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IN THE COURT OF CHANCERY OF 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, JENZABAR, INC. Defendants, and JENZABAR, INC. Nominal Defendant.	C.A. No. 4521-CC

PLAINTIFF'S OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS

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INTRODUCTION

Rather than address the nearly $8.1 million in unauthorized retroactive compensation that senior management (CEO Robert A. Maginn, Jr. and COO Ling Chai) seek to siphon from Jenzabar, Inc. ("Jenzabar" or "the Company") in violation of MCG Capital Corp.'s ("MCG") special voting rights, Defendants instead seek to blame MCG and complain that MCG brings this action because it wants to be paid an inflated price for its investment and "extract benefits to which it is not entitled." *See* Defendants' Opening Br., pp. 1, 3, 4 ("Br. p. __").[1] Nor do they address the false pretenses used by senior management to obtain a portion of their unauthorized retroactive bonuses. Apparently they operate from the position that, when responding to a complaint, if the facts are inconvenient, then ignore them or simply try to recast them to your liking. And contrary to Defendants' arguments, MCG is not complaining about a "mere" 2.5 percent per year raise for Maginn and Chai. Far from a "mere" 2.5 percent per year raise (which is still far better than what other senior executives are receiving in today's economic environment), the Defendants are actually seeking a nearly 100% retroactive raise for a five-year period when most companies are slashing, not heaping on, executive compensation.

But this is not a case about the comparative value of senior executive compensation—this is a case about bargained-for special voting and repurchase notice rights, which MCG is "entitled" to enforce, and which may not be ignored. The current Board, and senior management, have violated the Company's Fifth Amended and Restated Certificate of Incorporation ("Charter") and the parties' Preferred Stock and Warrant Purchase Agreement

[1] Although Defendants give lip service to the now familiar rule that they are to treat the well-pleaded allegations in the Complaint as true, *see* Br. p. 5 n.3; *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006), they nonetheless argue "facts" nowhere found in the Complaint or in any of the documents attached or referenced thereto. For example, Defendants' brief claims that MCG has been pressing Jenzabar to buy it out at "an inflated price," which is not only contrary to the facts, but is certainly alleged nowhere in MCG's Complaint.

("PSWPA")—contracts the parties had honored from MCG's June 2004 investment until Maginn was able to convince his handpicked Board to violate the explicit terms of the Charter and the PSWPA.

Pursuant to the PSWPA, § 5.12(h), and the Company's Charter, Article V, § A.1(b), Jenzabar and the Defendants may not increase senior management's compensation without MCG's consent. Nor may the Defendants deprive MCG of its special voting rights through an untimely and deficient repurchase notice that fails to comply with the Company's Charter. (Tellingly, Jenzabar has not sought to dismiss MCG's claim seeking a declaration that the Repurchase Notice is invalid.) Yet, as alleged in the Complaint, Defendants have done both in a blatant attempt to strip MCG and the other shareholders of the Company of the only effective brake on the Defendants' use of the Company for their own benefit, and have attempted to force MCG to sell its interest in the Company at an artificially deflated value (by reducing the value of the Company by paying excessive compensation that would otherwise be an asset of the Company that could be used to grow the business).

MCG brings this case on its own behalf and on behalf of the Company's other shareholders, who will be similarly harmed if the Defendants are permitted to continue to use Jenzabar for their own gain, all the while reducing the value of the Company. As set forth herein, the Motions to Dismiss should be denied for the following reasons. As to the direct counts, the plain language of the operative documents unambiguously provides MCG with special voting rights with respect to any increase in executive compensation, and therefore the motion must be denied as to Counts 1, 2, 9 and 10. In addition, because the Individual Defendants are necessary parties to the relief requested, the motion must be denied as to them for Counts 1, 2, 9 and 10 (as well as Counts 5, 7, 8, 11 and 12). Because the allegations are

sufficient to support a claim that the Individual Defendants Maginn, Chai and Jameson Barr, the Company's Vice President and General Counsel, induced a breach of the PSWPA and the Charter, the motion must be denied as to Counts 3 and 4.

As to the derivative counts, demand is excused because Maginn and Chai were clearly interested in the compensation decisions at issue and San Miguel and Mills demonstrated a lack of independence and are not entitled to the business judgment rule, both because the entire fairness standard should apply and because their conduct exposed them to a substantial likelihood of liability. The motion must be denied as to Count 5, which asserts both direct and derivative claims, because the Defendants breached their obligations to comply with the Charter and the Company's contractual obligations and breached their fiduciary duties with respect to the compensation process and decision making and in causing Jenzabar to breach its contractual obligation with respect to the Repurchase Notice. The motion must also be denied as to Count 6 because Maginn and Chai were unjustly enriched and their Employment Agreements do not preclude recovery. Finally, the motion must be denied as to Counts 7, 8 and 12 because courts routinely permit secondary claims such as accounting and rescission to go forward when, as here, the underlying claims are well pled.

FACTUAL BACKGROUND

I. MCG'S INVESTMENT IN JENZABAR

Plaintiff MCG is a publicly traded business development company that provides capital (equity and debt) and advisory services to middle-market companies with annual revenue of $20 million to $200 million. Compl. ¶ 1. On June 30, 2004, MCG invested $5,000,000 in Jenzabar, a software and services company, in exchange for 5,000 shares of Senior Preferred Stock, 109,800 shares of Subordinated Preferred Stock, and warrants to purchase 5,879,150 shares of Common Stock with contractual, anti-dilution provisions. *Id.* ¶¶ 2, 11. Contemporaneous with

MCG's investment, MCG and Jenzabar entered into the PSWPA, and Jenzabar adopted the Charter and its Fourth Amended and Restated Stockholders Agreement ("Stockholders Agreement"). MCG currently is the only holder of Jenzabar Senior Preferred Stock and holds a majority of the outstanding warrants. *Id.* ¶¶ 12-13. Apart from the fact that the Charter governs the legal power of the corporation to act, the Charter was also made a legal, valid and binding obligation of Jenzabar by section 3.3 of the PSWPA. *Id.* ¶ 14. It is undisputed that these documents govern the relationship between the parties. *See* Br. p. 5.

A. MCG's Special Consent And Voting Rights Govern Transactions Or Arrangements With Jenzabar's Officers And Directors

Both the PSWPA and Jenzabar's Charter afford MCG special consent and voting rights ("special voting rights"), which prohibit Jenzabar from taking certain actions without MCG's written consent or affirmative vote. Compl. ¶¶ 15-16; *see* Br. p. 7. These actions include, as Defendants contend, *see* Br. p. 7, certain significant corporate transactions, including mergers and sales, unless specified conditions are satisfied, and certain changes to the size of the Board of Directors. Compl. ¶¶ 15-16. More importantly, for present purposes, those special voting rights, as set forth in Section 5.12(h) of the PSWPA, also provide, in pertinent part, that:

> **[T]he Company and its subsidiaries shall not, without the written consent or affirmative vote of the holders of at least a majority of the then outstanding Warrants or Warrant Shares,** take any action or series of actions that would . . . :
>
> (h) **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 or any Subsidiary thereof**; provided that this Section 5.12(h) shall not apply to the Company's business arrangements with New Media Japan or Bain & Co. existing as of March 31, 2004 and the MCG Loan Agreement (emphasis added).

Similarly, Article V, § A.1(b) of the Charter provides, in pertinent part, that:

> **So long as any shares of Senior Preferred Stock remain outstanding, the Corporation and its Subsidiaries shall not, without the written**

> **consent or affirmative vote of at least a majority of the then outstanding shares of Senior Preferred Stock**, take any action or series of actions that would . . .
>
> (x) **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 Corporation or any subsidiary thereof**; provided that this Section A.1(b)(x) shall not apply to the Corporation's business arrangements with New Media Japan or Bain & Co. existing as of March 31, 2004 and the Credit Facility Agreement, dated as of June 30, 2004 . . . . (emphasis added).

The PSWPA includes numerous defined terms, which are indicated consistently throughout the document by initial capital letters. Compl. at Ex. 2, pp. 1-11. For example, the definition of "Affiliate" includes any director, executive officer, or general partner of the Company. It also includes definitions of "Contract" and "Material Contract."

B. The Repurchase Provisions And The Required Notice For Any Repurchase

Jenzabar's Charter permits the Company to repurchase MCG's Senior Preferred Stock under certain conditions and after providing MCG sufficient notice through one of three authorized methods. *Id.* ¶¶ 17, 75. MCG also has the right to put its warrants to purchase common stock in Jenzabar at any time after the occurrence of certain "Warrant Put Exercise Events," one of which is Jenzabar's repurchase of its Senior Preferred Stock, until June 30, 2016. *Id.* ¶ 18. Pursuant to Section 5.11(g) of the PSWPA, MCG's voting rights under Section 5.12 would lapse if Jenzabar repurchased MCG's Senior Preferred Stock before April 30, 2009, and MCG did not give notice that it intended to put its warrants. *Id.* ¶ 19. To trigger the repurchase, Jenzabar must provide MCG with at least thirty days notice along with certain substantive information in the Notice. *See infra* p. 13. If, on the other hand, Jenzabar repurchases MCG's Senior Preferred Stock on or after April 30, 2009, MCG would retain its special voting rights.

C. Jenzabar's Board Of Directors

Jenzabar's Board of Directors currently consists of Defendants Maginn and Chai as Founding Director Designees, Defendants Joseph San Miguel and Daniel Quinn Mills as the purported Independent Directors, and Peter Malekian as the Preferred Stockholder Designee. *Id.* ¶ 23. The Compensation Committee is comprised of Defendants San Miguel and Mills, and Malekian. *Id.* ¶ 24. Defendants San Miguel and Mills are Maginn's handpicked advocates on the Board, having been his professors at Harvard Business School. *Id.* ¶¶ 32-33; *see also* Br. p. 9. They have served on Jenzabar's Board of Directors since 2008. Compl. ¶ 34. Although MCG initially questioned their qualifications and independence, it consented to their appointment as "Independent Directors" based, in part, on their representations that they would remain independent despite their prior relationship with Defendant Maginn. *Id.* Defendants San Miguel and Mills are each paid $100,000 per year to serve as purported Independent Directors, consisting of $50,000 for serving on the Board, $25,000 for serving on the Audit Committee, and $25,000 for serving on the Compensation Committee. *Id.* ¶ 35; Br. p. 10.[2]

In addition to controlling the conduct of the Board, as reflected in their control over the compensation decisions discussed below, *see infra* pp. 7-10, Maginn and Chai also effectively maintain voting control over the Company. First, each has considerable equity holdings in the Company, including 7,727,472 shares of common stock. Compl. ¶ 30; Maginn and Chai Br., pp. 5-7 nn.5-6 ("Maginn Br. p. __"). Moreover, as part of the transaction whereby MCG acquired, among other interests, 5,879,150 shares of Jenzabar common stock, *id.* ¶ 11, Maginn

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[2] The average salary for full professors of business in 2008 was $102,965. *See* Audrey Williams June, *Law, Business, and Engineering Professors Are Found To Be Highest-Paid*, CHRON. HIGHER ED. (Mar. 14, 2008), *available at* http://chronicle.com/article/Law-BusinessEngineering/1745. Accordingly, $100,000 would likely have been material to Defendants San Miguel and Mills.

used Jenzabar assets to acquire an irrevocable proxy giving him voting control over 10,206,858 shares of Jenzabar stock held by Pegasus Capital Partners, II, L.P.[3]

II. DEFENDANTS' CAMPAIGN TO ENRICH SENIOR MANAGEMENT IN VIOLATION OF MCG'S BARGAINED-FOR SPECIAL VOTING RIGHTS

A. Maginn And Chai's Compensation Packages

From the very beginning of MCG's relationship with Jenzabar, Defendants Maginn and Chai have sought to increase their compensation packages in excess of what is expressly (and fairly) provided for by the terms of their Employment Agreements.[4]

Jenzabar has paid Defendants Maginn and Chai base salaries of $400,000 and $340,000 per year, respectively, since June 30, 2004. Compl. ¶ 27. Pursuant to their Employment Agreements, they have received a total of $3,774,756 and $972,235, respectively, in authorized bonuses over the same period. *Id.* ¶¶ 27-28. Both Defendants also hold considerable equity stakes in Jenzabar, including 4,033,448 options and 7,727,472 shares of common stock, some of

[3] Like the Employment Agreements placed before the Court by Defendants, Br. p. 6, the proxy was executed contemporaneously with the PSWPA as part of the closing process for MCG's investment in Jenzabar. Specifically, as a condition to execution of the PSWPA, and the related Credit Facility, Jenzabar and Pegasus executed a "Second Exchange Agreement" in which Pegasus exchanged certain securities it held in Jenzabar for cash and different securities and simultaneously granted Defendant Maginn a voting proxy over those new securities. *See* Second Exchange Agreement at p. 1, filed herewith as Exhibit A to the Transmittal Affidavit of Emily V. Burton ("Burton Aff."). The proxy at issue is found at Exhibit 8 of the Second Exchange Agreement. Upon information and belief, Maginn and Chai purportedly hold more than a majority voting control over the Company. Exhibit B to the Burton Aff. is a complete set of the Exhibits to the PSWPA. Exhibit C is a complete set of the Schedules to the PSWPA.

[4] Contrary to Defendants' suggestions, *see* Br. p. 6, n.5, MCG has no quarrel with the Court's consideration of the Employment Agreements on this motion to dismiss. Although the form of the Employment Agreements was known at the time of MCG's investment, *see infra* note 19; Br. p. 6 n.5, the agreements themselves are irrelevant to the interpretation of the PSWPA and the Charter for the reasons discussed below. *See infra* p. 24.

which the Company has provided as additional compensation. *Id.* ¶ 30.[5] Maginn alone has averaged approximately $1.14 million per year over that five-year period. *See* Maginn Br. p. 5.

Notwithstanding their already generous compensation packages during a time when executive compensation has come under increasing scrutiny, Defendants Maginn and Chai have led a relentless five-year campaign to extort more than $8.1 million for themselves from Jenzabar's Board of Directors in excess of the compensation negotiated and provided for by the terms of their Employment Agreements. Compl. ¶ 25. [6]

For example, at nearly every Board meeting since MCG's investment in Jenzabar, Maginn has sought Board approval for increases in salary, options, and/or bonuses for him and Chai beyond those in their Employment Agreements. *Id.* ¶ 26. Once, Defendant Maginn even brought his and his wife's personal lawyer to a Compensation Committee Meeting, without notice to the Committee, to lobby for increased compensation. *Id.* Notwithstanding Maginn's campaign, until recently, the Company had honored MCG's special voting rights.

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[5] Although Defendants attempt to shift the burden of proof to MCG to show that Defendants' compensation was unreasonable, Defendants misread the crux of the Complaint, which alleges that Defendants' salary increases and bonuses in excess of their Employment Agreements were unlawfully approved by the Compensation Committee and/or Board in violation of MCG's special voting rights and Delaware law. *See infra* Argument § VII. It is also clear, however, that Defendants Maginn and Chai received total compensation packages well in excess of their peers at public companies. Indeed, while Maginn and Chai were increasing their compensation packages in 2008, total compensation of CEOs for public companies in the Boston area in 2008 was, on average, "far less because of a global economic downturn that roiled revenue, profit and shareholder value." Tim McLaughlin, *Payout Paradise: Sullivan Is Boston's $57M Man but Comp for Most CEOs Slides*, BOSTON BUS. J., July 24-30, 2009, at 24. On average, total compensation for CEOs in the Boston area fell 39 percent in 2008. *Id.* In contrast, Defendants Maginn and Chai sought, and purportedly received, substantial raises.

[6] Executive compensation practices have received increased scrutiny since the beginning of the global financial crisis. The Obama Administration recently proposed legislation that would grant the Securities and Exchange Commission ("SEC") additional rulemaking authority with respect to executive compensation matters for public companies. The Administration's "say-on-pay" bill would direct the SEC to adopt regulations requiring public companies to grant shareholders the right (although nonbinding) to vote on annual compensation (including salary, bonuses, stock and option awards) for the company's top five executives. *See* "Statement by Treasury Secretary Tim Geithner on Compensation," June 10, 2009, *available at* http://www.ustreas.gov/press/releases/tg163.htm. MCG had already bargained for a similar right (although binding) through its special voting rights.

