IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

GEORGE GRAYSON,	:	
	:	
Plaintiff,	:	
v.	:	Civil Action No. 5051-CC
	:	
IMAGINATION STATION, INC., and RICHARD H. COLLINS,	:	
	:	
Defendants.	:	

DEFENDANTS' OPENING BRIEF IN SUPPORT OF THEIR MOTION FOR PARTIAL DISMISSAL OF PLAINTIFF'S VERIFIED AMENDED COMPLAINT

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NATURE AND STAGE OF PROCEEDINGS

Plaintiff George Grayson ("Grayson") filed this action (the "Delaware Action") on November 6, 2009. On November 17, 2009, Grayson effected service of the Verified Complaint (the "Original Delaware Complaint") on Defendants Imagination Station, Inc. ("Imagination Station" or "iStation") and Richard Collins (collectively, "Defendants"). Grayson had previously initiated a jury action involving the same parties and the same issues in the District Court of Dallas County, Texas (the "Initial Texas Action"), but terminated it shortly after being denied a temporary injunction. Shortly after Grayson filed the Delaware Action, Defendants filed another action in Texas (the "Second Texas Action"), and moved to dismiss, or in the alternative, to stay the Delaware Action, which motion the Court denied. Defendants subsequently filed a motion to abate the Second Texas Action. Plaintiff amended his complaint (the "Amended Complaint" or "Am. Compl.") in the Delaware Action, and, in response, Defendants have moved to dismiss Counts II and III of the Amended Complaint and claims that Plaintiff purports to bring derivatively for the benefit of iStation. This is Defendants' opening brief in support of their motion.

STATEMENT OF FACTS[1]

The genesis for this action is a dispute among the parties involving their respective rights and obligation pursuant to the Bylaws of Imagination Station (the "Bylaws"), and a Voting Agreement among the parties which Grayson would have this Court hold somehow modifies and/or annuls certain provisions of the Bylaws. Am. Compl. ¶¶ 6, 16-23, and 32-33.

Among other provisions, the Bylaws[2] set forth within Article IV that Imagination Station shall be managed by its Board of Directors. Article IV states, in pertinent part:

> Section 1. The business and affairs of this corporation shall be managed by its Board of Directors. The Board of Directors shall consist of a maximum of twelve (12) members, unless and until this number is changed by an amendment to this article. Each director shall be elected for a term of one year, and until his successor shall qualify or until his earlier resignation or removal.

Am. Compl. ¶ 32.

In December 2006, Imagination Station recapitalized. Am. Compl. ¶ 15. In connection with the recapitalization, Richard H. Collins ("Collins") and Randall Goss ("Goss") agreed to make additional investments to support the operations of Imagination Station. *Id*. Grayson retained his position as CEO, but entered into an amended and restated voting agreement (the "Voting Agreement") with Imagination Station, Collins and Goss agreeing to create a five (5) member board of directors with George Grayson retaining the right to select two (2) directors, Richard H. Collins and Randall Goss each having the right to select one director, and the fifth seat being selected by a shareholder vote which was to take place at an annual shareholder

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[1] For the purposes of this motion to dismiss, Defendants accept Plaintiff's factual allegations as true. However, Defendants deny the veracity of many of Plaintiff's allegations, and present this brief factual statement without waiving such denial.

[2] Plaintiff quotes the Bylaws in his complaint (¶ 32), but does not attach them. Because the interpretation of the Bylaws is pertinent, Defendants have attached a copy of the complete Bylaws as Exhibit A. On a motion to dismiss, the Court may consider the contents of documents incorporated in the complaint. *E.g., In re Lukens Inc. Shareholders Litigation*, 757 A.2d 720, 727 (Del. Ch. 1999).

meeting. *Id.* at 15, 58. In October 2007, Grayson was removed as CEO. *Id.* at 58. Thereafter Richard Collins assumed the role of CEO, and maintains such position currently. *Id.* at 8.

