



IN THE COURT OF CHANCERY FOR THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

LEONARD T. GANTLER, PATRICIA A.)
CETRONE, JOHN GERNAT, PATRICIA)
GERMAT, PAUL MITCHELL and)
MARSHA MITCHELL,)

Plaintiffs,)

v.)

C.A. No. 2392-N)

WILLIAM L. STEPHENS, P. JAMES)
KRAMER, WILLIAM S. EDDY,)
DANIEL E. CSONTOS, ROBERT I.)
SHAKER, LAWRENCE SAFAREK and)
FIRST NILES FINANCIAL, INC., a)
Delaware corporation,)

Defendants.)

BRIEF IN SUPPORT OF DEFENDANTS'
MOTION TO DISMISS PLAINTIFFS' AMENDED COMPLAINT

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NATURE AND STAGE OF PROCEEDINGS

Plaintiffs Leonard T. Gantler, Patricia A. Cetrone, John Gernat, Patricia Gernat, Paul Mitchell, and Marsha Mitchell (collectively, the "Plaintiffs") filed their Complaint on September 1, 2006, seeking both monetary and injunctive relief. In response, Defendants William L. Stephens, P. James Kramer, William S. Eddy, Daniel E. Csontos, Robert I. Shaker, Lawrence Safarek, and First Niles Financial, Inc. ("First Niles" or the "Company") (collectively, the "Defendants") filed a Motion to Dismiss on October 17, 2006. First Niles filed its Definitive Proxy Statement with the Securities and Exchange Commission (the "SEC") on November 16, 2006 (the "Proxy" or "Definitive Proxy") and Plaintiffs filed their Amended Complaint on November 20, 2006 seeking only monetary damages. Defendants filed a Motion to Dismiss the Amended Complaint on December 6, 2006. To date no discovery or other substantive matters have occurred in this proceeding.

The claims in this case arise out of the decision of the Board of Directors of First Niles (the "Board") to institute a Rule 13e-3 transaction to reclassify the shares of common stock held by shareholders who were the record holders of 300 or fewer shares of First Niles common stock into shares of Series A Preferred Stock ("Reclassification"). The Board's Reclassification decision was approved by the Company's shareholders on December 14, 2006 and became effective on December 20, 2006.

Defendants, by and through their undersigned counsel, file this Brief in Support of their Motion to Dismiss Plaintiffs' Amended Complaint.

STATEMENT OF FACTS

A. The Parties.

First Niles is the holding company for Home Federal Savings and Loan Association of Niles (“Home Federal”), a one branch savings and loan charter serving its namesake town of Niles in northeastern Ohio. *See* Amended Complaint (“Am. Compl.”) ¶ 7. Currently, First Niles has five directors on its Board, three of whom are outside directors. *See id.* ¶¶ 9, 10, and 13. Mr. P. James Kramer has served on the Board since 1994. *See id.* ¶ 9. He is President of William Kramer & Son, a heating and air conditioning company located in Niles, Ohio. *See id.* Dr. William S. Eddy has served on the Board since 2002 and is President of the Clinic of Osteopathic Medicine, Inc., also located in Niles, Ohio. *See id.* ¶ 10.

Mr. Robert I. Shaker joined the Board in January of 2006. *See id.* ¶ 13. He replaced Mr. Ralph A. Zuzolo who passed away on August 22, 2005. *See id.* ¶ 12-13. Mr. Shaker is an attorney with the law firm of Shaker & Shaker LLP, which is located in Niles, Ohio. *See id.* ¶ 13. Mr. Shaker was not a director of the Company on March 9, 2005 when the Board voted not to sell First Niles to First Place and he was not on the Board on December 5, 2005 when the Board voted to move forward with the Reclassification. *See id.* ¶ 13, 54, and 67.

Two members of First Niles management currently serve on the Board of First Niles. *See* Am. Compl. ¶¶ 8 and 11. Mr. William L. Stephens serves as Chairman of the Board, President, and Chief Executive Officer of both Home Federal and First Niles. *See id.* ¶ 8. Mr. Daniel E. Csontos is the Secretary of both First Niles and Home Federal and has served on the Board of Directors since April of 2006. *See id.* ¶ 11. Mr. Csontos was not a director of the Company on March 9, 2005 when the Board voted not to sell First Niles to First Place and he was not on the Board on December 5, 2005 when the Board voted to move forward with the Reclassification. *See id.* ¶ 11, 54, and 67.

Mr. Lawrence Safarek is the Treasurer and Vice President of both Home Federal and First Niles. *See id.* ¶ 12. Mr. Safarek has never served on the Board and Plaintiffs do not allege that he has ever served on the Board.

The Plaintiffs are First Niles shareholders, but none of their shares were subject to reclassification. *See Am. Compl.* ¶¶ 6 and 71. Plaintiff Gantler is a former director of First Niles and was a director during the vote regarding the sale of First Niles to First Place and the Reclassification. *See id.* ¶ 6.

B. The Board Determines to Explore Transaction Alternatives and Approves the Reclassification.

In August of 2004, the Board retained Keefe, Bruyette & Woods, Inc. (“KBW”) as its financial advisor to represent First Niles in a possible sale of the Company. *See Am. Compl.* ¶ 28. KBW received indications of interest from three banks: First Place, Farmers National Banc Corporation, and Cortland Bancorp. *See id.* ¶ 31. Ultimately, one of the banks, First Place, presented a definitive merger proposal to the Board. *See id.* ¶ 49. On March 9, 2005 the Board voted against accepting the merger proposal by a vote of 4-1. *See id.* ¶ 54. Plaintiff Gantler was the sole Board member voting for the sale. *See id.*

The Board and First Niles management had considered the possibility of Reclassification as early as September of 2004. *See id.* ¶ 29. First Niles conducted due diligence regarding the effects of Reclassification over approximately eight months. *See id.* ¶ 55. During this time, First Niles formed a committee devoted to exploring Reclassification and hosted a presentation from Powell Goldstein LLP regarding the effects of Reclassification upon First Niles. *See id.* ¶¶ 59-60, 62-63, and 66. On December 5, 2005 the Board decided to move forward with the Reclassification by a vote of 3-1. *See id.* ¶ 67. As a result, the Board retained Powell Goldstein LLP to assist with the necessary filings to effect the Reclassification. *See id.*

On June 29, 2006, pursuant to Rule 14a-6, the Board filed a preliminary proxy regarding Reclassification with the SEC. *See id.* ¶ 78. After First Niles filed the preliminary proxy, Plaintiffs filed their Complaint seeking damages and injunctive relief. *See* Complaint ¶ 1. In their Complaint, the Plaintiffs alleged that there were “egregious and material misdisclosures” in the preliminary proxy. *See* Complaint ¶ 78.

After following the procedure required by the SEC, on November 16, 2006, the Board filed its Definitive Proxy seeking approval of the Reclassification. *See* Am. Compl. ¶ 80. The Definitive Proxy contained several changes from the preliminary proxy, as acknowledged by the Plaintiffs. *See id.* On November 20, 2006, Plaintiffs filed their Amended Complaint alleging only money damages – abandoning their claim for injunctive relief entirely, despite their contention that the Defendants had “failed to remedy a number of disclosure concerns” before filing the Definitive Proxy and knowing that a shareholder vote would be taken based upon the Definitive Proxy. *See id.* ¶ 81.

ARGUMENT

Although there are three counts in the Plaintiffs' Complaint, the Plaintiffs make essentially only one claim in their Amended Complaint – that Defendants breached their fiduciary duties. They claim that the Defendants breached their fiduciary duties when they (1) did not sell First Niles to First Place Financial Corporation (“First Place”), (2) approved the Reclassification, and (3) made inadequate disclosures in the Proxy concerning the Reclassification. Plaintiffs' allegations are inadequate to support any of their claims for breaches of fiduciary duty and the Complaint should be dismissed for failure to state a claim upon which relief may be granted.

