



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ROBERT STROUGO, on behalf of
himself and all others similarly
situated,

Plaintiff,

v.

AARON P. HOLLANDER,
STANLEY J. HILL, JOSEPH J.
LHOTA, ITSIK MAARAVI, and
FIRST AVIATION SERVICES, INC.,

Defendants.

C.A. No. 9770-CB

PLAINTIFF'S BRIEF IN SUPPORT OF PLAINTIFF'S

MOTION FOR PARTIAL JUDGMENT ON THE PLEADINGS

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PRELIMINARY STATEMENT

Delaware Courts have interpreted corporate bylaws to operate as contracts between a corporation and its stockholders. It is a fundamental principle of contract law that a non-party to a contract cannot be bound by the terms of an agreement to which he is no longer a party. Once a contract is voided or terminated, a party's obligations arising out of the contract and benefits ensuing from the contract are dissolved. It therefore follows that a party cannot unilaterally amend a contract and affect the rights of an individual who is no longer a party to that contract.

In the instant case, Defendants attempt to bind Plaintiff to a bylaw provision of First Aviation Services, Inc. ("First Aviation" or the "Company") that was adopted **after** Plaintiff ceased being a stockholder of First Aviation. Plaintiff's stock ownership in First Aviation was extinguished through a reverse share split that occurred on May 30, 2014. On June 3, 2014, four days **after** Plaintiff's stock ownership was extinguished (along with every other member of the putative Class), First Aviation's Board of Directors adopted a fee-shifting bylaw that essentially claims a right on the part of the Company for its attorneys' fees and expenses in cases brought by stockholders that are not entirely successful (the "Bylaw").

In opposing this Motion, Defendants will likely argue that a board of directors can unilaterally amend the bylaws of a corporation to affect individuals who are no longer stockholders to the corporation. While on its face the Bylaw purports to apply retroactively to former stockholders, Delaware contract law clearly controverts the validity of such a provision.

Taking Defendants' argument to its logical extreme, a board of directors would be able to enact bylaws years after an event that extinguished a stockholder's ownership rights and purport to bind the stockholder. Defendant's position is inconsistent with Delaware law.

In addition to contradicting Delaware contract law, Defendants' position that the Board can purport to bind former stockholders through a unilaterally adopted bylaw is inconsistent with the Delaware General Corporate Law ("DGCL"). Section 109 of the DGCL authorizes a corporation to confer upon directors, in its certificate of incorporation, the power to adopt, amend, or repeal bylaws that are "not inconsistent with law." Since the Bylaw contradicts Delaware contract law, it follows that it is also violates DGCL §109.

Further, DGCL §109 only authorizes the adoption of bylaws that relate to the rights or powers of stockholders, directors, officers, or employees. DGCL §109 does not bestow upon directors the authority to regulate the rights or powers

of *former* stockholders.¹ Moreover, DGCL §109 explicitly states that the fact that power to implement bylaws has been conferred upon the directors in the certificate of incorporation “shall not divest the shareholders or members of the power, nor limit their power to adopt, amend or repeal bylaws.” However, the unilateral adoption of a fee-shifting bylaw that purports to apply to former stockholders effectively divests those stockholders of their power to amend or repeal the bylaw. Former stockholders have no power to repeal or amend a bylaw unilaterally adopted after their ownership rights in the corporation have been extinguished. Further, former stockholders do not have an opportunity to express their views concerning the bylaw in a non-binding way by issuing an advisory stockholder vote or indirectly by refusing to reelect directors who voted in favor of the bylaw. Unilaterally amended bylaws that purport to bind former stockholders rob stockholders of all the protections ordinarily enjoyed by stockholders in connection with board-adopted bylaws.

BACKGROUND

This litigation arises from a 10,000 to 1 reverse stock split announced by First Aviation on May 16, 2014 (the “Reverse Stock Split” or the “Transaction”).

¹ In contrast, when the General Assembly specifically wants to regulate the rights of former stockholders, directors, officers, or employees, it makes its intention clear. For instance, the indemnification rules found in DGCL §145 specifically apply to “present or former director[s], officer[s], employee[s] or agent[s].”

Defendant Hollander (“Hollander”), through two entities controlled by him, First Equity Group, Inc. and JEM III, LLC, acquired the outstanding First Aviation common stock not already owned by Hollander and his affiliates through the Reverse Stock Split of First Aviation Common A stock at \$8.40 per share. The Transaction became effective on May 30, 2014.