More recently, and after Defendants San Miguel and Mills were elected to the Jenzabar Board, at a Compensation Committee meeting in December 2008, Maginn demanded a 12.5 percent raise for himself and a 12 percent raise for Defendant Chai. *Id.* ¶ 44. At the same meeting, and after the Committee and/or Board had purportedly voted to approve these raises over Malekian's objection, Maginn demanded an additional $794,000 in excess "retroactive" bonuses for himself and Chai, over and above the bonuses that were permitted by their Employment Agreements. *Id.* ¶ 47. These additional bonuses were purportedly approved without MCG's consent, even though all transactions with executive officers are subject to MCG's special consent rights. *Id.*

And just five days later, Defendants Maginn and Barr informed the Board that they had "discovered" that an additional $750,000 bonus allegedly owed to Maginn in 2002 had not yet been paid. *Id.* ¶¶ 49-50. Over the objection of Malekian, Defendants San Miguel and Mills hastily voted to pay the additional $750,000 bonus without undertaking any independent investigation of the facts, not even inquiring as to why the supposedly legitimate bonus had not been paid. *Id.* ¶ 51.[7] These additional retroactive payments bring Maginn's average annual compensation to more than $1.4 million per year over the five-year period.[8]

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[7] Only two of the five directors present at the meeting voted for the bonus. Compl. ¶ 143. The purported approval of the bonus was therefore invalid as a matter of law. *See infra* Argument § VII. Moreover, Defendants Maginn and Barr only disclosed the true facts about the bonus *after* Defendants San Miguel and Mills voted to "approve" it: namely, that the necessary precondition of a third party investor's consent had never occurred. Compl. ¶¶ 52-53. Despite their newfound knowledge concerning this additional bonus, neither San Miguel nor Mills has done anything to attempt to rescind the invalid and deceptively obtained payment. *Id.* ¶ 55.

[8] Comparing Maginn's now $1.4 million annual compensation to that of other CEOs (for public companies) in the Boston area underscores just how generous his compensation has been. For example, State Street Bank CEO Ronald Logue received $1.12 million in total compensation in 2008, while State Street's revenues were $10.6 billion—more than *150 times* Jenzabar's revenue. McLaughlin, *supra* note 5, at 24. Constant Contact CEO Gail Goodman received $577,435 in total compensation in 2008 (approximately half Maginn's annual compensation), while Constant Contact's revenues were $87 million—greater than Jenzabar's. *Id.*

Although they had already received increases to their base salary, retroactive bonuses of $794,000, and an additional $750,000 bonus for Maginn allegedly dating back to 2002, Maginn and Chai demanded further retroactive bonuses from the Compensation Committee and/or Board. On December 28, 2008, Maginn requested an *additional* retroactive bonus of $3.5 million for himself plus an additional $3.1 million for Defendant Chai, for the five-year period of 2003 to 2008. *Id.* ¶ 56. Although the Defendants barely acknowledge this demand in their opposition briefs, the demands for a combined $6.6 million in additional retroactive bonuses would bring Maginn's salary to an average of $2.1 million per year for the five-year period. Thus, his total compensation would nearly double for that period.

B. Defendants' Efforts To Deprive MCG Of Its Special Consent And Voting Rights

Throughout their campaign to siphon money from the Company, Defendants Maginn and Chai have sought to deprive MCG of its special voting rights by repeatedly trying to marginalize the one person standing in their way—MCG's Director Designee Peter Malekian. At the beginning of the Compensation Committee meeting on December 18, 2008, at which the Committee purportedly approved base salary increases for Maginn and Chai, Defendant Barr introduced outside counsel for Jenzabar, and recommended that the Compensation Committee receive Jenzabar's attorney's advice on various compensation matters. *Id.* ¶ 41. Malekian

objected on the grounds that the same attorney should not represent both the Company and the Compensation Committee. *Id.* ¶ 42.[9]

Malekian reminded the Committee that any increase in salary required MCG's consent, pursuant to the PSWPA and Jenzabar's Charter, and he suggested that the Committee consult its own counsel on the matter. *Id.* ¶ 45. Defendants Barr, San Miguel and Mills decided to disregard his advice and objection. *Id.* ¶ 46. The Committee then voted to approve base salary increases for Maginn and Chai without seeking MCG's consent, in violation of MCG's special consent and voting rights. *Id.* At no time did they seek the advice of independent counsel or an independent compensation consultant.

III. DEFENDANTS' DELIBERATE ATTEMPT TO KEEP THE BOARD IN THE DARK

Defendants Maginn, Chai and Barr, in order to benefit themselves, have repeatedly and deliberately failed to keep the non-management members of the Board of Directors informed and involved. *Id.* ¶ 60. For example, Defendant Barr, who serves as the secretary to the Board, has routinely circulated meeting materials to Board members without sufficient time for review. *Id.* ¶ 61. Despite Malekian's repeated complaints to Barr, Defendant Barr has continued to email Board meeting agendas within hours of the scheduled meetings, and in at least one case, just 13 minutes before the meeting was set to begin. *Id.* ¶¶ 61-62.

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[9] Malekian's concerns regarding the need for independence of the Compensation Committee come at a time when financial regulators are focused on promoting transparency and accountability in the process of setting compensation. On June 10, 2009, Treasury Secretary Timothy Geithner announced proposed legislation to direct the SEC to promulgate rules requiring public companies to meet new standards to promote the independence of compensation committees. *See* "Statement by Treasury Secretary Tim Geithner on Compensation," June 10, 2009, *available at* http://www.ustreas.gov/press/releases/tg163.htm. Among the new regulations, compensation committees would be required to have the authority to engage independent counsel, consultants and other advisors.

In addition to circulating meeting agendas late, Barr also routinely distributes Board meeting minutes several months after the meetings have occurred, making it impossible for Board members to assess their accuracy or completeness. *Id.* ¶ 63. For example, Barr circulated minutes for four Board meetings on April 29, 2008, including minutes for the June 2007 Board meeting, which had occurred ten months earlier. *Id.* ¶ 64. When Malekian has sought to correct meeting minutes to reflect more accurately the discussion that occurred, Barr has resisted these efforts. *Id.* ¶ 63. For example, on May 2, 2008, Malekian proposed corrections to the minutes circulated on April 29, 2008. *Id.* ¶ 65. Barr did not respond to Malekian's suggestions until December 12, 2008—seven months later. *Id.* ¶ 66. Barr informed Malekian that he would not incorporate Malekian's suggestions because he purportedly could not find evidence for Malekian's corrections to the minutes. *Id.*

The withholding of Board meeting minutes continues to harm the Board members' ability to act in the best interests of the Company. For example, Malekian did not learn of the true facts relating to the $750,000 retroactive bonus requested by Defendant Maginn until mid-April 2009, when Defendant Barr finally disclosed the circumstances surrounding the bonus. Although the Defendants argue that MCG delayed filing this litigation, Maginn Br. p. 2 n.1, any purported delay is explained by the Defendants' deliberate attempt to keep Board members in the dark as to compensation matters (and their belated attempt to deprive MCG of its special voting rights through an invalid Repurchase Notice in late March, 2009, *see infra* pp. 13-14).

In addition to refusing to circulate Board meeting agendas and minutes in a timely manner, Defendants Maginn, Chai and Barr have also improperly attempted to exclude Malekian from deliberations when in their personal interests. *Id.* ¶ 68. For example, in an agenda for the

December 18, 2008 Board meeting—circulated at 4:47 p.m. the afternoon before the meeting—Barr announced Jenzabar's intent to hold an "executive session" excluding Malekian. *Id.* ¶ 69.[10]

IV. DEFENDANTS' INEFFECTIVE ATTEMPT TO DEPRIVE MCG OF SPECIAL VOTING RIGHTS BY REPURCHASING MCG'S SENIOR PREFERRED STOCK

Having attempted to marginalize MCG's Director Designee by excluding him from meetings, disregarding his corrections to minutes, and circulating Board materials without adequate review time, Defendants now attempt to formally strip MCG of its special voting rights. *Id.* ¶ 70. On March 31, 2009, Jenzabar emailed MCG a purported "Notice to Repurchase" (the "Repurchase Notice"). *Id.* ¶ 71.[11] The Repurchase Notice stated that Jenzabar intended to repurchase MCG's Senior Preferred Stock on or before April 29, 2009. *Id.* ¶¶ 71, 73.[12]

Jenzabar's Charter, however, requires that notice be delivered at least **30 days prior** to the scheduled repurchase date. *Id.* ¶ 75. Pursuant to the Charter, notice is deemed provided and received: (i) five days after deposit with the U.S. Postal Service if sent by registered or certified mail, postage prepaid; (ii) one business day after deposit with a nationally recognized overnight courier service; or (iii) on the day it is sent by telecopy, with receipt confirmed by telephone. *Id.* Not only does the Charter not authorize notice by email,[13] but Defendant Barr's March 31, 2009 email also could not qualify as notice 30 days prior to April 29, 2009, given that March 31 is just

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[10] Malekian was allowed to participate in the Board meeting only after he objected and promised to recuse himself if necessary.

[11] Although they acknowledge that it is "not pertinent to the Motion to Dismiss," Defendants Maginn and Chai claim that the Repurchase Notice was sent on March 30, 2009. Maginn Br. p. 8 n.7. This unsupported "fact" is belied by the date on the Repurchase Notice—March 31, 2009.

[12] Once again, Defendants assert as "fact" that MCG's Senior Preferred Stock was repurchased on April 29, 2009 (albeit correctly noting that MCG disputes the effectiveness of the "repurchase"). Br. pp. 6 n.4, 8 n.7. However, the Complaint, which was dated April 21, 2009, neither could nor does contain this allegation.

[13] Because Jenzabar's Repurchase Notice was not received pursuant to any of the methods authorized by the Charter, it was not provided and received on March 31, 2009. *Id.* ¶ 36.

29 days before April 29. *Id.* ¶ 77. Tellingly, Jenzabar has not moved to dismiss the Count seeking a declaration that the Repurchase Notice was invalid. *See id.*, Count 11.[14]

In addition to Jenzabar's failure to satisfy the threshold requirement that a Notice of Repurchase be timely delivered using one of the methods authorized in its Charter, it also neglected to provide the information in the Repurchase Notice required by the Charter, including the scheduled Repurchase Date and the applicable Repurchase Price. *Id.* ¶ 78. To the contrary, the Repurchase Notice made clear that the Repurchase Date was conditional on the approval of Jenzabar's Board and the Company's lender. *Id.* And rather than provide a Repurchase Price, the Repurchase Notice merely stated a range of prices that might be offered. *Id.*

When read together with the Defendants' efforts to extort excess compensation from the Company, keep Board members in the dark, and sideline MCG's Director Designee, Jenzabar's purported repurchase of MCG's Senior Preferred Stock is evidence of a larger campaign to deprive MCG of its bargained-for protections and investment in Jenzabar, including by repurchasing MCG's Warrants at a discount (by reducing the value of the Company by paying excessive compensation that would otherwise be an asset of the Company that could be used to grow the business and be reflected on the Company's balance sheet).

ARGUMENT

I. LEGAL STANDARD

In deciding a motion to dismiss, the Court must draw all reasonable inferences in the Plaintiff's favor. *See, e.g.*, *Thornton v. Bernard Techs., Inc.*, 2009 WL 426179, at *2 (Del. Ch.

[14] The Individual Defendants have moved to dismiss Count 11 solely on the basis that they were not parties to the relevant contracts. *See* Br. p. 44.

Feb. 20, 2009).[15] The Court may refer to documents integral to the Plaintiff's claims, but contrary to Defendants' arguments, in this case, those documents fully support MCG's claims. Any contractual ambiguity must be resolved in MCG's favor on a motion to dismiss. *See, e.g.*, *Vanderbilt Income & Growth Assocs., L.L.C. v. Arvida/JMB Managers*, 691 A.2d 609, 613 (Del. 1996) ("Dismissal is proper only if the defendants' interpretation is the *only* reasonable construction as a matter of law."); *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35, 38 (Del. 1996) ("[T]he court must give the pleader 'the benefit of all reasonable inferences that can be drawn from its pleading.'" (quoting *In re USACafes, L.P. Litig.*, 600 A.2d 43, 47 (Del. Ch. 1991))).

II. DEFENDANTS' STRAINED INTERPRETATION OF THE GOVERNING DOCUMENTS IS UNAVAILING

A. The Text Of The Provisions

Defendants labor mightily to narrow the scope of section 5.12(h) of the PSWPA and Article V, § A.1(b)(x) of the Charter. But these provisions are clear, unambiguous, and effectively unqualified in the right they give MCG to block the excessive compensation at issue.

In pertinent part, Section 5.12(h) of the PSWPA and Article V, § A.1(b)(x) of the Charter require MCG's written consent or affirmative vote before Jenzabar may "**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 or any Subsidiary thereof** . . . ." (emphasis added).

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[15] Unreported decisions cited in this Memorandum are collected in the Compendium of Unreported Cases Cited in Plaintiff MCG Capital Corporation's Opposition to Defendants' Motion to Dismiss, filed herewith.

Notwithstanding the repetition of words such as "any," "transaction," or "arrangement" with "a shareholder, officer, or director," Defendants seek to limit MCG's right to approval of "new" contracts with "affiliates" other than a shareholder, officer or director of the Company. *See* Br. pp. 30-31. Each of their various arguments fails, however, as set forth below.

B. The Plain Language Of The Charter And PSWPA Unambiguously Provides MCG Consent Rights With Respect To Increased Compensation For Officers

1. *The Ordinary Meaning Of The Provisions Supports MCG*

The Court should be guided in its interpretation of both the Charter and the PSWPA by general principles of contract interpretation, given that a Company's charter not only sets forth the powers of the corporation, but is also a contract among a corporation and its shareholders, as well as a contract among the shareholders. *In re Explorer Pipeline Co.*, 781 A.2d 705, 713-14 (Del. Ch. 2001). As to both documents, the Court must first review the language to determine if the intent of the parties can be ascertained from the express words chosen by the parties or whether the terms are ambiguous. *See Telcom-SNI Investors, L.L.C. v. Sorrento Networks, Inc.*, 2001 WL 1117505, at *5 (Del. Ch. Sept. 7, 2001) (construing charter's protective provisions for holders of senior preferred stock according to general principles of contract interpretation, and concluding that plaintiffs had reasonable probability of success that defendant company could not issue additional shares of preferred stock without approval of preferred stockholders).

Here, the words chosen by the parties make plain that the parties' intent was to assure MCG that Jenzabar and its insiders would not engage in transactions or arrangements that could impair the value of the Company without MCG's approval. *See id.* at *6 (provision requiring approval of preferred stockholders prior to issuance of other equity security was "clearly" designed to assure such holders that their interests would not be diluted without their approval). The analysis begins with the plain meaning of the words chosen by the parties. *Id.* at *5.

"It is well settled that if the terms of a contract are clear, the court must accord the language its ordinary meaning." *ThoughtWorks, Inc. v. SV Inv. Partners, LLC*, 902 A.2d 745, 752 (Del. Ch. 2006) (applying contract principles to interpretation of charter provision governing preferred stockholders' rights). Where the contract terms are unambiguous, there is no need to consider extrinsic evidence. *See Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997).

Delaware courts frequently look to the dictionary definition of a contract term to discern the term's ordinary meaning. *See, e.g.*, *Lorillard Tobacco Co. v. Am. Legacy Found.*, 903 A.2d 728, 740 (Del. 2006). Here, the ordinary meaning of the relevant provisions unambiguously entitles MCG to consent to changes in the terms of Maginn's and Chai's compensation.