I. STANDARD OF REVIEW.

A court should grant a defendant's motion to dismiss if a plaintiff's complaint reveals that it would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof. *In re General Motors (Hughes) Shareholders Litig.*, 897 A.2d 162, 167 (Del. 2006). While a court must draw all reasonable inferences in favor of the non-moving party, the trial court is not “required to accept as true conclusory allegations without specific supporting factual allegations.” *Id.*; *Malpiede v. Townson*, 780 A.2d 1075, 1082 n.16 (Del. 2001); *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35, 38-39 (Del. 1996). Further, “a trial court is required to accept only those reasonable inferences that logically flow from the face of the complaint and is not required to accept every strained interpretation of the allegations proposed by the plaintiff.” *Id.*; *see also Canadian Commercial Workers Industry Pension Plan v. Alden*, 2006 WL 456786, *3 (Del. Ch. Feb. 22, 2006).¹

¹ A compendium of unreported decisions is being filed simultaneously herewith.

II. COUNTS I AND III SHOULD BE DISMISSED BECAUSE THE PLAINTIFFS CANNOT OVERCOME THE PRESUMPTION OF THE BUSINESS JUDGMENT RULE.

To state a valid claim for breach of fiduciary duty against the Defendants, Plaintiffs must overcome the presumption of the business judgment rule. The law has long recognized, through the business judgment rule, that corporate directors, and not the courts, are in the best position to make business decisions for their companies. *See Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). The presumption underlying the business judgment rule is that in making business decisions, the directors of a corporation act on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. *Id.* at 812; *Orman v. Cullman*, 794 A.2d 5, 20 (Del. Ch. 2002). Absent allegations from a plaintiff that a director's action was an abuse of discretion, decisions of corporate directors will be respected by the courts. *Id.* "The burden is on the party challenging the decision to establish facts rebutting the presumption." *Aronson*, 473 A.2d at 812.

The presumption of the business judgment rule controls and counts I and III of the Plaintiffs' Amended Complaint must be dismissed unless the Plaintiffs sufficiently allege that either (1) a majority of the directors were interested in or lacked independence with respect to the relevant transaction or (2) the directors acted in bad faith or were grossly negligent. *Id.*; *Crescent/Mach I Partners L.P. v. Turner*, 846 A.2d 963, 984 (Del. Ch. 2000). To establish that a board of directors was interested or lacked independence in making a challenged decision, "a plaintiff must allege facts as to the interest and lack of independence of the individual members of the board . . . a plaintiff must normally plead facts demonstrating 'that a majority of the director defendants have a financial interest in the transaction or were dominated or controlled by a materially interested director.'" *Orman*, 794 A.2d at 22 (quoting *Crescent/Mach I Partners*,

846 A.2d at 979) (emphasis in original). “Unless Plaintiffs can plead with specificity facts that rebut the presumption of the business judgment rule, that the Board was corrupted and could not make a decision fairly and independently, in the best interests of the Corporation, then the Board’s decision will stand.” *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 351 (Del. Ch. 1998), *reversed in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

A. Plaintiffs Have Failed To Sufficiently Allege That The Majority Of The Board Lacked Independence Or Was Interested.

The Plaintiffs have failed to allege any facts sufficient to show that the majority of the Board lacked independence or was interested. At the time the Board voted against selling First Niles to First Place, there were five directors on the Board, four of whom were outside directors: Messrs. Eddy, Kramer, Zuzolo, and Gantler. When the Board voted in favor of pursuing Reclassification, there were four directors on the Board, three of whom were outside directors: Messrs. Eddy, Kramer, and Gantler.² In both instances, the majority of the Board was disinterested and independent.

“Independence means that a director’s decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences.” *Aronson*, 473 A.2d at 816. The question of independence is one that courts must answer using the following inquiries: “independent from whom and independent for what purpose?” *Khanna v. McMinn*, 2006 WL 1388744, *14 (Del. Ch. May 9, 2006).

A director is “interested” in a transaction when he is on both sides of the transaction or expects to derive a personal financial benefit that is not also shared by other

² Mr. Csontos joined the Board in April of 2006 and subsequently voted in favor of making conforming amendments to the Company’s Charter, but did not vote on the ultimate decision of Reclassification. *See* Am. Compl. ¶ 11, 54, and 67. Mr. Shaker joined the Board in January of 2006. He also voted in favor of the conforming amendments, but not on the ultimate decision of Reclassification. *See id.* ¶ 13, 54, and 67.

shareholders generally or the corporation as a whole. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *see also Nebenzahl v. Miller*, 1993 WL 488284, at *3 (Del. Ch. Nov. 8, 1993).

Plaintiffs' allegations that certain directors lacked independence or were disinterested are conclusory at best. Delaware courts are clear that "[c]onclusory, across-the-board allegations of a lack of independence will not prevail" as allegations of this sort "are akin to the shorthand 'shibboleth' which this Court has long rejected." *Khanna*, 2006 WL 1388744 at *15; *see also Orman*, 794 A.2d at 24. Reviewing Plaintiffs' allegations regarding the independence and interest of the outside directors demonstrates that as a matter of law, the business judgment rule requires dismissal of the Amended Complaint.

1. A Majority Of The Board Was Independent At All Relevant Times.

Plaintiffs never state that Mr. Stephens or any other members of management or the Board had control over any of the directors. They merely imply that certain circumstances and votes translate into domination and control. These conclusory allegations are inadequate to establish a lack of independence as a matter of law.

Plaintiffs make general and unsupported allegations throughout their Amended Complaint implying that Defendants as a whole lacked independence. For example, Plaintiffs allege that Mr. Eddy showed "unquestioning allegiance" to Messrs. Stephens and Kramer. *See Am. Compl. ¶ 10.* Conclusory, blanket allegations regarding a group of defendants as a whole are inadequate to show interestedness or a lack of independence of a particular director. *Khanna*, 2006 WL 1388744 at *15; *see also Aronson*, 473 A.2d 805 at 816; *see also Mayer v. Adams*, 167 A.2d 729, 732 (Del. Ch. 1961) (stating that plaintiff must allege cogent facts and bare conclusory allegations of domination and control are insufficient).

Plaintiffs specifically imply that Mr. Eddy lacked independence and submitted to Mr. Stephens' wishes on the challenged transactions because "[h]e has refused on numerous occasions to investigate the circumstances regarding stock options Kramer exercised in 'apparent' violation of the 1999 Stock Option and Incentive Plan" and "consented to...false disclosures...regarding Stephens' compensation." See Am. Compl. ¶ 10 and 56. Plaintiffs also imply that Mr. Kramer lacks independence and is controlled by Mr. Stephens because he allegedly "consented to false disclosures...[t]hat indicated that Stephens was not present during compensation committee deliberations and votes involving Stephens' compensation." See Am. Compl. ¶ 9.

Even assuming these allegations were true for purposes of this Motion only, they are insufficient to show a lack of independence because Plaintiffs' have failed to show how acquiescing in the allegedly improper actions actually materially benefited Mr. Eddy or Mr. Kramer, which they must do to overcome the business judgment rule. *Khanna*, 2006 WL 1388744 at *15; see also *In re CompuCom Systems, Inc. Stockholders Litig.*, 2005 WL 2481325, *8 (Del. Ch. Sept. 29, 2005) (reported at 31 Del. J. Corp. L. 687) ("The complaint simply does not allege that [the alleged] benefits were material to the directors."); see also *California Public Employees' Retirement System v. Coulter*, 2002 WL 31888343, *8 (Del. Ch. Dec. 18, 2002) (reported at 28 Del. J. Corp. L. 721) ("Mere approval of, or acquiescence in, a challenged decision of the board, without more, is insufficient to raise a reasonable doubt as to a director's independence or disinterest.").