Plaintiff filed a complaint on June 16, 2014 alleging breach of fiduciary duty (the “Complaint”) against First Aviation and members of the First Aviation board of directors (the “Board” or the “Individual Defendants”) in connection with the Transaction.

After the litigation was initiated, defense counsel informed Plaintiff’s counsel in an email dated July 22, 2014 that the Defendants had adopted a fee-shifting bylaw. Plaintiff had no knowledge of this fee-shifting bylaw at the time the Complaint was filed.² First Aviation did not provide any materials to former stockholders, who are purportedly bound by the bylaw, informing them of the adoption of this bylaw. Nor did First Aviation make any public announcement disclosing the adoption of the fee-shifting bylaw. In fact, at the time the Transaction was announced, First Aviation had been a non-SEC reporting company for over 7 years. First Aviation’s last filing with the SEC was on July 30,

² Plaintiff learned of the existence of the Bylaw through his counsel, following defense counsel’s July 22, 2014 email to Plaintiff’s counsel.

2007. Consequently, public information regarding First Aviation was rather limited and typically limited to the Company's public press releases.

On September 4, 2014, the parties entered into a stipulation for the production and exchange of confidential and highly confidential information. Pursuant to the confidentiality stipulation, Defense counsel provided Plaintiff's counsel with the text of the Bylaw, which was not otherwise publically available. Defense counsel also provided Plaintiff's counsel with director consents which appeared to indicate that the Bylaw was adopted on June 3, 2014; several days after the Reverse Stock Split went into effect.

Thus, it is clear that the Bylaw was adopted for the improper purpose of stemming stockholder litigation arising from the Reverse Stock Split and severely limits a stockholders' right to bring suit. The Bylaw threatens litigants with tremendous financial liability. Moreover, it is unacceptably broad in its application, and imposes unattainably high levels of success in order to be exempt from the Bylaw. The Bylaw provides:

Section VII.8. Expenses for Certain Actions. In the event that (i) any current or prior stockholder or anyone on their behalf (collectively a "Claiming Party") initiates or asserts and (sic) claim or counterclaim (collectively a "Claim"), or joins, offers substantial assistance to or has a

direct financial interest in any Claim against the Corporation or any director, officer, assistant officer or other employee of the Corporation, and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party has a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the Corporation and any such director, officer, assistant officer or employee for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) that the parties may incur in connection with such Claim.

Having reviewed the Bylaw, Plaintiff amended the Complaint on September 24, 2014 to, *inter alia*, challenge the validity of the Bylaw (the "Amended Complaint").

On October 7, 2014, the parties participated in a conference call with the Court to propose a plan of action wherein the parties would bifurcate the merits of the case and the validity and applicability of the Bylaw. The Court allowed the parties to stay the breach of fiduciary duty claims and litigate the claims pertaining to the applicability and validity of the Bylaw prior to addressing the merits.

On October 24, 2014, Defendants served their answer to the Amended Complaint (the “Answer”). In the Answer, Defendants “admit that the Transaction was effectuated on May 30, 2014.” *See* Defendant’s Answer to Amended Complaint ¶5. Defendants further “admit that Bylaw VII.8 was adopted on June 3, 2014.” *Id.*

There is no doubt that the effective date of the Reverse Stock Split marked the end of Plaintiff’s ownership rights in First Aviation. On May 29, 2014, First Aviation filed a certificate of amendment of certificate of incorporation with the Delaware Secretary of State which confirms that the rights of stockholders owning less than 10,000 shares of First Aviation Class A common stock were extinguished effective May 30, 2014, apart from the right to receive cash consideration of \$8.40 per share in exchange for each such share. The May 29, 2014 amendment to First Aviation’s certificate of incorporation states in relevant part:

Reverse Stock Split. Without regard to any other provision of this Certificate of Incorporation, each one (1) share of Class A common stock issued and outstanding immediately prior to 8:01 a.m., New York City time, on May 30, 2014 (the “Reverse Split Effective Time”) shall be and is hereby automatically reclassified and changed (without any further act), without increasing or decreasing the amount of stated capital or paid-in-surplus of the Corporation, into a ten-thousandth (10,000th) of a fully-paid and

nonassessable share of Class A common stock, provided that no fractional shares shall be issued to any holder of fewer than 10,000 shares of Class A common stock immediately prior to the Reverse Split Effective Time, and provided further that instead of issuing fractional shares to such holders, the Corporation shall pay an amount in cash equal to \$8.40 per share of Class A common stock held by such holders immediately prior to the Reverse Split Effective Time. *Each stockholder of the Corporation holding less than 10,000 shares of Class A common stock immediately prior to the Reverse Split Effective Time shall only have the right to receive cash equal to \$8.40 multiplied by the number of shares of Class A common stock owned by such stockholder immediately prior to the Reverse Split Effective Time, and such stockholder shall no longer have any further rights as a stockholder of the Corporation.* Promptly after the Reverse Split Effective Time, the Corporation shall send or cause to be sent to all persons who were holders of fewer than 10,000 shares of Class A common stock immediately prior to the Reverse Split Effective Time instructions for receiving their cash payment and surrendering their certificates, where shares are held in certificated form. Pending the surrender and exchange of such certificates, *such certificates shall represent only the right of the holder thereof to receive, upon surrender thereof, payment of the cash consideration therefor, at the rate*

of \$8.40 for each share of Class A common stock held immediately prior to the Reverse Split Effective Time, to which such holder has become entitled under this paragraph.

Once Plaintiff received Defendants' Answer, it became apparent that the validity and applicability of the Bylaw could be dealt with on a narrow point of law. On November 25, 2014, the parties participated in a conference call with the Court wherein Plaintiff requested that the Court allow Plaintiff to trifurcate the issues in this matter, and present briefing on one narrow issue – the timing of the adoption of the Bylaw – prior to addressing other issues concerning the validity of the Bylaw. The Court granted Plaintiff's request.

Accordingly, Plaintiff respectfully submits this motion for partial judgment on the pleadings on the grounds that the Bylaw cannot purport to bind Plaintiff, who was no longer a stockholder when the Bylaw was unilaterally adopted by the Board, under Delaware law.

STANDARD OF REVIEW

A motion for judgment on the pleadings may be granted where there exist no material issues of fact and the movant is entitled to judgment as a matter of law.

Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P., 624 A.2d 1199 (Del. 1993).

There exist no material issues of fact as Defendant's Answer admits that the Bylaw was adopted on June 3, 2014, after the Reverse Stock Split became effective on May 30, 2014. There is no question that Plaintiff was no longer a stockholder of First Aviation effective May 30, 2014. According to the May 29, 2014 amendment to First Aviation's certificate of incorporation, stockholders no longer had any further rights as stockholders of the Company as of the Reverse Split Effective Time.

Plaintiff is entitled to judgment as a matter of law. Delaware Courts have treated corporate bylaws and charters as contracts among a corporation's stockholders. *Airgas, Inc. v. Air Products & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010). This Court has held that "the proper construction of any contract is purely a question of law, and numerous decisions of this Court have interpreted provisions found in certificates of incorporation or bylaws on motions for summary judgment." *Lions Gate Entertainment Corp. v. Image Entertainment Inc.*, C.A. No. 2011, 2006 WL 4782450, at *4 (Del. Ch. June 5, 2006), attached as Exhibit A. Further, "[q]uestions of statutory interpretation are questions of law." *Dambro v. Meyer*, 974 A.2d 121, 129 (Del. 2009).

ARGUMENT

1. Bylaws Cannot Operate Retroactively Against Former Stockholders

Under Principles of Delaware Contract Law

a. Non-Parties to a Contract Cannot be Bound By the Terms of the Contract

Under Delaware law, “corporate charters and bylaws are contracts among a corporation’s shareholders.” *Airgas* 8 A.3d 1182, 1188 (Del. 2010). When Plaintiff became a stockholder of First Aviation, he agreed to be bound by the terms of First Aviation’s charter and bylaws “subject to his right to sell his shares or seek appraisal in certain instances.” *DiRienzo v. Lichtenstein*, C.A. No. 7094, 2013 WL 5503034 (Del. Ch. September 30, 2013), attached as Exhibit B, (stockholder agreed to be bound by the terms of a legally valid conversion of the company from a corporation to a limited partnership when he purchased his stock in the company, subject to his right to sell his shares or seek appraisal) . As *DiRienzo* indicates, if a stockholder no longer wishes to be bound by the terms of the corporate contract, the stockholder’s remedy is to sell his shares. Once Plaintiff’s relationship with the corporation was terminated through the effectuation of the Reverse Stock Split, Plaintiff was no longer a party to the contract, and thus no longer bound by any future amendment to the terms of the company’s charter or bylaws.

