IN THE COURT OF CHANCERY FOR THE STATE OF DELAWARE

MCG CAPITAL CORPORATION, for Itself and in the right and for the benefit of Jenzabar, Inc. Plaintiff v. ROBERT A. MAGINN, JR., LING CHAI, JAMISON BARR, JOSEPH SAN MIGUEL, DANIEL QUINN MILLS, and JENZABAR, INC. Defendants, and JENZABAR, INC., Nominal Defendant.	)	C.A. No. 4521-CC

OPENING BRIEF IN SUPPORT OF MOTION TO DISMISS OF DEFENDANTS JENZABAR, INC., JAMISON BARR, JOSEPH SAN MIGUEL, AND DANIEL QUINN MILLS

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INTRODUCTION

For more than three years, Plaintiff MCG Capital Corporation ("MCG") has been pressing nominal defendant Jenzabar, Inc. ("Jenzabar" or the "Company") to buy out MCG's investment in Jenzabar at an inflated price. Now, to ratchet up the pressure further, MCG has filed a complaint asserting 12 counts against Jenzabar, its officers, its directors, and even its general counsel. These 12 counts – consisting of both direct and derivative claims – can be grouped into three general areas: claims that the defendants breached contractual obligations to MCG and their fiduciary duties by granting modest increases in base pay and bonuses to the company's CEO and COO; claims that defendants breached their fiduciary duties by being tardy in circulating information to Board members and failing to accept all edits to the Board minutes proposed by MCG's designee to the Jenzabar board; and claims that defendants breached contractual obligations to MCG and their fiduciary duties by sending MCG an allegedly deficient repurchase notice for the Jenzabar preferred stock held by MCG. With the exception of one claim seeking a declaratory judgment concerning the repurchase notice,[1] all of these claims must be dismissed on the pleadings.

This brief is being filed on behalf of Jenzabar; Jenzabar's two independent directors, Joseph San Miguel and Daniel Quinn Mills; and Jenzabar's general counsel, Jamison Barr; a separate brief (incorporating by reference the arguments made herein) is being filed on behalf of Jenzabar's Chairman and CEO, Robert Maginn Jr., and its

[1] Defendants expect, however, to defeat this claim on the merits.

President and COO, Ling Chai. As explained in this brief, the Counts in MCG's Complaint are subject to dismissal for at least the following reasons.

First, the derivative counts in the Complaint – as best defendants can tell, Counts 5, 6, 7, 8, and 12 – must be dismissed for at least two reasons. As an initial matter, MCG concedes in its Complaint that it made no demand on the MCG board prior to filing suit. MCG claims that demand is excused in this case because it would be futile, arguing that a majority of the board is "interested" and/or "beholden" to the interested directors. MCG's allegations in this regard are, as a matter of law, deficient. Moreover, MCG is not an appropriate representative to bring derivative claims on behalf of all Jenzabar's shareholders because MCG is obviously more interested in its own direct claims against the defendants.

Second, the eleven counts that MCG brings that allege in various ways that Jenzabar improperly paid compensation to Maginn and Chai – Counts 1, 2, 3, 4, 5 (in part), 6, 7, 8, 9, 10, and 12 – all must be dismissed because the very documents that MCG refers to in its Complaint and in some cases appended thereto as exhibits contradict MCG's theory of the case. In particular, Jenzabar's employment agreements with Maginn and Chai – which were specifically negotiated and approved by MCG – do not prohibit, but instead explicitly contemplate, the Jenzabar board increasing their base pay and bonuses. (MCG's complaint repeatedly mentions and characterizes (or mis-characterizes) these employment agreements, but MCG fails to provide them to the Court.) MCG's entire case, in other words, is built on a premise that is demonstrably false, contradicted by the very documents that MCG asserts.

Third, Counts 1 and 2 of the Complaint – alleging breach of the Preferred Stock and Warrant Purchase Agreement ("PSWPA") between Jenzabar and MCG and breach of the Jenzabar corporate charter – must be dismissed against the individual defendants because they are not parties to these contracts and are not capable of being in breach of either.

Fourth, Counts 3 and 4 – asserting an "aiding and abetting" theory for breach of contract and breach of charter – must be dismissed because there is no such theory of liability.

Fifth, Count 5 of the Complaint, alleging breaches of fiduciary duty by the individual defendants, must be dismissed because the alleged breaches of fiduciary duty are actually just the same contract claims brought by MCG in the other counts. MCG's attempt to transform its contract claims against the corporation into claims against the individual directors and officers for breach of fiduciary duty has no basis in law or equity; MCG does it only for its *in terrorem* effect, as part of its ongoing campaign to extract benefits to which it is not entitled. MCG lacks standing to complain about alleged failures by the Jenzabar board to circulate information to directors or to accept changes to Board minutes proposed by a director. Moreover, Count 5 cannot be asserted against defendant Barr because he is not a director of Jenzabar, but only Jenzabar's general counsel.

Sixth, Counts 7, 8, and 12 – asserting claims of “accounting” and “rescission” – must be dismissed because those are remedies, not causes of action.[2] Moreover these Counts must be dismissed against Jenzabar, the independent directors, and Barr because they did not receive any of the supposed improper benefits – the compensation paid to Maginn and Chai – that are the subject of these Counts.

Finally, Counts 9, 10, and 11 – seeking a declaratory judgment with respect to provisions in the PSWPA and the Jenzabar Charter must be dismissed against the independent directors and Barr because those individuals are not party to the PSWPA and are not alleged to have breached the Charter in their individual capacity.

In summary, MCG’s ulterior purpose in bringing this lawsuit is obvious: MCG is using this lawsuit to attempt to gain bargaining leverage over Jenzabar, to extract a repurchase price far in excess of what MCG is entitled to receive by contract – a strategy that MCG has been aggressively and unabashedly pursuing for three years. MCG’s strategy is evident when its claims are subjected to the slightest legal analysis. For the reasons given herein and in the separate memorandum being filed by defendants Maginn and Chai, the Complaint filed by MCG must, with the limited exception of Count 11 as against Jenzabar, be dismissed on the pleadings.

NATURE AND STAGE OF PROCEEDINGS

MCG filed its Complaint on April 21, 2009. The defendants filed their motions to dismiss on May 18, 2009. The parties participated in a scheduling conference on June 24, 2009 in connection with MCG’s motion for preliminary injunction against Jenzabar’s

[2] Count 6 is, on the face of the Complaint, asserted only against Maginn and Chai.

ongoing valuation of MCG's warrants. Following the scheduling conference, MCG informed Jenzabar that it would not be pursuing the motion for a preliminary injunction.

This is the Opening Brief in Support of Motion to Dismiss of Defendants Jenzabar, Inc., Jamison Barr, Joseph San Miguel, and Daniel Quinn Mills.

STATEMENT OF FACTS[3]

MCG's Investment Is Governed By Its Written Contracts With Jenzabar

Jenzabar is a Delaware corporation with a principal place of business in Boston, Massachusetts. Complaint, ¶ 2. It is a private software and services company that provides business intelligence applications and services, internet enterprise software, and e-learning solutions to the higher education market. Complaint, ¶ 2.

Plaintiff MCG is a "business development company," Complaint, ¶ 1, essentially a publicly traded investment company that deals primarily in debt, debt-like, and derivative instruments. MCG invested in Jenzabar on June 30, 2004, pursuant to a Preferred Stock and Warrant Purchase Agreement dated June 30, 2004 between MCG and Jenzabar (the "PSWPA"). Complaint, ¶ 11. The Fifth Amended and Restated Certificate of Incorporation of Jenzabar, Inc. (the "Charter"), and the Fourth Amended and Restated Stockholders Agreement (the "Stockholders Agreement") were adopted simultaneously, as a condition of MCG's investment. *See* Complaint, Introduction and ¶¶ 10, 14. MCG

[3] Because this is a motion to dismiss, the defendants set forth the facts as they are alleged in the Complaint. The procedural rules require the Court to treat many (but not all) of MCG's allegations as true, but in fact the vast majority of MCG's allegations are mischaracterizations of events or documents, and many are simply untrue.

currently holds 109,800 shares of Subordinated Preferred Stock, and warrants to purchase 5,879,150 shares of Common Stock. Complaint, ¶ 4.[4]

Also as a condition of and simultaneous with MCG's investment, on June 30, 2004, Jenzabar entered into employment agreements (the "Employment Agreements") with, among others, defendants Robert A. Maginn, Jr. ("Maginn"), the Chairman and Chief Executive Officer of Jenzabar, and Ling Chai ("Chai"), the Company's president and Chief Operating Officer. The Employment Agreements were required by, and their form was approved by, MCG as part of the PSWPA. PSWPA (Complaint Ex. 2), Section 2.3(ii)(J).[5] The Employment Agreements establish an initial base salary and authorize the payment of performance bonuses. Employment Agreements, Ex. A, B, Section 5. Those

[4] MCG alleges in its Complaint that it holds Senior Preferred Stock, but that stock has since been repurchased.