Plaintiffs also imply that Mr. Eddy lacked independence because he "voted with defendant Stephens on every issue put before the Board during plaintiff Gantler's tenure as a director." See Am. Compl. ¶ 10. This allegation is inadequate to show a lack of independence

on the part of Mr. Eddy, again, because Plaintiffs must demonstrate how Mr. Eddy specifically and materially benefited from casting the same votes as Mr. Stephens. *Khanna*, 2006 WL 1388744 at *15; *see also CompuCom Systems*, 2005 WL 2481325 at *8.

Moreover, Plaintiffs must “set forth particularized facts showing a pattern of votes...from which the Court could draw a reasonable inference [of acquiescence].” *Khanna*, 2006 WL 1388744 at *15. “Although there may be instances in which a director’s voting history would be sufficient to negate a director’s presumed independence, routine consensus cannot suffice to demonstrate disloyalty on the part of the director. To conclude otherwise would simply encourage staged disagreements and nonunanimous decisions for the sake of nonunanimous decisions in the boardroom.” *Id.* at *15 n. 92; *see also Coulter*, 2002 WL 31888343 at *8. Plaintiffs failed to allege how Mr. Eddy’s votes negate his presumed independence.

Plaintiffs cannot even demonstrate that Mr. Stephens, Mr. Kramer, or any other defendant is capable of “controlling” any other director’s fate given that none of them own controlling shares of First Niles stock. Mr. Stephens owns less than eight percent (8%) of the Company’s stock and Mr. Safarek owns approximately six and a half percent (6.5%). *See Am. Compl.* ¶¶ 8 and 12; *see also Proxy* p. 38.³ Mr. Shaker, who was not a director at the time of either challenged transaction, owns approximately one percent (1%) of First Niles’ stock and Messrs. Eddy, Kramer, and Csontos, who also was not a director at the time of either challenged transaction, each own less than one percent (1%). *See Am. Compl.* ¶¶ 9-11, and 13; *see also Proxy* p. 38. The minimal ownership interests of the Defendants demonstrate that neither management nor the inside directors have the ability to control the outside directors, either inside

³ A copy of the Proxy is attached hereto as Exhibit A.

the boardroom or otherwise. Plaintiffs also fail to assert any allegations that any of the officers have control over the directors' livelihoods outside of the Company.

While they do not clearly allege as such, if Plaintiffs are attempting to imply that Mr. Eddy, Mr. Kramer, or any other director is not independent based upon his friendship with members of management or other directors, Plaintiffs fail again. A mere long-time personal relationship is insufficient to show a lack of independence. *Khanna*, 2006 WL 1388744 at *16, *19, *22 (Del. Ch. May 9, 2006); *Odyssey Partners, L.P. v. Fleming Companies, Inc.*, 735 A.2d 386, 409 (Del. Ch. 1999); *In re Paxson Communications Corp. Shareholders Litig.*, 2001 WL 812028, *9 (Del. Ch. July 12, 2001).

2. A Majority Of The Board Was Disinterested At All Relevant Times.

Plaintiffs first allege that all the Defendants were interested and voted not to sell First Niles and in favor of Reclassification because they did not want to lose their directorships. *See* Am. Compl. ¶ 54-56. It is axiomatic that if a board of directors votes for a merger, sale, or other business combination, their directorships may be in jeopardy. As this is a dilemma that will always accompany such a decision, that reason alone is not sufficient to establish a particular director is self-interested. The Supreme Court of Delaware rejected the conclusory allegation that because a majority of the board failed to approve an offer to purchase the company, they did so because they wanted to retain control and therefore were interested. *Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984) (overruled on other grounds); *Paxson*, 2001 WL 812028 at *8-9. The Court held that the plaintiff had the "burden to allege with particularity that the improper motive in a given set of circumstances, for example, perpetuation of self in office or otherwise in control, was the sole or primary purpose of the wrongdoer's conduct." *Pogostin*, 480 A.2d at 627 (emphasis supplied). In *Pogostin*, the plaintiffs sought "to establish a motive or primary purpose to retain control only by showing that the [] board opposed a tender offer." 480

A.2d at 627. The Court, however, rejected this argument stating that “[a]cceptance of such an argument would condemn any board, which successfully avoided a takeover, regardless of whether the board properly determined that it was acting in the best interests of the shareholders.” *Id.* Plaintiffs have failed to allege that the defendant directors voted to reject the offer to purchase First Niles or voted in favor of Reclassification solely to retain their directorships.

Plaintiffs specifically allege that Mr. Kramer is interested in the relevant transactions because he receives director fees for his service on the Board. *See* Am. Compl. ¶ 9. It is well settled, however, that the mere receipt of directors’ fees does not establish interestedness. *Khanna*, 2006 WL 1388744 at *16; *see also Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 175 (Del. Ch. 2005) (“[T]he fact that directors receive fees for their services does not establish an entrenchment motive on their part.”). Plaintiffs must show that the compensation was somehow “outside the norm” or otherwise material to the particular director. *Khanna*, 2006 WL 1388744 at *16. There has been no such showing here.

Plaintiffs imply that the combination of Board service fees and stock options are material to Mr. Kramer because he is a “man of modest means.” *See* Am. Compl. ¶ 9. But Plaintiffs fail to explain at all what “modest means” actually means and they fail to explain how the Board service fees and stock options are material to Mr. Kramer. A conclusory allegation that the Board service fees and stock options are material to Mr. Kramer without any elaboration as to how they are material is inadequate to show interestedness. As this Court has stated:

[I]n order to rebut the business judgment rule presumption, an interest must be subjectively material to the director. In other words, the alleged benefit must be significant enough as to make it improbable that the director could perform his fiduciary duties to the shareholders. [Plaintiff] has failed to allege how the benefits it alleges were subjectively material to any of these directors.

[Plaintiff] argues only that the Court must consider all of the various benefits received by the directors and their affiliates and states in a conclusory fashion that in the aggregate, these benefits are material. Without more, [Plaintiff] has not alleged enough to suggest that the Board could not perform its fiduciary duties to shareholders.

H-M Wexford LLC v. Encorp. Inc., 832 A.2d 129, 150 (Del. Ch. 2003).

Moreover, this Court has rejected the position advocated by Plaintiffs, which, if accepted, would improperly discourage the membership on corporate boards of persons of less than extraordinary means. *See In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342 (Del. Ch. 1998), *reversed in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (finding that teacher who received director fees greater than her salary was not beholden to the company's CEO).

Secondly, Plaintiffs allege that Messrs. Kramer and Zuzolo were interested because both directors are associated with companies that have business relationships with First Niles. Plaintiffs allege that Mr. Kramer is interested in the relevant transactions because his family's heating and air-conditioning company performs services for First Niles. *See Am. Compl.* ¶ 9. Plaintiffs also allege that Mr. Kramer is interested because his family business has a mortgage with First Niles. *See id.* Plaintiffs allege that Mr. Zuzolo⁴ was interested in the decision not to sell First Niles because he provided legal services to First Niles through his law practice and owned a real estate title agency that provided near exclusive title service for Home Federal's residential and commercial real estate loans. *See Am. Compl.* ¶ 14. These allegations are insufficient to overcome the presumption of the business judgment rule.

