to one factor is sufficient if that factor "involve[s] some conflict of interest between the derivative plaintiff and the class."[68] The primary factor in this inquiry "is whether there is an economic conflict between the plaintiff and the other stockholders making it likely that the interests of the other stockholders will be disregarded in the prosecution of the suit."[69] "Purely hypothetical, potential, or remote conflicts of interest [] will not disable a derivative plaintiff."[70]

The Delaware courts have not directly addressed what the proper procedural standard is to evaluate a motion to disqualify a derivative plaintiff pursuant to Rule 23.1. The inquiry is highly factual.[71] In this case, the record remains largely undeveloped. The movant Alden proffered facts outside of the pleadings but did not engage in any discovery; the nonmovant Plaintiff chose not to present any counterveiling evidence of its own. Therefore, the Court considers it appropriate to apply the familiar summary judgment standard:

> Summary judgment will be granted where the moving party demonstrates that there are no genuine issues of material fact in dispute and that the moving party is entitled to judgment as a matter of law. When determining whether to grant summary judgment, a court must view the facts in the light most favorable to the nonmoving party.[72]

As with a motion for summary judgment, CCWIPP does not have to supply affidavits or other competent evidence to meet Alden's motion to dismiss for inadequate representation. When it elects not to do so, however, the test is whether the factual showing made by Alden is sufficient to demonstrate that CCWIPP would be an inadequate representative.[73]

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[68] *In re Fuqua Indus., Inc. S'holder Litig.*, 752 A.2d 126, 130 (Del. Ch. 1999).

[69] David A. Drexler, Lewis S. Black, Jr. & A. Gilchrist Sparks, III, *Delaware Corporation Law & Practice* § 42.03[3] (2002) [hereinafter *Drexler, Black & Sparks*] (internal citation omitted).

[70] *Id.*

[71] *See Wolfe & Pittenger* § 9-2[b] ("[T]he Delaware decisions [on the question of adequacy of a derivative plaintiff] are markedly fact-specific.").

[72] *UbiquiTel Inc. v. Sprint Corp.*, 2006 WL 44424, at *2 n.15 (Del. Ch. Jan. 4, 2006) (internal quotation omitted); *Cf.* Court of Chancery Rule 12(b)(6); *Flynn v. Bachow*, 1998 WL 671273, at *4 (Del. Ch. Sept. 18, 1998) (exercising discretion to convert motion to dismiss into motion for summary judgment because movant offered documents outside of the pleadings to the court for consideration).

[73] *See Gutridge v. Iffland*, 2005 WL 3454129, at *5 (Del. Dec. 15, 2005) ("The burden

Alden submitted an affidavit in support of his motion and thus attempts to rely on facts outside of the pleadings.[74] CCWIPP argues that, Alden's facts notwithstanding, it is an adequate derivative plaintiff. Because CCWIPP has not disputed Alden's allegations, the Court assumes they are true, but otherwise draws inferences in favor of the nonmoving Plaintiff.

Alden first argues that because CCWIPP is a large creditor, as well as a stockholder, of Case Financial there exists a disabling economic antagonism between it and Case Financial's other stockholders.[75] This Court has held, however, that "the fact that the plaintiff may have interests which go beyond the interests of other stockholders, but are at least coextensive with the interests of the other stockholders, will not defeat the plaintiff serving as a derivative representative."[76] CCWIPP's interests are at least coextensive with the interests of the other stockholders: it wants the largest recovery possible so that it will realize some value for its equity investment.[77] Further, the requirement that this Court approve settlements of derivative actions provides a check against CCWIPP settling this suit for an inadequate amount that merely provides it recovery as a creditor but not as a stockholder.