[5] MCG's Complaint references the Employment Agreements more than a dozen times, but they are conspicuously absent from the exhibits to the Complaint. This omission is quite telling – it is difficult to avoid the inference that MCG did not attach them because the Court's examination of those agreements would reveal that the compensation review and adjustment about which MCG complains is expressly permitted (indeed, the review is mandated) under those Agreements. MCG's omission of the Employment Agreements does not insulate them from review, however, and this Court may consider those oft-mentioned agreements without converting this motion to one for summary judgment. A document becomes part of the pleadings when "the document is integral to a plaintiff's claim and incorporated into the complaint." *Vanderbilt Income & Growth Assocs., LLC v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996); *see also McMillan v. Intercargo Corp.*, 768 A.2d 492, 500 (Del. Ch. 2000). In *e4e, Inc. v. Sircar*, 2003 Del. Ch. LEXIS 119 (Del. Ch. Oct. 9, 2003), for example, this Court considered a letter that, like the Employment Agreements here, was not attached to the complaint but was referred to extensively and was a defined term in the complaint. *Id.* at *9-10. Here, moreover, MCG has incorporated the Employment Agreements by reference in the Complaint because the applicable form of the Agreements was an exhibit to the PSWPA, which is part of the pleadings. PSWPA (Complaint, Ex. 2), p. iv. A true and correct copy of the Employment Agreement between Jenzabar, Inc. and Robert A. Maginn, Jr., dated June 30, 2004, is attached as Exhibit A to the Transmittal Affidavit of Geoffrey G. Grivner, Esq. ("Grivner Aff.") and referenced herein as Exhibit A. A true and correct copy of the Employment Agreement between Jenzabar, Inc. and Ling Chai, dated June 30, 2004, is attached as Exhibit B to the Grivner Aff. and referenced herein as Exhibit B.

provisions require the Board to review and, in its judgment, consider increasing Maginn's and Chai's compensation from time to time. Section 5(a) specifically mandates that:

> The Board shall periodically review Executive's Base Salary consistent with the compensation practices and guidelines of the Company, <u>but</u> the Board shall have no obligation or requirement to increase such Base Salary at any time during the Term. If Executive's Base Salary is increased by the Board during the Term, <u>then</u> such increased Base Salary shall then constitute the Base Salary for all purposes of this Agreement.

Id. (underlining in original). Similarly, with respect to Performance Bonuses, Section 5(b)(2) of Maginn's Employment Agreement provides that:

> The Board shall periodically review Executive's Quarterly Bonus for increase (but not decrease below 54% of the Executive Bonus Pool), consistent with the compensation practices and guidelines of the Company.

Id. Chai's Employment Agreement contains identical language, except that the relevant percentage of the bonus pool for her quarterly bonus is 22%.

Section 5.12 of the PSWPA grants MCG certain voting rights that were intended to protect MCG's loan position. This provision requires Jenzabar to obtain MCG's written consent or affirmative vote prior to taking certain actions. Those actions include fundamental changes to the company, such as mergers, acquisitions, or sales; changes to the size of the Board; or liquidating, dissolving, or filing for bankruptcy protection. Complaint, ¶ 15, *citing* Ex. 2 to Complaint at 39-41. The Company is also required to obtain MCG's written consent or affirmative vote if it seeks to "enter any transaction, contract, agreement, or arrangement with an Affiliate." *Id.* The Charter has corresponding provisions. Complaint, ¶ 16. Neither the Charter nor Section 5.12 of the PSWPA gives MCG voting rights over executive compensation.[6]

When it made its investment, MCG agreed that Jenzabar would have the right, so long as there was no outstanding indebtedness to MCG, to repurchase MCG's Senior Preferred Stock. Charter (Complaint, Ex. 1), Article 4(a). If Jenzabar made such a repurchase before April 30, 2009 (the original maturity date of the loans), MCG was required to make a choice: MCG could put its warrants to Jenzabar at the current fair market value, or MCG could continue to hold the warrants, but without the benefit of the voting rights set out in Section 5.12 of the PSWPA. PSWPA (Complaint, Ex. 2), Section 5.11(g).

After paying off MCG's loans in March 2006, Jenzabar duly gave MCG notice of its intent to repurchase MCG's Senior Preferred Stock no later than March 31, 2009. Complaint, ¶ 71. MCG filed this action, without any prior notice, three weeks later. [7]

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[6] MCG contends that its right to vote on transactions with Affiliates also gives it the right to approve or veto compensation decisions. Viewed in the context of Section 5.12 of the PSWPA, and of Section 5 of the Employment Agreements, it becomes obvious that the provision regarding Affiliate transactions is intended to apply to business transactions between Jenzabar and its directors or officers acting in some other capacity or through some other entity. It makes no sense and is inconsistent with the express terms of the Employment Agreements to read this provision to apply to compensation decisions or employment contracts. *ee Crown Brooks Corp. v. Bookstop Inc.*, 1990 WL 26166, at *1 (Del. Ch. Feb. 28, 1990) ("in construing the legal obligations created by [a] document, it is appropriate for the court to consider not only the language of that document but also the language of contracts among the same parties executed or amended as of the same date that deal with related matters...."). If these sophisticated parties intended to give MCG special voting rights over employment agreements or executive compensation, they could have said so much more plainly.

[7] Jenzabar concluded the repurchase of the Senior Preferred Stock on April 29, 2009, transferring more than $6.2 million to a paying agent for the benefit of MCG. MCG disputes the effectiveness of the repurchase. Complaint, ¶¶ 70-78.

Jenzabar's Compensation Committee Adjusts Maginn and Chai's Compensation Pursuant To The Terms Of The Employment Contracts

MCG's claims primarily concern certain compensation decisions made by Jenzabar's Compensation Committee and adopted by Jenzabar's Board of Directors in December 2008. Jenzabar's Board is comprised of five members. Defendant Maginn is the chair of the Board and has served as Jenzabar's Chief Executive Officer since March 2001. Complaint, ¶ 3. Defendant Chai is Jenzabar's founder and its Chief Operating Officer. Complaint, ¶ 4. Defendant San Miguel, who is alleged to have been Maginn's professor at Harvard Business School, is an independent director.[8] Complaint, ¶ 6, 23, 33. Defendant Mills, also an independent director, is the Albert J. Weatherhead, Jr. Professor of Business Administration (Emeritus) at the Harvard Business School; the Complaint alleges that he also once taught Maginn. Complaint, ¶ 7, 23, 33. The fifth director, Peter Malekian ("Malekian"), is an employee of MCG and is MCG's designee to Jenzabar's Board pursuant to the PSWPA and Stockholders Agreement. Complaint, ¶ 23. Defendant Barr is not a director but serves as Vice President and General Counsel of Jenzabar. Complaint, ¶ 5.

San Miguel and Mills (together, the "Independent Directors") joined Jenzabar's Board in the Spring of 2008. Complaint, ¶ 31. The Complaint alleges no personal or professional relationship between the Independent Directors and Maginn or Chai, other than the fact that Maginn studied under Mills and worked as San Miguel's research assistant when he was at Harvard Business School in the early 1980s. Complaint, ¶ 32.

[8] Dr. San Miguel is currently a professor at the Naval Postgraduate School's Graduate School of Business and Public Policy in Monterey, California.

Fully aware of their past relationship at Harvard with Maginn, MCG consented to the appointment of both San Miguel and Mills as Independent Directors, agreeing that they were independent as defined in the Stockholders' Agreement, Art. IV, §4.2(a)(iii), and NASD Rule 4200(a)(15), which was a precondition to their appointment under the Stockholders Agreement. Complaint, ¶ 34.