The ordinary meaning of "transaction" or "arrangement" includes the payment of compensation to a corporate officer or director, whether by formal contract or agreement or some other method. A "transaction" is "an act, process, or instance of transacting," and to "transact" is "to carry on business." MERRIAM WEBSTER'S COLLEGIATE DICTIONARY 1252 (10th ed. 1996) ("WEBSTER'S at __"); *see also* BLACK'S LAW DICTIONARY 1341 (5th ed. 1979) ("transaction" is a "broader term" than contract). An "arrangement" is "an informal agreement or settlement," and to "arrange" is "to bring about an agreement or understanding." WEBSTER'S at 64; *see also* BLACK'S LAW DICTIONARY 74 (8th ed. 2004) ("agreement" is "an expression of greater breadth" than "contract," and agreements are a subset of the even broader term "arrangement"). These definitions do not in any way suggest, as Defendants contend, that only a "new" formal contract can constitute a "transaction" or "arrangement." *See* Br. p. 30. Rather, they cover the situation here where the Board/Compensation Committee carried on the Company's business and/or brought about an understanding regarding increased compensation for Maginn and Chai.

Nor does the use of the term "enter into" limit MCG's special voting rights to "new" formal agreements. *See* Br. pp. 30-31. The definition of the term has no such limitations. *See* WEBSTER'S at 386 (definition of "enter into" includes "to make oneself a party to or in" and "to participate or share in"). Thus, MCG's consent right is triggered whenever Jenzabar "enters into" not only a new, formal contract or agreement, but also when it makes itself a party to or participates in a transaction or arrangement, including, for example, by making material changes to the terms of the Employment Agreements. If "enter into" is understood to give the preferred stockholders a consent right only if Jenzabar enters a "new" formal agreement with insiders, there would be no limit on the terms that could be inserted into existing agreements without subjecting them to MCG's consent rights. For example, Jenzabar could "adjust" or modify Maginn's and Chai's Employment Agreements to provide them each with base salaries of $4 million annually, or a private home in Malibu. It is thus Defendants' interpretation, and not MCG's, that would lead to "ludicrous results." *See* Br. p. 31.[16]

Moreover, and contrary to Defendants' arguments, MCG did not bargain to vote just on "substantial corporate transactions, such as mergers or sales." *See id.* p. 30. Although such transactions are covered by MCG's consent rights, MCG bargained for and obtained more, as evidenced by Defendants' repeated assertion that the Employment Agreements themselves were negotiated and approved by MCG as part of its investment in Jenzabar. Br. pp. 2, 5, 29; Maginn Br. pp. 5, 9, 14. Coupled with the rights afforded MCG by Section 5.12(h) and Article V, § A.1(b)(x), which cover, directly, transactions and arrangements with officers and directors, this

[16] Contrary to Defendants' arguments, *see* Br. p. 31, the Board/Compensation Committee did not simply "perform [ ] the terms of [the] Employment Agreements" when it purportedly increased the compensation. The Employment Agreements did not provide Maginn and Chai any rights, nor impose any obligations on the Company to increase compensation. In fact, they state that the Board "shall have no obligation or requirement to increase such Base Salary at any time." Br. Ex. A., ¶ 5; Br. Ex. B, ¶ 5.

makes it illogical to suggest that MCG must sit on the sidelines while Defendants change the terms of the Employment Agreements to enrich Maginn and Chai to the detriment of Jenzabar and all of its shareholders. *See* Compl. ¶¶ 25, 31.[17]

The PSWPA protected MCG in several ways. First, section 3.24, relied upon by the Defendants, *see* Br. p. 31, included a representation by Jenzabar and its signatory, Maginn, that apart from the "Material Contracts," as that term was defined in the definitional section, § 1.1 (including "any employment agreement" between the Company and Maginn),[18] there was no other "material Contract or transaction" between "an officer or director" of the Company and the Company. Section 3.24 was, in effect, a catch-all representation to cover any other "material" interests that officers or directors of the Company may have had in the Company, apart from the specifically disclosed "Material Contracts."[19] This is evidenced by the use of the lower case term "material" which modifies the term Contract. The provision was thus broader than the defined term "Material Contract" in section 1.1.[20] Taken together, sections 1.1 and 3.24 acted as a representation by Jenzabar that it had made full disclosure of all material interests of officers

[17] Contrary to Defendants' argument, the special voting rights were not "intended to protect MCG's loan position." Br. p. 7. The special voting rights are nowhere tied to MCG's loan position, which was paid off in 2006. Compl. ¶ 21.

[18] The Employment Agreement with Chai was not explicitly referenced as a "Material Contract."

[19] Although Maginn's Form of Employment Agreement, *see* PSWPA, Ex. G, was known to MCG at the time of its investment, it was not carved out from the protections provided in section 5.12(h). *See supra* pp. 24-25.

[20] Indeed, if the portion of section 3.24 relied upon by the Defendants was simply intended to address "Material Contracts," then it would have been duplicative of the disclosure of "Material Contracts" set forth in section 3.10 of the PSWPA, and it would have rendered that portion of section 3.10 unnecessary.

and directors in the Company and thus MCG, as of June 30, 2004, was protected against any undisclosed material interests by any officers or directors.[21]

Second, the PSWPA (and the Charter) protected MCG from any efforts by Maginn and Chai to enrich themselves at the Company's expense going forward. It is customary for a significant new investor in a company without control over the Board or a majority of the outstanding shares, such as MCG here, to protect itself through a form of special voting rights. Section 5.12(h) provided that protection by barring any changes with respect to Maginn and Chai's compensation, or any other transactions, contracts, agreements, or arrangements with the Company for their benefit, without MCG's consent. Indeed, the paramount significance of the rights granted by section 5.12(h) (and the Charter) is evidenced by the fact that those specific consent rights, unlike MCG's consent rights with respect to so-called "significant transactions," *see* Br. p. 31,[22] continued even if the percentage of Warrants (PSWPA) or Preferred Stock (Charter) dipped below threshold ownership levels. *See* Compl. Ex. 2, PSWPA, § 5.12 (last paragraph); *id.* Ex. 1, Charter, Art. V, § A.1. The parties acted in conformity with those rights from June 2004, *see* Compl. ¶¶ 25, 31, until the two so-called Independent Directors abandoned their fiduciary duties to all of the shareholders in favor of doing Maginn and Chai's bidding.

2. *Case Law Usage Of The Terms In The Provisions Supports MCG*

Usage of the terms "transaction" and "arrangement" in Delaware case law also makes clear that those terms include Board decisions—not only formal contractual agreements—

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[21] The definitions of the PSWPA also support this reading. The PSWPA defines both "Contract" and "Material Contract." A "material" version of the former (as opposed to the use of the latter term) is the subject of the representation made in section 3.24. *See, e.g.*, *St. Clair Intellectual Prop. Consultants, Inc. v. Palm, Inc.*, 2009 WL 1220546, at *9 (D. Del. May 4, 2009) (distinguishing between "Invention," a defined term, and "invention").

[22] Defendants incorrectly argue that only "significant transactions," such as "mergers or sales," are covered by section 5.12(h).

regarding the compensation of officers or directors. *See, e.g.*, *Telxon Corp. v. Meyerson*, 802 A.2d 257, 265 (Del. 2002) ("Like any other interested *transaction*, self-compensation decisions lie outside the business judgment rule's presumptive protection, so that, where properly challenged, the receipt of self-determined benefits is subject to an affirmative showing that the compensation *arrangements* are fair to the corporation.") (emphasis added); *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996) ("[T]he board itself will be required only to authorize the most significant corporate acts or *transactions*[,] [including] appointment and compensation of the CEO . . . .") (emphasis added).[23]

3. *Contract Terms Should Be Construed To Avoid Redundancy*

Under Delaware law, "[a]n interpretation that gives an effect to each term of an agreement, instrument or statute is to be preferred to an interpretation that accounts for some terms as redundant." *Warner Commc'ns Inc. v. Chris-Craft Indus., Inc.*, 583 A.2d 962, 971 (Del. Ch. 1989). A reading of the Charter and the PSWPA that would entitle MCG to consent to only "new," formal *contracts* with officers or directors would render the terms "agreement," "arrangement," and "transaction," all terms that have meanings broader than the term "contract," *see supra* p. 17, redundant, an undesirable result under Delaware law.

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[23] *See also Julian v. E. States Constr. Serv., Inc.*, 2008 WL 2673300, at *18 (Del. Ch. July 8, 2008) ("Self-interested directorial compensation decisions made without independent protections, like other interested *transactions*, are subject to entire fairness review.") (emphasis added); *Valeant Pharms. Int'l v. Jerney*, 921 A.2d 732, 739 (Del. Ch. 2007) (describing option grant plan under which certain executives and all outside directors would receive stock options of a spin-off company as a "*transaction*") (emphasis added); *Carlson v. Hallinan*, 925 A.2d 506, 529-30 (Del. Ch. 2006) (describing the decision to cause the company to pay director-officers executive compensation as an interested "*transaction*") (emphasis added); *Haywood v. AmBase Corp.*, 2005 WL 5757734, at *6 (Del. Ch. Aug. 22, 2005) (unpublished opinion) (describing decision by company's personnel committee to grant discretionary bonuses to chairman, president, and chief executive officer as "executive compensation *transaction*") (emphasis added); *Hessler, Inc. v. Farrell*, 226 A.2d 708, 710 (Del. 1967) (describing unwritten agreement between employee and president that employee would receive reduced salary and work fewer hours as an agreement "to enter into a semi-retirement *arrangement*") (emphasis added).

4. *Broadly Worded Provisions Governing Rights Of Preferred Stockholders Are Given Effect If The Meaning Is Plain*

It is also beyond dispute that courts will give effect to broadly worded provisions governing the rights of preferred stockholders if the meaning is plain. In *ThoughtWorks*, a private equity firm, SV Investment Partners ("SVIP"), invested over $26 million in ThoughtWorks, Inc. ("ThoughtWorks"), and became a preferred stockholder. *ThoughtWorks*, 902 A.2d at 747. The corporation's charter provided that the consent of the preferred stockholders was required before ThoughtWorks could "[e]nter, or allow any subsidiary to *enter into*, any contractual arrangement providing for the payment of $500,000 or more per year by either party thereto and that is outside the ordinary course of business or that was not contemplated by the Corporation's annual budget." *Id.* at 748 (emphasis added). The court determined that, under that provision, ThoughtWorks could not increase an existing line of credit from $3 million to $10 million without obtaining SVIP's consent. The court rejected ThoughtWorks's argument that the charter provision did not cover debt transactions, such as the increase in the line of credit, stating:

> ThoughtWorks's proposed $10 million line of credit falls within the scope of Section 5(j) as a "contractual arrangement providing for the payment of $500,000 or more per year by either party." ThoughtWorks's contention that Section 5(j) is only a material contracts provision and cannot be read to relate to the incurrence of material indebtedness is not persuasive. The plain language of the section clearly states that it broadly applies to "any contractual arrangement providing for the payment of $500,000 or more." Such contractual arrangements can be easily read to include debt transactions. Therefore, if the line of credit is either outside of ThoughtWorks's ordinary course of business or not contemplated by ThoughtWorks's annual budget, ThoughtWorks must obtain prior consent from a majority of the preferred stockholders . . . .

Id. at 755 (footnotes omitted).

The Jenzabar Charter provision at issue is similarly broadly worded to entitle the holders of Senior Preferred Stock to consent to "any transaction, contract, agreement or arrangement" with an officer or director of Jenzabar, and should not be read to be limited to "new," formal contractual agreements. Just as the court in *ThoughtWorks* rejected the company's effort to limit the provision at issue by arguing that the charter contained no standard "material indebtedness" provision, *see id.*, this Court should reject Defendants' attempt to override the plain, unqualified language of the provisions at issue by claiming they are limited to so-called "new," "related party transactions." *See, e.g.*, Br. p. 30.

Defendants' argument that the increased salary and bonuses at issue fall outside MCG's consent rights because they are merely increases to an existing contract, *see* Br. pp. 30-31, is foreclosed by *ThoughtWorks*. In *ThoughtWorks*, the company, over the preferred shareholder's objection and assertion of its consent rights, increased its line of credit from $3 million to $5 million and then sought to increase it further to $10 million. *ThoughtWorks*, 902 A.2d at 750. In the face of similar consent right language that required preferred shareholder consent before the company could "[e]nter, or allow any subsidiary to enter into, any contractual arrangement providing for the payment of $500,000 or more per year," *id.* at 748, the court nonetheless concluded that the attempted *increase* in the line of credit ran afoul of the consent rights. *See id.* at 750, 757 (requiring ThoughtWorks to obtain "consent from a majority of the preferred shareholders" prior to taking actions that would "triple its existing line of credit").[24]

[24] The Court also rejected the argument that because no monies had in fact been paid, no "contractual arrangement" had been created. *ThoughtWorks*, 902 A.2d at 755 n.39.

C. The Employment Agreements Are Not "Clearly" Or "Expressly" Exempt From MCG's Rights

Notwithstanding the plain import of the consent provisions described above, Defendants repeatedly assert that the Employment Agreements entered into by Jenzabar with Defendants Maginn and Chai are "clearly" or "expressly" exempt from section 5.12(h) and Article V, § A.1(b)(x). *See, e.g.*, Maginn Br. p. 9 (section 3.24 of the PSWPA "expressly excludes" the Employment Agreements from the scope of 5.12(h)); *id.* p. 2 (the Employment Agreements "clearly permit the Jenzabar Board . . . to consider and grant increases in base salary and bonus to Maginn and Chai with or without MCG's approval").

Defendants point to no language in the PSWPA, the Charter, or the Employment Agreements themselves, however, that "clearly," "expressly," or "explicitly" exempts the Employment Agreements from the special voting rights. To the contrary, while section 5.12(h) and Article V, § A.1(b)(x) do exempt certain *other* identified matters from their scope, namely Jenzabar's business arrangements with New Media Japan and Bain & Co. and the MCG Loan Agreement, those provisions do not identify the Employment Agreements. Thus, the Court should conclude that the Employment Agreements do not fall outside the scope of MCG's consent rights. *See, e.g.*, *Kansas City S. v. Grupo TMM, S.A.*, 2003 WL 22659332, at *2-3 (Del. Ch. Nov. 4, 2003) (Chandler, C.) (applying doctrine of *inclusio unius est exclusio alterius* and

concluding that the absence of "shareholder approval" from a list of conditions to sellers' obligations meant that shareholder approval was not such a condition).[25]

D. Defendants' Argument About "Material Contracts" Is A Red Herring

With their exemption argument foreclosed by the plain language of the provisions of the PSWPA and the Charter, Defendants next rely on the definition of "Material Contract" in the PSWPA and section 3.24 of the PSWPA concerning "Transactions with Affiliates." *See* Maginn Br. pp. 14-15; Br. p. 31. This argument, however, fails to recognize that the parties used different terms with precision and fails to recognize the difference between what Jenzabar represented on June 30, 2004 and what MCG bargained for going forward.

Defendants begin with the fact that Defendant Maginn's Employment Agreement (but **not** Defendant Chai's Employment Agreement) is encompassed within the definition of "Material Contract" in section 1.1 of the PSWPA. Maginn Br. pp. 14-15; Br. p. 31. Defendants then turn to section 3.24 of the PSWPA, in which Jenzabar represented that, "[n]o Affiliate of the Company and no officer or director of the Company or any of its Subsidiaries, and no individual in the immediate family of such Affiliate, officer or director . . . is a party to any material Contract or transaction with the Company," *id.*, to argue that this representation could not have been made if Maginn's employment contract was an "affiliate transaction" for purposes of the PSWPA and the grant of special voting rights. Thus, according to Defendants, the special voting

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[25] *See also Active Asset Recovery, Inc. v. Real Estate Asset Recovery Servs., Inc.*, 1999 WL 743479, at *11 (Del. Ch. Sept. 10, 1999) ("If one subject is specifically named, or if several subjects of a larger class are specifically enumerated, and there are no general words to show that other subjects of that class are included, it may reasonably be inferred that the subjects not specifically named were intended to be excluded." (quoting 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 552, at 206 (1960)); *cf. In re Chrysler LLC*, 2009 WL 1360863, at *71 (S.D.N.Y. May 4, 2009) (attaching an exhibit containing a provision on "Transactions with Affiliates" which, in stark contrast to the provision at issue here, explicitly stated that the provision "shall not apply to" employment-related agreements or compensation matters).

rights cannot apply to the payment of compensation to Jenzabar's officers. Maginn Br. p. 15. This argument fails for three primary reasons.