As the Supreme Court of the United States has articulated, “[i]t goes without saying that a contract cannot bind a nonparty.” *E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279, 294 (2002) (where the Equal Employment Opportunity Commission was not a party to the contract and did not agree to arbitrate its claims, the pro-arbitration policy goals of the Federal Arbitration Act did not require the agency to relinquish its statutory authority if it has not agreed to do so). Once the Reverse Stock Split became effective, Plaintiff ceased to be a stockholder of First Aviation, and thus, ceased to be a party to the corporate contract. “Under Delaware contract law, a nonparty to a contract generally has no rights relating to it unless he or she is a third-party beneficiary to the contract.” *CitiMortgage, Inc. v. Bishop*, C.A. No. 09L-07-313, 2013 WL 1143670 (Del. March 4, 2013), attached as Exhibit C, (finding that defendants were not intended beneficiaries of the contractual assignment at issue). Similarly, a nonparty cannot be bound to the terms of a contract.

This Court has held that “only parties to a contract and intended third-party beneficiaries may enforce or be bound by that agreement's provisions.” *Kuroda v. SPJS Holdings, L.L.C.*, C.A. No. 4030, 2010 WL 4880659 (Del. Ch. Nov. 30, 2010), attached as Exhibit D, (finding that none of the parties to the litigation were parties to the arbitration agreement and thus could be bound by its provisions). *See also American Legacy Foundation v. Lorillard Tobacco Co.* 831 A.2d 335, 343

(Del. Ch. 2010) (“There is no doubt that a fundamental principal of contract law provides that only parties to a contract are bound by that contract.”); *MetCap Securities LLC v. Pearl Senior Care, Inc.*, C.A. No. 2129, 2007 WL 1498989, at *5 (Del. Ch. May 16, 2007), attached as Exhibit E, (“Well-settled within precepts of contract law is recognition that non-parties to a contract ordinarily have no rights under it”); *Kronenberg v. Katz*, 872 A.2d 568 n. 74 (Del. Ch. 2004) (“Of course, a nonparty to a contract ordinarily has no rights under that contract.”) *Gelfman v. Weeden Investors, L.P.*, 792 A.2d 977 n. 24 (Del. Ch. 2001) (“[I]t is generally true that non-parties to a contract may not bear contractual liabilities”).

b. By Virtue of the Reverse Share Split, Plaintiff’s Stockholder Status Was Dissolved, and He Was No Longer a Party to the Corporate Contract.

The May 29, 2014 amendment to First Aviation’s Certificate of Incorporation unequivocally states that as of the Reverse Split Effective Time, First Aviation stockholders who were subject to the Reverse Share Split no longer had any further rights as stockholders of the Corporation. In a further effort to disambiguate the role of affected stockholders after the Reverse Split Effective Time, the amendment specified that as of the Reverse Split Effective Time, the certificates that the former stockholders possessed entitled the former stockholders only to

cash consideration in exchange for their shares, and did not represent any continuing rights in the corporation.

The First Restatement of Contracts lists twenty two ways in which a contract may be terminated or discharged.³ Restatement (First) of Contracts §385 (1932). Among the methods to discharge a contract include performance of the duty, occurrence of a condition subsequent, rescission by agreement of the parties, and cancellation or surrender. Regardless of which category of termination properly describes this scenario, it is clear that the contractual relationship between Plaintiff and the Company was terminated. While the Board and First Aviation's remaining stockholders continued to be parties to the corporate contract, Plaintiff and all other First Aviation stockholders affected by the Reverse Share Split ceased to be stockholders at the Reverse Split Effective Time and are no longer parties to the contract. Delaware law is clear that a non-party to a contract is not bound by that contract.

2. Bylaws Cannot Operate Retroactively Against Former Stockholders

Under Principles of Delaware Corporate Law

a. DGCL §109 Does Not Authorize the Board of Directors to Enact Bylaws that Apply to Former Stockholders

³ See Introductory Note, Chapter 12, Restatement (Second) of Contracts

DGCL §109(a) provides that “any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors.” Section 109(a) further states: “[t]he fact that such power has been so conferred upon the directors or governing body, as the case may be, shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws.” Section 109(b) states “[t]he bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.”