A meeting of the Imagination Station Board of Directors was held on Thursday, September 4, 2008 (the "September 2008 Board Meeting"). *Id.* at 26. At the September 2008 Board Meeting, Grayson announced that his previous representative, Juana Daniels resigned, and that he wished to appoint Doug Kittelson ("Kittelson") as her substitute. Am. Compl. ¶27. Article IX of the Bylaws govern the resignation of a member of the Board of Directors, and provides:

> Section 6. Resignations: Any director or other officer may resign at any time, such resignation to be in writing, and to *take effect from the time of its receipt by the corporation*, unless some time to be fixed in the resignation and then from that date. The acceptance of a resignation shall not be required to make it effective.

See Ex. A (emphasis added). The Bylaws set forth the particular procedure by which vacancies on the Board are to be filled. To wit, Article VI of the Bylaws states, in pertinent part, that:

> Section 1. *Any vacancy occurring in any office of the corporation by death, resignation, removal or otherwise, shall be filled by the Chairman of the Board.* Vacancies and newly created directorships resulting from any increase in the authorized number of directors may be filled by the Chairman of the Board. If at any time, by reason of death or resignation or other cause, the corporation should have no directors in office, then any officer or any stockholder or an executor, administrator, trustee or guardian of a stockholder, or other fiduciary entrusted with like responsibility for the person or estate of a stockholder, may call a special meeting of stockholders in accordance with the provisions of these Bylaws.

Id. (emphasis added). Pursuant to the Bylaws,[3] Collins filled the vacancy by appointing Sandra

[3] Article XII of the Bylaws governs amendments of the Bylaws, to the extent Imagination Station wished to alter the manner in which it operates, stating:

> These Bylaws may be amended or repealed by the vote of stockholders entitled to cast at least a majority of the votes which all stockholders are entitled to cast thereon, at any regular or special meeting of the stockholders, duly convened after notice to the stockholders of that purpose.

See Ex. A. Plaintiff does not allege any amendment to the Bylaws by means of the stated

Thomas to hold office until the annual shareholder meeting. Am. Compl. ¶ 30.

The next shareholder meeting was set for September 14, 2009, and Kittelson was on the ballot for election. Am. Compl. ¶¶ 37-38.

On Sunday, September 6, 2009, Collins emailed a notice to the members of the Board of Directors for Imagination Station for a meeting taking place on Friday, September 11, 2009 at 11:00 a.m. by teleconference for the following purposes:

> a. Expansion of the stock option plan. We need to reward numerous employees for their hard work by giving the some ownership potential in the company.
> b. Approve a $3 million loan.
> c. Sales report from Bob Blevins.
> d. New products in development and schedule for completion and delivery.
> e. Budget for the year 2009-10.
> f. Other business.

Id. ¶ 35.

Despite Collins' appointment of Sandra Thomas pursuant to Article VI of the Bylaws, Grayson claimed that Kittelson was a member of the Board, having been designated by Grayson to fill the seat vacated by Juana Daniels. *Id*. ¶ 36.[4] Kittelson was not recognized as a member of the Board of Directors of Imagination Station despite his and Grayson's protestations to the contrary. Am. Compl. ¶¶ 35, 39, and 41.

On September 11, 2009, the Imagination Station Board held a meeting at which certain business, including the approval of business transactions with Collins, was approved. Am. Compl. ¶ 42.

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procedure.

[4] It is this contention which appears to form the basis of Grayson's complaint, namely his belief that the Voting Agreement, which calls for parties to vote for the election of Grayson's designated representative on the Board of Directors *at the next annual shareholder meeting,* results in Grayson's designated representative assuming a position on the Board of Directors immediately upon Grayson's designation.

The annual shareholder meeting for Imagination Station was held on September 14, 2009, pursuant to the notice forwarded previously by Sandra Thomas. Am. Compl. ¶¶ 35-38. After the election of Grayson and Kittelson at the September 14 shareholder meeting, Grayson demanded that Collins call another Board meeting to revisit the matters addressed on September 11, 2009. *Id*. ¶ 48. Collins declined to call another Board of Directors' meeting. *Id*.