After the Independent Directors joined the Board, the Board formed a Compensation Committee, comprised of the Independent Directors and Malekian. Complaint, ¶ 24. The Independent Directors are each paid $50,000 per year for their service on the Board, plus $25,000 each for their service on the Compensation Committee, and $25,000 each for their service on the Audit Committee. Complaint, ¶ 35.[9]

Pursuant to Section 5 of the Employment Agreements, the Compensation Committee undertook a review of the salary and bonuses paid to Maginn and Chai. Ex. A, B. At a Compensation Committee meeting in December 2008, the Independent Directors voted to approve a 12.5% increase in salary for Maginn and a 12% increase in salary for Chai. Complaint, Intro, ¶ 44. As a matter of simple math, this increase represents an annual compounding increase of approximately 2.5% since June 2004, when the salaries were first set. MCG's board designee Malekian nevertheless objected, insisting that any increase in salary required the consent of MCG; he suggested that the Compensation Committee consult its counsel on the matter. Complaint, ¶ 45. The

[9] As an employee of MCG and its designated director, Malekian presumably is paid by MCG for his service on Jenzabar's board.

Independent Directors conferred with outside counsel, who was present at the meeting, and then voted to authorize the increase in base salary to Maginn and Chai. Complaint, ¶ 46. The Compensation Committee also voted to approve bonuses to Maginn and Chai. Complaint, ¶ 47.

The Complaint also alleges that "Defendants Maginn, Chai, and Barr have routinely acted to keep the non-management members of the Board of Directors in the dark...." Complaint, ¶ 60. This Count is based on some complaints by Malekian: that he supposedly does not receive Board meeting materials sufficiently in advance of Board meetings (Complaint, ¶ 61), that draft minutes are not circulated as promptly as Malekian thinks they should be (Complaint, ¶¶ 63-64), and that Barr has not included some of Malekian's proposed additions and corrections to the minutes. (Complaint, ¶ 66).

A Summary Of MCG's Claims

MCG's Complaint purports to assert twelve counts, including both direct and derivative causes of action:

- Count One asserts a claim for breach of contract for allegedly violating MCG's rights under the PSWPA to approve or disapprove the salary increases and bonuses to Maginn and Chai. Complaint, ¶¶ 88-91.

- Count Two asserts a claim for breach of Jenzbar's Charter for allegedly violating MCG's rights under the Charter to approve or disapprove the salary increases and bonuses to Maginn and Chai. Complaint, ¶¶ 92-95.

- Count Three asserts that Maginn, Chai, and Barr are liable for aiding and abetting the Independent Directors in their alleged breach of the PSWPA. Complaint, ¶¶ 96-100.

- Count Four asserts that Maginn, Chai, and Barr are liable for aiding and abetting the Independent Directors in their alleged breach of the Charter. Complaint, ¶¶ 101-105.

- Count Five purports to state a claim against all of the individual defendants for breach of fiduciary duty, on the theory that the alleged breaches of the PSWPA and Charter also amount to a breach of fiduciary duty; MCG also claims that the individual defendants mistreated Malekian and failed to keep him adequately informed. Complaint, ¶¶ 106-109.

- Count Six contends that Maginn and Chai were unjustly enriched by receiving supposedly wrongful compensation. Complaint, ¶¶ 110-113. This count names only Maginn and Chai.

- Count Seven demands that Jenzabar provide an accounting of all compensation and payments made to Maginn and Chai. Complaint, ¶¶ 114-119.

- Count Eight seeks rescission of allegedly wrongful compensation payments to Maginn and Chai. Complaint, ¶¶ 120-125.

- Count Nine seeks a declaration that PSWPA prohibits Jenzabar from compensating Maginn or Chai beyond the "sums expressly set forth in their respective Employment Agreements" without MCG's consent or approval. Complaint, ¶¶ 126-130.

- Count Ten seeks a declaration that the Jenzabar Charter prohibits Jenzabar from compensating Maginn or Chai beyond the "sums expressly ... set forth in their respective Employment Agreements" without MCG's consent or approval. Complaint, ¶¶ 131-135.

- Count Eleven requests a declaration that Jenzabar's notice of its intent to repurchase MCG's Senior Preferred Stock on or before April 30, 2009 was invalid, and seeks additional declarations regarding MCG's rights under the PSWPA. Complaint, ¶¶ 136-140.

- Count Twelve seeks to rescind a bonus that was approved by Jenzabar's Board on December 23, 2008 and paid to Maginn. Complaint, ¶¶ 141-146.

ARGUMENT

All of the counts in MCG's Complaint are legally deficient, some for multiple reasons. MCG seriously confuses direct and derivative claims, fails entirely to justify its failure to make demand, asserts claims against individual defendants who cannot possibly be subject to liability, brings claims not recognized under Delaware law, and advances facially unreasonable interpretations of unambiguous written agreements.

I. THE COURT SHOULD DISMISS THE SUPPOSEDLY DERIVATIVE CLAIMS BECAUSE MCG IS AN INADEQUATE PLAINTIFF AND HAS FAILED TO MAKE THE REQUIRED DEMAND.

MCG's Complaint is difficult to parse; MCG has made no effort to identify, on a count-by count basis, which claims are direct and which are derivative. The Court must therefore make this determination itself, by looking to the substance of the allegations of the Complaint. *See, e.g.*, *Litman v. Prudential-Bache Prop., Inc.*, 611 A.2d 12, 15 (Del. Ch. 1992) (to determine whether claims are derivative or direct court "must look to the nature of the wrongs alleged in the body of plaintiffs' complaint, not plaintiffs' characterization or stated intention."). "The 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?" *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004).

When MCG's allegations are analyzed under this framework, Counts Six, Seven, Twelve, and most, if not all, of Five and Eight would be derivative to the extent that they purport to seek a remedy for alleged harm to Jenzabar and its stockholders.

A. **<u>MCG Cannot Assert Derivative Claims Because It Is Not An Adequate Representative Plaintiff.</u>**

A plaintiff asserting a derivative claim must, as a threshold matter, be qualified and able to represent its fellow stockholders in a "fiduciary capacity." *Katz v. Plant Indus., Inc.*, 1981 WL 15148, at *1 (Del. Ch. Oct. 27, 1981). ("[A] plaintiff shareholder in a derivative action must be qualified to serve in a fiduciary capacity as a representative of a class of persons similarly situated, whose interests are in plaintiff's hands and the redress of whose injuries is dependent upon his diligence, wisdom and integrity"). In determining the adequacy of a derivative plaintiff to discharge fiduciary duties with respect to the class of stockholders, the Court may consider the following non-exclusive factors:

> (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.

Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate and Commercial Practice in Delaware Court of Chancery* § 9-2[b][1] at 9-26 (2000) (citing *Katz*, 1981 WL 15148, and *Youngman v. Tahmoush*, 457 A.2d 376 (Del. Ch. 1983)). Fundamentally, a court should not find a plaintiff adequate to assert a derivative claim if there is "a substantial likelihood that the derivative action is not being used as a device for the benefit of all the stockholders." *Youngman*, 457 A.2d at 381 (citation omitted).

Here, there is more than a "substantial likelihood" that MCG is using this action for its own benefit; it is a certainty, evident from the face of the Complaint. This case is, put bluntly, all about MCG and its purported rights under the PSWPA and Charter. Counts Six, Seven, and Twelve, for instance, which are purportedly derivative claims for unjust enrichment, an accounting, and rescission, all arise from MCG's contention that salary increases and bonuses were granted in violation of its contractual rights under the PSWPA and Charter.

MCG's simultaneous pursuit and intermingling of both direct and derivative claims in this case – some of which, in particular those dealing with the preferred stock and warrant put repurchase processes, make MCG directly adverse to Jenzabar's other shareholders – ends the inquiry; MCG is unable to adequately represent the interests of Jenzabar in connection with the derivative claims. This Court has dismissed derivative suits where the plaintiff also brings direct claims, especially direct claims that make it adverse to other shareholders. *See Scopas Tech. Co. v. Lord*, 1984 WL 8266 (Del. Ch. Nov. 20, 1984) (granting motion to dismiss derivative suit where plaintiff's direct claims created conflict of interest regarding his capacity to adequately pursue the derivative claims and vigorously represent other shareholders); *see also, e.g., Rosan v. Chicago Milwaukee Corp.*, 1990 WL 13482, at *3-8 (Del. Ch. Feb. 6, 1990) (where defendants argued that the plaintiff's derivative claim was "being used ... as leverage to bolster [the plaintiff's] direct claims as a preferred stockholder," court concluded because the plaintiff's direct claims were dismissed the conflict lessened "to a point where [the plaintiff] appear[ed] able to serve as an adequate representative"). Federal courts applying Fed. R. Civ. P. 23.1 have similarly found that the simultaneous assertion of both direct and derivative claims in the same action creates "an impermissible conflict of interest" which renders a putative plaintiff an inadequate representative. *See, e.g.*, *Tuscano v. Tuscano*, 403 F. Supp. 2d 214, 223 (E.D.N.Y. 2005) (explaining that "an impermissible conflict of interest" exists where shareholder brings both individual and derivative claims); *Wall St. Sys., Inc. v. Lemence*, 2005 WL 292744, at *3 (S.D.N.Y. Feb. 8, 2005) (same); *Keyser v Commonwealth Nat'l Fin. Corp.*, 120 F.R.D. 489, 490 (M.D. Pa. 1988) (same).