The retroactive bylaw provision is in clear violation of DGCL §109. Section §109(a) expressly states a bylaw cannot “divest stockholders or members of the power or limit their power to adopt, amend or repeal bylaws.” Through the adoption of a retroactive bylaw, the directors have effectively obliterated stockholders’ power to amend or repeal the bylaw, as former stockholders no longer have the right to vote in matters relating to First Aviation. The certificate of amendment that was filed by First Aviation with the Delaware Secretary of State on May 29, 2014, clearly indicates that as of the effective date of the Reverse Stock Split, First Aviation stockholders affected by the split will only have the right to redeem their certificate of ownership in exchange for cash consideration. Hence, the adoption of the retroactive bylaw impermissibly extinguishes

stockholders' power to amend or repeal the bylaw in a manner forbidden by DGCL §109(a).

Further, DGCL §109(b) allows bylaws to contain provisions relating to the “rights or powers of [a corporation’s] *stockholders*, directors, officers, or employees.” (emphasis added). However, the retroactive bylaw adopted by First Aviation’s Board purports to bind former stockholders. No such authority is extended to the Board by the DGCL. The Delaware General Assembly, has, in certain circumstances, deemed it appropriate to allow retroactive application of benefits authorized under the DGCL. However, in those circumstances, the General Assembly has made its intention explicitly clear in the text of the DGCL. For instance, DGCL §145 explicitly allows for the indemnification of former directors, thus, a bylaw which provides for indemnification of former directors is consistent with the DGCL. However, a fee-shifting bylaw which purports to bind former stockholders to a fee-shifting provision is inconsistent with DGCL §109.

b. Plaintiff Has No Power to Repeal the Retroactively Enacted Bylaw

In upholding the forum selection bylaw in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) (hereinafter “*Chevron*”), the Court noted that Delaware has rejected the vested rights doctrine

that “boards cannot modify bylaws in a manner that arguably diminishes or divests pre-existing shareholder rights absent stockholder consent.” *Id.* at 955. Rather, the Court reasoned that “even though a board may... be granted authority to adopt bylaws, stockholders can check that authority by repealing board-adopted bylaws.” *Id.* at 956. Further, the Court remarked that “because the DGCL gives stockholders an annual opportunity to elect directors, stockholders have a potent tool to discipline boards who refuse to accede to a shareholder vote repealing a forum selection clause” *Id.* at 956-57.

However, none of the protections that the Court articulated in *Chevron* apply in this context where a corporation seeks to apply a bylaw that was adopted after Plaintiff’s ownership interest in the corporation was extinguished against a former stockholder. Plaintiff can no longer avail himself of the protections of DGCL §109(a), which “vests in the shareholders a power to adopt, amend or repeal bylaws that is legally sacrosanct, *i.e.*, the power cannot be non-consensually eliminated or limited by anyone other than the legislature itself.” *Chevron* 73 A.3d 934 at 956. Plaintiff cannot take any steps to repeal the Bylaw as he was no longer a First Aviation stockholder at the time the Bylaw was adopted. Similarly, Plaintiff cannot refrain from re-electing directors who passed the Bylaw, as Plaintiff no longer has any voting rights in First Aviation.

**c. The Bylaw Was Not In Effect At The Time that Plaintiff's Claim
Arose**

The Bylaw is inapplicable to Plaintiff because it was adopted after he was no longer a stockholder of the Company. By way of example, courts have found that claims that arose prior to the legal adoption of a forum selection provision are not subject to that forum selection provision. *See In re Facebook, Inc., IPO Securities and Derivative Litigation*, 922 F.Supp.2d 445 (S.D.N.Y. 2013). In *Facebook*, defendants argued that the forum selection provision contained in Facebook's⁴ certificate of incorporation mandated that plaintiffs' claims relating to the company's initial public offering ("IPO") must be litigated in Delaware. However, in *Facebook* the forum selection provision contained in an amendment to the certificate of incorporation was filed after the date of the IPO.

The Court rejected defendants' argument, noting that the forum selection provision did not become effective until the certificate of amendment was filed with the Delaware Secretary of State, four days after the IPO.⁵ The Court reasoned that since the Facebook's original certificate of incorporation was in effect at the time that Plaintiff's claim arose, the original certificate of incorporation governed

⁴ Facebook, Inc. is a Delaware corporation.