⁴ Mr. Zuzolo is a non-party, but was a member of the Board at the time the Board made the decision not to sell First Niles to First Place. *See Am. Compl.* ¶ 14. Mr. Zuzolo has since passed away. *Id.*

A director's ties to a company that does business with a company of which the director is a board member is not enough to show interestedness unless the plaintiff shows specifically how the benefit to the director from the relationship is material to him. *Khanna*, 2006 WL 1388744 at *17; *see also Jacobs v. Yang*, 2004 WL 1728521, *6 (Del. Ch. Aug. 2, 2004) (“[T]he existence of contractual relationships with companies that directors are affiliated with potentially makes the board's decision more difficult, but it does not sterilize the board's ability to decide. The plaintiff also does not assert particularized facts establishing that the business relationships are material....”). Where, as here, a plaintiff fails to demonstrate how much money the director receives from the business relationship and how that amount is material to the director, an allegation of business ties is insufficient to show interestedness. *Khanna*, 2006 WL 1388744 at *17; *see also Jacobs*, 2004 WL 1728521 at *6.

In *Khanna*, the Court found it insufficient to show interestedness where the plaintiff alleged only that the director had a role in the business that did work for the subject company and that he received a salary. 2006 WL 1388744 at *17. Similarly, here, Plaintiffs allege only that Mr. Kramer's family business does work for First Niles. They do not allege what work they do, how often, how much they are paid for that work, or what percentage of their business is attributable to First Niles. Not only do the Plaintiffs fail to allege the amount of salary or other benefit Mr. Kramer receives from the business relationship, but they also fail to allege the receipt of any salary or other benefits at all. In short, Plaintiffs' allegations regarding Mr. Kramer's family business are inadequate to show that he is interested.

Likewise, nowhere in their Amended Complaint do Plaintiffs state how much money Mr. Zuzolo's law firm or his real estate company received from their business relationships with First Niles nor do they allege how material any such income was to Mr.

Zuzolo. Without such information, as previously discussed, a mere allegation that a director has business ties to the relevant company is insufficient to show interestedness. Plaintiffs' allegations that Mr. Zuzolo lacked independence are insufficient to survive Defendants' Motion to Dismiss.

Thirdly, Plaintiffs allege that all the Defendants voted as they did on the challenged transactions so that they could maintain the ability to have their stock purchased by First Niles. *See* Am. Compl. ¶ 56. This allegation too is insufficient to establish self-interest. *Nebenzahl v. Miller*, 1993 WL 488284, at *3 (receipt of pre-existing benefit package following merger held not to establish self-interest). In *Nebenzahl*, the director defendants were to receive payments pursuant to their employment contracts following the proposed merger. The plaintiff alleged that the defendants voted in favor of the merger for that very reason. The Court rejected the argument and held that payments or other benefits received that are made pursuant to practices in place prior to the transaction are insufficient to show interestedness. *Id.* Here, any ability of the directors to have their stock bought back by First Niles was pursuant to a practice developed and available long before the Board began discussions about the challenged value maximizing transactions. As such, any allegation that Defendants were interested in the relevant transactions because they were attempting to benefit from already available practices is insufficient to overcome the presumption of the business judgment rule.

Finally, Plaintiffs allege that Mr. Kramer is interested in the transaction because he "has discussed becoming a full time banker" following the Reclassification. *See* Am. Compl. ¶ 9. Even assuming Mr. Kramer was interested in working for First Niles for purposes of this Motion only, this is but another conclusory allegation and as such will not support a claim of interestedness. *See Khanna*, 2006 WL 1388744 at *15. If Plaintiffs allege that Mr. Kramer's

interest in becoming a banker improperly motivated his vote for Reclassification or against a sale to First Place, they must provide support for that allegation. *McMillan v. Intercargo Corp.*, 1999 WL 288128, *7 (Del. Ch. May 3, 1999). Plaintiffs must allege how Mr. Kramer expected a vote for Reclassification or against a sale to provide him an actual, specific material benefit. Speculation about a possible motive that may cause some unspecified benefit is insufficient.

As demonstrated, a majority of the Board that voted on the two challenged transactions was independent and disinterested. Messrs. Eddy, Kramer, Zuzolo, and Gantler, all outside independent and disinterested directors, constituted a majority of the five member Board when it voted 4-1 not to sell First Niles to First Place. Again, Messrs. Eddy, Kramer, and Gantler constituted a majority of the four member Board when the Reclassification decision was made.⁵ Therefore, the business judgment rule requires that counts I and III be dismissed.

B. The Decision Not To Sell First Niles And The Decision To Reclassify Its Stock Do Not Support A Claim Of Breach Of Fiduciary Duty As A Matter Of Law.

The Court must dismiss counts I and III because Plaintiffs have not overcome the presumption of the business judgment rule. Consequently, it is not necessary to address the merits of the challenged Board decisions. Nevertheless, the decision not to sell First Niles cannot form the basis of a breach of fiduciary duty. Simply put, the Board was under no obligation to sell First Niles and therefore failure to do so cannot serve as the basis of a breach of fiduciary duty claim. *See generally Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *see, e.g., Cincinnati Bell Cellular Systems Co. v. Ameritech Mobile Phone*

⁵ As stated above, Mr. Csontos and Mr. Shaker were not involved in the initial decision concerning Reclassification. *See* Am. Compl. ¶ 67. Even assuming that their later votes to conform the Charter to the Board's prior decision operate as participation in the transaction, the majority of the Board at the time was still disinterested and independent as Messrs. Eddy, Kramer, and Shaker constituted a majority of the Board at that time.

Service of Cincinnati, Inc., 1996 WL 506906 (Del. Ch. Sept. 3, 1996). The Board was under no fiduciary obligation to abandon its business purpose and sell the Company. See 1996 WL 506906 at *13.

The decision to de-register a company's stock is also not the proper subject of a breach of fiduciary duty claim. *Wynnefield Partners Small Cap Value, LP v. Niagara Corp.*, 2006 WL 1737862 (Del. Ch. 2006), *aff'd in part, rev'd in part on other grounds*, 907 A.2d 146; see also *Lennane v. Ask Computer Systems, Inc.*, 1990 WL 154150 (Del. Ch. Oct. 11, 1990) (reported at Del. J. Corp. L. 1538) (affirmed on motion for reconsideration) (“[T]he corporation may voluntarily delist its securities at any time.”). In *Wynnefield*, the Court denied a shareholder's books and records request because it held there was no legitimate allegation of wrongdoing to uncover from a books and records review. Specifically, the court stated “Delaware law recognizes a corporate board's ability, in a proper exercise of their business judgment, to cause the corporation to take steps to deregister even if, as an incidental matter, deregistration might adversely impact the market for the corporation's securities.” 2006 WL 1737862, *9.

Moreover, First Niles' decision to reclassify its stock is not unusual. Reclassification has become a common trend among banks since the passage of the Sarbanes-Oxley Act of 2002 (“SOX” or “Sarbanes-Oxley”). It is an especially attractive option for small community banks because it avoids the costs of compliance with SOX and allows current shareholders to remain shareholders of the bank rather than being cashed out. See, e.g., Paul Gores, Another bank going private; Luxemburg cites SEC compliance, THE MILWAUKEE JOURNAL SENTINEL (June 4, 2005); Paul Gores, Bank to join others going private; First Manitowoc also cites SEC, THE MILWAUKEE JOURNAL SENTINEL (Mar. 1, 2005); Matthew

Squire, A finer line between being public and privately held, THRIFTINVESTOR, Vol. 17, No. 12 (Dec. 2003) at p. 1, 9; *see also* Mark R. Baran and Katherine M. Koops, Escaping SOX: The angst of Sarbanes-Oxley needn't be your future if you reconsider the benefit of being a public company, COMMUNITY BANKING (May 2005) at p. 20-28.⁶ As one bank chief executive officer stated,

[Our bank] is taking this action because, with our small number of shareholders and shares outstanding and the resulting low level of trading activity, continued listing on NASDAQ is no longer cost effective. The board of directors concluded that for [our bank], the advantages of being a reporting company under the 1934 Act do not offset the costs and administrative burdens associated with a NASDAQ listing and SEC reporting requirements.