ARGUMENT

Plaintiff purports to bring claims derivatively for the benefit of defendant Imagination Station, Inc. ("iStation"), but does not denominate any of the three counts of the Amended Complaint as direct or derivative. Plaintiff, however, has failed to comply with Court of Chancery Rule 23.1 in that he has not pleaded facts sufficient to demonstrate that demand on iStation's board of directors should be excused as futile. Plaintiff has also failed to comply with the procedural requirements of Court of Chancery Rule 23.1(b). As a result, all claims seeking relief derivatively should be dismissed. As will be shown, Count III asserts solely a derivative claim and therefore should be dismissed in its entirety.

Plaintiff also asserts a breach of fiduciary duty claim in Count II of the Amended Complaint. The breach of fiduciary claim, however, is based on alleged contractual rights and obligations, and thus is simply an effort to dress in fiduciary clothes the breach of contract claims asserted in Count I. Accordingly, the fiduciary claim should be dismissed in favor of the parallel contract claim asserted in Count I of the Amended Complaint.

On a motion to dismiss, the well-pleaded allegations of the complaint are taken as true and all *reasonable* inferences from such allegations are made in favor of the non-movant. *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006). "[E]very strained interpretation of the allegations proposed by the plaintiff," however, need not be accepted. *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001). Furthermore, no credence is given to conclusory allegations unsupported by specific factual allegation. *Gen. Motors*, 897 A.2d 162 at 168.

I. THE AMENDED COMPLAINT FAILS TO PLEAD A BASIS FOR DERIVATIVE RELIEF

A. Plaintiff Failed To Plead Facts Sufficient To Demonstrate That Demand On iStation's Board Of Directors To Bring Such Claims Should Be Excused As Futile

"The demand requirement also rests upon the presumption that the directors will adhere faithfully to their fiduciary duties." *Robotti & Co., LLC v. Liddell*, 2010 WL 157474 at *12 (Del. Ch.). To rebut this presumption and excuse the failure to make demand, a plaintiff must allege "facts creating a reason to doubt that (1) the directors are disinterested and independent [or that] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008) (quotations omitted). General assertions are insufficient. "A plaintiff must 'comply with stringent requirements of factual particularity' of Court of Chancery Rule 23.1." *Id.*

iStation's board, at the time that Grayson asserted his derivative claims, consisted of Collins, Grayson, Doug Kittelson, Randall Goss, and Robert Blevins. Pursuant to the Voting Agreement, Grayson designated two of the members—himself and Doug Kittelson. Also pursuant to the Voting Agreement, Goss and Collins each designated himself. Robert Blevins was elected by iStation's shareholders. Plaintiff failed to make demand on this board. Instead, Plaintiff avers that demand would be futile because Collins is directly interested in the challenged transactions, and because Goss and Blevins are not independent as they are "beholden to Collins and subject to his control." Am. Compl. ¶ 58. Plaintiff is wrong about the independence of Goss.[5]

[5] Plaintiff has not made particular allegations that Goss is interested. But to the extent Plaintiff relies on this argument, Plaintiff fails to meet the factual particularity requirement of Rule 23.1, and fails to show an interest sufficiently "substantial" to disqualify Goss. *Cf. Cinerama, Inc. v. Technicolor*, 663 A.2d 1156, 1169 (Del. 1995) (with respect to Section 144, distinguishing self-

To show lack of independence, Plaintiff must create a reasonable doubt as to whether Goss is so "beholden" to Collins, that Goss's "discretion would be sterilized." *See Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004). That is, the relationship between Goss and Collins must be so close that one could infer that Goss "would be more willing to risk his . . . reputation than risk the relationship with" Collins. *Id.* at 1052. The facts Grayson alleges, and reasonable inferences drawn therefrom, fail to rise to this level and fail to cast reasonable doubt as to Goss's independence.