MCG's own allegations make it clear beyond any doubt that MCG has brought this action to advance its own interests. It is hopelessly conflicted and unable to adequately represent the interests of Jenzabar and its stockholders. All of MCG's derivative claims must therefore be dismissed.

B. MCG Failed To Make Demand On The Board, And That Failure Cannot Be Excused.

MCG's purportedly derivative claims fail for yet another independently sufficient reason: it failed to make a demand upon the Board as required by Court of Chancery Rule 23.1.[10] The pre-suit demand requirement is a corollary to the elementary principle that "directors, rather than stockholders, manage the [business and] affairs of the

[10] Ct. Ch. R. 23.1 ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort.").

corporation." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984), *overruled on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000). Thus, "to cause the corporation to pursue litigation, a shareholder must either (1) make a pre-suit demand by presenting the allegations to the corporation's directors, requesting that they bring suit, and showing that they wrongfully refused to do so, or (2) plead facts showing that demand upon the board would have been futile." *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009).

MCG concedes that it did not even attempt to make a pre-suit demand. Complaint, ¶ 83. It instead alleges that a demand would have been futile. *See* Compl., ¶¶ 83-87. MCG's Complaint, however, does not come remotely close to pleading sufficient facts to support that allegation.

1. **Rule 23.1 requires MCG to plead futility with particularity.**

The Rules of this Court require that the facts establishing either the making of a demand or the futility thereof must be alleged "with particularity." Ct. Ch. R. 23.1. Rule 23.1 is not satisfied by conclusory statements or mere notice pleading .... What the pleader must set forth are particularized factual statements that are essential to the claim." *Brehm*, 746 A.2d at 254; *Seminaris v. Landa*, 662 A.2d 1350, 1351 (Del. Ch. 1995). This heightened pleading requirement of "Rule 23.1 is an exception to the general notice pleading standard" and is "more onerous than that required to withstand a Rule 12(b)(6) motion to dismiss." *Levine v. Smith*, 591 A.2d 194, 207, 210 (Del. 1991). Indeed, "only well-pleaded allegations of fact must be accepted as true; conclusory allegations of fact or law not supported by allegations of specific fact may not be taken as true. A trial 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." *Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988) (footnote omitted). Where plaintiff fails to plead the necessary allegations with particularity, dismissal of the derivative suit is required. *See Levine*, 591 A.2d at 210.

Thus, to establish that a pre-suit demand would have been futile, MCG must plead particularized facts that create a reasonable doubt as to: (1) the disinterestedness or independence of the directors, or (2) whether the board's challenged actions constituted a valid exercise of business judgment. *See Aronson*, 473 A.2d 805 at 814 (setting forth the two-pronged standard of pleading under Rule 23.1); *see also Levine*, 591 A.2d at 205. Under *Aronson's* two-pronged test, demand may be excused where the particularized facts alleged in the complaint indicate that at least one of the following is present: "(1) a majority of the board has a material financial or familial interest; (2) a majority of the board is incapable of acting independently for some other reason such as domination or control; or (3) the underlying transaction is not the product of a valid exercise of business judgment." *In re Affiliated Computer Serv., Inc. S'holders Litig.*, 2009 WL 296078, at *8 (Del. Ch. Feb. 6, 2009) (quoting *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996)).

To adequately plead that a director is interested, MCG must allege particularized facts indicating that "divided loyalties are present, or [that] a director either has received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not equally shared by the stockholders." *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984). Under *Aronson*, "disinterested" simply "means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 821 (Del. Ch. 2005) (quoting *Aronson*, 473 A.2d at 812, 816), *aff'd*, 906 A.2d 766 (Del. 2006).

Here, there are no allegations of self-dealing on the part of the Independent Directors or of any financial interest whatsoever in the challenged transactions. Instead, according to MCG, demand would be futile because a majority of Jenzabar's Board is "incapable of independently and disinterestedly considering a demand to commence and vigorously prosecute [the Derivative Claims]." Complaint, ¶ 84. Specifically, MCG alleges in its Complaint that demand would be futile either because San Miguel and Mills, the Independent Directors, are so beholden to Maginn and Chai that they cannot exercise independent judgment, *see* Complaint, ¶ 86, or because they are "substantially likely to be held [themselves] liable for the wrongdoing complained of by Plaintiff," *see id*.[11] MCG's Complaint, however, does not contain well-pleaded, particularized facts to support either assertion.

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[11] MCG's other half-hearted arguments on this issue hardly warrant attention. In the first instance, the allegation that the Independent Directors are incapable of fairly considering a demand simply because they approved the allegedly unlawful payments is contrary to the law of demand futility. *See Brehm*, 746 A.2d at 257, n.34 ("It is no answer to say that demand is necessarily futile because ... the directors ... approved the underlying transaction."); *Grobow v. Perot*, 526 A.2d 914, 924 (Del. Ch. 1987) ("It is now well-settled that an allegation that a majority of directors approved, participated, or acquiesced in the challenged transaction will not, in and of itself, establish demand futility."). That MCG has asserted this excuse for failing to make a demand merely highlights its inability to allege the particularized facts necessary to reasonably challenge the directors' independence. Similarly, MCG's passing reference to the Independent Directors "colluding with the recipients of the unlawful payments" is devoid of any

2. MCG's Prior Approval of Mills and San Miguel As Independent Directors Belies Its Current Claim That They Are "Beholden."

At the outset, before turning to application of the *Aronson* test, MCG's new allegation that Mills and San Miguel are beholden to Maginn and Chai is flatly contradicted by their earlier approval of these individuals as "Independent Directors" of Jenzabar. *See* Complaint ¶ 22. In approving San Miguel and Mills, MCG conceded that both directors satisfied the definition of "independent director" contained in NASD Rule 4200(a)(15), a precondition to appointment in the Stockholders Agreement (art. IV, § 4.2(a)(iii). NASD Rule 4200(a)(15) defines an "independent director" as a "person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director." At the time MCG approved the appointment of San Miguel and Mills as Independent Directors, MCG was fully aware of their prior relationship (if it can even be called that) with Maginn at Harvard, and MCG was also aware that they would be paid for their service on the Jenzabar board. MCG cannot now, in hindsight, contend that these directors lack independence based on exactly the same facts.

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factual allegations. Without some particularized factual support for this conclusory attack, this allegation cannot excuse MCG's failure to make a demand.

3. **The Complaint Fails to Allege Sufficient Facts to Raise an Inference that San Miguel and Mills are not Independent of Maginn and/or Chai.**

Even putting aside MCG's prior agreement that Mills and San Miguel are not beholden to Maginn and Chai, it is clear that MCG's Complaint fails to allege sufficient facts to demonstrate that the two directors are not independent.

A "mere allegation that a director is dominated and controlled does not raise a reasonable doubt as to his or her independence." *Affiliated Computer,* 2009 WL 296078, at *9. The plaintiff "must advance particularized factual allegations from which the Court of Chancery can reasonably infer that the board members who approved the transaction are acting at the direction of the allegedly dominating individual or entity," *Heineman v. Datapoint Corp.*, 611 A.2d 950, 955 (Del. 1992), and, as a result, "their discretion would be sterilized." *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993). To raise such an inference, plaintiff must plead facts adequate to show that

> the allegedly controlling entity has the unilateral power (whether direct or indirect through control over other decision makers), to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is so dependent or is of such material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to consider the corporate merits of the challenged transaction objectively.

Orman v. Cullman, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

The Complaint purports to present two grounds for finding San Miguel and Mills beholden to Maginn and/or Chai: the Independent Directors are former professors of Maginn at Harvard Business School (Complaint, ¶¶ 33, 87) and they receive compensation from Jenzabar for their service as directors of the Company. Complaint, ¶ 87. Neither ground comes close to meeting the rigorous pleading standard for finding a director to lack independence.