Alden also alleges that this suit is part of a pattern whereby the current CEO of Case Financial, Michael Schaffer ("Schaffer"), purchases assets, launches a new business with a new name to generate gratuitous trading activity in the new business's stock and then, when the stock price inevitably goes down, sues everyone involved.[78] Schaffer is the true driving force behind this litigation, Alden further argues, not CCWIPP.[79] Assuming these very general allegations are true, they do not necessarily disqualify CCWIPP from serving as a derivative plaintiff in this case because there may be an innocent explanation for the pattern of facts involving Schaffer. Drawing all reasonable inferences in CCWIPP's favor,

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initially falls upon the moving party to show the nonexistence of a material fact, but then shifts to the non-moving party to show the contrary."). The burden only shifts, however, if the movant has made a sufficient showing. *Phillips v. Del. Power & Light Co.*, 216 A.2d 281, 285 (Del. 1966) ("[W]e have made it plain that the moving party has the initial burden; he has the job of seeing that the record contains enough evidence to justify the granting of his motion. If he fails, the resisting party need not introduce anything into the record.").

[74] AOB Ex. D (Aff. of Eric Alden).

[75] Alden Aff. ¶ 14; AOB at 25-26.

[76] *Drexler, Black & Sparks* § 42.03[3] (citing *Youngman*, 457 A.2d at 380).

[77] *Cf. Production Res. Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 790 n.56 (Del. Ch. 2004) (observing that the interests of creditors and stockholders in an insolvent company may diverge). The *Production Resources* case did not address the specific situation presented here, however, where one entity is both a large creditor and a large stockholder.

[78] Alden Aff. ¶¶ 5-8.

[79] AOB at 26.

the Court cannot rule out that possibility. Further, there is nothing inherently improper about the CEO of a company being the driving force behind a suit attempting to recover money for his company.

Alden also alleges that instituting this suit against him when he had previously entered into a release with Case Financial demonstrates vindictiveness towards him. It is possible that CCWIPP brought this suit only to harass Alden, but it is also possible that CCWIPP did so because it had a good faith argument that the Release was not enforceable and believed Alden had wronged Case Financial. Further, "[i]nadequacy as a class representative is not made out merely because of a disconcordant relation between plaintiff and defendants. To the contrary, this may inspire plaintiff to be an even more forceful advocate."[80]

At this early stage of the litigation, where the only evidence offered on the question of adequacy is Alden's affidavit and there has been no discovery the Court finds that Alden's allegations and the inferences from them could support a conclusion that CCWIPP is an inadequate derivative plaintiff, but they do not compel that conclusion. In the Court's opinion, Alden has not yet shown a substantial likelihood that CCWIPP is not acting for the benefit of all Case Financial stockholders.[81] Further development of the facts, however, may prove that CCWIPP is an inadequate derivative plaintiff. Therefore, the Court denies without prejudice Alden's motion to disqualify CCWIPP as a derivative plaintiff.

E. The Case Financial Boards Decision to Allow CCWIPP to Prosecute this Action

Defendant Bibicoff asserts that the Case Financial board impermissibly abdicated its duties by delegating prosecution of this action to CCWIPP. CCWIPP served its demand on the Case Financial board on March 11, 2005; three days later, the board delegated prosecution to CCWIPP.[82] According to Bibicoff, "the haste with which the decision was made precluded the meaningful deliberations required of a board deciding whether to pursue derivative litigation."[83]

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[80] *Emerald Partners*, 564 A.2d at 676 (internal quotation omitted).

[81] *See Wolfe & Pittenger* at text accompanying n.95 ("Mere allegations that the plaintiff is motivated by personal gain or animus are unlikely to succeed, at least in the early stages of the litigation."); *Emerald Partners*, 564 A.2d at 676 (considering deposition testimony on the question of adequacy of a derivative plaintiff); *Youngman*, 457 A.2d 376 (same).

[82] Am. Compl. ¶¶ 71-72.

[83] Reply Br. of Defs.' [Bibicoff and Gregory] in Support of their Mot. to Dismiss (BRB) at 3.

Upon receipt of a valid stockholder demand, the board of directors of a Delaware corporation must engage in a two-step process.