First, Plaintiff alleges that Goss "has close financial ties with Collins" because Collins purchased half of Goss's stock. *See* Am. Compl. ¶ 58. The sale allegedly "afforded to Goss the opportunity to liquidate an otherwise illiquid investment." *Id.* In essence, Plaintiff asserts that Goss is beholden to Collins and under Collins' control because Collins purchased some of Grayson's stock over two years ago. Missing is any allegation that the transaction between Collins and Goss was anything other than an arm's length transaction between parties who wanted to acquire and divest, respectively, a block of iStation stock. Plaintiff fails to allege that the purchase price did not reflect the fair market value of the stock, including any illiquidity discount. No allegation exists from which one could infer, much less reasonably infer, that Goss received from the stock sale a benefit in excess of the stock's actual worth. Furthermore, the stock purchase occurred over two years ago. It would not be reasonable to infer that Goss, more than two years after the transaction, remains "beholden" to Collins so much so that his "discretion would be sterilized." The mere allegations of a sale of Goss's stock to Collins does not support Plaintiff's conclusory assertion of "close financial ties" between Goss and Collins.

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dealing from incidental director interest, indicating the latter "must be substantial" to be disqualifying). Goss has no interest in the contested transaction or the outcome of the litigation, in which he is not named as a defendant, and plaintiff does not allege otherwise.

Next, Plaintiff attempts to cast a nefarious motive on the stock purchase with his speculative accusation—"on information and belief"—that Goss supported Grayson's termination as CEO as "*quid pro quo*" for the sale. *Id.* Grayson offers no allegation of fact supporting his belief. The absence of particularized supporting allegations reveals the "quid pro quo" assertion to be Grayson's self-serving speculation. In any event, the allegation makes no sense. The Bylaws empower the Chairman of the Board, in his sole judgment, to remove any officer or agent of the corporation, including the CEO.[6] Therefore, there could be no *quid pro quo* with respect to Grayson's termination because Collins, as the Chairman, had authority to remove Grayson without Goss's support.

Finally, Plaintiff alleges—again, "on information and belief"—that Collins and Goss "participate together in various political, community and charitable events and otherwise *generally* have a social and professional relationship with each other." In other words, they are part of the same social circles. Missing is any allegation that they are friends, much less close friends. Some professional or personal friendships, which rival familial loyalty and closeness, such that they may be reasonably perceived as "bias-producing," may raise a reasonable doubt whether a director can appropriately consider demand. *Beam*, 845 A.2d at 1050. However, "[n]ot all friendships, or even most of them, rise to this level and the Court cannot make a *reasonable* inference that a particular friendship does so without specific factual allegations to support such a conclusion." *Id.* (quotations omitted) (emphasis in original). Here, Plaintiff fails to allege any facts from which one can reasonably infer that a professional or personal friendship, bordering on familial loyalty and closeness, exists between Collins and Goss. *See*

[6] *See* iStation's Bylaws at Art. V, Sec. 3 ("Any officer or agent elected or appointed by the Board may be removed by the Chairman of the Board of Directors whenever, *in his judgment*, the best interest of the corporation will be served thereby.") (emphasis added). iStation's Bylaws are attached as Exhibit A.

Orman v. Cullman, 795 A.2d 5, 26-27 (Del. Ch. 2002) (allegation of prior business relationship insufficient to overcome presumption of independence); *Highland Legacy Ltd. v. Singer*, 2006 WL 741939 at *5 (Del. Ch.) (allegation of prior business relationship insufficient to overcome presumption of director's independence); *Green v. Phillips*, 1996 WL 342093 at *5 (Del. Ch.)(allegations of directors' longstanding personal and business ties to former Chairman and CEO insufficient "to overcome directors' presumption of independence….").