First, the fact that San Miguel and Mills are paid for their service on the Jenzabar Board and committees thereof is insufficient to render them dependent on Maginn and Chai. Maginn and Chai do not have the unilateral power to remove San Miguel and Mills from the Board; the Stockholders' Agreement requires a showing of bad faith or willful misconduct, and also MCG's consent. Moreover, "the mere fact that a director receives compensation for her service as a board member adds little or nothing to demand-futility analysis, 'without more' – i.e., unless the pleadings demonstrate, for example, that the status or compensation was somehow 'material' to the director or otherwise outside the norm." *Khanna v. McMinn*, 2006 Del. Ch. LEXIS 86, at *58-59 (Del. Ch. May 9, 2006) (dismissing complaint for failure to adequately plead demand futility where basis for alleged lack of directorial independence arose from the "well-worn allegation" that the directors received compensation as board members and/or were nominated to their positions by allegedly interested directors); *see also Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 177 (Del. Ch. 2005) ("the fact that directors receive fees for their services does not establish an entrenchment motive on their part"). MCG offers nothing more than a conclusory allegation that $100,000 per year is "significant and material" to the Independent Directors; the complaint is devoid of any allegation that either of the Independent Directors is materially dependent on the $100,000 or on the good graces of Maginn and Chai to make a living. To the contrary, the allegations of the complaint in fact confirm that the Independent Directors are business persons with long and successful careers and much experience beyond Jenzabar, and who are so accomplished that they were appointed to the faculty of Harvard Business School.

Second, MCG also advances a curious perspective on the student-teacher relationship, insinuating that Maginn's former professors at Harvard Business School are somehow under his sway. A plaintiff challenging a director's independence because of a relationship to an interested director, however, must show the relationship in question is "of a bias-producing nature." *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004). It is well settled that mere allegations of long-standing professional and/or personal relationships are insufficient to support a finding of control. *See, e.g.*, *Orman*, 794 A.2d at 27 ("The naked assertion of a previous business relationship is not enough to overcome the presumption of a director's independence. The law in Delaware is well-settled on this point."); *Litt v. Wycoff*, 2003 WL 1794724, at *4 (Del. Ch. Mar. 28, 2003) (stating that neither personal friendships nor outside business relationships are sufficient to raise reasonable doubt regarding director independence). Courts have repeatedly rebuffed challenges to directorial independence based on ***much*** more substantial allegations of personal connections between interested and disinterested directors than what MCG has alleged here. *See, e.g.*, *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 352 (Del. Ch. 2008) (granting summary judgment in favor of disinterested directors involved in a challenged merger transaction where allegations of personal relationship between director of merged company and CEO of acquiring company, including that CEO had previously worked for director at three other companies, were insufficient to challenge directorial independence); *Benihana*, 891 A.2d 150 (plaintiff failed to prove directors lacked independence where, among other things, allegations pertaining to one allegedly beholden director were merely that an interested director had helped him obtain a position on another board,[12] and that he had maintained a 40-45 year friendship with another allegedly interested director); *Beam*, 845 A.2d at 1051 (holding, for purposes of demand futility, "[a]llegations that Stewart and the other directors moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends,' ... are insufficient, without more, to rebut the presumption of independence."); *Cal. Pub. Employees' Ret. Sys. v. Coulter*, 2002 WL 31888343, at *9 (Del. Ch. Dec. 18, 2002) (allegations of a lifelong friendship with an interested party are insufficient to raise doubts regarding another director's disinterest or independence); *Kohls v. Duthie*, 765 A.2d 1274, 1284 (Del. Ch. 2000) (plaintiff failed to adequately challenge directorial independence through allegations of a personal friendship between a member of a special committee of the board and an interested party to the challenged transaction, including that the interested party had once given the director a summer job); *Crescent/Mach I P'rs, L.P. v. Turner*, 846 A.2d 963 (Del. Ch. 2000) (granting motion to dismiss breach of fiduciary duty claims where allegations of "personal affinity," including 15-year personal and professional

[12] Indeed, the Court noted that "people normally get appointed to boards through personal contacts ...," and found as fatal the plaintiff's failure to prove *how* the separate board appointment, coupled with $44,000 compensation the director received, could cloud the director's independent discretion. *See id.* at 177.

relationship, failed to raise reasonable doubt regarding independence of disinterested director).

In summary, under any standard of pleading, MCG has not come close to alleging sufficient facts indicating that San Miguel and Mills are "dominated" by Maginn and/or Chai.

4. The Independent Directors face no likelihood of personal liability.

Finally, MCG asserts, without any basis, that the Independent Directors are "substantially likely to be held liable for the misconduct complained of by Plaintiff." Complaint, ¶ 86. Even if the Court were to examine MCG's conclusory allegation – an examination that must be conducted with respect to each count[13] – the examination would be wholly unavailing. "The mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors." *Aronson*, 473 A.2d at 815. As the Court recently noted in *Spellman v. Katz*,

> It is a "rare case" in which a director or member's actions are sufficiently egregious that a "substantial likelihood" of personal liability exists. This Court has no authority to guess those facts that might support a derivative claim. The burden is on the complaining party to put forth supporting factual allegations. A complaint devoid of factual specificity will fail to provide the necessary basis for excusing demand.

2009 Del. Ch. LEXIS 18, at *22-23 (Del. Ch. Feb. 6, 2009).

[13] Determination of demand futility is made on a claim-by-claim basis. *See, e.g., Coulter*, 2002 WL 31888343.

As discussed in detail, *infra*, the counts against the Independent Directors fail to state any cognizable claims against or seek recovery from the Independent Directors; consequently, the Independent Directors cannot face a substantial likelihood of liability. Indeed, several counts do not even seek relief from the Independent Directors. Count Six, alleging unjust enrichment, is asserted only against Maginn and Chai. Count Seven seeks only an accounting of payments made to Maginn and Chai, not damages or other equitable monetary remedies. Count Eight seeks only a rescission of payments made by Jenzabar to Maginn and Chai; regardless of whether it is direct or derivative, it simply does not seek damages or other equitable monetary relief against the Independent Directors. Similarly, Count Twelve, demanding rescission of supposedly unauthorized compensation, also seeks only rescission of a bonus paid to Maginn and does not pray for any relief against the Independent Directors.

Count Five is a jumble of claims, some obviously direct, others purportedly derivative, alleged against all the defendants without differentiation. Read generously, it apparently alleges that the Independent Directors breached their duty of care by supposedly accepting without investigation certain representations by Maginn and Barr. But this claim does not affect the analysis, because Jenzabar's Charter includes a Section 102(b)(7) provision that exculpates the company's directors from personal liability for breach of the duty of care.[14] *See, e.g., In re Baxter Int'l, Inc., S'holders Litig.*, 654 A.2d 1268, 1270 (Del. Ch. 1995) ("When the certificate of incorporation exempts directors

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[14] Article VIII of the Charter provides that "[t]o the fullest extent permitted by law, a director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director."

from liability, the risk of liability does not disable them from considering a demand fairly unless particularized pleading permits the court to conclude that there is a substantial likelihood that their conduct falls outside the exemption."); *see also Citigroup,* 964 A.2d at 124-25 ("Because the director defendants are exculpated from liability for certain conduct, then a serious threat of liability may only be found to exist if the plaintiff pleads a *non-exculpated* claim against the directors based on particularized facts.") (internal quotations omitted); *Khanna*, 2006 Del. Ch. LEXIS 86, at *106 ("The crucial factor ... would seem to be questions of the potential for personal liability which affect capacity to consider demand.").

Moreover, to the extent MCG complains of the Independent Directors' reliance upon the information provided by Maginn and Barr (or by Jenzabar's outside counsel), *see* Complaint, ¶¶ 41, 50-53, the General Corporation Law establishes that the Independent Directors are fully protected in relying in good faith on information presented by the Company's officers, 8 *Del. C.* §141(e). The Complaint is devoid of allegations sufficient to suggest that the directors' reliance upon Maginn and Barr was not in good faith or that Section 141(e) would not otherwise apply to protect the directors from liability.

In summary, at least three of the five Board members (Malekian, Mills, and San Miguel) face ***no*** likelihood of personal liability because MCG's claims are not asserted against them or because they are protected from liability by the provisions of Jenzabar's

Charter and the General Corporation Law.[15] Thus, a majority of the Board could have impartially considered the claims brought in MCG's complaint, wherefore a demand is not excused. Accordingly Counts Five, Six, Seven, Eight, and Twelve should be dismissed pursuant to Rule 23.1.