First, while Defendants accurately quote sections 1.1 and 3.24 of the PSWPA, they fail to point out to the Court, as noted above, that while "Material Contract" is used in section 1.1, a different term, "material Contract" (with a lower case "m"), is used in section 3.24 with a broader scope than the term used in section 1.1. Section 1.1 discloses those contracts that constitute known "Material Contracts." Section 3.24, on the other hand, is intended to act as a catch-all or residual clause to make sure that there were no other undisclosed "material" events involving the officers or directors or their affiliates. *See supra* pp. 19-20. It was not intended to somehow carve out Maginn's Employment Agreement from the broad protections given to MCG under section 5.12. Thus, and contrary to the Defendants' arguments, the representation in section 3.24 that no officer or director is a party to a "material" contract could properly be made even though Maginn's employment contract is a Material Contract for purposes of section 1.1. Section 3.24 is simply a further representation by Jenzabar about the lack of material events involving its officers and directors apart from those disclosed elsewhere in the PSWPA, such as the specifically disclosed "Material Contracts." *See supra* note 21 (noting that parties may distinguish terms through use of upper and lower case versions of same term).

Second, apart from the different language used in sections 1.1 and 3.24, section 5.12 itself does not cross-reference to either section and does not use the "material contract" language (whether upper or lower case). Section 5.12(h) stands on its own and its broad scope is not limited in any way. As described above, section 5.12(h) concerns "any" transaction, contract,

agreement or arrangement with an officer or director. It is manifestly not limited to "material" dealings between Jenzabar and its affiliates at the time of the June 30, 2004 closing.[26]

Third, Defendants never acknowledge, let alone explain, why their argument based on language in the PSWPA should have any bearing on the interpretation of Article V, § A.1(b)(x) *in the Charter*. After all, the Charter does not have a definition of "Material Contract," nor does it include a representation by Jenzabar regarding its transactions with officers and directors. The Defendants' position is apparently to simply ignore the Charter (and the absence of any similar reference to Chai's Employment Agreement in the PSWPA) when inconvenient.

E. MCG's Rights Do Not Improperly Interfere With The Board's Right To Set Compensation

Defendants imply that MCG's right must be narrower than the plain language of the PSWPA and the Charter suggest because Jenzabar's Board, and/or its Compensation Committee, have "wide latitude" and "broad discretion" regarding executive compensation under the law and are "required" to review Maginn's and Chai's compensation under the Employment Agreements. *See* Br. p. 32. MCG does not seek to prevent the Board or the Compensation Committee from exercising their discretion or reviewing the existing compensation; MCG simply notes that this discretion and review must be exercised consistent with MCG's voting rights. *See ThoughtWorks*, 902 A.2d at 748, 754-56 (giving effect to preferred stockholders' right to consent to any $500,000+ contractual obligation that was not contemplated in the annual budget); *Telcom-SNI Investors*, 2001 WL 1117505, at *6-9 (giving effect to preferred stockholders' right to consent to issuance of additional shares of preferred stock).

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[26] Defendants also purport to draw support for their arguments because section 3.24 is entitled "Transactions with Affiliates." Br. p. 31. Under section 7.5 of the PSWPA, however, the Agreement's headings are "for convenience only, do not constitute a part of this Agreement and shall not be deemed to limit or affect any of the provisions thereof." In any event, section 5.12 has no similar heading.

Indeed, the Defendants' discretion regarding executive compensation cannot be exercised in contravention of the Company's Charter. To the extent that the Defendants seek to act beyond the terms of the Charter, they have no authority to do so and such conduct is *ultra vires*. Accordingly, not only is their conduct a breach of contract, but it is also *ultra vires* and should be declared as such under Counts 9 and 10 of the Complaint. *See Robbins Hose Co. No. 1, Inc. v. Baker*, 2007 WL 3317598, at *8 n.49 (Del. Ch. Oct. 31, 2007) ("*Ultra vires* acts include 'acts specifically prohibited by the corporation's Charter, for which no implicit authority may be rationally surmised, or those acts contrary to basic principles of fiduciary law.' Void acts, including those that are *ultra vires*, 'are legal nullities incapable of cure.'" (quoting *Solomon v. Armstrong*, 747 A.2d 1098, 1114 (Del. Ch. 1999); *Apple Computer, Inc. v. Exponential Tech., Inc.*, 1999 WL 39547, at *15 (Del. Ch. Jan. 21, 1999)).

F. At Most, Defendants' Arguments Raise Questions That May Not Be Resolved On A Motion To Dismiss

Where there are two (or more) reasonable interpretations of a contract, the proper interpretation of the contract is a matter of fact, rather than law, and thus not properly the subject of a motion to dismiss. *See, e.g., Monier, Inc. v. Boral Lifetile, Inc.*, 2008 WL 2168334, at *5 (Del. Ch. May 13, 2008) (denying motion to dismiss where court could not conclude as a matter of law that plaintiff's reading of disputed provision was unreasonable). If the terms of the contract are ambiguous, the court must look to extrinsic evidence to ascertain the parties' shared intent and the motion to dismiss must be denied. *Appriva S'holder Litig. Co., LLC v. EV3, Inc.*, 937 A.2d 1275, 1292 (Del. 2007) ("Even if the Superior Court considered the defendants' [contractual] interpretation more reasonable than plaintiffs', on a Rule 12(b)(6) motion it was error to select the 'more reasonable' interpretation as legally controlling."); *see also Monier*, 2008 WL 2168334, at *5.

At most, Defendants attempt, by repeatedly positing the "intent" of section 5.12(h) and Article V, § A.1(b)(x), other than by resort to the plain meaning of the words themselves, to create an ambiguity. *See, e.g.*, Br. p. 7 ("Section 5.12 of the PSWPA grants MCG certain voting rights that were intended to protect MCG's loan position.").[27] They certainly have not put forth the "***only*** reasonable construction" of the relevant provisions. *See* Br. p. 33 (emphasis in original). As a result, the Motion to Dismiss must be denied. *Bay Ctr. Apts. Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451, at *8 (Del. Ch. Apr. 20, 2009) (denying motion to dismiss because "[o]n a motion to dismiss, the Court cannot choose between reasonable interpretations of ambiguous contract provisions"); *see also Monier*, 2008 WL 2168334, at *5.

III. MCG'S CLAIMS AGAINST THE INDIVIDUAL DEFENDANTS ARE PROPER AND SHOULD NOT BE DISMISSED

A. The Individual Defendants Are Necessary Parties For The Relief Sought (Counts 1, 2, 5, 7, 8, 9, 10, 11 And 12)[28]

As explained below, the individual defendants—Maginn, Chai, Barr, San Miguel, and Mills—have engaged in tortious behavior subjecting them to various forms of liability to MCG. *See, e.g.*, *infra* § III.B (inducing breach of contract and Charter); *infra* § V (breach of fiduciary duty). In addition, and regardless of whether the Individual Defendants are independently liable, they are necessary parties to this lawsuit because MCG cannot be adequately compensated for Jenzabar's breach of contract and Charter in their absence.

Under Delaware Chancery Court Rule 19(a), a person whose joinder will not deprive the Court of jurisdiction "*shall* be joined as a party in the action if . . . in the person's absence

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[27] This assertion is plainly incorrect as MCG's rights under section 5.12(h) are tied to its status as a Warrant holder, *see* PSWPA, § 5.12, and its rights under the Charter are tied to its status as a holder of Senior Preferred Stock, *see* Charter, Art. V, § A.1(b), not to its status as a creditor of Jenzabar.

[28] Only the Individual Defendants have moved to dismiss Count 11, and only as to them.

complete relief cannot be accorded among those already parties." Del. Ch. Ct. R. 19(a) (emphasis added). Here, Jenzabar's breach of contract and Charter cannot be remedied by Jenzabar alone. As this Court recognized repeatedly during the course of a teleconference in this case on June 24th, complete relief may well include ordering that Defendants Maginn and Chai disgorge their illegitimate compensation and declaring the Board votes of Defendants San Miguel and Mills null and void:

> [Compensation decisions are] easy to declare null and void later and require disgorgement or rescission of whatever compensation agreements were made. That's not a very tough thing to do.
>
> I'm on the record explaining to [defense counsel] that if his board does something with respect to compensation, and they ultimately lose on this question of whether or not they could do that over the objection or failure to consent from MCG, then I'm going to order people to disgorge everything that they have been paid.[29]

Preliminary Injunction Scheduling Hearing Tr. at 9, 25.

Accordingly, complete relief for Jenzabar's breach of contract and Charter will be necessarily inadequate in the absence of any of the Individual Defendants, and as such, their presence in this case is mandatory. *Cf. In re Nat'l Auto Credit, Inc. S'holders Litig.*, 2003 WL 139768, at *15-16 (Del. Ch. Jan. 10, 2003) (dismissing plaintiffs' claim for rescission of an agreement because plaintiffs did *not* join every individual whose rights would be affected if the agreement were rescinded); *Istituto Bancario Italiano SpA v. Hunter Eng'g Co.*, 449 A.2d 210, 226 (Del. 1982) (finding that the current owner of shares which plaintiff sought to have canceled was an "indispensable party" to the case).

[29] Complete relief should also include an order precluding Defendant Barr from encouraging or participating in further unjustified payments and requiring him to comply with his fiduciary duties.

B. The Facts Alleged In Counts 3 And 4 Are Sufficient To Sustain A Claim Against Defendants Maginn, Chai, And Barr

Under Delaware law, an individual may be liable for inducing a breach of contract—sometimes also referred to as "intentional interference with contract"—if five elements are present: "'(1) a contract, (2) about which the defendant knew and (3) an intentional act that is a significant factor in causing the breach of such contract (4) without justification (5) which causes injury.'" *Layfield v. Beebe Med. Ctr., Inc.*, 1997 WL 716900, at *5 (Del. Super. Ct. July 18, 1997) (quoting *Irwin & Leighton, Inc. v. W.M. Anderson Co.*, 532 A.2d 983, 992 (Del. Ch. 1987)).

MCG alleges all five elements in Counts 3 and 4 of the Complaint. With respect to the first two elements, the Complaint alleges that contracts existed (both the PSWPA and the Charter), and that Defendants Maginn, Chai, and Barr were aware of both. Compl. ¶¶ 97, 102. With respect to the remaining three elements, the Complaint alleges that Maginn, Chai, and Barr "purposely encouraged" San Miguel and Mills to breach the PSWPA and Charter, *id.* ¶¶ 98, 103; that they did so "without . . . justification," *id.*; and that "as a result," the PSWPA and Charter were breached and MCG suffered harm. *Id.* ¶¶ 99-100, 104-05. Thus, MCG's Complaint adequately alleges that Maginn, Chai, and Barr induced a breach of contract.[30]

[30] Defendants have suggested that Counts 3 and 4 should be dismissed because they are titled "aiding and abetting" breach of contract and charter, claims they argue do not exist in Delaware. The factual allegations contained in these counts, however, satisfy the elements required to sustain a claim for inducing a breach of contract and charter. MCG believes that it would be inefficient and uneconomical to amend its Complaint simply to replace "aiding and abetting" with "inducing" in the title to the counts. *Cf. In re USACafes*, 600 A.2d at 54 ("[A] pleader is not required in a complaint to identify legal theories . . . ." (citing *Michelson v. Duncan*, 407 A.2d 211, 217 (Del. 1979) ("[A] complaint in a civil action need only give defendant fair notice of a claim and is to be liberally construed. . . . [S]o long as claimant alleges facts in his description of a series of events from which a [claim] may reasonably be inferred and makes a specific claim for the relief he hopes to obtain, he need not announce with any greater particularity the precise legal theory he is using.")). Nonetheless, MCG requests leave to amend its Complaint should the Court conclude otherwise.

Defendants argue, however, that Maginn, Chai, and Barr cannot be held liable for inducing Jenzabar's breach of contract (or Charter) because they are officers of Jenzabar who simply asked for a raise and got it. *See* Maginn Br. p. 15; Br. p. 36. Although it is true, as Defendants note, 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,'" Maginn Br. p. 10 (quoting *Shearin v. E.F. Hutton Group, Inc.*, 652 A.2d 578, 590 (Del. Ch. 1994)), here, however, Maginn, Chai, and Barr were hardly acting *within their role*. To the contrary, they were disregarding the best interests of Jenzabar, siphoning off Company assets for their own personal benefit, and doing so in a misleading fashion by seeking previously "approved" bonuses while knowing that the condition for that approval had not been met. Compl. ¶ 52; *see supra* p. 9. They were acting in their own self-interest, and as such, are not entitled to the protection granted to corporate officers who act on their corporation's behalf. *See, e.g.*, *Layfield*, 1997 WL 716900, at *5 (denying summary judgment on a claim of inducing breach of contract because "an employee may be liable when he acts as an individual, for his own advantage, outside his corporate role").

At the very least, MCG has pled sufficient facts to raise a genuine question as to whether Maginn, Chai, and Barr were acting for their own advantage rather than Jenzabar's. Accordingly, the motion to dismiss as to Counts 3 and 4 should be denied.

IV. THE DERIVATIVE CLAIMS ARE PROPERLY BROUGHT

Defendants argue that MCG's derivative claims should be dismissed on the grounds that MCG has not pled demand excusal and is an inadequate derivative plaintiff. Neither argument is correct. In addition, Defendants incorrectly contend that all of the non-contract claims in Count 5 are derivative. They are not. Of the four claims advanced in Count 5, only one claim—breach of fiduciary duty when awarding compensation—is solely derivative. The other claims are direct

or both direct and derivative. This point is addressed below. *See infra* § V.F. However, as next explained, demand is excused with respect to whatever claims are found to be derivative.

The Complaint pleads facts establishing demand excusal under both prongs of *Aronson v. Lewis*. Demand is excused when "a reasonable doubt is created that: (1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). Under prong one of *Aronson*, demand is excused because plaintiff has established a reasonable doubt that a majority of Jenzabar's five-person Board is disinterested and independent. Two of the members of the board—Maginn and Chai—clearly were interested in the compensation decisions at issue. Two other members of the Board—San Miguel and Mills—were not independent of Maginn and Chai in connection with the compensation decisions. Compl. ¶¶ 41-48, 51-55. Drawing all reasonable inferences in the Plaintiff's favor establishes that there is "reasonable doubt" that both San Miguel and Mills were independent and disinterested. *See Gantler v. Stephens*, 965 A.2d 695, 707 (Del. 2009) (lack of director independence based on the director's course of conduct in the challenged transaction). Demand is also excused under the second prong of *Aronson* because—as a matter of law—the business judgment rule does not apply to the self-interested recommendation and grant of retroactive compensation to controlling fiduciaries. *Aronson*, 473 A.2d at 808 (demand excused "where facts are alleged with particularity which create a reasonable doubt that the directors' action was entitled to the protections of the business judgment rule"). Rather, such a transaction is subject to "entire fairness" scrutiny. *Kahn v. Lynch Commc'n Sys.*, 638 A.2d 1110, 1115 (Del. 1994) (where a controlling shareholder stands on both sides of a transaction, even disinterested directors are incapable of applying their

business judgment); *Kahn v. Tremont Corp.*, 694 A.2d 422, 429 (Del. 1997) (applying *Lynch* to impose entire fairness review beyond the merger context).

Defendants' argument that MCG is an inadequate derivative plaintiff also fails because, although MCG "may have interests which go beyond the interests of the [other shareholders], [MCG's interests] are at least co-extensive[] with the [other shareholders'] interest[s]." *Youngman v. Tahmoush*, 457 A.2d 376, 381 (Del. Ch. 1983) (finding plaintiff an adequate derivative plaintiff) (citing 7A WRIGHT & MILLER, FED. PRAC. AND PROC. § 1833 (1972)). Therefore, MCG has standing to pursue its derivative claims.