Plaintiff's allegations are further belied by the fact that the harm he allegedly suffered would also adversely affect Goss. Specifically, if Plaintiff were harmed by the dilution of shares because of the challenged loan, then so would Goss, as Plaintiff acknowledges Goss holds five percent of iStation's stock. Am. Compl. ¶ 9. Plaintiff asks the Court to infer that Goss is so beholden to or controlled by Collins that he would act *against* his own economic interests. This cannot be reasonably inferred from the alleged facts describing the relationship between Goss and Collins. *See Orman*, 795 A.2d at 27 n.56 (director's substantial shareholdings support his ability to consider transaction objectively); *In re Walt Disney Co. Derivative Litigation*, 731 A.2d 342, 355-56 (Del. Ch. 1998) (potential dilution of Chairman's substantial stock holdings support objectivity of his judgment concerning option grants to employee), *aff'd in part, rev'd in part on other grounds sub. nom, Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

Thus, plaintiff's allegations raise a reasonable doubt as to only two of the five iStation directors (Collins and Blevins), leaving a majority capable of considering any demand Grayson might make. Grayson has failed to surmount Rule 23.1's demand futility requirement.

B. Plaintiff Failed To Comply With Rule 23.1(b) Despite Defendants' Bringing The Issue To His Attention In Their Previous Motion To Dismiss

"Each person seeking to serve as a representative plaintiff on behalf of a corporation or unincorporated association pursuant to this Rule shall file with the Register in Chancery an

affidavit" that states that the person has not and will not accept compensation for bringing the derivative action in which the person is a named party except as approved by the Court or reimbursement, paid by the person's attorneys, for expenses incurred. Court of Chancery Rule 23.1(b). "The affidavit required by this subpart shall be filed within 10 days after the earliest of the affiant filing the complaint, filing a motion to intervene in the action or filing a motion seeking appointment as a representative party in the action." *Id.* Plaintiff did not comply with this requirement. Defendants brought this omission to Plaintiff's attention in their first motion to dismiss. Yet Plaintiff still did not file the required affidavit. Accordingly, Plaintiff's derivative claims should be dismissed for failure to comply with Rule 23.1(b).

II. COUNT III ASSERTS A DERIVATIVE CLAIM

Tooley v. Donaldson, Lufkin, & Jenrette, Inc., 845 A.2d 1031 (Del. 2004) simplified the test for determining whether a claim is derivative or direct: "Who suffered the alleged harm—the corporation or the suing stockholder individually—and who would receive the benefit of the recovery or other remedy?" *Id.* at 1035. . For a claim to be direct, the stockholder's injury "must be independent of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail *without showing an injury to the corporation."* *Id.* at 1039 (emphasis supplied). Count III of Plaintiff's Amended Complaint alleges that defendants failed to allow the properly constituted Board of Directors of iStation to function and thereby improperly secured the approval of the challenged transaction. Tellingly, Plaintiff captions this claim "Violation of 8 Del. C. § 141." Am. Compl. p. 18.

The duty this pleading places at issue is "the directors' normal duty to manage the affairs of the corporation…", which is "owed to the corporation and not separately or independently to the stockholders." *Dieterich v. Harrer,* 857 A.2d 1017, 1027 (Del. Ch. 2004). Changing the character of the alleged wrong from the directors' collective failure to manage, as in *Dieterich*, to

some directors' alleged interference with the whole board's ability to manage the corporation's business does not change the essence of the alleged wrong as one visited on the corporation. To be sure, plaintiff claims individual injury, but on the theory pled in Count III (as opposed to Count I where plaintiff can claim a direct contractual duty owed to him), plaintiff cannot "prevail without showing an injury to the corporation." *Tooley*, 845 A.2d at 1039. Because the duty owed is to the corporation, it is the corporation that is harmed by the alleged wrong and the claim is therefore derivative. *Dieterich*, 857 A.2d at 1027.