Matt Hirst, *Lexington B&L Financial deregisters with SEC, delists from NASDAQ*, THRIFTINVESTOR, Vol. 17, No. 4 (April 2003) at p. 3. The First Niles Board listed the same reasons for their decision to reclassify the Company's stock. *See Proxy* p. 11.

The Plaintiffs allege that because First Niles' stock will be de-listed as a result of Reclassification and allegedly that this will harm the shareholders, then the directors breached their fiduciary duties. Once again, the business judgment rule applies to the decision to reclassify the stock of First Niles and as a result the Court may not second-guess the Board's decision. Notwithstanding, Plaintiffs' allegation that the simple alleged harm to shareholders is grounds for a breach of fiduciary duty is incorrect. It is true that Reclassification will cause the de-listing of First Niles stock, but even as a listed company, the First Niles stock experienced low trading volume and so its shareholders' stock currently only enjoys limited liquidity. *See Proxy* p. 26. Even assuming, as the Plaintiffs would have the Court believe, that Reclassification somehow damages certain shareholders, Delaware law recognizes that directors may take actions

⁶ Copies of all cited articles are attached hereto as Exhibit C.

they believe, in their business judgment, will best serve the interests of the corporation or shareholders as a whole. *Gilbert v. El Paso Co.*, 1988 WL 124325, at *10 (Del. Ch. Nov. 21, 1988). In taking such actions, it may be impossible to avoid the fact that interests of a particular group of shareholders may be adversely affected. *Id.*

III. COUNT III SHOULD BE DISMISSED BECAUSE THE BOARD'S DECISION TO RECLASSIFY FIRST NILES' STOCK WAS APPROVED BY A MAJORITY OF THE FIRST NILES SHAREHOLDERS BASED ON COMPLETE AND ACCURATE DISCLOSURE.

On December 14, 2006, the shareholders of First Niles overwhelmingly approved the recommendation of the Board regarding Reclassification. The vote was 793,092 to 172,657 in favor of Reclassification with 11,060 votes abstaining.⁷ See Certificate of Inspector of Election attached hereto as Exhibit B. Shareholder approval of a recommendation of a board of directors provides an independent reason to apply the protections of the business judgment rule. *Solomon v. Armstrong*, 747 A.2d 1098, 1117 (Del. Ch. 1999); *see also In re General Motors Class H Shareholders Litig.*, 734 A.2d 611 (Del. Ch. 1999). Courts may properly consider the fact of shareholder approval on a motion to dismiss because courts may properly take judicial notice of matters that are not subject to reasonable dispute. *In re General Motors (Hughes) Shareholder Litig.*, 897 A.2d 162, 169 (Del. 2006) (taking judicial notice of shareholder vote).

In *Solomon*, the Court recognized that shareholder ratification does not always serve to protect a board's decision, such as when there is a controlling shareholder or other

⁷ Plaintiffs attempt to make an issue out of the fact that the Reclassification proposal was not subject to a "majority of the minority" vote. *See* Am. Compl. ¶ 77. There is no "majority" shareholder of First Niles stock and the directors and executive officers, collectively, own only approximately seventeen percent (17%) of the outstanding common stock. *See* Complaint ¶¶ 8-13. *see also* Proxy p. 38. The concept of a "majority of the minority" vote in the absence of a majority shareholder is irrelevant. Even if only the unaffiliated shareholders had voted on the Reclassification proposal, it would have been approved with 557,384 votes, as the affiliated shareholders only own 235,708 shares. *See* Proxy p. 38.

dominating force that compels a particular result. 747 A.2d at 1117. Plaintiffs have demonstrated no such control or dominance. Plaintiffs make no allegation that any director has control or dominance over any shareholder group. Even assuming that the Plaintiffs' allegations of management and directors controlling certain other directors would defeat the business judgment protection obtained from shareholder approval, those allegations are themselves insufficient, as previously discussed. Thus, the approval of Reclassification by the shareholders is yet another reason that the Board's decision in favor of Reclassification is protected by the business judgment rule and count III of the Plaintiffs' Amended Complaint should be dismissed.

IV. COUNTS I AND III SHOULD BE DISMISSED AS TO MR. SAFAREK AND MR. CSONTOS AND COUNT III SHOULD BE DISMISSED AS TO MR. SHAKER BECAUSE THOSE DEFENDANTS WERE NOT DIRECTORS DURING THE CHALLENGED VOTES AND DID NOT PARTICIPATE IN THOSE VOTES.

The claims for breach of fiduciary duty arising from the decision not to sell First Niles and in favor of Reclassification should be dismissed against Messrs. Safarek, Csontos, and Shaker because none of them were members of the Board at the time of the votes on the questioned transactions and did not cast a vote regarding those transactions. *See* Am. Compl. ¶¶ 11-13, 54, and 67. Mr. Safarek has never served on the Board and Mr. Csontos did not join the Board until April of 2006, well after the vote not to sell First Niles on March 9, 2005 and the vote in favor of Reclassification on December 5, 2005. Mr. Shaker did not join the Board until January of 2006, which was after the December 5, 2005 vote regarding the Reclassification. There can be no breach of fiduciary duty where one was not a director voting on the transaction at issue. *In re Tri-Star Pictures, Inc. Litig.*, 1995 WL 106520, *2 (Del. Ch. Mar. 9, 1995).

In *Tri-Star*, the court granted summary judgment to the director defendants where the directors did not participate in the board discussion regarding the vote or the actual vote on the transaction at issue. *Id.* Surely, if an actual director is not subject to liability when he does

not submit a vote, but is eligible to do so, someone who is not a director at all may not be subject to liability for an action of a board of directors.

Accordingly, counts I and III should be dismissed as to Mr. Safarek and Mr. Csontos and count III should be dismissed as to Mr. Shaker.

V. COUNT II SHOULD BE DISMISSED BECAUSE THE DISCLOSURES CONTAINED IN THE PROXY STATEMENT WERE ADEQUATE.

Plaintiffs allege that the Proxy contains misrepresentations and omits material facts. Plaintiffs bear the burden of showing that the Proxy Statement contained material misstatements and omissions. *Solomon*, 747 A.2d at 1128. “In order for a plaintiff to properly state a claim for breach of a disclosure duty by omission, he must plead facts identifying (1) material, (2) reasonably available (3) information that (4) was omitted from the proxy materials.” *Orman v. Cullman*, 794 A.2d 5, 31 (Del. Ch. 2002).

“In order for alleged misrepresentations to be material, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available to the shareholders.” *Orman v. Cullman*, 794 A.2d at 31-32. Consideration of materiality at the motion to dismiss stage is appropriate. *Id.* at 32 (“It is completely appropriate for a court to dismiss disclosure claims on the basis that the alleged omission was not material.”). The test for materiality is not “whether a disclosure might be helpful” in deciding how to vote, but rather whether the “information reaches the necessary threshold of materiality.” *Khanna v. McMinn*, 2006 WL 1388744, *33 (Del. Ch. May 9, 2006) (emphasis supplied); *see also Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 141 (Del. 1997) (“[A] pleader must allege that facts are missing from the proxy statement, identify those facts, state why they meet the materiality standard and how the omission caused injury.”). In *Khanna*, the court found the decision of

directors to settle a claim against the company immaterial to shareholders who were deciding whether to re-elect those directors because the decision was just one act among many that the directors took and this one particular act was not material to the decision of whether to re-elect these directors. 2006 WL 1388744 at *33.