> First, the directors must determine the best method to inform themselves of the facts relating to the alleged wrongdoing and the considerations, both legal and financial, bearing on a response to the demand. If a factual investigation is required, it must be conducted in good faith. Second, the board must weigh the alternatives available to it, including the advisability of implementing internal corrective action and commencing legal proceedings.[84]

There is neither a prescribed procedure that a board must follow in carrying out these tasks nor a set amount of time these tasks must take.[85] Further, a formal factual investigation may not always be necessary for the board to sufficiently inform itself.[86]

In essence, Bibicoff argues that the Case Financial board could not possibly have fulfilled its demand-response duties in the time it did. Bibicoff may be correct that three days was an insufficient amount of time for the Case Financial board to fulfill its duties in the context of this case, but the Court cannot draw that conclusion without further development of the relevant facts. Three days is not per se insufficient *as a matter of law*. In fact, the "amount of time needed for a response [varies] in direct proportion to the complexity of the technological, quantitative, and legal issues raised by the demand."[87] "[W]hether the board has taken a reasonable amount of time in its investigation is essentially a question of fact."[88] As such, the Court cannot resolve the question of whether the Case Financial board fulfilled its duties on the undeveloped record available at this preliminary stage of the litigation. Therefore, the Court denies Bibicoff's motion to dismiss the entire Amended Complaint because of an improper delegation by the Case Financial board.

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[84] *Wolfe & Pittenger* § 9-2[b] (quoting *Rales v. Blasband*, 634 A.2d 927, 935 (Del. 1993)).

[85] *Id.*; *see also Charal Inv. Co. v. Rockefeller*, 1995 WL 684869, at *3 (Del. Ch. Nov. 7, 1995) ("[N]o formula exists by which the Court may determine if a 'reasonable' investigation period has elapsed.").

[86] *Wolfe & Pittenger* § 9-2[b].

[87] *Charal Inv. Co.*, 1995 WL 684869, at *3 (quoting *Allison v. Gen. Motors Corp.*, 604 F. Supp. 1106, 1117-18 (D. Del. 1985)).

[88] *Id.*

F. Jurisdiction over Bibicoff with respect to the Fraud Claim

This Court has personal jurisdiction over nonresident directors and officers of Delaware corporations under 10 *Del. C.* § 3114.[89] "[T]he Delaware courts have consistently held that Section 3114 is applicable only in connection with suits brought against a nonresident for acts performed in his . . . capacity as a director . . . of a Delaware corporation."[90] Further narrowing the scope of Section 3114, "Delaware cases have consistently interpreted [early cases construing the section] as establishing that [it] . . . appl[ies] only in connection with suits involving the statutory and nonstatutory fiduciary duties of nonresident directors."[91]

Bibicoff argues that the claim of fraud arising out of his pre-formation conduct as an employee of Case Financial's predecessor, Old Case, does not concern his service as a director of Case Financial and thus this Court lacks personal jurisdiction over him with respect to that claim. "[O]nce a defendant has moved to dismiss the complaint for lack of personal jurisdiction the plaintiff bears the burden of showing that the court has personal jurisdiction over the defendant."[92] Where, as here, "no evidentiary hearing [has been] held, the plaintiff typically meets this burden by making a prima facie showing that the exercise of personal jurisdiction

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[89] Regarding directors elected, appointed or serving after September 1, 1977, 10 *Del. C.* § 3114(a) states in relevant part:

> Every nonresident of this State who . . . accepts election or appointment as a director . . . of a corporation organized under the laws of this State . . . shall, by such acceptance or such service, be deemed thereby to have consented to the appointment of the registered agent of such corporation . . . as an agent upon whom service of process may be made in all civil actions or proceedings brought in this State, by or on behalf of, or against such corporation, in which such director . . . is a necessary or proper party, or in any action or proceeding against such director . . . *for violation of a duty in such capacity*, whether or not the person continues to serve as such director . . . at the time suit is commenced. Such acceptance or service as such director . . . shall be a signification of such director . . . that any process when so served shall be of the same legal force and validity as if served upon such director . . . within this State . . . . (emphasis added).

Regarding officers elected, appointed or serving after January 1, 2004, *see* 10 *Del. C.* § 3114(b) (providing for same jurisdiction over officers as for directors).