⁵ In Delaware, a certificate of incorporation, or any amendment to it, becomes effective only "when filed with the Delaware Secretary of State." *Blades v. Wisehart*, C.A. No. 5316, 2010 WL 4638603, at *3 (Del. Ch. Nov 17, 2010), attached as Exhibit H.

Plaintiff's claim, and therefore, "the claims and parties in [the] action [were] not subject to the forum selection clause in the Certificate." *Id.* at 463.

Here it is undisputed that the Bylaw was not in effect at the time Plaintiff's Reverse Stock Split claim arose because it was adopted four days after the Reverse Stock Split. Accordingly, a bylaw not in effect at the time that a stockholder's internal affairs claim arose cannot bind that stockholder. *Id.*

3. Retroactive Application of Bylaws to Former Stockholders is Inconsistent with Delaware Public Policy

a. Delaware's Presumption Against Retroactivity

In Delaware, there is a "presumption against retroactivity." *A.W. Financial Services, S.A. v. Empire Resources, Inc.*, 981 A.2d 1114, 1120 (Del. 2009). In the context of statutory retroactivity, Delaware courts have followed the United States Supreme Court's precedent in *Landgraf v. USI Film Products*, 511 U.S. 244, 265-71 (1994). The Supreme Court of the United States announced in *Landgraf*:

Since the early days of this Court, we have declined to give retroactive effect to statutes burdening private rights unless Congress had made clear its intent.... The presumption against statutory retroactivity has consistently been explained by reference to the unfairness of imposing new burdens on persons after the fact.... The largest category of cases with which we have

applied the presumption against statutory retroactivity has involved new provisions affecting contractual or property rights, matters in which predictability and stability are of prime importance....”

Similarly, Delaware Courts have will not apply a statute retroactively unless there is a clear legislative intent to do so. *Homsey Architects, Inc. v. Nine Ninety Nine, LLC*, C.A. No. 4412, 2010 WL 2476298 (Del. Ch. June 14, 2010), attached as Exhibit F, (holding that amendments to the Delaware Uniform Arbitration Act affect substantive rights and therefore cannot be applied retroactively).

The reasoning supporting the Court’s presumption against retroactivity in the statutory interpretation context applies here as well. In this case, the Bylaw, which purports to apply retroactively to Plaintiff, affects Plaintiff’s substantive rights. A stockholder’s rights to sue and to vote are among a stockholder’s fundamental substantive rights. *See e.g. MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1127 (Del. Ch. 2003) quoting *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (“the stockholder franchise has been characterized as the ‘ideological underpinning’ upon which the legitimacy of the directors managerial power rests); *Carsanaro v. Bloodhound Technologies, Inc.*, 65 A.3d 618, 664-665 (Del. Ch. 2013) (“Having been deprived of a material portion of the merger consideration, the stockholders have an individual right to sue.”)

This amendment to First Aviation’s bylaws curbs Plaintiff’s fundamental right to vote by virtue of its enactment following the Reverse Stock Split, when Plaintiff was no longer a stockholder of the Company. Accordingly, Plaintiff had no opportunity to repeal or amend the bylaw as required under DGCL §109. Further, this amendment affects stockholder’s fundamental right to sue as most stockholders do not have the financial ability to absorb litigation costs, and the risk of tremendous financial liability will deter these stockholders from bringing suit.

This court has previously held that the board of directors had a duty to waive a bylaw when it was inconsistent with Delaware policy. *See Hubbard v. Hollywood Park Realty Enterprises, Inc.*, C.A. No. 11779, 1991 WL 3151, at *9 (Del. Ch. Jan. 14, 1991), attached as Exhibit G, (ordering the board to waive an advance notice bylaw where “[t]he policy underlying the shareholders’ fundamental right to exercise their franchise significantly outweighs the policies favoring the continued enforcement of the by-law. The harm caused to shareholders from enforcing the by-law will greatly outweigh its benefits.”)

b. Delaware Courts Protect Stockholders Against Retroactive Changes that Prejudice Stockholders

Consistent with Delaware law that a nonparty to a contract cannot be bound by a contract’s terms and DGCL §109 which does not authorize bylaws relating to

former stockholders, Delaware courts have never upheld a retroactive bylaw that was unilaterally adopted by the board of directors after the stockholder's ownership interest in the corporation had been extinguished against a former stockholder. On the contrary, Delaware has a history of protecting stockholders in the face of retroactive changes that may prejudice them.