II. MCG'S DIRECT CLAIMS ALSO FAIL TO STATE ANY COGNIZABLE CLAIMS.

Like the derivative claims, all of the direct claims against the Independent Directors and Barr must be dismissed under Rule 12(b)(6), as should all but one direct claim against Jenzabar (part of Count 11).[16] To survive a motion to dismiss under Rule 12(b)(6), "a complaint must plead enough facts to plausibly suggest that the plaintiff will ultimately be entitled to the relief she seeks." *Desimone v. Barrows*, 924 A.2d 908, 929 (Del. Ch. 2007); *cf. Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007) (plaintiffs must plead enough facts to "nudge[] their claims across the line from conceivable to plausible.") The rules of procedure may require a court to treat the well-pleaded factual allegations in a complaint as true, but those rules do not require the court to suspend reason and ignore documents incorporated into the pleadings that contradict the plaintiff's allegations, nor do the rules require a court to draw inferences unless they are "***reasonable*** inferences that logically flow from the face of the complaint." *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001) (emphasis supplied); *see also J.P. Morgan*

[15] This is not to suggest that Maginn and Chai face any likelihood of liability. They do not, for the reasons set out in Section II, infra, and in their separate brief in support of Defendants' Motion to Dismiss.

[16] Counts One, Two, Three, Four, Nine, Ten, and Eleven appear to be pled as direct claims.

Chase, 906 A.2d at 817 ("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." (internal citations and quotations omitted)).

MCG's Complaint here fails repeatedly – in Counts One, Two, Three, Four, Five, Six, Seven, Eight, Nine, Ten, Eleven, and Twelve – to allege facts that a give rise to a plausible claim for relief.

A. MCG'S Contract Claims Are Defeated By The Very Terms Of The Documents On Which They Are Premised.

Counts One, Two, Three, Four, Five (in part), Six, Seven, Eight, Nine, Ten and Twelve, all challenge the decision made by the Jenzabar's Compensation Committee and Board to increase the base salaries for Maginn and Chai and award them bonuses. Those compensation decisions were made in accordance with the terms of the Employment Agreements with Maginn and Chai (the "Employment Agreements"), which unambiguously direct that Jenzabar's Board "shall" periodically review salary and bonuses for "increase." *See* Ex. A, B. The Employment Agreements with Maginn and Chai, which were executed at the same time as the PSWPA, on June 30, 2004, were a part of the overall transaction in which MCG invested in Jenzabar which closed the same day. *Id.* The form of the Employment Agreements was approved as part of the transaction and was appended to the PSWPA as an exhibit. *See* PSWPA, Section 2.3(a)(ii)(J).

MCG repeatedly intones Section 5.12 of the PSWPA, arguing that increases in compensation are subject to its special voting rights, but that is not what Section 5.12

says. "Under Delaware law, the proper interpretation of language in a contract is a question of law. Accordingly, a motion to dismiss is a proper framework for determining the meaning of contract language." *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1030 (Del. Ch. 2006). The Delaware Supreme Court "has previously stated that 'a claim may be dismissed if allegations in the complaint or in the exhibits incorporated into the complaint effectively negate the claim as a matter of law.'" *VLIW Technology, LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 614-15 (Del. 2003).

Section 5.12, and the corresponding provision in the Charter, gives MCG special consent and voting rights over certain significant transactions. Those transactions include, among other things, substantial corporate transactions, such as mergers and sales, or changes to the size of the Board. *See* PSWPA, Section 5.12(h) (Ex. 2 to Complaint at 39-41); Charter, Article V, Section 1.A (Ex. 1 to Complaint at 3-7). One category of transactions that is subject to MCG's special voting rights – and the provision on which MCG builds its entire case – concerns related party transactions. Section 5.12(h) requires MCG's consent for the Company to "***enter into*** any transaction, contract, agreement or arrangement with an Affiliate, including, without limitation, any transaction, contract, agreement or arrangement with a shareholder, officer or director of the Company ...." PSWPA, Section 5.12(h) (emphasis added).

From its plain language, it is evident that this provision applies only when the Company intends to "enter into" a transaction – to become party to a new agreement – with a shareholder, officer, or other affiliate. MCG now glosses the language of Section 5.12(h), insisting that it prevents any change in compensation, even in accordance with the terms of *existing* agreements that MCG already approved. When the Compensation Committee and Board adjusted the compensation of Maginn and Chai, however, the Company did not ***enter into*** a new transaction; it simply performed the terms of Employment Agreements that required the Board to review compensation and the discretion to increase it. Section 5.12(h) does not require MCG's consent for the Company to perform under an agreement that MCG had already approved. Indeed, MCG's interpretation of Section 5.12(h) leads to ludicrous results: taken literally, MCG's interpretation would require Jenzabar to obtain MCG's approval each time it issued a paycheck to Maginn or Chai.

In addition, even if the Board were to approve new compensation agreements, compensation decisions and employment agreements are not "affiliate" transactions with respect to which MCG has any special voting rights under the PSWPA or Charter. The PSWPA explicitly states that Maginn's employment agreement is a "Material Contract," *see* PSWPA Section 3.10 and Schedule 3.10, *yet also* states, in a provision entitled "Transactions with Affiliates," that "No affiliate of the Company and no officer or director of the Company … is a party to any material Contract or transaction with the Company." PSWPA, Section 3.24. The second statement could not have been made if Maginn's employment contract was an affiliate transaction for purposes of the PSWPA. Thus the PSWPA's grant of special voting rights to MCG with respect to affiliate transactions, and the Charter's substantively identical grant, do not apply to Jenzabar's payment of compensation to its officers.

Even MCG apparently recognizes that some increases in compensation are permitted under the Employment Agreements. Notwithstanding its claim that ***any*** compensation increase is a "transaction" that requires MCG's consent, MCG repeatedly (and without elaboration) complains that the Board approved compensation and bonuses "in excess of what was permitted" under the Employment Agreements. Complaint, pp. 2-3, ¶¶ 47, 56, 111, 121, 122. But the Employment Agreements by their own terms leave increases in compensation to the business judgment of the Board, in accordance with traditional standards of corporate governance, which give corporate boards wide latitude to set executive compensation. *See* 8 *Del. C.* § 122(5); *White v. Panic*, 783 A.2d 543, 553 n.35 (Del. 2001) (highlighting board's "broad discretion to set executive compensation"); *Brehm*, 746 A.2d at 262, n.56 (indicating that outer limit of broad discretion to set compensation requires unconscionable conduct, waste, or fraud). MCG points to no limit on "what was permitted," as none exists in the Employment Agreements.

Jenzabar has a Compensation Committee, comprised of Malekian, San Miguel, and Mills, whose function is to approve such increases and who have broad discretion in making such decisions. *Citigroup*, 964 A.2d at 138 ("directors of a Delaware corporation have the authority and broad discretion to make executive compensation decisions."). The Compensation Committee reviewed compensation as required by the Employment Agreements and made the decisions at issue after consulting with counsel. (Complaint, ¶¶ 41-46) MCG's claim that it had the right to approve any change in compensation finds no support in the governing documents, and the language of Section 5.12(h) is clear and straightforward enough to resist MCG's efforts to bend and twist it. Because the defendants' interpretation is the "***only*** reasonable construction as a matter of law," *VLIW Tech., LLC*, 840 A.2d at 615, MCG's claims in Counts One, Two, Eight, Nine, and Ten should be dismissed.

B. The Court Should Dismiss Count One And Two Against All Individual Defendants.

Even if MCG could show that Jenzabar violated MCG's rights under the PSWPA and Charter, which it did not, the individual defendants cannot be liable for Jenzabar's alleged breach of contract or breach of charter. "It is a general principle of contract law that only a party to a contract may be sued for breach of that contract." *Wallace v. Wood*, 752 A.2d 1175, 1180 (Del. Ch. 1999); *Gelfman v. Weeden Inv., L.P.*, 792 A.2d 977, 978 (Del. Ch. 2001) (finding that "it is generally true that non-parties to a contract may not bear contractual liabilities"). Under Delaware law, directors of a corporation are not parties to a contract simply because the corporation is a party to the contract. *Ruggiero v. FuturaGene, plc.*, 948 A.2d 1124, 1132 (Del. Ch. 2008). "Delaware law clearly holds that officers of a corporation are not liable on corporate contracts as long as they do not purport to bind themselves individually." *Wallace*, 752 A.2d at 1180 (citing *Brown v. Colonial Chevrolet Co.*, 249 A.2d 439, 441 (Del. Super. 1968)). Similarly, "it has been held that employees or directors of a contracting corporation cannot be held personally liable for inducing a breach of contract by their corporations when they act within their role." *Shearin v. E.F. Hutton Group, Inc.*, 652 A.2d 578, 590 (Del. Ch. 1994) (citations omitted).