A. The Well Pled Facts In The Verified Complaint Establish That Demand Is Excused Under Both The First And Second Prongs Of *Aronson*

1. *Demand Is Excused Under The First Prong Of* Aronson *Because A Majority Of The Board Is Not Disinterested And Independent*

"'Directorial interest exists whenever divided loyalties are present, or a director has received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not equally shared by the shareholders. The question of independence flows from an analysis of the factual allegations pertaining to the influences upon the directors' performance of their duties generally, and more specifically in respect to the challenged transaction.'" *Rales v. Blasband*, 634 A.2d 927, 933 (Del. 1993) (quoting *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984)).

There is no question that Maginn and Chai were interested in the compensation they recommended and received. Thus, demand is excused if any one of the other three directors were not disinterested or independent. *Gantler*, 965 A.2d at 707 (disloyalty of a majority of the board excuses demand). The particularized pleadings in the Complaint viewed in their entirety create a reasonable doubt as to the independence of San Miguel and Mills. Compl. ¶ 86. It is important to note that demand is excused not simply where the allegations of the Complaint, if

true, would suffice at trial to prove a lack of independence; demand is excused if the allegations create a reasonable doubt concerning interest or independence. *See, e.g.*, *In re Chrysler Corp. S'holders Litig.*, 1992 WL 181024, at *5 (Del. Ch. July 27, 1992) (finding demand excused without concluding that plaintiffs would be able to prove an entrenchment motive at trial). Phrased differently, demand is excused if, viewing the particularized pleadings in the light most favorable to the plaintiff, the Board's disinterest and independence are not certain beyond a reasonable doubt. In this case, there is more than a reasonable doubt as to the independence of San Miguel and Mills.

First, San Miguel and Mills' conduct on Jenzabar's Board demonstrates their lack of independence. "[I]t is the care, attention and sense of individual responsibility to the performance of one's duties . . . that generally touches on independence." *Tremont*, 694 A.2d at 430 (quoting *Aronson*, 473 A.2d at 816) (alteration in *Tremont*). As the Delaware Supreme Court recognized in *Gantler*, demand may be excused based on the alleged conduct of a fiduciary. *Gantler*, 965 A.2d at 707 ("plaintiffs have alleged specific conduct from which a duty of loyalty violation can reasonably be inferred" where defendant failed to promptly respond to due diligence requests). In this case, reasonable doubt is created as to the independence of San Miguel and Mills because of their conduct, their prior and existing relationship with Maginn and Chai, and the fact that retaining their directorial positions is both material to them and depends upon Maginn and Chai.

First, Maginn was permitted to participate in his own compensation process and actually fashioned and proposed the compensation recommendations subsequently approved by San Miguel and Mills. Compl. ¶¶ 49, 51, 55. In fact, as alleged in the Complaint, Maginn and Chai requested and defined the very compensation at issue. *Id.* ¶¶ 26, 49, 56. They made the case—

factual and otherwise—that they were entitled to greater compensation than provided by their Employment Agreements and to retroactive increases in compensation already provided. *Id.* Participation by an interested director undermines the independence of a committee. *See In re Freeport-McMoRan Sulphur S'holder Litig.*, 2005 WL 1653923, at *13 (Del. Ch. June 30, 2005) (interested director participation in special committee meetings undermined independence of special committee).

San Miguel and Mill's conduct with respect to MCG's rights under the PSWPA further evidences their lack of independence. That contractual issue is essentially a dispute between MCG, which opposes the additional and retroactive compensation sought by Maginn and Chai, and Maginn and Chai, who seek compensation beyond that provided in their Employment Agreements. When the issue of compensation arose, Malekian suggested that an independent compensation consultant be retained to evaluate the increases sought by Maginn and Chai because "[s]pecial committee members should have access to knowledgeable and independent advisors, including legal and financial advisors." *Gesoff v. IIC Indus.*, 902 A.2d 1130, 1147 (Del. Ch. 2006). San Miguel and Mills rejected that suggestion and did not seek any independent advice as to what would be objectively reasonable compensation for Maginn and Chai. Compl. ¶ 32. Instead, San Miguel and Mills simply relied on Christopher Austin, an attorney previously retained and later proposed by Maginn, as the Compensation Committee's advisor, over Malekian's objection. *Id.* ¶ 42. Therefore, "[Maginn and Chai] ensured [their] control over the special committee process by the simple expedient of inserting [their] own

outside counsel directly into the opposition camp." *Gesoff*, 902 A.2d at 1151.[31] The absence of independent advisors undermines the Committee's independence. *Id.* at 1151; *see also Tremont*, 694 A.2d at 429 (reversing finding that special committee was independent where the company's general counsel "suggested the name of an appropriate legal counsel to the Special Committee, and that individual was promptly retained").

When the contract issue arose, Malekian suggested that the Board obtain advice from independent counsel as to Jenzabar's obligations—and MCG's rights—under the disputed contract. Compl. ¶¶ 98-99, 103. Mills and San Miguel rejected the suggestion that independent counsel be consulted. *Id.* ¶¶ 42-43. Instead, they relied upon the advice of an attorney retained by Maginn and Barr. *Id.* After hearing from counsel effectively retained by Maginn and Chai, San Miguel and Mills did not even consult with counsel for the other party to the contract—the party whose rights were at issue and who is a stockholder of the Company. *Id.* ¶¶ 45-46. This is not the conduct of unbiased and independent directors seeking to fairly and objectively evaluate the rights of one of the Company's stockholders. *Id.* Rather, it is the conduct of persons who have decided to do what is requested by Maginn and Chai and seek only legal "cover" to do so.

San Miguel and Mills also evidenced their lack of independence by purportedly approving a retroactive bonus demanded by Maginn and then not rescinding the bonus after learning that it was granted under false pretenses. *Id.* ¶¶ 53-55. Five days after the Board—without independent advice—granted salary and bonuses in excess of those set in Maginn and Chai's Employment Agreements, Maginn made a new demand. Maginn told the Board that he had "discovered" a $750,000 bonus that supposedly had been approved by the Board more than

[31] Similarly, over Malekian's objection, San Miguel and Mills involved Barr in the process of setting Maginn and Chai's compensation, despite Barr's dependence on Maginn and Chai for his livelihood. Compl. ¶ 42.

six years earlier in 2002, but never paid.[32] Without any independent verification of the grant or non-payment of this bonus, San Miguel and Mills approved the payment of it, even though Maginn could not explain why he had overlooked it for six years, including during periods in which Maginn was consistently seeking additional compensation for himself but oddly forgot what he later claimed was already owed him. *Id.* ¶¶ 26, 51. This purported approval also is invalid as a matter of law. *See infra* § VII.

In fact, as MCG only learned some months later, the supposedly forgotten bonus was only to be paid subject to certain conditions that were never fulfilled. *Id.* ¶ 52. Before MCG learned the truth, San Miguel and Mills did. *Id.* ¶ 53. Nevertheless, they never sought to reclaim the wrongfully awarded bonus. *Id.* ¶ 55. For them, it was enough that Maginn wanted it.

San Miguel and Mills' conduct with respect to the $3.5 million and $3.1 million additional retroactive bonuses sought by Maginn and Chai further evidences their lack of independence. When MCG sought an injunction in this action to prevent those bonuses from being paid, San Miguel and Mills did not state that the bonuses had been rejected; rather, they actively opposed any judicial constraint on their ability to award those bonuses and refused to commit not to award such bonuses. Preliminary Injunction Scheduling Hearing Tr. at 17:13-22, 19:2-7. Thus, seven months after these extraordinary, retroactive bonuses were requested by Maginn and Chai, these supposedly "independent" directors still have that request under consideration. *Id.* The implications of this inaction are obvious. Either the bonuses have been awarded without disclosure, or San Miguel and Mills have agreed to defer a decision until

[32] The existence of this bonus or liability for this bonus had never been disclosed to MCG when it invested in 2004. *Id.* ¶ 52.

Maginn and Chai's strategy of stripping MCG of veto rights is resolved. Then, if MCG is rendered defenseless, San Miguel and Mills will approve retroactive bonuses for the five years.

The Complaint's other allegations should be considered in conjunction with the narrative describing San Miguel and Mills' disloyal conduct. Maginn has long known both San Miguel and Mills through the Harvard Business School. Mills was Maginn's professor. Compl. ¶ 33. Maginn also studied under San Miguel and was his research assistant at Harvard Business School. *Id.*; Br. p. 9.[33] In short, Maginn has longstanding academic and professional relationships with San Miguel and Mills. The loss of those relationships with Maginn and Chai would be material to San Miguel and Mills, and San Miguel and Mills are not objective and detached when evaluating the compensation of Maginn and Chai, especially in the context where Maginn and Chai have placed such importance and persistence on increasing their compensation above the amounts specified in their Employment Agreements. *Id.* ¶¶ 25-35.

However, it is not simply the loss of professional relationships and the effect of professional relationships on objectivity that impairs the independence of San Miguel and Mills. San Miguel and Mills each receive $100,000 per year in compensation for their service on Jenzabar's Board. Compl. ¶ 35. Although, as Defendants' point out, the receipt of fees does not create a presumption that a director is interested, Br. p. 22,

> the rule that receipt of customary directors' fees does not create a disqualifying interest is one involving the application of a presumption (*i.e.*, the presumption of director disinterest). It is not an unvarying principle that mechanically applies irrespective of the circumstances.

[33] The fact that Maginn served as San Miguel's research assistant was noted in Defendants' Opening Brief, despite its omission from the Complaint. For the sake of completeness, MCG adds that Maginn also worked as Mills' research assistant as a student, and that Maginn and Chai have been invited to speak to Mills' class at the Harvard Business School every year for several years.

In re Nat'l Auto Credit, 2003 WL 139768, at *11 (quoting *Grobow v. Perot*, 526 A.2d 914, 923 n.12 (Del. Ch. 1987)); *see also id.* (denying motion to dismiss under Rule 23.1 based on "Complaint's particularized facts, that such amounts [of fees] are material").

Where the amount of fees awarded is subjectively material, the Court will overlook that usual presumption. *Id.* (citing *Orman v. Cullman*, 794 A.2d 5, 23 (Del. Ch. 2002)) (finding that plaintiff pled facts rebutting the application of the business judgment rule). Given the prevailing level of compensation for college professors, it is reasonable to infer that the opportunity to receive an additional $100,000 per year is material to San Miguel and Mills. Compl. ¶ 33; *see In re InfoUSA, Inc. S'holder Litig.*, 953 A.2d 963, 992 n.60 (Del. Ch. 2007) (C. Chandler) ("It is not too much to ask the Court reasonably to infer that college professors are not generally paid lavish sums, or that Professor Ravel's income, even if it were substantially higher than the average professor's, is likely to be no more than one order of magnitude away from the average.").[34]

Furthermore, the opportunity to serve on a board enhances San Miguel and Mills' professional reputations, provides experience important to their scholarship and teaching and buttresses their qualifications to serve on future boards. *See* Compl. ¶ 34 (pointing out San Miguel's lack of prior board experience). In short, there is a reasonable doubt about whether the loss of these positions is immaterial. Furthermore, MCG opposed Maginn's nomination of San Miguel as a director based on his lack of industry experience and lack of board experience. *Id.* ¶¶ 33-34. Both San Miguel and Mills became directors as a direct result of their personal relationship with Maginn and remain dependent on Maginn to retain their positions. *Id.*

[34] The average business school professor earns $102,965 a year in salary. *See supra* note 2.

Defendants ask this Court to rule that San Miguel and Mills are independent because MCG's approval of their election constitutes a concession that San Miguel and Mills are independent for purposes of determining whether demand is excused. Br. p. 20. This argument must fail for several reasons. First, the significance of and reasons for MCG's approval of San Miguel and Mills as directors turn upon facts that are beyond the allegations of the Complaint. *See Rattner v. Bidzos*, 2003 WL 22284323, at *7 (Del. Ch. Sept. 30, 2003) (finding demand excused based on review "confined to . . . allegations of the complaint"). MCG did not approve San Miguel and Mills because it believed they met the definition of Independent Directors, but rather because MCG believed, based upon assurances from Maginn, San Miguel and Mills, that they would act independently even though they did not meet the definition of Independent Directors. Compl. ¶ 34. Second, the definition of an "independent director" under the Stockholders Agreement, which incorporates the definition under NASD Rule 4200(a)(15), is not the same test as the "reasonable doubt" standard under Rule 23.1.[35] Third, at the time MCG approved San Miguel and Mills' election, MCG could not have been aware of the subsequent conduct by San Miguel and Mills evincing their lack of independence.

Finally, because Malekian would have been obligated to abstain from voting on such a significant matter involving MCG, Jenzabar's entire Board is incapable of considering MCG's demand. In the past, Malekian, who as Defendants correctly note is an employee of MCG, *see*

[35] *See* NASD Rule 4200(a)(15) (defining 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"). To not be independent under this definition, the board must conclude that the relationship "would interfere" with independent judgment. Under *Aronson*, the relationship must merely be such that a reasonable doubt exists as to independence.

Br. p. 10 n.9, has agreed to recuse himself from Board decisions involving MCG. Compl. ¶ 69.[36] Moreover, Malekian's recusal results in a four-director board. Defendants do not claim that Maginn or Chai are disinterested with regard to any of the claims in the Complaint. Therefore, even if San Miguel and Mills were disinterested and independent beyond a reasonable doubt, only half of the Board would be. Where half the board is interested or is not independent, demand is excused. *See, e.g., Conrad v. Blank*, 940 A.2d 28, 40 (Del. Ch. 2007).

2. *Demand Is Excused Under The Second Prong Of* Aronson *Because The Challenged Transactions Are Subject To Entire Fairness Review*

Demand under the second prong of *Aronson* is excused whenever the business judgment rule does not apply to the board decision at issue. *Aronson*, 473 A.2d at 808 ("In our view demand can only be excused where facts are alleged with particularity which create a reasonable doubt that the directors' action was entitled to the protections of the business judgment rule."). In this case, the business judgment rule does not apply to a self-dealing transaction between the corporation and Maginn and Chai—regardless of the independence or not of a majority of the Board—because Maginn and Chai exercise practical and voting control over the Company, as explained above. "The existence of a controlling stockholder with a conflicting interest in a decision will remove the board's decision from the protection of the business judgment rule even where a majority of directors is independent and disinterested." 1 EDWARD P. WELCH, ANDREW J. TUREZYN & ROBERT S. SAUNDERS, FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 141.2.3.4, at GCL-IV-74 (5th ed. 2009-2 supplement) (citing *In re LNR Prop. Corp. S'holders Litig.*, 896 A.2d 169, 177 (Del. Ch. 2005)). Under *Kahn v. Tremont*, "[e]ntire fairness remains

[36] *See Pogostin*, 480 A.2d at 624 ("*The question of independence flows from an analysis of the factual allegations pertaining to the influences upon the directors' performance of their duties generally*, and more specifically in respect to the challenged transaction.") (emphasis added); *see also Abraham v. Emerson Radio Corp.*, 901 A.2d 751, 757-58 (Del. Ch. 2006) (demand excused where directors were asked to consider suit against their employing entity).

applicable even when an independent committee is utilized because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny." *Tremont*, 694 A.2d at 428.

Maginn and Chai, husband and wife, act together as Jenzabar's controlling shareholders. Compl. ¶ 4.[37] A shareholder is controlling "if it owns a majority interest in or exercises control over the business affairs of the corporation." *Lynch*, 638 A.2d at 1113-14 (citing *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987)) (remanding for entire fairness determination). Maginn and Chai exercise actual control over Jenzabar. *See id.* (finding shareholder with 43% ownership controlling where he bullied independent directors into doing his bidding). Maginn serves as the Chairman of the Board and CEO of Jenzabar, Chai is a director, founder, President and COO of Jenzabar, and they maintain significant equity positions in the Company. Compl. ¶¶ 3-4. Furthermore, as described in connection with the *Aronson* prong one analysis above, Maginn and Chai have a demonstrated ability to corrupt independent Board processes in furtherance of their interests. As the facts recited above demonstrate, they have the ability to control their own compensation (and in fact have).