The Plaintiffs' allegations of disclosure violations must specifically identify the missing fact or misrepresentation and explain how the omission or misrepresentation is material:

In order to allege adequately a violation of disclosure requirements, a plaintiff must plead some basis for a court to infer that the alleged violations were material. For example, a pleader must allege that facts are missing from the proxy statement, identify those facts, state why they meet the materiality standard and how the omission caused injury. The test for whether an omitted fact is material is context-specific, and, therefore, determinations of materiality will not frequently be appropriate on a motion to dismiss. Nevertheless, this Court may resolve such questions at the motion to dismiss stage if it is satisfied with reasonable certainty that no set of facts could be proved that would permit the plaintiffs to obtain relief under the allegations made. Even though the Court's analysis in this context is not overly stringent, it is inherent in disclosure cases that the misstated or omitted facts be identified and that the pleading not be merely conclusory.

Id. at *29. Plaintiffs have failed to sufficiently allege that the disclosures in the Proxy Statement were materially inadequate and therefore their claim for breach of fiduciary duty relating to disclosure violations must be dismissed.⁸ Many of Plaintiffs' allegations are directly rebutted by the Proxy itself, which the Court may review in deciding this Motion. "As a general rule, when deciding a [motion to dismiss], the Court is limited to considering only the facts alleged in the

⁸ Plaintiffs make cursory reference to the alleged inadequacies of the preliminary proxy statement filed on June 29, 2006. *See* Am. Compl. 79. That is a red herring, of course, since that document was neither sent to the shareholders nor used to solicit votes in any way and the Definitive Proxy filed on November 16, 2006 expressly states that no other statements besides the Definitive Proxy should be relied upon: "We have not authorized any person to give any information or to make any representations other than the information and statements included in this proxy statement. You should not rely on any other information." *See* Proxy p. 10.

complaint and normally may not consider documents extrinsic to it.” *Orman v. Cullman*, 794 A.2d at 16. There is an exception, however, “when a document is integral to a plaintiff’s claim and incorporated into the complaint.” *Id.*; *see also Khanna*, 2006 WL 1388744 at *30 (considering the challenged company’s proxy statement). Here, the Court may consider the Proxy Statement because it is the basis of the Plaintiffs’ disclosure claims and it is integral to the Plaintiffs’ disclosure violation claim.

First, Plaintiffs allege that the disclosures in the Proxy are inadequate merely because the Proxy does not identify Plaintiff Gantler as the dissenting director and also because it does not explain the reasons for his dissent. *See* Am. Compl. ¶ 82(a). However, the Proxy states that the vote in favor of Reclassification was 3-1 in favor of the transaction (*see* Proxy p. 15) and the Proxy identifies the current litigation by name, number, and court and summarizes the stated reasons for Plaintiff Gantler’s objection to the transaction. Specifically, the Proxy provides as follows:

On September 1, 2006, Leonard T. Gantler, Patricia A. Cetrone, John Gernat, Patricia Gernat, Paul Mitchell and Marsha Mitchell filed a complaint in the Court of Chancery of the State of Delaware (CA No. 2392-N) naming the Company, William L. Stephens, P. James Kramer, William S. Eddy, Daniel E. Csontos, Robert I. Shaker and Lawrence Safarek as defendants. The complaint seeks to enjoin the Rule 13e-3 transaction, and asks for attorney’s fees and unspecified monetary damages for alleged breaches of fiduciary duty. The plaintiffs allege that the defendants breached their fiduciary duties by preferring their own interests over the non-affiliated shareholders by, among other things, terminating the Company’s exploration of sale opportunities without consummating a transaction, by filing a misleading proxy statement to effectuate a going-private transaction, and by recommending to shareholders approval of the Rule 13e-3 transaction. The defendants disagree with the allegations and believe the lawsuit fails to state a claim upon which relief may be granted and, as a result, have filed a motion asking the court to dismiss the three-count complaint.

See Proxy p. 43. Plaintiffs fail to allege how identifying Plaintiff Gantler's actual name as the dissenting director is at all material. The Proxy states that the vote of the directors was not unanimous and that there was litigation pending regarding the Reclassification. Even assuming the description provided in the Proxy regarding the litigation does not indicate in detail all of Plaintiff Gantler's reasons for dissenting, as Plaintiffs allege, information about specific allegations of a lawsuit in opposition to a business decision are not necessary – disclosing the fact of the litigation is sufficient. *Fisher v. United Technologies Corp.*, 1981 WL 7615 (Del. Ch. May 12, 1981). The *Fisher* Court described the problem with providing such detail:

The purpose of including a description of the litigation in the Proxy Statement was to put the [] stockholders on notice that some persons deemed the merger consideration unfair. This was clearly done. Further details would likely have been confusing to the stockholders and would not have been informative in helping the stockholders to exercise their business judgment whether to approve the merger.

Id.

Second, Plaintiffs allege that the Proxy “falsely describes the secret sales process,” omits the history of the sales process due diligence, and falsely represents the deliberation process. *See* Am. Compl. ¶ 82(b)-(c). The fact that a sales process was considered, that First Niles received three indications of interest, that one of the bidders submitted a definitive merger proposal to the Board, and that the proposal was ultimately rejected were all included in the Proxy. Specifically, the Proxy provides as follows:

In the summer of 2004, we engaged an investment banker to represent the Company in a possible sale of the Company. On our behalf, the investment banker solicited and we received three indications of interest in purchasing the Company. As a result of further negotiations, in March, 2005, one of the bidders presented a definitive merger proposal to the board. Under the terms of the proposal, our shareholders would have received 0.85 shares of the

acquiror's stock for each share of First Niles common stock that they owned. The proposal did not include any price protections in case the acquiror's stock price fell prior to consummation of the proposed merger. As of the date of the proposal, the offer represented a premium of approximately 6.75%. See Proxy p. 13. Disclosure of these facts is more than sufficient to satisfy Defendants' disclosure obligations.

Directors are required to include relevant facts (as they did here), but are not required to engage in self-flagellation, or draw legal conclusions implicating themselves "in a breach of fiduciary duty from surrounding facts and circumstances prior to a formal adjudication of the matter. Thus, even where material facts must be disclosed, negative inferences or characterizations of misconduct or breach of fiduciary duty need not be articulated." *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 143; see also *In re The MONY Group, Inc. Shareholder Litig.*, 853 A.2d 661, 682 (Del. Ch. 2004) ("[D]isclosures relating to the Board's subjective motivation or opinions are not per se material, as long as the Board fully and accurately discloses the facts material to the transaction."). In *Loudon*, the Court held that directors did not have to disclose the reason a director resigned from the board, which was supposedly because of alleged wrongdoing by the remaining directors, but only had to disclose the fact that he actually resigned. *Id.*

Moreover, directors are not required to include "details of a corporation's inner workings and its day-to-day functioning." *Loudon*, 700 A.2d at 144. Also in *Loudon*, the Court found it unnecessary for directors to disclose the details of the actions taken by a special litigation committee appointed to investigate alleged wrongdoing. *Id.* This Court has also stated that "[o]ne cannot conclude that a failure to disclose the details of negotiations gone south would be either viably practical or material to shareholders in the meaningful way intended by

[Delaware] case law.” *State of Wisconsin Investment Board v. Bartlett*, 2000 WL 238026, *8 (Del. Ch. Feb. 24, 2000); *see also McMillian v. Intercargo Co.*, 1999 WL 288128, *9 (Del. Ch. May 3, 1999) (do not have to disclose “all of the bends and turns in the road”). Here, the Defendants were only required to disclose the basic facts of the sales process and their ultimate decision, not the details of due diligence or the details of their reasoning or deliberations, and especially not Plaintiffs’ skewed and biased version of their reasons for the rejection of the merger proposal.