The remedy Count III seeks simply reinforces the derivative nature of the claim. Plaintiff asks for a ruling that "all actions taken at the September 11, 2009 meeting" of iStation's board "are void." Am. Compl. ¶¶ 76, 78. In effect, plaintiff seeks rescission of a loan to the corporation—relief for the benefit of iStation. Plaintiff, of course, claims to have suffered dilution from the alleged wrong. Dilution, however, is "traditionally understood" as a derivative claim. *Gatz v. Ponsoldt*, 2004 WL 3029868 at *7 (Del. Ch.). The dilution plaintiff claims to have suffered is not "independent of any alleged injury to the corporation." *Tooley*, 845 A.2d at 1039.

Thus, Count III pleads a purely derivative claim and must be dismissed for the reasons set forth in Argument I above.

III. COUNT II IMPROPERLY REPACKAGES PLAINTIFF'S BREACH OF CONTRACT CLAIM IN FIDUCIARY LANGUAGE AND THEREFORE MUST BE DISMISSED

"[W]here a dispute relates to obligations expressly treated by contract, it will be governed by contract principles." *Nemec v. Shrader*, 2009 WL 1204346 at *4 (Del. Ch.), *aff'd*, 2010 WL 1320918 at *6 (Del.). Fiduciary claims that relate to obligations expressly treated by contract are

reviewed as breach of contract claims and "any fiduciary claims will be dismissed."[7] *Id.*, 2009 WL 1204346 at *4. Stated differently, when "the contract claim addresses the alleged wrongdoing by the Board, any fiduciary duty claim arising out of the same conduct is superfluous." *Gale v. Bershad*, 1998 WL 118022 at *5 (Del. Ch.).

Here, Grayson asserts both breach of contract (Count I) and breach of fiduciary duty (Count II) claims based on Collins' alleged failure to recognize Mr. Kittelson as a director at the September 11, 2009 board meeting. To support his breach of contract claims, Grayson alleges that the Voting Agreement gave Grayson "the unconditional right to appoint two members of iStation's board of directors." Am. Compl. ¶ 64. According to Grayson, Collins violated his obligations under the Voting Agreement "by failing to recognize Mr. Kittelson as Grayson's designee." Am. Compl. ¶ 65. Grayson further alleges that Collins and Goss (who is not a defendant) further caused the Company to breach its obligations under the Voting Agreement by their failure to cause iStation to recognize Mr. Kittelson as a director. Am. Compl. ¶¶ 68-69.

These same allegations, although slightly repackaged, form the basis of Grayson's breach of fiduciary duty claim. For example, Grayson asserts that Collins' denial of Kittelson as a director was a breach of fiduciary duty. Am. Compl. ¶ 71. Grayson complains of the board selection process that "circumvent[s] the clear rights of Grayson to designate two Board members," which rights are purely contractual. Am. Compl. ¶ 72. Grayson ends his allegations stating that Collins breached his fiduciary duties because Collins allegedly caused iStation to

[7] *See also Grunstein v. Silva*, 2009 WL 4698541 at *6-7 (Del. Ch.); *Madison Realty Co. v. AG ISA, LLC*, 2001 WL 406268, at *6 (Del. Ch.); *Blue Chip Capital Fund II Ltd. P'ship v. Tubergen*, 906 A.2d 827, 833 (Del. Ch. 2006) (dismissing the fiduciary duty claim against directors because "the complaint asserts contractual and fiduciary claims that arise from the same alleged facts and underlying conduct"); *Gale v. Bershad*, 1998 WL 118022 at *5 (stating that "because the contract claim addresses the alleged wrongdoing by the board, any fiduciary duty claim arising out of the same conduct is superfluous").

breach its contractual obligations under the Voting Agreement. Am. Compl. ¶ 72(d).

Grayson's fiduciary claims relate to obligations that are expressly treated by the Voting Agreement and are the subject of breach of contract claims in the complaint. Because Grayson's fiduciary claims simply repeat his contract claims, prevailing law requires dismissal of Count II.

CONCLUSION

For the foregoing reasons, defendants respectfully submit that the Court should dismiss Counts II and III of the Amended Complaint and any claims asserted derivatively on behalf of Imagination Station, Inc.

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