Moreover, to supplement Maginn and Chai's own considerable equity holdings, Compl. ¶ 30; Maginn Br. pp. 5-7, nn.5-6, Maginn used Jenzabar assets to acquire an irrevocable proxy to another 10,206,858 shares of Jenzabar voting stock held by Pegasus, *see supra* note 3 and

[37] *Dubroff v. Wren Holdings, LLC*, 2009 WL 1478697, at *3 (Del. Ch. May 22, 2009) ("Delaware case law has recognized that a number of shareholders . . . can collectively form a control group where those shareholders are connected in some legally significant way . . . ."); *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 913 (Del. Ch. 1999) (plaintiff demonstrates defendant is a controlling shareholder when "its complaint alleges facts sufficient to support an inference that the defendant had actual control of a corporation's conduct, even if the complaint fails to make that express allegation").

accompanying text, purportedly giving Maginn and Chai voting control over Jenzabar.[38] Based upon these facts, there can be little doubt that Maginn and Chai exercise control over Jenzabar. *In re Cysive, Inc., S'holders Litig.*, 836 A.2d 531, 552 (Del. Ch. 2003) (finding actual control in part because defendant was the founder, chairman and CEO). Furthermore, "[b]ecause the question of whether a large block holder is so powerful as to have obtained the status of a 'controlling stockholder' is intensely factual, it is a difficult one to resolve on the pleadings." *Id.* at 550-51. Because Maginn and Chai were personally interested in the challenged actions, entire fairness review applies to Count 5.[39]

Although the *Lynch* doctrine arose initially in the context of mergers, the Court has explicitly extended it beyond that context:

> [I]n a post trial opinion in *Kahn v. Tremont Corp.*, Chancellor Allen explicitly refused to limit Lynch to merger cases. He said: "Defendants seek to limit *Lynch* to cases in which mergers give rise to the claim of unfairness, but offer no plausible rationale for a distinction between mergers and other corporate transactions and in principle I can perceive none. Thus, I conclude that under *Lynch* the operation of such a committee can only shift to plaintiff the burden of proving that the transaction was unfair."
>
> The Supreme Court reaffirmed Chancellor Allen's conclusion in its decision in the same case, when it stated that "when a controlling shareholder stands on both sides of the transaction, the conduct of the parties will be viewed under the more exacting standard of entire fairness as opposed to the more deferential business judgment standard."

T. Rowe Price Recovery Fund, L.P. v. Rubin, 770 A.2d 536, 552 (Del. Ch. 2000) (quoting *Kahn v. Tremont Corp.*, 1996 WL 145452, at *7 (Del. Ch. Mar. 21, 1996); *Tremont*, 694 A.2d at 428).

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[38] While MCG has asserted to Defendants that the proxy has expired and may have been invalid from the outset, Defendants have not accepted that position.

[39] Maginn and Chai's self-compensation clearly falls under the umbrella of a self-interested transaction. Because the Board Management Fiduciary Claims and the Repurchase Notice Fiduciary Claims, described *infra* § V.C-D, both allege conduct in service of Maginn and Chai's self-dealing, demand is excused as to those allegations as well.

Therefore, the transactions here are subject to entire fairness review and demand is excused. *Cal. Pub. Employees Ret. Sys. v. Coulter*, 2002 WL 31888343, at *13 & n.37 (Del. Ch. Dec. 18, 2002) (finding demand excused under prong two of *Aronson* under entire fairness review).

If the Court were to conclude that the entire fairness standard did not apply, then demand would still be excused under the second prong of *Aronson* for the reasons discussed above, *see supra* pp. 35-39; namely, that the conduct of San Miguel and Mills, including a knowing breach of the Company's Charter and the PSWPA, has exposed them to the substantial likelihood of liability for the breaches of the duty of loyalty and good faith. *See Ryan v. Gifford*, 918 A.2d 341, 355 (Del. Ch. 2007) (allegations of knowing and purposeful violations of shareholder plans, among other things, were sufficient to excuse demand); *see infra* pp. 51-52 (departing from known compensation structure based solely on advice of self-interested beneficiaries, while rejecting independent advice, amounts to conscious indifference to duty and evidences a breach of the duties of care, loyalty and good faith).

B. Defendants Have Failed To Meet Their Burden Of Proving That "A Serious Conflict Exists" And That MCG Cannot Be Expected To Act In The Interests Of The Other Shareholders Because Doing So Would Harm Its Own Interests

"A defendant has the burden of proof in a motion to disqualify a derivative plaintiff and he must show that a serious conflict exists, by virtue of one factor or a combination of factors, and that the plaintiff cannot be expected to act in the interests of the others because doing so would harm his other interests." *Emerald Partners v. Berlin*, 564 A.2d 670, 674 (Del. Ch. 1989) (citing *Youngman*, 457 A.2d at 379-80; 7C WRIGHT & MILLER § 1833) (denying motion to disqualify derivative plaintiff). Defendants' sole argument in support of the contention that MCG is an inadequate representative is that MCG has brought both direct and derivative claims in the present action and seeks to enforce its contractual rights. Br. pp. 15-16.

Under Delaware law, a plaintiff is permitted to maintain direct and derivative claims in the same action. *See, e.g., Carlson*, 925 A.2d at 513 (post-trial finding for plaintiffs on both direct and derivative claims). In fact, "'[c]ourts have long recognized that the same set of facts can give rise to both a direct claim and a derivative claim.'" *Gentile v. Rossette*, 906 A.2d 91, 100 n.19 (Del. 2006) (quoting *Grimes v. Donald*, 673 A.2d 1207, 1212 (Del. 1996)) (reversing Court of Chancery's dismissal of direct claims). "The fact that the plaintiff may have interests which go beyond the interests of the [other shareholders], but are at least co-extensive[] with the [other shareholders'] interest, will not defeat his serving as a representative of the [shareholder] class. Similarly, purely hypothetical, potential or remote conflicts of interests never disable the individual plaintiff." *Youngman*, 457 A.2d at 381 (citing 7A WRIGHT & MILLER § 1833) (finding plaintiff an adequate derivative plaintiff). "Though the plaintiff may well have in part a selfish motive in bringing this action, which is not unusual, he will be permitted to continue to act on behalf of all the stockholders[.]" *Id.* at 382 (denying motion to dismiss). Of the five cases cited by Defendants for the proposition that derivative claims cannot be brought with direct claims, *see* Br. pp. 14-15, two applied New York law, *see Tuscano v. Tuscano*, 403 F. Supp. 2d 214, 223 (E.D.N.Y. 2005); *Wall St. Sys., Inc. v. Lemence*, 2005 WL 292744, at *3 (S.D.N.Y. 2005), and the other three did not suggest that the presence of direct and derivative claims was necessarily impermissible. Rather, they examined the specific facts before them to determine whether the claims could coexist without conflict. *See, e.g., Keyser v. Commonwealth Nat'l Fin. Corp.*, 120 F.R.D. 489, 492 (M.D. Pa. 1988) ("This court agrees with the line of cases cited by plaintiffs that reject a *per se* rule prohibiting shareholders from simultaneously bringing both direct and derivative actions. The better reasoned and predominant rule of law is to look behind the

'surface duality' of these two types of actions and allow them to proceed together unless an actual conflict emerges.").[40]

MCG's interests are coextensive with those of the other shareholders. To the extent that MCG succeeds in limiting Maginn and Chai's misappropriations through the valid exercise of its contractual rights, all of Jenzabar's shareholders benefit. Compl. ¶ 32. MCG's direct claims seek to maintain MCG as a Jenzabar shareholder, thereby cementing MCG's ongoing interest in Jenzabar. *Id.* The fact that MCG has in the past and may at some point in the future desire to be bought out by Jenzabar does not disrupt the alignment of MCG's interests with those of Jenzabar's other shareholders for the purpose of this action. *See Emerald Partners*, 564 A.2d at 675 (denying motion to disqualify derivative plaintiff who formerly sought to greenmail corporation on the ground that plaintiff was not then attempting to sell stock). Therefore, the Defendants have not met their burden of demonstrating that a "serious conflict exists" between MCG's interests and those of Jenzabar's other shareholders, as is required to disqualify MCG as a derivative plaintiff. *Id.* at 674 (citing *Youngman*, 457 A.2d at 379-80).

V. COUNT 5 PROPERLY ASSERTS THAT DEFENDANTS BREACHED THEIR FIDUCIARY DUTIES

Count 5 identifies various conduct by the Defendants in breach of their fiduciary duties. First, Count 5 alleges that the Defendants awarded compensation to Maginn and Chai that is not entirely fair to Jenzabar and that was the product of grossly negligent and bad faith conduct. ("Fiduciary Compensation Claims.") These claims are derivative. Second, the Defendants

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[40] The other two cases cited by Defendants are readily distinguishable: *Scopas Tech. Co. v. Lord*, 1984 WL 8266, at *3 (Del. Ch. Nov. 20, 1984) (noting that the plaintiff, who had expressed a desire "to bring the company down," was hostile toward the corporation in a manner that "would handicap his ability to adequately represent the corporation and its shareholders in a derivative suit"); *Rosan v. Chicago Milwaukee Corp.*, 1990 WL 13482, at *8 (Del. Ch. Feb. 6, 1990) (noting that the direct claims had been dismissed and therefore no conflict existed).

breached their obligation to use requisite care to cause Jenzabar to comply with its Charter and contractual obligations, particularly as those obligations created rights for certain of Jenzabar's shareholders. The Defendants' motivation to distort the Charter and contractual provisions allowed Maginn and Chai to receive the compensation they desired despite MCG's opposition. In doing so, the Defendants did not exercise the requisite care in determining Jenzabar's obligations because they refused to obtain independent legal advice as to those legal obligations, and instead sought advice only from counsel selected by Maginn and Chai. ("Fiduciary Charter and Contract Claims.") Third, the Defendants conducted Board processes in a manner that undermined and obstructed the participation of Malekian in Board decision making. ("Board Management Fiduciary Claims.") Fourth, the Defendants caused Jenzabar to breach its contractual obligation to provide MCG with 30 days notice under the PSWPA so as to create a deadline that would cause MCG to lose its governance rights. ("Repurchase Notice Fiduciary Claim.")

Because, under *Kahn v. Lynch*, entire fairness review applies to MCG's fiduciary duty claims, these claims in Count 5 may not be dismissed on a Rule 12(b)(6) motion. *See Krasner v. Moffett*, 826 A.2d 277, 287 (Del. 2003) (finding Court of Chancery's dismissal of claims subject to entire fairness review premature).[41] As explained previously, MCG's fiduciary duty claims challenge transactions between Jenzabar and Maginn and Chai, Jenzabar's controlling shareholders, and are therefore subject to entire fairness review. *T. Rowe Price*, 770 A.2d at 552 (entire fairness review applies to transaction with controlling shareholder). "[W]hen . . . the

[41] *See also In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 605 (Del. Ch. 2005) (the *Lynch* "standard . . . makes it impossible for a controlling stockholder ever to structure a transaction in a manner that will enable it to obtain dismissal of a complaint challenging the transaction"); *In re Cysive*, 836 A.2d at 549 ("[T]he *Lynch* doctrine will generally preclude dismissal.").

entire fairness rule is implicated . . . defendants bear the burden of proof." *Krasner*, 826 A.2d at 287 (reversing Chancery Court's dismissal). Therefore, where, as here, a plaintiff establishes that entire fairness review applies to claims, those claims cannot be dismissed under Rule 12(b)(6). *See In re Cox*, 879 A.2d at 605.

Even were this Court to conclude that some claims in Count 5 are not subject to entire fairness scrutiny, MCG's fiduciary duty claims satisfy the Rule 12(b)(6) standard.

A. The Fiduciary Compensation Claims Demonstrate Breaches Of The Duties Of Loyalty, Care And Good Faith By All Of The Individual Defendants

The Fiduciary Compensation Claim cites specific examples of Defendants' misconduct in support of MCG's allegation that all of the Individual Defendants breached their fiduciary duties of care, loyalty, and good faith. Compl. ¶ 108. Maginn and Chai have a fiduciary obligation to not receive any benefits or compensation from the corporation that are not "entirely fair." *See, e.g., NL Indus., Inc. v. MAXXAM, Inc.* (*In re MAXXAM, Inc./Federated Dev. S'holders Litig.*), 659 A.2d 760, 771 (Del. Ch. 1995) (controlling shareholder standing on both sides of loan transaction "would be required to demonstrate that the 1987 loan transactions were entirely fair" under *Lynch*).[42] Retroactive compensation and compensation in excess of agreed contractual terms raise obvious questions of "entire fairness" that cannot be resolved on a motion to dismiss. *Zupnick v. Goizueta*, 698 A.2d 384, 388 (Del. Ch. 1997) (recognizing a "common law rule that . . . generally prohibits retroactive executive compensation," except where facts indicate that

[42] *See also Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 n.9 (Del. 1993) ("Where actual self-interest is present and affects a majority of the directors approving a transaction, a court will apply . . . exacting scrutiny to determine whether the transaction is entirely fair to the stockholders."); *Brehm v. Eisner* (*In re Walt Disney Co. Derivative Litig.*), 906 A.2d 27, 52 (Del. 2006) ("If [inapplicability of business judgment rule is shown], the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders.").

amount awarded is reasonable in light of extraordinary services rendered), *cited in Underbrink v. Warrior Energy Servs. Corp.*, 2008 WL 2262316, at *10 n.92 (Del. Ch. May 30, 2008).

In addition to Maginn and Chai's duty to receive only fair benefits from Jenzabar, they also had a duty to negotiate any further compensation increases honestly and in good faith. *Official Comm. of Unsecured Creditors of Integrated Health Servs. v. Elkins*, 2004 WL 1949290, at *16 (Del. Ch. Aug. 24, 2004) ("[O]nce an employee becomes a fiduciary of an entity, he has a duty to negotiate further compensation agreements 'honestly and in good faith so as not to advantage himself at the expense of the [entity's] shareholders.'" (quoting *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 290 (Del. Ch. 2003)) (second alteration in *Elkins*). Therefore, contrary to their arguments, *see* Maginn Br. p. 19, they can be found liable for the bonuses and salary increases they improperly obtained. Maginn and Chai breached their fiduciary duties in several ways. Compl. ¶¶ 25-26, 49, 52, 56. First, "Maginn and Barr informed the Board that as a result of an extensive search of historical documents they had 'discovered' that a $750,000 bonus owed to Defendant Maginn had not yet been paid." *Id.* ¶ 49. Yet, "[d]efendants Maginn and Barr knew at the time . . . that [the bonus] had been only conditionally approved." *Id.* ¶ 52. Then, "[n]ot yet finished with his compensation demands for 2008 . . . Maginn further demanded that he be paid an additional retroactive bonus of approximately $3.5 million and that Defendant Chai be paid an additional retroactive bonus of $3.1 million . . . ." *Id.* ¶ 56.[43] Therefore, Section III of the Complaint supports the claim that Maginn and Chai have not negotiated their compensation increases at arms length and in good faith.

[43] Chai's participation in the misconduct can be inferred from her parallel receipt of benefits from the flawed process. *Id.* ¶¶ 44, 47, 56; *see N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 97 (Del. 2007) ("'[T]he Court must draw all reasonable inferences in favor of the non-moving party . . . .'" (quoting *In re GM (Hughes) Shareholder Litig.*, 897 A.2d at 168)).