[90] *Wolfe & Pittenger* § 3-5[a] (citing cases).

[91] *Id.* Effective January 1, 2004, 10 *Del. C.* § 3114 was amended to bring officers of Delaware corporations within its reach. The language and holdings of the pre-2004 cases concerning Section 3114 thus now apply to officers, too.

[92] *Newspan, Inc. v. Hearthstone Funding Corp.*, 1994 WL 198721, at *3 (Del. Ch. May 10, 1994).

is appropriate."[93] "[I]n such a case, the record is construed in the light most favorable to the plaintiff."[94]

Bibicoff does not dispute this Court's jurisdiction over him for purposes of CCWIPP's breach of loyalty claims. The actions giving rise to the alleged fraud claim in Count I of the Amended Complaint, however, occurred before Bibicoff's service as a director of Case Financial.[95] As such, this Court has jurisdiction over Bibicoff with respect to the fraud claim only if one of the 'exceptions' to the strict construction of Section 3114 applies.[96] This Court has "held that once jurisdiction is obtained pursuant to Section 3114, nonresident directors are properly before the court with respect to any claims that are sufficiently related to the cause of action asserted against such directors in their capacity as directors."[97]

In this case, whether the fraud claim is sufficiently related to the fiduciary duty claims against Bibicoff to give rise to personal jurisdiction depends on whether the claims arise out of the "same nucleus of operative facts."[98] Or, put another way, construing the Amended Complaint in the way most favorable to Plaintiff, as the Court must, is the fraud claim predicated on the same nucleus of facts as one of the fiduciary duty claims?[99]

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[93] *Wolfe & Pittenger* § 3-3 (citing cases). Bibicoff argues, citing *Newspan*, 1994 WL 198721, at *3, that once a defendant questions the existence of personal jurisdiction over it, "a plaintiff cannot simply rest on the bare allegations in its complaint." BOB at 13. He further argues, again citing *Newspan*, that to meet its burden, "a plaintiff must offer 'affirmative proof' in support of its contention that there is personal jurisdiction." *Id.* at 13. Bibicoff accurately restates *one* of the standards described by former Chancellor Allen in *Newspan*. The Chancellor did not, however, decide among the various standards he set out. *See Newspan*, 1994 WL 198721, at *3 ("I need not, however, for resolution of this case decide the Delaware rule . . . ."). Later decisions of this Court have made clear that a plaintiff can, in fact, make the necessary prima facie showing using only the facts alleged in the complaint. *See Optimalcare, Inc. v. Hightower*, 1996 WL 417510 (Del. Ch. July 17, 1996) (denying a Rule 12(b)(2) motion to dismiss for lack of personal jurisdiction relying solely on facts as alleged in plaintiff's complaint despite quoting language from *Newspan* concerning plaintiff not resting on allegations in its complaint).

[94] *Cornerstone Techs., LLC v. Conrad*, 2003 WL 1787959, at *3 (Del. Ch. Mar. 31, 2003).

[95] Am. Compl. ¶ 22 ("After the asset purchase transaction was completed, Defendants took on positions as directors and officers of Case Financial."). On or about May 24, 2002, the assets and business of Old Case became the assets and business of Case Financial, a Delaware corporation. *Id.* ¶ 11.

[96] *See Goodrich v. E.F. Hutton Group, Inc.*, 1987 WL 17045, at *1 (Del. Ch. Sept. 10, 1987) ("[Section 3114] does not contemplate consent by a director [to jurisdiction] for acts that were not performed in his capacity as a director.").

[97] *Wolfe & Pittenger* § 3-5[a] (citing cases).

[98] *Hovde Acquisition, LLC v. Thomas*, 2002 WL 1271681, at *4 n.16 (Del. Ch. June 5, 2002) (citing a case construing Section 3114 in the context of applying Delawares implied consent statute for managers of limited liability companies).