In the context of certificates of correction to a corporation's original certificate of incorporation and other instruments, DGCL §103(f) states that "an instrument corrected in accordance with this section shall be effective as of the date the original instrument was filed, *except as to those persons who are substantially and adversely affected by the correction* and as to those persons the instrument as corrected shall be effective from the filing date" (emphasis added). Thus, a correction to an instrument can only apply retroactively if the application of the correction does not materially affect the interests of public stockholders.

The protection adopted by the legislature to protect stockholders against retroactive corrections to any inaccurate or defectively executed instrument authorized under the DGCL to be filed with the Secretary of State was applied by this Court to the doctrine of reformation. This Court has held that a document will not be reformed "when the 'correction' will materially affect the interests of public shareholders" *Lions Gate Entertainment Corp. v. Image Entertainment Inc.*, C.A. No. 2011, 2006 WL 4782450 (Del. Ch. June 5, 2006), attached as Exhibit A,

(refusing to allow retroactive application of reformation absent showing of unanimous intent).

As demonstrated above, this Court has a documented history of protecting stockholders against retroactive provisions that would adversely affect the interests of stockholders. Here, the Bylaw does not confer a benefit upon the former stockholder, but rather, curtails one of the former stockholder's fundamental rights: the right to sue. As such, this retroactive Bylaw should be deemed invalid.

c. Former Stockholders Lose Certain Rights When Their Ownership Interest Is Extinguished, Therefore They Should Not Be Bound By Changes To The Company's Bylaws After Their Ownership Interest Is Extinguished

There is no question that certain corporate actions including reverse stock splits and mergers end the relationship between a stockholder and the company. There are certain privileges that a former stockholder loses by virtue of his status as a former stockholder. For instance, under Delaware law, a plaintiff loses his standing to sue derivatively on behalf of the corporation when he is no longer an owner of the company. *See Lewis v. Anderson*, 477 A.2d 1040, 1043 (Del. 1984)

(“by reason of the merger, plaintiff lost his status as a shareholder of [the company] ... as a result, plaintiff lost standing to continue the derivative suit”).⁶

It follows then, if former stockholders lose their capacity to enforce rights on behalf of the company, that former stockholders should similarly be excused from any changes to the corporate contract that were adopted after their status as stockholders was extinguished. It should not be that former stockholders merely lose certain rights as a result of their status as former stockholders, but do not at least gain the right to be free from unilateral changes to the corporate contract that occur when the stockholders are no longer parties to that contract.

d. If Defendants Prevail, Former Stockholders Could Be Bound by Unilaterally Amended Bylaws In Perpetuity.

The wide-ranging implications of Defendants’ argument become clear when Defendants’ argument is taken to its logical conclusion. Defendant’s claim that the Bylaw, which was adopted several days after Plaintiff’s ownership interest in First Aviation was extinguished, can be applied retroactively to former stockholders. Taken to its ultimate end, Defendants’ position gives First Aviation the ability to

⁶ Plaintiff retains his standing to bring a direct claim. *See Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1188 (Del. 1988) (“Standing to pursue a derivative claim for injury to the corporate entity should not be confused with the right of a former shareholder claimant to assert a timely filed private cause of action premised upon a claim of unfair dealing, illegality, or fraud.”)

adopt bylaws for months or years after the termination of the stockholder relationship, and continue to bind former First Aviation stockholders to the terms of those bylaws.

Under this framework, a former stockholder could never be confident that a corporation's board of directors would not amend the bylaws in a way that negatively impacts the former stockholder years after liquidation of his position. A former stockholder might even be forced to keep the proceeds of the liquidation of his stock in escrow, in anticipation of a prospective bylaw that may apply retroactively to former stockholders.

This clearly cannot be permitted under Delaware law. As a matter of public policy, the law aims to achieve finality and certainty in all matters. Statutes of limitation and doctrines of claim preclusion exist so that a matter can be settled or preempted with a measure of confidence. This allows parties to be sure of their legal rights and status, without constantly anticipating a possible future action that may affect their rights, even when a matter has already been adjudicated or when the events giving rise to the claim occurred long ago. Accordingly, in light of the Bylaw's demonstrated inconsistency with Delaware corporate and contract law, and Delaware's espoused public policy, the Bylaw should be found invalid and inapplicable as to Plaintiff.

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that this Court grant his motion for partial judgment on the pleadings, finding that the Bylaw is invalid as applied against Plaintiff and the putative class, and any other relief that this Court deems appropriate.

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