Third, Plaintiffs allege that the Defendants “fail[ed] to disclose the fact that as a result of the Reclassification any future acquisition of the Company will become less likely.” *See* Am. Compl. ¶ 82(d). Plaintiffs’ doomsday prediction is nothing but speculation and “[s]peculation is not an appropriate subject for a proxy disclosure.” *Loudon*, 700 A.2d at 145.

Fourth, Plaintiffs allege that Defendants did not disclose whether they plan to reincorporate First Niles in a state other than Delaware. *See* Am. Compl. ¶ 82(e). The fact of state incorporation is completely irrelevant to the Reclassification. Plaintiffs have not shown either how such a plan would be relevant or whether any such plan even exists, and as stated above, “[s]peculation is not an appropriate subject for a proxy disclosure.” *Loudon*, 700 A.2d at 145. Moreover, “as a general rule, proxy materials are not required to state ‘opinions or possibilities.’” *In re The MONY Group, Inc. Shareholder Litig.*, 853 A.2d 661, 682 (Del. Ch. 2004) (internal citations omitted).

Fifth, Plaintiffs allege that the Proxy “creates a false sense of urgency regarding the Reclassification, incorrectly representing that ‘if our SEC reporting obligations cease prior to the effective date of Section 404 of the Sarbanes-Oxley Act, we will not need to incur these expenses; therefore, it is essential that the effective date of the Rule 13e-3 transaction occur in

2006;’ the Company’s obligation to disclose an auditor attestation under Section 404 of the Sarbanes-Oxley Act (and the attendant expenses related thereto) will not arise until the Company’s first fiscal year ending on or after December 15, 2008 and there is no related cost justification for the Reclassification to occur in 2006.” *See* Am. Compl. ¶ 82(f). As of the dates of the Proxy and their Amended Complaint, Plaintiffs misstate the law.

As of September 29, 2005, the SEC set the applicable compliance date for First Niles for internal control reporting mandated by Section 404 of SOX as the first fiscal year ending on or after July 15, 2007. Securities Act Release No. 33-8618, 2005 WL 2333674 (Sept. 29, 2005) (attached hereto as Exhibit D). At the time of the mailing of the Proxy and at the time of the shareholder vote regarding Reclassification, First Niles was obligated to file a report of management on the Company’s internal control over financial reporting, including a statement of management’s responsibility for establishing and maintaining adequate internal control over financial reporting, a statement identifying the framework used by management to evaluate the effectiveness of such control, and management’s assessment of the effectiveness of the Company’s internal control over financial reporting as of December 31, 2007. *See* 17 C.F.R. 228.308(a) (Regulation S-B, Item 308(a)). In addition, the Company would have been obligated to provide a registered public accounting firm’s attestation report on management’s assessment as of December 31, 2007. *See* 17 C.F.R. 228.308(b) (Regulation S-B, Item 308(b)). In SEC Release 33-8618, the SEC noted that it was “critical” to make any extensions effective as soon as possible so that companies could have the certainty of knowing what to rely on due to the significant work and expenses necessary to comply with the requirements of Section 404. *See* 2005 WL 2333674 at *4.

Later, on December 21, 2006, after the shareholder vote regarding Reclassification and after the effective date of the Reclassification, the SEC extended the compliance date for compliance with the internal control over financial reporting requirements mandated by Section 404 of SOX until the first fiscal year ending on or after December 15, 2007. Securities Act Release No. 33-8760, 2006 WL 3702644 (Dec. 21, 2006) (attached hereto as Exhibit E). Because the Company is a calendar-year reporting issuer, this extension did not change the deadline for the Company's management report on the Company's internal control over financial reporting, and First Niles would still be required to make such a report as of December 31, 2007. SEC Release 33-8760 separately extended the deadline for the registered public accounting firm's attestation report on management's assessment until its first fiscal year ending after December 15, 2008. *Id.* The SEC did not, and has not proposed to, extend what the Plaintiffs refer to as the "attendant expenses related thereto" and the Company would have remained obligated to implement a policy of internal control over financial reporting during 2007 if the Reclassification had not been effected.

Even assuming as true Plaintiffs' incorrect assertion that First Niles would incur no expenses to comply with the new internal controls over financial reporting under Sarbanes-Oxley, that is immaterial. The point of the Proxy discussion of the costs of compliance with Section 404, as well as the discussion of the annual costs of SEC compliance generally, is to explain to the shareholders that being a public company is expensive and time consuming for management. The Proxy was clear that SOX compliance is continuously costing money and time. Plaintiffs have failed to allege how information regarding the timing of the specific costs related to Section 404 compliance is material, as required to successfully support their allegation of a disclosure violation. *See Loudon*, 700 A.2d 135 at 141; *see also Orman*, 794 A.2d at 31-32

(Del. Ch. 2002) (“In order for alleged misrepresentations to be material, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available to the shareholders.”). Whether Section 404 costs are incurred all in 2008 or not, the bottom line is that Sarbanes-Oxley compliance is expensive and time consuming and First Niles can avoid any further such costs if the Reclassification is adopted.

Sixth, Plaintiffs allege that the Proxy “fails to disclose that one of defendants’ motives in endorsing the Reclassification was increased flexibility to effectuate negotiated buybacks of each others’ stock” and “misrepresents the advantages that defendants will enjoy as a result of the Reclassification by failing to disclose, among other things, that defendants face little threat of illiquidity because of the Board’s increased flexibility to effectuate share buy backs.” *See* Am. Compl. ¶ 82(g)-(h). Plaintiffs attempt to make an issue out of these buy backs. As previously discussed, directors receiving benefits post-transaction that were available pre-transaction is irrelevant. *Nebenzahl*, 1993 WL 488284, at 3. Negotiated buybacks are always available, with or without Reclassification.

Seventh, the Plaintiffs allege that the Proxy “falsely represents the effect of the Reclassification on [Employee Stock Ownership Plan] participants...by wrongfully claiming that the put and appraisal rights held by these defendants will only be exercisable if the Company is unable to list its stock on either the OTB or the pink sheets.” *See* Am. Compl. ¶ 82(i). Plaintiffs allege that “the put and appraisal rights will be triggered even if First Niles stock is traded on these platforms and under all the scenarios that the Board envisioned when it asked shareholders to approve the Reclassification.” *See id.*

Plaintiffs are incorrect as a matter of law. Put and appraisal rights are triggered if stock is not considered “readily tradable.” 26 I.R.C. § 409(h)(1)(B). According to the only available guidance on the definition of “readily tradable,” if First Niles’ stock is listed on the Over the Counter Bulletin Board or the Pink Sheets electronic quotation system, it will be considered “readily tradable” and as such, the put right will not be triggered. *See* I.R.S. Priv. Ltr. Rul. 95-29-043 (Oct. 30, 1995) (attached hereto as Exhibit F).⁹ Of course, if First Niles is not able to list its stock on the Over the Counter Bulletin Board or the Pink Sheets electronic quotation system, then the put right will be triggered and upon termination of the management defendants, they will be entitled to put their stock back to the Company and the Company will be required to purchase it at its fair value. As set out below, this possibility is fully disclosed in the Proxy.