[99] *Infinity Investors Ltd. v. Takefman*, 2000 WL 130622, at *6 (Del. Ch. Jan. 28, 2000)

CCWIPP alleges in support of its fraud claim that, in conjunction with the asset purchase agreement between Asia Web and Old Case, Asia Web purchased certain notes from a financing group of which Gregory was a part.[100] The debtor on the notes was Old Case and they were in default. Defendants neither informed Asia Web that the notes were in default nor told Asia Web that, shortly after the asset purchase agreement closed, Bibicoff would transfer $458,000 in accounts receivable that could have been used to repay the notes to Case Funding, Inc. ("Case Funding"), an entity in which he had a significant, direct interest.[101] As a result of this nondisclosure and subsequent transfer, Plaintiff alleges, Case Financial had to write off the value of the notes.[102]

In support of its breach of the duty of loyalty claim, Plaintiff alleges that Bibicoff transferred the same $458,000 in accounts receivable from Old Case to Case Funding instead of insisting that they be used to pay off the notes then owned by Case Financial.[103] Bibicoff thus profited at the expense of Case Financial, Plaintiff argues, in violation of his duty of loyalty to Case Financial.[104] Hence, Plaintiff's fraud claim is predicated on the same nucleus of facts as one of its fiduciary duty claims. In other words, both the fraud claim and the breach of the duty of loyalty claim depend on a number of the same facts. It is therefore proper as a matter of Delaware law for this Court to exercise personal jurisdiction over Bibicoff with respect to the fraud claim.

It is also proper as a matter of constitutional law for this Court to exercise jurisdiction over Bibicoff as to the fraud claim. "[T]he due process clause of the Fourteenth Amendment [of the U.S. Constitution] requires that a nonresident defendant have 'minimum contacts' with the forum jurisdiction 'such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.'"[105] "The touchstone

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("The Court of Chancery has held that once jurisdiction is properly obtained over a non-resident director defendant pursuant to § 3114, such non-resident director is properly before the court for any claims that are *sufficiently related to the cause of action* asserted against such directors in their capacity as directors. Here, Infinity's tort claim is predicated on the same set of facts as one of its breach of fiduciary duty allegations . . . . Clearly, the two claims are closely related.").

[100] Am. Compl. ¶¶ 19-20.

[101] *Id.* ¶¶ 20, 28. Plaintiff alleges, without greater specificity, that "Asia Web was not made aware that the notes were in default." *Id.* Reading this statement in the light most favorable to Plaintiff, the Court assumes that Plaintiff means *Defendants, including Bibicoff*, did not make Asia Web aware that the notes were in default. *See* Am. Compl. ¶ 85 ("Defendants . . . made misrepresentations to Asia Web . . . (d) by misrepresenting the value of the bridge financing group's Old Case notes.").

[102] Am. Compl. ¶ 21, 89.

[103] *Id.* ¶ 28.

[104] *Id.* ¶¶ 29, 75(b).

[105] *Conrad*, 2003 WL 1787959, at *13 (quoting *Int'l Shoe Co. v. Wash.*, 326 U.S. 310,

of this minimum contacts analysis is foreseeability — whether the defendant's conduct and connection with the forum State are such that he should reasonably anticipate being haled into court there."[106] Bibicoff's acceptance of a position as a director of a Delaware corporation certainly should have made him aware of the possibility of being haled into court here.[107] Further, having to defend against the fraud claim in Delaware cannot be said to be unfair or to offend notions of substantial justice when Bibicoff is already before this Court for alleged breaches of his fiduciary obligations to a Delaware corporation and that corporation was likely harmed as a result of his alleged fraud.[108] Bibicoff will face only minimal inconvenience in having to respond to an additional claim in this action.

III. CONCLUSION

For the reasons stated, Alden's motion to dismiss the entire Amended Complaint because of the Release is granted as to the *Caremark* claim, but denied as to the fraud and duty of loyalty claims. Alternatively, Count II of the Amended Complaint—the *Caremark* claim—is dismissed as to Alden for failure to state a claim. The *Caremark* claim is similarly dismissed as to Bibicoff. Bibicoff's motion to dismiss Count I of the Amended Complaint—the fraud claim—for want of personal jurisdiction is denied. Alden's and Bibicoff's motions to dismiss the entire Amended Complaint because CCWIPP is an inadequate derivative plaintiff and because of an improper delegation by the Case Financial board of directors, respectively, are denied.