In Count One, a direct claim, MCG attempts to impose liability on all of the individual defendants for Jenzabar's alleged breach of the PSWPA, a contract entered into "by and between" MCG and Jenzabar, to which none of the individual defendants are parties. The Complaint does not allege that the individual defendants entered into the PSWPA in their individual capacities, and the PWSPA does not bear their signatures (other than Maginn's on behalf of Jenzabar). For these reasons, the Court should dismiss Count One under Rule 12(b)(6) for failure to state a claim upon which relief can be granted.

Similarly, with respect to Count Two, MCG restates its breach of contract claim as a breach of charter claim against all defendants. However, under Delaware law, a certificate of incorporation "is a contract between the stockholders and the corporation." *Schultz v. Ginsburg*, 965 A.2d 661, 668 (Del. 2009). Even if Jenzabar violated MCG's protective rights under Jenzabar's charter, the individual defendants cannot be liable for "breach of charter," because they are not parties to that contract vis-à-vis the shareholders. *See Wallace*, 752 A.2d at 1180; *Shearin*, 652 A.2d at 590. That is to say, the issue in such a claim is not whether the *directors* have breached the corporate charter, but whether the corporation itself possessed the authority under its charter to engage in the conduct approved by the Board. *See In re Sunstates Corp. S'holder Litig.*, 2001 WL 432447, at *3 (Del. Ch. Apr. 18, 2001) ("[t]he wrong [alleged in a breach of charter claim] is not to the stockholders individually but to a provision of the corporate charter designed to protect [preferred shares]").

To the extent MCG is alleging in Count Two that Jenzabar's charter prohibited the Board from increasing officer compensation or awarding bonuses without first obtaining MCG's approval, its claim is solely against the corporation itself – not its individual directors. Indeed, because a corporation's authority to act is circumscribed by the corporate charter, "conduct in violation of the corporate charter is void as a matter of law." *In re Phila. Stock Exch., Inc.*, 945 A.2d 1123, 1134 (Del. 2008). Thus, allegations that a particular corporate act is invalid under the corporate charter, if proven, are properly remedied by voiding the allegedly wrongful transaction. *See Sunstates*, 2001 WL 432447, at *3 (acknowledging that proper remedy under breach of charter claim is to restore the *status quo ante*). Personal liability of directors is not at issue; Count Two should be dismissed against the individual defendants.

Counts One and Two thus only can at most state claims against the corporation itself and are legally untenable grounds for individual director or officer liability. Both counts must therefore be dismissed as against Barr, San Miguel, and Mills.

C. The Court Should Dismiss Counts Three And Four Against Barr Because Those Counts Allege Claims That Are Not Available Under Delaware Law.

With respect to Barr, the Court should dismiss Counts Three and Four for aiding and abetting breach of contract and breach of charter because those are not valid claims under Delaware law.[17] There are no cases expressly recognizing such a claim in

[17] Counts 3 and 4 are not brought against Jenzabar, Mills, or San Miguel.

Delaware,[18] and other jurisdictions do not recognize this cause of action. *See, e.g.*, *Montgomery v. Aetna Plywood, Inc.*, 231 F.3d 399, 413 n.6 (7th Cir. 2000) (no cause of action for aiding and abetting a breach of contract under Illinois law); *Dudrow v. Ernst & Young, LLP*, 1998 WL 800204, at *17 (Conn. Super. Nov. 4, 1998) (same, under Connecticut law); *Veilleux v. Fulmer*, 2000 WL 762228, at *5 (D. Me. Apr. 7, 2000) (same, under Maine law).

It is hardly surprising that there are no Delaware cases recognizing claims based upon an "aiding and abetting" theory; it is, rather, the necessary corollary of the familiar principle that "employees or directors of a contracting corporation cannot be held personally liable for inducing a breach of contract by their corporations when they act within their role." *Shearin*, 652 A.2d at 590 (citations omitted). Indeed, "Delaware law clearly holds that officers of a corporation are not liable on corporate contracts as long as they do not purport to bind themselves individually." *Wallace*, 752 A.2d at 1180 (citing *Brown*, 249 A.2d at 441). Because officers and directors cannot be held personally liable for a breach of contract (or charter) by the corporation, it follows *a fortiori* that Barr

[18] In *Fitzgerald v. Cantor*, the Court of Chancery held that "a legal claim does exist for aiding and abetting a breach of a contractually created fiduciary duty," but it analyzed the claim as one for aiding and abetting breach of fiduciary duty, reasoning that such a claim "is not dependent on the origin of the underlying fiduciary duty." 1999 WL 182573, at *1 (Del. Ch. Mar. 25, 1999); *see also Gotham P'rs, L.P. v. Hallwood Realty P'rs, L.P.*, 817 A.2d 160, 172 (Del. 2002) (declining to address defendants' argument that there is no cause of action under Delaware law for aiding and abetting breach of contract, and finding defendants liable for aiding and abetting breach of fiduciary duty). The contractual provisions alleged to have been breached here are ordinary covenants in a contract made by the corporation, not provisions creating fiduciary duties. A cause of action for aiding and abetting a breach of contract would differ fundamentally from the claim recognized in *Fitzgerald*, because corporate officers have fiduciary duties under Delaware law, but they do not have liability for corporate contracts, as discussed below.

cannot be liable for aiding and abetting breach of contract or charter by the corporation. *Weil v. Morgan Stanley DW Inc.*, 877 A.2d 1024, 1039 (Del. Ch. 2005) ("[H]aving failed to state an underlying claim for breach of fiduciary duty against Morgan Stanley itself, Weil's aiding and abetting claim against HarrisDirect necessarily fails."). Counts Three and Four should therefore be dismissed.

D. The Court Should Dismiss Count Five Because It Merely Restates Contract Claims.

As noted above, Count Five can be divided into: (i) Compensation Claims, (ii) a Repurchase Notice Claim, and (iii) Board Management Claims. The Compensation Claims challenge the approval of payments to the Management Directors in alleged violation of MCG's special protective rights under the PSWPA and Jenzabar's Charter. The Repurchase Notice Claim alleges an attempt to violate MCG's contract rights with respect to the March 31, 2009 repurchase notice. The Board Management Claims challenge the alleged mistreatment of MCG's designated director Malekian and the failure to keep the Board adequately informed.

1. The Compensation Claims and Repurchase Notice Claims merely restate the contract claims and should be dismissed.

In this action, MCG complains about alleged violations of its contract- and charter-based rights as a preferred stockholder and warrant holder of Jenzabar. The Court should dismiss the Compensation Claims and the Repurchase Notice Claims because they are based on an alleged violation of MCG's contractual rights as provided in the PSWPA and Jenzabar's Charter, and must be evaluated exclusively under contract law.

Delaware law is clear that MCG cannot restate its direct contract claims as fiduciary duty claims where the alleged rights underlying such claims are preferred-stockholder and warrant-holder rights governed exclusively by contract. Indeed, to the extent MCG relies on its rights as a warrant holder, such rights cannot give rise to fiduciary duty claims under any circumstances. *See, e.g., Feldman v. Cutaia*, 2006 WL 920420, at *6 n.37 (Del. Ch. Apr. 5, 2006) ("[D]irectors do not owe fiduciary duties to future stockholders"); *Cont'l Airlines Corp. v. Am. Gen. Corp.*, 575 A.2d 1160, 1168 (Del. 1990) (explaining that warrant holders are only protected by contractual rights). As explained in *In re Sunstates Corp. S'holder Litig.*,

> Section 151(a) of the Delaware General Corporation Law allows Delaware corporations to issue stock having such 'special rights, and qualifications, limitations or restrictions' relating thereto 'as shall be stated and expressed in the certificate of incorporation or of any amendment thereto ....' Thus, the law recognizes that the existence and extent of rights of preferred stock must be determined by reference to the certificate of incorporation, those rights being essentially contractual in nature.

788 A.2d 530, 533 (Del. Ch. 2001). It is also well settled in Delaware that:

> [w]ith respect to matters relating to preferences or limitations that distinguish preferred stock from common, the duty of the corporation and its directors is essentially contractual and the scope of the duty is appropriately defined by reference to the specific words evidencing that contract; where however the right asserted is not to a preference as against the common stock but rather a right shared equally with the common, the existence of such right and the scope of the correlative duty may be measured by equitable as well as legal standards.

Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 594 (Del. Ch. 1986).