Section III of the Complaint similarly pleads facts demonstrating that San Miguel and Mills consciously ignored their fiduciary duties of loyalty, care and good faith when they caused Jenzabar to award additional compensation to Maginn and Chai for no consideration. Compl. ¶¶ 36-59; *cf. Emerald Partners v. Berlin*, 1993 WL 545409, at *8 (Del. Ch. Dec. 23, 1993) ("If the defendant-directors knowingly approved a transaction in which the corporation received *no* consideration in return for the pledge of valuable corporate assets to secure the personal loans of its Chief Executive Officer, 8 Del. C. § 102(b)(7) would not protect them from personal liability because they would have acted in bad faith.").[44]

In this case, Maginn and Chai's compensation was set in contracts that they accepted, and the bonuses received and sought by Maginn and Chai were retroactive, covering periods for which they already had received bonuses. Compl. ¶ 56. To depart from this agreed upon and already effectuated compensation structure based solely on the advice of the self-interested beneficiaries of that compensation—after rejecting independent advice—is conscious indifference to duty. *In re Walt Disney Co. Derivative Litig.*, 825 A.2d at 289 (finding demand excused under the second prong of *Aronson*); *Ryan*, 918 A.2d at 357 ("Bad faith . . . may be shown . . . 'where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of known duty to act, demonstrating a conscious disregard for his duties.'" (quoting *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006))).[45] These directors knew the person from whom they were receiving advice was interested in the advice

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[44] As noted above, San Miguel and Mills heard presentations from Maginn, Compl. ¶ 26, relied on Maginn's attorney and handpicked employee to the exclusion of independent counsel, *id.* ¶¶ 41-42, 46, refused to engage a compensation consultant, *id.* ¶ 42, failed to properly inform themselves, *id.* ¶ 51, and failed to rescind compensation they knew was awarded in error. *Id.* ¶ 55.

[45] *See also ATR-Kim Eng Fin. Corp. v. Araneta*, 2006 WL 3783520, at *19 (Del. Ch. Dec. 21, 2006) ("Under Delaware law, it is fundamental that a director cannot act loyally towards the corporation unless she tries—*i.e.*, makes a genuine, good faith effort—to do her job as a director." (citing *Guttman v. Huang*, 823 A.2d 492, 506 & n.34 (Del. Ch. 2003))).

being given, knew that independent advice was available, knew that they were departing from established and effectuated contractual norms and even knew, after-the-fact, that they had been misled by Maginn and Chai. Compl. ¶ 55.[46] Yet, not only did these directors refuse to rescind the bonuses given in error, but they are actively considering granting even larger retroactive bonuses. Prelim. Inj. Scheduling Hearing Tr. 17:13-22, 19:2-7. Such conduct evidences breaches of the duty of care, loyalty and good faith.

Barr's participation in the process violated his own fiduciary duties of loyalty, care and good faith. *Gantler*, 965 A.2d at 708-09 ("[T]he fiduciary duties of officers are the same as those of directors." (citing *Guth v. Loft, Inc*., 5 A.2d 503, 510 (Del. Ch. 1939); *Cede & Co. v. Technicolor, Inc*., 634 A.2d 345, 361 (Del. 1993))). As corporate counsel, Barr had a duty "to ensure the board's compliance with its legal and equitable duties." *In re Am. Int'l Group, Inc.*, 965 A.2d 763, 822 n.220 (Del. Ch. 2009) (citing *Sample v. Morgan*, 935 A.2d 1046, 1063-64 (Del. Ch. 2007)). The Complaint alleges, among other things, that Barr deliberately misled the Board, Compl. ¶ 52, played a key role in undermining the independence of the Compensation Committee, *id.* ¶ 41, and conferred with San Miguel and Mills in connection with their flawed approval of the improper compensation. *Id.* ¶ 46.[47] Therefore, Barr should be held liable for the flawed outcome that his breaches of fiduciary duty created.

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[46] *See Gesoff*, 902 A.2d at 1151 ("In a similar case, the fact that the parent's 'General Counsel suggested the name of appropriate legal counsel to the Special Committee, and that individual was promptly retained,' was a notable indicator that the special committee's process was not to be trusted." (quoting *Tremont*, 694 A.2d at 429)).

[47] *Citron*, cited by Defendants, *see* Br. p. 42, is distinguishable, because the Court in *Citron* noted that Heckert brought "the two sides together *on terms that addressed the specific concerns* identified by the Merger Committee and its advisors," *see Citron v. E.I. DuPont de Nemours & Co.*, 584 A.2d 490, 499 n.12 (Del. Ch. 1990) (emphasis added), while MCG has alleged that Barr contributed to the flaws in the process, *see* Compl. ¶¶ 41-43, 46, 49-50, 52-53.

B. The Fiduciary Charter And Contract Claims Allege That Defendants Breached Their Duties To MCG And Jenzabar By Breaching Jenzabar's Charter And Causing Jenzabar To Breach Its Contract With MCG In Bad Faith

The Fiduciary Charter and Contract Claims turn upon the settled law that the responsibilities of directors include causing the corporation to comply with its charter and its contractual obligations and that these duties must be performed with the requisite care and in good faith. *See Bay Ctr. Apts.*, 2009 WL 1124451, at * 8-9 (finding breach of fiduciary duty where defendants caused LLC to breach LLC agreement to satisfy personal interests); *cf. Apple Computer*, 1999 WL 39547, at *4 (like a board's failure to comply with a contract, "a board's failure to comply with § 271 (if proven at trial) is a breach of fiduciary duty"). Those duties must be performed with the requisite care and for the proper purpose. *Apple Computer*, 1999 WL 39547, at *4. Maginn and Chai had an obvious self-interest with respect to the resolution of Jenzabar's obligations under its Charter and the PSWPA. San Miguel and Mills knew that MCG opposed the extra compensation Maginn and Chai sought from Jenzabar.

The conduct of San Miguel and Mills, as well as their relationships with Maginn and Chai, evidence a lack of care and improper motivation in resolving these Charter and contract issues. Notwithstanding their awareness of the self-interest of Maginn and Chai, San Miguel and Mills turned for advice solely to the interested officers—Maginn and Chai—and legal counsel retained by them. Compl. ¶ 46. In addition, San Miguel and Mills refused suggestions that they consult with independent counsel. *Id.*; *cf. Gesoff*, 902 A.2d at 1151 (finding defendants failed to prove fair dealing). Such conduct, at a minimum, constitutes gross negligence, and it creates a reasonable inference that San Miguel and Mills were consciously indifferent to their obligation to cause Jenzabar to comply with its Charter and contractual obligations. *Smith v. SPNV*

Holdings, Inc., 1989 WL 44049, at *4 (Del. Ch. Apr. 26, 1989) (motivation is a question of fact which is not properly disposed of before trial). This conduct, and San Miguel and Mills' relationship with Maginn and Chai, create more than a reasonable inference that they were attempting to aid Maginn and Chai to overcome and undermine MCG's rights under the Charter and contract. Such conduct violates their fiduciary duty.

C. The Board Management Fiduciary Claims Demonstrate Breaches Of The Fiduciary Duties Of Loyalty, Care, And Good Faith By All Of The Individual Defendants

The Board Management Fiduciary Claims assert that the Defendants undertook and tolerated governance processes that had the purpose and effect of obstructing Malekian's performance of his duties as a director. Compl. ¶¶ 60-69. The reason for this obstruction is obvious: Malekian's questions and suggestions were a threat to the control and compensation of Maginn and Chai. Maginn, Chai and Barr "breached their fiduciary duties to MCG" by "routinely acting to keep the non-management members of the Board of Directors in the dark so as to better operate Jenzabar for their own advantage." *Id.* ¶¶ 60, 108. Defendants present three primary arguments as to why acting to undermine corporate governance states no claim: (1) "MCG's right to representation is governed exclusively by contract"; (2) Board Management Fiduciary Claims "can only be brought by Malekian"; and (3) "Jenzabar's Section 102(b)(7) provision exculpates directors from personal liability for breaches of the duty of care." Br. p. 40. None of these arguments defeats MCG's entitlement to a fully informed board.

First, MCG's right to a functioning board has been modified by contract, but is not supplied by contract: "'[F]iduciaries, corporate or otherwise, may not use superior information or knowledge to mislead others in the performance of their own fiduciary obligations.'" *Hollinger*

Int'l v. Black, 844 A.2d 1022, 1061 n.84 (Del. Ch. 2004) (quoting *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1283 (Del. 1989)).[48] Yet, "Barr has withheld draft minutes of Board meetings from members of the Board," and has "resisted Malekian's efforts to ensure that the minutes accurately reflect the Board's actions and deliberations, using as pretext the fact that other participants did not recall the discussions Malekian sought to include." Compl. ¶ 63. Similarly, Barr has refused to circulate agendas in a manner that would permit Malekian time to prepare for Board meetings. *Id.* ¶¶ 61-62. This Court has previously found that allegations by a shareholder that "[board designees] were denied access to information necessary to fulfill their duties as directors . . . and were forced out of the Company's boardroom" stated a claim. *Cf. Acker v. Transurgical, Inc.*, 2004 WL 1230945, at *2 (Del. Ch. Apr. 22, 2004) (denying motion to dismiss contract-based claim). Here, "Maginn, Barr and Chai have . . . improperly attempted to exclude Malekian from deliberations when they deemed it in their personal interests." Compl. ¶ 68. Therefore, the Board Management Fiduciary Claims withstand dismissal.

Second, Defendants cite no authority for their proposition that shareholders lack standing to challenge these breaches of fiduciary duty. Br. p. 41; Maginn Br. p. 20. Defendants contend that only directors have standing to challenge improper board management on the basis of a group of statutes enabling directors to bring claims or obtain information; however, those same

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[48] *See also Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 441-42 (Del. 1996) (stressing the importance of duty to be candid with fellow directors); *HMG/Courtland Props., Inc. v. Gray*, 749 A.2d 94, 119 (Del. Ch. 1999) (directors have "'an unremitting obligation' to deal candidly with their fellow directors"); 1 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS & RECOMMENDATIONS, cmt. 6 § 5.02(a)(1), at 215 ("A director or senior executive owes a duty to the corporation not only to avoid misleading it by misstatements and omissions, but affirmatively to disclose the material facts known to the director or senior executive.").

statutes provide parallel rights to shareholders.[49] Furthermore, in *Schoon v. Smith*, 953 A.2d 196 (Del. 2008), the Delaware Supreme Court recently held that only a shareholder possesses standing to bring derivative claims. *Id.* at 209-10. Therefore, there is no authority for the proposition that MCG lacks standing to challenge the deliberate exclusion of one of Jenzabar's directors.

Third, contrary to Defendants' arguments, Br. p. 42; Maginn Br. pp. 20-21, the Section 102(b)(7) provision in Jenzabar's Charter does not eliminate the Board Management Claims: "[n]otwithstanding Section 102(b)(7), monetary damages are available for wrongful conduct going beyond duty of care violations. Moreover, equitable remedies not involving monetary damages are also permitted." *Arnold v. Society for Sav. Bancorp*, 678 A.2d 533, 541-42 (Del. 1996) (noting that despite a 102(b)(7) provision, "[stockholders] remain protected by the availability of injunctive relief. Stockholders are not discouraged from pursuing such remedies when warranted").[50] As discussed above, the Board Management Claims allege breaches of the duty of loyalty and good faith, Compl. ¶ 107, neither of which would be precluded by a Section 102(b)(7) provision. *Cal. Pub. Employees Ret. Sys.*, 2002 WL 31888343, at *17 (denying motion to dismiss because "[a]ll surviving breach of fiduciary duty claims may implicate the

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[49] *Compare* 8 *Del. C.* § 220(d) (permitting a director to bring a books and records request), *with* 8 *Del. C.* § 220(b) (permitting a shareholder to bring a books and records request); *compare* 8 *Del. C.* § 225(a) (permitting an office holder to obtain a ruling as to the outcome of an election), *with* 8 *Del. C.* § 225(b) (permitting a shareholder to obtain a ruling as to the outcome of an election); *see also* 8 *Del. C.* § 211(c) (after thirteen months without meeting a meeting shall be held by application of either shareholder or director).

[50] *See also Emerald Partners*, 1993 WL 545409, at *8 ("8 Del. C. § 102(b)(7) would not protect [directors] from personal liability [if] they . . . acted in bad faith."); *In re Am. Int'l Group*, 965 A.2d at 776 (only duty of care claims seeking monetary damages dismissed); *Hokanson v. Petty*, 2008 WL 5169633, at *5 (Del. Ch. Dec. 10, 2008) (applying 102(b)(7) provision only to duty of care claims); *In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 648 (Del. Ch. 2008) (due to presence of 102(b)(7) provision plaintiff must "plead facts suggesting that the Lear directors breached their duty of loyalty"); *McMillan v. Intercargo Corp.*, 768 A.2d 492, 501 (Del. Ch. 2000) ("[T]he defendants do not obtain a dismissal of the plaintiffs' loyalty claims as a result of the exculpatory charter provision; they obtain a dismissal *because* the complaint fails to properly plead a loyalty claim . . . ."), all cited in Maginn Br. pp. 20-21.

duty of loyalty for which the directors may not be afforded protection under § 102(b)(7), and, in several instances, the remedy sought is not limited to damages. Defendants' motion to dismiss any claims on the basis of an exculpatory provision in Lone Star's Certificate of Incorporation is denied"). Additionally, because of a continuing fear of improper management, Compl. ¶ 67, injunctive remedies have been requested and are available to remedy a breach of the duty of care, despite the Section 102(b)(7) provision. *Cal. Pub. Employees Ret. Sys.*, 2002 WL 31888343, at *17. Finally, the effect of a Section 102(b)(7) provision should not be considered until the remedy stage. *Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001). Therefore, contrary to Defendants' claims concerning the Section 102(b)(7) provision, MCG's Board Management Fiduciary Claims cannot be ignored. Br. p. 26.

Defendants' other arguments fare no better. Delaware law flatly contradicts Defendants' proposition, *see* Maginn Br. p. 20, that MCG lacks standing to bring its Board Management Fiduciary Claims due to lack of injury. *Gentile v. Rossette*, 906 A.2d at 102 ("No principle of fiduciary law or policy justifies any condonation of fiduciary misconduct, even where the resulting harm is not 'material'. . . ."); *see also President & Fellows of Harvard College v. Glancy*, 2003 WL 21026784, at *18 & n.27 (Del. Ch. Mar. 21, 2003) (plaintiff need not establish damages to state valid claim for a breach of fiduciary duty), *modified on reh'g in part, reh'g denied in part*, 636 A.2d 956 (Del. 1994); *Leslie v. Telephonics Office Techs., Inc.*, 1993 WL 547188, at *11 (Del. Ch. Dec. 30, 1993) ("[A] well pleaded claim for breach of fiduciary duty will survive a motion to dismiss, even in the absence of any allegation of damages flowing from

the breach.").[51] Consequently, MCG's Board Management Fiduciary Claims state a claim under Rule 12(b)(6).

D. The Repurchase Notice Claim Demonstrates That The Individual Defendants Breached Their Fiduciary Duties Of Care, Loyalty, And Good Faith In Causing Jenzabar To Breach Its Contract With MCG

The Repurchase Notice Fiduciary Claim asserts that the Board breached its fiduciary duties when it sought to redeem MCG's preferred stock without complying with Jenzabar's Charter, solely for Maginn and Chai's benefit. Compl. ¶ 108. Under section 5.11(g) of the PSWPA, if MCG's Senior Preferred Stock is repurchased prior to April 30, 2009, MCG's voting rights under section 5.12 of the PSWPA lapse unless MCG responds to the repurchase by putting its warrants. Compl. ¶ 19. If, instead, MCG's Senior Preferred Stock is repurchased after April 30, 2009, MCG's voting rights are unaffected. *Id.* ¶ 19, PSWPA § 5.11(g). Thus, Defendants caused Jenzabar to breach the PSWPA by failing to give the notice expressly required in order to force MCG to choose between surrendering its Warrants or losing its governance rights, rather than to secure a business benefit for Jenzabar. *Cf. Tooley v. AXA Fin., Inc.*, 2005 WL 1252378, at *5 n.21 (Del. Ch. May 13, 2005) ("[A]s the Court is charged under Rule 12(b)(6) with viewing all facts in the light most favorable to the nonmoving party, the plaintiffs get the benefit of the doubt that the [redemption] was in fact motivated [by defendant's personal interests]."). Defendants breached their fiduciary duties by exposing Jenzabar to a lawsuit for breach of contract in order to benefit Maginn and Chai, Jenzabar's controlling shareholders. *Id.* at *5 (finding that allegations that "the defendant directors agreed to the second extension because

[51] Also, Barr's role in preparing the minutes is "a process that normally relies on legal counsel." *Frank v. Engle*, 1998 WL 155553, at *2 (Del. Ch. Mar. 25, 1998) (finalizing board minutes is "a process that normally relies on legal counsel"). Thus, Barr's direct involvement is alleged in a manner distinguishing this case from *Citron*, cited by Defendants. *See* Br. pp. 42-43 (citing *Citron*, 584 A.2d at 499 n.12).