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316 (1945)).

[106] *Wolfe & Pittenger* § 3-3 (internal quotation omitted).

[107] *Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc.*, 1996 WL 608492, at *5 (Del. Ch. Oct. 16, 1996) (holding that Section 3114 puts directors on notice of the possibility of being haled into court in Delaware); *cf. Conrad*, 2003 WL 1787959, at *13 (observing that officer of Delaware LLCs should not be surprised at being haled into court here and exercising jurisdiction over nonresident officer); *see also Cairns v. Gelmon*, 1998 WL 276226, at *3 (Del. Ch. May 21, 1998) (holding that act of incorporating a company under the laws of Delaware satisfied the minimum contacts requirement of International Shoe); *Manchester v. Narragansett Capital, Inc.*, 1989 WL 125190, at *7 (Del. Ch. Oct. 19, 1989) ("Furthermore, given the fact that the individual defendants are all . . . directors of the corporation, it would be artificial to distinguish their actions as having been taken in different guises when, as directors, they control the corporation. In that capacity, they should expect to answer in a Delaware court for the contract actions related to plaintiff's breach of fiduciary duty claims.").

[108] *See Manchester*, 1989 WL 125190, at *7 (although not discussing due process requirements, finding jurisdiction over nonresident director proper with respect to breach of contract claim where the same facts that gave rise to breach of fiduciary duty claims gave rise to the breach of contract claim).

Pursuant to Rule 15(aaa), the dismissal of the *Caremark* claims against Alden and Bibicoff is with prejudice.

IT IS SO ORDERED.

CARLSON v. HALLINAN

Nos. 19,808 & 19,466

Court of Chancery of the State of Delaware, New Castle

March 21, 2006

Neal C. Belgam, Esquire, and Alisa E. Moen, Esquire, of Blank Rome LLP, Wilmington, Delaware, for plaintiffs.

Wheeler K. Neff, Esquire, of Wilmington, Delaware; and Kenneth M. Dubrow, Esquire, The Chartwell Law Offices LLP, of Philadelphia, Pennsylvania, of counsel, for defendants.

PARSONS, *Vice Chancellor*

This direct and derivative action arises out of a dispute between two men engaged in the business of making short term, unsecured loans. Plaintiffs have asserted against various defendants direct claims for breach of contract, derivative claims for breach of fiduciary duties and aiding and abetting said breach and claims for attorneys' fees for a prior, related action and for this action. Specifically, plaintiffs assert that defendant Charles Michael Hallinan breached an oral agreement with plaintiffs by firing plaintiff G. William Carlson, paying himself and defendant Gary Dave Gordon executive compensation and authorizing the payment of certain management fees. Plaintiffs also assert that the individual defendants breached fiduciary duties they owed nominal defendant CR Services Corp. ("CR") by paying themselves an excessive amount of executive compensation, by authorizing CR to pay certain management fees, by causing CR to bear the expenses of other entities, by abandoning and diverting CR's business and usurping a corporate opportunity of CR, by

terminating Carlson to facilitate said breaches and by causing CR to pay for their defense of this action. Finally, plaintiffs assert that certain corporate defendants aided and abetted the aforementioned breaches of fiduciary duties. Plaintiffs seek damages, both for their direct and derivative claims, the dissolution of CR and the appointment of a custodian or receiver and attorneys' fees on their derivative claims.

These issues formed the basis for a seven day trial held from November 16 to 24, 2004. After post-trial briefing and argument, defendants moved to supplement the record, and plaintiffs opposed that motion. This Opinion embodies the Court's post-trial findings of fact and conclusions of law, as well as its ruling on defendants' motion to supplement.

For the reasons stated, the Court denies the motion to supplement and concludes that Hallinan breached the oral contract with Plaintiffs, Hallinan and Gordon committed multiple breaches of their fiduciary duties to CR, certain corporate defendants aided and abetted certain of those breaches of fiduciary duty, Plaintiffs are entitled to their attorneys' fees for the Section 220 action and for the derivative claims on which they prevailed in this action. The Court further holds that CR should be dissolved and a receiver appointed to wind up its affairs.