"According to Delaware law where a dispute relate[s] to obligations expressly treated ... by contract[, it] will be governed by contract principles. If the fiduciary claims relate to obligations that are expressly treated by contract then [the Court of Chancery] will review those claims as breach of contract claims and any fiduciary claims will be dismissed." *Nemec v. Shrader*, 2009 WL 1204346, at *4 (Del. Ch. Apr. 30, 2009) (internal quotations and footnotes omitted). Accordingly, this Court has repeatedly "held that ... plaintiffs [may] not prosecute a claim for breach of fiduciary duty that essentially restate[s] their claim for breach of contract." *Blue Chip Capital Fund II Ltd. P'ship v. Tubergen*, 906 A.2d 827, 833 (Del. Ch. 2006) (discussing *Madison Realty Co. v. AG ISA, LLC*, 2001 WL 406268, at *6 (Del. Ch. Apr. 17, 2001) and various other cases supporting decision to dismiss fiduciary duty claims where contract claims are asserted based on identical facts). In *Tubergen*, for example, this Court concluded that "if the dispute relates to rights and obligations expressly provided by contract, the fiduciary duty claims [are] 'superfluous.'" *Id.*; *see also HB Korenvaes Inv., L.P. v. Marriott Corp.*, 1993 WL 205040, at *6-7 (Del. Ch. June 9, 1993) (dismissing fiduciary claims and holding that the preferred stockholders' claims must be evaluated under the contractual law governing the special rights and preferences of the preferred stockholders); *Gale v. Bershad*, 1998 WL 118022, at *5 (Del. Ch. Mar. 4, 1998) (allegation that redemption of preferred shares violated certificate provisions stated a claim in contract, but not for breach of fiduciary duty).

All of the Compensation Claims and Repurchase Notice Claims can be resolved by answering the following questions: (1) what are MCG's contractual rights as a preferred stockholder and warrant holder under the PSWPA and Jenzabar's charter; (2) have those rights been violated by Jenzabar; and (3) if those rights have been violated by Jenzabar, is there an available remedy? MCG's protective rights in Jenzabar's Charter and in the PSWPA are unique protections afforded to MCG in its capacity as a preferred stockholder and warrant holder, rather than rights shared with Jenzabar's stockholders generally. *See* Charter (Complaint Ex. 1), Article V, Section 1.A; PWSPA (Complaint Ex. 2), Section 5.12. As a result, the Court should dismiss MCG's contract-based Compensation Claims and Repurchase Notice Claims in Count Five (whether or not Counts One or Two are allowed to proceed against the individual defendants) on the grounds that MCG's rights, if any, must be evaluated under contract law.

2. <u>The Board Management Claims should be dismissed.</u>

The Court should also dismiss the Board Management Claims for several reasons. First, MCG's rights to representation on the Board are governed exclusively by contract and, for the reasons discussed above, they cannot serve as the basis for fiduciary duty claims. Second, even if the Board Management Claims were a proper subject for fiduciary duty claim, those claims may be brought only by Malekian, who is not a plaintiff here. Third, even if MCG had standing to pursue the Board Management Claims, Jenzabar's Section 102(b)(7) charter provision exculpates the directors from personal liability for breaches of the duty of care, which MCG apparently seeks as its relief in Count Five. Complaint, ¶ 109.

a. The Board Management Claims should be evaluated under contract law.

To the extent the Board Management Claims are based on an alleged violation of MCG's contract right to board representation, they must be evaluated exclusively under contract law and should therefore be dismissed on the same grounds as the Compensation Claims and the Repurchase Notice Claims.

b. MCG does not have standing to assert the Board Management Claims.

If the Board Management Claims stated a claim for breach of fiduciary duty, which they do not, only director Malekian, not MCG or Jenzabar, would have standing to complain of the alleged mismanagement. The Board Management Claims complain about alleged problems with the timeliness of circulation of minutes and agendas, as well as Barr's alleged refusal to make various corrections to the minutes requested by Malekian for which Barr was unable to find any evidence. These claims are specific to Malekian and may not be asserted by MCG. Indeed, while various provisions of the General Corporation Law expressly confer standing upon individual directors to challenge corporate actions or protect their rights as directors, *see*, *e.g.*, 8 *Del. C.* § 220(d); 8 *Del. C.* § 225; 8 *Del. C.* § 211(c), no such provisions grant standing to MCG, as a preferred shareholder, to complain that its director-designee has been mistreated. At most, the Board Management Claims suggest that Malekian might have standing to pursue a claim, but MCG enjoys no such right.

c. **The Board Management Claims should be dismissed because Jenzabar's Charter contains a Section 102(b)(7) Provision.**

The Board Management Claims do not allege bad faith conduct on the part of the Board; they allege, at most, breach of the duty of care by the directors of Jenzabar. However, Jenzabar's Charter at Article VIII contains a Section 102(b)(7) provision that exculpates its directors from personal liability for breaches of the duty of care. For this reason, the Board Management Claims should be dismissed against San Miguel and Mills.

3. **Count Five cannot be asserted against Barr, because he is not a director.**

The Compensation Claims, Repurchase Notice Claim and Board Management Claims underlying Count Five are particularly baseless as to defendant Barr, who is not even a Jenzabar director.

In Count Five, MCG alleges in essence that Jenzabar's board of directors took actions that violated contractual rights granted to MCG by the PSWPA and Jenzabar's charter. This claim is fatally flawed, as discussed previously, with respect to Jenzabar's directors. As applied to defendant Barr, however, this claim suffers the added flaw: Barr was not a director and not a decision-maker with respect to the challenged actions.

This Court's prior decisions, including *Citron v. E.I. DuPont de Nemours & Co.*, 584 A.2d 490 (Del. Ch. 1990), make it undeniably clear that an officer or director who did not participate in a challenged decision cannot be liable for breach of fiduciary duty. In *Citron*, shareholders of Remington Arms Company ("Remington") filed a class action against Remington's directors, alleging breach of the duty of care and other torts for their roles in approving Remington's merger into E.I. DuPont de Nemours & Co. ("DuPont"). DuPont was a majority owner of Remington's stock. The Remington directors who were DuPont director-designees did not vote on the merger, but plaintiffs alleged that one such director, Heckert, had breached his duty of loyalty to Remington's shareholders by playing an active role in the merger on DuPont's behalf, which included breaking a logjam in the negotiations. 584 A.2d at 496, 488. The Court held that plaintiffs did not have even an "arguable claim" against the DuPont director-designees, including Heckert. *Id.* at 499. As the Court noted, "even if it were assumed *arguendo* that the merger terms were unfair, Mr. Heckert is not one of the persons whose decision making actions caused that result to come about." *Id.* at 499, n.12.

Heckert's alleged involvement in the *Citron* case far exceed what Barr is alleged to have done here. Barr is not a director of Jenzabar, did not make the decisions that MCG currently challenges, and cannot be the cause of the harm of which MCG complains. Accordingly, MCG does not have even an "arguable claim" that Barr can be liable, and Count Five (and the other counts against him) should be dismissed.

E. The Corporation, Independent Directors, And Barr Cannot Be Liable For Rescission Because They Did Not Receive Any Challenged Benefit.

To the extent Count Eight, which seeks rescission of the disputed compensation to Maginn and Chai, is considered direct rather than derivative because it is based on the alleged violation of "MCG's special voting rights," (Complaint, ¶ 123), the Court should dismiss this claim for the reasons stated above, and because it simply reasserts MCG's breach of contract claim under the guise of a particular type of relief that it seeks for the alleged breach. The grounds for dismissal would thus be the same as those asserted for dismissal of the Compensation Claims of Count Five.

Moreover, in the event that Count Eight is not dismissed in its entirety, it should be dismissed against Jenzabar, San Miguel, Mills, and Barr because they did not receive any of the payments that MCG seeks to have rescinded.

F. The Court Should Dismiss Counts Nine, Ten, And Eleven Against The Individual Defendants.

In the alternative, if the Court does not dismiss Counts Nine, Ten, and Eleven for the grounds stated above, it should dismiss those counts against all of the individual defendants. Counts Nine, Ten, and Eleven ask the Court to interpret contracts entered into between MCG and Jenzabar that are not binding on any of the individual defendants in their personal capacities.

Similarly, to the extent Count Twelve, a derivative claim, is not dismissed under Rule 23.1, it should be dismissed against Jenzabar, San Miguel, Mills, Barr and Chai, because they did not receive the payment sought to be rescinded and MCG does not seek any other form of relief with respect to its claim for “Rescission of Unauthorized Compensation.”

CONCLUSION

WHEREFORE, Jenzabar, San Miguel, Mills, and Barr respectfully request that the Court grant their motion to dismiss all of the claims asserted against them.

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Dated: July 2, 2009

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing were caused to be served electronically upon the following counsel of record, this 2nd day of July, 2009:

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