AXA Financial dominated the DLJ board and because AXA Financial determined it would benefit from the extension because of administrative needs . . . adequately alleged that the defendants breached their duty of loyalty by engaging in self-dealing").

Furthermore, the disenfranchisement of shareholders is a classic breach of fiduciary duty. *Tooley*, 2005 WL 1252378, at *5 (denying motion to dismiss claims that adjustment of merger date for majority shareholders' benefit breached fiduciary duties); *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1130-32 (Del. 2003) (reversing Chancery Court's post-trial ruling that defendants did not breach fiduciary duties by disenfranchising shareholders). In other contexts, this Court has noted that purposeful efforts to disenfranchise shareholders are "strongly suspect" and cannot be sustained without a "compelling justification." *Id.* at 1130 (reversing Chancery Court's post-trial ruling in defendants' favor). In *Tooley*, this Court held that a board's adjustment of a merger date, a date established solely by contract, for the preferred shareholders' benefit and to the minority shareholders' detriment properly stated a claim "without resorting to contract or expectancy interest theories." *Tooley*, 2005 WL 1252378, at *5 (denying motion to dismiss). Therefore, Defendants present no justification for the dismissal of the Repurchase Notice Fiduciary Claim.

E. Count 5 Does Not Merely Restate Contract Claims

Defendants argue that Count 5 merely restates contract claims alleged in Counts 1 and 2. However, the fiduciary duty claims in Court 5, as described above, are neither controlled by contract terms nor duplicative of contract claims. "[MCG] can maintain an action based on the alleged breaches of the independent set of fiduciary duties that [Defendants] owe[] [Jenzabar] stockholders even though the claims arise from some or all of the same facts that relate to the transactions that provided the basis for its contract claims. [Defendants'] fiduciary duties to [Jenzabar] consist of a set of rights and obligations that are independent of any contract . . . ."

Parfi Holding AB v. Mirror Image Internet, 817 A.2d 149, 156-57 (Del. 2002) (reversing Chancery Court dismissal of fiduciary duty claims). Misappropriation of corporate assets, bad faith breaches of governing documents, improper corporate governance, and interference with shareholder voting are all grounds on which shareholders may assert claims absent a contractual arrangement.[52] The cases cited by Defendants for the proposition that the contractual rights cannot give rise to fiduciary claims are distinguishable on the grounds that MCG is asserting breach of fiduciary duty claims independent of its contract claims. Br. pp. 38-39.[53] Furthermore, the relief sought by MCG, including an injunction, accounting, and rescission, is not entirely co-extensive with the remedies sought for MCG's contractual claims. Compl. pp. 31-32. Therefore, Defendants are incorrect when they claim that Count 5 pleads only redundant claims, "governed exclusively by contract." Br. p. 38.

F. Count 5 States Both Direct And Derivative Claims

Whether a claim is derivative or direct "turn[s] *solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)." *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). Defendants do not contest the derivative nature of the claims alleged in Count 5 "to the extent

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[52] *Emerald Partners*, 1993 WL 545409, at *8 (finding demand excused where directors awarded stock options to controlling shareholder); *Solomon*, 747 A.2d at 1114 (acts prohibited by corporate charter are *ultra vires*); *Hollinger Int'l*, 844 A.2d at 1061 n.84 (controlling shareholder breached fiduciary duties by failing to keep directors informed); *MM Cos.*, 813 A.2d at 1130-31 (ruling that defendants breached fiduciary duties by disenfranchising shareholders).

[53] *See Blue Chip Capital Fund II L.P. v. Tubergen*, 906 A.2d 827, 833 (Del. Ch. 2006) (dismissing where alleged breach of fiduciary duty was failure to interpret contract in good faith); *In re Sunstates Corp. S'holder Litig.*, 788 A.2d 530, 553 (Del. Ch. 2001) (granting summary judgment where alleged rights were unique to preferred shareholders); *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 594 (Del. Ch. 1986) (noting that preferred stock remained entitled to "a fair apportionment of the merger consideration"); *HB Korenvaes Inv., L.P. v. Marriott Corp.*, 1993 WL 205040, at *6-7 (Del. Ch. June 9, 1993) (preferred challenging distribution to common stockholders); *Gale v. Bershad*, 1998 WL 118022, at *5 (Del. Ch. Mar. 4, 1998) (no fiduciary claims arising from redemption pursuant to preferred stock specific provision).

they purport to seek a remedy for alleged harm to Jenzabar and its stockholders." Br. p. 13. They do claim that Count 5 fails to state any direct fiduciary duty claims. But, "'[c]ourts have long recognized that the same set of facts can give rise to both a direct claim and a derivative claim.'" *Gentile*, 906 A.2d at 100 n.19 (quoting *Grimes*, 673 A.2d at 1212) (reversing the Chancery Court's dismissal of direct claims).

The Fiduciary Compensation Claim in Count 5, challenging the grant of extra compensation to Maginn and Chai as a breach of fiduciary duty, is derivative in nature. However, the remaining claims in Count 5 are both direct and derivative. Specifically, the claims that the Board hampered its own corporate governance and failed to exercise due care and acted for improper purposes in causing Jenzabar to violate its Charter and contractual obligations to MCG are both direct and derivative. Both MCG and Jenzabar were injured by those breaches. *Gatz v. Ponsoldt*, 925 A.2d 1265, 1277 (Del. 2007) (challenge to recapitalization shifting voting power in controlling shareholder's favor stated direct claim). As in *Gentile v. Rosette*, the Fiduciary Charter and Contract Claims, the Board Management Fiduciary Claims, and the Repurchase Notice Fiduciary Claims are simultaneously direct and derivative in nature because they assert that the minority shareholders' voting interests or governance rights were impaired. *Gentile*, 906 A.2d at 100.

"In this case, as in *Tri-Star* and *Rossette*, [Maginn and Chai] exercise[d their Board] control to expropriate, for [their] benefit, economic value and voting power from [MCG]." *Gatz v. Ponsoldt*, 925 A.2d at 1281 (finding claim that controlling shareholder sold voting power to third party to be direct). The Board Management Fiduciary Claims and the Repurchase Notice Fiduciary Claim allege that Defendants are impeding the shareholders', specifically MCG's, ability to participate in corporate governance by impairing the ability of uncooperative directors

to serve on the Board or by eliminating MCG's ability to elect a Board member entirely, in order to clear the way for their financial expropriations. Compl. ¶¶ 67-68, 70. Therefore, those claims allege a wrong involving MCG's right to vote and state a direct claim.

The Fiduciary Charter and Contract Claim, Board Management Fiduciary Claims, and Redemption Notice Fiduciary Claims mirror claims that this Court implicitly found to be direct in *Tooley*, 2005 WL 1252378. In *Tooley*, the plaintiffs were former shareholders, possessing standing to bring only direct claims. Yet, this Court denied defendants' motion to dismiss claims based on the board's improper adjustment of a merger date for the majority shareholder's benefit, on the grounds that shareholders "have the right to be treated fairly by the board of directors." *Id.* at *5. Therefore, this Court has implicitly held that breaches of the board's "duty not to treat one stockholder more generously at the expense of another stockholder," create direct claims. *Id.* In this case, all of these claims allege that the Board has acted to undermine MCG's contractual and Charter rights in order to facilitate the control of Maginn and Chai over the affairs of Jenzabar, including with respect to their own compensation. Under *Tooley*, these claims survive a motion to dismiss. *Id.*

VI. DEFENDANTS MAGINN AND CHAI WERE UNJUSTLY ENRICHED BY THE RECEIPT OF UNJUSTIFIED COMPENSATION

Unjust enrichment is defined as "'the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience.'" *Schock v. Nash*, 732 A.2d 217, 232 (Del. 1998) (quoting 66 Am. Jur. 2d *Restitution and Implied Contracts* § 3 (1973)). "The elements of unjust enrichment are: (1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and

impoverishment, (4) the absence of justification and (5) the absence of a remedy provided by law." *Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 393 (Del. Ch. 1999).[54]

Those elements are present here: (1) Maginn and Chai were enriched through increased salaries and bonuses, Compl. ¶¶ 56, 59; (2) "Jenzabar has been deprived of at least $749,000, and more likely $1,544,000, as well as a pro-rated portion of the increased salaries" and any retroactive bonuses ultimately paid, *id.* ¶ 59; (3) this unlawful compensation flowed directly from Jenzabar to Maginn and Chai, *id.*; (4) the compensation was the result of breaches of fiduciary duty by Maginn, Chai, San Miguel and Mills and was granted in contravention of the PSWPA and Jenzabar's Charter, *id.* ¶¶ 25, 45; and (5) a damages remedy from Maginn and Chai will be unavailable at law unless this Court finds Maginn and Chai liable for inducing a breach of contract and Charter by MCG. *Id.* ¶¶ 101-05. Therefore, the Complaint adequately pleads a claim for unjust enrichment.

Defendants challenge this well pled allegation on two grounds. Maginn Br. p. 17-19. First, they contend that the existence of the Employment Agreements defeats a claim for unjust enrichment. *Id.* p. 17-18. However, compensation awarded to Maginn and Chai would be unjustly received if in violation of the PSWPA, particularly where Maginn and Chai acted to encourage and facilitate the very breach in question, even if the award of such compensation did not otherwise breach the Employment Agreements. *See Fleer Corp. v. Topps Chewing Gum*, 539 A.2d 1060, 1063 (Del. 1988) (finding unjust enrichment where defendant entered into contract with Major League Baseball ("MLB") to produce baseball cards in violation of MLB's excusive contract with plaintiff). In this case, the unjust enrichment claim is a supplemental

[54] *See also Oliver v. Boston Univ.*, 2000 WL 1038197, at *9 (Del. Ch. July 18, 2000); *Grace v. Morgan*, 2004 WL 26858, at *3 (Del. Super. Ct. Jan. 6, 2004).

remedy to assure that fiduciaries do not benefit from such a breach. Claims of unjust enrichment are not precluded where breaches of contract render the enrichment unjust. *Id.*

Even absent a violation of the PSWPA, Maginn and Chai would be unjustly enriched by the receipt of compensation resulting from breaches of fiduciary duty. The Employment Agreements do not preclude such a claim for unjust enrichment. Br. pp. 29-30; Maginn Br. pp. 14-15. If the Employment Agreements obligated Jenzabar to pay the compensation at issue, Defendants' proposition would be correct, but the Employment Agreements do not obligate Jenzabar to pay the compensation at issue. *See* Br. Ex. A, § 5 (a); Br. Ex B, § 5 (a). At the most, they simply permitted it to be paid if Jenzabar, with MCG's consent, found additional compensation appropriate. Therefore, the Employment Agreements do not preclude recovery for unjust enrichment.

In addition to asserting that MCG's unjust enrichment claim fails due to the presence of a valid contract, Maginn and Chai claim that MCG failed to plead enrichment or impoverishment. Maginn Br. p. 18. However, as stated above, the Complaint alleges that Maginn and Chai received over a million dollars of benefit from their misconduct and stand to receive several million more in additional retroactive bonuses if the Court does not intervene. Compl. ¶ 59. Whether those amounts are just compensation is a question of fact which must be resolved in MCG's favor on a motion to dismiss. *Weiss v. Swanson*, 948 A.2d 433, 447 (Del. Ch. 2008) (whether option compensation was appropriate was a question of fact, unsuitable for

determination on a motion to dismiss). Defendants cite two post-trial rulings in support of their argument.[55] Therefore, their argument is improper at this stage of the case.

VII. THE INCREASED COMPENSATION IS VOID BECAUSE IT WAS NOT AUTHORIZED BY A MAJORITY OF THE JENZABAR BOARD

Count Twelve of the Verified Complaint seeks rescission of the $750,000 bonus because it was not properly authorized by the Board. Compl. ¶¶ 141-46; *see also* 8 Del. C. § 141(b) (action by board requires at minimum the vote of "the majority of directors present at a meeting in which a quorum is present"); *Dillon v. Berg*, 326 F. Supp. 1214, 1227 (D. Del. 1971), *aff'd*, 453 F.2d 876 (3d Cir. 1971) (finding that a resolution was not validly passed where 3 directors voted in favor of the resolution, 2 voted against, and one abstained).

Specifically, at the December 23, 2008 Board meeting all five directors of Jenzabar were present—and a quorum established—yet ***only two of the five directors present voted for the bonus***. Compl. ¶ 143; *see also id.*, p. 3 ("Only two out of five members of the Board present at the meeting voted for the bonus, and for this reason, among others, the bonus given Maginn is invalid."); *id.* ¶ 51 (same); *id.* ¶¶ 22-23 (listing five members of the Board). Tellingly, Defendants fail to address this point in their opening brief.

Furthermore, to the extent that the actions on December 18, 2008 were taken by the Board, in which it "purported to approve transactions with Defendants Maginn and Chai," *id.* ¶¶ 40, 40-48, they are invalid for the same reason.

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[55] Maginn Br. pp. 18-19 (citing *Triton Constr. Co. v. Eastern Shore Elec. Servs., Inc.*, 2009 WL 1387115, at *2 (Del. Ch. May 18, 2009) (post-trial ruling); *Technicorp Int'l II, Inc. v. Johnston*, 2000 WL 713750, at *6 (Del. Ch. May 31, 2000) (same)).

VIII. MCG'S CLAIMS FOR AN ACCOUNTING AND RESCISSION SHOULD NOT BE DISMISSED BECAUSE REMEDIES MAY BE PLED AS CLAIMS WHEN SUPPORTED BY UNDERLYING CLAIMS AND THE DEFENDANTS DO NOT CONTEST THE PROPRIETY OF THE REMEDIES THEMSELVES

Defendants incorrectly claim that because Counts 7, 8 and 12 (the "Secondary Claims") address remedies rather than causes of action they should be dismissed. Maginn Br. pp. 12-13; Br. p. 43. This Court routinely permits counts asserting secondary claims to go forward where the underlying causes of action are well pled. *AQSR India Private, Ltd. v. Bureau Veritas Holdings, Inc.*, 2009 WL 1707910, at *14 (Del. Ch. June 16, 2009) (denying motion to dismiss claims for "injunctive relief, an accounting, and constructive trust").[56] Aside from the unsupported contention that claims for remedies should be dismissed, none of the Defendants offer a reason why MCG is not entitled to an accounting or to the equitable remedy of rescission. Such remedies are not limited to the fiduciaries who received the wrongful compensation; fiduciaries who breached their duties in awarding such compensation may also be called upon to account to the corporation. *See, e.g.*, *Strassburger v. Earley*, 752 A.2d 557, 582 (Del. Ch. 2000) (awarding rescission as a remedy against two directors who violated their duty of loyalty in approving the self-dealing transaction of a third director, but who did not personally profit from the transaction). Therefore, case law establishes that MCG properly pled its Secondary Claims.

CONCLUSION

For all the above-stated reasons, the Motions to Dismiss should be denied.

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[56] *See also Schuss v. Penfield Partners, L.P.*, 2008 WL 2433842, at *11 (Del. Ch. June 13, 2008) (denying motion to dismiss count demanding an accounting because court "cannot at this preliminary stage exclude the possibility that an accounting will provide an appropriate form of relief"); *Jacobson v. Dryson Acceptance Corp.*, 2002 WL 75473, at *4 (Del. Ch. Jan. 9, 2002) (denying motion for summary judgment as to count of complaint demanding an accounting because "[i]f, at trial, I conclude that Jacobson has no enforceable right to stock, the action for an accounting will also fail").

Respectfully submitted,

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