In any event, even assuming that First Niles stock will not be considered “readily tradable” if it is traded on the Over the Counter Bulletin Board or the Pink Sheets electronic quotation system and the put right is triggered, Plaintiffs’ allegation is immaterial because the possibility that the management defendants would receive a put right as a result of the Reclassification is fully disclosed:

[Messrs. Stephens, Safarek, and Csontos] own shares of our common stock through our Employee Stock Ownership Plan (the “ESOP”). Pursuant to federal law, upon an employee’s termination of employment with the Company for any reason, such employee has the option of selling any shares he or she owns through the ESOP to us for fair value of such shares, determined by appraisal, unless our common stock is readily tradable. Currently, the Company is not obligated to purchase shares that an employee owns through the ESOP upon termination because our common stock is listed on the Nasdaq Capital Market and therefore

⁹ Defendants understand that IRS private letter rulings are not binding authority except as to the parties to whom they are issued and that they may not be cited as legal precedent. Defendants do not cite I.R.S. Priv. Ltr. Rul. 95-29-043 as precedent, but merely as the only available guidance.

deemed to be readily tradable. As a result of the Rule 13e-3 transaction, our common stock will no longer be listed on the Nasdaq Capital Market, but we have plans to make our common stock readily tradable by listing it on the Over the Counter Bulletin Board or the Pink Sheets electronic quotation system. If we are not able to list our common stock with either service, in the event of an employee's termination of employment with the Company, we will be obligated to purchase any shares that such employee owns through the ESOP for the fair value of such shares if the employee exercises his or her put right.

See Proxy p. 22. Thus, the First Niles shareholders are aware of the possibility of the put right and if that fact was enough to prevent them from approving the Reclassification, they had the information before them and could cast an informed vote.

Moreover, this alleged disclosure violation is immaterial because, after approval of the Reclassification, First Niles common stock is, in fact, traded on the Over the Counter Bulletin Board¹⁰ and so the put right is not triggered.

Eighth, Plaintiffs allege that “the Company will no longer be quoted or traded on the NASDAQ SmallCap Market. First Niles shares will not be readily tradable on an established market. If they trade at all, it will be over-the-counter or on the pink sheets, although the Proxy does not disclose which.” *See* Am. Compl. ¶ 70. The Proxy fully discloses that as a result of the Reclassification, the stock that is subject to the Reclassification will be less liquid as it will no longer be listed on the Nasdaq Capital Market. The Proxy further discloses that First Niles will attempt to list, but cannot promise to list, its stock on the Over the Counter Bulletin Board or Pink Sheets electronic quotation system:

¹⁰ The Court may take judicial notice of the fact that First Niles stock is currently traded on the Over the Counter Bulletin Board. Del. R. of Evid. 201(b) (courts may take judicial notice of facts that are “not subject to reasonable dispute in that it is...capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned”); *see also Weiss v. Samsonite Corp.*, 741 A.2d 366, 374 n. 26 (Del. Ch. 1999) (taking judicial notice of stock prices).

After the Rule 13e-3 transaction, neither our common stock nor our Series A Preferred Stock will be quoted or traded on the Nasdaq Capital Market. As a result, the market liquidity of our common stock will be reduced. ... [F]ollowing the Rule 13e-3 transaction, we plan to list our common stock on another automated quotation system such as the Over the Counter Bulletin Board or the Pink Sheets; however, we cannot guarantee that [sic] we will be able our common stock will be listed on either system.

See Proxy p. 26; *see also* Proxy pp. 3, 4, 5, 20, and 23. Plaintiffs have failed to allege how it is a material misrepresentation or omission that the Proxy disclosed two possibilities. Moreover, any disclosure other than the one provided in the Proxy would have been speculation and “[s]peculation is not an appropriate subject for a proxy disclosure.” *Loudon*, 700 A.2d at 145.

As part of Plaintiffs’ allegations that the Defendants were interested in the Reclassification decision, Plaintiffs allege that the Defendants voted as they did because Reclassification ensures that they are no longer subject to restrictions of the Securities Act, information regarding their compensation and ownership will no longer be publicly available, and the directors’ percentages of beneficial ownership will “likely” increase. *See* Am. Compl. ¶ 73. All the facts that underlie Plaintiffs’ allegations are disclosed, and as such, the shareholder vote was pursuant to complete and accurate disclosure. Specifically, the Proxy provides as follows:

After the Rule 13e-3 transaction, our common stock will not be registered under the Securities Exchange Act. As a result, beginning 90 days after the effective date of the Rule 13e-3 transaction, our executive officers, directors and other affiliates will no longer be subject to many of the reporting requirements and restrictions of the Securities Exchange Act, including the reporting and short-swing profit provisions of Section 16. After that time, our affiliates may realize “short-swing” profits on purchases and sales of the Company’s securities that occur within a six-month period. Currently, under Section 16 of the Securities Exchange Act, the Company would be entitled to receive any such short-swing profits from the affiliate. ...

After the Rule 13e-3 transaction, First Niles will no longer be subject to the periodic reporting requirements or the proxy rules under the Securities Exchange Act. As a result, information about our affiliates' compensation and stock ownership will no longer be publicly available. . . .

As a result of the Rule 13e-3 transaction, we expect that the percentage of beneficial ownership of First Niles common stock held by our directors and executive officers as a group will increase from approximately 17.0% before the Rule 13e-3 transaction to approximately 17.5% after the Rule 13e-3 transaction.

See Proxy p. 21; *see also* Proxy pp. 4 and 38.

As Plaintiffs have failed to sufficiently allege that the disclosures were not adequate, count II must be dismissed.

VI. EVEN ASSUMING THE AMENDED COMPLAINT STATES A CLAIM UPON WHICH RELIEF MAY BE GRANTED, COUNTS I AND III SHOULD BE DISMISSED AGAINST MR. CSONTOS AND COUNT III SHOULD BE DISMISSED AGAINST MR. SHAKER FOR LACK OF JURISDICTION UNDER FED R. CIV. P. 12(B)(2).

This Court has no jurisdiction over Mr. Csontos as to count I and III regarding the decisions not to sell and the Reclassification. Also, this Court has no jurisdiction over Mr. Shaker as to count III regarding the Reclassification.

Plaintiffs do not allege that Mr. Csontos is or ever was a resident of Delaware. Although Delaware courts may obtain jurisdiction over individuals regardless of their residence if they were directors or "officers" "at any time during the course of conduct alleged in the action or proceeding to be wrongful," pursuant to 10 *Del. C.* § 3114, jurisdiction is unavailable under this statute as to Mr. Csontos.

As evident from the face of the Amended Complaint, Mr. Csontos was not a director when the vote regarding the sale to First Place was taken. The Plaintiffs allege that he was the "compliance officer" for First Niles. *See* Am. Compl. ¶ 11. Even assuming that Mr.

Csontos was the “compliance officer,” which will be denied if the Defendants’ answer is ultimately filed, that office is not one of the officer positions listed in 10 *Del. C.* § 3114. Mr. Csontos was also not a director when the votes not to sell First Niles and regarding Reclassification took place. *See* Am. Compl. ¶ 54 and 67. He did not join the Board until April of 2006, which was after the March 9, 2005 vote not to sell First Niles and after the December 5, 2005 vote regarding Reclassification. *See id.* at ¶ 11, 54, and 67.

Plaintiffs do not allege that Mr. Shaker is or ever has been an officer of First Niles. Mr. Shaker was not a director when the vote regarding Reclassification took place. *See* Am. Compl. ¶ 13 and 67. He did not join the Board until January of 2006, which was after that vote. *See id.* at ¶ 13 and 67.

Consequently, this Court may not exercise jurisdiction against Mr. Csontos as to counts I and III or against Mr. Shaker as to count III and those counts against them should be dismissed.


CONCLUSION

For all of the foregoing reasons, Defendants respectfully request that the Court dismiss Plaintiffs' Amended Complaint with prejudice.

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