I. BACKGROUND

A. The Parties

Carlson is the majority shareholder, a director and President of plaintiff Contact Results, Inc. ("Contact," and collectively with Carlson, "Plaintiffs").[1] Contact is a Pennsylvania corporation in the business of providing communications and technical services to the payday loan industry.[2] Contact is the record owner of 30% of the authorized, issued and outstanding common stock of defendant CR.[3] Carlson is a director and former President of CR.[4]

Defendant Hallinan is the Chairman of the Board of Directors of CR and, with 65% of its authorized, issued and outstanding stock, the controlling shareholder.[5] Hallinan, whether directly or through another

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[1] Revised Pretrial Stip. ¶ II.2; Tr. at 7-8. Citations in this form are to the trial transcript ("Tr.") and indicate the page and, where it is not clear from the text, the witness testifying.

[2] Revised Pretrial Stip. ¶ II.1. Payday loans are short term, unsecured loans so named because their due date is the borrower's next pay date. Tr. at 26-27 (Carlson).

[3] Revised Pretrial Stip. ¶ II.1.

[4] *Id.* ¶ II.2.

[5] *Id.* ¶ II.4; Tr. at 472.

wholly owned company, is the sole shareholder and Chairman of the Board of Directors of defendants TC Services Corp. d/b/a Telecash ("TC") and Main Street Services Corp. d/b/a Easy Cash ("Main Street").[6] CR, TC and Main Street are all Delaware corporations engaged in the payday loan business.[7] All three corporations operate from the same offices in Bala Cynwyd, Pennsylvania.[8] Hallinan also controls several other nonparty payday loan companies, including Tahoe Financial Advisors d/b/a Axcess Cash ("Axcess") and CRA Services d/b/a Cash Net ("CRA").[9]

Defendant Gordon is a director and the Vice President of CR.[10] He also holds the remaining 5% of the authorized, issued and outstanding stock of CR.[11] In addition, Gordon works for TC and serves as its Controller.[12]

B. The Formation and Initial Operation of CR

In the summer of 1998, Contact began providing services for TC.[13] At that time, Hallinan owned 60% of the shares of TC, while Rick Mickman owned 40%.[14] Hallinan and Mickman had been involved in the payday loan business together for several years.[15] Contact was to develop software and technology solutions to enhance the efficiency of TC's operations.[16] The contract with TC provided Contact with needed business as it had begun to fall on hard times.[17]

Soon after Contact began providing services for TC, Carlson, Hallinan and Mickman began discussing the creation of another payday loan company.[18] These discussions culminated in the formation of CR in

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[6] Revised Pretrial Stip. ¶ II.4; Tr. at 472-73.

[7] Revised Pretrial Stip. ¶¶ II.3, II.5. Plaintiffs dropped their claims against defendant TCS Management Inc. *Id.* ¶ II.5 n.1. The Court also assumes that Plaintiffs have dropped their claims against defendant TC Management Inc. because no mention was made of them at trial or in post-trial briefing.

[8] Tr. at 719 (Hallinan).

[9] Revised Pretrial Stip. ¶ II.5.

[10] Tr. at 1169. The Court will refer to Hallinan and Gordon collectively as the "Director Defendants."

[11] Revised Pretrial Stip. ¶ II.6.

[12] *Id.* Tr. at 1168.

[13] Tr. at 31 (Carlson). TC originally was known as RAC. The company then became Telecash and, finally, TC. Tr. at 147 (Mickman). Because the record is not clear as to when these changes occurred, the Court will simply refer to the entity as TC.

[14] Tr. at 148 (Mickman).

[15] Tr. at 131-32 (Mickman).

[16] Tr. at 27-29 (Carlson); Tr. at 764 (Hallinan).

[17] Tr. at 277-78 (Carlson).

[18] Tr. at 31-32 (Carlson).